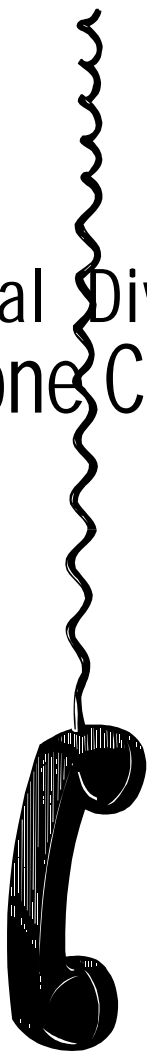


Texas Digital Divide: Telephone Competition Promise Falls Short



In Brief

New telephone companies in Texas are not competing to provide local phone service to the average household. Although the phone book lists dozens of companies as “Local Service Alternatives,” most of the companies surveyed by Consumers Union Southwest Regional Office do not provide basic service to the average person.

Instead, they target high revenue users like business customers or select high-usage residential customers.

Or they target low income people with very costly prepaid service.

This niche marketing creates a digital divide that ultimately threatens the universal access Texans have always enjoyed.

The Digital Divide

Consumers Union and the Consumer Federation of America released this month a national study of this “digital divide.” According to the authors, a scramble for the high-end customer will ensure that neighborhoods with the highest usage see infrastructure investment while others may not. Meanwhile, “the majority of consumers face price increases for many essential telephone and TV services offered under monopolistic conditions.”¹

Consumers Union Southwest Regional Office found, in this follow-up analysis, that the “digital divide” in Texas is intensified by the rapidly expanding market for very expensive pre-paid service marketed primarily to lower income consumers or consumers with a poor credit history. This is not the picture of a competitive telecommunications market painted by proponents of deregulation in 1995 and 1996.

The Assumptions of
Telecommunications Competition
In September 1995 the Texas Legislature passed an amendment to the Public Util-

ity Regulation Act (PURA) to open up the local telephone market to competition, primarily from long distance and cable companies. Congress passed the Federal Telecommunications Act (FTA) one year later in 1996 to foster competition in local markets nationwide. Both state and federal lawmakers told consumers that encouraging vigorous competition in local service would reduce prices and increase the quality and array of services.

State and federal lawmakers assumed that, 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. Both state and federal telecommunications deregulation acts also assumed that certain actions by the monopoly telephone companies to reduce barriers to competition would directly result in competitive markets. Former Baby Bells, like Southwestern Bell (SWB) in Texas, are required to initiate fourteen “market opening” reforms. In return for compliance they can enter the long distance market.

Unfortunately, the “14 point checklist” does not include the existence of actual local phone competition. Although the PUC recently announced that SWB has fully met ten of the 14 items required to enter the long distance market,² it still serves 98 percent of the Texas local phone service market.³

With negligible price competition, residential rates continue to increase. Although residential phone rates in Texas are capped at 1995 levels until September 1999, rates have in fact increased due to the addition of new fees and surcharges. Consumers are (or soon will be) paying new fees for extended local calling service and “number portability”. In some cities consumers are paying more due to “rate group reclassification”. And the costs of universal service programs, previously paid through long distance and other rates, are now surcharged on the local

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residential bill.

At the same time, the expense of building out infrastructure to compete for the average family telephone account has prevented others from entering the market. Instead of building alternative infrastructure, most phone companies purchase line access and operator service from SWB.⁴ They then target specialized markets where they hope to generate significant revenue from a small number of customers.

Consumers Union Study

To assess the strength of competition in local markets, Consumers Union conducted a survey of local residential telephone companies in six major Texas markets (Dallas, Fort Worth, Austin, San Antonio, Houston and El Paso). Over a two week period last fall, CU surveyed companies listed as "local service alternatives" in area phonebooks and companies that advertise in the "Greensheet". 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, service and portability for 36 companies. We compared this information to SWB rates and services in each region.

Overall Findings

Very few companies compete for residential customers today. Although over 200 companies have registered with the PUC to provide local service in Texas, Consumers Union found that very few are actually providing competitively priced basic residential services that a consumer can find.

Of the 36 companies listed as local residential service providers in local phonebooks and classifieds in the six markets studied, 17 percent (6 companies) serve high volume business customers only or have opted to provide long distance services only.

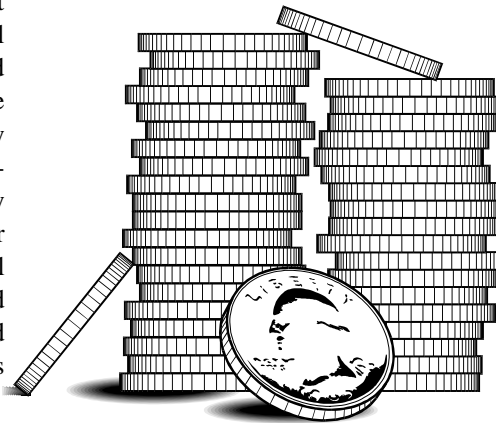
More than half of companies surveyed (22 companies) target low-income customers or people with a poor credit history and provide pre-paid basic service at a price far above the capped local SWB rate.

Of the handful of companies that do provide residential service at prices competitive with SWB, three companies only provide service to new housing developments or apartment complexes. If you don't live in selected developments you cannot subscribe.

One company offers residential service only packaged with other high-end telecom services like ISDN and Internet access time. This company compete primarily for the higher income households who spend significantly on multiple phone and computer services.

Only four companies surveyed compete on price for the average residential customer. Even these companies advertise sparingly or not at all, which makes them practically invisible to the consumer.

Consumers Union reviewed print advertisements in local newspapers over a one month period and identified only one ad for local telephone service—an ad for Southwestern Bell. In fact, only the companies selling pre-paid service advertise widely in



print media. From the perspective of an average consumer, local phone competition is virtually non-existent.

Business Users

When the FTA was passed in 1996, many legislators hoped that long distance carriers entering the local phone market would intensify competition for residential customers. Instead, many of these companies exclusively provide local service to high volume business segment or they opted not to enter local competition at all. Of the thirty-six companies listed as local carriers and surveyed by CU, one company (USLD, found in each of the six markets) listed as a "local provider" actually provides long distance services only. One company (American Telco, serving the Metroplex, Austin and San Antonio) serves business only. Four companies offer long distance service and local service to business only.

Prepaid Service

Since the passage of state and federal telephone laws, a number of companies have expanded the local residential market by providing service to customers previously not served by Southwestern Bell. These customers include individuals whose phone service has been disconnected due to payment problems, customers with bad credit, and those without social security numbers. Consumers Union found that over half of the companies providing residential service in six large Texas metropolitan areas provide services to customers in this segment only. By accepting customers rejected by SWB or GTE, these companies are expanding the market but providing limited competition to the much less expensive monopoly.

Although this new market enables customers without phones to get service, access to such phone service is not cheap. Companies in this segment are charging, on average, \$43 per month for basic service, a rate that is over \$25 per month more than SWB. Additional one-time fees for phone set-up can also be as high as \$69, although many companies set installation fees lower than SWB.

These companies sometimes advertise very low startup costs—a low first month, and no installation fees—but the overall cost remains high. For example, last fall Local Fone Service in Dallas quoted us basic monthly service at \$49.95 with a \$20 installation fee. This week we called again and they have a special: \$21.64 for the first month and the installation fee is waived. But the monthly charge thereafter will be \$58.63 for basic service.

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.⁵

Furthermore, customers in this segment must often go through a lot of trouble to get phone service. For example, customers who want service from Preferred Carrier Services (PCS) must go to a designated convenience store to buy a "phone service card" which

High Cost Pre-Paid Local Phone Service Options Abound in All Markets

(all prices as quoted over the phone during a two week period, October 1998)

Company	Surveyed in these Cities	Basic Service	Installation Fee	Call Waiting	Caller ID	3-Way	Other Features*	Credit Check	Pre-Paid?	Cash	Checks
American Telephone	A S H E F D	\$39.00	\$20.00	\$5.60	\$13.00	\$4.20	all	no	yes	yes	yes
Basic Phone	A S H E	\$41.00	\$20.00	\$5.61	\$10.00	\$5.61	most	no	yes	yes	no
Com Central	F D	\$39.00	\$30.00	\$4.00	\$10.00	\$3.00	most	no	yes	yes	no
Com Tel	F D	\$44.95	\$25.00	\$5.00	\$12.00	\$4.43	most	no	yes	yes	no
DCI	F D	\$39.95	\$0.00	\$5.00	\$10.00	\$5.00	most	no	yes	yes	no
DMJ Communications	F D	\$47.00	\$20.00	\$4.00	\$10.00	\$4.00	most	no	yes	yes	no
Fast Connections (or 1-800-Reconex)	S F A D H E	\$49.95	\$39.00	\$5.00	\$10.00	\$5.00	few	no	yes	yes	no
Golden Harbor (Hometown)	F D	\$39.95	\$50.00	n/a	na	na	none	no	yes	yes	no
Hometown Telephone	S A	\$39.95	\$50.00	n/a	na	na	none	no	yes	yes	no
Kero Communications	A	\$39.99	\$39.99	\$4.00	\$10.00	\$4.00	most	no	yes	yes	no
Local Fone Service	F D	\$49.95	\$20.00	\$5.00	\$10.00	\$5.00	most	no	yes	yes	no
Local Telephone Service Co	A	\$35.00	\$60.00	\$5.00	\$15.00	\$5.00	most	no	yes	yes	no
MaxTel Communications	S H E A	\$44.50	\$29.99	\$8.00	\$12.00	\$5.00	most	no	yes	yes	no
OPC-Telecommunications	S F A D H E	\$39.95	\$48.00	\$5.00	\$10.00	\$5.00	most	no	yes	yes	no
PCS (Preferred Carrier Services)	S F A D H E	\$49.99	\$15.00	na	na	na	none	no	yes	yes	yes
Phone America	F D	\$49.00	\$69.00	free	\$10.00	\$5.00	most	no	yes	yes	no
Smoke Signal communications	F D A	\$53.00	\$43.25	\$5.41	\$10.82	\$5.41	most	no	yes	yes	no
Teleco USA Inc.	A	\$47.50	\$18.50	\$4.99	\$12.99	\$4.99	most	no	yes	yes	no
Texas Home Tel	F D	\$44.00	\$20.00	\$5.00	\$10.00	\$5.00	most	no	yes	yes	no
Tin Can Communications	S F A D H E	\$34.95	\$39.95	\$5.95	\$10.95	\$5.95	most	no	yes	yes	no
Trinity Telephone	F D	\$45.00	\$25.00	\$3.00	\$7.00	\$3.00	most	no	yes	yes	no
US Dial Tone	S F A D H E	\$29.95	\$20.00	\$2.80	\$6.80	\$2.10	most	no	yes	yes	no
Average		\$42.89	\$31.94					100%	100%	100%	91% no

* Other Services: "All" includes voicemail, which is often only available from SWB (the trademarked "Call Notes"). "Most" includes all other services except voicemail. "Few" includes 4 or fewer optional services.

Competitively Priced Services Available to Selected Customers
(Houston prices for comparison except where otherwise noted)

Company	Areas	Services	Basic	Installation Fee	Call Waiting	Caller ID	3-Way	Features	Credit check	Pre-Paid?	Cash	Checks	Limiting Factors
Time Warner*	A S H	local LD cable	\$12.95	\$35.00	\$2.75	\$6.25	\$2.00	all	cable bills only	no	yes	yes	Service provided to limited complexes only
En Touch Systems, Inc**	H	local LD cable	\$9.95	\$25.00	\$1.89	\$4.46	\$1.89	all	yes	no	yes	yes	limited service to new housing developments.
Summerwood Technologies	H	local LD cable and alarms	\$9.95	\$25.00	\$1.89	\$4.46	\$1.89	all	yes	no	yes	yes	limited service to new housing developments.
Sienna Technologies	H	local LD cable and alarms	\$9.95	\$25.00	\$1.89	\$4.46	\$1.89	all	yes	no	yes	yes	limited service to new housing developments.
Coles Technologies	H	local LD cable and alarms	\$9.95	\$25.00	\$1.89	\$4.46	\$1.89	all	yes	no	yes	yes	limited service to new housing developments.
ATT***	D H	local LD	\$16.45	\$38.95	na***	\$6.50	na	most	yes	no	yes	yes	Campden Properties only
Cypress Technologies	H	local LD	\$13.26	\$16.00	\$2.60	\$6.34	\$1.89	all	yes	no	yes	yes	
NTS Communications	A S E	local LD	\$13.50	\$40.00	\$2.80	\$6.50	\$2.10	most	yes	no	yes	yes	need letter of approval
ChoiceCom	S F A D H E	local LD	\$10.10	\$50.00	\$2.80	\$6.50	\$2.10	most	yes	no	yes	yes	
Westel	S F A D H E	local LD	\$10.47	\$38.35	\$2.70	\$5.40	\$1.89	most	yes	no	yes	yes	
TNI TeleNetwork Inc.	A	local LD		\$20.00	\$2.80	\$6.95	\$2.00	all	yes	no	yes	yes	Bundled with ISDN, LDÑ no basic service.
SWB Houston			\$14.73	\$38.35	\$2.80	\$6.50	\$2.10						

* Prices for Time Warner are for TW Connect in Austin. Time Warner in Houston is called Time Warner Communications, and provides local service to targeted communities only. Time Warner in Austin and San Antonio is called Time Warner Connect, and also provides local service targeted communities. Time Warner Communications in Austin provides business service only.

** En Touch Systems is the parent company for Summerwood, Sienna, and Coles Technologies.

***ATT offers call waiting, 3-way calling, call forwarding and other services in package deals starting at \$24.50 per month.

includes one month of basic phone service and an installation fee for \$49.99. The customer can set up service by calling a number on the card; five to ten days later the service begins. To continue service, the customer must go back to the convenience store each month and buy a card for \$54.99. If a customer discontinues service for one month, the customer must pay the initial \$64.99 to start up service again.

PCS's strategy is not unique in this segment. Myriad other companies have similar processes. Smoke Signal Communications, a company that frequently advertises next to other low-income targeted classified ads for services (such as pawnshops) charges \$43.35 up front for installation of phone service. Ten days later the company expects customers to pay \$53.00 for the first month of service. Like many other companies in this

group, Smoke Signal does not run a credit check, accepts only cash or money order, and has a very short grace period and a hefty suspension fee if a monthly bill is late. For example, Smoke Signal Communications customers are given a 7 day grace period but are charged a \$22.50 late suspension fee.

Competing for the High End Customer

Since 1996, a few new residential service competitors have emerged and price at a rate competitive with SWB. Most (6 out of 8) of these companies purchase access to SWB infrastructure and resell service to customers at a lower rate than SWB charges residential customers. A closer look at these competitors, however, reveals a trend towards niche marketing to high revenue customers who use many different telecommunications services.

Three 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 individuals in a handful of designated apartment properties. Service is only available to residents and is usually bundled with cable television and long distance.

In Houston and Dallas, AT&T provides residential telephone services to Camden Properties only. Camden Properties recently announced an agreement to offer high speed, broadband data services (very fast Internet access over cable TV infrastructure) to its residents. According to the Chairman of Camden, increased Internet use and telecommuting makes high speed access an essential service.⁶

En-Touch Systems entered the local

market through new residential housing developments in Houston. Each housing community has its own provider, such as Sienna Technologies (which serves Sienna Plantations), but all are owned by En-Touch Systems. These “captive” customers are also likely to purchase expensive premium services. Sienna Plantations, for example, is a “planned community” with houses that cost from \$130,000 to over \$400,000.⁷ Higher income people are more likely to purchase bundled services and spend more on telecommunications overall.⁸ Sienna Plantations markets itself as one of the first communities in the Houston area to be wired with state-of-the-art fiber optics.⁹

Companies also target services toward premium package buyers by bundling services. Telenetwork Incorporated (TNI) does not offer basic local service as a standalone service. Instead, TNI offers packaged deals that include options such as ISDN, cable and calling features that start at \$31.95 per month. Its telephone book advertisement emphasizes its Internet speed and ISDN services. TNI only accepts payment by credit card, emphasizing its high end target market.

Time Warner Connect, En-Touch Systems, Inc., Choice Com, WESTEL and NTS offer basic service at competitive rates, but they also 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 \$58.79 per month to a “Maximum Value” package that includes 13 optional calling features, long distance, premium cable, and a fire and burglar alarm for \$135.63 per month.

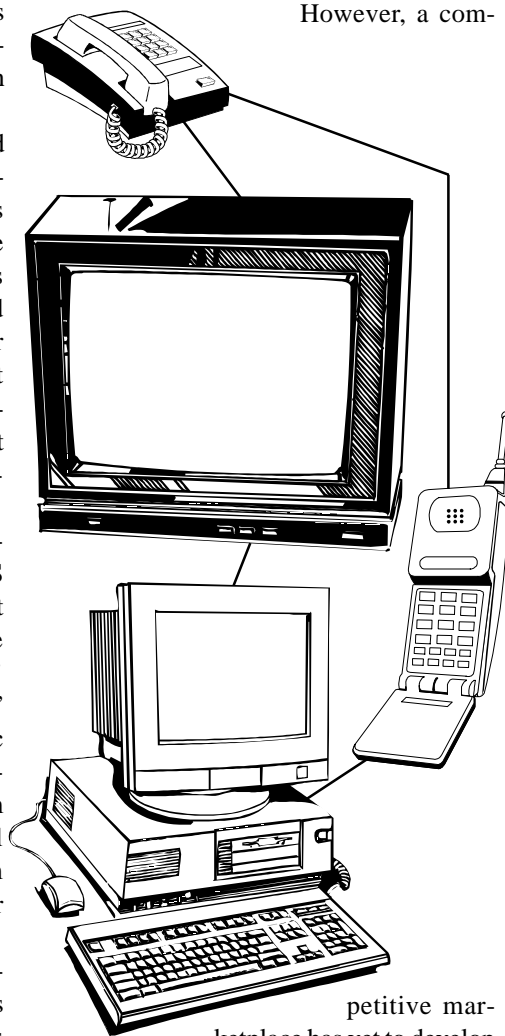
Finally, these companies are not seeking average shoppers through advertisements in traditional media. Many of the providers are listed in the phone book, but once consumers contact the company it is often difficult to get information on services and prices. WESTEL and ChoiceCom, two new local providers that entered the Texas local telephone market in the summer of 1998 are pricing at a stand alone basic service rate that is competitive with SWB. However, we found no evidence of these companies marketing their services. These companies may be testing the waters or may be having difficulty interfacing with SWB systems. Whatever the reason for their lack of marketing, they

offer consumers little real competitive choice. Even with good prices a market is not competitive if consumers have to hire a private detective to find out about new providers.

Conclusion

The Texas Legislature and Congress passed laws based on the assumption that after a transition period consumers would be protected by competition in price and service rather than by traditional regulation.

However, a com-



petitive marketplace has yet to develop for basic local phone service offered to residential customers in Texas. Only customers who live in selected developments or apartment complexes, particularly higher income customers interested in bundled services, might see lower rates or infrastructure investment by new companies.

But, almost half of residential phone customers are modest users, according to the Consumers Union/CFA study. Typically, they have only one phone line, few enhancements (call waiting, caller ID, voicemail etc.), no Internet account and do not own a cell

phone. Another 16 percent may have a cell phone but have below average cable and long distance bills. For these basic service customers, competition in its current form has nothing to offer. Instead, they are subject to rate increases as the monopoly phone and cable companies add fees and reshuffle services. And, new infrastructure enhancements already offered to those who live in exclusive developments may come to the basic service customer late, if at all.

Recommendations

Consumers Union SWRO recommends several policies to keep basic telephone services affordable.

- 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 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 the packaged deals, 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 and surcharges, 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 or packaged services, or of any competitive services, are not being subsidized by basic service prices.
- Reform the state’s universal service fund. Universal service should be limited to covering legitimate costs for high cost areas and programs for the poor and disabled. Currently the law allows phone companies to make up virtually any lost revenues through new surcharges on customers. Companies with “overearnings” should not be permitted to draw money from the universal service fund.

Consumers Union recommends additional policies to ensure access to reasonably priced phone service for low income consumers or those who may have developed bad credit with the phone company.

- Prohibit disconnection of basic phone service when customers make partial pay-

ments on their phone bills. Customers who keep up the basic payment would lose access to other services for which a debt is owed.

- Use “automatic enrollment” to get lower income customers into the “Lifeline” rate program. Far fewer consumers than are eligible actually receive the discounted rate provided under federal and state regulations. Automatic enrollment reduces paperwork for the customer and the company.

- Offer all consumers free or low cost option for controlling their phone bills, such as blocking of long distance, or setting a limit on long distance usage. These should be options the customer chooses, rather than

forced on customers who are perceived as bad credit risks.

Footnotes

¹Cooper, Mark, *The Digital Divide Confronts the Telecommunications Act of 1996*, Consumer Federation of America and Consumers Union, February 1999, p. vii, 1.

²PUC Update, “SWB’s long distance bid nears finish line,” January 28, 1999.

³Public Utility Commission, 1999 Report on Scope of Competition in Telecommunications Markets of Texas, p. vii. The PUC notes that SWB and GTE have greater than 98 percent market share by any significant measure (access lines or revenues, residential or business).

⁴Public Utility Commission, 1999 Report on Scope of Competition in Telecommunications

Markets of Texas, pp. 58-59. “Total service resale appears to be the only significant way competitors were providing basic local exchange service in 1997.”

⁵Although the PUC ordered SWB and GTE to offer pre-paid phone service, the service is not well publicized. Also, it is not available to all customers who cannot pay their outstanding debt to SWB.

⁶I3S and Camden Development, Inc. Agree to Deliver High Speed Internet Connectivity to Apartment Homes, Press Release, I3S, 1998. Available at www.i3s.com/prcamden.html.

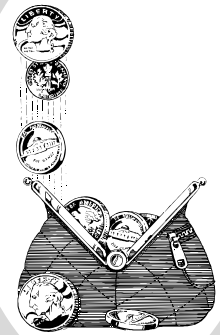
⁷Advertising material at <http://www.siennaplantation.com>.

⁸Cooper, Mark, p. 25.

⁹Sienna Technologies 1998 brochure, mailed to interested potential customers.

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