

Local Telephone Competition Still on Hold

Monopoly Phone Companies and High Cost Pre-Paid Service Dominate Residential Market Five Years After Launch of Competition

In Brief

As the fifth anniversary of the signing of the Federal Telecommunications Act (FTA) approaches, Texas consumers find the promise of competition in the local telephone market all talk, and no savings. Indeed local phone bills are higher, rather than lower, for consumers who use minimum service. These findings are striking, considering Texas is one of only two states to have its local phone market pass the federal "checklist" as being sufficiently open to competition.

On December 16, 1999, Texas Public Utility Commission (PUC) Chairman Pat Wood III declared "this market is open" and "competitors have a meaningful opportunity to compete." Commissioner Brett Perlman predicted that "Texas will be the most competitive market for local phone service."¹

However, more than a year after those bold predictions, five years after the federal law, and nearly six years after passage of a state law to promote competition for local telephone service, there are few companies emerging as true competitors to incumbent Southwestern Bell Telephone (SWBT). This lack of local telephone service competition in Texas leaves local monopoly providers and their rates largely unchallenged.

Local telephone books continue to list dozens of companies as "Local Service Alternatives." However, most of the companies surveyed by Consumers Union Southwest Regional Office do not provide competitive basic service to the typical household.

Instead, they target high revenue users like business customers or select high-usage residential customers. Or they target low income people and those with credit problems, selling them very costly prepaid service.

Meanwhile, those consumers who use

only basic service and a few add-ons have seen increases or new fees and surcharges on their phone bills. In 1999 the Texas Legislature granted the monopoly phone companies the flexibility to increase rates for many services without approval of regulators. Since then, Southwestern Bell has raised prices several times for those services. For example, in June 2000 SWBT increased its monthly rates for residential Caller ID services in a range of 22% to 30%.² And most consumers have little real opportunity to reject such increases by switching to a different local phone company.

Local Service in Texas

In September 1995 the Texas Legislature amended the Public Utility Regulation Act (PURA) in HB 2128 to open up the local telephone market to competition, primarily for long distance and cable companies. The next year, Congress fully opened the door to competition for local telephone service in the United States when it passed the Federal Telecommuni-

Many Companies, Little Competition

Of 46 companies surveyed:

- 21 supply only high cost prepaid service.
- 10 supply local phone service to business customers only.
- 9 are no longer in business or bought out by other companies.
- 2 supply only bundled service to high end telecommunications users or services to selected developments.
- 3 companies have started to offer basic residential phone service, one of them in San Antonio only.
- 1 company was SWBT.

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cations Act of 1996 (FTA). This law introduced local competition on a nationwide basis and established requirements for Bell companies to get back into the long distance business.

Supporters of local service competition argued that encouraging vigorous competition in local service would reduce prices and increase the quality and array of services. Those competitors offering substandard or overpriced services would, in theory, suffer loss of market share, thus allowing the market to “protect” consumers. Therefore, after a transition period, consumers would be protected from high rates and a declining infrastructure by competition in price and service rather than by traditional rate regulation. During the transition, the price for local phone service offered by SWBT and Verizon (GTE) is “capped.”

As an incentive for cooperating in opening up their former monopoly market, the FTA permitted the “Baby Bells” to once again offer long distance service packaged with their local service (the very situation which existed prior to the “break-up” of AT&T). To win approval to offer long distance, state and federal regulators had to find that the local phone market met a “checklist” of criteria which would enable competitors to enter the market. Only Texas and New York state have met this test thus far.

Consumers Union Study

The objective of this study is to examine the market for residential phone service in Texas. To accomplish this, Consumers Union surveyed 46 local residential telephone companies in six major Texas markets (Dallas, Fort Worth, Austin, San Antonio, Houston and El Paso).

CU surveyed companies listed as “local service alternatives” in area phonebooks and companies that advertise in local newspapers and classified papers (“Greensheet” from Greensheet, Inc.).

CU called companies as any normal consumer would, and asked questions related to price and service that any informed consumer might ask. CU asked for basic local rates, installation fees, optional services, credit requirements, and charges for changing address. We compared this information to SWBT prices

and services in each region.

Overall Findings

Very few companies in Texas compete for residential customers nearly five years after telephone deregulation.

Consumers Union found that the much-anticipated competitive market for local telephone service still has not emerged despite SWBT’s entry into the long distance market.

Of the 46 companies surveyed from local phonebooks and classifieds in the six markets studied, 22

percent or 10 companies tell us they serve business customers only.

Nearly half (45 percent or 21 companies surveyed) of companies that have emerged to provide local residential service target low-income customers or people with a poor credit history and provide pre-paid basic service at a price substantially above the capped local SWBT rate.

Of the handful of companies in our major cities that do provide basic residential service at prices competitive with SWBT (5 companies), two do not offer basic service to all consumers. For example, En Touch Systems only markets service to new housing developments or apartment complexes. If you don’t live in selected developments you cannot subscribe. Westel, only offers service in the Austin area and requires bundled services. This company competes primarily for the higher income households that spend more for additional services.

A Faltering Market

In April 2000, the PUC reported that, “several large carriers, including Sprint, AT&T and MCIWorldcom, have begun to ramp up their statewide efforts to service all customers in the Texas market. These developments are dramatic evidence that competition is here and it is here to stay.”³ Indeed, this month in its biennial report to the Legislature the PUC concludes business customers have a variety of competitive alternatives, and their options are growing. However, for residential

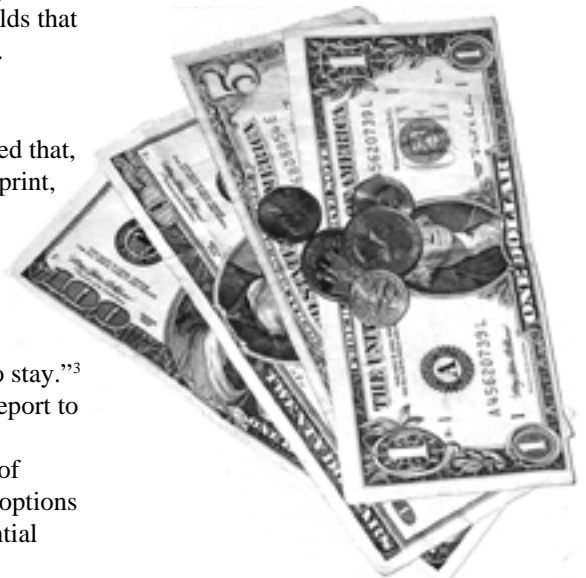
customers, the forecast is cloudy, “Whether residential and rural customers will have sustainable competitive choice in the near future is less certain.”⁴

In November 2000, the Sprint Communications Company announced that it was ceasing to offer residential phone service to new customers in Texas.⁵ AT&T and MCI Worldcom initiated marketing campaigns to reach consumers last year. Yet they too have pulled back on their marketing to residential customers.⁶ AT&T has been the subject of a growing number of service complaints filed with state regulators. Most typical are billing problems, which are not only frustrating, but have resulted in consumers paying more for service than they bargained for.⁷

Further, ChoiceCom and Westel, two new competitive local providers that entered the Texas local telephone market in the summer of 1998 have discontinued operations and restricted operations to Austin respectively.⁸ Of the 46 companies surveyed, fully nine were no longer in business by the time we called them. They had either been bought out by another company (2 companies) or the line was disconnected and they could no longer be found at all (7 companies).

Prepaid Service

Since FTA was passed in 1996, a number of companies have expanded the local residential market by providing service to customers previously not served by Southwestern Bell. These new customers include individuals whose phone service has been disconnected due



Many Companies Compete to Provide High Cost Pre-Paid Service

(all prices quoted over the phone during a two week period, September 2000)

Company	Service Area	Type of Service	Basic Service	Install Fee	Call Waiting	Call ID	3-Way	Other Features	Credit Check	Pre-Paid	Cash	Checks
American Telephone	A	local	\$39.00	\$40.00	\$5.60	\$13.00	\$4.20	most	no	yes	yes	yes
Basic Phone	AH	local	\$43.00	\$20.00	\$5.66	\$11.33	\$5.66	most	no	yes	yes	no
DMJ Communications	DFH	local	\$39.00	\$-	\$10/\$5	\$15/\$10	\$5/\$5	most	no	yes	yes	no
Fast Connections	FW	local	\$49.95	\$39.00	free	Not Avail.	free	few	no	yes	yes	no
Go Comm	DF	local	\$49.00	\$10.00	\$5.00	\$10/\$10	\$5.00	most	no	yes	yes	no
Phone Reconnect of America	ADEFSH	local	\$49.95	\$43.95	\$5.00	\$5.00	\$5.00	most	no	yes	yes	no
Teleco USA, Inc.	ADEFSH	local	\$29.95	\$38.35	\$4.99	\$9.99	\$4.99	most	no	yes	yes	no
Texas Home Tel	DFS	local	\$43.00	\$30.00	free	\$10.00	\$10/\$5	none	no	yes	yes	no
Express Telephone Service	ADFHS	local	\$25.94	\$59.00	\$5.00	\$10.00	\$5.00	most	no	yes	yes	no
Millenium One. Com	ADFH	local	\$25.99	\$49.99	\$5.00	\$10.00	\$5.00	most	no	yes	yes	no
Texas Teleconnect	FD	local	\$39.00	\$20.00	\$5/\$5	\$10/\$9.95	\$5/\$5	most	no	yes	yes	no
PCS (Preferred Carrier Services)	A	local	\$49.99	\$20.00	<i>Package Only--\$15.00 all services</i>			most	no	yes	yes	no
Comtel	AEHS	local	\$46.28	\$32.16	\$5.12	Not Avail.	\$4.45	most	no	yes	yes	no
E Z Fon	DF	local	\$39.00	\$10.00	\$5.00	\$10/\$10	\$5.00	most	no	yes	yes	no
Uni Communications	F	local	\$42.00	\$20.00	\$5.00	\$10.00	\$5.00	none	no	yes	yes	yes
Progressive Concepts	DF	local	\$39.00	\$40.00	\$2.80	\$7.95	\$3.00	most	no	yes	yes	no
Telephone Service Co.	ADF	local	\$45.00	\$20.00	\$5.00	\$15.00	\$5.00	all	no	yes	yes	no
Cytel	H	local	\$22.95	\$46.70	\$7.00	Not Avail.	\$7.00	most	no	yes	yes	no
Local Telephone Service Co.	H	local	\$45.00	\$20.00	\$5.00	\$15.00	\$5.00	most	no	yes	yes	no
SouthWest Teleconnect	AS	local	\$39.00	\$20.00	free	\$20/\$10	\$10/\$5	most	no	yes	yes	no
Lone Star State Telephone Co.	AS	local	\$52.30	\$-	\$4.00	\$10.00	\$4.00	most	no	yes	yes	no
Average			\$40.68	\$27.58					100%	100%	100%	90% no

*Service areas include: Austin, Dallas, El Paso, Fort Worth, Houston and San Antonio.
 **Other Services: "All" includes voicemail, which is often only available from SWB (Call Notes). "Most" includes all other services except voicemail. "Few" includes 4 or fewer optional services.

Competitive Services (all prices as quoted over the phone during a two week period, September 2000)										
Company	Service Area	Type of Service	\$ Basic Service	Install Fee	Call Waiting	Caller ID	3-Way	Other ¹	Credit Check	PrePaid?
Time Warner	S	local, LD, Cable	\$12.95 ²	\$35.00	\$2.75	\$6.25	\$2.00	all	Cable only	no
AT&T	ADEFSH	local, LD	\$15.00	\$54.10	\$3.00	\$7.00	\$3.00	all	Yes	no
MCI Worldcom	ADEFSH	local, LD	\$8.85	\$52.95	\$2.65	\$6.15	\$2.65	all	Yes	no
Westel	A	local, LD	\$24.95	\$20.74	all included				Yes	no
SWBT	ADEFSH	local, LD	\$18-22	\$38.35	\$2.80	\$7.56	\$2.80	all	Yes	no, but prepaid also avail.

¹Other Services: "All" includes voicemail, call waiting, caller ID and 3-way calling.
²Basic service charge quoted over the phone may include mandatory fees and tax.
³PUC reports basic service charge range of \$7.75 to \$10.50.
⁴PUC reports range of \$12-\$16. Prices quoted to us over the phone may include mandatory fees and tax.



a rate that is more than double SWBT rates. Additional fees for phone set-up can be as high as \$59.

Companies that serve this market claim that high rates compensate for the high risks they take by serving a population that has a history of payment default. However, every one of these companies surveyed by CU offer pre-paid services only. Customers pay for monthly service up front. Thus, there is no risk involved. If customers do not pay, they do not get service. Since customers in this segment have few choices, they are forced to pay these higher rates if they want any telephone service at all.

Furthermore, pre-paid customers often endure obstacles getting phone service. For example, customers who want service from Express Telephone Service must go to a designated convenience store to make a "money gram payment" which includes one month of basic phone service and an installation fee for a total of \$78.44. The customer will be connected approximately 5 days later. To continue service, customers must go back to the convenience store each month and make another money gram payment of \$46.28. If a customer discontinues service for one month, he or she must pay the initial \$32.16 start-up fee again.

Competing for the High End Customer

Since local telephone service deregulation, some companies have chosen to target only high revenue residential customers who use many different telecommunications services.

Two companies provide service to specific real-estate developments or apartment complexes. For example, in Austin and San Antonio, Time Warner Connect provides local telephone service to customers in a handful of designated apartment properties. Service is only available to residents, thus granting collective buying power to force low basic rates. However, companies are betting on these more affluent customers to purchase a whole package of more expensive, bundled services including optional telephone features, cable television and long distance.

En-Touch Systems of Houston has entered local market through exclusive contracts with new residential housing developments. Each housing community has its own provider, such as Sienna Technologies (which serves Sienna Plantations), but all are owned by En-Touch Systems. The "captive" customers of these more affluent new communities (homes ranging from \$140,000 to \$440,000)⁹ are also likely to purchase expensive premium services.

to payment problems, customers with bad credit, and those without social security numbers or who do not want to provide their social security number.

Consumers Union found that more than three quarters of the companies actually providing residential service in six large Texas metropolitan areas provide services to customers in this segment only. By accepting customers rejected from the monopoly phone company, these companies are not actually competing with SWBT and Verizon (GTE) basic services.

Although this new market enables these customers to get phone service, access to such phone service is not cheap. Companies in this segment charge, on average, \$40 per month for basic service,

Companies also target services toward premium package buyers by bundling services. Although most offer basic service at competitive rates, they tend to market higher-end package deals. For example, Sienna Technologies' packaged deals range from the "basic value" package that includes long distance, basic cable, a fire and burglar alarm, and call waiting for \$55.62 per month to a "Maximum Value" package that includes 13 optional calling features, long distance, premium cable, and a fire and burglar alarm for \$114.81 per month.¹⁰

Conclusion

By deregulating the telephone market and allowing competition, the Texas Legislature and Congress hoped to allow market forces to decrease prices, increase the number of new providers, and speed the deployment of new telecommunications services. But the opposite has happened. Competitors offering residential service are pulling out of the market. Without any competitive check and balance, Southwestern Bell has used the 1999 law to raise prices for commonly used optional services.

For example, a call to 1-411 Directory Assistance cost \$.30 per use in 1999 but now costs \$.75. To use Directory Assistance and then have the call connected once cost \$.60, and now costs \$.80. Three way calling and call forwarding increased from \$2.10 to \$3.00. Rates also increased for auto redial, caller ID, call blocking, and call return (*69).¹¹ New or increased fees and surcharges have been added to the bottom line of phone bills in order to reduce prices for high volume long distance customers.

To date, only customers who live in selected developments or apartment complexes, particularly higher income customers interested in bundled services, might see lower rates.

A recent Consumers Union/Consumer Federation of America national study shows that almost half of all residential phone customers nationwide are not these "bundled", high-end users. Instead they have only one phone line, few enhancements (call waiting, caller ID, voicemail etc.), no Internet account and do not own a cell phone.¹² Local telephone competition in Texas has brought very few alternatives for these customers. Instead, they are

subject to rate increases as the monopoly phone and cable companies add fees and reshuffle services.

While the PUC's report had similar findings, several of its recommendations favor competitors over consumers. Of most concern is the PUC's suggestion to lift the current price cap and raise local phone rates. Prices were "capped" to protect consumers during a transition to competition. It can't be denied that the higher the price the more likely it is that another company will want to serve residential customers. The question is whether it is good public policy to increase prices in order to help new market entrants earn more money. We think that's a bad public policy.

Recommendations

- Maintain the current price cap. Reconsider the deregulation of basic local phone service prior to the expiration of the price cap in 2005. Continued price regulation of local telephone services must be maintained for each segment of the market and area of the state that does not have effective competitive alternatives for residential phone service. Effective competition means there are numerous competitors offering comparably priced basic service on a stand alone basis (in other words, if the good rates are only available in package deals then low-use consumers do not have real choice).
- State law must make it a priority to keep monthly bills affordable. That means stemming the tide of add-on fees, surcharges, and optional service price increases, many of which are nothing more than rate increases in disguise. For most consumers, the new surcharges on

bills are not offset by promised reductions in competitive prices.

- The PUC must have authority to ensure the prices of bundled services or packaged services, or any competitive services are not being subsidized by basic service prices.
- Support initiatives to bridge the digital divide, including programs to provide advanced service in rural Texas and to lower-income households.
- To ensure access to reasonably priced phone service for low income customers, prohibit disconnection of basic phone service when customers make partial payments on their phone bill. Customers who keep up the basic payment would lose access to other services for which a debt is owed. Current law now prohibits local service disconnection for non-payment of long distance. The law must be expanded to include other optional services.
- Offer all consumers free or low cost options for controlling phone bills, such as blocking or setting limits on long distance usage. These should be options the customer chooses, rather than choices forced on customers perceived as bad credit risks.
- Do not once again lower long distance "access" charges and permit phone companies to turn around and make up for it by raising prices on residential services or by adding or increasing surcharges on bills. Currently the law allows phone companies to make up virtually any lost revenue through new surcharges on customers. Companies with "overearnings" should not be permitted to draw money from the universal service fund.



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Endnotes

¹ News Release, "PUC Gives SWB Long Distance Full Support," PUC of Texas, released December 16, 1999. Brief in Support of Application by SBC for Provision of In-Region Interlata Service in Texas, Quoted statements of Pat Wood, January 10, 2000, p. 6.

² Public Utility Commission of Texas. Scope of Competition in Telecommunications Markets of Texas. Report to the 77th Texas Legislature. January 2001. p. 64.

³ The Evaluation of the Public Utility Commission of Texas, CC Docket No. 00-65, In re Application of SBC Communications, Inc. Pursuant to Section 271 of the

Telecommunications Act of 1996, April 26, 2000, p. 5.

⁴ PUC Report, pg. ix.

⁵ PUC Report. p. 61.

⁶ PUC Report. p. 58-59.

⁷ Dallas Morning News. *Problems mount with AT&T's service.* January 18, 2000.

⁸ Telephone interviews with companies November 2000.

⁹ Accessed via Internet at <http://www.siennaplantation.com/homes>.

¹⁰ Accessed via Internet at <http://www.siennaplantation.com/technologies>.

¹¹ Texas Senate Bill 560 provided incumbent local exchange companies

(ILECs) with pricing flexibility. SWBT raised prices on all but a few of its calling options. Prices were reduced for priority call (a distinctive ring for calls from designated numbers), personalized ring for second number on a single line, and call trace. Public Utility Commission of Texas, 2001 Report on Scope of Competition in Telecommunications Markets of Texas, Table 21, SWBT Price Changes Made Under SB 560, p. 64.

¹² Cooper, Mark. The Digital Divide Confronts the Telecommunications Act of 1996. Consumers Union/Consumer Federation of America. February 1999.

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