

MARKETS OR MONOPOLIES IN
LOCAL TELEPHONE? HOW THE
REGULATORY MONOPOLY MODEL
HAS FAILED PENNSYLVANIA
CONSUMERS

Allegheny Institute for Public Policy

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**"The emphasis on reforming rather than abolishing regulation reflect[s] the fact that that most economists and lawyers [have] considerable faith in government and considerable distrust of free markets...They [have] far more sensitive antennas for sources of "market failure" than for sources of "government failure". The former were thought systemic, the latter the product of accident...
If a source of market failure could be identified, a scheme of regulation could readily be devised and administered"**

Richard Posner, "Natural Monopoly and its Regulation"

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I. Key Findings

- Despite the passage of the Telecommunications Act of 1996, the goal of introducing competition into the local telephone market has yet to be achieved.
- The dominant local provider in Pennsylvania is Bell Atlantic, which holds 79 percent of the access lines in the state.
- The FCC has recently completed audits of the seven Regional Operating Bell Companies and has found that the companies' Central Office Equipment is substantially overstated. The FCC audit reports recommend that the companies write off a combined \$4.8 billion to reflect the overstated investment.
- The audit findings and the resulting excess earnings point to the need to move quickly to a fully competitive market for local phone service in which rates are set by market forces as opposed to rates imposed by regulators who must rely on potentially inaccurate data and at best imperfect, inefficient procedures to determine rates.
- Missing or overstated equipment has important implications for the revenue and income of the phone companies. Historically, phone service rates and company revenues were set by regulators by a procedure using the dollar value of equipment. If equipment is overstated, then phone company revenues and incomes would be excessive and unfair.
- FCC recommended equipment write-offs ranged from \$430 million at BellSouth to \$1.15 billion at Southwestern Bell.
- Excess earnings attributable to equipment overstatement as a percent of actual reported regional Bell corporate income ranged from a high of 15.2 percent in Arizona to 2.6 percent in South Carolina. Excess earnings in most states fell in the range of 8 to 10 percent of corporate earnings.
- The excess earnings of Bell Atlantic total over \$17 million per year in Pennsylvania. Capital equipment overstatements exceeded \$148 million, the second largest amount of the state sample.
- These levels of excess earnings resulting from the overstatement of equipment are important because they reflect the importance of accurate records in a regulated rate setting environment and the customer overcharges which stem from inaccurate records.

II. Introduction

Why do a few companies have such a strong grip on the local telephone industry? Is it because they are responsive to the needs of their customers? Is it because most telephone customers like the service they currently receive from Bell? In a word, no. It is simply because there is a lack of choice in the local telephone market.

Each local telephone market is a "regulated monopoly", a market in which there is only one seller of a good or service. Local telephone providers operate under a regulated monopoly pricing structure that can produce excessive revenues and profits. State public utility commissions that set telephone prices based on the dollar value of capital equipment held by the telephone company give the monopoly an incentive to overstate the total worth of its equipment, and these overstatements result in over-pricing. Given the lack of competition in the local market, consumers cannot choose another provider of phone service if they are unhappy with monopoly rates. If there were competition, overstatements of capital equipment would be at best irrelevant because the company's rate of return would be determined by prices based on supply and demand, and at worst counter-productive because of its impact on the market value of the firm.

The objectives of this paper are twofold: first, it will attempt to uncover the reasons why there is a lack of competition in the local telephone market by examining contemporary telecommunications policy and obstacles that inhibit a free local telephone market. Three years after Congress attempted to inject competition into the local telecommunications industry, almost no resident can shop around for local service. Second, it will evaluate the results of a recent FCC audit of Regional Bell Operating companies which reveals a serious overstatement of capital equipment as an example of "regulatory failure".

A Brief History of Telecom De-Regulation

The attempts to bring competition into this industry have been more like "trust-busting" than relaxing the regulations that prohibited competition. But while the antitrust effort of the early 1980s sought to rein in the telephone monopoly, it actually perpetuated it by prohibiting local providers to compete in long-distance while local providers succeeded in keeping competitors out of local service.¹ Thus, telecommunications faces a local versus long-distance inconsistency. Consumers have plenty of long-distance choices, but the local service remains a monopoly.

In 1984, the federal court decision in U.S. v American Telephone and Telegraph broke up the nationwide telephone monopoly. The settlement broke the company into seven Regional Bell Operating Companies (RBOCs or baby Bells) that were allowed to offer basic local service and the new AT&T, which was given long-distance and equipment manufacturing.² It was expected that prices would fall and business would increase. And indeed, long-distance revenues tripled from 1984 to 1996 but at least half of this increase went to cover the overhead costs of the local and long-distance system. These revenues became an attraction to potential long-distance carriers who were without requirements to provide for an infrastructure of local networks.³

The local carriers were permitted to offer local exchange and toll rates regionally under supervision from federal and state commissions.⁴ Despite their hold on the local market, the RBOCs have pushed for entry into lucrative long-distance markets.⁵ At the same time, the "baby Bells" have been busy investing in non-core functions such as undersea cable operations, mining operations in Latin America, and internet capacities.⁶ These actions come at a time when these companies continue to neglect their legal requirements to create a competitive local market. These requirements for competition are described below.

The Telecommunications Act of 1996

The Telecommunications Act of 1996 was designed to create competition in the local telephone market, establish the rules for the RBOCs to enter into long-distance, and promote cable competition by allowing telephone companies into that market. The Act permitted prospective telephone competitors to resell local service as part of a package, to buy unbundled network elements (UNE) to use as part of their local package, or to build their own network to customers.⁷

The RBOCs entry into long-distance markets is restricted:

- The provider has to demonstrate that the local exchange market in which they operate is competitive

¹ Fred McChesney, "Of Stranded Costs and Stranded Hopes"

² Robert Litan and Roger Noll "Unleashing Telecommunications: The Case for True Competition"

³ Discovery Institute Report, "Is the Telecommunications Sector Suffering a Regulatory Shakedown?"

⁴ There are five consolidated baby bells: Bell Atlantic, Ameritech, Bell South, U.S. West, and SBC Communications

⁵ Litan and Noll

⁶ Stephanie Mehta, "They Don't Look Like Babies or Bells Anymore"

⁷ AT&T, "The Telecom Act of 1996: Key Points"

- The FCC is in charge of the process of certifying the competitiveness of the local market. To do so, an Interconnection Checklist has to be satisfied⁸

Competition in local exchange was to result from an arrangement in which new local carriers would use parts of the networks of incumbent companies. Unfortunately, this arrangement encouraged incumbent providers to do everything in their power to maintain control of their own piece of the telecommunications industry, discounting the goals of the Telecom Act to get local providers, the baby Bells, into long distance and long distance providers into local service. This has not been accomplished.

Congress recognized that consumers want convenience, value, and variety, and that the marketing of telecommunications on a service by service basis would not meet the needs of consumers.⁹ Data, voice, and Internet service should be purchased as a package, thus giving customers not only choice, but a lower bill. But as utility analyst Fred McChesney has noted, as government control of telecommunications has lessened, much telephone de-regulation has turned into re-regulation.¹⁰ Without competition in the local telephone market, the ability of customers to buy package deals will be limited.

Setting Telephone Rates

The rates of telephone companies are determined by state regulators. Most local telephone service prices have been set to ensure a fair profit above company costs. Commonly referred to as "rate of return", this pricing arrangement ensures that the company's costs are covered and that the profit is enough to attract investment. Rate of return is usually based upon the firm's equity or capital. This regulation limits profits by guaranteeing a return on investment, but it eliminates many of the risks associated with unwise ones. Another problem with rate of return is that phone companies can overstate their costs and pass them on to consumers, the situation discovered in the FCC audit of the RBOCs.¹¹

Realizing the problems with rate of return, regulators in 35 states have replaced this system with an alternative plan of regulation that usually takes the form of a price cap. Here the cost to consumers, rather than profit, is regulated. The cap is often based on the existing prices or revenues of the regulated company and are either frozen or periodically adjusted. Thus, the current price cap method of determining prices originates from the rate of return prices of the old model. In order to generate profits, a local carrier must provide services at a cost below the regulated price. This arrangement ensures that a phone company will measure investment risk and aim to provide better service at a lower cost to the consumer.¹²

Two researchers have found that under the price cap system, network modernization is done more rapidly, fiber optic cable is deployed more quickly, network lines are served with more

⁸ Discovery Institute

⁹ Tom Tauke, "Fulfilling the Intent of Congress under the Telecommunications Act of 1996"

¹⁰ McChesney

¹¹ Kent Lassman, "A Primer on Price Cap Regulation"

¹² Ibid

efficiency, and basic local service rates are lower.¹³ However, these benefits come at the cost of cross-subsidization from non-basic services. Therefore, price cap regulation is not a good substitute for genuine market pricing.

Competition v. Monopoly

In summary, the desire to bring competition to local phone markets using the Telecom Act of 1996 has yet to be achieved. In an ideal world, local telephone companies would necessarily operate under the same constraints that other competitive business do; to provide the best possible services at the lowest prices and to operate according to the rules of the marketplace. Rivalry between companies leads to innovation, introduction of cost-cutting techniques into their methods of doing business, and secures customers based on their performance. Competition fixes the rates of all productive resources and rewards companies that strive for market excellence.

Under the current telephone rate-setting system, regulators fix the prices under which telephone companies operate. The participation of government is imperative to the continuation of monopoly control in cable television, cellular phones, and exclusive franchises of public utilities.

The Need For a Free Market

Competition must be introduced into the local telephone market. If it is not, new technologies will come to fruition but will be under-utilized because monopoly control will prevent their full use. Great things are happening in telecommunications. Enron Corporation, a Houston based company, recently planned to unveil plans to trade communications capacity, commonly referred to as bandwidth. This market will make high-speed telecommunications more efficient, cost-effective, and readily available for Internet service. "Project Angel" a trial of fixed wireless service in Dallas, will reach customers where traditional fiber optic infrastructure will not. It uses radio waves to transmit calls. In Pittsburgh, North Point (a San Francisco based telecommunications company) began to offer high-speed data services to businesses at a rate well below that of Bell Atlantic.

Thus, the future of telecommunications will not be "one-size-fits-all". Mergers and acquisitions in long-distance service are about the number of services offered by a particular company. Data, voice, Internet and international will all be "under the same umbrella". Local telephone competition cannot lag behind this movement. There needs to be an infusion of choice into the system, an infusion for which the federal legislation calls.

In analyzing the recent FCC audit of the RBOCs, it is evident that the time to introduce competition into the local telephone market is long overdue. If competition existed in this market, the results of the audit would be null and void. However, given the status of the incumbent telephone providers, such audits are exemplary of the monopolistic control of a handful of companies.

¹³ Chunrong Ali and David Sappington, "The Impact of State Incentive Regulation on the U.S. Telecommunications Industry"

III. Background of the FCC Audit

The FCC's Accounting Safeguards Division has over the past 5 years conducted audits of the Continuing Property Records (CPR) of the Regional Bell Operating Companies (RBOC's). Audits were conducted in 1994 and again in 1997. The central focus of the 1997 audit was asset verification and regulatory compliance of their central office equipment (COE) accounts. Audit reports were released in March 1999 for each of the seven Regional Bell Operating Companies.

The FCC requires carriers (RBOC's) to maintain up-to-date descriptions and locations of each plant asset in service. The equipment may be spot-checked for proof of physical existence. Accurate plant (fixed asset) accounts are important because policymakers use them to: evaluate financial performance, make cost allocations for regulated and non-regulated services, perform asset separations and allocations along jurisdictional boundaries, compute depreciation rates, make earnings adjustments and develop productivity factors for price cap companies. The assets serve as inputs for forward-looking cost models, interconnection agreements, and access charges for any competing local service provider.

Audit results determined that RBOC's have not maintained their central office equipment and CPR in a fashion consistent with FCC rules and that central office equipment was substantially overstated. The audits found deficiencies and overstatements in RBOC systems relating primarily to hard-wired equipment and undetailed investments. Hard-wired equipment consists of complicated, permanent equipment such as telephone switches and circuit equipment. The undetailed equipment represents fixed asset investments that are not specifically associated with identifiable units of equipment. The audits overall found the central office equipment accounts in their CPR's to be overstated by substantial amounts in both categories.

This report provides, at the state level, the economic impact of the overstated equipment of the Regional Bell Operating Companies. The analysis looks at the effect on after-tax earnings and excess revenue that results from including an overstatement of equipment in the company's asset base.

Historically, regulators have used a rate-of-return on asset model to set phone company charges. Any overstatement of assets would have produced excessive revenues and profits for the telephone company. Although most phone rates are now set using a price-cap model, those price-caps are predicated on prices which were previously determined by the rate-of-return methodology. Thus, an overstatement in the past is implicitly included in today's pricing structure. This report, starting with the assumption that the FCC audit findings are correct, provides an assessment of the impact of the equipment overstatement on RBOC revenues and profits.

The FCC audit findings of substantial missing equipment point to the superiority of a competitive model in which the market--not regulators-- determine local phone service rates. It is only in the current environment of monopoly regulation in which rates are set in relation to invested capital-- either directly or in relation to some pricing agreement-- rather than by the market, that the accuracy of accounting records is crucial. Only in such a regulated environment

would a company have an incentive to carry equipment that does not exist on its books. In a competitive market these incentives could not exist.

IV. National and Regional Summary of FCC Audit Findings

A recap of the FCC audit findings of Regional Bell Operating Companies is shown in the table below. Nationally, the missing and undetailed central office equipment for all RBOCs totals \$4.8 billion or 5.5% of all central office equipment. The FCC audit reports recommend that this amount be written-off.

The FCC audits found deficiencies in central office equipment records ranging from 18.5% for Pacific Bell & Nevada Bell to 24.7% for US West.

Missing hard-wired equipment ranged from \$222 million for Southwestern Bell to \$806 million for Bell Atlantic-South. At the same time, undetailed investments ranged from zero at Bell Atlantic-South to \$924 million for Southwestern Bell. Combined, overstatement of central office equipment ranged from \$430 million at BellSouth to a remarkable \$1.15 billion for Southwestern Bell.

RBOC Records Deficiency and Asset Overstatement

Regional Bell Operating Company	Percent Deficient Records	Hard-Wired Equipment Missing (Millions)	Undetailed Investment (Millions)	Combined Asset Over-Statement (Millions)
Bell Atlantic-South	24.1%	\$806	\$0	\$806
Ameritech	23.3%	\$306	\$261	\$567
Pacific Bell & Nevada Bell	18.5%	\$499	\$28	\$527
Southwestern Bell	21.8%	\$222	\$924	\$1,146
US West	24.7%	\$379	\$219	\$597
NYNEX (BA-North)	20.9%	\$382	\$377	\$758
BellSouth	18.7%	\$292	\$139	\$430
Total		\$2,884	\$1,946	\$4,830

Regional Bell Operating Companies states include:

Bell Atlantic South

Washington, D.C., Maryland, Virginia, Delaware, Pennsylvania, New Jersey and West Virginia.

Ameritech

Illinois, Indiana, Michigan, Ohio and Wisconsin

SBC (Pacific, Nevada and Southwestern Bell)

California, Nevada, Arkansas, Kansas, Missouri, Oklahoma and Texas.

US West

Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, South Dakota, Oregon, Utah, Washington and Wyoming.

Bell Atlantic-North (NYNEX)

New York, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont and Connecticut

BellSouth

Alabama, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina and Tennessee.

V. Selected State Analyses

A sample of sixteen states were selected from the various markets of the seven Regional Bell Operating Companies. They are presented on the following pages and are listed in alphabetical order by state. The table below contains a summary of the key findings for the 16 selected states.

Economic Impact of Missing Telephone Equipment Based on FCC Audit of The Regional Bell Operating Companies

State	Region	Missing Equipment In dollars	Excess Income In dollars	% of Income	Excess Customer Charges In dollars	% of Total
Arizona	US West	62,732,414	3,513,015	15.2	5,803,501	0.7
Illinois	Ameritech	124,383,565	33,210,412	10.5	55,663,971	2.6
Louisiana	BellSouth	30,765,340	4,891,689	2.7	6,769,609	0.8
Maryland	Bell Atlantic-South	92,559,312	13,328,541	7.4	18,953,185	1.7
Massachusetts	Bell Atlantic-North	132,087,958	16,378,907	6.1	26,162,028	1.9
Mississippi	BellSouth	19,157,444	3,352,553	2.9	4,719,053	0.9
Missouri	SBC	122,849,379	9,213,703	10.1	14,324,545	1.8
Montana	US West	8,762,452	569,559	7.7	964,606	0.9
New Jersey	Bell Atlantic-South	129,346,642	18,496,570	7.8	22,597,259	1.7
New Mexico	US West	21,172,419	2,646,552	5.3	4,174,407	1.5
Ohio	Ameritech	88,857,531	20,259,517	9.7	30,634,416	2.3
Oklahoma	SBC	73,648,682	6,922,976	13.0	10,570,692	2.2
Pennsylvania	Bell Atlantic-South	148,924,230	17,424,135	8.9	23,560,915	1.5
South Carolina	BellSouth	19,206,168	2,996,162	2.6	3,899,805	0.7
Texas	SBC	487,275,110	57,498,463	10.8	84,183,500	3.0
Virginia	Bell Atlantic-South	94,303,849	17,068,997	8.6	20,795,159	2.0

THE RETURN, TAX RATE AND TAX FACTOR ARE AVERAGES OF 1996 AND 1997 DATA.

VI. The Case of Pennsylvania

Regardless of the number of local telephone providers in a particular state, each local market continues to be controlled by a monopoly. Until true competition is introduced, this situation will be perpetuated.

The share of the local telephone market in Pennsylvania illustrates the entrenchment of the telephone monopoly. The incumbent RBOC, Bell Atlantic, holds 79 percent of the access lines in the state. The next largest provider, GTE, holds 8 percent of the access lines. This shows the disparity inherent in the local telephone market that exists even among incumbent providers.

Since the passage of the Telecom Act in 1996, movements toward competition have shown mixed results nationwide. In Pennsylvania, competition can be measured by interconnection agreements of two types; facilities based agreements, in which a competitor will "wire" an individual site, and resale agreements, or interconnections in which competitors resell local service as part of their package. To date, these approved interconnection agreements total 87.

The pricing structure in the state is governed by provisions of Chapter 30 in the state law. This gives alternative regulation, or price cap plans, to companies that make a commitment to network modernization under Title 66 of the Public Utilities Code. As of February of this year, 11 alternative regulation plans were approved by the Public Utility Commission. During the third quarter of 1998, 19 small, rural LECs filed a consolidated petition for alternative regulation. Sprint-United and GTE have also filed for this type of regulation. The PUC has 9 months to approve, modify, or reject the plans.

FCC Audit Results Impact in Pennsylvania

The description below illustrates the findings of an FCC audit of Bell Atlantic. The findings demonstrate the problem of a regulated monopoly in which prices are based on the company's reported capital investments. Bell Atlantic's overstatement of capital equipment resulted in excess earnings of over \$17 million dollars for the company, or 9 percent of their after -tax profits.

The Federal Communications Commission recently released the results of a 1997 audit of central office equipment (COE) of the Bell Atlantic (South) Telephone Operating Companies. **The audit, performed by the Accounting Safeguards Division, concluded that Bell Atlantic's COE investment is overstated by a minimum of \$806 million.** The audit found serious deficiencies in the company's records for items relating to: 1) Hard-wired or permanent equipment, and 2) undetailed investment and other unallocated costs. The FCC has recommended that the missing equipment be written off.

The equipment overstatement has important implications for Pennsylvania. Historically, pricing of telephone service was based on an allowable return on investment set by the state's regulators. Although rates are currently established in a "price cap" scenario, the missing equipment, which was part of the asset base previously used to set telephone service prices, will cause customer telephone service charges to be too high because the old rates formed the basis for the currently capped rates.

Allocating the Bell Atlantic audit results to Pennsylvania places the state's equipment overstatement at \$149 million. With an average 11.7 percent rate of return on Pennsylvania operations in 1996-1997, the overstatement of Bell Atlantic's Pennsylvania assets produces earnings of \$17.4 million per year above what they would be if the missing equipment were written off as the FCC has recommended. These excess earnings represent nearly 9 percent of Bell Atlantic's after-tax profits in Pennsylvania.

Meanwhile, customers in Pennsylvania are paying \$23.6 million more for yearly service because of the overstatement of central office equipment. This overcharge amounts to \$4.00 per customer phone line. While this is not a substantial sum on a per line basis, when accumulated over all customers it contributes substantially to company earnings. The overcharges per customer boost company profits 9 percent higher than they would be if the missing equipment had been discovered and written off years ago.

How important is this excess 9 percent in after-tax earnings? If a Pennsylvania family with an annual after-tax income of \$40,000 could somehow receive an "extra" 9 percent in take home pay, they would have an additional \$ 3,600 to spend or save each year. Over 10 years that would accumulate into enough to pay for a substantial portion of a college education or make a down payment on a house.

Economic Impact of Missing Telephone Equipment in Pennsylvania
Based on FCC Audit of Bell Atlantic – South

Bell Atlantic – Pennsylvania

Missing Equipment * \$148,924,230

Economic Impact	Dollars per Year	Percent of Total	Per Access Line
Excess Earnings	\$17,424,135	8.9 **	
Excess Customer Charges	\$23,560,915	1.5 ***	\$ 4.00

* Allocation to Intrastate Pennsylvania Based on FCC Audit Results

** Intrastate After-tax Income is basis.

*** Basic Local Services Revenue is basis.

VII. Recommendations

First, it is recommended that the Bell Regional Operating Companies adopt the audit findings by the Federal Communications Commission and implement the audit recommendations by writing-off the reported amounts of missing central office equipment.

Second, it is recommended that each state in the country move to adopt full and meaningful competition in local telephone service permitting consumers to choose their telephone service supplier. In a fully competitive market where prices are determined by the interplay of supply and demand, overstatements of equipment are irrelevant. If states adopt competitive local telephone service, the RBOC's will have every incentive to write off or remove any missing equipment.

**INCUMBENT LOCAL EXCHANGE CARRIERS:
LOCAL TELEPHONE MARKET CONCENTRATION**

STATE	DEGREE OF MARKET CONCENTRATION OF RBOC AND SECOND LARGEST PROVIDER	NUMBER OF APPROVED FACILITIES BASED AND RESALE AGREEMENTS TO DATE
PENNSYLVANIA	BELL ATL. 79%, GTE 8%	87
MASSACHUSETTS	BELL ATL. 93%, GTE 3%	77
MARYLAND	BELL ATL. 95%, MFS 1%	65
VIRGINIA	BELL ATL. 76%, GTE 12%	69
SOUTH CAROLINA	BELL SOUTH 65%, GTE 10%	60
MISSISSIPPI	BELL SOUTH 96%, CENTURY TELE. 1%	55
LOUISIANA	BELL SOUTH 92%, CENTURY TELE. 4%	45
TEXAS	SBC 75%, GTE 15%	162
OKLAHOMA	SBC 82%, GTE 5%	60
MISSOURI	SBC 72%, GTE 15%	41
OHIO	AMERITECH 59%, GTE 12%	44
ILLINOIS	AMERITECH 83%, GTE 11%	44
NEW MEXICO	U.S. WEST, 88%, GTE 10%	28
ARIZONA	U.S. WEST 89%, CITIZEN'S TELE. 3%	67
MONTANA	U.S. WEST 70%, CENTURY TELE 11%	43

Source: State Public Utility Commissions

Appendix 1: Sample ARMIS Report on Financial Data
(Amounts shown in thousands)

43-01: Table I. Cost and Revenue Table

Year	Company Name	Row #	Row Title	Total	State	Interstate
1996	Illinois Bell	1010	Basic Local Services	2,113,447	2,113,447	-
1996	Illinois Bell	1020	Network Access Services	871,959	98,845	784,320
1996	Illinois Bell	1030	Toll Network Services	251,097	194,510	45,113
1996	Illinois Bell	1040	Miscellaneous	178,947	154,760	24,187
1996	Illinois Bell	1045	Nonregulated	246,157	N/A	N/A
1996	Illinois Bell	1050	Settlements	-	-	-
1996	Illinois Bell	1060	Uncollectibles	107,620	94,412	5,620
1996	Illinois Bell	1090	Total Operating Revenues	3,553,987	2,467,150	848,000
1996	Illinois Bell	1110	Equal Access Expenses	N/A	488	1,572
1996	Illinois Bell	1120	Plant Specific	764,166	477,047	158,186
1996	Illinois Bell	1130	Plant Non-Specific	239,058	161,881	54,861
1996	Illinois Bell	1140	Customer Operations Marketing	185,601	126,084	38,292
1996	Illinois Bell	1150	Customer Operations Services	394,290	282,445	52,865
1996	Illinois Bell	1160	Corporate Operations	329,771	230,219	66,865
1996	Illinois Bell	1170	Access	34,541	29,095	5,446
1996	Illinois Bell	1180	Depreciation/Amortization	658,931	487,818	162,377
1996	Illinois Bell	1185	FCC Expense Adjustment	N/A	N/A	206
1996	Illinois Bell	1190	Total Operating Expenses	2,606,358	1,794,589	539,098
1996	Illinois Bell	1290	Other Operating Income/Losses	(429)	(501)	(165)
1996	Illinois Bell	1320	Inc Effect/Jurisdictional Difference (Rev)	55,326	55,326	N/A
1996	Illinois Bell	1330	Extraordinary Items (Rev)	-	-	-
1996	Illinois Bell	1340	AFUDC (Rev)	3,577	2,660	882
1996	Illinois Bell	1350	Special Charges (Exp)	7,548	2,749	797
1996	Illinois Bell	1360	All Other Non-operating Items (Rev)	17,258	-	-
1996	Illinois Bell	1370	FCC Non-operating Adjustment (Exp)	N/A	N/A	-
1996	Illinois Bell	1390	Total Non-operating Items (Exp)	(68,613)	(55,237)	(85)
1996	Illinois Bell	1410	State and Local Income	49,236	34,511	17,299
1996	Illinois Bell	1420	Other State and Local	91,371	71,515	17,186
1996	Illinois Bell	1490	Total Other Taxes	140,607	106,026	34,485
1996	Illinois Bell	1510	Fixed Charges (Exp)	120,711	71,100	37,976
1996	Illinois Bell	1520	IRS Income Adjustment	2,900	1,947	953
1996	Illinois Bell	1530	FCC Taxable Income Adjustment (Rev)	N/A	N/A	206
1996	Illinois Bell	1540	ITC Amortization (Rev)	18,992	14,033	4,660
1996	Illinois Bell	1550	FCC ITC Adjustment (Rev)	N/A	N/A	-
1996	Illinois Bell	1590	Federal Income Taxes (Exp)	239,849	179,208	78,471
1996	Illinois Bell	1610	Equal Access Investment	N/A	5,390	17,368
1996	Illinois Bell	1620	Support Plant	1,313,345	939,720	272,191

1996	Illinois Bell	1630	COE-Operator Systems Equipment	41,742	38,777	6,413
1996	Illinois Bell	1640	COE-Switching	1,871,209	1,465,614	321,703
1996	Illinois Bell	1650	COE-Transmission	1,556,507	981,993	503,724
1996	Illinois Bell	1660	Cable and Wire Facilities	3,757,198	2,707,738	948,703
1996	Illinois Bell	1670	IOT Equipmt	289,068	213,065	70,841
1996	Illinois Bell	1680	Amortizable Assets	40,125	32,453	9,398
1996	Illinois Bell	1690	Total Plant In-Service	8,869,194	6,379,360	2,132,973
1996	Illinois Bell	1705	Other Jurisdictional Assets-Net	107,412	104,843	-
1996	Illinois Bell	1710	Property Held for Future Use	519	662	220
1996	Illinois Bell	1720	Plant Under Construction	52,193	46,022	15,273
1996	Illinois Bell	1730	Plant Acquisition Adjustment	-	-	-
1996	Illinois Bell	1740	Investment in Nonaffiliated Companies	1,194	-	-
1996	Illinois Bell	1750	Other Deferred Charges	119,703	26,757	8,887
1996	Illinois Bell	1760	Inventories	18,678	6,913	2,424
1996	Illinois Bell	1770	Cash Working Capital	N/A	N/A	(6,253)
1996	Illinois Bell	1780	FCC Investment Adjustment	N/A	N/A	58,111
1996	Illinois Bell	1790	Total Other Investments	299,699	185,197	78,662
1996	Illinois Bell	1820	Accumulated Depreciation	4,152,966	2,914,458	982,492
1996	Illinois Bell	1830	Accumulated Amortization	23,351	20,576	5,958
1996	Illinois Bell	1840	Deferred FIT	746,840	578,580	182,299
1996	Illinois Bell	1850	Customer Deposits	4,117	4,076	1,354
1996	Illinois Bell	1870	Other Deferred Credits	49,588	35,504	11,785
1996	Illinois Bell	1880	Other Juris Liab & Deferred Crs-Net	1,602,307	1,347,312	94,717
1996	Illinois Bell	1885	FCC Reserve Adjustment	N/A	N/A	-
1996	Illinois Bell	1890	Total Reserves	6,579,169	4,900,506	1,278,605
1996	Illinois Bell	1910	Average Net Investment	N/A	1,664,051	933,030
1996	Illinois Bell	1915	Net Return	N/A	N/A	195,866
1996	Illinois Bell	1920	Rate of Return	N/A	N/A	21
1996	Illinois Bell	1925	FCC Ordered Refund	N/A	N/A	-
1996	Illinois Bell	1926	Refund Adjusted for Taxes	N/A	N/A	-
1996	Illinois Bell	1930	Net Return Including FCC Refund	N/A	N/A	195,866
1996	Illinois Bell	1935	Rate of Return (Including refund)	N/A	N/A	21
1996	Illinois Bell	1950	Lifeline Adjustment	N/A	(267)	267
1996	Illinois Bell	1960	Universal Service Fund	N/A	-	-
1996	Illinois Bell	1970	Common Line Support-Long Term	N/A	N/A	(17,395)
1996	Illinois Bell	1980	Common Line Support-Transitional	N/A	N/A	-

Appendix 2
Economic Impact of Missing Telephone Equipment
Based on FCC Audit of The Regional Bell Operating Companies

State	Region	Percent of		Intrastate Amount	Intrastate Amount	Income Impact	Revenue Conversion Factor	Revenue Effect
		Total Region	Amount Allocated to Each State					
Arizona	US WEST	15.1%	90,464,410	69.3%	62,732,414	3,513,015	1.6520	5,803,501
Illinois	Ameritech	30.6%	173,562,713	71.7%	124,383,565	33,210,412	1.6761	55,663,971
Louisiana	BellSouth	9.7%	41,593,907	74.0%	30,765,340	4,891,689	1.3839	6,769,609
Maryland	Bell Atlantic - South	17.1%	137,437,995	67.3%	92,559,312	13,328,541	1.4220	18,953,185
Massachusetts	Bell Atlantic -- North	24.3%	184,348,575	71.7%	132,087,958	16,378,907	1.5973	26,162,028
Mississippi	BellSouth	6.1%	26,200,664	73.1%	19,157,444	3,352,553	1.4076	4,719,053
Missouri	SBC	16.2%	185,017,132	66.4%	122,849,379	9,213,703	1.5547	14,324,545
Montana	US WEST	2.3%	13,911,122	63.0%	8,762,452	569,559	1.6936	964,606
New Jersey	Bell Atlantic - South	26.8%	215,796,300	59.9%	129,346,642	18,496,570	1.2217	22,597,259
New Mexico	US WEST	5.3%	31,658,300	66.9%	21,172,419	2,646,552	1.5773	4,174,407
Ohio	Ameritech	21.2%	120,391,199	73.8%	88,857,531	20,259,517	1.5121	30,634,416
Oklahoma	SBC	9.3%	105,988,026	69.5%	73,648,682	6,922,976	1.5269	10,570,692
Pennsylvania	Bell Atlantic - South	27.3%	219,948,320	67.7%	148,924,230	17,424,135	1.3522	23,560,915
South Carolina	BellSouth	6.3%	26,999,631	71.1%	19,206,168	2,996,162	1.3016	3,899,805
Texas	SBC	60.5%	693,311,753	70.3%	487,275,110	57,498,463	1.4641	84,183,500
Virginia	Bell Atlantic -- South	17.7%	142,217,454	66.3%	94,303,849	17,068,997	1.2183	20,795,159