P U B L I C H E A R I N G

before

ASSEMBLY TRANSPORTATION AND COMMUNICATIONS COMMITTEE

on

AT&T

Held:
June 14, 1982
Assembly Majority Conference Room
State House
Trenton, New Jersey

MEMBERS OF COMMITTEE PRESENT:

Assemblyman Thomas F. Cowan (Chairman)
Assemblyman Wayne R. Bryant (Vice Chairman)
Assemblyman Edward K. Gill
Assemblyman John W. Markert

ALSO:

Laurence A. Gurman, Research Associate
Office of Legislative Services
Aide, Assm. Transportation and
Communications Committee

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I N D E X

ASSEMBLYMAN THOMAS F. COWAN (CHAIRMAN): As the chairman of the Assembly Transportation and Communications Committee, I do have a statement I would like to read here this morning.

As you all know, in January 1982, the world's largest private organization, The American Telephone and Telegraph Company (A. T. & T.) acting under the "Modification of Final Judgment," popularly known as the Divestiture Agreement, consented to give up its local operating companies, including this State's largest private employer, New Jersey Bell, and to retain AT&T Long Lines, Western Electric Company, AT&T's manufacturing arm, Bell Laboratories, its research and development organization, and AT&T International. In return, AT&T will be allowed to enter unregulated and computer-oriented markets, such as data processing.

This Committee is holding this meeting to gather information regarding the divestiture of the American Telephone and Telegraph Company and to ascertain the possible effects of the divestiture upon the citizens of New Jersey. Before proceeding further, I wish to point out the Committee's recognition that the total restructuring involved in the divestiture of AT&T is a difficult and complicated process which is being considered on the Federal level where the primary jurisdiction for resolution of this issue resides.

Our primary interest is to better understand what divestiture of AT&T will mean for the people of this State. This includes the 75,000 Bell System employees and the millions of telephone users in New Jersey who depend upon their telephone service. There is some concern that higher telephone rates and a deterioration in the quality of telephone service will result after AT&T divests itself of local phone companies. This is a topic that we will explore today. Another important issue is what role the State regulatory body maintaining jurisdiction over telephones, the Board of Public Utilities, will play after divestiture, and to what extent will the State have any authority and responsibility with regard to telephone regulation?

As Chairman of the Assembly Transportation and Communications Committee, I invite any interested party to assist in providing information to this Committee that may be useful. Your involvement is most important and fully appreciated.

At this time, one of the Committee members would like to make a statement also. Assemblyman Gill.

ASSEMBLYMAN EDWARD K. GILL: Mr. Chairman, I would like to say as a matter of record, that I am a member. I am a retired corporate manager from the Western Electric Company. I don't think this will in any way affect my judgment or my ability to assess the testimony, but I do want this fact to be known. Thank you.

ASSEMBLYMAN COWAN: Thank you, Assemblyman. Our first witness today will be Commissioner Edward Hynes of the Board of Public Utilities.

E D W A R D H Y N E S: Good morning, Mr. Chairman, Members of the Committee. I thank you for this opportunity to come. When asked how I feel as a Public Utilities Commissioner, I am reminded of the story of the three commissioners who took a hunting trip and arrived by plane. As the skids came up to the dock, the pilot told them, "there are three Commissioners, you have three rifles, but I can only fit one moose on the plane when I return in one week." A week later the plane came back, he taxied up to the dock, and there were three hunters and three moose. The pilot said, "I told you guys I can only fit one moose on this plane, that's it."

They said, "Sir, you have to understand. Last year we did exactly the same thing. We did pay the guy $50 apiece to do it. He did it." "He did?" With that they paid the fifty bucks apiece. An hour later they had the three moose shoved onto the plane, they squeezed in, the pilot got through the windshield and got behind the steering wheel. They took off, got about 500 feet into the air and the plane crashed into the mountains. About an hour later they came out of their unconscious state and one said to the other, "Where are we?" The guy looked around and said, "Well, it looks like we got about 100 yards further than we did last year."

That's the progress we've made at the Commission this year. We're about 100 yards further than last year. The reason for my appearance today is the AT&T divestiture. On January 8, the Commission, as well as I'm sure every operating company personnel manager, was shocked to learn that AT&T and the Department of Justice had ended a long period of litigation over whether or not AT&T had in fact violated antitrust statutes. This divestiture in effect called for a dismemberment of what I claim is the best international telecommunications system ever seen on the face of the earth. Speaking from the perspective of New Jersey, we have a tremendous telephone system and at, in my eyes, very reasonable rates. In fact, it's one of the few areas of regulation in this State where no one complains about the cost of their telephone service. In effect, Mr. Baxter, which concerns me in this respect, neither the Attorney General, who is the leader of the Attorney General's Office, nor his number one deputy were allowed to participate in this divestiture because of the fact that they had prior contact with AT&T in their law businesses, so they, in effect, removed themselves because of a potential conflict of interest. So, the decision was made by one person, Mr. Baxter.

What it did was to divest two-thirds of AT&T's assets which comprised one-third of their profit margin. So, in effect, AT&T when presented with the choice, decided to do away with their least profitable service. This raised tremendous areas of concern for this Commission because that divestiture agreement called the "Modified Final Judgment" talked about telephones, who would own them, and under this "Modified Final Judgment" they go to the parent corporation, Ma Bell. Yellow Pages -- this is one of the most profitable aspects of Bell Telephone business throughout the country. In fact, their gross revenues on Yellow Pages are 2.6 billion dollars. The annual revenue to New Jersey, or I should say the net income after deducture expenses, is approximately 53 million dollars per year which goes to reduce your rates. The valuation of assets is left very vague and unclear, because as a result of the divestiture AT&T and each operating company would decide what business should belong with the now unregulated parent corporation and what should stay with the local operating company.

We're very concerned about this issue because we want to make sure that if there is to be a valuation of assets, it's not done simply on net book value, because a lot of the property of Bell Telephone today, be it phone retail stores, be it major buildings in the major metropolis areas of our State, are worth far more than the net book value, both buildings, as well as land.

Access charges -- a very technical term that we use in the trade is the word "separations." What it is is the payment AT&T will make to the local operating companies to compensate them for the profit they make off of long distance telephone calls using local operating equipment. So, if I would like to call a colleague of mine in California, the phone that I use now belongs to New

Jersey Bell, but it's needed to make that long distance call. So AT&T will then give back to each of the local operating companies a certain amount of money, which goes to reduce your local operating costs and consequently makes for a very reasonable monthly charge on your local operating bill.

And last, and of great concern to the Board, are exchange boundaries. We have never worried about what the rate would be in any part of this State, because New Jersey Bell operated solely within the State of New Jersey. In addition, both the local service and the toll message units from let's say Newark to Camden were set by the New Jersey Board of Public Utilities Commissioners. Under S-898, a bill that is now defunct, but which some of the principles still remain, New Jersey would have been divided into twelve exchange territories. Thanks to the cooperation of the New Jersey Bell, the Board of Public Utilities' staff was able to present an alternative to S-898 in that particular fashion proposed by Senator Bradley which reduced our exchange territories to four exchange territories. Now, why is this so important? Because there is a question of who will regulate the rates between the exchange boundaries. If we had twelve exchange boundaries, it's quite conceivable that Washington would regulate Edward Hynes when I call from Bergen County to Hudson County if it's a different exchange territory, and your redress would be diminutive, if you were unhappy with that exchange boundary.

Those are the problems we face. Each of them have a tremendous dollar number attached to them and, in addition, we are concerned about the negotiating ability of each of the operating companies in this country as they negotiate with the parent, Ma Bell, as to what they should have or should not have.

I personally use as one of the litmus paper tests, what is the operating company's position on Yellow Pages, because Yellow Pages produces 53 million dollars a year and, under the terms of the agreement, the Yellow Page revenues will go to AT&T, the parent corporation. Taking this particular instance, it is my personal view that it has been rate payers who have funded all the necessary operations to build up a very profitable Yellow Page operation.

We face another problem. We here today are talking about divestiture, but let me tell you that we will never know what the actual divestiture plan is or how it is going to be implemented, because it probably will not be published until after the Department of Justice and AT&T have presented their consent decree to a Federal Court Judge named Harold Greene in Washington, D.C. Judge Greene has absolutely no ability to modify this consent decreement without the consent of both parties and, in fact, even that is a rather limited negotiating stance to be taken by a Federal Court Judge. So, if you ever heard the expression "flying blind," this is truly it. In addition, the Commissioners were privileged to hear from Mr. Baxter who negotiated this settlement in Washington soon after, and it is his contention that people would be more than willing to pay more for their telephone service after this divestiture. Needless to say, that was not the feeling of every Public Utility Commissioner in Washington that day at the Interstate Commerce Committee.

What do I predict could happen if this divestiture moves forward? I have made the prediction in Washington that rates, either as a direct result of divestiture or in the climate of divestiture where people only pay their cost of service -- there's no longer a cushion given, give Yellow Pages to Ma Bell, give all the telephones to Ma Bell, give all the profitable terminal equipment to Ma Bell, that rates could double or triple within three to five years. During this trial, AT&T presented studies that said if rates were to double, they expected to

lose 9% of their clientele. The 9% that would be lost would obviously be the people who were least able to afford it in our State, primarily in the urban areas. We have achieved in this State universal service at a reasonable cost. I cannot predict as a result of this divestiture whether universal service will be a goal which we will maintain in this State. In fact, what scares me is that the FCC and the AT&T now talk about universality of access, which means that if you have the money you can plug into this network. No longer is universal service the keyword.

So, what is the Board doing about all this? We have testified in Washington before the Judiciary Committee. My colleagues have testified before Congressman Wirth's Committee. We have submitted comments to Federal Judge Harold Greene, and NARUC, which is our national association, and this Board have embraced the concepts embodied in House Bill 5158, which is sponsored by Congressman Wirth. It is my personal feeling that on an issue this great, that the two parties, both DOJ and AT&T, should not be left alone to fashion this remedy. There should be a Congressional bill with the input of Republicans and Democrats, conservatives and liberals throughout the country, in the forums which we have elected them to participate in, the United States Congress. That bill is up for markup this week. I will tell you that it is the position, I believe of both AT&T and all the operating companies, that 5158 should be killed immediately -- that we should proceed with the consent decree and see what happens there.

Based on what I have told you and the concerns that we have and how little input a Commissioner or a board or any Commission in the State has to modify that consent decree, because remember it's take it or leave it. There's no negotiation with the Federal Judge about what's best for New Jersey. House Bill 5158 does have some warts, I'm the first to admit it. One of the provisions is that inter-exchange toll calls in our State are going to be regulated by Washington. If I call Camden, New Jersey from Bergen County, that rate would be regulated under 5158. That's not too good. In fact, we think it should remain with the Board as it historically always has remained. But 5158 has a lot of good points. It sets up a fund to help fund the subsidy for local rate payers.

I conclude by telling you that my greatest fear with this new system is that a person may get three telephone bills, that is from AT&T if they have an AT&T telephone, the long lines will send them a bill for interstate telephone calls or MCI whoever, plus your local telephone company will send you a bill for local telephone rates. Another fear. New Jersey Bell -- you cannot believe what a good system has been built up, but I'll tell you, it's an awesome system. When your phone goes dead, who do you call now? Are they going to argue about, is it past the house boundary, is it on whose line? It could be a potential nightmare. I would like to see history rewritten. If I could go back in time, I would hope that the DOJ and the AT&T could come out with a better divestiture. If divestiture is the answer, then 5158 gives us the philosophical outline of how to handle the breakup of the world's biggest and most profitable corporation.

If you have any questions, I would be very happy to respond to them.

ASSEMBLYMAN GILL: Just one. If I gather from what you say Commissioner, what we have here is an efficient, profitable operation, AT&T, as far as New Jersey users are concerned.

COMMISSIONER HYNES: Absolutely correct.

ASSEMBLYMAN GILL: And this divestiture, which apparently was the result of the Department of Justice, is not going in the direction which would be

good for New Jersey, as far as you are concerned?

COMMISSIONER HYNES: I am very provincial. I look at factors, since I take the blame for all the rate increases, I want to make them as painless as possible. We've got a great system. There are certainly problems, but if you look at overseas and see what they manage for a telephone system, we've got the best system in the world. We can work with this company and in effect it has the resources and technology of AT&T Bell Labs behind it. I think we are as advanced because of the integration of the Labs, Western Electric and the operating companies. Under this new process, we are not guaranteed all these benefits will flow to the rate payers at subsidized rates.

ASSEMBLYMAN GILL: You had mentioned Judge Greene, who of course has been in this investigation for quite some time. What has been your feeling, or what conversations have you had with Judge Greene which might indicate a reversal on his part of that which has been done in the way of divestiture?

COMMISSIONER HYNES: Well, first of all, we are not allowed to speak to Federal judges before they make a major decision, although I would like to in this case to make an exception to that rule, to tell him, "Judge, you don't know what you are getting yourself into, or what we're getting into, if you approve this consent decree." He has just released a list of questions which shows that even he has some reservations, but remember his two options are to accept the consent decree between two parties to a major case, the Department of Justice and AT&T, and rewrite the entire program, which is even beyond his power, or to accept it. His ability to modify this proposal is severely limited and, as a result of what is happening with the Tunney Act, Congressman Rodino has spoken about revising just what procedures must be implemented before a Tunney Act consent decree is proved.

ASSEMBLYMAN GILL: Would you fairly well conclude at this point of the game, on a temporary basis, that if the divestiture as agreed to at the moment spins off the profit-making operations, such as Yellow Pages, Western Electric, etc., this would leave the New Jersey Bell in a position where in all probability they would have no other recourse than to raise their rates? This is what we are primarily interested in.

COMMISSIONER HYNES: I have predicted, and I would not like to be Cassandra. I mean, Cassandra was right, but then the whole city was sacked. I have predicted that rates will double or triple within a period of about five years or many, many reasons. We're petrified that AT&T may decide they don't want to use the local loops. They're not required to. The bill, 5158, would require them to. But we're concerned that the major long-distance carriers can simply circumvent these loops by building the big dishes and the transmitting earth stations, and go right around the telephone pole lines and leave us to pick up the bill.

I can't emphasize that enough. We're taking what I think are reasonable rates in this State and in grafting a complicated system where people will be more confused about who owns my telephone and how many bills I get and, what's worse, the rates will double or triple and the service may not be as good because today we benefit from the technology provided by Bell Labs. We won't have it anymore and, if we do, it's going to be at a higher cost. So all of these factors make me very concerned about the future and I'm fighting especially hard with my two colleagues, because you can be sure if rates double or triple, who is going to get the blame? It's called the Board of Public Utility Commissioners, so we're

fighting now so that people know this isn't such a great idea. Let's see if we can change it.

ASSEMBLYMAN COWAN: My understanding is that this divestiture is supposed to be completed in 18 months.

COMMISSIONER HYNES: Correct.

ASSEMBLYMAN COWAN: Then that would be sometime a year from now, approximately. Do you feel that enough information has come out as of now from this so-called meeting of the minds between AT&T and the Justice Department, along with Judge Greene?

COMMISSIONER HYNES: No. I can emphatically state no, and in fact, just based on the comments of Mr. Baxter who represents the Department of Justice and in effect all of us, his comment that people would willingly pay more for their telephone systems based on the laws of supply and demand, that is unacceptable from a commissioner's point of view. Mr. Baxter's entire background is a professor of law at Stamford University and honestly that's why I'm urging strenuously that the United State Congress tackle telecommunications policy and revise the 1933-1934 Telecommunications Act.

ASSEMBLYMAN MARKERT: I'd like to just if I may here follow up, Commissioner, on that last statement you just made. To what extent do you think, or do you feel, that that Act should be changed? Where do you feel the control should then lie or at least the organization of control, and to what degree do you think the parts in New Jersey the PUC Commissioner should be able to play?

COMMISSIONER HYNES: Okay, well first of all, the analogy I make, imagine the State of New Jersey divesting the biggest employer in the State and that decision was made by an Assistant Attorney General of the State of New Jersey when the commissioners were forced to disqualify themselves for conflict of interest, and the number two person was forced to disqualify himself. Would this State Legislature accept the dismemberment of the largest employer in the State by a number three man, so to speak, in the Attorney General's Office? As a former member of the Legislature, I don't think I would have wanted to see that happen. Now that we're stuck with that, we want to move with legislation. We are lobbying for H.R. 5158 because one, it would put Yellow Pages back in the money that New Jersey Bell would have only for a short period of time, a transition period. We're seeking to have that modified to make sure Yellow Page revenue stays in there all the time. But it's a beginning. Under the modified consent decree none of that is there. Number two, the bill would prevent AT&T from bypassing the system, until, I think 1988. AT&T might have no reason to stay in a system if the Commission and the local operating company try and raise the access charges to keep the subsidy for local ratepayers. That's a great concern of this Commission and my colleagues across the country. Number three, we would allow a local operating company to move into the competitive services such as selling telephones. Who knows more about telephones than New Jersey Bell Telephone? Under the modified consent decree all of that business would go, plus terminal equipment, which is the heavily competitive equipment, to Ma Bell. What really concerns me is what negotiating ability does New Jersey Bell have with Ma Bell when every major official in each operating company has spent their entire careers with Ma Bell. How do you now say to Ma Bell, "Hey, wait a minute, we don't want to do this, we don't want to do that." In addition, besides the other

protection, it would allow New Jersey Bell to continue servicing your telephone, keep the Yellow Pages, move into some competitive areas, and stop the bypass in the system by AT&T for a certain period of years, all of which we believe will strengthen New Jersey Bell's opportunity to be healthy. What I said in Washington I can repeat here; we are concerned that New Jersey Bell could become a Grandma Bell, capital hungry, labor intensive, and no longer able to keep a lot of its big money-making operations. And what does that translate into -- going to the Board and asking for higher and higher rate increases. And that's what is inevitable.

ASSEMBLYMAN MARKERT: Just to follow up, Mr. Chairman, on the last part of the question. I thank you, Ed, that does make it a little clearer, at least with your feeling about H.R. 5158. But how would this, if H.R. 5158 were to pass, and if it were not to pass, in both situations, how will that effect the control that we have within New Jersey through the BPU?

COMMISSIONER HYNES: It is going to be the Board's position that if the modified consent judgment is approved by Judge Greene that we still have the authority to regulate intrastate operations. If I call from Bergen County to Camden County, the Board will make a strong effort to say we should control how much is paid for that call, even though this business will no longer be simply with AT&T or New Jersey Bell. Because, as you might suspect, many of the people who move into the competitive, profit-making end of the business, the intra, interstate exchange calls, we will maintain that we are not sure what the results of that will be. You must understand our position. It has been this Board's policy for decades to ensure universality of service. That means the toll calls in this State are priced above the actual cost to make them. The extra money goes into a pool of money in this State to subsidize your local telephone exchange rate. If you are a new competitor in this State like MCI, or Southern Pacific, or ITT, you may not accept the Board's policy in this matter, you may say, "I simply want to pay the cost of interconnecting through the Bell loop exchange, or local exchange, and I don't want to pay any subsidy price." That is a tremendous fear. They may take us to court, and commissioners around the country to court to say, "Hey, we don't want to pay this subsidy cushion."

ASSEMBLYMAN MARKERT: So really, there's no way at this point in time that we can determine what the outcome of that would be.

COMMISSIONER HYNES: No, but I always believe in Murphy's Law, and with this particular divestiture, it's very possible. Expect the worst, and you're going to get it.

ASSEMBLYMAN GILL: Commissioner, I think we all agree that New Jersey Bell is probably one of the better run, and I imagine one of the more profitable companies in the Bell System.

COMMISSIONER HYNES: It is.

ASSEMBLYMAN GILL: What's been your experience with Bell of P.A., New York Telephone Company, and the others? Are they in about the same position? I could probably ask a subsequent witness. I'd like to ask you though.

COMMISSIONER HYNES: Well, we have now been put into a seven-operating-company unit which extends from New Jersey Bell through Bell of Pennsylvania down to West Virginia, Chesapeake and Potomac. You are correct, New Jersey Bell has been one of the lead states in the operating company system. New Jersey and Illinois

are, in my eyes, two of the best operating companies. A lot of our new innovations have started in New Jersey. The electronic switching station -- they have a traffic program system originated at Bell Labs that started in New Jersey. And so the two key flagships of the system have been Illinois and New Jersey.

What concerns me is we are now put in an operating group or block that comprises New Jersey to West Virginia. I don't think it takes much imagination to believe that New Jersey is by far and away the best of the seven operating companies in this group. What I'm going to be concerned about is, where does the revenue go once money is raised in the financial markets for this operating block? Is it going to go to West Virginia to improve their services, or will it be channeled to New Jersey?

One of the great dilemmas of this divestiture, and it's worth repeating, is that we have no idea what this all will mean. I might say that neither does AT&T nor the Department of Justice, because whoever was faced with such a massive divestiture as a result of an antitrust action? So we're all in the dark, except the commissions across the country are in worse shape, because once it happens, we have no ability to modify the final plan. Judge Greene will make his critical decision within a month or two. That's it, and that's why we're lobbying for legislation in Washington.

ASSEMBLYMAN COWAN: Do you feel that decision will be within the next month or two? Is there some indication that that is going to happen, and from what you say here now --?

COMMISSIONER HYNES: Well, he's asked some very cogent questions, which means he's read a lot of the material submitted to him. I am hopeful that means once these are provided, there will be oral argument, I believe at the end of this month in Washington, D.C. So I would hope that sometime at the end of July, early August -- however, it's worth repeating, this judge is severely limited in what he can or cannot do, and we won't know what all this looks like until 18 months from now, at which time none of the members of this Board will have any opportunity to influence what's come about.

ASSEMBLYMAN GILL: Not unless we do it in advance?

COMMISSIONER HYNES: Correct, and so if I had any -- what we're going to do -- we like to practice what we preach. We hope to be in Washington, the Commissioners, to lobby when H.R. 5158 begins its markup this week. I believe it has the support of Congressman Dingle, who is the Chairman of the Commerce Committee. It was released from the subcommittee of which Congressman Renaldo and Congressman Florio, not a member of the subcommittee -- Florio is a member of the major committee, but Congressman Renaldo was there, got out 15-0. Now that committee is Republican and Democrat, conservative and liberal. It got out 15-0.

ASSEMBLYMAN COWAN: With your national association of the utility commissioners, have they taken any specific positions on this divestiture, and if they have, would you just give a broad outline on them?

COMMISSIONER HYNES: Well, many of my colleagues were present when Mr. Baxter gave us his idea of what it all meant. And if they weren't sure about how they felt about the divestiture, they were after his appearance at the Interstate Commerce Commission. They all, in fact NARUC is strongly lobbying for H.R. 5158 with certain modifications. I mean, no bill is perfect. And so they want certain modifications. But almost unanimously, every commission in the country

is seeking federal legislation to preempt AT&T and the Department of Justice from deciding what's best for this country.

ASSEMBLYMAN COWAN: Thank you very much.

COMMISSIONER HYNES: Thank you for taking an interest in an issue, which unfortunately, can't be changed in New Jersey but is going to make a big impact on all our lives when this comes about.

ASSEMBLYMAN COWAN: I'm sure, Commissioner, as you can well understand as a former legislator, we would be just as much interested as you are in the point you raise so far as the raising of the tariffs for the telephone.

COMMISSIONER HYNES: I tell you, as I leave you, you can complain. I live in New Jersey, you do, and you can make your voice heard to any Cabinet member in this State. But if H.R. 5158 goes through with the provision that allows the F.C.C. to regulate the rates from Bergen County to Cape May County, you won't find Washington as receptive as a Cabinet official in New Jersey, I can assure you.

ASSEMBLYMAN COWAN: Thank you very much.

COMMISSIONER HYNES: Thank you very much, Mr. Chairman. Thank you members of the Committee.

ASSEMBLYMAN COWAN: Our next witness is Roger Camacho, Division of Rate Counsel, Department of the Public Advocate.

R O G E R C A M A C H O: Mr. Chairman, members of the Committee, I thank you for the opportunity to appear before you today on behalf of the Public Advocate. I am Deputy Director of the Division of Rate Counsel. Pursuant to statute, we represent the public interest in public utility rate increase applications before the BPU, and one of those cases, of course, is the New Jersey Bell case, and prior cases. As you have indicated, various branches of the federal government today are restructuring the entire telecommunications industry, and most importantly, redefining telecommunication goals. My concern is that the interests of local ratepayers in terms of affordability of rates should receive sufficient weight and consideration in that development of telecommunication goals, and my concern is that it has not. To the degree it has not, there will result the increase in rates here in New Jersey. As Commissioner Hynes has indicated, we're somewhat flying blind in terms of no independent audit with regard to cost as to the impact. I think, given the consequences that are eminent, we have to play what is termed the "what if" game, "what if -- happens." And in that regard we have to assume the worst, and try to prepare for it, try to avoid it if we can.

What are our local interests? How would you define these interests? I would define them in terms of the principle mentioned by Commissioner Hynes, that is, the universal service principle. What is its genesis? That principle has dominated telecommunication goals for nearly half a century now. It finds its genesis in Section 151 of the Telecommunications Act of 1934. It has been defined in New Jersey and applied here as a development of a rate for the local residential ratepayers, which is affordable to practically everyone. This is to ensure telecommunication services in each and every household.

It is the concern that I have about the potential demise and death of that particular principle that brings me here today and I think it is worthy of discussion.

Competing interests are on the horizon and we don't know if our universal service principle is going to survive.

As I've indicated, the Board of Public Utilities does apply this principle, as is evidenced by our rates. It was applied most recently this Spring, with the most recent Bell Telephone rate increase. That being the case, I think we must take every action that we can to try to assert this interest at all levels.

Now, I think a bit of history is warranted here in terms of what gives rise to the competing interests, to challenge our universal service interests. Our universal service doctrine developed in the 1934 Act, was developed in an environment of monopoly services. AT&T, in essence, was given monopoly status. The return for that was that they were to press for universal service in all households. If one can control the environment in which one is setting rates in operating, one can price certain services well above cost to maintain others at an affordable rate. Thereafter, it soon developed that this monopoly was to be confined, or constrained, to the telecommunications area. This came with the Department of Justice/AT&T suit of 1949. The concern there was that AT&T allegedly was leveraging off the monopoly services with regard to expanding into other than telecommunication services. This resulted in the consent decree of 1956, whereby AT&T agreed that it would not go beyond tariff telecommunication services in providing its business. Thus we have the monopoly services operating within the telecommunications area.

In the mid 60s we begin to see the advent of competition. We see a series of cases beginning at the F.C.C. with regard to the provision of terminal equipment, that is the apparatus on the end of the line. We see some battling back and forth, ultimately with the registration program, whereby the providers of terminal equipment can register their equipment for technical accuracy at the F.C.C. and sell the equipment and compete. At the same time, we see competitors in the inner-city market. There's the MCIs, the Sprint-type services, which provide the microwave services between cities. During the 60s we see the advent of competition there and inroads being made at the F.C.C. and in the courts.

In 1974, the Department of Justice brought the current suit, the one we've been discussing today. Hereto we see allegations with regard to anti-competitive action and this monopoly status of AT&T. I think it's important to outline the thrust of the suit for a reason that I'll mention later.

The Department of Justice, looking at a time frame from 1962 to the present, looks to three areas. It asserts and alleges anti-competitive activity with regard to the terminal equipment market, that is again, the producers producing telephone apparatus for the end of the line -- asserts and alleges anti-competitive behavior with regard to the inner-city services market, that is access into the market, and asserts anti-competitive activity with regard to manufacturing telecommunications equipment, that is, equipment that is sold to telephone companies themselves, Western Electric assertively being so large and so dominant.

So, we see throughout history some external pressures trying to get into the system, which we have enumerated. Then we see internal pressures developing to get beyond the bounds of the '56 consent decree, and what is this? It's an observation that AT&T, of course, is interested in participating in the data processing area. This is the lucrative area, the growth area. So as business people, which is to be expected, they are interested in getting beyond the '56 consent decree that I mentioned resulted from the '49 antitrust suit, which confined them to the tariff telecommunications area.

In this mix of pressures and competing interests, again I have to wonder whether the basic doctrine of universal service that I outlined can survive. Is it compatible? Is it incompatible? As some would argue, is it time for the local ratepayers to "bite the bullet" in the name of some of these other principles?

We see AT&T with the pressure, or a motive, to move beyond the '56 consent decree and get into the data processing area. The Department of Justice asserts an interest. It is against the bottleneck, so to speak. It is against AT&T having control of the basic network and being able to control these other competitors coming into that network. Interconnect companies want the freedom to provide terminal equipment at a greater level. The carriers providing inner-city service want into the system to provide the inner-city services.

The F.C.C. favors the competition and the inroads of competition. We will hear language from them in terms of increasing the rate of technological change, opening up Bell Telephone Labs. Under that '56 consent decree that I mentioned, many of the items that are developed by BTL, much of the technology, is considered to be under wraps. If AT&T is precluded from expanding into other areas, there is no profit incentive to release that technological innovation. We'll also hear this before the federal Congress in terms of the national productivity level and in terms of improving our national productivity through freeing up the Bell Telephone Labs.

But again, the basic issue to me is, can universal service and that principle survive all these innovations? There's a good deal of forum shopping going on in my opinion, that is our inability to get to these issues at the federal level. I've observed many branches of government participating in this. We mentioned the stipulation before Judge Greene. I've seen that since 1976 at the federal Congress. In each year through 1981, there's been legislation to restructure the telecommunications industry. The F.C.C. has also participated in this in terms of its Computer Science II proceeding. But the most eminent is the settlement before Judge Greene, which Assemblyman Cowan opened up this discussion with.

On April 20, our department filed comments with the Department of Justice pursuant to Judge Greene's directive, in essence urging that that stipulation be rejected. Overall, we have the same dilemma or general problem asserted by Commissioner Hynes; that is that two parties, namely the Department of Justice and AT&T, in essence agreed to restructure the entire telecommunications industry. Again, I'm looking for the input with regard to universal service, our local BPU, the public advocate, the local legislators who will eventually bear the responsibility for this, would be to a degree shut out, and to a great degree.

I enumerated the basis of the suit because one of the items that we contended before Judge Greene was the parties had gone well beyond the purposes of the suit. The suit was about AT&T dominance in these three areas. Once one would sever, that is, the AT&T system from the operating companies, one could cope with that dominance -- avoid it. The balance of items included in the stipulation, such as some provisions with regard to the access charge, such as certain provision with constraints on the local operating companies. The local operating companies would be precluded from operating in any areas other than those that are natural monopolies.

Thus, this is the situation. AT&T is sued for alleged anti-competitive activities and the operating companies bear the thrust of the penalty. The operating companies cannot compete with AT&T, but there's no prohibition against AT&T competing with the local company in the local area through a separate system of fiber optics or through some item, such as cellular radio.

This we see is basically unfair, and it's in that area that we see the potential development. The third area that we brought to the attention of Judge Greene was the transfer of assets area. Here again, my comments will parallel those of Commissioner Hynes. We're concerned about the lack of an independent management to negotiate on the question of which equipment will go, to negotiate on the price of the equipment. Of course, to take one step back, if one were simply to sever the system, that is, sever AT&T and the labs, Western Electric, from the operating companies, and let each compete at all levels with the other, I think many of these problems could be avoided, i.e., there would not have to be a transfer of assets at that point. This would move into a free enterprise system which the Department of Justice has wanted for a long time. It would avoid this system of hamstringing local companies with the potential of -- I've seen them referred to as possible "Ma Bell's orphans" -- left behind in the State and we simply don't need the dilemmas, such as another J.C.P.&L. in this State. We would want to ensure the viability of the local company through its being able to compete in all areas. Problems of regulating between a monopoly and competitive services, we see it in the public interest to litigate and debate these issues before our local BPU, to at least have a grasp at the issues.

The access charge provision in the stipulation -- one reads language that at first blush appears very palatable and that is that the access charge that Commissioner Hynes outlined would be unbundled, cost-justified, and applied on a non-discriminatory basis. Perhaps to the antitrust people this appears to be very palatable, but in terms of our flying blind on the system, what type of cost allocation would be applied? We've spoken about a subsidy, but would one use a fully distributed cost allocation to determine cost or an incremental analysis? Whichever one is chosen will have a tremendous effect on what happens to us here in New Jersey. And, of course, what influences that is who will decide it and where. We'd like to see the local BPU determine that type of an issue, as opposed to the federal level. We think that the local BPU would be more receptive to our arguments on universal service.

In the area of the access charge, we think an important notion is to provide the latitude over and above cost justification. That is, to provide a reasonable non-discriminatory adder over and above cost to be paid by all the competitors in the inner-city inter-exchange market. This is, perhaps, an answer to reconciling universal service with the competing pressures that I mentioned. Entities would compete, they would simply compete at a higher level, providing for the local service and to keep our local rates at a minimum. However, we'd have to get a change in even H.R. 5158 to effectuate this, and I think that some further advancements there would be effectuated. It sounds palatable to say cost-justified. It sounds palatable to us all. But I want

through the history to indicate that in the telecommunications industry this universal service has been more. It's been a notion that's been with us for half a century and I think if that could be propelled into the future and compatibly built into the system, we would have an opportunity to keep our rates at a level where most people could afford them. We do not have the high ground on that issue right now, as we've gone through with Commissioner Hynes.

Let me sum up with regard to possible areas, goals, to reconcile universal service and that is, one, I believe we should do all in our power to increase and maintain the authority of the local BPU over the transfer of assets, over the divestiture. Our local Title 48 provides significant authority in the local BPU with regard to approving transfers of assets. We took the position before Judge Greene that the court in structuring a remedy under the stipulation, could not preempt that statute, that they had to give some deference to our local BPU. Secondly, we think an access charge should be priced high enough to ensure that our local rates will not go through the roof, that our principle of universal service will not be lost. Again, there's forum shopping on this element. We would like to see this element determined by our local BPU. Third, I think we should do all in our power to prevent constraints on the businesses in which the local operating companies can participate after the divestiture. We want to ensure the financial viability of the local companies after this divestiture.

I thank you for the opportunity to speak on the subject matter, because I too believe so often we're frustrated by a system where policy is determined beyond the control of the people who must bear the responsibility of that. We've seen this with natural gas pricing. There's a policy of deregulating the natural gas price. This is filtered down through the local rates, and the local authorities must bear the responsibility. So I commend you for airing this very, very important area before the public.

ASSEMBLYMAN COWAN: Thank you, Roger. Do you have anything to add, John?

ASSEMBLYMAN MARKERT: No, thank you.

ASSEMBLYMAN COWAN: Ed?

ASSEMBLYMAN GILL: We've heard twice, I guess, about all the disadvantages of divestiture for the people of New Jersey -- rate-users, telephone-users. Are there any advantages for the people of New Jersey? Why are we doing all this if there are no advantages at all?

MR. CAMACHO: Assemblyman Gill, I mention these in terms of some of the pressures or assertions being made. Some of the antitrust considerations are on a broad base. In other words, will it improve the nation's productivity to free up the Bell Labs to get them out from under the consent decree of 1956? Perhaps so, we don't know this. The antitrust law itself -- even if someone can produce the lowest cost widget -- the antitrust people would argue there's a certain negative aspect of concentrating political and economic power in too great an entity. Therefore, there is some type of amorphous benefit. I've looked at the case law in terms of the competitors moving in. There's an assertion that perhaps the competition will hold rates down in certain other areas. Again, we don't know. But I think that given the flow, I don't think that we can oppose the divestiture per se. I think we must seek a system which would make our principle of universal service compatible with all these other elements. These forces have been coming stronger and harder in the last fifteen years. And they

are forces to be reckoned with. The competitors are going to the right there. They're going to be wanting to open up the system. The federal government does see, and if my view, would vote for the competitive principles that I've enumerated. Technological change -- right now under regulation they would argue that AT&T controls the development of vintages of items depending on their own prerogatives pretty much at this point. Whereas, if one moves competitors into this sphere, the competitor, by developing new products, can stimulate growth, technology, to come along. The dilemma again is, I don't want to see this doctrine of universal service, that which is controlled for half a century, be abolished in that process, because then there would be the detriment that we've all been concerned about today. It's a weighing process and it seems to be a weighing process that's somewhat beyond our control at this point.

ASSEMBLYMAN GILL: I just want to make it clear that I'm not arguing either for AT&T or for the divestiture, because I'm wondering at this stage of the game why the hell we're doing this, if it's going to have nothing but disadvantages. I'd still like back in your opinion, also in Commissioner Hynes' opinion, why are we doing this? What advantage will it have to New Jersey Bell? Or would you rather pass for awhile?

MR. CAMACHO: Our local BPU did not develop the divestiture, did not develop the pressures behind it, that is going toward competition and the breakup. That theory has been foisted upon us, really from the elements that I mentioned. Competitors want in. The F.C.C. has gone in that direction in terms of Hush-a-Phone, Carterphone -- I'm sure you're familiar with the landmark cases in this area. And the Antitrust Division of the Department of Justice has been definitely moving in that area, first with the '49 suit, then with the '74 suit. So they provide this as a given. This is what I mean, Assemblyman, in terms of -- the philosophy is determined at the federal level, yet the consequences are borne by the local BPU, the advocate, local legislators who must bear the responsibility of that determination. So what I'm saying is that at the local level we did not bring this upon this situation. The Department of Justice, the F.C.C. and the courts, and our federal legislators, are bringing this on us. Also, I see the internal pressure that I mentioned from AT&T, -- you would expect that businessmen seeing a lucrative area like the data processing area -- this notion of permitting one computer to communicate and speak to another is a lucrative area. It's the area of the future. It's where they want to be, and to get there they must move beyond the 1956 consent decree. So what I'm saying is these pressures are being applied on high and foisted on us. At this point what we're trying to do is reconcile our local interests with those pressures.

ASSEMBLYMAN GILL: In other words, what you are saying, if I'm hearing you right, is that divestiture is not necessarily an anti-monopoly move by the government. There were pressures, too, from AT&T in order to make them more competitive in data processing, computers, and the like. All we have to do then is to reconcile those.

MR. CAMACHO: I see it in their economic interest to move in that direction. And once that takes place, then this brings about the entire restructuring. But, it's difficult. I went back into the history to cite the universal service coming out of a monopoly sphere. Once one starts breaking that monopoly up, it gets more difficult to press for universal service. But

I think it is compatible, if we try and if we apply the pressure. And this access charge, I believe, is the area where this will come to the forefront. Right now, through the separations process, we're able to achieve the revenues to keep our local rates down. We have to try to ensure that through the access charge we can keep our local rates at that reasonable level. It's difficult. There are two issues -- two sides of it. As Commissioner Hynes mentioned, if you make the access charge too high, the AT&T system will argue, "We're going to go around -- we'll build fiber optics, we'll go around the local system," at which point, if we're precluded from getting into other areas, the local company will be in terrible shape. But I think that there is a range, there is a zone in there where the regulators can attempt to reconcile these issues. This is where I get to the forum shopping and the feeling that this forum is being provided on high when we can't really move into that area. I mentioned the fully-distributed cost allocation. There are those who will argue that there is no subsidy, that if one moved to a fully-distributed cost allocation system, the local rates would be taken care of. But I have no idea which system will eventually be utilized -- incremental costing procedures or the fully-distributed costing procedure. I'd much prefer to see that litigated at the local level than before the F.C.C. or the federal level.

ASSEMBLYMAN COWAN: Assemblyman Bryant?

ASSEMBLYMAN BRYANT: Yes, maybe you can enlighten me and maybe the whole committee will be enlightened. It was my understanding that AT&T was not required to divest itself from all companies, local companies. How was New Jersey chosen as one of the local companies for it to be divested?

MR. CAMACHO: It's my belief that the divestiture applied to all operating companies, especially the wholly-owned subsidiaries. The 22 companies would be divested under the stipulation process. This gets back to the theory where the Department of Justice is concerned about a single entity controlling the basic network and also having the potential, and I phrase it carefully, as allegations, assertions of also being able to control the degree of competition coming into that system, so that they are most interested in breaking up that bottleneck. That's why my concern, and Commissioner Hynes also mentioned this, when you have AT&T and the Department of Justice stipulating or agreeing on the restructuring, they're going to be emphasizing the antitrust aspects and perhaps not emphasizing the rate-making and the interests of our local ratepayers at this level. The instant the access charge is defined as non-discriminatory, I think the Department of Justice would be elated and would not be concerned with cost-justification language. Whereas from the rate-making side, one would like to see latitude to go beyond. And I want to carefully couch my statements. Their entire myriad of other issues, antitrust issues, which apply if one speaks about the top level of the horizontal split-up, that is Long Lines, AT&T, Western Electric, and BTL. There are many issues with regard to how that should be structured. Should it all be one? Should it be split up? I'm deferring on those particular issues and speaking today with regard to local rates.

ASSEMBLYMAN COWAN: In that regard now -- Wayne?

ASSEMBLYMAN BRYANT: When you're talking of local rates, you're bringing in the fact that the excess would help to maintain some viability for the local operating company -- the access charge?

MR. CAMACHO: Yes, in terms of currently, the separations procedure would provide those revenues. What we would wind up with is competitors competing at the national level inter-exchange, as defined. They no longer look to state boundaries under the proposed stipulation. Carriers moving inter-exchange would be competing with one another. Right now, given the current state of technology, those carriers must hook into the local loops, in most instances, to complete the telephone call at both ends. So the charge paid to the local company for that latter service becomes critical. If that charge is underpriced, we know where the local company has to go, they must go to the local BPU to make up for it. What I've been arguing for is, one, let's try to get costing methodologies which would make the access carriers pay their way on a fully-distributed cost methodology, and two, let's reserve the latitude to bump it up a little to each carrier. In other words, if each of you gentlemen had an entity that was competing on the inner-city market or inter-exchange, each of you could compete with this non-discriminatory adder. You'd have to compete to the rest of cost, with regard to the rest of cost, but you can compete and local ratepayers would be enjoying these additional revenues to hold the local rates down. And that type of concept is not new. It's not novel. It's dominated for the last 50 years in terms of universal service. I don't know if I properly articulated that, but I think that's where the battlegrounds will be with regard to the local rate. That, plus when that local company is of course providing the service, the inter-exchange -- we like to see it in as many businesses competing with AT&T to ensure a strong company.

The transfer of assets is a logistical area. That's one where, again, we want to see a strong entity left behind. I guess one way I've heard it explained is in terms of the balance sheet, the right side has the liabilities on it. There's always bondholders, there's always creditors there to enforce their rights, fix that in. The left side, the assets and the evaluation of that will be discretionary. Again, forum shopping, depending on who does that, decides which assets are transferred from the local company to AT&T and how they're priced. We could wind up with a very, very weak company in New Jersey which must go to the BPU and ask the commissioners for rates constantly, or we could wind up with a strong company. There, too, we see a great ally in an independent operating company management to negotiate which equipment -- what about the equipment that does both -- where would that go -- and maximizing the price which would be paid for the assets. But again, this is a fallback position in terms of there having to be a transfer. If before Judge Greene there could simply be the split-out -- split them out, leave them where they found them in terms of going to the local agencies for rates and whatever, there need not be the transfer of those assets. And we can ask for some true competition between the seven aggregated companies and AT&T.

ASSEMBLYMAN COWAN: Along those lines with the transfer of assets, is it proper to assume that you are suggesting that that be done before divestiture is completed?

MR. CAMACHO: Yes, as a position, if we are at that point. No, I'm sorry. Let me back off that statement. I would be asking if we must transfer assets -- I would be asking that the split-out take place and an independent management be set up. In other words, a management that knows it's going to be responsible for and in charge of the operating company here at the local level. Then transfer the assets so that you would have an independent management at the local level debating and

negotiating with the AT&T management to get the finest equipment and to maximize the price on any equipment that was transferred over. As for that, most of the expertise on this equipment is, of course, within the Bell System. It becomes very difficult to determine what type of equipment services within exchanges and what type services inter-exchange and another type of equipment that does both. So that we see a great ally in an independent local company at that stage.

ASSEMBLYMAN COWAN: And this would be over a period of time following divestiture?

MR. CAMACHO: Yes. Otherwise my concern is that there would not be adversarial negotiations with regard to those items and it becomes very difficult.

ASSEMBLYMAN COWAN: It doesn't appear to me that something that has been going on for close to 30 years, 25 years, would have any real answer within a period of 18 months with what's laying out there.

MR. CAMACHO: There are some really difficult issues, and we've frankly asked Judge Greene to reject that stipulation because of these impediments that we see. We, too, believe that there should be maximum input by the local officials, by the local BPU, and we're stressing -- we raised the legal argument with Judge Greene that under Title 48 our local BPU has some real rights which must be respected in this process. The right to approve the transfer of assets, the right to determine who operates a franchise in New Jersey, for the good of the local people. The local people are here. They're close to those local BPU Commissioners, and we think that we would get a much better hearing and more credence on that issue. Again, we do not have the high ground on that, but it is something that I will look for, even in terms of the modification of H.R. 5158. I'd like to see the local BPU have the power to set these access charges. I'd like to see them have as much power as possible because, as Commissioner Hynes indicated, the BPU realizes it will bear the responsibility for any increased rates. Therefore, it wants to make certain that our local interests are represented. So I would support that notion fully.

ASSEMBLYMAN COWAN: Thank you. Do you have a question?

ASSEMBLYMAN GILL: Just two quick questions, if I may. You had mentioned, or it has been mentioned, that Yellow Pages are very profitable to AT&T and $53,000,000 worth go to New Jersey Bell. Would it not be, not easily done, but would it not be a sensible thing to do to maintain some of the balance for New Jersey Bell? That's all I'm interested in, New Jersey people. To transfer the Yellow Pages and the profit therein to New Jersey Bell, instead of retaining it with AT&T?

MR. CAMACHO: I agree with you wholeheartedly. I think that even in terms of growth in that area, $53,000,000 is a lot of money and currently it is a lucrative area which helps defray our rates. But we do see some prognosticators of the future speaking in terms of that area expanding and providing almost a daily service, and becoming even more lucrative, so that's an important battleground and an important lucrative service to keep at the local level.

ASSEMBLYMAN GILL: Secondly, your comment about competition as far as long distance carriers, toll carriers. As I understand it, Long Lines, which is part of AT&T, is one of the more profitable parts of the AT&T system, particularly when they tie into local telephone companies. Is there any problem with

having them all put on a competitive basis and the rates fixed sufficiently high to make it an advantage or an asset to New Jersey Bell? Do I make myself clear? Have them all pay a sufficiently high, and here the BPU would have to come in to assure that the rates were set high enough that New Jersey Bell would profit from it. When I say profit I don't mean -- they at least wouldn't lose as much as we thought they were going to.

MR. CAMACHO: That's correct, Assemblyman. That's my position with regard to -- even get beyond cost justification. Reserve the latitude to move along univerisal service line. To provide that non-discriminatory adder over and above costs. And I have to reserve that, because we had no independent study on what those costs are to do exactly what you mention and, again, this is not inconsistent with prior regulation. In fact, this universal service doctrine has dominated for nearly half a century. This concept is not foreign to the telecommunications industry. And that's where I see the compatibility of our local interests with all these competing business interests and competition interests of all the other parties and the federal government.

Let them compete, let them compete at a higher level.

ASSEMBLYMAN COWAN: Thank you very much, Roger.

MR. CAMACHO: Thank you.

ASSEMBLYMAN COWAN: Our next witness representing AT&T, the Bell System, and New Jersey Bell, Bernard Hartnett.

B E R N A R D H A R T N E T T: Good morning, Mr. Chairman, Assemblymen. I very much appreciate your invitation to appear before this Committee this morning on behalf of the Bell System companies in New Jersey in order to provide to you our best view as to the consequences to the New Jersey Bell Telephone subscribers of the proposed divestiture by AT&T of its 22 operating companies, including New Jersey Bell. I might mention, Assemblyman Bryant, what you may be thinking about when you asked the question you did about the companies that were not divested. There were two companies that were considered Bell System companies, the Southern New England Company and the Cincinnati Bell Company, wherein AT&T did not own the majority of the stock. They were minority interest companies, and therefore they were not included in this proposal.

The major purpose of my appearance here today is to assure you that following divestiture, New Jersey Bell will continue to provide the same high quality of telephone service citizens of New Jersey need, and have come to expect. And, furthermore, that these services will also be provided at a reasonable price. Now, you've had some background information from both Commissioner Hynes and from Mr. Camacho, but I'd like to set the stage for our discussion here today by briefly describing a few other background events leading up to this proposed settlement. I'd like then to discuss the major terms of the agreement, what its current status is, and finally why I believe New Jersey Bell, as well as the other operating companies, despite the restrictions that are imposed on these companies by the terms of the settlement, will nevertheless prove to be viable companies providing quality service at reasonable rates.

The announcement on January 8 that the Department of Justice and AT&T had agreed upon the terms of a modified consent judgment under which AT&T would be required to divest about two-thirds of its assets, came as something of a shock, not only to the employees and shareholders of the Bell System, but to our regulators,

to legislators such as yourselves, at both the State and federal levels, to the business and financial communities and, most importantly, to the public at large. Concerns were raised from every direction as to whether quality telephone service as we've known it in this country could survive the breakup of the vertically and horizontally integrated Bell System. Speculation that local telephone rates would double or triple were laid at the doorstep of the proposed settlement. As a long-term career lawyer with the Bell System, I guess I would have to confess that I was as surprised as anyone else by the January 8 announcement. But on reflection it's clear to me that the settlement agreement is nothing more or less than the natural culmination of the series of events which began about 25 years ago, but which accelerated very rapidly over the last 10 years.

It would take a good deal more time than we have this morning to review these developments in detail. Let me just say that they can be characterized as the selective introduction of competition into a world which back in 1956 most of us saw in terms of the classic natural monopoly. As Mr. Comacho mentioned, in 1956 AT&T and the Justice Department settled an earlier antitrust case on terms which left the integrated structure intact, so long as the members of that system, Bell Laboratories, Western Electric, AT&T Long Lines and the operating companies, confined themselves to the business of providing telephone service. I might add, and Assemblyman Gill would be familiar with this, that the major thrust of that antitrust action was to split off Western Electric from the Bell System. That was the Justice Department objective. The settlement preserved the system intact, but restricted the activities of the system in the years thereafter.

In this tightly integrated world, the Bell System companies had what was called "end-to-end responsibility." Bell owned the entire system and was responsible for its operation and its maintenance. The only product that we sold was service. And in that environment, and in cooperation with our regulators, it was possible, and it was even desirable, to identify and pursue socially attractive goals. Universal service, about which you've heard so much all ready today, was such a goal, and by the 1960's it was essentially achieved by pricing basic service and initial installation charges well below cost. That was the basic mechanism for gaining market penetration, and market penetration was universal service. Even those of us who are old enough to remember tend to forget that at the conclusion of World War II, which really wasn't that many years ago, less than half of the homes in New Jersey had telephone service. So that, in about 15 years, we had accomplished that universal service objective, from 1945 to about 1960.

Now this, and other kinds of what I would describe as social engineering, were also possible in this natural monopoly environment. For example, it didn't much matter what price was charged for any particular service, so long as in the aggregate the total costs of the firm, including the return on the investment, were covered. Therefore, concepts such as rate averaging and value of service pricing were deemed appropriate and they were the mechanisms by which basic residents' telephone service was subsidized. I'm sure you recognize that we charge higher prices to business customers, we charge higher than cost prices for toll service and optional equipment, and that extra that was available from those sources was the source of the subsidy to the basic exchange ratepayer.

Well, the ink was hardly dry on this 1956 consent decree before this tight little integrated world began to unravel. In a series of decisions beginning

with the Hush-A-Phone case and the Above 890 case, later followed by Carterphone and Execunet, the F.C.C. began to allow the selected entry of competition into both the terminal equipment and the intra-city toll markets.

Now, it doesn't take a whole lot of intelligence to figure out that the pricing flexibility one has in the case of the natural monopoly is vastly different than the pricing options that are available in a competitive market. Predatory pricing violates the antitrust laws, and it is unlawful to subsidize the competitive part of our business with revenues derived from monopoly services. In short, the entry of competition into our business severely limits our ability to subsidize at all, and it is only because local exchange service still retains monopoly characteristics that the existing subsidies to that service are allowed to continue. If we had a competitor for local exchange service, we couldn't subsidize that. We'd have to price it at cost or we would violate the antitrust laws. It's just that simple.

Because the Bell System resisted at the F.C.C. level the selected entrance into the competitive world and these departures from the natural monopoly concept, we began to find that we were exposing ourselves to significant antitrust litigation. Apart from the Department of Justice case, about which we've been talking today, there have been about 100 private antitrust cases. You've heard about some of them, the IT&T case, the Litten case and the MCI case, and there are dozens more of them that are still pending. In nearly every one of these cases, the plaintiffs point to our efforts to resist these changes as evidence of anti-competitive conduct. I know as a lawyer, Assemblyman Bryant, you'd appreciate the dilemma that this put us in. We were tossed between the antitrust courts and the regulatory arena, and we concluded about eight years ago that the only answer to that was to take our problems to the Congress and to ask them to articulate either a new national telecommunications policy or to reaffirm the old one. But do something, don't leave us in this ping-pong game.

Now these efforts were largely unproductive. I should say as an aside, that the earliest effort at that became known as the Bell Bill, and all of these competitors mounted every conceivable lobbying effort to defeat that bill. That bill essentially was designed to freeze conditions as they then were so that we could retain some of the monopoly characteristics of our business and also retain the ability to subsidize and provide universal service. As most of you recall, that effort eight years ago was unproductive, as have all of the efforts to date been unproductive, except for the passage last October of a bill in the United States Senate that would have preserved the various parts of the Bell System under common ownership. It didn't provide for any breakup of the system, but it would have imposed rather severe restrictions on the relationships of the various entities within the Bell System with each other. The purpose of those restrictions was essentially to insure against what the Congress had identified as the cross subsidy problem, the ability to subsidize competitive entry with revenues from the monopoly side of the business. The fact that that wasn't the case didn't deter them from having that concern and that fear, and that's why these various restrictions were built into that bill.

That particular bill also contained many requirements dealing with the procurement of telephone equipment and provided for equality of treatment for both the vendors of that type of equipment and equality of treatment for the inner-city carriers.

The Senate Bill from a Bell System perspective was barely livable, but we could live with it. But it became clear shortly after that passage in October that we could not get comparable legislation passed in the House of Representatives. In December of last year, Congressman Wirth of Colorado introduced his bill in the House. Following the January 8 announcement it was amended very substantially. But even before those amendments, many of which were adopted without any real opportunity for study or comment, the House Bill was completely unsatisfactory from a Bell System viewpoint. It was not my intention today to discuss the many flaws in the Wirth Bill. We're been talking about those flaws publicly for some time, and I'm sure most of you are aware of our concerns with that bill, but I would be happy to respond to any questions you might have concerning the reasons for our opposition to it.

Now, while all of this was going on, you know the world never stands still, the technological side of the business was exploding. Because of the revolutionary changes in micro-electronic technology, new products and new services are becoming available which merge data processing and communications functions. Since much of this technology is the fruit of Bell Labs research, it was somewhat ironic that the Bell System was restricted in the use of its own technology by the terms of the old 1956 decree. With no congressional relief from the situation in sight, the logjam had to be broken in some fashion. We were fully confident that we could win the Department of Justice case in the long haul, but if we had to litigate it fully, what I mean by fully is probably up to the United States Supreme Court, that case would have dragged on for several more years and given that, and given the difficult picture insofar as legislation was concerned, the hard choice was made to accept the government's divestiture remedy and settle the case.

Let me make it very clear that AT&T didn't welcome this disposition. This is not something that we sought or desired. It was agreed upon only because it was the only way the case could be disposed of. But I should add further that it was not negotiated in the sense that AT&T got very much out of it. You know as an old labor negotiator, Mr. Chairman, you know that there is give and take in negotiation. This was all give in terms of the remedy, because it was the preferred remedy that the Department of Justice had articulated for some time. They felt because the operating companies had these local exchange bottlenecks, as they call them, that there was the power to choke off the competition. The only thing that Professor Baxter, who is the head of the Antitrust Division of the Department of Justice, would listen to was a remedy that would divest those bottleneck facilities.

Under the terms of the decree, the operating companies would be limited to the provision of exchange service and exchange access. Now, as I've said, the theoretical basis for the restrictions is found in the Justice Department's view that the real monopoly power of AT&T was exercised through control of these so-called bottleneck facilities. The reasoning went something like this, that absent AT&T ownership, there is no incentive for the operating companies to discriminate against the inter-city competitors of AT&T or the equipment manufacturers and vendors who are competing with Western Electric. If the same people don't own them, what does the operating company care whether AT&T or Western Electric are profitable if they are totally separate businesses owned by different individuals. Consistent with this theory, the settlement seeks to separate those portions of the business

which retain natural monopoly characteristics, i.e., exchange service and exchange access from those portions of the business which are essentially competitive. The terminal equipment issue and the Yellow Page issue fall on the competitive side of the line. In fact, the separation of the terminal portion of the business had been ordered by the F.C.C. a year before the modified judgment was agreed upon.

Now, what is the current status? Judge Greene, as you know, must make a decision as to whether the proposed decree is or is not in the public interest. He has received comments from about 600 interested parties, including our State Commission and our Public Advocate. He has directed that those parties who have filed such positions support them by legal briefs which are due today, June 14. He has set aside a couple of days at the end of this month for oral argument and thereafter, hopefully sometime in July, he will render his decision. There's no way we can control that. In the meantime, interest is once again stirring in the Congress. As Commissioner Hynes indicated, markup is proceeding on H.R. 5158, but I believe and I hope that most members of the Congress are persuaded to await Judge Greene's decision before determining what legislation may be necessary to supplement the terms of the consent judgment.

Assuming the court finds that the decree in its present form essentially is in the public interest, what kind of a future is there for New Jersey Bell and its customers?

Most of the comments before Judge Greene and from other sources as well, focus on two major concerns. First, restrictions placed on the future activities of the divested companies; and secondly, the impact of divestiture on local telephone rates. While these concerns are understandable, I hope I can persuade you today that they are not well-founded concerns.

As I said earlier, following divestiture the operating company, New Jersey Bell, will be limited to the provision of local exchange service and local exchange access. They will no longer provide terminal equipment nor will they provide certain inner-city toll service. Moreover, after a four-year phaseout period, revenues presently received from Yellow Page advertising will no longer be available as a contribution to the overall revenue requirements of the firm. Although responsibility for these changes is frequently placed on the proposed consent judgment, I think it is important to understand that each of them was either mandated by earlier F.C.C. decisions, three, only through a separate subsidiary. In other words, with or without the antitrust settlement, New Jersey Bell would be out of the terminal equipment business by F.C.C. fiat, at least for new equipment, by January, 1983, just about six months from now. As a matter of fact, initially it was to be March, 1982, a date which already has past.

In addition, the transfer of certain inner-city toll services in the interstate jurisdiction and the separation of Yellow Pages from the operating companies were both included in the bill which passed the Senate last October, three months or so before the settlement was announced. The decree, therefore, must be seen as fully consistent with the general thrust of regulatory and legislative developments from which a new national telecommunications policy has been evolving over these last several years.

Now, where to place the blame for these changes is a whole lot less important than whether after they occur the operating companies can be financially viable without raising basic telephone rates to exorbitant or unaffordable levels. So let me get to that issue.

As to the notion that local rates will have to increase substantially as a direct result of the decree, I have already made the point, I think, that the decree itself is the culmination of a long series of developments moving in the direction of restructuring the old natural monopoly into a fully competitive and ultimately deregulated market.

The simple but inescapable fact is that there is a price which must be paid for the real or supposed advantages of competition, and on that score I'm afraid we've passed the point of no return. Competition exists today in almost every facet of our business. It is entrenched and it is growing. It is widely, and in my opinion, correctly perceived that there will be long-term benefits in the form of new products, services and wider customer choice flowing from this change in national policy. But as I said, there is a price and one obvious casualty must be the social engineering which has characterized rate making in the telephone industry for most of this century.

In preparing for my appearance here today, I asked that we put together an analysis of the price changes in our basic exchange rates since 1958. I chose 1958 because in the period from 1958 to 1970 there were no rate changes, except rate decreases. But, in that period of 23 years, average monthly rates have increased by $2.36, or an average of 10.3¢ per year. Now that's quite a record. That rate of increase is equal to about one-fifth the percent change in the CPI over that same period. That history is only possible in a monopoly environment because it is perfectly apparent, or should be, that the costs of such service far outstrip the revenues that they produce. As any economist will tell you, competition drives prices toward cost and the major upward pressure, and I don't deny that there is upward pressure, on local exchange rates will be from the continued erosion of the ability to provide subsidies from those other services which are now competitive. The more competitive they get, the less subsidy that will be available. Significant changes in the way we price our services come about as we move from a totally regulated business to a fully competitive one. I'm sure all of you have seen or heard the MCI ads on radio and television, you know, "you don't talk too long, you just pay too much," or something like that. They offer reduced rates to the heavy users of long-distance service. Now, in the face of that kind of competition, the ability to subsidize local rates from our toll business is clearly limited.

Assemblyman Gill asked before whether there were any advantages in all of this and, while it is sometimes hard to find a silver lining in as traumatic an incident as this to a career Bell employee, I think there are some long-term advantages. I think the ability to have AT&T and the resources of the Bell Laboratories and the Western Electric Company freed of the constraints of the 1956 decree will see, and sort of push along, the introduction of new and innovative kinds of services. I think too that to the extent that the subsidies are eroded from the toll business, that you will see a shrinking of the costs of the toll. So your total bill may not change that much. You may have an increase on the basic exchange side and a reduction on the toll side because of competition.

But there are other pressures on local rates that are unrelated totally to the consent judgment. One obvious one is inflation. Another one, which is maybe not so obvious, is the need to recover our capital more rapidly through revised depreciation schedules. Whenever you have newer and newer technology coming into the market, the equipment lives are shortened because of that

accelerating technological change and you've got to recover your capital through the depreciation rate at a faster rate than you would in a pure monopoly environment. In short, I cannot dispute the local rates will go up, but not because of the consent decree. Moreover, they will not go up as precipitously nor as high as some have predicted because the operating companies will continue to have major revenue sources apart from these basic exchange revenues which will permit the subsidy to be reduced gradually over a period of years.

We will, for example, and Commissioner Hynes made a reference to this, and we thank the Commission for their support of this particular position, retain a major portion of our intrastate toll business. Our best estimate now is that we will keep about three-quarters of that intrastate toll business, and that is a profitable business, and is a major source of the subsidy toward the local ratepayer. In addition, we will be paid an access charge by AT&T and anyone else who wants to use our local exchange network, which is the end link for the vast bulk of present day communications.

I did want to say a couple things about access charges in response to both Commissioner Hynes and Mr. Camacho. The decree provides that AT&T and the AT&T competitors in the inter-city business will pay equal access charges. Those access charges will be determined at two levels. They will be determined for interstate services by the F.C.C. and for intrastate access they will be determined by our local Commission. I need to make one other point in that regard. One of the major reasons for our opposition to H.R. 5158 is that it would freeze the access charges currently paid by people like MCI, IT&T and Southern Pacific at present levels, at January, 1982 levels, which we calculate represent about 55% of our costs, and they would be frozen for a period, I believe, of three years and then there is another three-year period during which they would be gradually phased up toward full cost. Now, the decree would allow us to get 100% of the costs of those access charges, therefore, a subsidy for the local ratepayer, whereas the bill would restrict us where we would be getting just about half of it for three years, and then only a portion of it thereafter, until it would be close to 1990 before we'd be getting full revenues from that source -- from AT&T's competitors. That aspect of the bill is designed to handicap AT&T in competing with MCI, Southern Pacific, and the newer inter-city carriers.

I mentioned that this access relates to getting into the local network which will retain, at least for some time as we see it, the natural monopoly characteristics. There are possibilities of bypass for that network, but as we see them today, they are prohibitively expensive so long as our access charges are not raised to the level where they would make it economically feasible to build a bypass system. We think most carriers will continue to use the local exchange network that is already there and in place.

We also foresee new uses for that network which will vastly increase its potential revenues, home information, education, security, or entertainment services. As they are offered to the public, and as new business services combining data processing with voice communication become more and more available, we see growing use of that local network. And, again, if it is priced properly, that should produce significant revenues which again can keep the price of the basic service within reason. We also feel that we must improve the quality of that local network and keep our access price reasonable.

Now, there is one other point I should make with respect to operating company viability. Just last week applications were filed with the F.C.C. seeking authority to construct cellular mobile telephone facilities in the nation's largest markets, including the metropolitan New York/North Jersey market. Following divestiture, this service which was developed by Bell Laboratories about 15 years ago and is widely used in Japan today but not yet offered as a service anywhere in the United States, except on an experimental basis in Chicago -- but that service under the settlement will be provided by the local operating companies. That's a brand new service that's not offered today. It promises to be highly successful and I think it will add a whole new dimension to the communications environment in this State.

ASSEMBLYMAN COWAN: What is that service totally, Bernie?

MR. HARTNETT: It's what we call Advanced Mobile Phone Service and, Mr. Chairman, if you have not had the opportunity to see it work, and very few of you have I'm sure because it's only operational in Chicago at the present time, you cannot distinguish it in quality from the Land Line regular telephone service that you have in your home. It is absolutely beautiful -- it does a great, great job and if you compare it with the present mobile service today, which I frankly don't know why anybody wants because you can never get a channel, there's always a lot of noise, it's a very unsatisfactory service from a quality perspective. You compare that with this new service, and we're going to have a lot of customers for that service. Presently we have a waiting list that will take five years to reach the last name on it for mobile service which is of very poor quality. If we can get this new service up and working, and we hope we can within about two years, I think you will be very impressed with it and I think too that it will prove to be a service that a lot of people will want and will be willing to pay a good price for. So, that's another one of the aspects of the operating company future, which I consider to be quite bright.

There is just one more point that I think it is very important for me to make with respect to the future viability of the operating companies. Stating it as plainly as I can, it is that the terms of the proposed decree itself require that the operating companies be spun off with sufficient resources in terms of facilities, personnel, technical information to insure that they are in a position to provide exchange telecommunications and exchange access services. There is simply no reason to believe that AT&T will not honor that commitment. It's not simply a matter of trusting AT&T to do the right thing, but of recognizing the reality that it is in AT&T's self interest to insure that result. And I say that for several reasons -- let me just mention a few of them.

Just the other day, AT&T declared its 400th consecutive quarterly dividend. That's a hundred years of paying quarterly dividends without interruption. In doing that it has built up the largest, and perhaps the most loyal, body of investors in corporate history. There are now three million individuals in this country who own AT&T stock. That's almost half the population of the State of New Jersey. Two-thirds of their money is invested in those portions of the business which will be divested. AT&T cannot, and obviously will not, jeopardize the good will of those three million shareholders by dealing cavalierly with their money. It just doesn't make sense for them to do that. The same thing can be said for the one million employees of the Bell System, many of whom have invested their life's work in the business. Here again, AT&T's reputation for fair dealing with its employees is on the line.

And if concern with these constituencies was not sufficient, consider the further fact that because we are dealing here with an incredibly valuable national resource, and make no mistake, that's what we're dealing with, the general public must be satisfied that quality service will remain universally available. You've heard from Commissioner Hynes, he and regulators from many other states, legislators such as yourselves, are closely following these events. Moreover, Congress which holds the ultimate power to change national telecommunications policy stands ready, as I read it, to overturn any part of the divestiture plan with which it disagrees. In short, this entire process is taking place under glass and the overriding incentive on AT&T is to produce a result which will be broadly perceived as fair and reasonable.

Now, there is plenty of time here too for the Congress to act. Mr. Chairman, you asked about the timing of this -- you mentioned 18 months. The 18 months begins to run with the finding by the judge. Should he find that the settlement is in the public interest, the 18-month period begins to run then. In the six-month period following that, AT&T must file a divestiture plan with the Department of Justice. That plan will deal with many of the issues that have been discussed here today. If that plan is not seen as satisfactory, the Congress has another year before the divestiture would become effective under the terms of the settlement to take whatever action they deem appropriate. And, with the level of interest that has been shown in Congress, and I should add that we are not, although we are opposing H.R. 5158, we are not opposed to legislation -- we started this legislative thing eight years ago -- we still believe that Congress is the right place to resolve these problems. We think it is untimely for the Congress to act before Judge Greene, and we think that particular bill that is before the House is a bad bill. But we don't believe that no legislation is the way to go. We think legislation ultimately will be appropriate -- legislation different from H.R. 5158, and legislation which will be molded following the entry of the decree by Judge Greene, because while it is true that Judge Greene doesn't have the power to change the decree, because it is after all a settlement, he does have the power to say, "I won't approve this unless changes A, B, and C are made." I think people can see that he does have that kind of authority. The option is to go back and try the case again.

Well, the fact that this is all taking place under glass, and as I said that the incentive on AT&T is to produce a result which is broadly perceived as fair and reasonable, is particularly significant to those of us in New Jersey. I'm sure you are aware that in recent years New Jersey, of all the 50 states, has clearly emerged as the Bell System state. The three largest private employers in New Jersey are New Jersey Bell, AT&T, and Bell Telephone Laboratories. Way down in seventh place, Assemblyman Gill, is the Western Electric Company. So, four out of seven -- four out of the top seven private employers in New Jersey are Bell System companies. Together these four companies employ more than 75,000 people in New Jersey. Because we are such a major presence in the State, as employers, taxpayers, and as concerned corporate citizens, the continued good health of each of these Bell System entities directly affects the economic climate of our State. Therefore, it is gratifying to us that your Committee has demonstrated such interest in the effects of the divestiture plan, and I hope that I have satisfied you that the fundamental interests of the Bell System companies are very much the same as yours. I'll be pleased to answer any questions that any of you may have.

ASSEMBLYMAN COWAN: Do you want to start?

ASSEMBLYMAN BRYANT: I have one question. You were saying that the F.C.C. already by 1983 would require the operating companies to make sure that they were not in the business of equipment. My question would be, was that decision or regulation made by F.C.C. done prior to the divestiture? If that was the case, wouldn't it seem logical the reason they were doing that was based on the fact that at that point in time AT&T owned all the operating companies? Would not possibly a different decision be made in that regulation if in fact they were separating operating companies without AT&T's control?

MR. HARTNETT: That's a very good question. Obviously, the F.C.C. decision did predate the settlement which provides for divestiture. However, the F.C.C. has, post divestiture, reasserted that it has reexamined that decision and finds no reason to change it -- so that we're on this kind of a course right now, unless somebody changes it. We're planning, as of January 1983, to comply with the F.C.C.'s requirement, which in effect causes us to be out of the business of providing new terminal equipment. We can continue to service what's there, and what's in service now, but if you want a new telephone in January 1983 don't come to us because, as we understand the decree, we're not going to be able to provide it to you. But there will be a subsidiary -- a new subsidiary of AT&T that will.

ASSEMBLYMAN BRYANT: Secondly, I guess, let me make a few statements concerning me as a legislator in New Jersey. I look at telephones as a basic, almost a right, of individuals to have at a low cost. I look at senior citizens who are on a fixed income who could care less whether in fact toll calls might be less if their basic charges are going to out-price them from putting in their monthly budgets for their health and their sicknesses. Those are the things that concern me. I think the poor that now can have an affordable telephone basic rate where they might never make a toll call is important. My problem, I guess, is one in terms of what you said is going to happen to Yellow Pages within four years and what that is going to do to the rate structure. Number 2, in terms of bypassing access lines, and you said that you felt as long as the fees were reasonable, you felt competitors would not go. It would seem to me more logical to make that mandatory that they use the local access lines and have some control of that by the local Public Utility Commission.

MR. HARTNETT: I think you can do that only if you say that you are going to regulate all of the entrance into the telecommunications field. That flies directly in the face of what's been happening for these last dozen or so years.

ASSEMBLYMAN BRYANT: That's exactly what I'm saying.

MR. HARTNETT: Yes, I wish it could be done to turn the clock back. What are you going to do with the MCIs, the Southern Pacifics, and these companies that have grown immensely over these last five or so years? They have tens of millions of dollars invested in these businesses now, on the assumption that they are going to be able to continue to build -- they are going to continue to have access to the local network, and they would have the right to build their own local network or perhaps hook it into a CATV local network which is also out there -- you just can't turn the clock back. This stuff is in existence, it's out there now. These companies are in busines. You know, there are a lot of us who like the old world very much and are quite comfortable with it, but I think we have to accept the reality that it has changed and, you know, there are still a lot of parts of it that are going to be regulated. I think our local commission will continue to be very protective of the local ratepayer. I think the history that I recited to you about

ten cents a year for 23 years is very largely the result of a very strong attitude that we encounter every time we come down to the BPU with a rate case. This last decision that we had just a couple of months ago -- there was no change in the basic rates. Obviously, our costs are going up all the time, and we have had real slippage, if you will, in terms of just maintaining the local rates in step with inflation. If we had done that, the rates would be double what they are now, at least, but we haven't, and that's been because we've been able to have these subsidies for the services.

ASSEMBLYMAN BRYANT: One last question, what is your position in terms of what the Public Advocate has said in terms of having an independent body negotiate for different equipment? It seems to me already today, and being an attorney there would seem to be somewhat of a conflict of a child negotiating with his parent, and listening to your testimony going back from New Jersey Bell, and then going back to AT&T, can you really have an unbiased opinion and be able to properly negotiate those who are now in control of New Jersey Bell with AT&T?

MR. HARTNETT: If you proceed on the assumption that there is something to negotiate, you may have a point, but my position is that there is not. The same people who own AT&T stock, those three million people, own all of the assets of the Bell System, and so you would be negotiating with yourself. Commissioner Hynes made the point, and this is in the Wirth Bill, that there should be divestiture and then you negotiate. Well, let me tell you what the effects of that would be. Number 1, a 5.8 billion dollar tax bill immediately due that the ratepayers of the Bell System would have to cough up because that is a taxable sale under our Internal Revenue Code. So you can't do that. Secondly, for most of this century our rates have been regulated on the basis of our book cost. I heard the suggestion here today that somehow we ought to negotiate and get a higher than book cost price for assets that will be transferred to AT&T. AT&T shareholders already own those assets, number one, so they shouldn't pay anything for them. You're just separating them. Secondly, the valuation that should be placed on those, since both at the State and federal level we are regulated on book cost, should be book cost. If you do anything other than book cost, what you run into is this,that assets that were transferred, let's say you put market value on them and let's say that's 50% above book cost, that goes to AT&T. If we went into our Commission and said, "Okay, those same kind of assets that we're keeping are valued at 50% above that, we want to be regulated on that basis -- our rate base is 50% higher now than it was," I'm sure I wouldn't get five minutes worth of Commissioner Hynes' time with such a claim. So that it's got to work both ways. If you're going to be regulated on book cost on both sides of it, then that's the value of the assets for purposes of separating them.

ASSEMBLYMAN GILL: Bernie, you mentioned common public interest a couple of times. While we're concerned about common public interest, we're more concerned about common public interest in New Jersey, and as I understand it, H.R. 5158 does have a provision which I appreciate AT&T might object to, but it considers the divestiture of the Yellow Pages with the returns to go to the telephone company. I don't want to put you on the spot, but is there anything wrong with that from the standpoint of New Jersey?

MR. HARTNETT; Nothing wrong with it from the standpoint of New Jersey. We'd love to keep the Yellow Pages' revenue, okay? But you can't take a piece of that bill and reject all the rest of it. And I have to say that the

reality is, Assemblyman, that the Yellow Page issue -- if you look at it just in terms of the paper part of it, you know we all think of it as the telephone book that gets delivered every year, and the back part of it, that's the Yellow Pages. That's part of our telephone service. If you think of it in those terms, you might make an argument that it belongs with that monopoly part of the business, just as the white pages do. But, as I said before, this world isn't standing still. The Yellow Pages of the future is not paper, it's electronic. Let me give you an example. This isn't dreamworld stuff. Next month -- no, a month after next month, August, we're conducting a trial, I say we, AT&T is conducting a trial in conjunction with CBS up in Ridgewood of an electronic toll information system. Let's say you're a Chevrolet dealer in Kearny and you take an ad in the Yellow Pages now. You know it's going to be published three months from now, so you have to compose your ad today and you put it in the book; it's going to be there for a year. So you've got a 15-month lead time for that. Now, let's say you want to run a sale and you've got a yellow Impala convertible that you want to offer. It's electronic -- you could put that this morning in your ad and when someone dials the Yellow Page number you could have flashed on a T.V. screen in their home every car you have in stock, the options, the prices, the whole bit. You could change that any time you want. That's the Yellow Pages of the future, and that's what people are talking about. That's why the newspaper publishers are so exorcised about this whole issue, because they see that as a threat to their classified advertising business.

But, again, I don't think you can stand there and say, "world stop." It doesn't work that way. The technology is moving and a lot of that technology came right out of New Jersey -- the Bell Laboratories, and the citizens of New Jersey and the people who produced that ought to be able to have the benefits of it.

ASSEMBLYMAN GILL: You sound though as if you're saying that when AT&T shakes New Jersey, it will take all the brains with it. It isn't so. You have your own capabilities -- doing all this electronic stuff.

MR. HARTNETT: If I left that impression I would quickly recant, because that's not so. I think we're going to continue, as I see it, even though the terms of the decree cancel the license contract and cancel the general supply contract that we have with Western Electric Company. There is nothing in the decree that would prevent the operating companies from forming their own Bell Labs, if you will, and I think they're going to do just that. For those portions of the laboratories that have the kinds of talent that would be directly utilizable in the areas where the local companies will be operating, those talents will be part of a centralized service company which will service the remaining operating companies.

ASSEMBLYMAN GILL: One other question, Commissioner Hynes was misinformed, but if the costs of access were to be fixed by the BPU of New Jersey, fixed at a sufficiently high rate that New Jersey Bell in effect would continue to be subsidized, but the subsidy would be even right across the board, do you see any objections to that? In other words, Long Lines, anybody at all, would pay the same rate, subsidized as it may be.

MR. HARTNETT: No, I don't see any problem with that, Assemblyman. As a matter of fact, my understanding is that the objective that the Bell System has with respect to the initial access charges is that they will be equal to the flow of money that comes now from separations, and that there will not be a loss

there. The danger, of course, is that if you don't recognize the need to put some of the cost increases on the basic exchange ratepayer and you continue to look for subsidies all the time, then you are going to be a posture where those access charges are going to get out of whack and if they get too high, then the economic realities are that somebody is going to find a cheaper way to do it, and if they find a cheaper way to do it, then the local operating companies will suffer. But if we can maintain our edge, and we have an edge, you know we're out there, every home and business in the State is wired to us, we think it is a high quality access that we provide -- we want to make it even better so that it can handle all kinds of new services people might want to sell over those lines and it's priced reasonably, then I don't see bypass as a serious problem. I think it will only be a serious problem if that price gets too high.

ASSEMBLYMAN GILL: Two-thirds of your toll calls now are interstate and safely under the regulation and control of our New Jersey BPU.

MR. HARTNETT: Intrastate.

ASSEMBLYMAN GILL: Intra, intra.

MR. HARTNETT: Yes, and they would remain under the control -- even if it's not New Jersey Bell that's offering it. Let's say, as Commissioner Hynes said, a call from his home in Bergen County to Camden went over the AT&T inter-exchange lines, that call within the State would be regulated by the BPU. AT&T would have to come to the BPU for approval of the rate for that call.

ASSEMBLYMAN COWAN: Mr. Hartnett, I would just like to preface any questions I will submit to the fact I think everyone here today has mentioned the fact that AT&T, and particularly New Jersey Bell, has served the consumers quite well over the number of years, and certainly no one is -- we don't want you to recant anything you have said today. I would just again preface my questions with the one question, would you be remaining with New Jersey Bell?

MR. HARTNETT: I hope so, and I expect to be.

ASSEMBLYMAN GILL: That's a good start, Mr. Chairman.

ASSEMBLYMAN COWAN: In the relationship we mentioned earlier in your testimony as far as freezing with these other independent, shall we say, companies that will be coming in, at what rate is that charge now if they are being freezed at 55? Will there be a loss presented to our consumers here in the State because of that freeze?

MR. HARTNETT: You would be getting the same dollars, because it would be frozen at the level that they're paying now. The problem is that what they're paying now is less than our cost, so that somebody else is picking up that burden today. One of the things that is particularly galling to an old Bell Systemer about the ads that we see from the MCI companies is that knowing that if the ability of that company to complete the telephone call requires the use of our equipment at both ends, all they're providing is that highway in between and, as Assemblyman Gill can tell you, over the last many years much of the technological improvement in the telephone business has been in the ability to handle that long-haul piece in between. The technology of the copper wire from the pole into your home, and the inside wire in the telephone, hasn't changed a whole lot in the last 50 years. But that other piece has changed a lot, and that's where the lower costs have come in as technological changes impacted, that part of it. That's the part they do. We still do the other pieces. So they come in with the low-cost piece, they serve the high density routes -- you know, they'll say we'll take your call from New York to Chicago, cause there's a million calls every day

from New York to Chicago. But how many calls are there from Podunk to Squidunk? We have to handle those, and we charge the same if the mileage is the same. That's one of the casualties that you may see, and one of the reasons why the rural legislators in Congress are so concerned about what's happening, because they see the risk that if you get everybody competing for the high density routes, unless somebody is required to serve that low density route, the poor farmer who's got to have ten miles of wire strung from the central office for him to get telephone service may find that it is difficult to get.

ASSEMBLYMAN COWAN: Does the Wirth Bill address that in any fashion?

MR. HARTNETT: I think it does. I think all of the bills have had concerns about, you know, protecting that rural ratepayer. But all I'm trying to point out is that that's one of the reasons why our competitors are able to price the service lower. They're paying less than our costs, and they're only serving the lucrative routes -- the high density routes.

ASSEMBLYMAN COWAN: In the matter of the time frame of divestiture, now you mentioned it in your testimony, what I would like you to do is just spell it out specifically, you say it takes place 18 months after, and then you have six months after that. When is the total completion date as you see it?

MR. HARTNETT: Well --

ASSEMBLYMAN COWAN: Because I think that many of the citizens out there are concerned about something such as this and I think it should be more in common knowledge, if it can be defined a little more clearly.

MR. HARTNETT: Well, the problem is not defining the 18 months. The problem is defining when it starts to run, and it will start to run upon the entry of the decree by Judge Greene, and we have no way of knowing for sure when that will happen. Several people who are close to the case tell me that they think Judge Greene will act quickly, and when you say, "what does that mean?" they say, "Well, probably within two months after he completes the hearings," which are scheduled right now for the last week in June. So if that's so, maybe by September 1, we could expect a decision from Judge Greene, and six months after that, which would be what, March 1, you would have the AT&T plan filed, and 12 months from then -- so we're talking about probably the Winter of 1984, if it goes quickly.

ASSEMBLYMAN COWAN: Before the actual completion date if everything is resolved and of course Judge Greene initiates his decision?

MR. HARTNETT: Yes, I would say it would be about March of '84 at the time.

ASSEMBLYMAN COWAN: What changes do you see would be made necessary, if any, so far as the local Public Utilities Commission?

MR. HARTNETT: Well, I would hope that we would not see very many changes of substance in our dealings with the Public Utilities Commission. They would still regulate local rates. Commissioner Hynes is talking about the doubling or the tripling -- he's got a control on that and we haven't seen, as I've indicated before, any evidence of anything other than great concern for the local ratepayer, and I expect that would continue. They will regulate us with respect to that. They will regulate the access charges for the intrastate part of the business, and that will be essentially the role.

ASSEMBLYMAN COWAN: So local control will be --

MR. HARTNETT: The only thing that would be different is that they wouldn't have the terminal equipment which they now regulate.

ASSEMBLYMAN COWAN: Anything?

ASSEMBLYMAN BRYANT: But there was no requirement either in the divestiture agreement or judgment settlement, or in any of the bills in Congress requiring that access be local? In other words, are these systems developed outside of the local accesses, as I understand it?

MR. HARTNETT: The only provision with respect to the development bypass is a provision that would prohibit AT&T from bypassing. It doesn't affect anybody else, it's aimed just at AT&T.

ASSEMBLYMAN COWAN: Thank you very much.

MR. HARTNETT: Thank you very much.

ASSEMBLYMAN COWAN: Our next witness is Jean Fawcett, New Jersey Area Director for the Communications Workers of America.

J E A N F A W C E T T: Mr. Chairman and Members of the Committee, I thank you in advance for the opportunity to have our union issue a statement about this important subject.

My name is Jean Fawcett. I am the New Jersey Area Director for the Communications Workers of America, AFL-CIO. As you are aware, we are one of the largest unions in New Jersey, representing workers in the public and private sectors. My duties cover primarily the private sector, including traffic, which is the operator services, the commercial and marketing department employees of the New Jersey Bell Telephone Company, as well as Western Electric, AT&T, Bell Laboritories and the United Telephone System.

Ours basically is a union of telephone workers and public employees throughout the length and breadth of the State of New Jersey. As such our members have a major interest in the changes now taking place in the structure of their industry, in the deregulation, in the customer "do-it-yourself" installation and repair, in the new technology and in the rapidly growing competition that has begun to characterize our industry. At stake are our jobs and our futures as individual workers and as a union.

This hearing is concerned with the impact of the divestiture by AT&T of its Bell System operating companies, the BOCs, upon telephone rates. In view of this and the limited time that has been given to me, I will not comment on recent Federal Communications Commission actions, the current status of divestiture or the Washington Legislative picture other than to say that the Computer II decision of the F.C.C. reportedly is on track and will become effective January 1 of this year.

Computer II is consistent with divestiture. AT&T has recognized this. It has just named chief executive officers of the seven regional holding companies that will be established when divestiture finally takes place. As members of this Committee know, New Jersey Bell is slated to become one of the four companies within a mid-Atlantic entity. With divestiture -- and for that matter with Computer II in place -- New Jersey Bell and other BOCs will become solely providers of dial tone. They will, over limited time, operate much in the same way as the electric power utilities.

While our major interest in the proposed divestiture of the BOCs from AT&T and the restructuring of AT&T itself is the impact on our members, their skills and their jobs, we are also concerned with the impact upon telephone users, the industry and the economy of this State and the nation. We recognize that over the longer pull our jobs and living standards will be intimately connected with the price and the availability of service and the economics of the industry. It is our sincere hope that we will not have in telephones the kinds of competition that now exist on the airlines and which, in our view, will ultimately lead to the cartelization of that industry.

In testimony before the House Telecommunications Subcommittee in Washington earlier this year, Glenn Watts, the President of C.W.A., pointed out that unless fairness exists in the breakup of the Bell System, "in 1990 or 1995, the users will have found that the old monopoly situation wasn't so bad as it had been painted in the 1970s and 1980s; they will be looking back to the days of low-cost telephone service provided on an end-to-end service responsibility with rate levelling; and they will wonder if anyone in the current period was examining the implications of public policy."

Rate levelling, also known as rate averaging, permitted the use of long-distance and lush business revenues to be used to hold down the costs of local services. The object was universal and affordable service. There wasn't anything altruistic about it. It simply was good for business, the economy and the phone company, as well as the telephone user. It permitted flat-rate service and the extension of service into rural areas.

Technology and competition have changed this. As the BOCs move toward their destiny as dial tone providers, a new price structure has developed. With the computerization of service, local measured service is becoming the rule. That means, of course, that local service will be charged the same way as long distance service -- by time of day, the distance between calling and called phones within the local dialing area, and the number of minutes consumed, all on top of a basic service charge.

With deregulation and divestiture, each service will be called upon to produce at least its cost, plus a profit. That means higher and higher telephone rates. This, it seems to us, is inevitable because the heavy embedded costs of exchange equipment and local wire must be met and paid for. And it will be these costs, not wages, that will determine charges to the consumer.

Whether or not he talked out of school, Bud Staley, President of New York Telephone, predicted as divestiture was announced last January that "local rates will have to double over the next five years to bear their share of the costs." Mr. Staley retracted these words at a later hearing in Washington, but there is reason to believe that he was correct.

Paul H. Henson, President of United Telecommunications, recently predicted the doubling of phone costs over the next four or five years in a recent talk to the Cleveland Society of Security Analysts. As you know, United Tel is the nation's third largest phone system.

Bernard Wunder, the Assistant Secretary of Commerce for Communications and Information predicted at a Congressional Hearing in Oklahoma City in April that the combined impact of deregulation and inflation will see local phone rates soar by 76% over the next four years.

It has been said that the access charge imposed by the divested BOCs upon AT&T, MCI, Southern Pacific and other long distance competitors will be sufficient to hold down local rates. But there is a danger that too high a rate will see steps taken to avert the network, especially by major users. Already some banks and other bigger users are combatting higher rates by establishing their own internal networks, using ultra shortwave systems. You can see it now in those dishes on the roofs of their buildings.

I will not go into the costs of installations that are already here. Nor will I go into the question of instrument and premises wiring after divestiture is a reality. I would only point out that there will probably be maintenance contracts, especially for business users, and they will be high.

We have been able to win from AT&T job protection in moves resulting entirely from restructuring. For us that's a plus. We are nonetheless concerned over the new developments. We fear a loss of subscribers and of jobs. We also feel that given the realities of today, that the best course for the nation is to give AT&T the same right to compete as all others -- mostly such giants as ITT, Sony, MCI and IBM. Over the longer pull, there will be no room for the Mom 'N Pop operation, even in the interconnects.

The future is here. How prices are set will in part be determined by the regulators, the PUCs, but consumer costs will go up and universal service will tend to fade. We, as a union, have no choice but to deal with reality as we find it. We intend to do just that. Thank you.

ASSEMBLYMAN COWAN: Thank you, Jean. Ed, do you have anything?

ASSEMBLYMAN GILL: Just a comment -- it would appear that you agree it would be nice if we could be back in the old system, of no divestiture or anything else.

MS. FAWCETT: Certainly.

ASSEMBLYMAN GILL: -- facing reality we are back there, do you see any problems with working as hard as we can to assure New Jersey Bell gets absolutely the best protection possible? You're representing New Jersey?

MS. FAWCETT: That is correct. I think that's essential.

ASSEMBLYMAN GILL: Is it with respect to access, Yellow Pages, etc.?

MS. FAWCETT: Everything.

ASSEMBLYMAN GILL: Very good.

ASSEMBLYMAN COWAN: I think, Jean, you have mentioned everything here that everyone else has as far as the access charges and, as Assemblyman Gill said, the Yellow Pages, etc., and of course we're just looking here today for an overview and we're getting a very good one from everyone involved.

MS. FAWCETT: I understand that.

ASSEMBLYMAN COWAN: Thank you very much.

MS. FAWCETT: Thank you very much.

ASSEMBLYMAN COWAN: Our next witness will be John Scarpa, President of the New Jersey Cable Television Association.

J O H N F. S C A R P A: I have edited this statement to be very brief. I appreciate your time limits, and obviously thank you in advance for being here.

My name is John F. Scarpa. I am the President of the New Jersey Cable Television Association, a trade industry association comprising suppliers of cable television service to more than 99% of the approximately one million cable television subscribers in the State. The Association and its members are concerned with the preservation of the current, highly competitive structure of the entertainment and information services markets within which the suppliers of cable television services compete, i.e., the State of New Jersey and the amount of free television that is available, especially in the northern part of our State.

While the impact of the proposed consent decree in the Department of Justice/AT&T antitrust litigation upon local telephone rates is of concern, we believe that the public interest also demands an awareness and serious consideration of the impact of the proposed decree upon the telecommunications marketplace. Such, we believe, impacts upon the initiation of innovative and imaginative services as they become available to the public, rather than at a pace which best serves the marketing strategies of a monopolistic provider. It is for that reason we appear here today.

I should also point out that I am the General Manager of the New Jersey cable television systems of Warner Amex Cable Communications. The system which I manage provides cable television service to all or parts of five municipalities in Cape May County, New Jersey. Our headquarters is in Avalon, New Jersey. Warner Amex, a joint venture of Warner Communications, Inc. and the American Express Company, is the nation's fifth largest multiple cable television system operator, with 144 cable television systems providing service to over 900,000 subscribers in 27 states.

Because of the existence of, and our vital interest in legislation pending in the United States Congress, I think it will also be useful to briefly comment upon its impact on the telecommunications marketplace.

When I learned of these proceedings last Wednesday, I consulted with Francis R. Perkins, who is here with me today and is the attorney for the New Jersey Cable Television Association, and by the way is prepared to comment on any questions you may have, and Richard M. Berman, Senior Vice President and General Counsel of Warner Amex Cable Communications. Because of the national interest of Warner Amex Cable Communications, Mr. Berman particularly has followed with a great degree of professional interest the Department of Justice suit against American Telephone & Telegraph Company, the proposed consent decree, proposed Federal legislation and the impact of those upon the telecommunications marketplace. After several conferences involving Mr. Perkins, Mr. Berman and me, we determined that Mr. Berman should provide testimony before this committee today. Unfortunately, we learned on Friday afternoon that Mr. Berman would be unable to make the trip to Trenton this morning. We do have copies of his prepared testimony, however, and with your permission I would like to distribute it to members of the committee, and I believe we have done that already.

My comments generally parallel Mr. Berman. The position of the New Jersey Cable Television Association is entirely consistent with his remarks. Mr. Perkins and I, at the conclusion of my remarks, will attempt to answer whatever questions you might have. Should any member of this committee, or the committee staff, wish additional information, or if there are questions that we cannot answer to your satisfaction, we are prepared and most anxious to provide whatever additional information you may require

The New Jersey Cable Television Association supports the proposed consent decree insofar as it prevents the Bell operating companies (BOCs) from entering into and inevitably monopolizing the cable television business. The consent decree, however, in this regard, should be clarified to insure that the BOCs never misuse the decree's "natural monopoly" exception to extend their telephone exchange monopolies into the provision of cable television service.

I should also point out that the National Cable Television Association, in comments filed with Judge Harold Greene in the Department of Justice action, also identified the area of federal pole attachment law as one which would require clarification in the consent decree. In New Jersey, however, jurisdiction concerning the attachment of cable television plant to utility-owned poles is within the Board of Public Utilities, Office of Cable Television, pursuant to the Cable Television Act. There is presently pending before the New Jersey Legislature, a bill, S-1287 sponsored by Senator Rand, which would incorporate the language of the Federal legislation into the Cable Television Act, obviously one which our industry supports.

The New Jersey Cable Television Association opposes the proposed consent decree to the extent that it permits AT&T to expand its interstate telephone monopoly beyond common carrier transmission functions (and closely related enhancements) into information publishing and electronic journalism, including cable television services.

The Telecommunications Act of 1982, sponsored by Congressman Tim Morris, Democrat, Colorado, which was reported out of the Subcommittee on Telecommunications, Consumer Protection, and Finance of the House Energy and Commerce Committee, with rare unanimity (a vote of 15-0) on March 26, 1982. With modifications which would restrict AT&T operating in the provision of information publishing services and in the ownership of cable television systems, the New Jersey Cable Television Association supports passage of that legislation as being essentially complimentary to the proposed consent decree. AT&T, on the other hand, has mounted a vigorous campaign, the likes of which are unprecedented, against passage. Any consideration by this committee of the proposed consent decree should also consider the terms of H.R. 5158, which has been obviously mentioned earlier today.

Consistent with our support of the proposed consent decree with the clarification that the Bell operating companies not be permitted to misuse its "natural monopoly" exception to extend their telephone exchange monopolies into cable television services, we are likewise opposed to any modification of the consent decree which would permit the BOCs' entry into information and mass media services, including cable television. There should be no concern by this committee regarding the impact of the proposed consent decree upon any specific segment of the electronic communications industry, except to the extent that such impact bears upon the overall public interest. We think our concerns are public interest concerns and require consideration by anyone reviewing the propriety of the proposed consent decree.

Thank you very much for the opportunity to comment before you this morning. Again, Mr. Perkins and I will be happy to answer whatever questions we can.

ASSEMBLYMAN COWAN: Do you have anything, Wayne?

ASSEMBLYMAN BRYANT: No.

ASSEMBLYMAN COWAN: Ed?

ASSEMBLYMAN GILL: No.

ASSEMBLYMAN COWAN: Thank you very much.

MR. SCARPA: Thank you, Mr. Chairman.

ASSEMBLYMAN COWAN: Are there any further witnesses who wish to address the Committee? If not, we will stand and recess.

(Hearing Concluded)

TESTIMONY OF RICHARD M. BERMAN

Senior Vice President and General Counsel

WARNER AMEX CABLE COMMUNICATIONS

Before the

Transportation and Communications Committee

Assembly of the State of New Jersey

June 14, 1982

My name is Richard M. Berman, and I am Senior Vice President and General Counsel of Warner Amex Cable Communications. Warner Amex is the nation's fifth largest cable television operator with 144 systems, serving 900,000 subscribers, in 27 states (including New Jersey).

I appreciate this opportunity to present Warner Amex's views on the impact of the Department of Justice-AT&T Consent Decree now pending before the United States District Court for the District of Columbia. I believe it will be useful also to comment upon the impact of the Federal telecommunications legislation pending before the U.S. House of Representatives and Senate.[1]

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[1] H.R.5158 is most relevant to this discussion as it includes provisions adopted following receipt of testimony concerning the Decree and its potential impact; certain provisions of H.R. 5158 were specifically intended to modify the Consent Decree. Legislation has also been approved in the Senate (S.898) respecting the appropriate economic role of AT&T; however, S.898 was debated and approved prior to the announcement of the Consent Decree.

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The focus of these hearings, as I understand it, is two-fold: (i) what impact will the AT&T/Justice Department Consent Decree and Federal legislative proposals have upon local telephone service and rates, and (ii) what will the impact be upon the telecommunications marketplace. The first point is really a question better addressed by persons other than myself, although my observation is that the proposed Decree and legislative initiatives will not negatively impact the quality of local telephone service or the rates charged therefore.[2]

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2 In his testimony before the Senate Committee on Commerce, Science and Transportation (February 4, 1982) Assistant Attorney General Baxter stated unequivocally that whether or not local telephone company rates rise in the future -- and the degree of future changes in rates -- is not a function of the Consent Decree (or divestiture). Rather, increases in local telephone company rates, which Mr. Baxter conceded were inevitable, are dependent upon a series of other factors such as inflation, depreciation rates, taxes, etc. This is essentially the same conclusion reached by FCC Chairman Mark Fowler in a recent statement presented to the Senate Judiciary Committee (March 25, 1982).

Mr. Baxter also expressed the view that the local operating companies such as New York Telephone (BOCs) can be expected, in the post-Decree era, to be quite viable. For example, Mr. Baxter stated that the BOC's will be able to replace current long distance service revenues or subsidies ("separations and settlement") with appropriate charges to AT&T and other inter-exchange carriers outlined in the Decree, i.e., the so-called exchange access tariff.

Mr. Rocco J. Marano, President of the New Jersey Bell Telephone Company, has also expressed the view that the BOC's will remain viable and vital in the post Consent Decree period. In a statement before the House of Representatives Committee on Energy and Commerce Subcommittee on Telecommunications (February 23, 1982), Mr. Marano stated:

> "I am confident that . . . [the] framework [of the proposed settlement] is a fair and workable solution which will serve the needs of New Jersey Bell and its customers . . . . [W]hen we and other operating telephone companies are separated from AT&T, we will be in sound financial condition, well positioned . . . to prosper . . . . I view . . . [our] future with a sense of excitement and genuine optimism. . . . Our customers want reliable, reasonably priced local telephone service and they shall continue to get it." (emphasis supplied)

H.R.5158 seeks to further ensure the economic viability of the BOC's in several ways: (i) it provides that the BOC's shall retain printing of the Yellow Pages rather, as in the case of the Consent Decree, than transferring this activity to AT&T after divestiture; (ii) it provides for the BOC's offering certain electronic Yellow Page services; and (iii) it provides that sale of terminal equipment shall be a BOC function rather than an AT&T activity as provided in the Decree.

With regard to the second point, in my view the competitive impact of the Consent Decree and legislative proposals will be far-reaching. In particular, if, and to the extent that, the Decree and proposed legislation allow AT&T (and/or the operating telephone companies) into information services, the result will be a substantial reduction in effective competition from other service providers, including cable systems. It is principally this aspect I will address today.

The Impact of the Consent Decree on Competition in the Telecommunication Field

A. The "New" AT&T

Under the Consent Decree, AT&T would be free to enter any and all new business activities on an un-regulated basis, including information services, cable television, etc. The public policy questions (i.e., the stakes involved, if you will) inherent in this approach are of the highest magnitude. If history is any guide, such direct involvement by AT&T in new markets may be expected to be accompanied by serious threats to competition. The record of AT&T's past abuses of power (acting through its operating companies) vis-a-vis the cable industry is well documented in the files of the Justice Department, the Federal courts, and the FCC.

In its First Statement of Contentions and Proof in the 1974 anti-trust case against AT&T, the Justice Department charged that early on "AT&T became increasingly aware of the potential competitive threat of cable

systems". It sought to "meet" this perceived threat in many improper ways: i.e. by restricting the types of services that could be provided by cable operators over cable attached to AT&T's poles; by manipulating (increasing) pole attachment and "make-ready" rates; by "encouraging" its operating companies to offer competitive services at artifically low rates; and by other anti-competitive tactics all designed to restrict cable growth. Thus, AT&T's objective has been to own and control, through its operating companies, the exclusive communications "pipe" into the home. The potential -- and, we fear, the clear expectation -- for continued abuse of AT&T's power in the field of information services is enhanced, not diminished, by the Consent Decree.

Compounding the problem in our view, is the fact that under the Decree, AT&T retains its monopoly hold on the delivery of long lines services. That is, AT&T is to be allowed free reign in developing new businesses and new markets while simultaneously retaining the huge economic strength of one of the largest single profitmaking businesses in the world, i.e., its 97% monopoly over long-line services.

Given the documented patterns and practices of anticompetitive abuses which the Justice Department found to exist, it is naive to assume, as the Justice Department appears to do, that divestiture alone would remove both the ability and incentive for the "new AT&T" to engage in predatory practices in the new information services markets opened up to it. Indeed,

tne record would indicate that tne new AT&T would simply utilize its economic domination in the inter-city (Long Lines) telephone market to acnieve anti-competitive results (by cross-subsidy and predatory pricing) in the business of information services.

Thus, we feel that tne Consent Decree standing alone poses serious threats to competition in the field of information services. The danger is that absent meaningful legislation, AT&T would emerge as an unregulated, enormously well capitalized company, that could afford to lose money for years to develop dominance in competitive markets. The danger is particularly acute in tnis area as nothing is more fundamental to the democratic fabric of our society tnan tne right of the average citizen to receive information. The core issue, then, is not tne size of new AT&T (not bigness per se), but excessive economic power amassed under special dispensation of tne government, and which if turned loose could be utilized to dominate the next generation of information dissemination.

B. New Jersey Bell and Local Telephone Operating Companies

Tne proposed Consent Decree precludes the local operating companies (BOC's) from entering information and mass media services, including cable television. We oelieve tnis approacn is essential; and we would caution this Committee against support for modifications of the proposed Decree that would allow tne local companies to enter the cable television or information services business.

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In our view, the weight of the evidence is that the divested local operating companies will be economically viable. There appears, therefore, to be no compelling rationale for expanding their economic role.

Moreover, the arguments for preventing a monopoly common carrier from providing unregulated services in the same market, utilizing much of the same plant, are overwhelming.[3] The potential for abuse in extending the regulated monopoly into unregulated areas is simply too great; monoply revenues can too easily be used to cross-subsidize the new services and predatory pricing can too readily be used to compete unfairly with independent service providers such as cable operators.[4]

Divestiture by AT&T of the BOC's does not diminish the threat to cable companies inherent in the BOC's owning and controlling entry into the American home and their ability to engage in anti-competitive practices.

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3 These arguments led originally to the adoption of the FCC's telephone/ cable cross ownership restrictions, without which there would today be no independent cable industry and few if any of its innovations.

4 See also TV Signal Company of Aberdeen v. AT&T (8th Circuit Court of Appeals, 1980). Where the local operating company refused outright to allow a small independent cable system to utilize pole and conduit space, and instead demanded that the cable operator lease a cable distribution system to be built and controlled by the telephone company.

Even after divestiture, the BOC's are likely to remain substantial corporate entities capable of exercising enormous (monopoly) strength. It appears that the BOC's will be spun off as part of regional combinations of operating companies; e.g., it is reported that New Jersey Bell, Pennsylvania Bell, Delaware Bell and the Chesapeake & Potomac Companies of Washington, Maryland, Virginia and West Virginia will be combined as one entity. Legalizing the entry of these huge entities into information services, would virtually guarantee the development of information monopolies, which we believe is undesirable from a public policy perspective.

As for as cable television is concerned, it must be remembered that local operating companies control the poles, conduits, and ducts which the cable company must be able to use in order to be and remain in business. We do not feel it is realistic to suppose that such use will be forthcoming from a BOC competitor when it is only reluctantly provided in the absence of head-to-head competition.[5]

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5 While the Federal Pole Attachment Law is helpful to the cable industry in this area, it has not provided the entire solution to the problem. First, the control which local telephone companies exercise over, for example, the timing of cable installation and the costs of "make ready" continues to place them in a position of great leverage. Second, with respect to pole rates, the BOC's seem able to thwart the impact of the Federal statute by proceeding at the state level (rather than at the FCC) in those states which have stepped in to assert pole jurisdiction. The nature of the problem is demonstrated by comparing the results of pole rate proceedings in the FCC versus the results at the state PUC level. For example, in April of this year an Administrative Law Judge of the New York Public Service Commission reached a decision in the three-year old controversy over pole rates in New York. Utilizing the same formula as found in the Federal law, the Judge allowed the utility company to levy a $6.50 pole rate. This is roughly three times higher than the FCC has determined on the average to be appropriate in comparable cases.

It would only magnify the incentives for the local telephone companies to impose higher and higher pole and make-ready charges and engage in other unfair practies if the telephone companies were permitted to offer information services, including cable television.

Congressional Initiatives

H.R.5158 is the principal Congressional initiative which focuses on the issues we are examining today.[6] Entitled The Telecommunications Act of 1982, H.R.5158 was reported out of the House Subcommittee by unanimous (15-0) vote on March 26, 1982. H.R.5158 contains the following provisions which apply in the post divestiture period:

i. AT&T would be precluded from offering transmission services over or owning or operating any interexchange facility; its Long Lines division would operate as a separate common carrier subsidiary;

ii. The Long Lines subsidiary could offer only common carrier services; it could not, for example, provide Information Publishing Services (IPS);

iii. AT&T may provide IPS service (including cable service) on a stand-alone basis, i.e., it may not utilize its common carrier Long Lines subsidiary or any other non-carrier facility to obtain these services;

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6 S.898 also deals with the role of AT&T but was considered by the Senate prior to the announcement of the Consent Decree. S.2172 (the Goldwater Bill) was recently introduced and deals with a cross section of cable related issues; not, however, with the role of AT&T or other common carrier issues. S.2445 was introduced on April 27, 1982 by Senators Cannon and Hollings. It does not deal with the role of AT&T but does refer to the limited circumstances under which the BOC's might provide service in rural and non-rural areas.

iv. AT&T would be precluded from providing "local loop" service directly until 1988;

v. After 1988, AT&T would be precluded from offering common carrier services over its own local loop facilities, if those facilities are also used for unregulated IPS services;

vi. Local operating companies could not provide IPS service over their regulated (common carrier) facilities;

vii. Local operating companies could not provide cable service in their telephone exchange area;

viii. Local operating companies may provide printed Yellow Pages and limited electronic Yellow Pages, terminal equipment, and, if not otherwise prohibited, certain enhanced services.

Generally speaking, we believe that H.R.5158 moves the communications policy debate in the right direction and contains some important additions to the Consent Decree. The Bill endeavors to preclude AT&T from using its monopoly Long Lines revenues from cross subsidizing unregulated services by creating a separate subsidiary, by restricting the activities of that subsidiary to common carrier services, and by precluding AT&T from developing alternate (non-regulated) interexchange facilities. It does not go far enough however in that H.R.5158 also allows AT&T to provide IPS service and own cable systems. For the reasons indicated above, this is enormously troublesome in terms of telecommunications public policy. We are skeptical that AT&T would compete fairly in these new unregulated markets based upon its past practices; and the risks are simply too great to take the chance.

H.R.5158 does not appreciably change either the status quo or the Consent Decree as these bear upon our industry's relationship to the BOC's. It is consistent with the current FCC rules (and the Decree) in that it precludes cable/telco cross ownership. Codification of that principle, we feel, is absolutely critical to cable's continued growth and development.

At the same time, the Bill would appear to be quite favorable to the local operating companies vis-a-vis their relationship to AT&T in the post divestiture period. The aspects of H.R.5158 favorable to the local operating companies are the following: (i) ability to provide printed Yellow Pages and limited electronic Yellow Pages; (ii) ability to sell terminal equipment; (iii) ability to offer services such as call forwarding, call waiting, etc.; and (iv) requirement that AT&T utilize (and pay for) the local operating companies' facilities and services at least until 1988.

* * * *

In conclusion, it is our belief that both the Consent Decree and pending Federal legislation ought to be further revised to preclude AT&T from entering the information services business. This area is highly competitive at present and characterized by a multiplicity of service providers ("risk takers") none of whom enjoys a dominant market position.[7]

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7 The perception that these information (content) services, such as cable television, videotext, and electronic shopping, are each immediate economic bonanzas is not accurate; and the notion that these new services could somehow provide immediate relief for lower telephone rates is naive. To the contrary, it is more likely that the telephone utility rates would bear the increased financial burden of these incipient services.

The entry of AT&T would radically change this market given AT&T's unique status, its dominant power in related markets and its access to capital. The formidable impact of AT&T would chill investment and retard the development and introduction of services. Over time, given its inherent advantages, AT&T would come to dominate the information industry as it did the telephone industry. In this case, however, AT&T would control the origination and dissemination of information intended to influence public opinion.

Equally important from the perspective of this hearing, if AT&T is allowed to operate cable systems or other local facilities, it is clear that it will attempt to by-pass the local operating companies for the transmission of lucrative high-speed data and voice services at its first opportunity. Even under H.R.5158 it is unrealistic to assume that once AT&T builds stand-alone cable systems it will not be able to modify the prohibition against the provision of local loop service under those same facilities. To the extent that AT&T has built its own local facilities it has every incentive to use these facilities for local loop service thereby avoiding substantial local access charges.

The answer to avoiding this likelihood is quite simple. AT&T should be kept out of the operation of its own local facilities for IPS service from the outset.