

## The Imperative to Reduce Access Fees

From the time of divestiture through the 1980s, access fees typically represented half or more of a long-distance carriers' cost structure. That meant roughly 50 cents of every dollar paid to a long-distance company was, in turn, paid to an ILEC. A long-distance carrier incurs access charges for each circuit it supports and for each long-distance call that a customer makes. Each customer location is served by a local phone company, which charges the long-distance companies to both originate and terminate long-distance calls to/from the customer. The rates charged for this access to and from the local network were set artificially high at divestiture to help the local companies support universal service, mimicking the subsidies provided from AT&T's long-distance service to the local companies pre-divestiture.

Access charges apply equally to residential and business long-distance services, but businesses generate more than half of the long-distance revenue in the U.S. market and generated as much as two-thirds in recent history. Therefore, they generate most of the access fees.

Early after divestiture, there were few ways around incurring access fees in the competitive long-distance business because the Bells owned the monopoly local service franchise. But access fees were so large that even the smallest percentage reductions resulted in huge dollar savings.

Early efforts to combat high access fees ranged from simply disputing bills to detailed audits of access charges. The long-distance companies knew that the access charge regime was set up hastily at divestiture and the RBOCs built the systems to bill for access very quickly. But more importantly, the source data used for billing the new long-distance carriers was taken from pre-divestiture systems that were not originally designed to support access requirements. Why was the source data of such low quality?

Before the competitive market opened, the Bells were regulated in most cases on a rate-of-return basis. This meant that, in order to provide reasonable returns to investors, the Bell companies' rates were set so as to provide for profits that would amount to a certain percentage of the asset base of the companies. In this way the investors who, in theory, paid to build the assets would see regular, but not excessive returns.

In a rate-of-return environment, though, a larger asset base means that the company can make more profit, since rates are set to guarantee the return. More assets means higher rates which drive higher profits. The Bells thus made sure that they spent every capital dollar that they could reasonably spend (they were the conservative, regulated Bells, after all) to build the asset base.

The flip side of this mind-set by the Bells was an inability to reclaim assets when service was turned off. The process followed for an order to disconnect service had no feedback loop to ensure that all steps were performed. Since billing was usually the last step in the order flow, any error along the way jeopardized the ability of the process to complete the movement of the order to the last stop on the line and turn off billing. With no incentive to return assets to the "available" pool (that might limit the need to spend capital dollars later), the Bells weren't motivated to build tighter order processes. Obviously certain assets, like outside cable, had such a high cost and immediate effect on service that they needed to be more efficiently reused. But electronics such as those that reside in Bell central offices (the type of assets that accumulated in higher numbers with

the advent of access requirements for the competitive long-distance business) were easy to stockpile before they were needed and conveniently left behind when they were disconnected.

Like the cable companies living with high debt levels (cable company debt levels are discussed in Chapter 8), the RBOCs lived under unique financial rubrics in the days of the walled gardens. In the case of the RBOCs, their unique regulatory environment made increased asset levels okay and, in fact, facilitated increased profits.

The competitive long-distance companies caught onto the fact that the inventory systems used to bill access were weak and that the disconnect processes of the RBOCs were designed to forget assets, not reuse them. The long-distance companies used this information to dispute their access bills.

The story was told by many in the early days of MCI that, for certain access bills with known errors, MCI would pay 90% of the bill and tell the RBOC to sue them for the rest; understanding that it was not cost effective for the Bells to assemble the evidence needed to sue. It was also likely that it would be impossible for the Bells to prove that more than 90% of the charges were valid.

From disputing bills, the long-distance companies moved on to more formal auditing of bills. This came several years after divestiture, though. MCI built its first database to audit access bills in 1989, nearly six years after divestiture. MCI's perpetual cash starvation prevented them from taking care of the problem earlier. Merely loading the bills into a relational database and applying simple algorithms to identify audit candidates was a step forward at the time. The project cost less than \$5 million and was said to pay for itself in less than 30 days after installation. MCI's bill for access that year was \$3.5 billion.

Later, the long-distance companies combated high access costs by building their own local facilities. These efforts didn't have the financial returns of disputing bills, though. Building local network required much regulatory work before the '96 Act because the Bells' monopoly on local services was, in many areas, government sanctioned. Add the capital outlay required to build the network, and the returns were smaller and more risky because of the extended time to payback. While the '96 Act reduced some of the uncertainty of the regulatory process for any prospective local competitor, it didn't materially shorten the time to revenue from these sorts of investments.

These and other efforts to reduce dollars paid to the RBOCs became part of the long-distance companies' DNA. The possibility of reselling unbundled RBOC network elements, created by the '96 Act, was attractive to the long-distance companies not just for competitive reasons, but also because resold lines were not subject to access fees. The UNE resale opportunity was only available in the consumer and small business market, but the opportunity to avoid access fees was nevertheless a strong incentive for the long-distance carriers to enter the local market. There are few differences in how the network elements are physically assembled for resale vs. access; the main differences are in how they are sold and billed. It is more of an accounting maneuver than a real distinction. But tens of billions of dollars were at stake in the competitive battle for the customer that was about to be waged.