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AUTHOR	Valdez, Armando; And Others
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ABSTRACT

This white paper informs Californians of the implications of the possible merger of Pacific Telesis and Southwestern Bell Corporation, under consideration by the California Public Utilities Commission (CPUC). The decision will determine the future direction and character of telecommunications in California. Only a small number of Californians are aware of the pending merger and its significance. This document is a call to civic participation by community and public interest leaders across the state, who should raise their collective and individual voices on these issues. It also seeks to enlarge the public discussion on this decision. One of the paper's major objections to the merger is that it would reduce investments in the state's telecommunications infrastructure, including use of the "Information Superhighway" (see p. 5-6). With the passage of the passage of the Telecommunications Act of 1996, competition, rather than regulation, is the primary means by which consumers will be guaranteed affordable access to both phone service and the information superhighway. Since the passage of the bill, telecommunication companies have been merging and consolidating at an unprecedented rate. This paper provides recommendations on conditions that should be imposed on the merger in order to protect Californians' public interest. (SWC)

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Staking Out the Public Interest

in the Merger between Pacific Telesis and Southwestern Bell Corporation

A White Paper

Prepared for the California Telecommunications Policy Forum

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A White Paper

Preface

The California Public Utilities Commission (CPUC) is scheduled to decide on the merger of Pacific Telesis and Southwestern Bell Corporation. Whatever the outcome, its decision will likely determine the direction and character of telecommunications in California for the foreseeable future. One would expect that such a momentous decision would be the subject of vigorous and widespread discussion and debate across the state and nation. But such is not the case. Only a small number of Californians are even aware of this pending merger and the significance of the pending decision before the CPUC. The intent of this white paper is to inform Californians about the magnitude of the merger and the public interest stake in any decision made the Commission. This document is also a call to civic participation by community and public interest leaders across the state. It is a call to raise their collective and individual voices on this issues and thus enlarge the public discussion on this pivotal decision.

The California Telecommunications Policy Forum is an aggregation of independent community and civic leaders from communities of color across the state who have been meeting over the past four years to examine current and emerging telecommunications policy issues. The effort was initially supported by a grant from the Telecommunications Education Trust, a fund created by the CPUC as a result of a fine against Pacific Bell in the early 1990s for marketing abuses directed at low-income and language minority communities in California. The Forum is currently supported by the Benton Foundation, one of the nation's foremost telecommunications policy institutions.

The principal authors of this white paper are Armando Valdez, Ph.D., Charles Carbone, and Laura Stuchinsky, M.A. Other contributors to this paper include Michael Shames; Andrew Blau, Susan Goslee and Kevin Taglang of the Benton Foundation's Communication Policy Program; and Audrie Krause. We would also like to thank the staff of The Utility Reform Network (TURN) for their help with background information and materials. The section on Allocating the Public Int*erest Share* represents the collective opinions and recommendations of participants in the California Telecommunications Policy Forums, which were developed in mid-1996. Support for this publication was provided by the California Consumer Protection Foundation.

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Executive Summary

The passage of the Telecommunication Act of 1996 dramatically changed the rules that have governed telecommunication policy in the United States for the last 60 years. Now, competition, rather than regulation, is considered the primary means by which consumers will be guaranteed affordable access to not only phone service but the information superhighway. However, competition has yet to be realized on the scale necessary to effect rates. In fact, since the bill's passage, telecommunication companies have been merging and consolidating at an unprecedented rate. For example, four of the seven Baby Bells created by the break-up of AT&T in 1984 have sought to merge, including Pacific Telesis and Southwestern Bell Corporation (SBC). A preliminary decision by the CPUC on this application is imminent.

If SBC's $16.52 billion bid to buy Pacific Telesis is approved, it will constitute the fourth largest corporate merger in the history of the US, assuming the price is adjusted for inflation. The new company would control more than 20 percent of the nation's access lines, with approximately 50 million customers nationwide and more than $20 billion in operating revenues.

Pacific Telesis and SBC have argued that the benefits of consolidation—greater efficiency, lower prices, and one-stop shopping for consumers—outweigh any risks of lessened competition. But the market dominance of the merged companies will be felt most acutely in "economically unattractive" sectors of the market that are least likely to see competition—r1ural, low-income, language and ethnic minority and communities of color, and seniors and disabled persons. Consequently, those who are least able to pay may be forced to pay higher rates to subsidize Pacific Telesis-SBC's rates in more lucrative, and therefore competitive, sectors of the market. Or, these economically vulnerable consumers may be forced out of the telecommunications market entirely, at the same time that access is becoming more critical to political, economic and social participation in society.

Section 854 of California's Public Utilities Code requires that the CPUC determine if the proposed merger is in the public interest. Conditions may be imposed on the corporations to protect that interest. If the merger is approved, this law requires that the public receive half of the long- and short-term benefits that would result from the merger. The law does not say how that calculation should be made, or how the money should be returned.

We feel the merger, as proposed, is not in the public interest. The corporations have made numerous promises ostensibly to safeguard the public interest, but in most cases their assurances are vague or unsubstantiated and therefore are impossible to enforce. For example, the companies have promised to invest in California's economy, but they declined to attach a dollar figure or a time period to their commitment.

The corporations have estimated that the benefits of the merger would range between $184 million and $273 million. We believe those estimates vastly understate the value of the merger. An expert from the CPUC's Office of Ratepayer Advocacy—an objective source—calculated the value between $2.1 billion and $8 billion. An expert hired by The Utility Reform Network (TURN), a consumer advocacy organization, estimated the value at $3 billion. Assuming that the calculation might include some services that are not regulated by the Commission, they also reasoned that $2 billion would be a fair estimate.

We believe that $2 billion is a fair and conservative estimate of the merger's value. Half of that amount, $1 billion, should be returned to consumers. Pacific Telesis and SBC have argued that ratepayers will benefit from the merger as competition forces the company to lower its rates. However, the companies have offered no guarantees when and if consumers will ever see those reductions. Thus far, California ratepayers have yet to see any savings as a result of the new incentive -based regulatory framework.

The corporations have signed an agreement with 11 California community groups in which they promise to provide up to $50 million over ten years for a community technology fund. However, their attorneys have withdrawn the Community Partnership Agreement from their merger application so the CPUC cannot impose guarantees or penalties to ensure enforcement.

We propose that half of the $1 billion obligated to the public, or $500 million, be refunded to the ratepayers immediately after the merger is approved. The other half should be used to support community and consumer technology programs that would provide long-term benefits to the public. We are urging the CPUC to require the corporations to fulfill their promises under the Community Partnership Agreement as a condition of the merger. In addition, we propose that, as a condition of approval, the CPUC require the corporations to invest:

▲ $25 million over five years to create and support an independent consumer education program to help consumers, particularly low-income and language-minority communities, become well informed about their telecommunication choices and to help guard them against unfair marketing practices and aggressive advertising campaigns. The money may also be used to ensure that the public's interests are represented in regulatory and legislative matters.

▲ $150 million over five years to create and support sixty community technology centers in communities with the lowest socio-economic indicators for income, education, employment and telephone penetration in order to ensure that emerging technologies do not by-pass low-income communities. The centers will be equipped with state-of-the-art technology and provide training and support to community members, including job training for the community's youth focused on telecommunications and information technologies.

▲ $60 million over five years to wire schools and public libraries in California's lowest-income neighborhoods with high-speed, high-capacity fiber optic lines and an additional $20 million for the necessary hardware and software, and training, and technical support needed to ensure that the infrastructure is used effectively.

▲ $10 million over five years to fund college scholarships for low-income students majoring in telecommunications and computer science.

Due to the state's size and influence, the CPUC's decision on the SBC-Pacific Telesis merger will influence the shape of local competition in telecommunication services throughout the country. But more immediately, it is likely to determine the direction and character of California's telecommunication market for the foreseeable future. In order to ensure that the public's interests are protected, we urge community leaders and consumer advocates to join the public debate on this matter and endorse the recommendations outlined in this paper. There is only a short window of time for public comment before the Commission makes its final decision in mid- or late March, 1997.

Staking out the Public Interest in California's Telecommunications Future

For sixty years, the nation has considered residential telephone service essential. All residents were guaranteed access to a low cost, reliable and ubiquitous phone system. In exchange, the country's phone monopolies—first AT&T, and later the seven Baby Bell phone companies—were guaranteed healthy profits. But the rules of the game have changed.

With passage of the Telecommunications Act of 1996, the country's leaders have chosen competition, rather than regulation, as the means to ensure access. That guarantee is being stretched to include not only phone service, but the evolving digital telecommunications system commonly known as the information superhighway. Ultimately, this system will transform our society, socially, economically, and politically. It will change how we work, learn and receive medical care. But in a deregulated, private marketplace, access to the network may be determined by income. If segments of our society are left behind, racial and class divisions are likely to widen. Our democratic institutions may be undermined.

Ultimately, this system will transform our society, socially, economically, and politically

State regulators are currently considering a merger proposal submitted by Pacific Telesis and Southwestern Bell Corporation, two of the nation's seven Baby Bell companies. Their application illuminates some of the risks consumers face in this new and rapidly changing market. It also presents consumer advocates and community leaders an opportunity to ensure that the public is treated fairly and that the companies are held accountable for their promises.

The Proposed Merger: Pacific Telesis and SBC

In April 1996, Pacific Telesis applied to the California Public Utilities Commission for permission to merge with Southwestern Bell Corporation (SBC). Pacific Telesis Corporation, is the holding company for California and Nevada's local telecommunications provider. Its annual operating revenues top the $9 billion mark. Pacific Telesis' subsidiary, Pacific Bell, serves approximately 75 percent of California's 31 million residents and Nevada Bell serves approximately 40 percent of that state's 600,000 residents. Pacific Telesis' recent entrance into the wireless digital television market will enable the company to reach seven million more homes in 1997. The holding company has 49,000 employees.

SBC, the holding company for the local phone company Southwestern Bell Telephone, wants to buy Pacific Telesis through a tax-free "stock swap." Texas-based SBC generates more than $10 billion in

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annual operating revenues and serves more than 27 million households in its home state as well as Kansas, Arkansas, Missouri and Oklahoma. SBC also provides wireless services in 36 markets in those states as well as 27 markets in cities outside the region, including Chicago, Boston, Baltimore, and Washington D.C. In addition, the corporation serves 250 million households in Mexico, Chile, South Korea, Australia, France, South Africa, and Israel. SBC and its subsidiaries employ 59,000 people.

If the CPUC approves the application, it would essentially double the size of the individual companies, creating a combined entity with approximately 50 million customers nationwide, and more than $20 billion in operating revenues. It would also control more than 20 percent of the nation's access lines. SBC's $16.52 billion agreement to buy Pacific Telesis would rank as the fourth largest corporate merger in the history of the United States, once it is adjusted for inflation, according to the Associated Press (*San Diego Union Register*, January 30, 1997).

Significantly, this proposed merger comes at the same time that the Federal Communication Commission and California's Public Utilities Commission are trying to open up the California market to competition. Because of its size, the state of California is foremost among state jurisdictions, and second only to the FCC, in the revenues its decisions affect. As a result, the CPUC's decision will influence, directly or indirectly, the shape of local competition in telecommunication services throughout the country.

The Promise of Telecommunications Deregulation

On February 8, 1996, Congress passed the Telecommunications Act of 1996. The law, which was years in the making, was supposed to open the telecommunication industry to competition. It was trumpeted as a "landmark" bill that would create millions of jobs and "unleash a torrent of competition heralding nothing less than the dawn of a new information age," in one trade journal. Deregulation was supposed to unleash a free-for-all rivalry between local phone companies, long distance companies and cable system operators that would result in more and better services being offered to consumers at lower prices. It was argued that market forces, rather than regulations, would spur the telecommunications industry to grow, to the benefit of the industry, consumers, and the nation as a whole. Consumers would profit from a wider variety of devices and services at lower prices.

However, concentration of ownership has proceeded at a faster pace than competition. Freed from regulatory barriers, the response of telecommunications companies was to buy, merge and consolidate with their potential competitors. Since the law's passage, four of the seven Baby Bells created when AT&T was broken up in 1984 have sought to merge: NYNEX and Bell Atlantic on the east coast, and SBC and Pacific Telesis on the west.

Pacific Telesis and SBC have argued that the benefits of consolidation—greater efficiency, lower prices, and one-stop shopping for consumers—outweigh any risks of lessened competition. But the dominance of the merged companies will be felt the strongest in the sector of the market most vulnerable and least likely to see competition—rural, low-income, language and ethnic minorities, seniors and disabled persons.

Satisfying the Public Interest Standard

In order to approve the Pacific Telesis/SBC application, the CPUC must find that the proposed merger is in the public interest, as defined by California Public Utilities Code, Section 854. If the Commission decides that the merger, on balance, is not in the public interest, it must impose corrective measures or deny the merger proposal.

According to 854(c), the merger must:

1. Maintain or improve the financial condition of the resulting public utility.
2. Maintain or improve the quality of service ratepayers receive.
3. Maintain or improve the quality of management of the resulting utility.
4. Be fair and reasonable to the affected public utility employees.
5. Be fair and reasonable to the majority of affected public utility shareholders.
6. Be beneficial overall to state and local economies, and to the community served by the resulting utility.
7. Preserve the jurisdiction of the Commission and its capacity to regulate and audit the utility's operations in the state.
8. Suggest measures that would alleviate any significant adverse consequences that might result from the merger.

If the Commission decides that the merger, on balance, is not in the public interest, it must impose corrective measures or deny the merger proposal.

Another section of the code, 854(b), says that the Commission must also find that the proposal:

1. Provides short and long-term economic benefits to ratepayers.

2. "Equitably allocates, where the Commission has rate-making authority, the total short-term and long-term forecasted benefits, as determined by the Commission, of the proposed merger, acquisition,

or control, between shareholders and rate payers. Ratepayers shall receive not less than 50 percent of those benefits."

3. Does not affect competition adversely.

Taken as a whole, Section 854's various subsections make evident that the Commission must ensure that the merger offers significant benefit to the public, not only the companies. In our estimation, the proposal fails that test. Our principal objections to the merger are as follows. The merger may:

- ▲ Increase costs to consumers
- ▲ Reduce investments in the state's telecommunications infrastructure
- ▲ Diminish quality of service
- ▲ Injure local and state's economies.

Costs to consumers

Although the Telecommunications Act of 1996 and actions taken by the CPUC opened the door to competition, it has yet to arrive on the scale and degree necessary to affect price or quality. And it may be some time before it does. The proposed merger would eliminate one of Pacific Telesis' strongest, and most experienced potential competitors for phone service in California: SBC. Even more to the point, the combined strength of Pacific Telesis and SBC may deter other, smaller companies from venturing into the California market. SBC has a reputation for ruthlessly undercutting its competition. Rivals of the Texas-based local phone company "accuse[d] the company of trying to keep competitors out of the marketplace, either by financially squeezing them through its control of the local phone network or forcing them into long legal battles," the *Wall Street Journal* reported in November 1993. As a result, the *Journal* said, some business services used elsewhere in the country weren't available in Southwestern Bell's territory, or were available solely from the company at relatively higher prices. Southwestern Bell officials blamed "outmoded" state and federal regulations for stifling the competition they insisted they welcomed. However, in at least two cases, juries concluded that Southwestern Bell's actions were an illegal attempt to monopolize the market. (Great Western Directories v. SBC and MetroLink Telecom Inc. v. SBC).

"we will go after the best customers, the ones we can make the most money off of," said SBC executive James Kahn.

Freed from many of the legal and regulatory barriers that once constrained their activities, the former phone monopolies are likely to pursue their economic interests like any other business enterprise. During the merger hearings last year, an SBC executive acknowledged that the competitive market might entirely abandon "economically unattractive" customers. When entering a competitive market, "we will go after the best customers, the ones we can make the most money off of," said SBC executive James Kahn. As a result, economically vulnerable communities, such as minority, rural, senior, and disabled persons, may face higher rates, lower quality service, or be entirely shut out of the telecommunications market.

Telecommunications Infrastructure

The "Information Superhighway"—the pairing of modern computers and a high-speed, digital broadband network—has the potential to enrich the lives of most Americans. The synergy of these technologies creates a conduit that can transmit information—whether by voice, text, data, graphics or video—at blazing speeds. It offers the potential for a dizzying array of new products and services.

For example, residents could do their banking and food shopping electronically; play computer games on demand, and take a course at a university half-way across the country. Doctors at remote rural and low-income health clinics could review patient X-rays via computer screens with specialists in distant cities, or use video conferences to confirm diagnoses and discuss treatment options with colleagues. All these activities are technologically possible, but the infrastructure—the roads and avenues the information must travel, has yet to be fully installed.

Although California's Silicon Valley leads the nation in the design and production of information technologies, the state's network, which is owned and operated by Pacific Bell, lags far behind. According to Stanford University Telecommunications Professor Francois Bar both SBC and Pacific Telesis rank near the bottom among the seven Baby Bells in terms of upgrading their outdated systems to accommodate advanced networking technologies. For example, in 1995, Pacific Telesis ranked last in terms of its use of fiber optics. Less than 6 percent of its access lines were fiber optic cables compared to Bell Atlantic which ranked first at 11 percent. In 1993, the most recent year for which data was available, the company ranked second to last in its installation of digital switches. Both technologies indicate the extent to which the company is able to support advanced, interactive multi-media applications and flexibly adapt to new communication services.

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Unfortunately, SBC is vying with Pacific Telesis for last place in terms of the backwardness of their systems. In 1993, SBC ranked last in digital switching deployment, the only company with a worse record than Pacific Telesis. Similarly, in 1995, SBC ranked second to last, just ahead of Pacific Telesis, in fiber optic deployment with 7.2 percent of its plant utilizing fiber optic cables. Both companies are poorly positioned to take advantage of telecommunication advances.

What is more, Pacific Telesis and SBC have been draining their phone company's assets—and their customer's pockets—to subsidize other, unregulated business initiatives. After AT&T was broken up in 1984, the seven Baby Bells won regulatory concessions that allowed them to accelerate the pace and rate of depreciation of their physical plants. They argued that rapid investment recovery was essential for the companies' to finance the upgrade and maintenance of their networks. But, a 1993 independent analysis by the Boston-based Economics and Technology, Inc., found that the companies used their increased cash flow to subsidize non-regulated, non-utility ventures operated by the parent company. Between 1984 and 1992, 95.7 percent of Pacific Telesis' and 93.8 percent of SBC's non-regulated ventures were funded by local phone company assets. In fact, Pacific Telesis and SBC have actually been disinvesting in their plants—consuming their capital by accelerating the depreciation of their infrastructure faster then they are investing in it.

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In November 1993, Pacific Telesis acknowledged its network problems and launched an ambitious modernization effort known as "California First." The company announced it would spend $16 billion over seven years to upgrade its network infrastructure in order to provide advanced voice, data and video services. But, shortly after the merger negotiations began, Pacific Telesis began to retreat from its commitment, announcing delays in its initial deployment. In contrast SBC invested only $1.5 billion in its 1995 system upgrade. Moreover, SBC has made no commitment to honor Pacific Telesis' promise.

In his remarks to the Commission, Professor Bar concluded: "...the overall backwardness of SBC's own network, combined with its apparent lack of a sense of urgency about addressing the issue and investing in the modernization of its network, do not offer much assurance that SBC would endorse a continuation of the critical effect Pacific Telesis has undertaken with California First." According to Bar, California First is critical to the state's long-term economic well-being, a belief Pacific Telesis also promulgated in numerous press releases, testimonies and press interviews before the merger talks. In fact, the company used that argument to convince the Commission to abandon a productivity factor that would have required the company to return $100 million to ratepayers in 1996. The regulatory relief will allow the company to hang onto at least that much again this year and next, although Pacific Telesis appears to have forsaken its side of the bargain.

<u>Quality of service</u>

Consumer groups that testified at the CPUC hearings on the merger last year presented detailed testimony indicating that both Telesis and SBC have worsening customer service track records.

The companies claim their intent is to improve, and assert that growing competition will compel them to provide higher quality service. But it may be years before any significant competition exists in markets most susceptible to service deficiencies, most notably in the residential basic service market. Later in the hearing, the companies contradicted themselves arguing that heightened competition had eroded their quality of service. If this is true, more competition could make matters worse.

One graphic example of the problems identified in the merger hearings is the company's Business Office Answer Time (BOAT). The BOAT measures the time customers must wait before a business office representative answers their call. The standard measure assumes that 80 percent of the calls will be answered within 20 seconds. Between 1993 and the first half of 1996, Pacific Telesis failed to meet the standard 42 percent of the time. In the first six months of 1996, it failed 83 percent of the time.

Pacific Bell ranked second in the FCC's 1996 "Common Carrier Scorecard" in terms of the volume of complaints it generated.

In fact, the failure rate may be much higher. Callers who get a busy signal are not counted in the BOAT figures. Also, when calls are particularly heavy, customers are asked by a recording to call back later and are disconnected. The company admitted that 10 percent of those who called the business office in 1996 heard such a recording.

SBC has an equally poor record of customer service. According to the trade journal *Telephony*, Pacific Bell ranked second in the FCC's 1996 "Common Carrier Scorecard" in terms of the volume of consumer complaints it generated. Southwestern Bell tied with GTE for third place. But one year earlier, SBC had the worse record. FCC's service quality reports showed that the number of residential consumer complaints per million access lines averaged four to six times higher for SBC than Pacific Telesis between the third quarter of 1993 and the third quarter of 1995. In fact, SBC ranked fourth out of the seven regional Bell companies in residential customer satisfaction in the first half of 1995. Neither company has offered quantifiable measures—benchmarks, timelines, etc.—to ensure that their assurances of service improvements are realized.

Economic impact

The promises of the prospective partners to boost, rather than drain, the economy as a result of the merger are largely hollow. Mergers typically result in numerous layoffs. When NYNEX and Bell Atlantic announced their plans to merge last April, they predicted that the companies would generate $600 million in savings within three years by combining operations and laying off 3,000 people from their combined 133,000 workforce (*New York Times*, November 27, 1996). This scenario is likely to be repeated in California if the proposed

Pacific Telesis/SBC merger is approved.

Pacific Telesis and SBC insist they will not lay off workers if their application is approved. In fact, they have gone one step further, promising to creating 1,000 new jobs. This commitment is only one of a number made by the companies that have come to be called the California Covenants. However, it is impossible to determine how many jobs Pacific Telesis would have created if the company weren't pursuing the merger. The company has no employment projection plans. The companies have also acknowledged they could meet the 1,000-job commitment simply by moving 1,000 SBC employees to California or by eliminating 1,000 jobs formerly held by SBC employees and hiring their replacements in California. Furthermore, the merging companies have refused to spell out the nature of the new jobs. For example, what the salary levels would be, where the person would be placed, whether the job would be union or not. A commitment to locate, not create, 1,000 jobs of an unknown quality in California for an undetermined period of time is meaningless.

According to California Public Utility Code, Section 854, at least half of the benefits produced by the merger of the two public utilities...must go to the ratepayers

SBC's commitment "to invest in the California and Nevada economy" is equally transparent. In its testimony before the CPUC, SBC said it "can't attach a dollar figure" to its investment in California. Nor did it stipulate how long it intended to honor its promise. "If the California market was less lucrative as [sic] originally imagined," one SBC executive testified," SBC might decide to use its investment resources in other markets, international or long distance perhaps." Even more troubling, during the merger hearings another SBC executive suggested the company was just as likely to reduce investment in California as increase it.

The failure of both companies to commit to a substantial upgrade of the state's telecommunications system, a critical determinant of California's economic future, undermines the vigor of their arguments. The undeniable truth is that SBC will invest in the state's economy only to the extent that the state's market remains lucrative. By attaching neither a dollar figure or a time period to its commitment, SBC's offer is unenforceable.

Quantifying the public's share

According to California Public Utilities Code, Section 854, at least half of the benefits produced by the merger of two public utilities such as jobs, cost-savings and new services must go to the ratepayers. However, the law does not say how those benefits—short- and long-term—should be determined or allocated. Nevertheless, the law suggests that the Commission's first obligation must be to the ratepayers.

Pacific Telesis and SBC have estimated that the benefits of their merger will range between $184 million and $273 million. It is obviously in their interests to understate the value of the merger. Consequently, it is necessary to use a more objective evaluation, such as the one offered by the state Office of Ratepayer Advocates (ORA).

ORA's expert estimated the value of the merger between $2.1 billion and $8 billion due to imputed savings given the corporation's dominance of the industry and corresponding economies of scale. He pointed out that Pacific Telesis' shareholders would reap significant benefits—more than $4 billion—from the merger and argued that, by law, those benefits should be shared with ratepayers.

Using the same methodology employed by the phone companies, but revising some of their projections, an expert testifying on behalf of The Utility Reform Network (TURN) calculated the total savings from the merger at $3 billion. Of that, TURN estimated that $977 million stemmed solely from savings related to local and toll phone calls. Assuming that their estimate included some services outside the CPUC's jurisdiction, TURN reasoned that the merger could be conservatively valued at $2 billion.

The fact that TURN, a consumer advocacy organization, also arrived at a similar figure reinforces the reliability of the calculations. We believe $2 billion, the lowest estimate offered by both organizations, is a fair and conservative evaluation of the merger's short- and long-term benefits.

ORA's expert estimated the value of the merger between $2.1 billion and $8 billion due to imputed savings given the corporation's dominance of the industry and corresponding economies of scale.

The two phone companies have argued—but not guaranteed—that the benefits of the merger will flow to ratepayers as competition forces down rates. But, according to a Community Partnership Agreement Pacific Telesis signed with 11 California community organizations last October, the companies have promised to invest "up to" $5 million a year for 10 years—a maximum of $50 million—in a community technology fund to support projects that would bring telecommunication technologies to under-served communities. Under certain circumstance, the company said it would be willing to allocate as much as $81 million. But Pacific Telesis' highest offer is still less than half of its lowest estimate of the merger's benefits and at best, only eight percent of the $1 billion ratepayers would be due if the Commission concurred with our $2 billion estimate.

Pacific Telesis has said it can't afford to provide more than $50 million. In fact, if the Commission orders the companies to pay more than $81 million, Pacific Telesis and SBC have reserved the right to abandon their commitment to honor the Agreement. Cleverly, Pacific Telesis' lawyers have already withdrawn the Agreement from the merger application, so the Commission cannot impose guarantees or penalties for non-compliance.

The prospective partners have also set aside $450 million in contingency funds for unanticipated liabilities or inefficiencies that might arise as a result of the merger. What is more, by its own admission, Pacific Telesis' coffers have swelled in response to a tidal wave of orders for second phone lines in the last year. Earlier this year, Pacific Telesis issued a press release boasting a 9.0 percent increase in revenues between 1995 and 1996 as a result of "continued strong growth." In mid-1996, Pacific Bell announced a $50 million agreement with the San Francisco Giants—the largest alliance of its kind in the history of professional sports—to become the prime sponsor of the club's new San Francisco ballpark. The company also testified to the CPUC that the merger would improve Pacific Bell's financial condition, enabling it to fund a variety of projects.

In addition to urging the CPUC to settle for no less than $1 billion in short- and long-term benefits, the CPUC and ratepayers must determine how they will ensure those benefits continue to flow to Californians after Pacific Telesis is swallowed by a multinational corporation which is already unwilling to guarantee any asserted benefits, or, in the alternative, find a way to quantify and capture those benefits now.

Allocating the Public Interest Share

California has frequently served as a bellwether for the nation on political, cultural and economic trends, including in telecommunications. The Pacific Telesis/SBC merger will set in motion powerful market forces that will indelibly shape the telecommunications landscape in California for the foreseeable future. The merger offers Californians an opportunity to act boldly, to create a model for the rest of the nation that genuinely balances public and corporate interests. The magnitude of the merger and its implications for the telecommunications future of the state obligate us to ensure that all sectors of California's diverse economy and population derive measurable and substantive benefits from this landmark decision.

The merger offers Californians an opportunity to act boldly, to create a model for the rest of the nation that genuinely balances public and corporate interests.

While this white paper pays particular attention to communities that will be the most severely impacted—and have thus far had the least voice in deliberations about this decision—it also ensures that California's high-technology corporations and small businesses, home-based businesses and telecommuters, hospitals, schools and libraries, rural farmworkers and farmers, urban laborers, seniors, disabled citizens and low- and middle-income families all derive significant benefit from the merger.

This document has already established that $1 billion—half of the assessed value of the merger—should be returned to the ratepayers and citizens of California. We propose that half of those funds be refunded directly to ratepayers following approval of the merger. The remaining $500 million should be designated for grants to community projects that will provide long-term benefits to the public and consumers. A telecommunications consumer trust fund will be created to administer the money. Pacific Telesis/SBC would be required to make annual installments of $95 million a year for 5 years to the trust, and $5 million a year for the next five years to meet the corporation's obligations under the Community Partnership Agreement. While there may be a number of ways to manage and distribute these funds, we believe Pacific Telesis/SBC's proposal to establish an independent foundation, as outlined in the Partnership Agreement, would receive widespread support from community and consumer groups.

We propose that half of those funds be refunded directly to ratepayers following approval of the merger. The remaining $500 million should be designated for grants to community projects that provide long-term benefits to the public and consumers.

In the alternative, the CPUC could require Pacific Telesis/SBC to transfer $500 million in cash or stock to an independent foundation immediately to be used as a permanent endowment to fund community and consumer telecommunications programs. An endowment, funded with Pacific Telesis-SBC stock, would ultimately produce the fairest return for California consumers because it makes them actual shareholders in the success or failure of the merger. Predicating the amount of stock purchased on actual earnings and share growth over 10 years insures that consumers receive short-term benefits, while long-term benefits are achieved through the endowment. Allowing Pacific Telesis/SBC to transfer $500 million to a foundation immediately may, however, be more expedient for all parties.

Enlarging the Community Partnership Agreement

The Community Partnership Agreement provides a good framework for addressing consumer and public interest concerns raised by the merger, but its scope and funding are too sparse. This proposal enlarges the range and substance of the corporation's commitments under the Agreement in relation to community access to technology, consumer education and advocacy and affordable and universal service. It also proposes a college scholarship program to expand the number of low-income women and minorities in computer science and telecommunications fields and calls for specific and measurable benchmarks for enforcing Pacific Telesis and SBC's existing commitments in these areas.

Community Access to Technology

Under the terms of the Agreement, Pacific Telesis and SBC have committed up to $50 million over 10 years to a Community Technology Fund to be used for network infrastructure, communication services, hardware, universal design applications and related training, technical assistance, consumer advocacy, consumer leadership and education, research, and administrative costs. For each of the first three years, $1.5 million of that Fund could be granted for non-telecommunication projects.

We propose that the companies invest in a five-year, $150 million effort to develop community-based technology centers in sixty California communities with the lowest socio-economic indicators for income, education, employment and telephone penetration.

If other telecommunication company's agree to match Pacific Telesis/SBC's contributions to the Fund, the merged company would contribute up to $3 million a year more, for nine years, beginning three years after the merger is approved. In addition, the companies have promised to provide up to $200,000 annually for five years to fund a consumer-oriented "think tank" on the evolving telecommunications market.

The goals of the Community Technology Fund are worthy. The Fund targets money to communities that need and deserve the support. However, the proposed level of funding and the general-purpose character of the fund are unlikely to foster community access to technology on a scale that would be meaningfully to most low-income and minority communities in California. In order to ensure that advanced technologies don't by-pass low -income communities, we urge the CPUC to require Pacific Telesis/SBC to expand the scope of its Community Technology Fund. We propose that the companies invest in a five-year, $150 million effort to develop community-based technology centers in sixty California communities with the lowest socio-economic indicators for income, education, employment and telephone penetration. These centers should be operated by nonprofit community-based organizations and be located in areas that ensure that the majority of households currently without telephone services can access them within a 15-minute drive during off-peak hours, or on public transportation, where possible.

As envisioned, these community-based technology centers will be equipped with state-of-the-art technology and provide training and support to community members. These centers will have multiple functions; they will serve as technology access centers, provide job training programs for the community's low-income youth and adults, and offer consumer education on telecommunication services and devices to the surrounding community. The center may also serve as a buying club for area residents. The job training will be specifically focused on telecommunications and information technologies including skills related to installation, maintenance, programming, HTML and web-site development skills, graphic design and technology marketing to provide them with marketable, entry-level skills in the telecommunications market.

A total of $30 million per year for five years will support this initiative.

Consumer education and advocacy

Although consumer education, advocacy, and leadership were included in its goals for the Community Technology Fund, no money was specifically earmarked for these. We would like to expand the terms and funding of those objectives.

As competition in California's telecommunications marketplace increases, it will most likely introduce new telephone, cable, wireless and Internet providers and products to consumers. While the prospect of increased choice is welcome, that new marketplace may also bring aggressive marketing practices and confusing messages to consumers. Indeed, following the AT&T divestiture in 1984, low-income and language-minority consumers were frequently the victim of aggressive, misleading and fraudulent marketing practices by an overzealous telecommunications industry.

Indeed, following AT&T's divestiture in 1984, low-income and language-minority customers were frequently the victim of aggressive, misleading and fraudulent marketing practices by an overzealous telecommunications industry.

A community grants program will fund an independent, statewide, consumer education program to help California consumers—particularly low-income and language-minority communities—to become well informed about the range of telecommunication choices available to consumers and small businesses. The program should also educate consumers about Internet-related consumer issues, including potential threats to the privacy of electronic records, Internet fraud, and marketing and service quality-related aspects of Internet service. Consumers should also be informed about where they should direct complaints about Internet Service Providers as well as computer hardware and software retailers. As a result, consumers will be able to make informed decisions about: (1) their local, mobile, and long-distance telephone, cable and digital television, and Internet providers; (2) their options for equipment to receive telecommunication services; (3) the comparative costs associated with purchasing, leasing and maintaining equipment; and (4) privacy considerations related to each of these telecommunication choices. Last, but not least, funds should be allocated to support consumer and community groups who represent the public's interests in the regulatory and legislative process to ensure that consumer's concerns are appropriately represented in matters that affect them.

A total of $5 million per year for five years will support this initiative.

Affordable and universal service

The Partnership Agreement allocates up to $100,000 for seven years to fund the expenses of a Universal Service Taskforce to study barriers to universal service. Pacific Telesis has made a commitment to a "good faith effort" over the next seven years to increase telephone penetration for minority, limited-English speaking and low-income communities to 98 percent. However, the company did not set aside funds to implement recommendations that arise from their research. Pacific Bell has also pledged to increase its allocations for corporation and foundation grants, as compared to the 1996 budget, by $1 million a year for three years. These funds are intended to help maintain or improve its quality of service; expand its service to disabled people and communities of color; and amplify its support of the community generally. Again, we would like to expand the scope and funding level for this goal.

In order to ensure affordable and ubiquitous access to telecommunication services, we propose that pay telephones and advanced telecommunication services be included as appropriate methods of expanding universal service in California.

Despite the existence of a universal service fund, a significant number of California households—an estimated 454,000—did not have telephone service in 1995. While some of the barriers were informational, these households were largely urban and rural low-income individuals and families that could not afford telephone service or could not afford the costs of reconnecting following a high telephone bill that led to their disconnection. We recognize and applaud the fact that the CPUC enacted new universal service rules effective February 1, 1997, that introduced a High Cost Fund and a Teleconnect Fund as methods to fund universal service. In order to ensure affordable and ubiquitous access to telecommunication services, we propose that pay telephones and advanced telecommunication services be included as appropriate methods of expanding universal service in California.

Pay telephones- Families and individuals who don't have home telephone service rely heavily on pay telephones. Although the exact number of these households is not known, it is clear that most are concentrated in low-income neighborhoods across California. Any rate increase would disproportionately and unfairly affect these households. We urge the CPUC to require Pacific Telesis and SBC, as a condition of the merger, to freeze the cost of pay phone calls at the current 20-cents until the companies' achieve a 98 percent penetration rate for <u>all</u> California households.

Infrastructure development- We recognize the significant investment required to build or upgrade the telecommunications infrastructure to accommodate emerging technologies and the need to deploy this investment strategically. However, it is essential that these improvements not bypass low- and moderate-income households. We urge the CPUC to require Pacific Telesis-SBC, as a condition to approving the merger, to invest the $16 billion dollars that Pacific Telesis agreed to commit to modernize Pacific Bell's infrastructure in return for regulatory relief, and that Pacific Bell develop and upgrade its infrastructure in a manner that ensures universal access to the digital network and the advanced services and products that will be made available as a result, regardless of the geographic and income characteristics of particular neighborhoods. In addition, we urge the Commission to require Pacific Telesis-SBC as a condition for approving the merger to invest $25 million annually for a period of five years to wire schools and public libraries in California's lowest-income neighborhoods with high capacity, high speed lines equivalent to presently available T1 technology, and an additional $20 million for the necessary hardware, software, training and technical support needed to ensure that this infrastructure is used effectively.

A total of $45 million per year for five years will support the initiative to expand infrastructure development to low-wealth school districts and libraries. Funding for the $16 billion California First initiative is a prior commitment. The costs of a pay telephones rate freeze shall be borne by the merging companies until such time as they meet their universal service objectives.

A total of $60 million per year for five years will support the initiative to expand infrastructure development to low-wealth school districts and libraries.

<u>Telecommunications and Computer Science Scholarships</u>
We urge the CPUC to require as a condition for approving the merger that Pacific Telesis-SBC set aside $10 million—$2 million per year for 5 years—to fund college scholarships for low-income students majoring in telecommunications and computer science. This relatively small contribution would help rectify the severe under-representation of women and people of color in computer information sciences.

A total of $10 million per year for five years will support this initiative.

<u>Benchmark enforcement</u>
We urge the CPUC to require as a condition of approval of the merger for Pacific Telesis/SBC to establish timelines and spell out the nature of the 1,000 jobs and infrastructure improvements. Automatic penalties should be imposed for failing to meet those goals, of which 20 percent would go to the CPUC for administration, 20 percent to ORA, 30 percent to the intervenor funding program and 30 percent to an independently administrated advocacy trust fund.

Call to Action
The Pacific Telesis-SBC merger application pending before the California Public Utilities Commission is a pivotal case. The Commission's decision will have a profound impact on the direction and character of telecommunications in California far into the next century. The merger, if approved, will create a mammoth telecommu-

nications corporation that will indisputably become the market leader in California. The dominance of the company will be particularly acute in the residential market, raising significant public interest concerns that need to be fully addressed by the Commission in its decision. Two paramount issues are the valuation of the proposed merger and the allocation of benefits to California consumers.

A preliminary decision by the Commission is imminent. There will be a four-week period for public comment before the Commission issues its final decision.

■ The valuation of the merger offered by Pacific Telesis and SBC significantly understates the benefits the corporation's shareholders will achieve as a result of efficiencies of scale achieved by the merger. While it is certainly in the interests of the corporations to understate the value of the merger, it is not credible. The estimate developed by the CPUC Office of Ratepayer Advocacy offers a more reasonable assessment of the value of the merger. This estimate ranges from a low of $2.1 billion to a high of $8 billion. The Utility Reform Network (TURN) conservatively assessed the merger at $2 billion. This paper adopts the lowest-range projection of $2 billion as a minimum appraisal of the merger's short- and long-term benefits. Coincidentally, an independent valuation by TURN, a public interest organization with a successful record of involvement in telecommunications proceedings before the CPUC, arrived at a comparable estimate.

■ The law governing the decision on the merger requires that the CPUC ensure that half of the benefits of the merger accrue directly to California consumers. Under the Community Partnership Agreement, Pacific Bell has promised $50 million to $81 million over ten years for telecommunication-related projects benefiting California consumers. While this commitment is laudable, it significantly understates the public's share of the corporations' profits as required under California Public Utilities Code, Section 854.

A preliminary decision by the Commission is imminent. There will be a four-week period for public comment before the Commission issues its final decision. The importance of these issues compels community and civic leaders throughout the state to join the public debate on this matter. We urge you to take the following actions to ensure that the full measure of the public's power is considered and that its interests are protected:

1) <u>Endorse the recommendations</u> for allocation of the $1 billion public benefit share of the merger valuation by signing and circulating the attached petition to other community, civic, labor, education and public interest leaders among your network of colleagues. Please return it to the address below prior to March 18 so it can be submitted to the Commission for consideration during

their deliberations on the merger.

"Staking Out the Public Interest,"
10 Jordan Avenue
Los Altos, CA 94022-1254

2) Contact (via fax, phone, e-mail or regular mail) the Public Utilities Commission and the merging companies during open comment period after decision is announced and urge consideration of the allocation of $1 billion to the arenas proposed in this white paper.

3) Plan to appear before the Commission during the open comment period following announcement of their decision on the merger to urge that the $1 billion be allocated in the manner proposed in this white paper.

Contact information:

- Chairman P. Gregory Conlon
California Public Utility Commission
State Office Building
505 Van Ness Avenue, San Francisco, CA 94102-3298
(415) 703-2440

- Mr. Philip Quigley, Chair and CEO
Pacific Telesis
130 Kearny Street, 37th fl..
San Francisco, CA 94108
(800) 791-6661

- Mr. Edward E. Whitacre, Jr., Chair and CEO
SBC Communications Inc.
175 E. Houston St.,
San Antonio, TX 78205
(201) 351-5401

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Signature: Armando Valdez	Position: Benton Telecommunications Policy Fellow
Printed Name: Armando Valdez, Ph.D.	Organization: CA. Telecommunications Policy Forum
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