

The Future of the Telecom Industry

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My wife asked me yesterday when I left where I was going and I was contemplating whether or not I should tell her and I said, "Well I'm kind of like going to a cocktail party." And she looked at me puzzled and I said—she said, "Why would you be going to a cocktail party?" I said, "Well it's kind of like a cocktail party because when I go to a cocktail party with you I end up pissing somebody off in the room and I'm sure I'm going to do that tomorrow morning." So I will try to be as provocative as I can over the next thirty minutes. I'm sure I'll say some things that some of you don't agree with. I hope that we can have a good exchange and discourse on that in the Q & A session. I should probably tell you that this is a bit of a comedown I need to think about when I elect to tape one of these speaking engagements I don't know that the topic will be as exciting as building the hydrogen powered car or solving AIDS in the continent of Africa. But we're going to try to do our best to relate it to important issues for the country right now, which is really economic development and that really needs to be the theme. I think in this case is to how regulation in the country at this point in time is impacting economic development in the telecommunications industry.

What I'd like to do is give you just kind of a brief snippet of some of my biases on this. It's important for you to know that I do have biases that are built

out of a couple of things. I think you heard Steve say that one of the jobs I had was running the industry markets organization, which is the wholesale arm of SBC and in that capacity I started in the wholesale business in about 1997. Shortly after the 1996 Telecom Act and a lot of the competitors of SBC were my customers in that role and I got to work closely with, frankly, a lot of ex-friends or they're still friends of mine, a lot of ex-coworkers of mine, friends of mine, other businesses that were starting across the table as they started to execute their business plans. It was a national organization across thirteen states and I worked with regulators in all parts of the country and in Washington and that experience has definitively shaped my opinions about regulation and what needs to happen.

I also spent some time prior to that looking at analyzing and building alternative local networks other than traditional telecom networks, largely technology cable companies use today analyzing and building those and that experience in terms of the economics around investment and plant and what alternatives were out there and serving customers is pretty significantly shaped my viewpoint. I think you'll let that come into the discussion. Ashley, if you could hit the next slide for me and let me go ahead and tell you what I'd want to work through today.

I'm going to quickly touch on a couple of key points. I don't think you can really understand regulation without taking a quick step back in time in telecommunications and we're going to march back to 1984 and thereabouts and then move forward from today. I want to talk about the Telecom Act of 1996 and

kind of how that's shaped the blueprint for where we are today. From policy perspective I will give you a characterization of what that act has done relative to how the industry is performing today. I want to talk a little bit about investment levels and this is really the key of what we need to discuss today is how companies are investing in telecommunications and what the implications of that are. There's a major policy making revue coming up in Washington that's due on the twentieth of February or maybe a little bit sooner. It's called 'The Triennial Revue,' and I'll touch on that and then I'll talk a little bit about what we're trying to advocate from a policy perspective and one of the reasons why I'm in the state today is to try to forward this cause not only with you but with others and discuss that. If I can go ahead.

Let's step back to 1984 before and actually the period of time before that. What's important to understand, some of you in the room are too young to remember this, but we had a situation where we have explicit social policy in this country of what we refer to as 'universal service.' And the basic fundamental tenant of that was we felt it was good social policy to have as many people connected to the telecommunications network as possible. That high rates of penetration of local phone service was a social good and we set up a defacto monopoly and a regulatory scheme to try to encourage that to happen. And the net result of that was we put explicit subsidies in place from a policy perspective to make that happen in 1984 and before. And that explicit policy was what was very expensive to connect people to the network with the local facility, we didn't want people to have to pay the full cost of that particular investment and we

lowered artificially the connection rate so the monthly service rates that people pay to connect to the network and subsidize them with other services at well above cost rates. So, well you could get a basic connection very inexpensively you paid obscenely high amounts for every minute of toll that you used on the network, as an example. And there were other subsidies built into that including Yellow Pages and directory listings and a lot of other things we won't get into this morning.

Many of you will remember back in the days where your biggest fear was opening up the long distance bill to see how many minutes you generated at thirty cents a minute to call from Los Angeles to St. Louis. Now that has changed rapidly. In 1984 the breakup of the Bell System started that change. The first step in that was deregulating the long distance industry. And if you step back and you think about that, that was obviously the long lines piece. We still by default said that there is a local monopoly in the local access piece, and it wasn't a perfect monopoly because there were opportunities for people to come in and build their own facilities and do things, but it was generally run and regulated as a monopoly. Well, the long distance industry at that point in time was open to competition and A.T.&T took the long lines business or the long distance business and had the opportunity to go and compete.

Now there's a couple of things that I want to draw a comparison to because as you move forward to today, I think its important and instructive to understand we have a very robust long distance competitive marketplace today. There's been innovation, there's been price competition, there's been service

innovation, and if I go back to 1984 my memory serves me correctly I don't recall that the government pursued a policy at that point in time of forcing A.T.&T. to do some things like to unbundled their network and make it available in piece parts to competitors. I don't recall them using a pricing theory known as TelRic that was based on forward looking, long-run incremental cost, and forcing them to sell their products and services to M.C.I. or Sprint. In fact, what I remember at that point in time is that many folks had to start and build their own facilities and build their own networks and ultimately work their way into this business. I think the only two requirements that were on A.T.&T. at that time were that they had to take the retail products that they sold at discount and sell them wholesale so they had discounted aggregated services, they had to extend that to other aggregators and sell that to them, and the other issue was they had to file tariffs to let people know what they were charging for their service, up until the point where they lost about 20% of the market. So that was 1984 and that's how we got started in the long distance business that most of you are familiar with today.

Now, we get into this thing where we have the Telecommunications Act of 1996. That was the next step—all right, we had a good experience in long distance, let's do something different in the local market. So those of us who were down at a local market certainly wanted the opportunity to get into the other parts of the telecommunications industry. We saw the fact that things were changing, we saw that customers had a desire to buy products and services from one place; wireless was starting to drive some of that. There were other alternatives coming out in how people got services and we understood that if we

didn't have the opportunity to work across the entire continuum of services that a customer wanted over time, our business would be marginalized. So the 1996 Act was created and Congress put a blueprint out. They didn't give specifics of how to get it done, but they put a blueprint in place and it was called the Fourteen Point Checklist. In our case, you know, obviously a biased comment here, we would come back and say it was fourteen points—fourteen fairly straightforward points that the local monopoly had to execute on to prove that their markets were open, to open up that local monopoly so others could use the bottleneck services to be able to reach customers. Now, in effect, and I'll talk about this in just a minute, the fourteen points probably turned into fourteen thousand points. There were hundreds of sub bullets under each one and our position on this is that regulators who took the blueprint Congress passed, just the raw blueprint, and they filled in all the lines around it. They went a lot further than anybody ever believed originally that they should go. And the premise I'm going to put forward is that there was some overreaching here that was not necessarily good policy.

So, it's real clear that competition in the local market was a good thing. The law that Congress passed per se is not problematic. People say, oh the Telecommunications Act needs to be changed. I would argue that there's really nothing wrong with the law that was passed, the issue is how those people that were given the responsibility to define it in more detail—in this case the FCC and the state run regulators have not interpreted as effectively as they possibly could. Maybe well intentioned when they started, but at this point in time with our raw experience and what's gone on with the market we can step back and say that

some changes are probably necessary. So the fundamental issues in this law were that we were required to do these fourteen points, the most substantive of which was if we had bottleneck facilities like copper wire from the central office to a customer's home, we would be required to open that up and share that with others to use as they assembled and put their network in place. The notion was not that everything the local incumbent owned had to be unbundled and shared and what I will try to contrast for you is the policy that actually went in place was to say that everything, everything that the local company owned had to be shared with the competitor whether it was a database, an operating support system, a piece of plant or equipment—no matter how available it was in the market or how many other people might have had it. The other thing that I would share with you is that the difference that came out of this is some of the policies and the mechanics around implementing it and I want to try to highlight those.