The Road Ahead – Part 4

Planning for divestiture has moved into a second phase: working on what *must* be done to *get* it done.

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It takes an ageless author of axioms to capture the current tempo of planning afoot to break up the nation's largest and most interlocked corporation: "The road to success," Anonymous writes, "is always under construction."

That sentiment carries a wry corollary as well, notes James G. Cullen, AT&T director-corporate planning, whose department is in charge of coordinating divestiture implementation activities now that the divestiture agreement has been approved. "We are in the midst of a very intense and- in many ways almost impossible effort to develop implementation plans," Cullen says. "Nevertheless, we *are* developing them; the job *is* getting done."

Ever since August 24, the day U.S. District Court Judge Harold H. Greene modified and approved the Justice Department's plan to split off the 22 Bell operating companies from the rest of the Bell System, divestiture planning has moved into a second phase, Cullen says. "Before we knew the verdict, we were planning for implementation. Now we are working on what actually must be done to implement divestiture- and we still have significant issues outstanding. We have to decide how they should be resolved, when, and by whom. The time is past to draft assumptions 'for planning purposes only.'"

Helping to speed along the process was the November I appointment of officers for the prospective AT&T interexchange entity and for the central staff the seven prospectively divested regions will operate. Other major undertakings m comprising literally thousands of specific activities- also must be completed to ensure that divestiture is implemented smoothly.

As Cullen points out, "We have to make sure that someone is thinking about everything that has to be thought of, and that we don't have two people unknown to one another thinking about the same thing, or, where required, that we do have more than one person thinking about the same thing. Now is the time to
make decisions. Corporate, functional, and entity plans must fit together so that we can overlay them on a calendar."

At the top of the calendar are two focal points, both scheduled to occur by the end of November: AT&T's delivery of a reorganization plan to the Justice Department and to the court, and AT&T's first iteration of divestiture implementation guidelines, due to be sent to the operating companies and Long Lines. Divestiture guidelines will provide a

complete list of specific activities that must be completed by January 1, 1984, the date AT&T has targeted for the divestiture to occur.

"Because of this tight time frame," Cullen says, "we don't have the luxury of waiting for the reorganization plan to be approved before beginning to develop guidelines on how to implement the divestiture. Accordingly, we have to presume m for now m that the reorganization plan will be approved substantially as it will be presented or that we can modify our implementation guidelines quickly if required." He adds that two subsequent updates of divestiture implementation guidelines are expected to be published February 1, 1983, and April 1, 1983.

Neither does the corporation have the luxury of fine-tuning every one of its strategies to match the procedures outlined in the reorganization plan and divestiture implementation guidelines. Thus, the questions implicit, for example, in how to best provide customer premises equipment will continue to devour the time of planners in the operating companies and prospective AT&T entities long past the November deadlines, Cullen says.

As the launching pad for divestiture implementation work, the reorganization plan will outline a number of general principles and ground rules: how 80 billion dollars of physical assets will be divided between AT&T and the seven prospective regions that will encompass the 22 operating companies, how the new entities will be financed, staffed, and structured, and what functions they will perform. The plan will undergo rigorous scrutiny by the Justice Department, the court, and the more than 100 intervenors the judge has allowed to participate in approval proceedings. The chief executive officer-designates of the prospective regions also will participate in the process to certify that the plan leaves the companies with the resources necessary to perform their functions. In reviewing the plan, the judge will decide whether its provisions comply with the divestiture agreement, called the Modification of Final Judgment, which he affirmed in his 178-page opinion to be "in the public interest."

Despite the court's affirmation, several parties have appealed the judge's decision, asking that it be overturned on the grounds that it illegally preempts state jurisdiction over operating company assets, among other charges. Apparently in anticipation of such appeals, Greene wrote in his opinion that state regulatory statutes are "unenforceable to the extent that they prevent compliance" with the Sherman Antitrust Act. The appeals could go directly to the Supreme Court, but, as *Bell Telephone Magazine* went to press, it wasn't known when the case would be decided.

Unless the appeals are successful, the Modification of Final Judgment will remain in effect. Under the terms of that judgment -- including the court's 10 modifications to which AT&T and the Justice Department agreed -- the operating companies can provide local exchange access and local exchange services, new customer premises equipment, the printed Yellow Pages directories, and cellular mobile telephone services. They also can pursue lines of business in other areas, providing they show that there is "no substantial possibility" they could "use... monopoly power to impede competition."

The new AT&T can provide both interstate and intrastate interexchange services, enhanced services and new customer premises equipment, embedded customer premises equipment, cellular mobile telephone systems, information planning services, and telecommunications equipment and systems around the world through AT&T International. AT&T also can continue to own and operate Bell Telephone Laboratories and Western Electric and its subsidiaries. However, the final configuration of both the prospectively divested operating companies and the remaining AT&T will be shaped by another sweeping decision as well- the FCC's computer Inquiry II Order- key aspects of which must be implemented a full year earlier than the terms of the Modification of Final Judgment. The Order detariffs new customer premises equipment and enhanced services on January 1, 1983, and requires that they be provided by a separate subsidiary -- American Bell Inc. – operating at "arm's length" from AT&T.

So-called "embedded" equipment – that which is currently in-service or in-inventory -- remains regulated with the operating companies until divestiture. Combined with the requirements of the Modification of Final Judgment, the CI-2 Order means that the operating companies would be out of the new equipment business for a year or so from January 1, 1983, until at least the effective date of divestiture, when they could again offer new equipment.

The delay in detariffing embedded equipment at the same time as new equipment results from the complexity inherent in determining the value of embedded assets, says Daniel J. Culkin, AT&T assistant vice president-federal regulatory matters. "The Order clearly intends to detariff embedded equipment eventually and allow AT&T to transfer it to American Bell, but with billions of dollars invested in embedded equipment, the valuation process must proceed deliberately to be accurate."

To facilitate the valuation of embedded equipment, Bell operating companies will work with state regulatory commissions to file plans by the end of next March to sell embedded single-line equipment to residence and business customers. In addition to advancing state and federal regulatory policies that encourage competition in the customer premises equipment market, the decision to sell basic telephones reflects the companies' recognition of customers′ growing desire to own their phones. several operating companies already have filed sale plans, and companies in three states _ New York, California, and oregon m now offer sale options to customers, under the new sale plans proposed, customers would have the option to buY in-place and refurbished single-line equiPment or continue leasing their telephones.

Because the sale of existing equipment would reduce the size of the embedded base m and reduce the scope of valuation concerns _ AT&T has asked the FCC to detariff embedded customer premises equipment before divestiture occurs so that the equipment can be transferred to American Bell. If the FCC approves the request, American Bell will continue the purchase option for single-line business and residence telephones for two years. A price predictability program also will be included to give

customers assurance that any price increases will be moderate after detariffing takes place.

AT&T has asked that the detariffing and transfer of embedded equipment start by July, 1983, and end by January 1, 1984. The primary task during the period would be to begin the massive job of transferring and converting the records for the tens of millions of customers who currently lease embedded equipment.

A major advantage of the detariffing recommendation is that it eliminates the need for a separate organization to manage the embedded base after it is transferred to AT&T at divestiture. "An embedded base organization necessarily has a limited life and limited purpose -- dealing only with tariffed customer premises equipment as long as supplies last," Culkin explains. "The cost of setting up such an organization, not to mention the confusion and operational inefficiencies it will generate, will only add to the ratepayers' burden in the long run."

As the Bell System awaits an FCC decision on the request to detariff embedded equipment, the operating companies have begun preparing for the detariffing of new equipment. In August, the companies initiated a set of tariff filings with their state commissions to eliminate new customer premises equipment and enhanced services from their product lines after January 1, 1983. The filings asked state regulators to approve the valuation and transfer of 88 million dollars in assets - including such facilities as Bell PhoneCenters - that American Bell will need to begin offering new equipment.

Bell operating companies also announced agreements to install and maintain new business communications systems for American Bell under contract. CI-2 allows such a contractual arrangement to remain in effect until July 1, 1984, but as a practical matter, the contract will last only until divestiture is completed, Cullen says; at that time, installation and maintenance personnel will transfer to American Bell.

In another move to comply with the FCC's Order, the operating companies, Long Lines, and the AT&T General Departments assigned employees in early September to the regulated and detariffed sides of the business. Less than three percent of operating company employees will shift to American Bell on
January 1, 1983, Cullen says, but that figure represents about one-third of the current business marketing and Bell PhoneCenter forces.

While the operating companies and AT&T try to resolve the discontinuities caused by the differing requirements of CI-2 and divestiture, planners are scratching their heads on what to do in the meantime. "We are committed to managing customer premises equipment as one line of business -- from research through manufacturing to sale and distribution," Cullen notes. "But we must proceed to plan for two contingencies: providing embedded equipment under regulation until the FCC completes asset valuation and detariffing, and, at the same time, providing embedded equipment on a detariffed basis if we're allowed to." Systems must be developed for either scenario. For

example, the embedded base organization must begin designing stand-alone service order and billing capabilities for its millions of customers. Recognizing the "physical impossibility," as Cullen says, of billing its customers by the date of divestiture, the embedded base organization proposes to have the operating companies do the billing under contract for a transition period of up to two years. If embedded equipment were detariffed before divestiture, the embedded base organization could combine its accounts with American Bell's, but that option also requires an independent service order and billing system.

Aside from the logistics of how to provide those functions, the expense inherent in the service order and billing process presents a problem, Cullen adds; the fixed costs associated with these systems can't decrease in proportion to the number of telephones removed from the embedded base as customers buy them.

The issues are no less clear-cut for providing customer premises equipment after divestiture, Cullen continues. On the one hand, American Bell must consider what it should offer in its product line, what combinations of sale and lease it should provide, and how best to distribute its products. The agreement announced in late October to begin selling residence equipment in Sears stores is one example of new distribution options opening up.

The operating companies, on the other hand, are pondering a number of questions as well, Cullen reports. First they must decide whether they even want to offer new customer premises equipment after divestiture. If they decide to do so, then they are confronted with the same questions now facing American Bell, their future competitor: what product lines? what pricing terms? what distribution channels? Finally, must the prospective holding companies form separate subsidiaries to conduct competitive activities, such as offering new equipment, in compliance with Computer Inquiry II?

Even the FCC doesn't seem to have an answer to this last question. In written comments prepared for a U.S. House of Representatives' telecommunications subcommittee oversight hearing that was scheduled but never held, the FCC said it hasn't yet determined whether the prospectively divested regions would have to establish separate subsidiaries.

"Even the largest of the planned seven divested region[s] does not pose the threat of cross-subsidy on a national scale to the same extent that the currently structured AT&T does," the FCC admitted. "On the other hand, there may be opportunities for divested operating company operations to favor.., their own customer premises equipment sales with unequal provision of interconnection service and facilities. [And] while divested operating company resources available [to] support structural separation are not as large as those of predivestiture AT&T, they are large by any measure.

Although Judge Greene has acknowledged the FCC's jurisdiction in the matter, he pointed out in his 178-page opinion on the Modification of Final Judgment that the operating companies "are more likely than any other competitive entity to provide an

effective counterbalance to AT&T's market strength and thereby to promote a genuinely competitive market" because of their "existing relationship to telephone users"-- their ability to offer local exchange service and new terminal equipment through a single company.

While planners from all entities wrestle with the most effective ways to provide customer premises equipment, this much is certain: Customers will have to make two separate contacts to get basic service and new equipment from January 1, 1983, to the date of divestiture. During that time, customers can get embedded equipment (unless it is detariffed), dial tone, and network services from the operating companies, but for new equipment, customers will have to go to American Bell outlets or to non-Bell suppliers.

While the prospective local exchange companies will probably remain "the phone company" in the public's mind, the interexchange entity will be viewed as AT&T's intercity communications company. After divestiture, the interexchange company will connect not states but communities -- local access and transport areas (LATAs). The interexchange entity's 60 million residence customers and six million business customers will live in thousands of farflung communities comprising 161 LATAs, if the area boundaries are approved by the court.

The AT&T interexchange entity will be one of the operating companies' biggest customers, because the companies will be the principal source of access for interexchange carriers. "Without the operating companies, we can't deliver services to our customers," notes Kenneth L. Garrett, AT&T assistant vice president-operations staff, who is coordinating interexchange planning and implementation.

This new relationship to the operating companies is one aspect characterizing what Garrett calls the four "planning challenges" now confronting the interexchange entity. "First of all," Garrett says, "we must develop the strategies for operating in a competitive environment. Second, we must decide how best to do business with our customers m including how to put a new corporate identity into their minds. Third, we need to determine how to deal With a competitive market while still operating under regulation and how to position a regulatory presence in state jurisdictions. And last D but by no means least m we must plan how to merge the assets and the 130,000 or so people from 24 different organizations -- the 22 operating companies, Long Lines, and the AT&T General Departments D to make one effective, efficient, and competitive new organization."

The AT&T interexchange entity will find itself regulated amid a burgeoning number of unfettered competitors. It will require marketing strategies that strengthen its leadership _ "primarily by capitalizing on our service reputation, experience, and technology," Garrett says _ and it will need to be represented within state regulatory jurisdictions. In fact, approximately 20 percent of its revenue is projected to come from inter-LATA calls within states. "We'll be a new organization for state regulators to work with, and dealing with them will be a new experience for us," he says. "However, the regulators will see some familiar faces, because some of the people in the operating companies who deal

with state commissions now are expected to transfer to the interexchange entity to perform the same function."

Over the long term, the interexchange entity hopes to be freed from "regulations that don't apply equally to our competitors," Garrett says. "The real bottom line is that a firm's success should depend totally on its ability to produce what the market demands when it demands it, at the price the market demands."

The AT&T interexchange entity is also looking toward the day when it may be in a position to negotiate service orders and billing directly with customers, rather than contract with the operating companies to perform the service, as the Modification of Final Judgment allows. ..... Questions about whether AT&T's interexchange service will continue to be regulated are overshadowed, for the time being, by the more pressing question of how the operating companies should charge for access to the local network. The interexchange carriers, their customers, and the operating companies each hold a major stake in the outcome of the access charge debate. Access charges will be a large expense for the prospective AT&T interexchange entity and a major source of revenue for the divested companies. In fact, access charges could represent approximately one-third of the companies' revenue after divestiture. It's critical, therefore, that the access rate structure be set correctly; otherwise, both the companies and the carriers could lose customers, says A. Gray Collins, Jr., project director for the operating company presidents' study group on access charges.

The issue is so crucial that the FCC has called its access charge docket its Number One priority, and aims to have a decision made by the end of the year. Of four access charge proposals now before the FCC, two would charge interexchange carriers for all costs of access, and two would place all the fixed costs on the customer.

At the heart of the issue is who should pay how much to recover the non-traffic sensitive costs of access -- the fixed costs of installing and maintaining customers' lines and equipment -- that don't vary with usage. In 1981 alone, seven billion dollars in interstate revenues -- and more than half again that much in intrastate revenues -- were used, along with local service revenues, to cover the fixed costs of service.

In a regulated and franchised monopoly environment, fixed costs were recovered partly through intrastate and interstate long distance rates. But competition drives prices to costs, and the days of long distance support for local service are numbered, Collins says, leaving a large question still unanswered: Who's going to pick up the costs that can no longer be supported -- the interexchange carriers, the customers, or some combination?

"Clearly, the answer isn't black and white," Collins says. "If the carriers have to pay all the fixed costs of access, some will find a way to bypass the operating companies' local loop to avoid having to pass on such high costs to their customers. Alternatives to the telephone company's local distribution facilities certainly exist. Bypass suppliers could be less efficient than the local telephone company, but they could still attract customers

because they could establish an access price that is above their costs but still below the companies' prices."

On the other hand, if customers pay the full fixed costs of access, service charges would increase, because high-volume toll users today pay many times the cost of their lines to keep local service charges low for others. Low-volume toll users would be hard hit, because they would pay the same access charge as high-volume toll users. Rural customers, as well, could notice substantial increases in the cost of local service because of the high costs of providing service in sparsely populated areas.

As Collins summarizes the problem, regulators and the companies are caught between Scylla and Charybdis on the access charge issue: "We all want to keep basic rates low and, at the same time, protect the companies from being bypassed because access to the network is overpriced. Understandably, regulators are cautious in developing guidelines. But we're urging them, especially the FCC, to move quickly. Otherwise, the companies will have to anticipate the regulators' moves when they file their access tariffs in January."

The access charge issue is further complicated by the fact that interexchange carriers may well pay not just one access charge but two -- one set by the FCC to cover access to the network for interstate inter-LATA calls, and one set by the states to pay for calls made between LATAs within states.

The spotlight is currently on the FCC, which is reviewing comments from some 60 groups on the four proposals it advanced. The operating companies and AT&T have said they believe that, in the long run, customers and not interexchange carriers should pay for the costs of accessing the network, a position echoed by most of the groups filing comments with the FCC. "The principle is one we've advocated since the advent of competition -- that prices must be driven towards cost," Collins notes.

But Collins also issues a call for flexibility, saying, "We cannot advocate full recovery of fixed costs on a recklessly ambitious timetable without endangering universal service. We must have some kind of transition plan that is fair to the carriers and fair to the customers."

One such plan, suggested to the FCC by the operating companies and AT&T, would initially charge all customers a modest flat monthly charge for access; the carriers would pay for the remaining costs as they do today, customers would pay more of the fixed costs over time, and charges to the carriers would be reduced. The companies argued against national averaging of access charges because they could be forced to charge more than their underlying costs in certain areas, "providing fertile ground for bypass," Collins notes. Instead, they suggested a separate interexchange carrier charge for areas where the costs of providing service are high to help cover some of those costs but continue to keep local service rates reasonable.

Whatever the outcome of the access charge proposals on the federal and state levels, the subject of access charges is a "hot issue" that will cool only as fast as customers get accustomed to a competitive environment wherein prices are driven to costs. That means, Collins says, that some customers will pay more and some will pay less than they do today for access to the local and interexchange network. The key questions for them - and for operating companies, interexchange carriers, and regulators alike- are these: How much more or less for access--- and over what period of time?

Much closer to resolution than the issue of access charges is the subject of asset assignment. The LATA filings that will determine where the interexchange entity provides communications links were a crucial step toward finalizing the assignment of assets between the operating companies and the AT&T carrier. However, "assets can't be completely assigned until we know where the boundaries will be located," Cullen points out.

Even without final information on LATA boundaries, asset assignment study group teams have been able to prescribe an underlying principle to their work that is not unlike the Bauhaus school of design dictum that "form follows function." In this case, assignment follows function. Assets are assigned based on their predominant use, because the court-approved divestiture agreement prohibits joint ownership of facilities. Facilities used to provide local exchange service and access will stay with the operating companies. Equipment used predominantly to provide interexchange switching and transmission will be assigned to AT&T m an estimated 20 to 30 percent of operating companies' plant.

The #4 electronic switching systems -- toll switches that also perform local tandem switching -- are apt examples of the predominant-use concept. In those cities having more than one #4 switcher, the operating companies and AT&T "have essentially determined that these machines should be allocated on the basis of predominant total usage within a metropolitan area, not on predominant individual machine usage, to achieve a more equitable assignment," Cullen says. In cities having only one #4 switcher, the #4 machine is expected to be assigned to AT&T, based on predominant usage.

But the targeting of equipment assets -- albeit a major step- is only half the process. The vital accounting data such as property and tax records, and life and location of equipment- still must be moved from operating company records to AT&T books, because the information is critical to plant retirement accounting and important in determining depreciation rates.

Even on the day of divestiture, the book on assignment can't be closed completely. Three work functions in the prospective AT&T interexchange entity could require additional employee transfers after divestiture during the several years when force-sharing arrangements wind down, Cullen reports: operator services, circuit provisioning for special services, and business and residence service centers for direct customer contact. Guidelines for transferring employees between entities after divestiture will be

incorporated into the reorganization plan AT&T will submit to the Justice Department and to the court.

Concomitant with the step-by-step process of assigning employees and equipment and charting service territories, operating companies are establishing a strong central staff to perform many of the functions that will be eliminated when License Contract services with AT&T end. A centralized laboratory, for example, will be a "mini-Bell Labs," says Ian M. Ross, Bell Labs president, "a technical universe that will grow to more than 2,000 people."

A total of 8,000 central staff employees are expected to fill positions "which, in terms of career prospects and compensation, will be no different from those of comparable managers within our companies," according to Thomas E. Bolger, AT&T executive vice president and designated regional chief executive officer, who chairs a Bell System task force developing plans for the central staff. The largely technical organization staffed mostly by AT&T employees on rotation from the operating companies, as well as by employees from the Labs and Western Electric _ will have an annual operating budget of more than 700 million dollars.

No less important to the operating companies' future are the stirrings of a regional identity. Regional steering committees are asking what markets their companies should pursue and contemplating what their organizational structure should be. Prospective regional holding companies are studying ways to ensure the financial stability of the operating companies they oversee. During the months remaining -- a baker's dozen or so -- before the "D-Day" target, the companies on their own and in partnership with others in their region will discover just how awesome the job of implementing divestiture truly is. As AT&T chairman C.L. Brown has described it: More than one million employees must follow their jobs, and tens of thousands of them must transfer from one former Bell company to another. Data processing systems must be reprogrammed, reconfigured, and, in some cases, redeployed- systems that control maintenance, repair, and installation work, that generate employees' paychecks and customers' bills, that keep records and manage the large information systems needed to run a giant business. State and federal tariffs establishing prices must be amended and refiled _ in perhaps as many as 50 thousand pages of documents.

On Day One after divestiture, the former Bell companies must be prepared to process 600 million telephone calls, dispatch 100 thousand installation and repair technicians, and continue a 17.5-billion-dollar modernization and expansion program.

In the years to come following divestiture, what will set these future enterprises apart will be what an 18thcentury New England theologian, Jonathan Edwards, called the "right spirit" of their people: "A person of right spirit is not one of narrow and private views, but is greatly interested and concerned for the good of the community to which he belongs, and particularly of the city or village in which he resides, and for the true welfare of the society of which he is a member."

Such "a right spirit," Brown told the 57th Pioneer General Assembly in Detroit in September, is "more than management, more than people, more than the Spirit of service m although each of those elements contributes heavily to the whole. ['A right spirit'] encompasses conscience, honor, and a bit of what the French call _lan .... More than any other individual attribute, 'a right spirit' defines for me our greatest strength -- immeasurable though it may be."