The years 1995 and 1996 saw both state and federal laws allowing entry into the former monopoly local telephone service markets. Actual competitors remain scarce, even though Tennessee regulators moved quickly to implement the new laws. The lack of competitors arises from the strategies adopted by the interested parties, slower-than-expected technological developments, and the complexity of opening networks designed for monopolies to use by competitors. Despite a few remaining regulations that may hinder entry, competition finally may be on the verge of breaking out.
In June of 1995, Governor Sundquist signed the Tennessee General Assembly’s Telecommunications Act of 1995. The Act removed the statutory impediments to the entry of companies to compete with the heretofore monopoly local telephone companies. In reality, this affected only the areas served by BellSouth and United Telephone-Southeast, a subsidiary of Sprint, as small company territories in largely rural parts of Tennessee are exempt. These two large companies, however, serve more than 90 percent of the local telephone lines in the state. The Tennessee Public Service Commission (PSC) granted 13 certificates for Competing Telecommunications Service Providers before the end of 1995.

In February 1996, President Clinton signed the Federal Telecommunications Act of 1996. This act promotes competition in telecommunications markets by providing for resale of local telephone company services, for setting the prices local companies charge their competitors for connecting with their networks, and for preserving “universal service” as competition develops. Implementation was delegated to the Federal Communications Commission (FCC), which was given strict deadlines for rule-making, and to the state regulatory bodies. By early 1997, the FCC had promulgated its rules on interconnection pricing, which were appealed almost immediately to the federal courts, and the Tennessee Regulatory Authority (TRA) had approved nine interconnection agreements between BellSouth and competitors.

Nevertheless, at the end of 1996, only two local telephone service competitors reported any customers at all, in total less than 100. Their 1996 revenues totaled less than $100,000. Only business customers received service from competitors; no competitor had attracted residential customers. At the end of 1998, only 15 competitors out of the 29 holding certificates...
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were providing local telephone service in Tennessee. By late 1998 competitors reported a total of $170 million in telecommunications-related investment in Tennessee.

**Why has competition been so slow to develop? Have regulators been dragging their feet? As I see it, Tennessee regulators have moved with more than deliberate speed to open these markets to entry.** The lack of actual entry is due to a number of factors. Slower than expected technological developments, the strategies pursued by various interested parties, and a few holes in the legislation must all shoulder part of the responsibility. Some of the details follow.

First, this telecommunications drama transpired against a backdrop of continual change in Tennessee’s regulatory personnel and their roles.

In 1994, the Consumer Advocate Division was created under the Attorney General by transplanting nearly half of the PSC’s utility regulatory staff to that office. The advocate took over the litigation duties of the PSC staff in contested matters heard by the commission acting as a judicial body. The remaining PSC staff became advisors rather than litigators. In 1995, legislation “abolished” the PSC effective July 1, 1996, and placed its utility regulatory functions in a new agency, the TRA. While most of the PSC’s utility staff carried over to the TRA, the elected PSC Commissioners were replaced by appointed TRA Directors.

**Progress Under the Tennessee Act**

Tennessee’s Telecommunications Act of 1995 sought to foster the development of an efficient and technologically advanced statewide telecommunications system by permitting competition and alternative forms of regulation. It permits the certification of Competing Telecommunications Service Providers (CTSPs) in competition with the large Local Exchange Carriers (LECs) and allows the LECs to choose price regulation instead of the traditional rate-of-return regulation. Under price regulation, a company may adjust its prices annually using a formula based on the rate of inflation in the U.S. economy generally. The act also set up a fund to guarantee loans to small and minority-owned telecommunications businesses, and it provides for a fund to promote “universal service”—the availability of basic residential service at an affordable price—if regulators determine the need for it.

To gain certification, prospective CTSPs need only demonstrate the technical, managerial, and financial ability to offer telecommunications services and the intent to abide by TRA rules, policies, and orders. Due to the ease in meeting these criteria, the PSC and the TRA have approved all but one of the applications decided to date, a total of 29 since 1995. The one denial was based on a legal contractual technicality. The approved CTSPs include some of the largest communications-related companies in the U.S. or their subsidiaries: AT&T, MCI, Sprint, GTE, Worldcom, Time Warner, Intermedia, and others. As of late 1998, only 15 competitors were actually offering service, and then primarily in the Nashville and Memphis areas. In any event, regulatory approval has not been a major stumbling block to entry.

Soon after the passage of the act, three companies opted for price regulation: BellSouth, United Telephone-Southeast, and Citizens Telecommunications. These were all approved by the PSC by March of 1996, but BellSouth chose to appeal the PSC’s order containing a $56.5 million price reduction at the inception of price regulation. The Tennessee Court of Appeals vacated the PSC’s order in October 1997, remanding the matter to the TRA. The Tennessee State Supreme Court subsequently declined to hear appeals. On remand, the TRA approved BellSouth’s application for price regulation in December 1998.

The PSC also initiated rule-making to establish the small and minority-owned telecommunications business fund and completed a generic contested case proceeding on universal service during 1995.

The first collections flowed into the small and minority-owned business fund in 1997, allowing loan guarantees and educational programs administered through the Tennessee Department of Economic and Community Development to begin. The PSC found that no explicit funding for universal service was required in late 1995. A new universal service proceeding is pending before the TRA at this time.

Subsequently, the Tennessee General Assembly passed a law in 1997 allowing municipally owned electric utilities to offer telecommunications services by obtaining CTSP certificates from the TRA. The Chattanooga Electric Power Board is the first municipal electric utility to seek this certification, and its application is pending at this writing. This law also established a study committee of the General Assembly to consider other legislative changes affecting electric utilities. Some of the proposals made to that committee include allowing electric cooperatives to enter telecommunications service and allowing both municipals and cooperatives to offer cable television, Internet access, paging, and security alarm services.

**Progress Under the Federal Act**

The Telecommunications Act of 1996 seeks to open the incumbent local exchange companies’ (LECs’) networks to competitors through, where possible, negotiated agreements, and otherwise through arbitration or other actions at the state level. Many important details lacking in the Tennessee act, such as resale of LEC services and the process for determining interconnection prices, are covered in the 1996 act. Other details were delegated to the FCC. In addition, the act prohibits states from imposing conditions on new competitors that could form barriers to entry. In return for opening their networks to competitors, the act allows the former Bell Operating Companies, those companies (BellSouth and others) that were split off from AT&T in 1983, to enter the long-distance markets from which they have been barred since their divestiture. Universal service is addressed through a revision in the administration of the national fund that supports service in high-cost areas.

The first issues from the 1996 act to arise in Tennessee were the pricing of services purchased for resale from the LECs and the pricing, terms, and conditions for interconnection of competitors with the LEC networks. In July 1996, well before the August due date for the FCC’s rules on interconnection, AT&T requested arbitration of the disputed items in its interconnection negotiations with BellSouth. Soon after the FCC’s rules came out in August, MCI also requested arbitration of its negotiations with BellSouth. During October-December 1996, the TRA not only set the
wholesale discount rate for services purchased for resale from BellSouth and United Telephone-Southeast, but also resolved these interconnection disputes, in part by setting short-term “proxy” prices for unbundled elements of BellSouth’s network. By the end of 1998, the TRA had arbitrated, and/or reviewed and approved, 21 interconnection agreements. Forty-nine purely resale agreements were also approved.

BellSouth’s ability to apply for entry to long-distance service is driving many of the parties’ strategies in these proceedings. BellSouth is anxious to set “permanent prices” for interconnection and unbundled elements of its network, as this facilitates its long-distance entry, even though the establishment of these prices may also facilitate entry into its local service territory. In contrast, the established long-distance carriers, many of whom are also potential local service entrants, are less enthusiastic about setting interconnection rates and entering the local markets than they would be without the threat of BellSouth entering long-distance service. Nevertheless, a permanent prices docket is open, and hearings are pending before the TRA at this writing.

On December 12, 1997, BellSouth filed its application to enter long distance for review by the TRA. The TRA is to advise the FCC on deciding BellSouth’s application, as is the Justice Department. BellSouth may file with the FCC later in 1998, and the FCC must issue its decision within 90 days. To gain approval, BellSouth must satisfy a 14-point “checklist” demonstrating that its network is actually open to competitors; or it may need only show that it has a contract available to competitors that implements an open network, if and when competitors may choose to enter. Although not necessarily pertinent to BellSouth’s Tennessee application, similar applications have been denied by the FCC for South Carolina and twice for Louisiana.

On universal service, the FCC issued its order on May 8, 1997, as required by the act. This order asked states to inform the FCC if they wished to develop their own cost model for estimating universal service costs by August 15, 1997. Alternatively, states could use the still unaunnounced FCC model. The TRA decided to consider developing its own cost model, as did regulators in several other states. That process is now under way in a formal universal service proceeding. States’ cost models were due to the FCC by May 26, 1998. The FCC’s target implementation date is now August of 1999.

Cost modeling is important, because any costs in excess of the revenues for the basic local telephone services composing universal service will be explicitly subsidized by a fund collected from all telecommunications companies. Currently, monthly charges for basic local telephone service, especially in rural areas, are kept low by charging high prices for other telephone services. The act contemplates making the existing implicit “subsidies” explicit through the universal service process.

Remaining Impediments to Entry

Other than the strategies of the incumbents and their potential competitors already mentioned, there remain factors that may not prevent entry, but which slow it down, delay it, or raise its cost. The failure of certain technologies to become available in the expected time frame, for example, seems to have delayed the entry of cable television systems into telephone service. Technology, of course, is outside the direct control of legislators and regulators and, as such, not easily manipulable by policy-makers. Statutory and regulatory requirements imposed on entrants are another matter.

Legislation to date at both the state and federal levels has left in place requirements that were appropriate under traditional monopoly regulation, but do not fit a competitive environment. For example, under Tennessee law the TRA must approve the financing arrangements of public utilities. This made sense for monopoly rate-of-return regulated utilities, because any debt financing they obtained essentially imposed an obligation for payment of that debt on the utilities’ customers. No such obligation exists for the customers of competing firms; if a firm cannot pay its debts, it goes out of business, and its customers must patronize one of its competitors. Yet state law requires pre-approval of long-term debt and stock issues by competing telecommunications companies. Many of these companies merely repackage and resell the services of another carrier and have no assets located in Tennessee. Such requirements impose unnecessary costs on entrants and restrain competition. One company has gone so far as to give up its certificate, effectively withdrawing from the state, in order to avoid this form of regulation.

The TRA’s regulatory rules, most inherited from the PSC, also contain some unsuitable provisions. Fortunately, the TRA issued new rules for entrants that eliminate the notice period for new service offerings and price decreases, but maintain the 30-day notice period for price increases. While this notice period may constrain the ability of competing firms to respond to changing market conditions, customers are given the opportunity to respond to a price increase before it takes effect. The old rules for incumbents require a 30-day notice period on all tariff changes, but the TRA may waive the notice period on a case-by-case basis. Other rules, however, require entrants and incumbents alike to use the FCC’s Uniform System of Accounts and to file monthly or quarterly financial reports. These rules unnecessarily impose costs on entrants and expose their performance to rivals.

Conclusion

While regulators have moved diligently to implement the competitive provisions of recent legislation, much remains to be done. The processes set up by the federal act have proven to be more complex, more open to manipulation by interested parties, and more time consuming than initially expected. Some competition-hampering statutes and rules remain on the books. Perhaps the worst policy move now, however, would be to scrap the existing law. Proceedings to set interconnection prices and to address universal service concerns are on the verge of conclusion. The winners of the FCC’s wireless PCS licenses, a kind of small-cell digital cellular telephone service, are just ramping up. The stage is almost set for an explosion of competitive telecommunications offerings.

Christopher C. Klein is the chief economist for the Tennessee Regulatory Authority. He was previously a senior staff economist at the Federal Trade Commission and the first staff economist of the Tennessee Public Service Commission. The views expressed here are Dr. Klein’s and do not necessarily reflect those of the staff or directors of the TRA.