BOC LONG DISTANCE ENTRY DOES NOT BENEFIT CONSUMERS

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Introduction

Section 271(d(3)(C) of the federal *Telecommunications Act of 1996* specifies that the FCC may not approve a Bell Operating Company ("BOC") application for Section 271 authority to provide in-region interLATA services unless the Commission finds that "the requested authorization is consistent with the public interest, convenience, and necessity." As part of the BOCs' ongoing efforts to advance such a showing, BOCs engaged Professor Jerry A. Hausman of MIT and the Lexicon consulting firm to produce a study[1] purporting to show that consumers have benefitted from BOC long distance entry in New York and Texas, the first two states in which Section 271 authority was granted. In this paper, I demonstrate that the various research methods and analysis techniques that were utilized by Hausman *et al* are fatally deficient, in that they rely upon undocumented and nonreproducible econometric

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1. Jerry A. Hausman, Gregory K. Leonard and J. Gregory Sidak, "The Consumer-Welfare Benefits from Bell Company Entry into Long-Distance Telecommunications: Empirical Evidence from New York and Texas" ("Hausman/Leonard/Sidak" or "HLS"), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=289851

models that exclude highly relevant explanatory variables, make highly selective and obviously results-driven "comparisons" with non-entry states, select an unrepresentative time period in which to perform their "comparisons," and inexplicably exclude certain source data without any justification or basis.

There has been and continues to be robust *competition* in the long distance market since the 1984 break-up of the former Bell System. That competition, together with the FCC's ongoing policy of moving switched access charges toward cost, has brought down the inflation-adjusted retail price of long distance calling by nearly 80% since 1983, just before the Bell divestiture. These enormous consumer benefits have been achieved not only without BOC entry into the long distance market, but *because* the BOCs were placed in the position where they had no incentive to discriminate in favor of or against any long distance carrier. BOC long distance entry reinstates those incentives, and portends a diminution of competition and a potentially serious loss — certainly not a gain — in consumer welfare.

The succession of price decreases of residential long distance service are in sense the result of or caused be BOC entry into the long distance business.

The dramatic drop in long distance prices that has occurred over the past two decades provides compelling evidence of the extraordinary success of several key FCC policies — the development of competition in telecommunications markets, and the rebalancing of rates to be more reflective of the structure of costs. That downward trend in long distance prices has been underway for nearly twenty years, and began and persisted long before the entry of

BOCs into the in-region long distance market in a handful of states starting a little more than two years ago.

The *single most important source* of the enormous drop in long distance prices is the succession of FCC-required decreases in "access charges," the fees that long distance companies pay to local phone companies to connect their long distance networks to the phone companies' local subscribers. Access charges have been dropping steadily following their introduction in 1984, shortly after the break-up of the former Bell System.[2] That, along with unprecedented technological innovation in telephone switching and long-haul transmission technologies and the growth of an intensely competitive long distance market, has pushed down the *real* (inflation-adjusted) price of long distance service by *nearly 80%* since 1983 — the last year before the 1984 Bell System break-up and the introduction of access charges — *without BOC entry into the long distance business.* By contrast, and as graphically demonstrated in Figure 1, the inflation-adjusted prices of *monopoly* local phone service have remained largely unchanged over that same period.

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2. *See generally* MTS and WATS Market Structure, CC Docket No. 78-72, *Notice of Inquiry and Proposed Rulemaking,* 67 FCC 2nd 757 (1978). *Supplemental Order (Phase I),* 94 FCC 2nd 852 (1983). *Phase I Order Modified on Reconsideration,* 97 FCC 2nd 682 (1983). *Phase I Order Modified on Further Reconsideration,* 97 FCC 2nd 834 (1984). Phase I Orders Affirmed in Part, *Remanded in Party sub nom. National Association of Regulatory Utility Commissioners v. FCC,* 737 F.2d 1095 (D.C. Cir. 1984). *Cert. denied,* 469 U.S. 1227 (1985). *Report and Order (Phase III),* 100 FCC 2nd 860 (1985). *Phase I Order Modified on Second Further Reconsideration,* 101 FCC 2nd 1222 (1985). *Aff'd sub nom. American Telephone & Telegraph Co. v. FCC,* 832 F.2d 1285 (D.C. Cir. 1987).

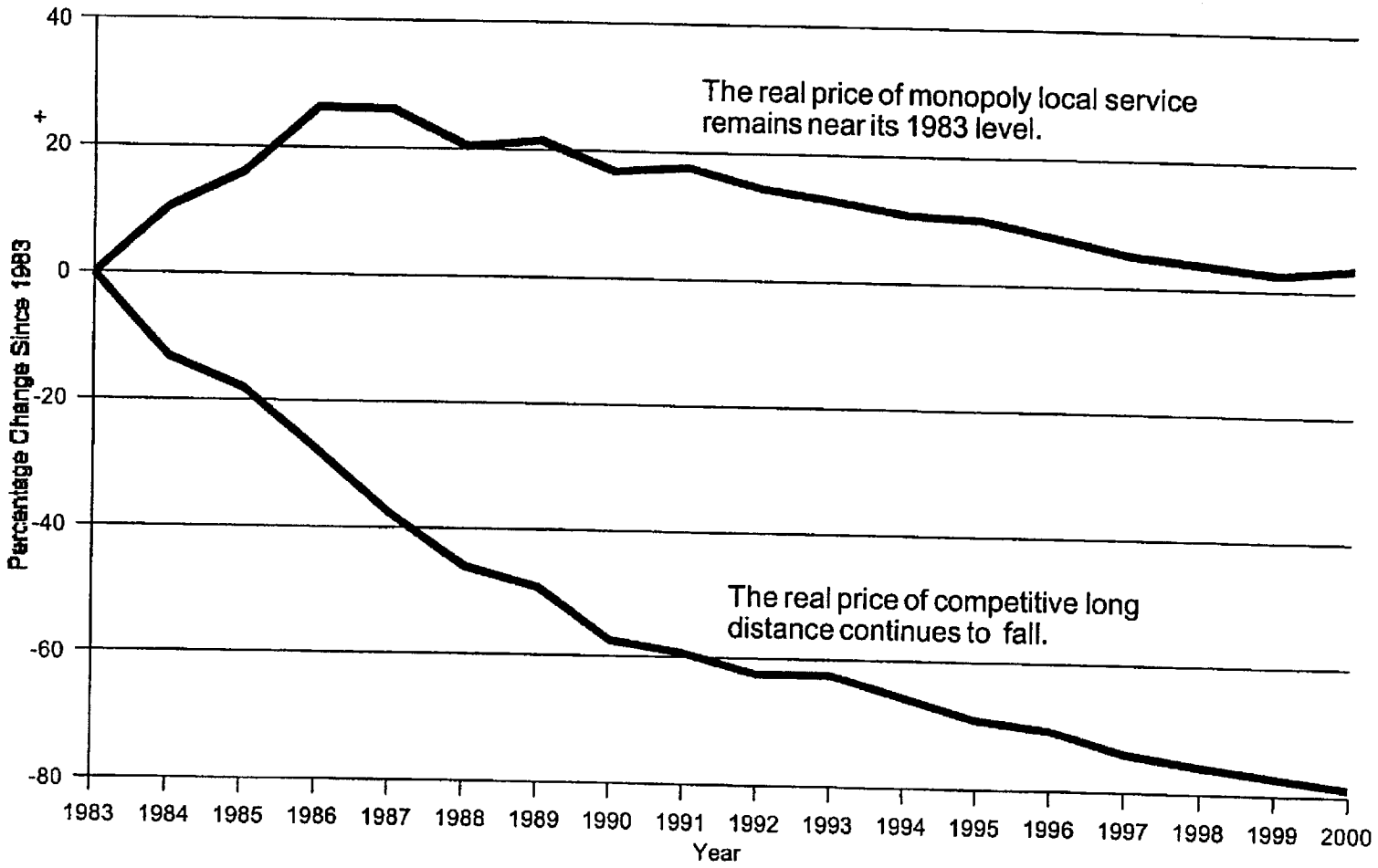

Figure 1: Adjusted for inflation, long distance rates have fallen by nearly 80% since 1983, the last year before the Bell System break-up. By contrast, ILEC local rates have remained essentially unchanged over that same period.

Source: FCC, *Trends in Telephone Service*, Table 14.5; FCC, *Statistics of Communication Common Carriers*, 1995/1996 Edition, Table 8.4 and 2001 Edition, Table 5.6; Bureau of Labor Statistics, Inflation Calculator at: *http://www.bls.gov/cpi/*. Long distance rate for 2000 is an estimate.

The RBOC-commissioned Hausman *et al* "study" purporting to estimate the "consumer welfare benefits" of BOC long distance entry is based upon an undocumented and nonreproducible "econometric model" that excludes important sources of long distance price decreases and thereby mis-attributes some recent long distance price drops to BOC entry rather than to the development of intense competition and the succession of reductions in switched access charges.

In their unpublished "study" apparently commissioned by one or more RBOCs and recently released by Jerry A. Hausman, Gregory K. Leonard and J. Gregory Sidak, the authors claim to have made "empirical findings that BOC entry has produced substantial consumer-welfare benefits in New York and Texas in the form of lower prices for long-distance service" and claim to have found "statistically significant evidence that BOC entry enabled the average consumer to reap a 9-percent savings on her monthly interLATA bill in New York and a 23-percent savings in Texas."[3] Based upon these findings, the authors go on to "predict that, when the BOCs receive section 271 approvals in other states, a similar significant decrease in long-distance prices will occur that leads to consumer benefits."[4] In offering these "empirical" results, Hausman/Leonard/Sidak fail to provide the actual data set that they utilized in their regression analysis; hence, their model results cannot be reproduced, nor can alternative specifications be examined. Significantly, in their paper the authors provide *no source for the data* that was used for the "empirical evidence" upon which their "conclusion" is founded! It is likely, however, that this data was acquired from the so-called "bill harvesting" study regularly collected and published by TNS Telecoms. In another paper by Hausman and Sidak in which the TNS data is utilized, the authors offer the following

3. Hausman/Leonard/Sidak, at 3.

4. *Id.*, at 13.

description: "Each quarter, TNS Telecoms surveys roughly 30,000 consumers as to their telecommunications expenditures. Of all the customers polled in its general survey, approximately 3,000 customers provide TNS Telecoms with their actual long-distance bills."[5]

In using the TNS data, HLS inexplicably "eliminated households with more than one telephone line and households that switched service providers during the billing cycle" but provide no justification or rationale for deliberately selecting-out such customers.[6]

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5. Jerry A. Hausman and J. Gregory Sidak, "Do Long Distance Carriers Price Discriminate Against the Poor and the Less-Educated?," unpublished, January 2002 ("Hausman/Sidak"), at 13; available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=296368

6. Hausman/Leonard/Sidak eliminated households with more than one long distance bill during a billing period, apparently *assuming* that this will "eliminate households with more than one telephone line and households that switched service providers during the billing cycle." Hausman/Leonard/Sidak, at 6. This statement is not true, since (a) multiple-line households can in fact have a single long distance bill — either because the second line has no PIC at all, or because the IXC combines calls for the several working telephone numbers on a single bill. Also, there are many explanations for why a customer would have more than one bill. For example, a customer would receive "multiple" long distance bills if he places some but less than all calls on a 1+ basis using the PIC'ed carrier, and uses one or more "dial around" ("101-XXXX") services for the remaining calls. Even where both the PIC'ed IXC and the 101-XXXX usage is billed through the local phone company, TNS will nonetheless identify the customer has having received two "separate" long distance bills. Thus, if the customer uses AT&T (for example) as the PIC but also uses 1010-220 (Telecom USA), the TNS customer record will show two separate bills, and thus would have been omitted from the Hausman/Sidak dataset. In addition, characteristics of customers with a "single bill" may differ from state to state, rendering incorrect the comparisons of these unique sub-groups across several states. It is also unclear as to how Hausman/Sidak treated so-called "threshold billed" customers, low-volume users who do not receive a long distance bill every month, but are billed once every 2-3 months or when their accumulated bill reaches a "threshold" level, e.g., $30, whichever comes first. Depending upon whether a particular customer happened to be billed in a particular month, some of these customers will have no long distance bill in the TNS data, while others will have a bill that reflects several months' usage. Hausman/Sidak

(continued...)

Customers who switch carriers or who have two phone lines are likely to be above-average users who are also more aware of the various pricing options, and are thus most likely to have been paying lower rates to begin with; thus, eliminating these customers likely creates a systematic upward bias in the resulting average prices.

The "methodology" utilized by HLS involved the development of comparisons between the first two states in which BOCs had received Section 271 authority (New York and Texas) with two "control" states — Pennsylvania for New York, and California for Texas — that they selected. The authors' claims of "9-percent savings ... in New York and a 23-percent savings in Texas" were developed on the basis of comparing New York vs. Pennsylvania and Texas vs. California average bill changes between the second half of 1999 ("2H99") and the second half of 2000 ("2H00"). In making these comparisons, HLS used the New York 2H00 usage characteristics to develop the average bill for both time periods *and for both states* (New York and Pennsylvania); similarly, the 2H00 Texas usage characteristics was used to develop the average bill for both time periods and for both Texas and California. While there might be some justification for holding usage constant *within the same state* for the two different time periods so as to accurately measure the effects of price changes *in each jurisdiction*,[7] the use of New York and Texas usage for Pennsylvania and California,

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6. (...continued)
may have excluded these customers altogether as not meeting the criteria of "... having only a single long distance bill during the billing cycle," or they could have misinterpreted the total threshold billing level as representative of the customer's usage *in the billing month.*

7. Even so, using 2H00 minutes for both 1999 and 2000 may produce distorted results, if the price changes occurring between the two time periods are such as to affect consumer
(continued...)

respectively, serves only to distort local usage patterns, which are heavily influenced by such state-specific attributes as geography, number of LATAs, and the relationship between customers' communities of interest and their local calling areas.

The TNS Telecoms "bill harvesting" survey is also a source of the type of data that could be used to draw comparisons between "Section 271 states" and those in which BOC long distance entry is still barred. AT&T subscribes to the TNS Telecoms data, and at my request prepared summary results in the same format and for the same two time periods as those selected by HLS for the four states whose results are provided by HLS as well as for several other non-271 states in which the average long distance bill decreased by *considerably more* than in either New York or Texas. These results are reproduced in Tables 1 and 2 below. For the sake of comparison (and because we were not able to replicate the precise HLS summary data either because they had obtained it from a source other than TNS Telecoms and/or because they may have processed the individual billing data differently[8]), I also

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7. (...continued)
behavior either in terms of total consumption or the mix of peak and off-peak calling. New calling plans that either eliminate peak/off-peak price distinctions or that modify the peak/off-peak price relationships, or the introduction of "block-of-time" plans, could materially impact calling volumes. For example, under a block-of-time plan (e.g., SBC's 300 minutes for $18 offering), a customer who might ordinarily use only 200 minutes would view the additional 100 minutes as "free," and might well increase total usage considerably to the extent that such an increase does not result in a higher total bill. Holding calling volumes constant over the two time periods used in the HLS "analysis" ignores this important effect.

8. The TNS Telecoms Bill Harvesting data contains virtually all information from customer bills along with both "state weights" and "national weights." Due to the literally hundreds of carriers, types of calling plans, etc., the resulting database is extremely complex. The user of the data must make many decisions about what records to include or exclude, the (continued...)

requested that AT&T provide results for the four states used by HLS using the same methodology as was used for the four additional states, except that for each state, I asked that that state's usage characteristics be utilized instead of the New York and Texas usage levels that HLS had incorrectly used for their "control" state calculations.

When the results for the two HLS "control states" (Pennsylvania and California) are recalculated using the usage characteristics *of those states* rather than those of New York for Pennsylvania and Texas for California, the price decreases in the two HLS "control states" turn out to have been significantly larger than those reported by the authors — a 10.52% decrease for Pennsylvania rather than the 1.89% calculated by HLS based upon *New York* usage characteristics, and an 11.93% decrease for California rather than the 0.77% *increase* that HLS had calculated using *Texas* usage levels:

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8. (...continued)
appropriate weights to use, etc. Because it is unclear whether in fact the TNS data was the data source and, in any event, none of the details as to how the data was processed and utilized are documented in the Hausman/Sidak paper, there is no way to determine whether the data was used correctly and consistently.

Table 1

Savings on InterLata Bills for the Average Customer
New York and Pennsylvania

	Avg Mins (NY 2H00)	Avg Price NY 2H99	Avg Price NY 2H00	Avg Mins PA 2H00	Avg Price PA 2H99	Avg Price PA 2H00
Peak (7am - 7pm weekdays)	32	$0.17	$0.13	23	$0.17	$0.14
Off Peak (7pm - 7am weekdays & Sat.)	48	$0.12	$0.09	28	$0.14	$0.11
Off Peak (Sunday)	20	$0.09	$0.08	13	$0.09	$0.09
Fee (MRC)		$1.17	$1.66		$1.19	$1.61
Total Bill *		$14.19	$11.80		$10.10	$9.14
Total Savings			$2.39			$0.96
Savings as Percentage of Total Bill			20.26%			10.52%
Incremental Savings in Entry State			$1.43			
Incremental Savings as Percentage of Total Bill			9.74%			

Texas and California

	Avg Mins TX 2H00	Avg Price TX 2H99	Avg Price TX 2H00	Ave Mins CA 2H00	Avg Price CA 2H99	Avg Price CA 2H00
Peak (7am - 7pm weekdays)	31	$0.15	$0.12	38	$0.15	$0.12
Off Peak (7pm - 7am weekdays & Sat.)	42	$0.13	$0.11	34	$0.12	$0.10
Off Peak (Sunday)	16	$0.10	$0.09	21	$0.09	$0.08
Fee (MRC)		$1.85	$1.68		$1.43	$1.87
Total Bill *		$13.64	$11.56		$12.94	$11.56
Total Savings			$2.08			$1.38
Savings as Percentage of Total Bill			17.96%			11.93%
Incremental Savings in Entry State			$0.70			
Incremental Savings as Percentage of Total Bill			6.03%			

Notes to Tables 1 and 2: To attempt to match HLS methodology, only households with one Long Distance Bill were included in the sample. Threshold billed households (i.e., consumers billed only once every "x" months or when a certain spending level is reached) were also excluded. Average Minutes and Price was calculated for interLATA domestic dial-1 calls only; international calls were excluded. Minutes without associated charges (i.e., such as calls made with "block-of-time" plans) were included in average price per minute calculations since the corresponding charges are reflected in the monthly recurring charges (MRC). Source: TNS Telecoms ReQuest Bill Harvesting Study, National Weight used. (TNS advises use of national weights when two or more states are being compared.)

The specific choice of "control states" and the two time periods was entirely arbitrary. Because we do not know exactly what data sources were used or whether alternate "control states" or alternate time periods were examined, there is no basis to conclude that the particular *entirely non-random* selections of Pennsylvania and California that were made by HLS are in any way representative of actual conditions. During the 2H99 through 2H00 time frame, of the 48 jurisdictions (47 states plus the District of Columbia) in which Bell operating companies provide local telephone service, 46 had not as of that time frame received Section 271 authority. Thus, HLS had a wide range of choices for their "control states." Had they selected different "control" states, their "comparisons" might well have yielded dramatically different results. For example, if Florida, Wisconsin, Missouri or Kentucky were used instead of Pennsylvania and California as the "control states" for New York and Texas, then rather than indicating "consumer-welfare benefits" of BOC entry, one would instead conclude *precisely the opposite* — that BOC entry had *harmed* consumers — since the price decreases in these *non-271 states* was significantly greater than for either New York or Texas.

Table 2

Savings on InterLATA Bills for the Average Customer in Alternate "Control" States

Kentucky and Florida

	Avg Mins KY 2H00	Avg Price KY 2H99	Avg Price KY 2H00	Avg Mins FL 2H00	Avg Price FL 2H99	Avg Price FL 2H00
Peak (7am-7pm wkdys)	41	$0.22	$0.10	46	$0.20	$0.11
Off Peak (7pm-7am weekdays & Sat.)	39	$0.17	$0.07	59	$0.14	$0.09
Off Peak (Sunday)	17	$0.14	$0.06	29	$0.12	$0.08
Fee (MRC)		$1.06	$3.43		$0.99	$2.10
Total Bill		$19.33	$11.24		$21.76	$14.92
Total Savings			$8.09			$6.84
Savings as Pct of Total			72.03%			45.88%
NY Savings ($)			$2.39			$2.39
NY Savings (%)			20.26%			20.26%
TX Savings ($)			$2.08			$2.08
TX Savings (%)			17.96%			17.96%

Missouri and Wisconsin

	Avg Mins MO 2H00	Avg Price MO 2H99	Avg Price MO 2H00	Avg Mins WI 2H00	Avg Price WI 2H99	Avg Price WI 2H00
Peak (7am-7pm wkdys)	24	$0.23	$0.10	46	$0.23	$0.10
Off Peak (7pm-7am weekdays & Sat.)	30	$0.16	$0.08	75	$0.16	$0.08
Off Peak (Sunday)	13	$0.11	$0.10	25	$0.11	$0.10
Fee (MRC)		$2.14	$2.59		$2.02	$2.75
Total Bill		$14.12	$8.92		$27.71	$16.33
Total Savings			$5.19			$11.39
Savings as Pct of Total			58.19%			69.73%
NY Savings ($)			$2.39			$2.39
NY Savings (%)			20.26%			20.26%
TX Savings ($)			$2.08			$2.08
TX Savings (%)			17.96%			17.96%

From my inspection of the TNS bill harvesting data for all states that was provided to me by AT&T, it is clear that there is *enormous variation* from state-to-state in the percentage and absolute dollar change in average rate per minute between the 2H99 and 2H00 rate periods. There are a number of reasons why this variation is present, reasons that have nothing to do with BOC entry or lack thereof. One particularly important source of difference results from the *timing* of access charge reductions in each state. For example, California intrastate access charges were subject to substantial decreases as a result of two CPUC rate rebalancing decisions that took effect in 1995 and 1998, respectively.[9] The corresponding decrease in Texas access charges did not occur until the 1999-2000 time frame, following an act of the Texas legislature requiring the reductions and flow-through in retail intrastate long distance rates.[10] On August 9, 1999, the Texas PUC voted (in Dockets 18515 and 18516) to reduce intrastate access charges for all ILECs by a weighted average of approximately $0.05 per minute (both ends). As shown on Figure 2, for the first nine months of 1999, the combined Southwestern Bell originating and terminating switched access rate was 11.89 cents. Following several reductions, by July of 2000, the beginning of the "post-entry" 2H00 period presented in the HLS study, those rates had dropped to 5.66 cents. Verizon's rates over that same period went from 12.72 cents down to 3.25 cents.[11]

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9. California PUC, I.87-11-033, *Alternative Regulatory Frameworks for Local Exchange Carriers*, Implementation and Rate Design phase, Decision (D.)94-09-065, 56 CPUC 2d 117 (1994); *Re: Pacific Bell*, A.97-03-004, D.98.07-033, 187 PUR 4th 120 (1998).

10. Texas Sen. Bill 560 (1999).

11. Texas Public Utilities Commission, *Report on Switched Access Charges*, December 29, 2000, Chapter 1, "Recent Changes in Access Charges."

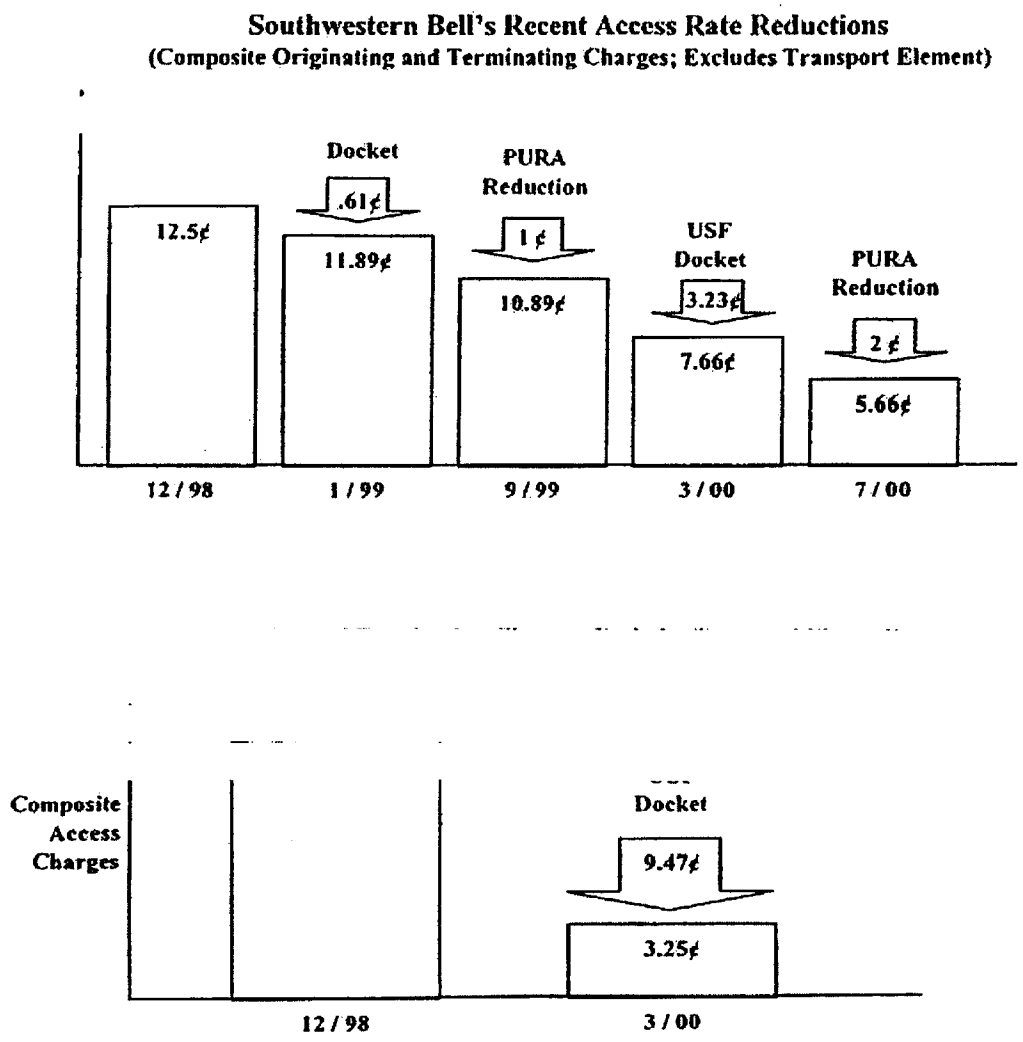

Figure 2. Recent reductions in Texas intrastate switched access charges. Source: Texas Public Utilities Commission, *Report on Switched Access Charges*, December 29, 2000, Chapter 1, "Recent Changes in Access Charges."

There is also considerable variation in access charge rate level, and hence retail toll rate levels, from state to state. For example, according to HLS' Table 4, peak period rates in Texas decreased from 19.3 cents to 14.4 cents between 2H99 and 2H00. But that same table also indicates that peak rates in California *started out* in 2H99 at only 14.9 cents, dropping to 13.7 cents a year later. Obviously, Texas had much further to go than California, so it's hardly surprising that the percentage and dollar reductions were greater. Yet another factor influencing the average interLATA rate is the relative mix of intraLATA vs. interLATA and intrastate vs. interstate calling. The size of the local calling areas, and the number and geography of LATAs is also a key factor. New York has much larger local calling areas than Pennsylvania, whereas calling to northern New Jersey, which represents a substantial portion of the New York City metropolitan area, is interstate interLATA. Texas has large flat-rate local calling areas covering, in each case, entire metropolitan areas. By contrast, California, whose metropolitan areas are far more expansive than those in Texas, limits flat-rate local calling to a 12-mile band. All of these factors have a material impact upon price level and the nature of price changes, *yet HLS did not control for even a single one of them in their "model."*

As I have previously noted, while the reductions in access charges at both the interstate and intrastate levels have been and continue to be the largest single factor in driving down long distance prices, there is no "access charge" explanatory variable in the HLS model. The omission of this critically important variable renders all other model results entirely spurious.

Indeed, whereas in the "discrimination" model the authors admit to an R^2 of 1.4%,[12] in their "consumer-welfare benefits" model they do not even disclose the R^2 at all, suggesting that it is probably even lower than 1.4%!

For example, the roughly 3-cent drop in the average price of long distance calling in Texas between 1999 and 2000 that HLS report and that they seek to ascribe to SBC's entry into the long distance market is *entirely attributable* to an average decrease of slightly *more* than 3 cents in intrastate and interstate access charges that occurred in Texas in that same time frame.[13]

HLS's choice of time periods — which ended as of the second half of 2000 — is particularly noteworthy in light of the fact that, in February 2001 – *immediately following the*

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12. Hausman/Sidak, at 16.

13. SWBT's access charges decreased by approximately $0.035 per minute; Verizon (GTE) by about $0.096 (terminating by $0.067). From 2H99 to 2H00, interstate switched access charges dropped by about $0.01, for a weighted average decrease (for intrastate calls originated on SWBT phones) of approximately $0.031 per minute. HlS identify average savings per Texas customer at $3.04 with average usage of 97 minutes, representing an average price decrease per minute of $0.0313, *almost exactly the same as the decrease in access charges.* Hence, essentially *all* of the price decrease that authors ascribe to "BOC entry" in Texas is entirely attributable to reduced access charges, *which the authors chose to exclude from their model and causality analysis.* With respect to the "control" state for Texas — California — the authors identify virtually no price change for California between 2H99 and 2H00 (the total LD bill is shown as decreases by $0.098 for the same 97 minutes of usage, or about $0.001 per minute. California *intrastate* access charges were reduced in 1995 and again in 1998, but during the 2H99-2H00 period remained essentially unchanged, and *interstate* access charges decreases by about $0.01, for a weighted average decrease of around $0.004.

end of the HLS "study period" — SBC increased its Texas long distance rates by between 1 and 2 cents a minute – erasing nearly half of the access charge driven rate decreases that had occurred in the previous year.[14] By limiting their "study" to 1999 and 2000, HLS conveniently *leave out* that large rate increase that SBC had put through following its long distance entry. The HLS study also conveniently omits any mention of the increases in *local* rates that occurred in Texas since SBC started selling long distance service. For example, Southwestern Bell increased monthly rates for popular features like Caller ID from $4.95 to $7.00 between January 1, 2000 and January 1, 2002.[15] During that same period, SBC's Texas rates for Call Forwarding and Three-way Calling went from $2.10 each to $5.00 each, and SBC increased its local directory assistance rate from $0.30 to $1.25.[16]

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14. "SW Bell raises interstate rate; current subscribers unaffected; PUC approval not needed," *Ft. Worth Star-Telegram*, February 2, 2001:

> Southwestern Bell announced it was raising the interstate rate on its flagship plan from 9 cents a minute to 10 cents a minute for new customers seven months after entering the long-distance market in Texas. Current subscribers will see no change in their domestic U.S. calling charges, said Shawn Ramsey, a San Antonio-based spokeswoman for Southwestern Bell, a unit of SBC Communications.
>
> Ramsey defended the increase, which doesn't require approval by the state's Public Utility Commission, by saying the plan is superior to many offered by the major long-distance services. "We beat the pants off of them," she said. "We've got great rates any way you slice or dice it." Asked if the higher rate reflects a need to boost profits, she said: "We've been in the market about eight months now. We've learned a lot and made a number of changes that reflect what we've seen. And we've changed our plan accordingly."

15. SWBT-Texas General Exchange Tariff, Sec. 10, Sheet 9, Revision 3, Eff. August 26, 1998; Revision 7, Eff. January 17, 2002.

16. *Id.*

Conclusion

Hausman/Leonard/Sidak provide no credible support for the purported "consumer-welfare benefits" they seek to ascribe to BOC entry into the in-region interLATA long distance market in New York and Texas. The "econometric model" omitted access charges — the single most important explanatory variable affecting the price of long distance service — as well as other potential sources of differences in individual state pricing and usage attributes. Their selection of "control states" against which to "compare" outcomes for New York and Texas was arbitrary and entirely results-driven, inasmuch as decidedly opposite conclusions regarding consumer-welfare benefits would have been obtain had HLS selected Florida, Wisconsin, Missouri or Kentucky — or possibly others — as their "control states." Calculations of rate changes for the "control states" that were selected by the authors — Pennsylvania and California — incorrectly utilized New York and Texas usage characteristics rather than usage attributes for the "control states" themselves. No sources were provided for the data upon which the HLS "model" was based, and customers with more than one telephone line or who changed long distance companies during the billing month used for the sample were inexplicably — and improperly — eliminated from the sample data. It is not clear whether the HLS dataset includes or excludes international usage, nor is there any indication as to how the monthly fee was handled if the particular calling plan to which the customer subscribed also included discounted international calling.

There is simply no valid scientific basis for HLS's attempt to ascribe the lower long distance rates that existed in 2000 vs. 1999 to BOC long distance entry, and their convoluted

effort to advance such a theory is devoid of credibility and fails entirely to demonstrate that BOC entry into the in-region long distance market is in the public interest.

Bullet points re Hausman/Leonard/Sidak "Benefits of BOC Entry" paper

- The *single most important source* of the decreases in long distance prices is the FCC-requires decreases in "access chargesm" the fees that long distance companies pay to local phone companies to connect their long distance networks to the phone companies' local subscribers.
    - For example, the roughly 3-cent drop in the average price of long distance calling in Texas that Hausman *et al* claim to have taken place between 1999 and 2000 is *entirely attributable* to an average decrease of slightly more than 3 cents in intrastate and interstate access charges that occurred in Texas in that same time frame.
    - Access charges have been dropping steadily since the break-up of the former Bell System in 1984. That, along with unprecedented technological innovation in telephone switching and long-haul transmission technologies and the growth of an intensely competitive long distance market, has pushed down the *real* (inflation-adjusted) price of long distance service by *more than 80%* since 1984 *without BOC entry into the long distance business*. By contrast, the inflation-adjusted prices of *monopoly* local phone service have remained largely unchanged over that same period.
    - Incredibly, despite the *central role* that access charge reductions have played in bringing down the price of long distance service, the Hausman *et al* "study" omits entirely this critically important explanatory variable from its economic analysis.
- Hausman's selection of so-called "control states" (Pennsylvania for New York; California for Texas) and his choice of the 1999-2000 time frame are entirely arbitrary and self-serving.
    - During the 1999-2000 time frame, there were *forty-five states* in which the Bell Operating Company (BOC) was still prohibited from entering the long distance business. Hausman offers no particular basis for his selection of Pennsylvania and California as "control states" to be used as a basis for comparison with the "Section 271 states" of New York and Texas.
    - For example, there were large long distance rate reductions – due primarily to lower access charges – in **LIST STATES** during that same time frame.
    - On January 1, 2001 – *immediately following the end of the Hausman et al "study period"* – SBC *increased* its Texas long distance rates by between 1 and 2 cents a minute – erasing nearly half of the access charge driven rate decreases that had occurred in the previous year. By limiting his "study" to 1999 and 2000, Hausman conveniently *leaves out* that large rate increase that SBC had put through following its long distance entry.
    - The Hausman study also conveniently omits any mention of the increases in *local* rates that occurred in Texas since SBC started seeling long distance service. For example, Southwestern Bell increased monthly rates

for popular features like Caller ID Name & Number from $6.50 to $9.50 between Jan. 1, 2000 and Jan 1, 2002. During that same period, SBC's Texas rates for Call Forwarding and Three-way Calling went from $2.10 each to $5.00 each, and SBC increased its local directory assistance rate from $0.30 to $1.25.

- There is no way to verify the accuracy of the results that Hausman *et al* report.
  - No source is identified for the "billing data" that the authors claim to have studied in reaching their conclusion.
  - The source data itself has not been provided.
  - Important statistical test results, such as the "coefficient of determination" that indicates the overall explanatory power of the Hausman analysis, has not been provided. In another Hausman study of long distance pricing that was published in January, the value for this statistic is given as 1.4% — which means that fully *98.6 percent* of the variation in the dependent variable in that model is *unexplained.* Since no corresponding value was provided in the present study at all, one can reasonably *assume* that it is even lower than 1.4%!
  - The authors inexplicably "eliminated households with more than one telephone line and households that switched service providers during the billing cycle" but provide no justification or rationale for deliberately selecting-out such customers. Customers who switch carriers or who have two phone lines may be above-average users who are also more aware of the various pricing options, and are the most likely to have been on a discount plan to begin with.
- There is no valid scientific basis for Hausman's attempt to ascribe the lower long distance rates that existed in 2000 vs. 1999 to BOC long distance entry.
  - The study ignored the *real cause of the lower rates* – lower access charges.
  - The authors' choice of time frame and "control" states was not representative and produced highly selective and distorted results.
  - The exclusion of certain more price-sensitive customers from the sample had no basis, and introduced a bias in the data that tended to exaggerate the apparent differences between 1999 and 2000.
  - The authors misrepresent the change in *local* rates between 1999 and 2000 by conveniently omitting certain rates that were increased by the BOCs during that same period.