Will the Bells Steal America's Digital Future Again?

by Audrie Krause

In June 2000, NetAction released a comprehensive report [http://www.netaction.org/broadband/bells] describing how the Regional Bell Operating Companies (RBOCs) had broken the promises they made to regulators in the 1990s to deploy high-speed fiber optic networks. If the Bells had delivered on those promises, 44 million households — almost half of the households in the United States — and the vast majority of the nation's schools would already be wired with networks capable of delivering data at speeds many times faster than digital subscriber line (DSL) service. Instead, only about 500,000 households had access to the Internet over fiber at the time the report was released, and that number has not increased significantly since the report was released. NetAction sees this as a contributing factor to the digital divide because, if the Bells had delivered on their promises, fiber optic networks would be widely deployed by now in low-income urban neighborhoods and rural communities, as well as in schools, libraries and health care facilities.

Bruce Kushnick of New Networks Institute, who prepared the report for NetAction, used the companies' own words from annual reports, press releases and regulatory applications to document specific plans and time lines that the companies announced in the early 1990s for building fiber optic networks. In many instances the Bells' promises to deploy fiber optic networks were made in exchange for relief from important pro-consumer regulations.

In states where regulators went along with this tradeoff, traditional rate-of-return regulation intended to protect consumers from profit gouging was replaced with incentive or price cap regulation. The new regulatory schemes gave the Bells more profits, ostensibly to be used to build fiber optic networks. But few of these high-speed networks were ever completed and the companies retained the higher profits. Not surprisingly, the Bells are among the most profitable companies in the nation. According to Kushnick's research, Bell return-on-equity was a whopping 163% above that of the nation's major long distance telecommunications companies, and 130% above that of the industry average. Kushnick is updating his financial analysis now and it appears that little has changed.

Table I
Business Week's Industry Ranking:
Bells/GTE Compared to ScoreBoard for Utilities

	1998		1999	
	Net Margin	**Return-on-Equity**	**Net Margin**	**Return-on-Equity**
Bells	13.65 %	28%	12.03%	28%
ScoreBoard for Utilities	6.3 %	9%	6.9%	11%

	Difference	Difference	Difference	Difference
Bells Compared to Utilities	110%	214%	86%	154%

Source: Business Week, March 29,1998 and March 27, 1999.

(Note: We have excluded U.S. West from the 1999 calculation in Table I because the company's ROE reported by Business Week was 87.8% and consequently would have biased the results.)

Table II
Bell Return-on-Equity Compared to Long Distance Companies and to the S&P 500 Telecommunications Industry Average

	Return-on-Equity
AT&T	7.3%
MCI	8.1%
Sprint	16.6%
Combined Long Distance	10.67%
S & P 500 Telecommunications Industry Average	12.2%
Bells	28.1%
	Difference
Bells Compared to Combined Long Distance	163%
Bells Compared to Telecommunications Industry Average	130%

Source: Business Week's Performance Ranking of the S & P 500, March 27, 2000

NetAction believes that the Bells' long record of failed promises should be a warning to Congress to resist RBOC pressure to modify the Telecommunications Act of 1996 until there is much stronger evidence that robust competition has emerged in the telecommunications and information technology markets, as specified in the Act. Congress is considering a variety of bills that would free the local phone companies from restrictions placed on them by the Act. One bill is especially worrisome is H.R.1542, which would allow Bell entry into long distance data markets without regard to the state of competition in local phone service. The bill is co-authored by Rep. Billy Tauzin (R-La.) and John Dingell (D-Mich.), who introduced a similar bill last year. Although last year's version never made it out of committee, it eventually gathered some 240 co-sponsors. This year, Tauzin has moved the bill aggressively. (For up-to-date information on the status of this bill, see NetAction's Broadband Briefings newsletter [http://www.netaction.org/briefings].)

Supporters claim that H.R.1542 will expand the deployment of broadband Internet service and consequently bridge the "digital divide" by allowing the Bells to enter long distance data markets. But what is really does is open a "back door" to Bell entry into the long distance market. Supporters' claims that the bill would only apply to data are deceiving since voice traffic and data travel over the same telephone lines. Moreover, data already accounts for more than half of the traffic on phone lines, and is expected to increase to 80% of traffic by the end of the year. Lifting the restrictions on Bell entry into long distance data markets is tantamount to lifting the restrictions on Bell entry into long distance telephone markets.

That is the point, of course. In the 1990s, traditional rate-of-return regulation was supposed to protect consumers from profit gouging, but state regulators replaced it with incentive or "price cap" regulation in exchange for Bell promises to deploy fiber optic networks. H.R.1542 is packaged in promises of widespread deployment of DSL in rural areas. But it would effectively undermine the chief consumer protection that Congress included in the Act: compliance with a 14-point checklist for determining if there is sufficient competition in the local phone market. The Act requires state and federal regulators to determine that competition exists before a Bell can enter the long distance market in states where it is the incumbent local service provider. The checklist is protection against the potential threat of re-monopolization of the telephone industry at the regional level.

Despite Rep. Tauzin's promises, H.R.1542 actually poses a threat to competitive DSL providers. This should be a cause of concern to all of us who are concerned about bridging the "digital divide" and expanding access to broadband technology. Demand for high-speed access is skyrocketing. But full deployment of cable broadband won't be possible for several more years because of the need for network upgrades, and high-speed wireless and satellite service will also take some time to develop. That makes DSL an increasingly popular choice for consumers who want high-speed Internet access. But DSL won't remain affordable if the Bells monopolize the market, and that's a real possibility

Competition is absolutely crucial to keeping broadband Internet access affordable and accessible, but competitive DSL providers are in a tough position. These mostly small companies compete head-to-head with the Bells in offering high-speed service to consumers. But the Bells own the networks these companies must buy the service from in order to sell it to consumers. Since the Bells are selling to their competitors, they have absolutely no incentive to sell wholesale DSL service at an affordable price. The incentive that Congress included in The Telecommunications Act of 1996 linking entry into long distance markets to the requirement that local markets be competitive would vanish if H.R.1542 were enacted, and the Bells would again avoid the need to comply with pro-consumer regulations.

If the Bells had kept their promises in the 1990s, the nation might have been fully wired with fiber optic networks by now. If the Bells had met the conditions spelled out in the 14-point checklist, the national might already have vigorous competition in both DSL and local phone service. But the Bells chose instead to stonewall competition by engaging in protracted legal and regulatory maneuvers, and by lobbying Congress to change the law. If the Tauzin-Dingell bill is enacted, DSL will go the way of fiber optics. And the Bells will once again have stolen America's digital future.

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