

The Road Ahead – Part 1

Destination: a restructured way of doing business. The Bell System will encounter detours _ but not deterrents as it travels toward its brave new world

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The shortest distance between two points, as experienced travelers know, isn't always a straight line. Detours and heavy traffic, among other potential hazards, can change the course of the journey -- though the destination stays the same.

An oversimplified analogy perhaps -- but it does illustrate the situation confronting the Bell System and others who have a vital interest in restructuring the telecommunications industry. And, looking down the road -- to go on with the analogy -- it's a situation they will continue to be faced with while a consensus of "which way to go" is painstakingly sought.

But the destination is constant; the Bell System goes forward with its preparations for increasing competition, for a partly tariff-regulated/partially detariffed and unregulated response to marketplace demands. Thus, the FCC's further reconsideration -- announced October 7 -- of its Computer Inquiry II proposals is seen as a detour, not a deterrent to getting where the Bell System needs to go.

On October 7, the FCC postponed the effective date for offering detariffed customer premises equipment through an unregulated subsidiary -- from March 1, 1982, to January 1, 1983. At the same time, it ordered the Bell System to provide customer premises equipment through both the regulated and unregulated sides of the business for the time being. This two-pronged, split approach -- known as bifurcation -- means that all equipment Bell now offers will remain with the regulated entity, but any new terminal equipment must be sold or leased through a separate unregulated subsidiary. From January 1, 1983, forward, the regulated entity can't acquire any new customer premises equipment.

The FCC said that postponing the detariffing date will allow more time to resolve how much Bell's existing equipment is worth, and how soon the equipment should be transferred to the proposed unregulated entity. The commission envisions that the equipment will be transferred and detariffed eventually, sold to customers, or eliminated over time through wear and tear, loss, or damage. Meanwhile, the FCC decided December 17 that asset valuation and transfer decisions should rest with an advisory committee -- which, by statute, must fairly represent all parties interested in its deliberations, including state and federal regulators, officials of common and private carriers, and equipment manufacturers.

The FCC's bifurcation decision took Bell's restructuring on a detour because the company had hoped and planned for a decision to "flash-cut" customer premises equipment -- that is, offer both existing and new equipment only through the unregulated subsidiary. _The FCC's decisions contain some unsettling pronouncements" says

James R. Billingsley, AT&T vice president-federal regulatory matters. _But the order is clear and candid. We now know exactly where we stand and why"

Restructuring activities will continue on schedule. Chairman C.L. Brown told the Bell System Presidents' Conference in mid-November, "We will sort out the assets and the entities when we must -- and when we know the final ground rules and when we make the business decisions which must derive from those ground rules."

Nevertheless, many observers believe restructuring efforts have been sidetracked in the wake of the October 7 events. For example, the commission's order has led to speculation that Bell, buffeted by events, is unable to set its own course. The subject of clout -- or lack thereof- has garnered considerable media attention. Business Week, for one, noted that AT&T's efforts to move into the competitive marketplace have encountered obstacles -- from Capitol Hill to the FCC"; others suggest that "AT&T's ability to mold deregulation of the industry is diminishing"

Employees, too, raise the issue of whether Bell is a victim of- rather than a victor over -- circumstances. We don't control the situation" says one Bell manager. "There are outside forces -- Congress, the FCC, the Department of Justice -- to be heard from." There are. But there always have been. The Bell System has never operated in isolation; it has always been accountable to outside forces. No one group can or does control the situation -- especially a situation with such complex issues, whose solutions are still subject to change.

"It's frustrating" admits Joyce Rhodes, New Jersey Bell district manager-residence installation and maintenance, "but I can't afford to get hung up over it any more than the company can. There's a job to do, and doing that job well is more important now than ever before." As for the postponement of the detariffing date, "frankly, it didn't seem very realistic in light of all the piece parts to be considered" she says. "Not that we weren't working to meet that date; once we make up our minds to do something, we do it. But the postponement has given me more time to work through all the changes and talk them over with my people."

For Frederick D. Lawrence, Michigan Bell division manager-switching systems, the postponement is "really disappointing because I want to get on with it. But a delay of a few months is not traumatic. I'm totally satisfied that once we get on with it, we will do well."

Perhaps the most important strategy for "getting on with it" is Bell's decision to manage customer premises equipment as one business, regardless of the bifurcated way that equipment must be offered to customers. Viewing all equipment -- both current and planned -- as one line of business is the "single, coherent, long-range business strategy" that will "assure that we act in concert to reduce costs, improve responsiveness, and bring to market the new features, functions, and products we must have" Brown told the Bell presidents.

Because bifurcation poses a whole new set of considerations for the Bell System, an interdepartmental task force at AT&T has been appointed to examine the effects of bifurcation in detail.

"The Bell System's first aim is that our restructuring -- even with bifurcation and postponement -- be accomplished without inconvenience to the customers we serve, with no adverse effect on our share owners' investment, and with minimal disruption in the lives of employees who provide our service" says Lee S. Cutcliff, AT&T assistant vice president-corporate planning, who chairs the task force.

For customers, bifurcation means that the task force must decide how to manage inventories in the regulated entity so that customers will be able to upgrade and expand the capacity of equipment they already have. "To the extent Bell Regulated Entity (BRE) inventories are inadequate, the planned subsidiary will be a source to meet customers' needs" Cutcliff says.

For employees, bifurcation may mean fewer people will work in the prospectively detariffed/unregulated sector than had been forecast, "because the detariffing date has been postponed and the initial size of the operation will be reduced" he explains. "We expect some employee dislocations as we line up the right talent with the right job, and we expect that some employees will be retrained. However, right now our biggest need is to decide how many people it takes to work with customers who already have equipment versus how many it takes to sell and service those with new equipment.

"Obviously, the strategies and operations arrangements we ultimately select will affect manufacturing, marketing, and distribution forces as well as installation and maintenance forces. When the precise effects are known, we'll inform employees promptly if their present responsibilities are affected."

As for share owners, the FCC's order doesn't appear to have affected the price of AT&T stock. "If anything" Cutcliff notes, "share owners should benefit from our ability to get into new markets."

The task force also must keep in mind two of the principles on which the commission based its October 7 decision. The first is that the FCC believes that providing detariffed terminal equipment is *not* a public utility service. Consequently, the Bell System has no legal obligation to provide untariffed equipment at all.

Second, the FCC decided that the Bell System's prospectively detariffed/unregulated sector must be treated as a completely new entrant in the competitive marketplace, subject to the costs and risks of a new venture. Such a company typically would begin life as a relatively small entity and grow incrementally; it would not start as the 10-billion-dollar company with 100,000 employees that the media estimated would be the size of the planned subsidiary. In fact, the commission concluded that if the subsidiary started out with the large base represented by AT&T's investment in existing customer

premises equipment, it might jeopardize the evolution of competition in the terminal equipment field.

Finally, the task force must consider other decisions the FCC made October 7, which have tended to be overshadowed by the postponement and bifurcation rulings. For example:

- The FCC said it would like state public utility commissions to encourage Bell operating companies to sell terminal equipment to customers while the larger asset value and transfer issues are being determined.
- It noted that existing enhanced I services, such as Dial-It, could continue to be offered under tariff until January 1, 1983, but Custom Calling Services II must be offered only through the prospective separate subsidiary.
- It gave AT&T the option of having the regulated entity install and maintain customer premises equipment for the planned subsidiary after January 1, 1983 -- but only for the subsidiary's business customers and only for 18 months. This decision prompted commissioner Joseph R. Fogarty to write in his dissent, "Under bifurcation, it is far better to be a business than a residential customer." The company must decide by January 13, 1982, whether "to submit a plan showing how the regulated entity will perform installation and maintenance functions for business customers in the prospectively detariffed sector. The plan must describe how the costs will be allocated between the regulated and unregulated sides, and outline the accounting system to be used. If a plan is filed, the FCC must respond within 75 days.
- It affirmed that Bell is the only entity subject to the separate subsidiary requirement. The Bell System was defined to include Cincinnati Bell and Southern New England Telephone, which AT&T holds only minority ownership in. Cincinnati and SNET have subsequently asked the FCC to reconsider its refusal to waive the structural separation requirement.
- It prohibited sharing of systems between the company's regulated and prospectively unregulated sectors. Only certain administrative services -- such as pension, insurance, and benefits coordination -- may be shared. AT&T expects to file plans with the FCC for sharing such systems by January 13, 1982.
- It made clear that both the implementation process and the operational subsidiary would be monitored to insure compliance, scrutinize transactions, and investigate claims of anticompetitive conduct.

FCC observers have suggested that the commission's October 7 reconsideration order was based as much on outside forces as it was on a further review of the issues involved. For instance, only two weeks before the FCC issued its order, the government's General Accounting Office (GAO) had heavily criticized the commission in

a mammoth report; asserting that the FCC is currently unable to regulate the Bell System effectively, the GAO recommended many more stringent restrictions on AT&T's further participation in the competitive marketplace.

The FCC continued to feel pressure even after its October 7 decision. Just weeks later, the Department of Justice petitioned the Court of Appeals in New Jersey to review a U.S. district judge's opinion, delivered in a Newark court, that AT&T is not barred by the 1956 Consent Decree from providing customer premises equipment and enhanced services under the Computer Inquiry II decision. Some state commissions as well are trying to slow the deregulation process to forestall increases in local rates.

"Given that the Bell System is going through the most significant changes in its history -- indeed, no corporation has ever confronted such a pervasive realignment of its operations -- it might be unrealistic not to expect delays and changes" says AT&T's Cutcliff. _The issues facing the Bell System are as far from simple as they can be. But they can -- and are -- being dealt with."

Recent developments bear him out. On November 30, 1981, for example, AT&T announced plans to form a new, separate subsidiary to offer Advanced Communications Service, which is widely viewed in the computer industry as being the most sophisticated service yet to allow different types of data terminals and computers to "talk" to each other. ACS is an enhanced, shared data communications network service that will be offered on or before June 1, 1982, if the FCC approves the capitalization plan [see The Briefing Session *in this edition*].

In filing the plan, AT&T vice chairman James E. Olson said, "We have said all along that we were prepared to step up to a competitive environment, and this proposal underlines that commitment." Indeed, the company had planned to offer ACS in March, 1982, the FCC's original detariffing date.

As work proceeds to restructure current operations, and as procedures are hammered out for a bifurcated world, planners remain aware that the FCC's October 7 orders aren't likely to be the last word on the Bell System's configuration. For example, more votes on legislation and a decision in the Justice Department's antitrust suit are expected by mid-Summer. AT&T's Billingsley points out that _in some respects, it's going to be tougher to plan ahead because we do not know where, when, or how some of these changes might be implemented."

In fact, regulation may well continue despite an increasingly deregulated world. William S. Cashel, Jr., AT&T vice chairman and chief financial officer, told the World Telecommunications Conference in November that "deregulation, as presently constituted, does not spell the end of regulation for the Bell System -- any more than a few government budget cuts spell the end of government spending" He said that unique restrictions continue to be placed on the Bell System: "We are the only party being required to establish a separate subsidiary to provide deregulated services -- with all the costs, duplication of effort, and customer confusion that could create. And the

relationship between our deregulated subsidiary and the regulated side of the business will be closely watched by the government."

FCC commissioner Anne P. Jones, speaking before the Information Industry Association, echoed Cashel's thoughts. "The commission's involvement with the separate subsidiary has hardly begun" she said. She pointed to a new office being formed within the FCC's common carrier Bureau to monitor transactions between the regulated and prospectively detariffed entities. She called the deregulation process "the gentle art of elephant training.., the elephant and the mouse, of course, being a common parable for AT&T and its competitors."

She also predicted that the commission will receive many more petitions for yet further reconsideration of Computer II. "I am afraid" she said, "that eternal surveillance may be the price of a separate subsidiary... [and] I also believe we are just beginning to understand the regulatory complexity of the post-separate-subsiidiary world"

And so: The road is far from being a straight, clean shot. It seems certain that more detours are ahead.

"Even so" as Michigan Bell's Lawrence points out, "there are many opportunities ahead for the Bell System. We are in one of the fastest-growing industries in the world. And that's exciting. Too often, people get so caught up in immediate concerns they forget that. I'm confident we'll do well in both the regulated and detariffed/unregulated parts of the business. Now, if I were a middle manager in the steel or auto industry, I'd worry."