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AT&T DIVESTITURE:

Restructuring the U.S. Domestic Telephone Industry IP0257A

On January 8, 1982, the Justice Department and the American Telephone and Telegraph Company announced the settlement of the Government's seven year old antitrust suit against AT&T. Nineteen months later, in August 1983, U.S. District Court Judge Harold Greene gave final approval to the AT&T divestiture agreement. The breakup of AT&T will affect every aspect of the U.S. domestic telphone industry from the yellow pages to the manufacture of telephones. AT&T officially spun off its 22 local operating companies into seven regional phone companies on January 1, 1984.

This Info Pack focuses on the Department of Justice settlement with AT&T and how the resulting divestiture will affect the U.S. domestic telephone industry.

Members of Congress desiring more information on this topic should contact CRS at 287-5700.

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The AT&T Breakup: A World of Confusion

By Peter Behr
and Michael Isikoff
Washington Post Staff Writers

For most of this century, the telephone has been a simple necessity of American life, as much taken for granted as the kitchen faucet.

That relationship between Americans and their telephone is about to be turned inside out. On New Year's Day, American Telephone & Telegraph Co., the country's oldest and biggest monopoly, will be broken up into eight separate billion-dollar companies, accelerating a chain re-

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action of confusing changes in telephone service.

These changes should mean a dazzling proliferation of new services and phone equipment for consumers and businesses—and a rapid escalation of basic local phone rates. Although rates would have risen without the breakup of the Bell System, it will speed up their ascent.

"It's pretty clear that consumers are going to pay a minimum of 50 percent more in their monthly bill in the next 12 months—and that's the best case," says Sam Simon, executive director of the Telecommunications Research Action Center. "In some cases, they're going to pay much more than that, depending on where you live. It can be 100 percent or 200 percent."

In the District, the Chesapeake & Potomac Telephone Cos. have proposed to raise the flat monthly local telephone charge from $8.83 to $13.08 and the cost of a pay phone call from 15 cents to 25 cents. Larger rate requests are pending in suburban Maryland and Virginia. C&P President Thomas Gibbons predicts that local rates in the Washington metropolitan area will double in the next several years.

Nationally, the local Bell phone companies—about to be separated from AT&T—are seeking an unprecedented $6.7 billion in higher rates and fees, at least in part to help cover the costs of divestiture. In addition, the Federal Communications Commission has ordered that consumers and businesses pay a new set of access fees to replace subsidies the local phone companies will no longer receive from Ma Bell.

These higher rates and fees have triggered political fears in Congress that the country's 50-year-old policy of universal phone service is in jeopardy. Last month, the House passed legislation aimed at preserving that policy and blocking the new access fees, adding to the confusion.

FCC Chairman Mark Fowler said he now fears the Senate will pass similar legislation early next

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A1, A14-A15

Bell Breakup Will Be Painful Before Benefits Start to Appear

BELL, From A1

year and warns of a "national catastrophe in the making.

"We're going to see the industry turned into an economic Lebanon. It will be an industry ripped apart, faction fighting faction, total chaos," Fowler said. "What we're going to see is a crumbling, rapidly deteriorating public telephone network" in the 1990s if Congress passes the bill.

The hope of divestiture is that the disruption will more than be offset by the benefits of competition as America enters a new age of information.

One benefit should be a decline in the costs of long-distance calling, as the competition intensifies between AT&T and long-distance rivals like MCI Communications Corp. and GTE/Sprint. One telecommunications expert, Robert LaBlanc, predicts that long-distance rates in 1990 may be 40 percent below today's levels.

The second benefit will be the evolution of the telephone into a new kind of communications device for home and business—part phone, part computer. One of AT&T's newest offerings, for example, is the "Genesis" telephone priced at $450 with all its options, including snap-in memory cartridges that store telephone numbers, automatically redial busy numbers, and prompt the owner about upcoming appointments and anniversaries.

At the other end are throwaway phones for less than $10 apiece that will be discarded when they break down because it will be cheaper to replace them than to send them to the manufacturer in Hong Kong or Taiwan for repairs.

Will the benefits outweigh the costs and turmoil? Certainly not at first, many experts say, and observers are clearly concerned about the long-term outcome.

"It will be mass confusion for consumers for awhile," says Fred Goldberg, Washington counsel for the National Association of State Utility Consumer Advocates.

"If there were a way to force AT&T back into business, I'd be in favor of it," says Sen. Barry Goldwater (R-Ariz.), chairman of the Senate communications subcommittee.

Charles L. Brown, chairman of AT&T, says: "This is a major upheaval . . . It was not our idea."

"What I would like . . . is to go back before this whole thing was started and put the cork back in the bottle," says Glenn Watts, president of the Communications Workers of America, the union that represents telephone company employes. That can't be done, he admits.

Why the Breakup

But the truth is, says C&P's Gibbons, "the way you get phone service in this country is never going to be the same."

The Bell breakup is the direct result of the rapid blossoming of computer and microwave technologies developed during World War II.

The new technologies made it possible and profitable for more and more companies to bypass AT&T's long-distance network by setting up their own satellite, microwave and cable systems, notes Philip L. Verveer, former chief of the Federal Communications Commission's Common Carrier Bureau.

In 1969, a small Washington-based company, MCI Communications Corp., was given permission to compete with AT&T by setting up a microwave tranmission service. Now MCI is a $1.1-billion company, and along with other companies is offering long-distance service at rates significantly below AT&T's.

"The technological change was occurring and it gradually became obvious that the telecommunications industry was not moving as rapidly on that technology as it would if it were competitive," says Bruce Owen, a former Justice Department economist and a key figure in the Bell breakup.

During the 1970s, AT&T tried to stifle that competition, pushing legislation in Congress that would have virtually outlawed its fledgling rivals. AT&T's power, fed by its monopoly revenues from local and long-distance service, posed a stark choice for federal policymakers, Owen said:

Either allow the monopoly to continue, retarding technological growth in a crucial industry, or challenge AT&T head on. In 1974, the Justice Department chose the second course, filing a suit to break up AT&T.

On Sept. 11, 1981, U.S. District Judge Harold H. Greene, presiding over the trial, denied AT&T's motion to dismiss the lawsuit. He concluded: "The testimony and the documentary evidence adduced by the government demonstrates that the Bell System has violated the antitrust laws in a number of ways over a lengthy period of time."

On Jan. 8, 1982, before the trial had ended, AT&T and the Justice

Steps Toward Divestiture

1956: American Telephone & Telegraph Co. signs a consent decree with the U.S. government to end a major antitrust suit. The decree bars AT&T from entering any non-regulated, non-telephone activity, such as data processing.

1968: The Federal Communications Commission issues its first ruling promoting competition in the telephone industry by allowing customers for the first time to hook up non-Bell System phones to the telephone networks.

1969: The FCC permits MCI Communications Corp. to launch a private-line service between St. Louis and Chicago, creating the first long-distance competition for AT&T.

1974: The Justice Department files a new antitrust suit against AT&T, accusing it of trying to keep competitors out of the equipment and long-distance markets.

1976: In the face of increasing competition, AT&T mounts congressional campaign for legislation dubbed "the Bell Bill" that would protect AT&T's monopoly in much of the telecommunications market.

1978: The mood shifts against AT&T in Congress as Rep. Lionel VanDeerlin (D-Calif.), the chairman of a House subcommittee on telecommunications, introduces legislation to break up the Bell System. U.S. Judge Harold Greene takes over the AT&T antitrust case after presiding judge dies.

1981: MCI Communications Corp., charging AT&T with anticompetitive conduct, wins $1.8 billion verdict. Appeals court orders new trial on amount of award.

1982—January: The government and AT&T announce they have reached an agreement settling the antitrust suit.

1982—August: Judge Greene approves most of the breakup plan, making several key changes designed to help local phone companies.

1983—July: FCC issues plan to impose $1.9 billion in higher residential phone fees and other charges to help local phone companies after divestiture. The House moves to block the new charges.

1984—January: The former local Bell phone companies are separated from AT&T in the most extensive corporate breakup ever.

Department stunned Congress and the telecommunications industry by announcing an agreement to break up the Bell System. Their agreement, modified by Judge Greene, is the plan that will take effect Jan. 1.

AT&T will keep its long-distance business, Bell Laboratories, its Western Electric manufacturing division and an equipment sales division, AT&T Information Services.

The 22 Bell operating companies have been regrouped as seven large regional telephone companies, separated from AT&T. As part of the Bell System, they bought most of their equipment from Western Electric. Now they are expected to buy from a growing number of equipment firms, stimulating one of the nation's most important industries.

In the end, AT&T accepted the dismemberment because it saw new opportunities in leaving its old local phone business behind and emerging as a smaller but still powerful competitor in intermingled businesses of computers and telecommunications.

By settling its court fight with the Justice Department, AT&T was able to escape from the confines of a 1956 court decree that had blocked AT&T from entering the computer business. Now, AT&T expects to be a key competitor in a fast-growing market for sophisticated computerized telecommunications equipment.

AT&T: 'Welfare State?'

The Bell breakup and the decision to throw open the door to long-distance competition has also opened the way to the escalation in local telephone rates and fundamental changes in how customers are charged for phone service.

Divestiture has wiped out billions of dollars in subsidies that AT&T shifted every year from its long-distance business to the 22 local Bell phone companies. These subsidies had helped slow down the increase in local phone rates.

The subsidy was a response by AT&T to state regulators, who saw local phone service costs rising faster than long-distance costs and complained that long-distance profits were excessive. The size of this cross-subsidy is disputed by experts, but the current estimate is $10.7 billion a year.

AT&T was able to make this transfer because, with its national telephone monopoly, it could function more like a federal government than a private corporation.

"I've said many times that AT&T was more like national government, almost like a welfare state with the power to tax some people way above cost, which they then used to hold down costs to other people," says Alfred E. Kahn, President Carter's anti-inflation advisor who has served as a consultant to the Bell System.

The people who benefitted from these "welfare" policies were phone users who rarely made long-distance calls. The people who were taxed to support those benefits were long-distance callers, particularly a handful of very large corporations that account for 50 percent of all business long-distance revenues.

The divestiture, taking the local operating companies from AT&T's long-distance arm, forced an end to the internal subsidies.

However, the loss of the subsidies confronts the local companies with a large loss in revenues, and the FCC, Congress and the courts all are involved in a battle over how that loss will be made up in higher for local and long-distance service.

Access Charge Fight

This year, the FCC proposed to replace the subsidies with access charges to be paid by residential and business customers and by the long-distance companies. Beginning April 3, residential phone users would pay $2 more per month next year, escalating to $6 per month by 1988. Business would pay $6 per phone line next year, but that fee would not increase. These are the "subscriber access charges." The long-distance companies would pay a "carrier access charge." The money would go to the local phone companies.

The philosophy was that, since a long-distance call travels part of the way over a local company's wires and through its switches, a local company should get some payment for access—the use of its services.

But the proposed new monthly charges—on the eve of a congressional election year—set off a chorus of outrage among House and Senate Democrats.

The direction of the emotion comes across in a Nov. 9 House speech by Rep. Ron Wyden (D-Ore.):

"I cannot believe my colleagues want to let the FCC lay a foundation

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BELL, From A14

for an information aristocracy where the well-to-do have [phone] access to in-home computers for shopping and banking, while senior citizens will have to fight to avoid being priced out of a phone they can use to call the doctor."

The political dilemma was clear. If members of Congress permitted the access charges to stand, they would have to explain them to voters at home.

But if access charges on residential and business customers were ruled out, as the House Democrats proposed, where would the local phone companies get new revenue to make up for what they lose with the end of the Bell subsidies?

There are only two sources: Higher local phone rates—or higher access charges imposed on the long-distance companies, prompting higher charges for long-distance calls.

Technology complicates the decision. A large business can set up microwave antennas or a private phone cable and transmit its long-distance calls directly to a long-distance carrier, bypassing the local phone network.

The local phone companies complained that if Congress blocked residential access charges, more and more businesses would bypass their systems rather than pay the higher long-distance rates.

And the loss of this local revenue would result in higher rates for the remaining local customers—just what congressional Democrats were trying to avoid. Finally, AT&T warned that if the House bill became law, the company would scrap plans for a 10.5 percent reduction in long-distance rates, eliminating perhaps the most immediate tangible benefit from divestiture for consumers.

While that fight is in limbo during the congressional holiday recess, state utility commissions are considering heavy rate increase proposals all over the country.

In Texas, Southwestern Bell filed for $691 million in higher rates and fees that would triple phone rates there. Friday, a Texas Public Utility Commission judge granted the company a $653.3 million interim increase, which Southwestern Bell called "insufficient." Pacific Telephone filed for a $1.3 billion increase in California that would double local rates, and so far has received an interim increase of $446 million.

Closer to home, C&P asked for $82 million in the District, $134.8 million in Virginia and $218 million in Maryland. C&P's request in the District was trimmed to $41 million.

The phone companies' critics see greed at work. "The operating companies took a look at divestiture and said, 'Ha-Ha, we can rip off the state commissions,' " says Henry Geller, former telecommunications adviser to President Carter. "So they came up with these outrageous rate requests."

The local telephone companies put it a different way, saying they need rate increases to make up for a loss of revenues from toll calls within state borders. These long-distance calls will be carried by AT&T or its competitors after Jan. 1—not the local companies.

Paying by the Call?

And the local operating companies argue that since they must now stand on their own, as separate utilities, the profits they return to investors must be large enough to keep a stream of capital flowing in to finance future growth and development.

But the size of the rate increase requests is only part of the controversy. There is a growing debate over the telephone companies' plans to tailor charges to the phone services received. Traditionally, a telephone company set one charge for everyone, regardless of income—one basic monthly rate paid for an unlimited number of local calls.

"When we were ubiquitous, we looked at everything the same way," says C&P's Gibbons.

The monthly residential charge averaged the costs of providing service for both the heavy phone user and the infrequent caller. It averaged the relatively low costs of serving a new suburban development or apartment house close to a phone company switching center with the higher costs of reaching a distant rural area. Some phone customers subsidized others.

Many local telephone companies—including C&P—are pushing as rapidly as they can to move customers away from the flat monthly charge in favor of a measured charge based on the number of calls and the length of calls.

"The whole idea of divestiture is to get out of the subsidy business, allow competition and allow prices to reflect costs," says Gibbons.

Thus, C&P has proposed a range of "optional measured service" packages, such as an economy service in the District that would permit customers 60 local calls a month for the discount rate of $4.51, and then charge an extra 4.9 percent for each additional call.

Almost half of all District residents now subscribe to flat-rate service allowing an unlimited number of local calls for $8.83 a month, with C&P proposing to raise it to $13.08. Those who want to escape the increase—and are willing to cut back on local calling—can switch to measured service, says C&P.

The campaign for measured charges is

bitterly attacked by some consumer activists. "They want to put a pay phone in everybody's home," complains Sylvia Siegal, founder of California's TURN (Toward Utility Rate Normalization). The campaign for measured service strikes at the basic fairness of a single flat rate for all, she says.

Under the current flat-rate system, the subsidy is substantial, phone industry estimates indicate: 20 percent of residential phone customers make 45 percent of the calls. At the bottom of the scale, another 20 percent of residential customers make only 5 percent of the calls.

And there is a growing traffic of data transmission by computer firms, who pay a flat rate although they tie up local lines for 24 hours a day, seven days a week, complains Gibbons. "That kind of cost is being shared by everybody else," he says.

Telephone industry officials say that measured service and low rates for a limited number of calls give consumers new ways to economize that were impossible in a flat-rate system.

"There are lot of options that the customer can have and still keep his rates low," says C&P spokesman Web Chamberlin.

In a year or two, C&P will be asking for permission for time-of-day pricing for local service—the same approach that permits lower long-distance charges for evening and weekend calls, Gibbons says. That will reduce the number of calls in peak periods, holding down requirements for new switching equipment, he predicts.

More and more information will be transmitted between computers over phone lines in the future, says Gibbons, and if C&P can charge measured rates for those transmissions, it should become a lucrative business that could help keep local residential rates down, he says.

"If you get away from flat-rate pricing you have all kinds of opportunities," says Gibbons.

THOMAS GIBBONS
... C&P President says rates will double soon

The campaign is nationwide. "We don't see how people can argue against paying for what they use," says John Hulse, vice chairman of Pacific Telesis, the holding company for the former Bell telephone companies in California and Nevada.

But there is an argument. The political flareup in the final days of the Bell System is a reminder that the divestiture plan has really settled nothing where telephone rates are concerned. It has merely opened a new chapter.

Next: What the new industry will look like; will competition work?

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What Divestiture Will Cost You

The following questions and answers are meant to help consumers understand the changes in phone service that take effect Jan. 1. For further information, call C&P at 800-555-5000 or AT&T at 800-555-8111.

Q: What do I do with my phone on Jan. 1?

A: First, check to be sure whether you own it or whether you are currently leasing it from C&P.

If it's leased, you have three choices. You can buy it, or continue to lease it, or you can turn it in. This month you can deal with C&P, but after Jan. 1, be sure to make the arrangments with AT&T, not C&P. The court order that breaks up the Bell System gives C&P's home phone equipment to AT&T on Jan. 1. C&P will pay you $4 if you turn in the phone this year. AT&T doesn't plan to pay for phones next year.

Q: Can I do nothing?

A: If you now lease a phone from C&P, and you do nothing, AT&T will take over the lease on Jan. 1. Although you will then owe monthly phone rental payments to AT&T, those charges will be included on your monthly C&P bill. So you can keep making one payment.

Q: How do I decide whether to buy or lease?

A: Owning clearly is far cheaper than leasing in nearly all cases. An exception could be if you own an expensive phone that requires frequent and costly repairs.

Until the end of this year, District residents can buy the basic C&P rotary dial phones now in their homes for $18.25 apiece. (This price and the other examples don't include taxes.)

If they continue to rent, the charge per phone is $1.50 a month plus tax. So in just one year, the rental charges will exceed the purchase price. The same is true in the suburbs, although the purchase price is slightly higher.

You can buy your Touch Tone desk phone for $33.00 if you live in the District or rent it for $2.71 a month at today's rates. The purchase price is $41.95 in the suburbs, where the monthly rental is $2.07 for Virginia and $2.11 for Maryland. If you buy your current phone from C&P or AT&T, you get a 30 day warranty.

Q: What if I'm moving to a place that has no phones?

A: After Jan. 1, you can rent a phone from AT&T. The charge will be $1.50 a month for a basic dial phone, and $2.85 a month for Touch Tone.

This month, C&P will sell you a rebuilt Touch Tone desk phone for $54.95, with a 90-day warranty. After Jan. 1, AT&T will charge $61.95 for a new phone and give a one-year warranty. The Public Phone Store will sell you an ITT model for $49.95 with a two-year warranty, or a rebuilt ITT model for $39.95 with a 90-day warranty. Radio Shack has a $59.95 model with a one-year warranty, and many retail and appliance stores also carry phones.

One of the best buys is a telephone company rental phone. They were "over-engineered" and designed to last 20 years or more, and current models don't have the same durability.

Repairs

Q: What if my phone breaks down.

A: If you arrange to lease your old C&P phone from AT&T, AT&T will be responsible for repairing the phone if it breaks, for no charge.

Leasing may make sense for shut-ins who would have trouble taking a phone to be repaired. If you lease from AT&T and the phone goes on the blink, AT&T will send you a replacement phone by express mail, at no charge. Or you can take it to one of AT&T's 1,500 service centers around the country.

If AT&T comes to your home to fix a leased phone, it will charge for you for time and materials. How much hasn't been announced.

Q: If I buy my old C&P phone, who will repair it?

A: AT&T will, but only if it an AT&T or C&P phone covered by warranty. If your warranty has expired, AT&T will charge you for repairs.

Q: How much?

A: C&P's current price is $27 for rotary phones, $29 for Touch Tone. In the future, AT&T's charges will vary based on costs for labor and parts. It hasn't announced those prices yet.

Q: Where are the AT&T phone centers?

A: AT&T will take over the current C&P phone stores on Jan. 1. AT&T hasn't said whether some will be closed and new phone stores opened. Call 800-555-8111.

Q: What if I bought my phone from a store and it isn't a Bell model. Will C&P or AT&T repair it?

A: No. These phones may be covered by a warranty from the manufacturer or the store that sold them. Check the warranty first. Contact the dealer who sold you the phone.

Q: If it isn't covered by warranty?

A: Some phone stores won't offer warranties on the cheapest "electronic" phones that come from Hong Kong and Taiwan. These phones use computer chips to create the sound "pulses" similar to what you hear when you operate a dial phone. Because they don't stock replacement chips, they won't attempt repairs. Their advice: If these phones break, throw them away.

Q: All push button phones aren't alike?

A: No. The "pulse" push button phones don't generate a tone and thus can't be used for computerized phone services such as home banking or the long-distance services of AT&T's competitors. And you can't use a standard rotary dial phone for these services, either.

Q: Where can I get my phone repaired?

A: Try the private phone repair shops listed in the Yellow Pages under

"Telephone Equipment & Service Systems-Service & Repair."

Q: If there's a problem on the line, should I call C&P?

A: Not right away. First, try to make certain the problem is with the line and not your phone.

Q: How?

A: If the buttons are stuck, or the dial or plastic case is broken, or a cord is split, chances are the problem is in the phone. Check it by unplugging the problem phone from the wall jack and plugging in another phone, either one of yours or a neighbors. If the problem continues, it's probably the line.

Q: If the problem is in the line?

A: C&P will fix it without charge. But if they come to your house and decide the problem was in the phone after all, they will charge you for the service call. And your phone still won't be fixed.

Q: How much will they charge?

A: C&P is currently authorized to charge $41.55 per repair visit.

Q: If I move to an older home or apartment that doesn't have the "plug in" style wall jacks. Will C&P install new jacks?

A: Yes, but it will be expensive. C&P is asking for permission to charge for parts and labor, the way other home repair services do.

For a "simple" installation of a phone jack, C&P wants to charge $21 for the first 15 minutes and $11 for each additional quarter-hour.

However, most consumers should be able to handle simple installations, using the plug-in phone jacks and instruction pamphlets available at most phone stores.

Long Distance

Q: What happens to long distance?

A: Nothing, at first. You still have a choice of using AT&T or buying long-distance service from one of its discount competitors such as MCI Communications, GTE/Sprint, ITT, Western Union, Skyline and Allnet.

The discount services don't make sense unless you make a lot of long-distance calls. Check the details. AT&T currently charges $2.70 for a five-minute call from Washington to New York City during the day. MCI charges $2.15 for the same call for a savings of 55 cents. But MCI also charges customers a monthly fee of up to $10, so you don't save money with MCI unless you make at least 19 Washington-New York calls per month like that one.

Q: After Jan. 1, do I still have to dial a lot of additional numbers if I use MCI or one of the other services?

A: Yes, but over the next three years, that will change.

The break-up ruling requires C&P and other local phone companies to make improvements to switching centers to give AT&T's competitors the same high-quality, long-distance connection that AT&T receives. They don't have that now, and that's why access numbers are required and rotary dial phones can't be used on these services.

Once the switching improvements are made in your area, you can choose to have your long distance calls routed automatically through the service you choose. Or you can choose among the various companies each time you make a call by dialing four access numbers.

Q: When will that change take place?

A: Sometime between September 1984 and September 1986, according to the plan. C&P and the long-distance companies will let you know.

Q: What will happen to long-distance rates?

A: Once AT&T and its rivals are equal competitively, federal regulators will remove the price advantage that the rivals now enjoy. Everyone expects competition to push long-distance charges lower, but future long-distance charges are impossible to predict now because Congress, the regulators and the courts still are wresting with the issue.

A New Era of Hot Competition

By Caroline E. Mayer and Merrill Brown
Washington Post Staff Writers

The game is monopoly. The board is the telecommunications industry, one of the fastest growing markets in the world.

For the past 50 years, nearly all the spaces on the board have been occupied by American Telephone & Telegraph Co., whose $66 billion in revenues this year will probably exceed all

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of the 1983 federal tax payments by all of the businesses in the United States.

On Jan. 1, the rules of the game will suddenly change, when a court-ordered split of AT&T's local and long-distance businesses takes effect.

Thousands of companies will grapple for chunks of the old AT&T empire and the outcome will affect how Americans communicate in a new age of information. It will decide the fate of AT&T, the largest corporation in the world and a unique American institution.

The stakes are great for millions of employes in the industry and its millions of shareholders. And the money on the table comes ultimately from the savings and spending of consumers.

The separation of AT&T's former local phone companies from the rest of the Bell System represents a gamble that consumers will benefit more from competition than from a continuation of AT&T's telephone monopoly.

"The whole basis of the antitrust law is that competition will drive prices down and will ultimately benefit the consumer," says U.S. District Judge Harold H. Greene, who is overseeing the AT&T divestiture. "Nobody has

See BELL, A12, Col. 1

BELL, From A1

given any good reason why that shouldn't be true in the telephone industry."

To decide whether the AT&T breakup is working for consumers one must look first at the long-distance telephone market. Today, AT&T is the Goliath of the $40 billion long-distance telephone market. Nearly two-thirds of AT&T's revenues and the bulk of its profits come from long-distance tolls. Lumped together, the Davids in the long-distance market have only 5 percent of the revenues and a single one of them, MCI Communications Corp., has 3½ percent of the business. AT&T has the rest.

Long Distance

The contenders in the long-distance ring have been growing at tremendous speed, taking advantage of rates approved by the Federal Communications Commission that make their long-distance service 20 to 40 percent cheaper than AT&T's for those who do a large amount of long-distance calling.

Jan. 1 marks the beginning of a crucial new round in the fight between AT&T and its long-distance competitors. Judge Greene's decision calls for an upgrading of local switching centers between September 1984 and September 1986 in order to give the competitors the same high-quality connection to local phone companies that AT&T now receives. This would eliminate the main inconveniences the rivals' customers now face, such as the need to push 12 additional numbers to make long-distance calls.

With increased competition, the long-distance business should boom, growing from about $45 billion to $100 billion by 1990, says Stephen Chrust, a financial analyst with Sanford C. Bernstein.

If the competition is strong, consumers could benefit from sharply lower long-distance charges, which could fall by 40 percent or more by 1990, says Robert LaBlanc, a telecommunications consultant.

But a vital and unknown factor will be the difference between the long-distance rates charged by AT&T and its competitors.

The discounts now offered by the other long-distance carriers are their weapon against AT&T. But earlier this year, the FCC jolted the long-distance industry with a decision that sharply raised the rates AT&T's competitors would have to pay local telephone companies for access to local networks.

The FCC's access charge plan, designed to increase the revenues of local phone companies, would impose a charge of $2 a month next year on residential bills, climbing to $6 by 1988. Businesses would pay $6 month per phone line.

At the same time, the plan, as currently designed, would sharply raise the rates GTE, MCI, International Telephone & Telegraph Co.'s USTS, Satellite Business Systems and other long-distance companies pay the local telephone companies for access to their customers.

And that, they say, could put them out of business. For they will be forced to raise their rates to customers, eliminating most of the discounts that enable them to set their prices far below AT&T's.

"If the access charges go into effect, then we will not be expanding in the business," says ITT's Robert Braverman. "They will make the business unprofitable."

GTE's "Sprint will try to find other ways to use our network," says company chairman and chief executive officer Theodore F. Brophy.

MCI's Chairman William G. McGowan adds, "no one will be coming in. It will be AT&T, ourselves and Sprint."

"The ultimate result will be a return to a monopolization of the [long-distance] industry by AT&T, making the coming [divestiture] of AT&T a totally futile and senseless action," the competitors say jointly in a letter to the FCC.

Charles L. Brown, AT&T's chairman, says Bell's rivals "have always complained that they're starving at the same time their business is growing 50 percent to 100 percent a year."

However, most Washington telecommunications attorneys and New York financial analysts do not believe that these firms are making idle threats this time around.

They are convinced that the FCC will revise its earlier decision and lower the rates these carriers must pay; for failure to do so could wipe out competition—just the opposite of what the FCC had in mind. If the FCC doesn't compromise, it is possible that Congress would force it to.

No matter what happens with access charges in the short run, analysts and industry officials are convinced that in the long run AT&T will have to let its 90 percent share of the long-distance market drop to at least 75 percent—or else the company probably will be dragged back in court and charged with violating the antitrust laws by trying to keep its competitors out of the profitable market.

Morris Tannenbaum, chairman-designate of AT&T's communications subsidiary that oversees long-distance service, doesn't dispute that theory, saying it could be in the company's political interests to see its market share fall.

For the next few years, Tannenbaum predicts, the competitors will continue to grow very rapidly, with a 60 to 70 percent increase in revenues each year, while AT&T's revenues will grow around 5 percent a year. "Our share of the market will decline," says Brown.

In the long run, industry experts all predict that there will be, at most, no more than a handful of long-distance companies transmitting voice traffic.

"The market can support four to six long-haul carriers," says LaBlanc, the telecommunications consultant.

"Unless you can put in your own facilities, you won't be able to exist," he says.

The most likely winners in the long-distance game are AT&T, MCI, and GTE/Sprint, most analysts say. "ITT, SBS and Western Union don't add up to a hill of beans in relation to MCI and GTE/Sprint," says financial analyst Chrust.

Chrust is particularly bullish about MCI, which plans to expand its network to every single local calling area by 1986, the only other long-distance company besides AT&T planning to offer nationwide service.

The ambitions of some of MCI's competitors are not as grand. ITT's Braverman does not plan to follow MCI's strategy. "MCI is after the large residential market. We are focusing on the medium-to-large-size business user," who will provide more revenues per customer.

Local Service

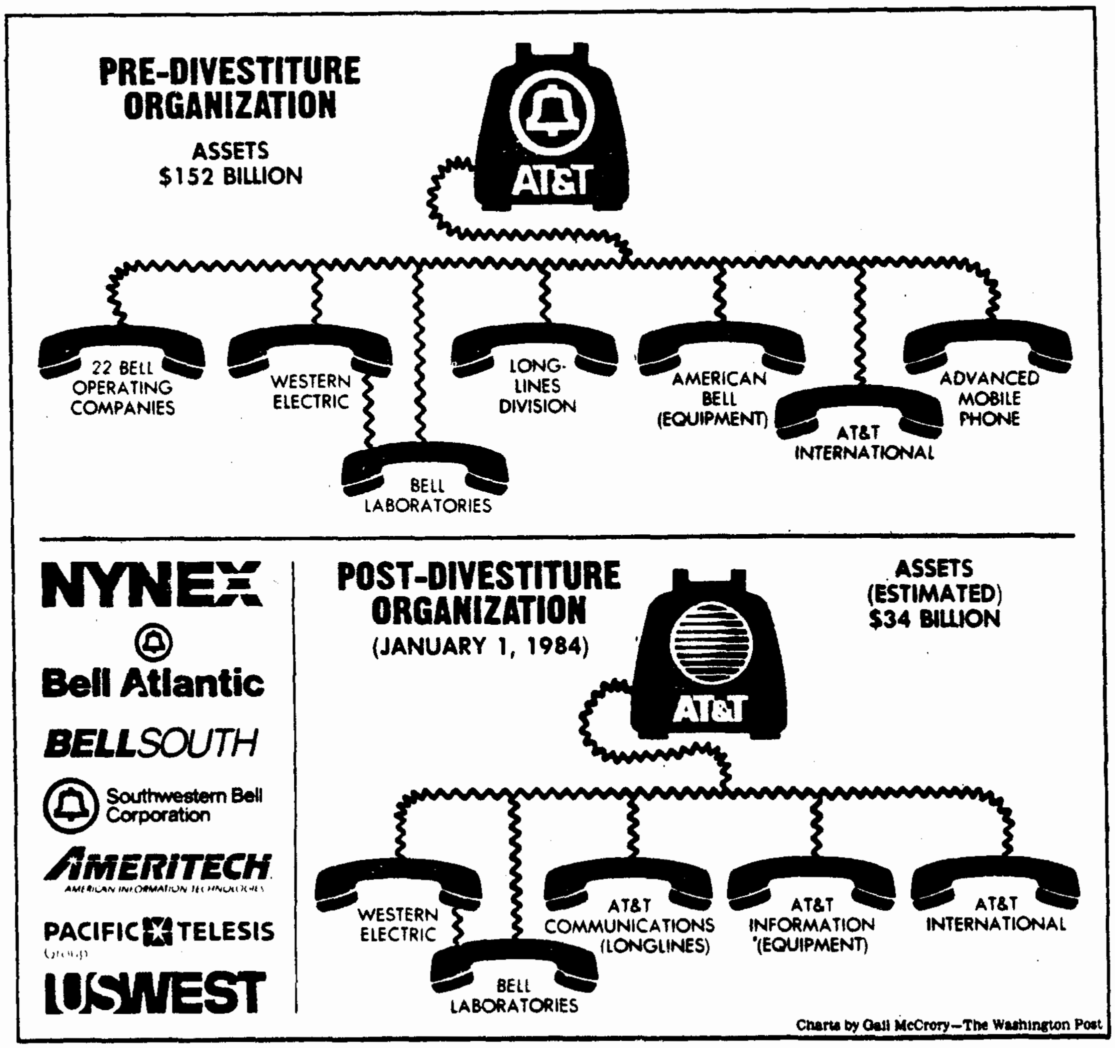
On Jan. 1, AT&T's 22 local operating companies will be spun off from the parent and regrouped into seven new holding companies. And each of these new entities, now freed from the Bell System, no longer is content to be just a local telephone company.

Untied from Ma Bell's apron strings, these regional companies are eager to test their independence in a host of new ventures, from business telephone equipment to such diverse businesses as managing real estate, repairing home computers and setting up cable televison networks. They are aiming not just at their own regions, but at possible ventures all over the country.

After being a traditional telephone company for more than 100 years, the local firms might appear to be taking a big risk to suddenly branch out into new areas, acknowledges Sam Ginn, vice president of Pacific Telesis, the holding company that will serve California. But, he adds, "we finally decided it was the most risky option" to remain only a telephone company, because that is where the revenues are the most vulnerable.

What concerns Ginn and other local telephone officials is the growing inclination, particularly by large corporations, to utilize other technologies, such as microwave, satellites or cable television wires, to bypass the local telephone system and reduce their local phone bills.

That could cause local telephone company revenues to drop significantly. Thomas Gibbons, president of Chesapeake & Potomac Telephone Cos., says 2 percent of its business customers—the largest companies—generate 50 percent of business telephone revenues. "Bypass is happening," and it hurts, says Gibbons.



Charts by Gail McCrory—The Washington Post

A recent survey by the accounting firm of Touche Ross & Co. showed that in many states over half the companies questioned said they planned at some point to bypass the telephone network. In Ohio, 63 percent of the respondents said they are using or are planning to use technologies other than the local telephone service to make intra-office and long-distance calls.

About 45 percent of the California companies surveyed say they are planning to bypass their local telephone companies, which could support Pacific Telesis' enthusiasm for diversification. PacTel wants to ring a cable television network around Palo Alto and Silicon Valley.

For Bell Atlantic, diversification could ultimately lead to data-processing and long-distance service as well as nationwide equipment sales—all in competition with its former parent, AT&T.

The new regional companies "will try almost everything," predicts Allan M. Stewart, the vice president of marketing for GTE Corp. "In fact, they will try businesses that surprise us."

But LaBlanc believes regional companies will have to abandon many of their ambitious plans and stress improved services for their telephone customers, such as using telephone lines to read residential electric and gas meters remotely or by participating in marketing, installation and billing for direct broadcast satellite systems.

Equipment

Not very long ago, a telephone was a simple device that the phone company brought to the house after you moved in.

Now, 2,000 firms are involved in manufacturing, distributing or servicing a mushrooming variety of telecommunications products, making it one of the hottest areas of consumer electronics. According to AT&T's figures, the retail market for new home phones has doubled each year since 1981. It will probably pass the $1 billion mark this year and reach $1.8 billion next year. The business market, already at $2.8 billion, is expected to grow to nearly $4 billion next year and to more than $10 billion by 1990, according to a marketing study by Frost & Sullivan.

This growing competition is expected to produce "the most vicious price war ever seen in this country," predicts Edwin B. Spievack, president of the North American Telephone Association, the trade group that represents equipment manufacturers and distributors.

And while that may spell good news for consumers, Spievack fears that the price war could do tremendous damage to his industry: "There is going to be a lot of money lost out there and a lot of companies aren't going to make it."

As is the case with many other industries, equipment firms are chasing the affluent "upscale" consumers, offering a host of fancy gadgets such as automatic dialers, call screening, conference calling and in-home intercoms, which up to now have not been widely available to the ordinary consumer.

Publicly, at least, few U.S. phone manufacturers say they want any part of the cheap, "disposable" residential phones now being sold, predicting a lot of consumer dissatisfaction with the quality of that equipment.

That opens the market even wider for foreign firms, which have been flooding the United States with imports.

For the first nine months of this year, imports of telephone instruments climbed to 18.5 million, nearly nine times the total in 1982. The bulk of these phones were from the Far East, geared towards the residential market, according to the international market research firm of Stoll Gasman Inc.

While a few companies, including new entrant General Electric Co., are counting on a big payoff from the consumer market, most others are aiming at business equipment, moving towards sophisticated products that tie telephones into computers, word processors and other office-of-the-future equipment.

AT&T is clearly gearing up its equipment towards that direction.

"We expect AT&T to make a major entry into the data processing/office automation markets, with a product line ranging from teleterminals to personal computers to minicomputers," predicts Probe Research Inc. in its new report, "The Future of the New AT&T."

Analysts expect AT&T will make a major entry into the data-processing market with the unveiling of a desktop personal computer early next year.

Among AT&T's strengths, Probe Research says, are its semiconductor manufacturing capabilities. It is producing a state-of-the-art computer memory chip that can store more than 256,000 bits of information—four times the capacity of current chips.

Yet, Probe notes, AT&T will first have to overcome some serious corporate weaknesses, including flabby marketing and an inflexible organizational structure that is not known for prompt decision-making.

Dick Moley, vice president of marketing for an AT&T competitor, Rolm Corp., says, "We're not terrified by them . . . I think we've all been underwhelmed."

AT&T will hold on to Western Electric, its manufacturing arm, but Western will lose its best and biggest customers when the local operating companies are spun off. Formerly Western's captive customers, these companies will be turning to AT&T's competitors to buy everything from simple telephones to sophisticated electronic gear to run their networks.

Largely because of that, financial analyst Bradford L. Peery of Sutro & Co. expects that Western will reach only half of its normal rate of profitability, or $430 million, next year.

That makes divestiture "an excellant opportunity for ITT," says John W. Guilfoyle, president if ITT Telecommunications Corp.

It is similarly a boon for GTE, TIE, Com-Dial and Northern Telecom, AT&T's major equipment rivals, who are likely to be joined by new companies that will jump at the opportunity created by divestiture, says Spievack.

Another big winner will be International Business Machines Corp. Many industry officials expect a bloody battle between IBM and AT&T, as each tries to enter the other's market, and AT&T's chairman Brown seems to be holding out an olive branch. "We aren't at the heart of each other's business, and I don't predict the demise of either of us because of a competitive environment," he said in a recent interview. "There's plenty of business here for both of us."

The New AT&T

And what of AT&T? Will divestiture cripple what many regard as a keystone of America's industrial foundation?

Its size will be drastically reduced Jan. 1. Its $152 billion in assets before divestiture—10 times the value of all taxable commercial property in the District of Columbia—will be valued at $34 billion after the breakup.

But AT&T will still be the nation's fourth largest company, behind Exxon Corp., General Motors Corp. and Mobil Oil Corp.

AT&T will lose one of its chief assets come Jan. 1 when it surrenders control of local telephone companies: its direct link to 70 million households.

Even so, Western Electric will still give it the largest manufacturing capacity in the telecommunications industry. AT&T also will retain Bell Laboratories with its $2 billion annual research budget.

Most significantly, AT&T will continue to dominate the long-distance business, which will provide nearly two-thirds of its revenues and account for the bulk of the $2.1 billion in profits AT&T expects to record next year.

This deep current of cash will help finance AT&T's entry into data processing and other unregulated, non-telephone activities—ventures it has up to now been barred from entering under an earlier government agreement. That agreement is lifted with divestiture.

"They have the critical mass to hang in there," says LaBlanc. Profits from long distance alone "will feed them until Western Electric finds out how to [compete]."

Additionally, in an effort to recoup some of its lost revenues, AT&T is making a big push to enter the international telecommunications market. "Our intention is to be a global market leader," Brown said in a recent speech.

It will not be easy for the 107-year-old utility to change its spots and become a competitive high-technology telecommunications company.

"We're not naive enough to say that this business is going to be a piece of cake," admits James Adams, a vice president of the Western Electric's Consumer Products division.

Being smaller may have important benefits, however. "For AT&T, being too big meant that all of its elements had to sign on to individual strategies [and] programs, a process that killed many projects of reasonable merit," notes Ivan L. Wolff at Donaldson, Lufkin & Jenrette.

Even so, adjusting to its new size and the new competitive, unregulated arena will require a difficult adjustment.

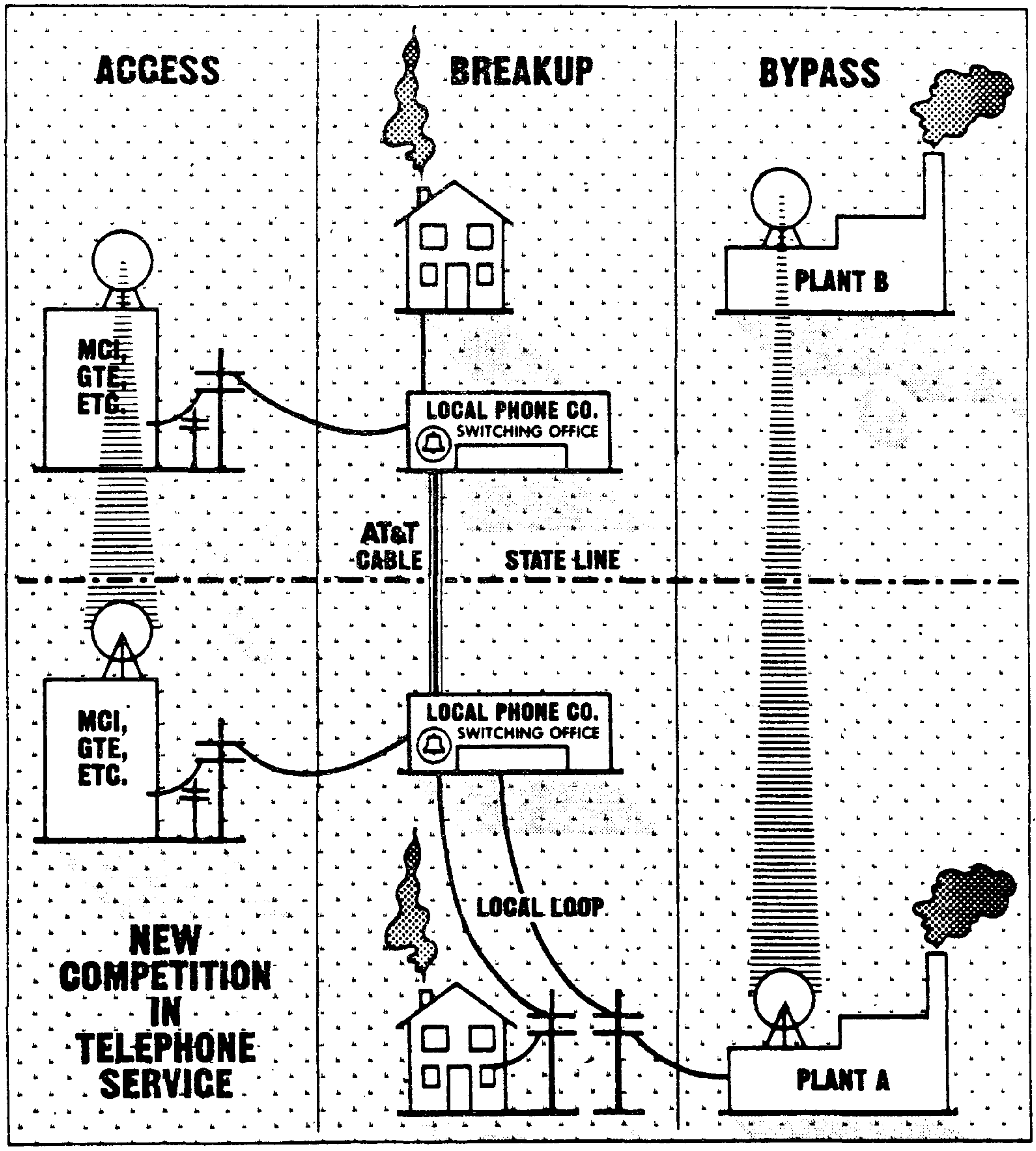
"In the short term, they've got some problems," says John Bain, a first vice president and telecommunications analyst at Lehman Brothers Kuhn Loeb Inc. "For the past 70 years, they sat down and decided what would be offered to the public. Now they are at the point where . . . the customers and not the company are making the decisions."

Yet, Bain adds, few companies have such dramatic technological advantages in the new telecommunications world. "They will be big, they will be good and they will be making money. But they will never be a 100 percent monopoly supplier of anything again."

Having fought long and vigorously against divestiture, AT&T officials say they eagerly await the new era of competition.

"It wasn't our idea," says Brown. "But we're going to do the best we can to make it work."

Next: The telephone of the future.



BREAKUP: On Jan. 1, American Telephone and Telegraph Co. gives up its former local phone companies but keeps its long-distance network and other businesses.

ACCESS: Satellite and microwave technology enables AT&T's rivals to cut into AT&T's long-distance business offering cheaper service. A key issue after Jan. 1: How much will AT&T and its rivals have to pay local phone companies for transmitting long-distance calls over the local network? AT&T's rivals want to continue paying a lot less that AT&T to maintain cheaper prices.

BYPASS: Local phone companies are threatened by bypass. Large businesses can create communications systems to send calls and data rather than going through the local phone company. In this example Plant A transmits directly to Plant B. The two plants also could communicate through a long-distance service without going through the local network.

Technology Changing How We Communicate

By Michael Schrage
Washington Post Staff Writer

Roughly 2 billion times every day, people all over the world pick up a telephone at home or at work and give someone a call. Randomly sample those calls and chances are you'll hear, in a diversity of languages, the bits and pieces of people's lives.

In the telephone network of the future, the few human operators left won't hear many voices on the line.

Conversation will be transformed by computers into bits of numbers that pulse through wires and off satellites, squeezed in with music, pictures and virtually any other form of information and intelligence you can imagine. The telephone network is becoming the highway of the information age.

And in the process, the way people communicate, seek information and obtain intelligence will be radically altered.

TURMOIL OVER TELEPHONES

CONCLUSION

"An old-time operator patching into a line would hear voices," says Robert Lucky, executive director of communications sciences research at American Telephone & Telegraph Co.'s Bell Labs. "Now, there's data and music and graphics. There's more of real life flowing by in more and more quantities. There's more of the essence of life."

The shape of the future is evident in the Bell System network of today, which already has to transmit much more than voice conversations. Phone lines today carry high-quality television pictures and the electrical impulses necessa to make remote electrocardiogram heart diag..osis possible. High fidelity music, text, animation, sensory data, light, color, remote control commands, information from computerized data bases, communications between personal computers, video games, music videos, the news,

See BELL, A18, Col. 1

BELL, From A1

facsimile copies of documents, numbers, instructions and money all circulate through the network as disembodied bits of information.

"Today, you think of the network as something for reaching out and touching someone verbally," says Lucky. "I'd like to think it's becoming something that puts you in touch with a larger intelligence. Whether human intelligence—singly or in groups—or computer intelligence. What we're talking about here is accessing intelligence."

This technology revolution was a vital source of pressure leading up to the court-ordered breakup of the Bell System on Jan. 1. The breakup, which permits Bell's former telephone companies to buy from any equipment supplier they choose and encourages consumers to do the same, is certain to lead to even faster technological change.

The telephone itself will soon be something far more powerful and expressive than it now is, as today's dividing line between computers and telephones disappears and the two instruments become one.

The bumper crop of "smart" telephones that fill the counters of phone stores and the pages of mail order catalogues are a crude forerunner of what lies ahead.

"The feature content of the telephone will dramatically expand," says Allan M. Stewart, a vice president of GTE Corp. Before 1990, phones with memory to store telephone numbers and dial them automatically; portable phones; home phones with features now reserved for businesses, such as intercom and conference calling, will cost no more than the basic telephone today, says Stewart.

Smart Phones Act Like Computers

Bit by bit, the telephones of today are becoming digital dinosaurs. Just as the Touch-Tone surpassed the rotary dial phone, new technology will make the Touch-Tone beeps obsolete.

"Soon, you won't be dialing anything," asserts Sol Buchsbaum, an executive vice president of Bell Labs. "You'll be talking to your terminal and telling it what to do. That'll be no problem in 10 years."

Buchsbaum says he "will be disappointed if we don't have a phone with a voice-recognition chip in it within five years."

No doubt, future phones will have a speech synthesis chip to go along with the recognition chip so that they can actually tell if you're asking for a wrong number. Perhaps it will speak in a voice or accent you find pleasant. The point is that it will be a home appliance that transforms people's expectations of what technology can do for them.

The telephone of the future will also be a computer. It will be as programmable as any state-of-the-art personal computer. In fact, if you're phone isn't also a personal computer, the chances are your personal computer will also be a phone.

"We will make telephones more intelligent," says Lucky. "The phone is going to look like everything you can possibly imagine. But maybe we're stuck on the word 'telephone' because that's not what it will be when we're through with it. Maybe we need another word, like 'teleterminal.' "

By the turn of the century," asserts one Stanford University computer scientist, "there will be telephones that are smarter than the people using them."

That's a technocratic vision of the future, but it reveals just how strongly some people believe that the technology of communications will help reshape the world.

"If you recognize what's going on," says Michael Tyler, chairman of CSP International, an international telecommunications consulting firm, "you'll know that we are in the information age."

By 1992, according to one IBM estimate, the global demand for information technology products and services will exceed $1.4 trillion, making it the fastest growing industry in the world.

The core of that global growth will be telecommunications. Wire, cable, satellite and virtually every band of the frequency spectrum will be exploited to carry the data of the information age. "Telecommunications is the leading area of infrastructure in the world today," says Tyler of CSP. "Telecommunications technology is as fundamental to the information age as the automobile and the highway system have been to us over the past fifty years."

Two mutually reinforcing trends are driving this redefinition of information and the networks that carry it, according to IBM's Stephan H. Haeckel, director of Advanced Market Development for IBM. "The first trend," he says, is "the rapidly falling cost of technology."

The introduction of the microprocessor a decade ago and the phenomenal cost-efficiencies of mass produced silicon chips has made computer intelligence cheaper than ever before.

"There will be more microprocessors made than McDonald's sells hamburgers in 1986," said Bell Labs scientist Arno Penzias, who won a Nobel for physics in 1978.

Computer intelligence isn't the only thing getting cheaper. The cost of transmission also is declining because of technological breakthroughs in satellite and microwave communications, as well as in optical fibers, which carry information in the form of laser-light impulses. These new technologies allow people to create their own private telecommunications networks that can alternately bypass or complement the mammoth national telecommunications network of AT&T. As the "threshold of affordability" declines, says Haeckel, new uses for the technologies are more easily justified.

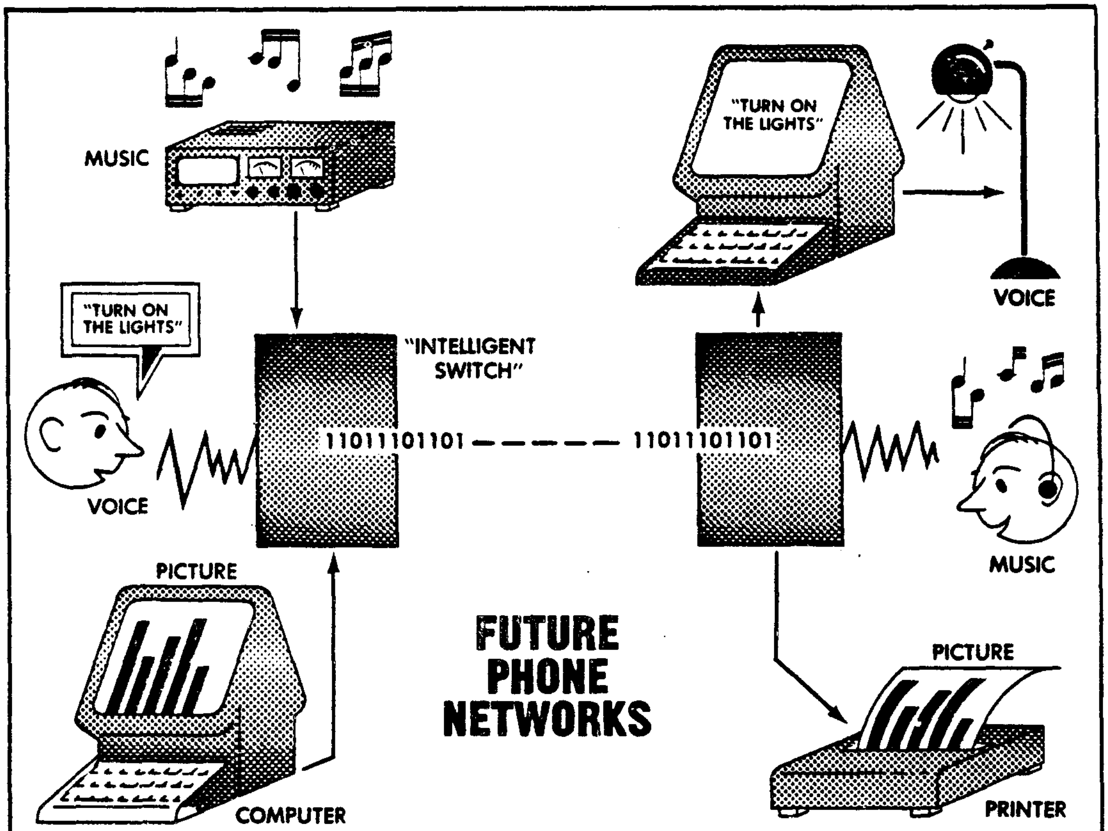
The second trend is subtler but equally important. It is the rate at which all the disparate forms of information—text, image and data—are becoming "digitized," says Haeckel. That is, all these different kinds of information can be broken into the binary number combinations of ones and zeros that computers are particularly adept at processing. Even the human voice can be split into little digitized packets representing sound and piped down wires or bounced off a satellite in the same way that ordinary data are.

This shift in the information flowing through telephones and computers and television screens is doing something critical: it is changing consumers' expectations of what information is and what information technology can do.

"One of the big questions about divestiture is how it will affect the average American who is not technically inclined," says Bell Labs' Buchsbaum. "How is the technology going to bring synergism to the separate technologies in the home?"

The blend of low-cost and digital communications means that formerly incompatible technologies can now talk with one another. It means that your teleterminal could soon become the communications hub of the house—interconnecting appliances, thermostat and all the computers in the home into a little network of its own. You should be able to call up your home and tell your teleterminal to start defrosting the refrigerator.

It means your teleterminal, in its phone guise, should be able to store phone numbers, make calls and serve as a



The telephone network of the future: With the spread of home computers and computerized telephones in the next few years, the telephone network will carry not only voices, but pictures, data, financial information and every other conceivable form of information. "Intelligent phone switches" using computer technology permit the conversion of sounds and pictures into coded numbers that can be unscrambled at the other end of the line and recreated in the same or different forms. Thus a person could "speak" to a home computer over a telephone connection, instructing it to turn on the lights or control home appliances. By Gail McCrory—The Washington Post computerized "switch" that lets you transfer calls to other lines. It can serve as an electronic mailbox that sends text messages to other teleterminals on the network. You may have access to "bank at home" service and see "shop at home" catalogues on the teleterminal screen and place your order electronically to the company's computer.

Computer data banks will proliferate to the point where your teleterminal can retrieve useful nuggets of information—such as stock quotes or the betting line on Sunday's game—or actual computer programs that you would "offload" into the memory of your teleterminal for later use.

You or your children might choose to play video games against other people or other machines on the network, not always knowing with whom or with what you are playing.

The teleterminal may also come in portable form. It may fit into a pocket or travel along in a car and use cellular radio technology to link to voice and data networks. The market will take the teleterminal to whatever shapes and sizes and functions that sell.

Fundamentally, though, it means that you can communicate with people in ways other than just the sound of your voice. All manner of information—from pictures to text to voice to perhaps even tactile sensations—all can be captured by digital transmission.

You can "touch a pool of people in different ways," says Bell's Lucky. "You can do the equivalent of writing graffiti or sending junk mail or just browsing through all the messages on the system. It's something new."

Technology vs. Regulation

Successful new technologies always affect society. The difficulty with the technology of the information age is that it has constantly warred with public policy. Technical innovations were hamstrung by the regulatory structure and AT&T's monopolistic structure. Many experts argue that it was the advance of technology, much more than free market ideology, that thrust the Bell System into the regulatory and legal whirlpools that ultimately shattered it.

The irony, perhaps, is that Bell's technical brilliance may have sown the seeds of its own destruction. For example, in the 1950s, Bell Labs created the semiconductor technology that made silicon chip computers both possible and practical. Increasingly, the phone lines were used to permit computers to exchange data. Bell began offering special services to its computer users and gradually sought to enter the computer business itself.

In the 1960s, the mix of communicating computers and computing communications equipment had backed the Federal Communications Commission into a nasty problem of semantics. Technology had made a Möbius strip of communications and computations—one ran into the other and back again. Drawing a clean regulatory line between the two had become virtually impossible.

For example, create a phone that has a built-in pocket calculator, a useful device when talking with accountants, bankers and bill-collectors. You could keep tabs on the numbers as they came up in conversation. Suppose your calculator could pipe its calculations down the phone lines and into the calculator of the person you're chatting with. That calculator, in turn, runs your numbers through a little program and then sends the new-and-improved numbers back. You fiddle with them until you're satisfied, check them by voice, make small talk and hang up.

Is that pocket-calculator-phone a telephone, a computer terminal or a computer? If it's all three, when is it which device?

Could it follow from this that the FCC should regulate the calculator—and, by extension, the computer industry?

In 1970, the FCC thought that might be the case and launched what it called a "computer inquiry" to find out.

The flip side of that question proved equally troublesome. If the technologies of communications and computations were converging, why shouldn't Bell offer computer peripherals and data processing services in the marketplace? Bell might have cheerfully gone into those new businesses, but a 1956 Justice Department antitrust consent decree prohibited it from offering any unregulated products and services. That meant that if Bell wanted to sell computers, those sales would have to be regulated by the FCC. But if Bell's computers could be regulated, why shouldn't IBM's?

To further confuse the situation, new technologies prompted challenges to Bell's traditional monopoly preserve. Satellites and microwave distribution—technologies not imagined by the framers of the 1934 Communications Act—shifted the economics of long-distance communications away from the monopolist structure and to the entrepreneur.

Moreover, other companies wanted to link their communications products to Bell. The phone company responded the way an organism's immunological system responds to unwanted bacteria—with rejection.

In 1968, the Carterfone company sued Bell for the right to attach its product to the network. Bell argued that it was responsible for protecting the network's performance and that it alone could determine what "foreign attachments," if any, could be hooked into the lines. Bell's position was ultimately rejected by both the federal courts and the FCC, and the rulings helped accelerate the network's shift from simply carrying voice to carrying an array of information.

Those battles underscored the belief held by many in the technology industries that Bell was trapped into being a telephone utility rather than an information utility, and innovation suffered as a result.

"One hundred years after the invention of electricity, there was a vibrant and diverse appliances industry in this country," says Robert E. LaBlanc, a telecommunications consultant and former vice chaiman of Continental Telecom Inc. "One hundred years after the invention of the telephone, only 50 percent of the households in the Bell System have more than one phone.

"If a monopoly like Bell had run the appliance industry, you'd now have something like a couple of lightbulbs in your house, each with a thick cast-iron chandelier that will never, ever break and with a filament that would never burn out.

With the arrival of affordable "smart" phones, "we're going to see a very vibrant market in customer premises equipment after divestiture," said LaBlanc.

"I look at divestiture as a good thing for us," says Bell Labs's Buchsbaum. "For the very first time, our scientists and engineers are truly free to follow our technologies where they may lead us. It opens vistas we never had before."

"It means a whole new series of opportunities for the entrepreneur," says William von Meister, a co-founder of The Source, a personal computer network now owned by Reader's Digest that makes financial information, news, games and other services available for its customers. Von Meister also is chairman of Control Video Corp., a tiny, year-old company that wants to distribute video games and computer software over phone lines and into home computers. "I'm very excited by [divestiture]. The personal computer software market may be $32 billion by 1992—and half of that might be capturable by our kind of 'down-line' distribution."

That kind of opportunity, says von Meister, simply might not be there if entrepreneurs or even larger, well-established companies, had to deal with an AT&T monopoly extending from long-distance service to local telephone equipment.

Cracking that monopoly may be the incentive necessary to produce a cornucopia of technological products and services for the information age. Yet that means it will be the market and consumer demand, not public service, that will be the foundation of the information age. It means the biggest and most intensive users of telecommunications services will reap the lion's share of benefits.

That represents a fundamental shift in public policy, away from the historic goal of promoting "universal access" to basic telecommunications services.

Will Society Be Divided?

Because of this new emphasis on economics rather than service, telecommunications quality could vary from region to region. Some operating companies may prove more adept at introducing the new technologies and services than others.

With the industry now driven by the profit motive, many observers believe that there will be a society split between the "information rich" and the "information poor," with the line between the two drawn by price.

"There's no question that there will be a differential between people," says John Legates, managing director of Harvard University's Program on Information Resources Policy. "What isn't clear to us is whether being information rich or information poor is any more significant than any of the other discriminants."

However, others believe that the difference will be as significant as those who are or are not functionally literate in society. If information is the stuff of the information age, they say, then the people and companies who can't afford easy access are at a competitive disadvantage that may prove insurmountable.

The problem assumes global proportions. In "The Geopolitics of Information," media observer Anthony Smith points out that the Third World countries lag far behind the industrialized world in both telecommunications and computers. Indeed, most Third World countries do not even have an adequate telecommunications infrastructure and are thus unable to take advantage of the benefits a more advanced communications system can provide. As the rest of the industrialized world comes to rely on information technology for improved efficiencies, says Smith, the gap between the rich and poor nations widens.

"Technology advances are by nature international," says Harvard's Legates. "Everyone will be subject to the same market demands. It's simply a matter of time."

Technology has forced a massive reevaluation of laws and policies governing telecommunications not just in the United States but in virtually every industrialized country. West Germany, England, France and Japan all are in the throes of creating new structures for their telecommunications industries.

"The underlying phenomena are global phenomena—new technologies," says Legates, "and what we're seeing are different national approaches to it. In this country, it was divestiture."

Clearly, though, there is no stopping technology. Regulation or no, innovation continues.

"Nobody in college told me that my real world would change exponentially every few years," says Bell Labs' Lucky. "You never really learn to live with it—it would be nice to take a break.

"You know, when I came to Bell in 1961, we had a different vision of the future. We were working on the Picturephone and that kind of Buck Rogers stuff. Instead of the world of pictures, we're going to get the information age."

At the Bell System's long-distance nerve center in Bedminster, N.J., traffic managers watch for overloads while tracking more than 21 million calls o

Economy & Business

COVER STORY

Click! Ma Is Ringing Off

The breakup of giant A T & T sets the stage for a telecommunications upheaval

Time is running out for the largest company on earth. Ending too is a long era of inexpensive phone service that Americans have taken for granted. But just on the horizon, heralding its arrival with the attention-getting power of a jillion jangling telephones, is a revolution in telecommunications. Propelled by both marketing and technology, the coming changes will rank second in importance only to the establishment of the U.S. telephone system itself, acknowledged as the world's best.

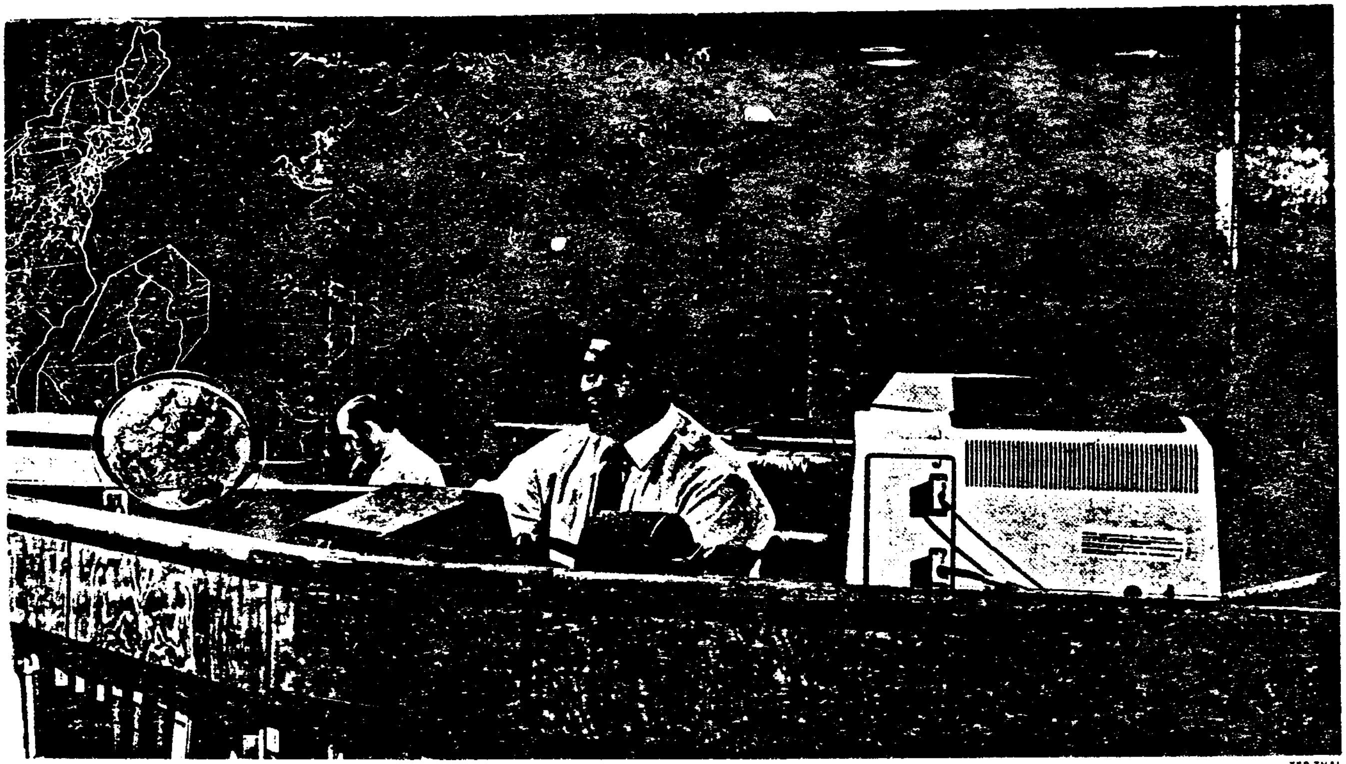
It all starts happening on New Year's Day, just six weeks from now. Under the banner of promoting competition in the U.S. phone service, American Telephone & Telegraph, the Bell System, will die at age 107, shattered in the largest court-mandated breakup of a company since the split-up of Standard Oil in 1911. In place of the old Ma Bell will stand the "new" A T & T and seven regional telephone holding companies, all beginning life as giants and carrying such unfamiliar names as Nynex, Ameritech, U S West and Pacific Telesis. The eight new companies will immediately join the ranks of the 50 largest U.S. corporations in terms of assets.

The breakup will affect all of America's millions of phone users in ways large and small. Instead of receiving a single monthly bill for phone service, for example, consumers may now get three or more: one for local service, another from one of A T & T's proliferating competitors for long-distance tolls, and one from A T & T Information Systems for the lease of the telephone. Many people who previously rented their phones, though, may now buy them outright. Next week A T & T will launch the biggest private direct-mail operation in history. It will send brochures to 70 million customers telling them that under divestiture it will be taking over ownership of their telephone equipment. Consumers currently renting phones will be given options to buy them, continue leasing them, or purchase new equipment from A T & T or from non-Bell suppliers like Uniden or GTE.

For the moment the clearest thing about the breakup of A T & T is the confusion. As recently as last week, it was unclear, for instance, whether local phone companies had the right to offer phone services like weather and time of day after Jan. 1. The gigantic physical task of divvying the Bell System's assets among the new parts, from whole telephone exchanges down to trucks, repair equipment, paper clips and brooms, is still going on. Though phone service has not been hampered, companies trying to do business with Bell report that they sometimes have trouble finding out who is in charge of an office or division.

Much of the American public seems bewildered about the breakup. Polls show that only one in five people knows what is about to happen to their phone system. Says Cecil Woods, 33, a Chicago maintenance worker: "I think it's supposed to be a good thing for everybody, but I don't quite understand how. I just hope something good comes of it, and I think it will."

Even among those who are aware that something big is on the way, there is gnawing concern that telephone service will suffer. Says Yale Professor Stephen Ross, an expert on telecommunications: "We may be trading in a Cadillac for a Ford." Frets Senator Barry Goldwater, normally a fan of freer markets and less government regulation: "We're going to be sorry that we tampered with a system that was functioning well. I wish



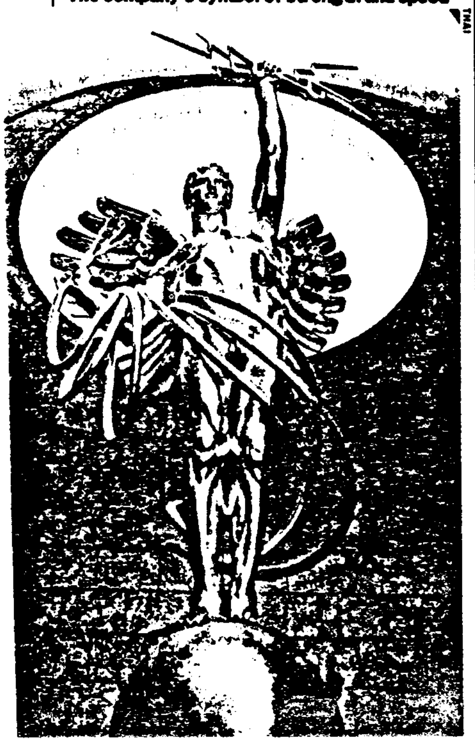
typical day. The torrent of messages began 107 years ago with the statement: "Mr. Watson—come here—I want to see you"

TED THAI

this divestiture had never happened."

Consumers seem apprehensive—and concerned. Colleen Todd, 32, a writer for a Tulsa ad agency, says, "Ideally, I think breaking up the monopoly was the thing to do. But realistically, I'm not sure it was the thing to do. I don't think it's necessarily a bargain for the consumer." Says Wilbur E. McCoy, 42, a machinist from Akron: "From what I hear, it's going to cost me more money for them to break up a monopoly. To tell you the truth, I never looked at A T & T as a monopoly, but I guess that's what it is." Worries Dorothea White, 86, a widow living alone in Los Angeles: "I think it'll make my phone bills go up. I don't really see why they had to break it up. It was a good system, and it seemed to be working."

The company's symbol of strength and speed



Those concerns about higher phone bills have been heard by vote-sensitive Washington politicians, who are rushing in with legislation to keep prices down. Last week, despite heavy opposition from A T & T's lobbyists and the Reagan Administration, the House passed decisively a proposal to ban a surcharge on local phone bills that was to be part of an overall restructuring of phone prices.

To Wall Streeters and communications-industry executives, the breakup presents countless questions and, particularly for stockbrokers, the opportunity to make a great deal of money. Will the new parts of A T & T be equal to the whole? How well will the new companies adjust to the world of competition after decades of guaranteed prices and government regulation? Will the corporate culture of the old Bell System, with its emphasis on service, be lost or weakened?

A T & T and its seven new sisters will begin answering some of the questions this week, when they file stock-registration statements with the Securities and Exchange Commission, along with volumes of financial projections as big as Manhattan phone books. What investors think of the new companies' prospects will start becoming clear later this month, when something like 655 million shares of seven holding companies begin showing up on the New York Stock Exchange. They will be offered on a "when issued" basis, meaning they will be traded as if they already existed, even though the stock certificates will not be delivered until mid-February.

A total of 3.2 million individuals and organizations own shares in A T & T, the paradigmatic "widows and orphans" investment, making it the most widely held security in the world. People now holding A T & T stock will keep those shares, which will automatically be equity in the new A T & T. And for every ten of those shares, they will receive one share in each of the seven regional companies. Investors with fewer than ten shares will receive cash for their partial holding.

Just printing the new stock certificates cost $2 million. Distributing them and dealing with other transfer details of the new issue require an A T & T staff of 1,400, housed in a three-story building in Jacksonville. Individual investors with ten to 499 shares will be able to swap stock ownership among the seven new regional companies through A T & T at a cost of 25¢ per share until mid-April.

But there will also be plenty of trading on Wall Street. The New York Stock Exchange is adding a computer to the three it already uses just to keep up with an anticipated 15 million-share-a-day increase in trading volume.

What should an A T & T investor do? Buy, sell or hold? Experienced Wall Streeters advise: do nothing immediately, just wait for the chaos to subside. Once it does, investors could begin trading out of one holding company and into another or concentrate their investment in the new A T & T. Merrill Lynch, Dean Witter and several other brokerages have set up mutual or trust funds made up of stocks from all the new companies. The accounts, called Humpty Dumptys, in effect put A T & T

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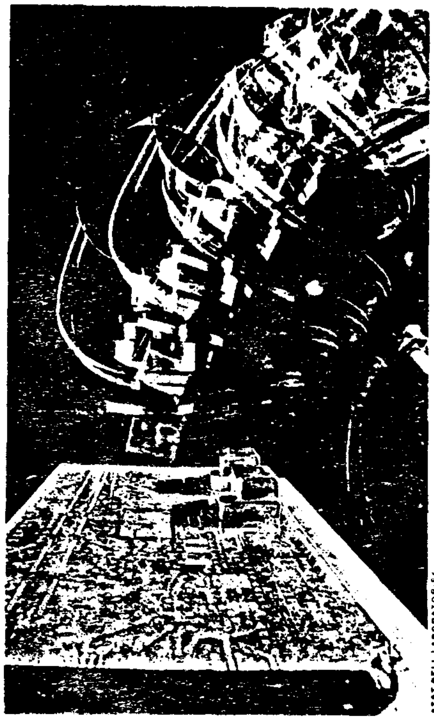
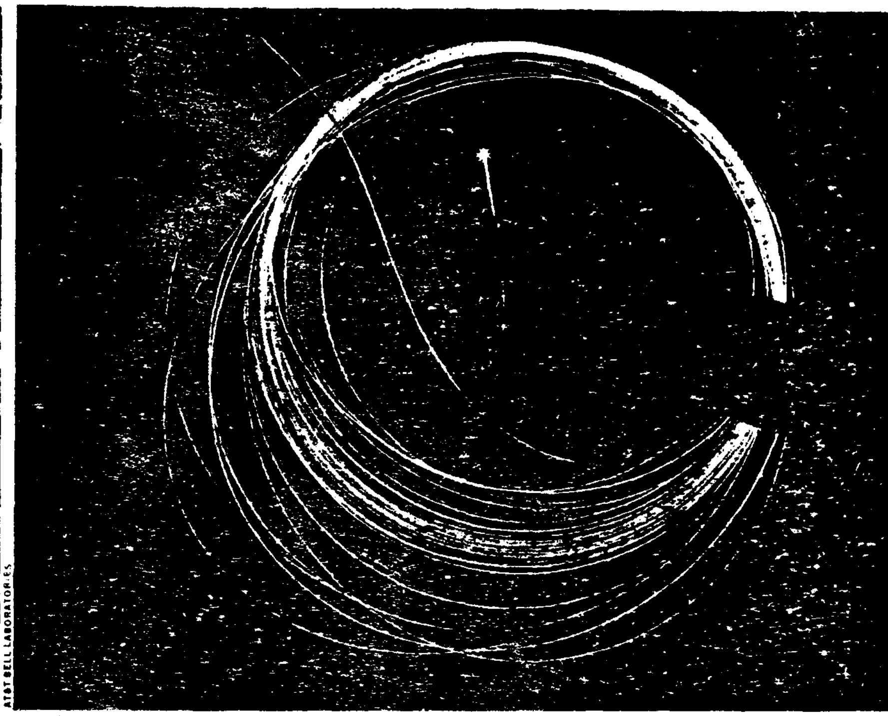

A robot arm being tested at Western Electric


Wonder wire: a strand of glass fiber, here illuminated by laser, can carry voices on light waves

AT&T BELL LABORATORIES

back together again for an investor.

The American phone network and the A T & T divestiture are collections of superlatives. After all, the Bell System has spread telephones just about everywhere imaginable in America, from the bottom of the Grand Canyon to the 106th floor of New York City's World Trade Center. Americans make more than 800 million phone calls a day and have twice as many telephones (183 million) as home toilets (87 million).

The breakup of A T & T has so many possible ramifications that few people even pretend to understand it thoroughly. Wall Street firms have held dozens of investor seminars on the divestiture, all run by veteran staffers bristling with law degrees and M.B.A.s. But at one session last month, "I don't know" was a tellingly frequent response from, among others, panelist Alfred Kahn, chairman of the Civil Aeronautics Board under Jimmy Carter. An expert on the telephone industry, Kahn presided over the deregulation of U.S. airlines in the late 1970s and is now a professor of political economy at Cornell. Says Ulric Weil, telecommunications analyst for investment bank Morgan Stanley: "No honest observer can claim to know where this is all going." Agrees Peter J. Jadrosich, a vice president of Paine Webber Jackson & Curtis: "We believe historical performance may be nearly irrelevant to predicting future success."

History, in the case of the Bell System, goes back more than a century, to March 10, 1876. That was the day Alexander Graham Bell, 29, sent his booming voice over a wire to an assistant: "Mr. Watson—come here—I want to see you." Bell's patent, which was actually filed before he built a working telephone, made possible the construction of the American phone network.

It was Theodore N. Vail, though, who invented the Bell System. Brilliant, sweeping, subtle, an organizing genius with uncanny foresight, Vail was boss from 1878 to 1887, during which time he put together all the pieces of the modern goliath. He built up an engineering department to develop new phone technology, and a manufacturing department to build telephone equipment. All the while he systematically sought to exclude non-Bell phone companies from his network. But Vail felt thwarted by Boston financiers more interested in fast profits than his far-reaching ideas, and so he quit at 42 and went into retirement.

In 1907, after a 20-year absence, bankers summoned Vail back to save A T & T from financial ruin. The company was a mess. The original Bell patents had expired. Populists were attacking the firm over rates, and farmers were organizing their own telephone companies. The system was becoming technically obsolete; independents offered dial phones before Bell. Within a decade, Vail had transformed A T & T into a communications power. By the time he died in 1920, he had set the foundation for vigorous growth. Indeed, A T & T by 1929 was the first corporation to generate annual revenues of more than $1 billion.

In a series of famous essays, Vail put forth the idea that fatter profits are not the be-all and end-all of a corporation. Service counts more, he wrote, and the Bell System could deliver it best by being a regulated monopoly that struck a balance between public and private interests. In a 1908 advertising campaign, Vail sounded the theme that prevailed until the current divestiture: "One system, one policy, universal service."

Monopoly, to Vail, meant that A T & T would have U.S. telephone service mostly to itself, in exchange for submitting its rates to federal and state regulatory authorities for approval. Non-Bell phone companies, which handled about half the phones in the U.S. at that time, did not like that idea. Neither did the Federal Government. It questioned Bell at every turn. As far back as 1913, when European phone systems were being nationalized, the Postmaster General advocated Government ownership of the phone system. But a privately controlled monopoly seemed to be the most efficient way to run a national phone system, and Vail's concept won out.

A T & T's quasi-monopoly, however, was always an uncomfortable arrangement. The company wanted to get into related fields like computers when they began developing; other firms were eager to enter the phone business; and the Government was worried by the size and power of the telephone giant. In a far-reaching decision, the FCC in 1968 allowed a Texas firm to sell a device called a Carterfone, which connected mobile radios to A T & T lines. It was the first time any non-Bell product had ever won the right to be wired into the Bell System and was the first electronic breach in the monopoly.

One by one, other bars to competition began to fall. By the end of the 1960s certain forms of long-distance telecommunications other than Bell's were approved by the FCC. Still, Bell supplied 79.5% of U.S. telephone service. That was too much, said antitrust enthusiasts. On Nov. 20, 1974, the Justice Department filed a


AT&T BELL LABORATORIES

Worker installing high-tech gear atop a pole

JOHN MC GRAIL

At a retail outlet in a shopping mall, styles range from basic black to Mickey Mouse

suit to break off Western Electric, the telephone company's manufacturing division, from the rest of A T & T.

The Justice Department's suit dragged on endlessly in court like the Jarndyce and Jarndyce case in Dickens' *Bleak House*. The first judge in the case died and was replaced in 1978 by Judge Harold Greene, a refugee from Nazi Germany who had helped draw up the Civil Rights Act of 1964 while working in the Justice Department. Greene conducted more than 18 months of hearings, pretrial discovery and major filings by the parties. Not until January 1981 did the trial begin.

By then, the feeling was growing among officials of both A T & T and the Government that the time had come to settle the case. A T & T wanted to catch up with the communications revolution that was increasingly blurring the lines between computers and telephones, but it was unable to get into that business because of its status as a regulated monopoly. Competitors were itching to get closer to phone users, but A T & T's monopoly kept them from doing much more than chipping away at that market. The new Reagan Administration wanted to settle the longstanding case. In a stunning move on Jan. 8, 1982, the Justice Department and A T & T struck a deal to break up the Bell System.

Greene did not immediately accept their deal. Meticulously, he read 8,000 pages of comments and interviewed 600 witnesses. Among those who spoke out in opposition to the breakup was Defense Secretary Caspar Weinberger, who said that dealing with an array of companies could threaten national defense and drive up communications costs. Greene also reviewed 25,000 pages of trial transcripts. Many months passed, with Greene raising objections along the way, continually shaping and modifying the parts that were now to be independent. In August 1983, Greene gave final approval to the divestiture agreement.

Whether the company was guilty of antitrust-law violations has never been proved, although some suits by competitors have yet to be resolved. Some Wall Streeters think A T & T gave in too easily and in fact could have struck some sort of compromise short of total breakup. But all that is now academic. As A T & T Chairman Charles Brown says of divestiture: "The ship has left the dock."

The A T & T vessel that is lifting anchor has $155 billion in assets. It is bigger than GM, Mobil and Exxon combined. With nearly a million employees, it is the second largest employer in America, behind only the U.S. Government. Its annual spending of $17 billion equals about 4% of all U.S. capital investment. Its Bell Laboratories, incubator of the transistor, the laser and Direct Distance Dialing, is the world's foremost industrial research organization. Western Electric makes 80% of all the telephone equipment used in America, including most of A T & T's 827 million miles of copper wire.

After Jan. 1, each of the eight brobdingnagian pieces of the old A T & T will sell conventional regulated telephone services but will also be free to venture into certain nonregulated communications fields. The parts:

The "new" A T & T. With about $35 billion in assets, it will be far smaller than the old A T & T. Yet the firm will still be as big as Mobil, and twice as large as GTE, its nearest competitor. Moreover, it will be a powerhouse of money, research talent and manufacturing muscle. Bell Labs and Western Electric will remain parts of the new entity.

To the average citizen, the most familiar part of the shrunken firm will be A T & T Communications. Essentially Bell's former Long Lines Division, it will provide long-distance service as well as the familiar WATS (Wide Area Telephone Service) lines and 800 Area Code calling. These will account for more than half the new company's revenues, perhaps $35 billion.

But more jazzy things are in store, as seen in some of A T & T's sci-fi television ads. Those stress the more glamorous unregulated activities of information systems for business—services like teleconferencing and data processing. In those areas A T & T now will be free to square off with IBM, Burroughs and Honeywell.

At its Western Electric facilities, A T & T will make telephone equipment for sale to consumers and all kinds of exotic electronic whizmos like powerful memory chips for computers. Through A T & T International, the company has already struck a deal with N.V. Philips' Gloeilampenfabrieken of The Netherlands to sell switching equipment throughout the world. Says Gerrit Jeelof, head of Philips' Telecommunications Division: "It was a natural marriage between two of the most desirable partners in the world." The new subsidary will pit A T & T against GTE and ITT in the European market, which it abandoned in 1925 to concentrate on the U.S. telephone system. A T & T and Philips could pry open an unusually tough market long closed to outside suppliers because of dominance by state-owned post, telephone and telegraph services.

Regional holding companies. The 22 local Bell telephone operating companies will continue much as before, collecting revenues from Yellow Pages (around $3.6 billion at present), mailing bills to customers under the familiar names of Michigan Bell, New York Telephone, or whatever, and providing phone service in all states except Alaska and Hawaii, which have independent firms. But the 22 will be stitched together into huge new holding companies that are roughly equal in numbers of telephones and potential revenues. The holding companies, with small staffs at the top, will be free to tread where no phone company has ever gone, into almost any nonregulated business, except manufacturing telephones or certain kinds of information processing. Some have chosen to use the Bell name and logo, a privilege that Greene denied the parent A T & T, while others have attempted to get away from the dowdy image of the "telephone company."

The new Bell companies: Nynex of New York City will cover New York and parts of six New England states; Bell Atlantic of Philadelphia will serve New Jersey, Pennsylvania, Delaware, Maryland, Virginia, West Virginia and the District of Columbia; BellSouth of Atlanta will have customers in Georgia, North Carolina, South Carolina, Florida, Alabama, Kentucky, Louisiana, Mississippi and Tennessee; Ameritech of Chicago will reach the heartland states of Indiana, Michigan, Illinois, Ohio and Wisconsin; Southwestern Bell of St. Louis will join Arkansas, Kansas, Texas, Missouri and Oklahoma; U S West of Denver will cover the largest geographical area, 14 states in the Midwest, Rocky Mountains and Northwest; and Pacific Telesis of San Francisco will oversee California and Nevada.

Who got the choicest cuts in the carving up of the Bell System is a matter of intense debate among industry analysts. Some feel that A T & T walked off with what was really important in the network, leaving only one-third of the revenue-generating capability to the operating compa-

"Hi, I'm Charlie Brown"

The decision was the most difficult Charles Lee Brown had ever confronted during a 37-year career with the telephone company. Yet on the night the A T & T chairman made up his mind not to fight the Justice Department's plan to break up the Bell System, he squelched all second thoughts and slept soundly. "If I worried after a decision," he says, "I'd be a basket case, and I don't do that." Armed with such self-assurance, Brown, 62, has for nearly two years calmly dealt with criticism, fears and confusion among customers, employees, shareholders and Congressmen while presiding over the most extensive reorganization in U.S. corporate history. Says Belton Johnson, a Texas ranch owner and a director of A T & T: "Charlie Brown's done an amazing job. Nobody could have done it better."

A graceful, gray-haired man with an easygoing smile, Brown is as unpretentious as a telephone repairman, perhaps because he has fixed a few phones in his time. "Hi, I'm Charlie Brown," he introduces himself. Throughout all the congressional hearings, bargaining sessions with the Government and marathon staff meetings surrounding the divestiture, he has kept a self-effacing sense of humor. On one arduous day, an employee accidentally trod on Brown's foot in an elevator at A T & T's Manhattan headquarters. "Oh, that's O.K.," Brown said. "Everybody's stepping on me nowadays."

DAVID STRICK

The chairman: unflashy but unflappable

Brown admits that his deal with the Government was a retreat from A T & T's longtime resistance to a breakup. "Divestiture was not our idea," he says, "and we think it is wrong from the standpoint of the country's interests." But the alternative seemed bleaker: "Time was not on our side. The Government's determination to restructure the Bell System would have gone on for years, draining our energy and preventing us from planning our own future." Rather than cling to the past, Brown was eager to get on with the "exciting" task of building the new A T & T.

Even so, the breakup is almost like a divorce in the family for Brown. A native of Richmond, he is a Bell brat. His mother had been a Bell operator before getting married, and his father spent 37 years with the company, eventually rising to district traffic manager in Richmond. While earning a bachelor's degree in electrical engineering at the University of Virginia, Brown worked two summers as an A T & T ditchdigger and cable layer, making $13 a week. After joining the Navy during World War II and serving as a radioman in the Pacific Fleet, he became an equipment maintenance man for A T & T in Hartford, Conn., in 1946.

Showing more versatility than flash, Brown climbed up A T & T's corporate telephone pole step by step, going through 23 jobs in nine cities. He became president of Illinois Bell Telephone in 1969 and earned a place in A T & T lore by making service calls during a repairmen's strike. After becoming chief financial officer of the parent company, he developed innovative ways to reduce A T & T's debt. As president, he began pushing A T & T forward rapidly in such advanced fields as fiber optics and electronic voice recognition.

In 1979 he became chairman, succeeding the colorful and quotable John deButts, who was a company spokesman in A T & T commercials. Brown's image has been bland by comparison. While respected for his intelligence and technical expertise, he has never been a great communicator. His speeches to groups of employees or Wall Street analysts can have a narcotic effect. Asked to explain his formula for success, he admits that "it isn't my charisma." A T & T insiders say he hides his emotions and signals distress only by growing ominously silent. On balance, that stolid style has been an asset. Says Rawleigh Warner Jr., chairman of Mobil and an A T & T director: "He's equitable, and he doesn't lose his cool. There are no highs or lows, just steadiness." Brown, who lives in Princeton, N.J., with his second wife, Ann Lee, works off much of his tension by playing tennis and at least two rounds of golf each week. His handicap: 11.

One of the few ways to get a rise out of Brown is to suggest that A T & T is a monopoly-coddled giant without the agility needed to compete in free markets. "If we're not competent," he says, "I wonder why the competitors are trying to get Congress and the Federal Communications Commission to restrict us in various ways. We must be making a mark somewhere, or the competition wouldn't be so frightened." After spending nearly four decades in a company shackled by Government regulation, Brown is eager to show what an unbound A T & T can do. He is sure that the competition will soon be saying in awe, "Good grief, Charlie Brown!"

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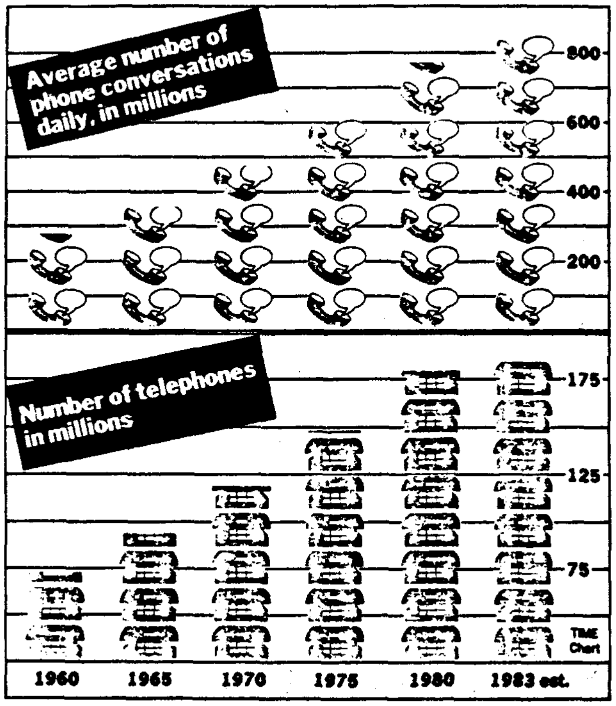


fees for local directory assistance, phone-line installation and pay telephones.

The Federal Communications Commission has proposed one way of helping local companies make up for part of the loss of the long-distance subsidy. It has called for customers to pay local phone companies for access to long-distance lines. The monthly access charge would start at $2 and could rise to $6 or $7 by 1989. Businesses would pay $6 at the beginning. But the proposal is running into trouble. Legislation proposed by Colorado's Democratic Congressman Timothy Wirth and Oregon's Republican Senator Bob Packwood would eliminate the charge to private individuals and small businessmen and shift it back to A T & T and other long-distance phone companies. Theodore Brophy, chairman of GTE, calls the access charge "an unmanageable economic burden on those who make minimum use of long-distance service."

Wirth's bill passed the House last week, but Senate action is not expected until next year. In any case, the FCC last month delayed the fees until April 3 to give itself more time to study A T & T's arguments in favor of the surcharge.

When the long-distance subsidy stops, A T & T will find itself with an additional $3.3 billion a year, and has proposed giving some of that money back to consumers by cutting the cost of long-distance calls by 10.5%. Critics point out that this would add up to a reduction of only $1.75 billion, or about half the amount A T & T is getting. Says John Bryant, a Congressman from Texas, in a medley of metaphors: "They're trying to have their cake and eat it too. That put the last nail in the coffin of A T & T as a truthteller." Judge Greene will conduct a hearing into the entire matter next week.

The latest House action disturbs many industry officials, including Archie McGill, a former IBM vice president, onetime head of A T & T Information Systems and now president of Rothschild Ventures. Says he: "It's a real tragedy that Congress is poking its nose in at this point. The game plan is in place. To shake it up for two bucks a month is just not rational."

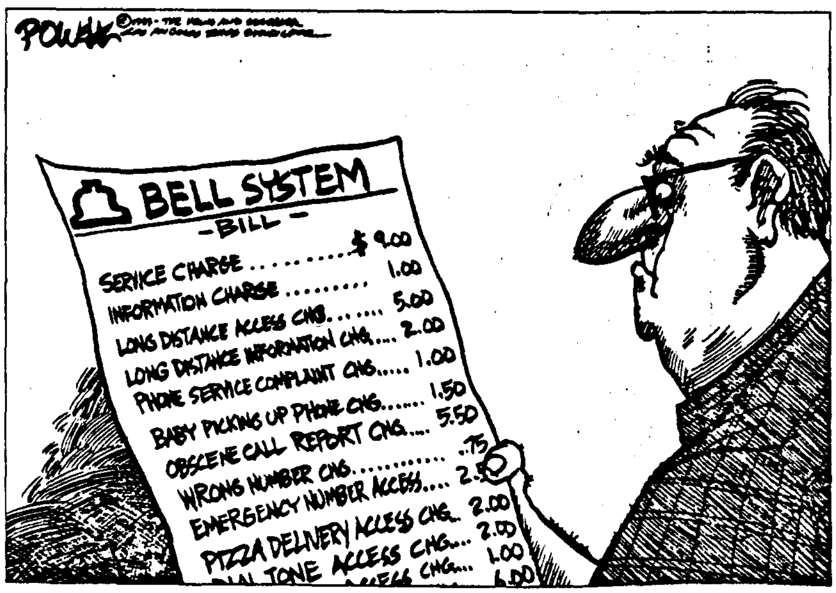
The $2 surcharge is not the only rate increase in the works. Local phone companies have been madly filing for price hikes with state public service commissions. A total of $6.7 billion in increases has been requested this year. The outlook for those applications is uncertain, and public service commissions are expected to be tough with the phone companies.

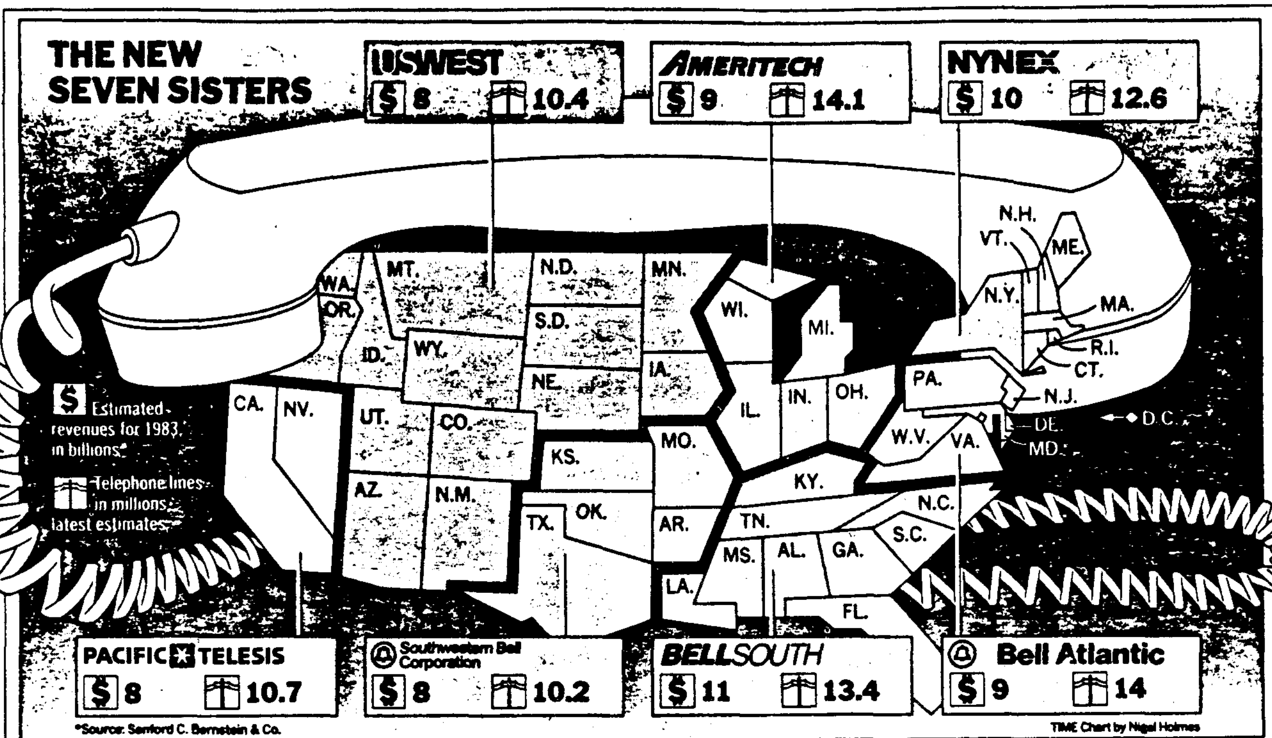
By asking for so much so soon, some of the operating companies have expended goodwill even before getting started. Judge Greene has accused them of using divestiture as an excuse to request more money, and called some of the requests "unjustified."

One of the biggest questions facing the new A T & T is how well it will do in the world of competition. For most of its 107 years, the phone company has been shielded from rivals by its controlled monopoly status. Wall Street analysts and industry experts disagree on how successful A T & T will be. In general, the new A T & T is expected to excel at its traditional business of long-distance telephone service. But it may run into trouble when it tries to take on other markets. Says ITT Chairman Rand Araskog: "A T & T has to learn all over to compete. It has definitely lagged behind technology and the competition."

The most interesting competitive skirmish to come out of the telephone divestiture will be the head-on confrontation between A T & T and IBM. A T & T, which is now free to enter the computer market in full force, has the size and resources to match IBM. The phone company has been making computers largely for its own use for a generation; most telephone calls are switched by computers developed by A T & T for the Bell System. For legal reasons, though, they were called microprocessors. Says Vice Chairman James Olson: "We can now call them computers without looking over our shoulder." A T & T will have a desktop business computer ready early next year. The machine will probably be built around a super chip that has more than 256,000 bytes of random access memory. Says Robert Casale, head of marketing and sales for A T & T Information Systems: "We will be selling the leading edge of technology. Nobody can touch us."

Another bruising market battle will be over long-distance service, where a host of companies are trying to take business away from A T & T. The most aggressive has been MCI Communications, based in Washington, which since 1969 has been permitted by the FCC to offer long-distance service in competition with A T & T. Under Chairman William McGowan, 54, MCI has grown to more than 1 million subscribers (*vs.* A T & T's 70 million) and to $1.1 billion in sales.





nies. Says Cornell's Kahn: "A T & T won by losing." Others believe the local companies have bright futures and good potential in their markets, although there are doubts as to just how eager their top managers, mostly old telephone-company men with decades of doing things the Bell way, are to enter the new world of competition.

Just how well the newly independent parts fare is critical to the question of how much phone bills will rise after the split. If the regionals make money, attract investors, improve efficiency and keep costs down, phone bills stand a better chance of staying reasonable. If they do not, pressure to collect money from phone users for lost revenues will increase.

Bills are destined to go up anyway, though, at least at first. Some charges, say consumer groups like Boston's Fair Share, may go up by 50% to 100% during the next twelve to 36 months. But total phone bills are not likely to increase by that much. Chairman Charles Brown estimates they will increase by only 8% to 10% a year for the next five years, slightly more than the average rate of increase since 1940.

Most industry watchers agree on one thing: telephone service has been too cheap, for too long, with costs spread unevenly. Says Lee Selwyn, president of Economics and Technology Inc. of Boston, a telecommunications consultant: "People were simply not aware of how cheap service really was."

Thomas Bolger, the new chairman of Bell Atlantic, is fond of pointing out that the prices of other commonplace products like a Chevrolet have increased about 1,000% since 1940, while the average basic monthly U.S. telephone rate has gone up from $3.67 to just $11.38 during that period, or by 210%. A private line to a dwelling in Great Falls, Mont., costs about $8 "for access to the world," says U S West Chief Executive Jack MacAllister, while it costs $30 to install and maintain the connection. Even if that basic monthly bill doubles, to $16, it is "still only about the price of a tank of gasoline," he says.

The level of telephone bills after divestiture will depend on whether the user is an individual or a business, how many local and long-distance calls are made, over what distance and for how long. The entire philosophical underpinning of pricing phone services is changing, a departure much in line with the national thrust toward deregulation in many other fields. In essence, Americans are going to begin paying more and more of the full and true

Federal Judge Harold Greene in his chambers

His homework: 25,000 pages of transcripts.

cost of phone services they use. At the same time, they will not pay as much for those they do not use.

That has seldom, if ever, been the case. Through a complex system of cross subsidies, brilliant in concept but worrisome in practice, one type of phone service has helped pay for another. That kept phone costs down and within almost everyone's reach, but led to price inequities. A phone line in San Francisco that cost Pacific Telephone $29 to install and maintain monthly was billed to the customer at $7. The difference was made up by higher prices for other services, like heavy tolls for calls from one end of the Bay Area to the other. Similar subsidies allowed the dime for a pay phone call in New York City; the true cost is more like 28¢.

Without some congressional action, a big chunk of the cross-subsidy system is going to disappear, putting fierce upward pressure on bills for local phone services. Regional phone companies stand to lose about $3.3 billion in revenues that they received from A T & T's long-distance tolls when they were still under Ma Bell's roof. Currently, about 37¢ from each dollar in revenues from long-distance charges is plowed back into the local companies.

To compensate for the loss, the regional phone firms are going to have to get money from somewhere. That means phone subscribers in general can expect higher prices for almost all aspects of local service, fees that in the past were bundled in packages and, for the most part, never seen by users. Rates will certainly go up for local services like calls to the grocery down the street or to the pharmacy. Higher rates are in store for calls to distant points within states, along with sharp escalations in

MCI and the other new competitors in the long-distance market, GTE's Sprint and ITT's Longer Distance, have been able to offer sharply discounted long-distance rates. The firms connect only markets with heavy phone traffic, where the big profits are, using the most modern equipment, leaving to A T & T the smaller, less profitable areas. But some potential customers considered the low-cost competitors inconvenient because customers have to punch in up to eleven extra numbers to make a call. An MCI customer making a long-distance call has to hit as many as 22 digits. Beginning next fall, though, all long-distance lines will be on an equal footing. Whether a customer is using A T & T, MCI, Sprint or Longer Distance, the person will use the same dialing procedure.

A T & T's Western Electric division will face very stiff competition. It will be entering a market with such powerful competitors as Canada's Northern Telecom, Rolm, GTE and ITT. In 1982, Western did 90% of its $12.6 billion in business with the Bell companies. Now those companies will be free to buy their equipment from anyone, at the best price. They are, in fact, doing that already. This year three Bell companies reached deals with TIE/Communications of Connecticut for $125 million worth of switchboards.

Western Electric sales could be cut in half next year, according to one particularly grim Wall Street view. That is nonsense, says Charles Meetsma, general manager of the division's plant in Allentown, Pa. Says he: "We're aware that many persons deride Western Electric's ability to compete. But to them I say, 'You haven't seen anything yet.' " With its Bell Labs providing research for ingenious new products, Western Electric is confident that it will do well.

The new regional phone companies will be kept busy at first just providing local telephone service, where they will not face competition. It will be a while before they realize big earnings from any activities other than the plain old telephone business. Says Pacific Telesis Chairman Donald Guinn: "Our first priority is to keep the core business—the Bell operating company—healthy. That's the place where most of our money comes from."

Nonetheless, the holding companies are trying to stir up investor interest by stressing glamour, growth and marketing in a rush of ads, and in talks before financial analysts. Typical is Ameritech, which uses the snappy slogan "A company you'll be hearing from." Says Chairman William L. Weiss, 54: "The future of our industry lies in exotic services. It lies in the explosion of information services."

While most of those new businesses have yet to be determined, some local phone companies have shown where they are heading. Ameritech intends to go into fiber optics, the superfine lines increasingly used as an efficient and versatile new way to carry telephone signals. Ameritech, BellSouth and the other holding companies are planning major efforts in AMPS, for Advanced Mobile Phone Service, a Bell Labs invention that currently is the hottest telecommunications innovation around. The system is expected to increase radiotelephone use in cars greatly. Buick became the first automaker to offer such a phone as an option on some 1984 models. The cost is about $3,000, but prices are bound to come down.

The seven holding companies are likely to develop in very different directions once they leave Ma Bell. BellSouth is favored by a good economic climate in the Sunbelt. Ameritech has a vast and important industrial base, but in a declining area. Pacific Telesis has battled long and hard with ratemakers reluctant to permit higher charges, so it feels tested and ready for anything. Says Chairman Guinn: "Divestiture doesn't pose any problems that are more difficult than the ones we've already faced."

HUGH F. BROWN

Long line rivals: Chairman Theodore Brophy

TERRY ASHE

McGowan: "The revolution is arriving fast"

BILL KELLY

Araskog: "A T & T has to learn to compete"

Both the new A T & T and the seven operating firms are preparing for the new era of competition by looking for ways to cut costs and changing some old company habits. Managers everywhere are searching for places to slash payrolls. Some companies are turning to extensive early retirements, although layoffs have also occurred. That goes against a long tradition of Bell paternalism. To many A T & T employees who were kept on payrolls during the Depression of the 1930s, "the President" was not Franklin D. Roosevelt but A T & T President Walter Gifford.

Some 16,000 Bell employees already have taken early-retirement inducements, and 8,000 more are expected to do so by year's end. That could cut payrolls by $500 million a year. Pacific Telesis expects 1,400 to 1,800 people to accept early retirement. Throughout the Bell System, families are being uprooted as employees shift between the various entities. In some cases former colleagues are becoming competitors.

Perhaps the most important long-range impact of the A T & T breakup will be to speed up the already breathtaking developments in telecommunications. With more competition from more companies, progress is likely to be even faster. Says MCI's McGowan: "The technological revolution is arriving fast in the phone business. Look at that instrument on my desk. It looks like a phone, but it's really a computer. By pressing buttons, I instruct a computer to do things it's programmed to do."

One of the signs of that technological revolution is the way major corporations and state agencies are literally setting up their own phone companies. By building microwave dish antennas and aiming them at communications satellites, they can legally bypass public phone systems. That significantly cuts into the revenue of A T & T and all other phone companies. Says Gideon Gartner, a telecommunications researcher: "The danger to A T & T of bypass cannot be overestimated."

The Port Authority of New York and New Jersey, working with Western Union and Merrill Lynch, is building a gigantic $84 million Teleport on New York City's Staten Island. Its 17 earth stations will be beamed at all domestic and some international satellites and will feed communications into the World Trade Center, skirting the phone company in New York City. Citicorp, the largest U.S. bank, is installing its own $100 million system in Wall Street's financial district, which will take most of its communications out of the phone system. Even Salt Lake City's Mormon Church is getting into the act. Its private microwave link to Brigham Young University 45 miles distant in Provo, Utah, has replaced an A T & T system and is costing Mountain Bell $42,000 annually in lost revenues.

Metropolitan phone companies are vulnerable to bypassing because so much of their business comes from so few customers. About 24% of the revenues of New York Telephone last year came from just 1% of business customers. All the bypass systems already constructed have drained as much as $32 million in revenues from the A T & T operating companies.

The promise, and the peril, of telephone bypass is typical of the new era in telecommunications. The Bell System, in the end, was done in by the rush of technology. The system's structure could not contain or protect itself against better and cheaper ways of allowing people to reach out and touch someone. Boundaries crumbled between voice and data transmission, between domestic and international calling points, between telex, submarine cable and satellite. What counted was communication between parties, sometimes machines, no matter how or where.

The new competition, plus new technology that allows more information to be carried more efficiently, will lead to a bountiful array of new uses for telephones and telephone lines *(see box)*. Says James Martin, author of *The Wired Society:* "Deregulation of the U.S. telecommunications industry will stimulate our imaginations. It will briefly raise the cost of telephone service, but in the end we'll all profit from a revamping of the system." With any luck, as a result of deregulation, the world's best telephone system could become even better. ***—By John S. DeMott. Reported by Bruce van Voorst/New York, with other bureaus***

Tomorrow's Telephones

"People have to forget the notion of dial, ring, talk and listen," says Randall Tobias, president of A T & T Consumer Products. The phone that is within easy reach of most consumers is about to undergo a dramatic transformation. It will no longer be just an instrument to call Uncle Fred in Fredonia. The phone of the future will be more mobile, do a host of different tasks and be part of a complex, far-reaching information network. Says Hans Mattes, director of A T & T's Home Communications Laboratory: "The telephone will be the cornerstone of a communication system in the home."

A T & T is already offering two new versions of its standard telephone that show the way the phone is going. Both instruments have key pads and display the date and time or the number of the person being called on calculator-style windows. The Touch-a-matic 1600 ($160) can store up to 16 phone numbers. The $680 Genesis Telesystem, which A T & T Chairman Charles L. Brown uses at home, can forward calls to another number, remember 75 alphabetized names and numbers and restrict outgoing calls.

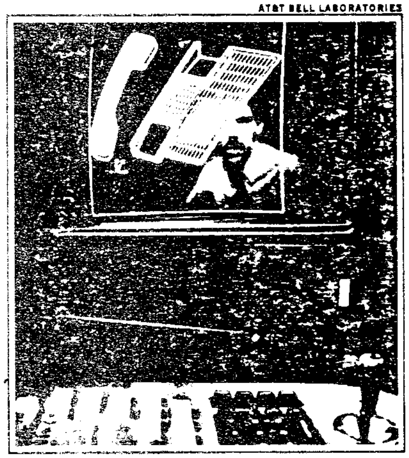
With more and more homes empty during the day because both parents are at work and children at school, telephone manufacturers believe a variety of emergency and remote features will be hot sellers. A T & T offers a fire-alert system linking smoke alarms to phones that will dial two numbers when smoke is detected ($199 a system, $29 a link). A pocket-size medical transmitter ($49) alerts a unit ($199) that dials up to two numbers if a patient needs immediate attention. Gulf + Western's Sensaphone ($250) monitors room temperatures, sound levels and electrical systems. If a room's temperature rises above or drops below a preset level when a householder is away, perhaps because of a fire or a pipe-freezing chill, the device will automatically send a message to one of four emergency numbers. Technicom's Energy Control System, attached to a phone, allows owners to turn appliances on and off while away from home.

Cordless phones, priced around $200, first came on the market three years ago. In 1982 sales reached 2 million units, and industry observers expect that about one-third of the 19 million phones sold this year will be cordless. The walk-around phones now have a range of about 700 feet from the base unit, but they are expected to become more powerful as technology develops. Uniden, Mura, A T & T, ITT and Cobra are the major sellers of cordless models.

Cellular phones rely on low-power transmitters in designated cells, or districts, to relay signals from passing automobiles equipped with the mobile phones. Last month Ameritech Mobile Communications introduced in Chicago the first commercial cellular mobile radio service. Bell Atlantic's Mobile Systems expects to launch cellular service early next year in Washington, Baltimore and Philadelphia. By 1990 1.5 million cellular phones could be operating in the U.S.

The products currently on the market, though, are nothing compared with what is about to arrive. A T & T is working on silicon chips that will recognize individual voiceprints. That way the phone could screen incoming calls or allow a person to call his or her own phone from a distant location and set off some operation like turning off the stove. The phone could even become a substitute for an apartment or house key. A microphone at the door would transmit the voice pattern to a phone. If it recognizes the voice pattern, the phone would then activate a mechanism to unlock the door.

AT&T BELL LABORATORIES



New designs emerge on a computer screen

Telephones and video screens in the future will work closely together. A T & T already sells a Sceptre videotex terminal ($900) for shopping and marketing. Several manufacturers are working on a flat-screen terminal that would display bank balances and shopping guides—or the image of a conversation partner. "The telephone will be a computer terminal as you now understand it," says Tobias.

The telephone linked to a computer screen will become enormously flexible as an information-retrieval system. Viewers will be able to look at an index on a screen and touch it or point to it to get more detailed information. For example, the viewer could point to the word Beirut in a world-news index, and the screen would project a full report on the subject. "People may see all this as new," says Mattes, "but we will simply be making available to a wider public services that already exist."

It was in 1946 that Cartoonist Chester Gould gave Dick Tracy a two-way wrist radio. A similar device may not be far off. Says Tobias: "Except for the long-life battery needed to power it, the technology for the Dick Tracy watch phone is here."

AT&T Stresses Health of Independent Units

By Merrill Brown
Washington Post Staff Writer

NEW YORK, Nov. 16—American Telephone & Telegraph Co. today moved closer to the largest transfer of corporate assets in history as it issued reports on the financial health of the Bell System companies after the Jan. 1 breakup.

The reports, eagerly awaited by the investment community, showed that, in terms of assets, the "new" AT&T would rank as the nation's fourth largest industrial company, behind only Exxon, General Motors and Mobil Oil, while each of the seven regional companies it will spin off would be among the nation's 20 largest. And AT&T would remain the nation's most profitable company.

"We take comfort and pride in the fact that on [Jan. 1, 1984] our investors will own assets which, by every test, are as sound as the assets they owned in 1983," Robert E. Allen, AT&T executive vice president and chief financial officer, told reporters here.

AT&T, blessed with a powerful long-distance business, is expecting revenue of about $56.5 billion next year, 80 percent of its projected 1983 total. In addition to its long-distance service, it is retaining its Bell Labs research facility and its Western Electric manufacturing arm.

By contrast, the seven AT&T local operating companies are expected to have revenue of $59.5 billion and profits of $6.58 billion in 1984, compared with AT&T's projected profit of $2.11 billion, although AT&T will retain assets of $34 billion, while the local companies will have total assets of $117 billion.

"What it means is that AT&T will be an extremely leveraged entity," said Bradford L. Peery of Sutro & Co. Inc., a San Francisco brokerage house. "It's not the stable long-term investment it's been in the past. Small changes in margins will result in signficant changes in profitability, a whole new way of looking at AT&T.

"You've never seen that kind of volatility before," Peery said.

In what AT&T officials said they hoped would be the first and only time they would project results, the company said the combined dividends of the divested system would total $5.46 a share next year, just above the $5.40 figure for this year.

The dividend figure for AT&T itself is predicted to be $1.365 in the 1984 first quarter, just over the current $1.35.

The surviving AT&T will, however, be extraordinarily dependent on its long-distance business, to be known as AT&T Communications, which will provide the company with about $35 billion of its revenue.

While the long-distance business is growing dramatically, AT&T is almost certain to see increasing erosion of its 90 percent-plus share of that $40 billion market as the competition intensifies in the coming years.

Of the seven regional companies, Nynex, with projected 1984 sales of $9.8 billion, would rank the highest by that measure. Bell South would have the highest profits—projected at $3.3 billion in 1984—and the largest asset base, with holdings about $20.8 billion. Bell South also has the lowest debt-to-equity ratio at 43.1 percent, while Pacific Telesis reported the highest at 46.5 percent.

Company officials used the release of the data to repeat their warnings about the consequences of congressional action to modify the Federal Communications Commission's access charge decision on the way phone companies compensate each other for connections to local networks. The AT&T calculations assume that the FCC plan will go into effect on April 1.

The total access charge plan—which the company values at some $20 billion—is widely thought to be the remaining major mystery of the divestiture. Most analysts suggested today that AT&T's assumptions are unlikely to hold up in light of the

See AT&T, D3, Col. 1

WASHINGTON POST NOV. 17, 1983 D1, D3

AT&T Describes Spin-Offs as 'Sound'

AT&T, From D1

congressional move against the access fees.

"It is very unlikely that what is on the books is going to go into effect," said John Bain of Lehman Brothers Kuhn Loeb Inc.

Release of the data today held up trading of AT&T stock on the New York Stock Exchange for nearly an hour and half. The stock closed at 63⅛, up ⅞, and was the most active, with almost 2.7 million shares changing hands.

The publication of the financial documents was expected for months as AT&T moved closer to the day—Jan. 1—when it relinquishes its local phone business under the terms of the antitrust settlement with the Justice Department. AT&T paid $2.5 million in printing costs for the basic documents and stock prospectus, and will spend another $1.4 million mailing them to the company's 3.2 million stockholders.

In preparation for initial trading Monday—on a "when-issued" basis—of the stock of the seven regional companies and the "new" AT&T, and the subsequent decisions stockholders will be asked to make, scores of Wall Street analysts began to scrutinize the reports in order to issue recommendations.

For the most part, several key analysts said they would stick with initial recommendations to hold onto or buy AT&T stock. "I think they're being conservative and we're still recommending AT&T strongly," said Edward M. Greenberg, an analyst with Sanford C. Bernstein & Co. Inc. "Even if you take their numbers, the stock is worth at least $70 a share today. Over a time horizon, some time next year the combined pieces should sell for about $80 a share."

Further, the general consensus from analysts seemed to point to the fact that AT&T's figures today are largely conservative. "The average between hot and cold is lukewarm," said Ivan Wolff of Donaldson, Lufkin & Jenrette Inc. "If they wanted to impress stockholders they would have come in at $9.25 to $9.50 a share. [Total earnings of all the current AT&T entities was estimated at $8.70 a share.] But they also wanted to impress regulators."

THE TELEPHONE COMPANIES AFTER THE BREAKUP OF THE BELL SYSTEM

ALL DOLLAR AMOUNTS IN MILLIONS EXCEPT PER SHARE DATA

	AT&T	AMERITECH	Bell Atlantic	BELLSOUTH
REVENUES*	$56,544.1	$8,344.0	$8,323.1	$9,799.1
NET INCOME*	$2,110.0	$923.7	$952.2	$1,198.8
E.P.S.*	$2.02	$9.47	$9.69	$12.21
QRTLY DIV.**	$.30	$1.50	$1.60	$1.95
6/83 ASSETS	$34,276.5	$16,257.0	$16,264.1	$20,808.8

	NYNEX	PACIFIC TELESIS	Southwestern Bell Corporation	US WEST
REVENUES*	$9,825.2	$8,082.1	$7,754.9	$7,436.8
NET INCOME*	$937.6	$827.7	$869.6	$877.8
E.P.S.*	$9.54	$8.00	$8.93	$8.96
QRTLY DIV.**	$1.50	$1.35	$1.40	$1.35
6/83 ASSETS	$17,389.0	$16,190.8	$15,507.4	$15,053.6

*ESTIMATED 1984

**NOTE: A shareholder with 10 AT&T shares retains them and is entitled to one share in each regional company. An AT&T share today pays a quarterly dividend of $1.35. The May 1 dividends can be compared to this amount by taking one-tenth of the regional company dividends (for a total of $1.06½) and adding the dividend for one AT&T share ($.30)

By Gail McCrory—The Washington Post

Answers About the Phone Legislation

Q: So the FCC proposed to boost what people pay for local service to replace part of that subsidy?

A: Yes. When you make a long-distance call, it travels over a local phone company's lines to a switching station and [illegible] out over long-distance lines—or satellite. Now, a long-distance company bills you for the entire call, but has to pay the local company something for the handling the conversation.

Q: How much is the access charge worth?

A: It would transfer about $5.5 billion a year from local phone users to local phone companies initially, more in later years.

Q: What if the local companies don't get the access charge money?

A: The companies would have to raise what they charge long-distance companies to use local lines and switches.

Q: What's wrong with that?

A: That would create a strong incentive for companies that make lots of long-distance calls to bypass the local system. AT&T, MCI Communications Inc., and the other long-distance carriers could take a corporate customer's long-distance calls and transfer them directly to their long-distance networks without using local lines.

The access fees were intended to deal with that problem: since high-volume phone users would pay a lot more for local service—whether they used it or not—there would be less incentive for them to bypass the local network, the FCC reasoned.

Q: Bypass could hurt the local companies a lot?

A: Perhaps. There aren't solid estimates, but the local companies would probably set up separate links for big customers, bypassing their own local phone lines, says William Albertini, director of investor relations for Bell Atlantic, the regional company that will take over the Chesapeake and Potomac Telephone Companies in this area.

Q: If they lose revenue from big customers, how would the local companies make that up?

A: By raising local phone rates even more, AT&T says. Like other utilities, local phone companies are entitled to provide their stockholders with a "just and reasonable" return on their investment. State regulators will permit local phone rates to rise high enough to achieve what they believe that return should be. So local rates would rise.

Q: But isn't that exactly what the House was trying to prevent Thursday?

A: Yes. The fight is over how much that increase should be, and who should pay it in the first place. That and some political maneuvering.

U.S. Judge Harold Greene, who is presiding over the Bell breakup, noted that half of the country's residential telephone users "make only nominal use of long distance and 15 percent make no use at all." A flat fixed fee on all consumers penalizes those who don't use long distance much, Greene says, and House Democrats agree, by and large.

Q: What do the Democrats want to do?

A: The bill approved by the House Thursday—championed by Democrats and fought by Republicans—would require long-distance companies and customers—not local-rate payers—to contribute to the costs of the phone lines and facilities that are used jointly for local and long-distance service. The cost of long-distance service would be about $1.4 billion a year more under the House bill than under the FCC plan. The bill would establish a federal fund to help low income telephone users and would impose charges on bypassers who rely on the local telephone system as a backup to private phone systems.

The Telephone Bill And Your Phone Bill

By Peter Behr
Washington Post Staff Writer

After a steaming debate, the House passed a bill Thursday that would block an increase in telephone rates proposed by the Federal Communications Commission that is set to go into effect April 3. The FCC's plan was intended to help local operating companies when the Bell System is broken up Jan. 1.

Here are some questions and answers about the rate dispute:

QUESTION: How does the House action Thursday affect my phone bill?

ANSWER: If the bill were passed by the Senate and signed by President Reagan it would prevent the FCC from raising local phone bills on April 3 as planned.

Q: How big would those increases be?

A: Residential rates would go up $2 a month initially, rising to $5 in 1987. Businesses would pay an additional $6 monthly for each phone line.

Q: If the FCC's fees do take effect, where does the money go?

A: To local telephone companies. (After Jan. 1 the local Bell companies will be combined into seven operating companies split off from AT&T, which will continue to provide long-distance service.)

Q: Why does the FCC want to impose the fees?

A: The telephone industry and the FCC say that the local bills paid by telephone customers have not covered the full cost of local service—that AT&T traditionally shifted some of the profit from long distance back to help pay for local service. The FCC wants to end the subsidy, tying rates to their true costs. The access charges are supposed to accomplish that.

See PHONES, D9, Col. 1

WASHINGTON POST NOV. 12, 1983 D8, D9

Limit on 1984 Rise in Local Phone Bills Clears House Over Opposition by AT&T

By Jeanne Saddler
Staff Reporter of The Wall Street Journal

WASHINGTON—The House passed by voice vote legislation that would limit increases in local telephone bills next year, frustrating American Telephone & Telegraph Co.'s effort to kill the measure.

The bill, the first major telephone legislation approved by the House in nearly 50 years, gained support as lawmakers anticipated voter reaction to a predicted doubling of local telephone rates in an election year.

The final vote came after a Republican substitute bill put forward by Rep. Thomas Tauke of Iowa was rejected on a party-line vote of 264-142. That bill would have delayed for one year the Federal Communication Commission's plan to charge residential and small-business telephone customers for access to long-distance lines. The bill that finally passed would eliminate those charges.

Rep. John Dingell, the Michigan Democrat who heads the Commerce Committee, and Rep. Timothy Wirth (D., Colo), whose subcommittee authored the bill, led the fight for the measure, which will increase costs to some large businesses but limit the predicted increases for smaller telephone users. Congressmen concede, however, that consumer telephone costs still are likely to increase because of rate increases that may be granted by states.

"We are distressed," said Kenneth J. Whalen, executive vice president of AT&T, "that the American consumer will be deeply hurt because Congressmen Dingell and Wirth have engineered this bill in their enthusiasm to embarrass the FCC for political reasons and to simply continue their bias against AT&T. They claim the bill is supposed to protect the consumer. Instead, the consumer will pay the price of bypass in a very few years. But the congressmen don't care; by then, the 1984 elections will be over."

Mr. Whalen added that the bill would hurt the Bell operating companies more than it does AT&T.

At stake is whether extra charges to long-distance service will continue to pay for some local telephone costs, as they do currently, or whether each local customer will pay those charges, following a plan developed by the FCC and supported by AT&T. The FCC has set the new pricing system to take effect April 3, about three months after the Jan. 1 government-mandated breakup of AT&T's Bell Telephone system.

AT&T has argued that the House measure, which would maintain part of the current system, would keep the cost of all long-distance service overpriced, the company also contends that large businesses would be encouraged to build private telephone networks, thus taking revenue away from the public phone system.

But members of both the House and Senate have argued that legislation is necessary in the wake of the AT&T breakup to protect residential customers and small businesses with only one telephone line. They contend the FCC's access-charge order, along with other expected telephone cost increases, would overburden smaller customers and favor businesses that make a lot of long-distance calls.

After the divestiture, AT&T will offer only long-distance service, and its other units will focus on equipment and research.

"AT&T has been spending millions of dollars of late to oppose this bill. Why?" Rep. Dingell asked as debate on the legislation began. "AT&T wants to reach out and touch everybody in their wallet."

After defeating the Tauke substitute, the House rejected 270-122 a similar amendment offered by GOP Rep. Matthew Rinaldo of New Jersey. The amendment would have barred new access charges before Jan. 1, 1985. The FCC could then impose a charge of as much as $1 a month in 1985 and as much as $4 a month by 1992. The amendment also would prohibit access charges for poor customers, or for local telephone companies with fewer than 50,000 customers in one state.

The Tauke proposal also would have modified the FCC's plan by allowing access charges to be phased in after the one-year delay. One of the Democrats, Rep. Edward Markey (D., Mass.), called the vote "a decision on whether to side with AT&T's million-dollar campaign against the measure, or consumer and labor groups." Mr. Tauke said his proposal would ensure a strong telephone system "for the next generation."

Under the FCC plan, access charges would be $2 a line a month for residential customers in 1984 and would increase to $6 a line monthly by 1990. The House measure the Democrats favor would continue extra charges against long-distance service and expand a system of assessments the commission established against businesses that build private telephone networks.

The overall cost of long-distance service would be about $1.4 billion greater under the House legislation than under the FCC plan, and AT&T has said it won't go through with its promised $1.75 billion reduction in long-distance rates next year if such a bill eventually becomes law.

MCI Communications Corp., AT&T's principal long-distance rival, supports the House measure because it wouldn't increase the competitors' cost of doing business as quickly as the commission plan. GTE Corp.'s Sprint long-distance unit is backing only the Senate bill.

The ultimate fate of the House measure is tied to whether the Senate passes its version of legislation on the telephone controversy. That bill, approved by the Senate Commerce Committee, would delay imposition of the controversial access charges for two years, and would require the FCC to reconsider its decision. The Senate is scheduled to consider the bill early next year.

Any bill might also be subject to presidential veto, because the Reagan administration said earlier this week that it opposes the House bill.

AT&T Files Proposal On Fees to Bell Firms During Interim Period

By a Wall Street Journal Staff Reporter

WASHINGTON—American Telephone & Telegraph Co. yesterday announced its plan for dealing with the three-month delay of the scheduled start of access charges.

Under the plan, the company said, it would pay local Bell companies about as much for interstate calling as it does currently between their Jan. 1 divestiture and April 3, when the delayed start of the access charges takes hold.

Shortly after AT&T announced the plan, however, the House voted to do away with many of the access fees entirely, so it is uncertain whether either the interim plan or the delayed access fees will take effect.

In papers filed in federal court here, AT&T said it agreed to pay the seven regional companies rates designed to give them a return on their investment of about 11.5%.

AT&T said this is more than it would have paid under the access charge tariffs that the Federal Communication Commission has delayed from its original target date of Jan. 1. But it said the rates would make up for only "a portion" of the subscriber access fees that the local companies will lose during the three-month delay of the new charges.

Those fees from business and residential phone users were expected to net the local companies $3.3 billion annually. AT&T didn't say how much of the loss would be made up.

The arrangement falls short of the compensation previously sought by the Bell Atlantic companies, one of the regional companies that will be divested under the AT&T antitrust consent decree. It sought rates that would generate a return of 12.75%, about what it would earn under the delayed access charges.

In the court papers, AT&T said the rate it will charge the local companies to lease portions of its facilities also will be reduced to 11.5% from 12.75%.

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Phone Bill Threat Held F xaggerated

Some Regulators, Analysts See States Holding Line

By Michael Isikoff
Washington Post Staff Writer

The threat of sharply higher telephone rates stemming from the breakup of the Bell System is already proving to be exaggerated, according to some federal regulators and phone industry analysts.

The reason: State regulators, holding their fingers to the political winds, have been getting tougher with local phone companies. Despite record rate requests filed earlier this year by Bell operating companies, state utility commissions have actually been allowing smaller increases in 1983 than in either of the past two years, industry figures show.

"The states are doing their job just as we expected them to do," says Jack Smith, chief of the Federal Communications Commission's common carrier bureau. "When we see what rates are at the end of the year, they're not going to be nearly as outrageous as everybody thought they were going to be."

Consumer advocates and other critics say such comments blithely ignore the future impact of some of the FCC's own actions, particularly its controversial access charge order which, starting April 3, is scheduled to add $2 a month to every consumer's phone bill. In their view, nothing less than the country's historic policy of "universal telephone service" is in jeopardy—one main reason they are pushing legislation that would prevent the $2 fee from taking effect. The telephone measure, bitterly opposed by AT&T, is scheduled for House floor action this week.

But while the debate over phone rates intensifies in Congress, evidence of more stringent regulation at the state level continues to accumulate.

During the first 10 months of this year, local telephone companies were allowed $1.4 billion in rate increases by state regulatory commissions, which was only 38 percent of the $3.7 billion total they requested.

That represents a nationwide phone company batting average significantly below that of recent years. In 1982, for example, state commissions approved 55 percent of phone company requests, for a total of $2.8 billion in rate increases. In 1981, state commissions also approved 55 percent, for a total of $3.2 billion in rate hikes.

"The state commissions have been sensing the political situation and have been very stringent in what they've been giving out," said Mark Luftig, analyst for Salomon Brothers Inc. in New York. "They can't afford to lose credibility. They can't look like they're giving away the store."

Fears of a doubling or even tripling in local telephone rates were first heard earlier this year after a spate of staggeringly large

See PHONE, G7

PHONE, From G1

rate requests were filed by many of the Bell operating companies.

In California, Pacific Telephone asked for $1.24 billion. In Texas, Southwestern Bell requested a record $1.7 billion. In New York, New York Telephone asked for $947 million.

These filings—unprecedented for telephone rate cases—were quickly linked by most analysts to the confusion and uncertainty surrounding the impending divestiture by AT&T. As of Jan. 1, 1984, the Bell System's 22 local phone companies are to be spun off from its corporate parent and reorganized into seven regional operating companies.

Fearing the imminent loss of the protection of Ma Bell, and facing the prospect of entering the financial markets as independents for the first time, the local companies began racing to their state regulatory commissions with requests far in excess of their real needs, according to some state regulators.

"The telephone companies were trying to get away with everything they could and take advantage of the confusion" (over divestiture), said Paul Rodgers, director of the National Association of Regulatory Utility Commissioners.

Whatever the phone companies' motivation, state commissions haven't

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G1, G7

PENDING RATE REQUESTS

TEN LARGEST GENERAL RATE CASES PENDING BEFORE STATE COMMISSIONS

State	Amount	Company
Texas	$1.704 billion	Southwestern Bell
California	$1.248 billion	Pacific Telephone & Telegraph
New York	$947.58 million	New York Telephone
Oklahoma	$280.4 million	Southwestern Bell
Missouri	$233.0 million	Southwestern Bell
Pennsylvania	$257.0 million	Bell of Pennsylvania
Tennessee	$279.7 million	South Central Bell
Illinois	$247.5 million	Illinois Bell
Alabama	$217.4 million	South Central Bell
California	$318.7 million	General Telephone of California (non-Bell Co.)

Source: Federal Communications Commission.

been buying. In the past few months alone, Georgia's commission disallowed 77 percent of a $158-million request filed by Southern Bell, while Michigan chopped a $451 million request by Michigan Bell down to $182 million.

In Texas, Southwestern Bell's record request is still pending, but the staff of the public utility commission has recommended that nearly half of it be denied.

The extent to which these actions are a guide to the future is a subject of intense debate, however. Eric J. Schneidewind, chairman of the Michigan Public Utility Commission, argues that a number of FCC actions will literally force state commissions to approve higher rates next year no matter how much regulators feel pressured to hold them down.

For openers, the FCC has stripped states of their power to set depreciation schedules and mandated faster write-offs of phone company equipment, thus adding to the rate base. In addition, Schneidewind says, the access charge decision itself will effectively require states to match the new $2 monthly fees with their own access fees on the local level.

"A lot of these increases we won't even have the authority to disallow," he says. "It's totally inaccurate to say the pattern of the past [year] will exist in the future."

Moreover, consumer advocates argue that to rely on the protection of state regulators is a historically risky proposition. To be sure, some state commissions have hundreds of professionally trained economists, accountants and auditors capable of analyzing sophisticated phone company requests. In New York, for instance, the Public Service Commission has a budget of $29 million and a staff of 625, including its own Communications Division, Office of Research and Office of Accounting and Finance.

Yet for every New York there is a Vermont—a state with a three-member Public Service Board (two of whom are part-time) and an 11-member staff, including a single "telecommunications analyst" assigned to telephone rate requests. That is not particularly surprising because, during the energy crises of recent years, state commissions tended to beef up their electric utility staffs without making comparable increases in the number of their telephone analysts.

"The majority of states don't have the kind of commissions that can analyze these requests," says Robert Nichols, legislative counsel for Consumers Union. "They've tended in the past to rubber stamp a local request. The usual telephone rate game is for the local Bell company to come in and ask for significantly more than what they really want and then the state cuts that in half and everybody's happy."

In the final analysis, the precise impact on phone rates remains highly uncertain, most analysts acknowledge. Under the FCC's access charge order, historically underpriced local rates are supposed to gradually rise while long distance rates come down. Since about two-thirds of the average residential phone bill of about $37.50 per month is attributable to long distance service, that could mean an overall reduction for most consumers.

Yet less affluent customers—who make fewer long distance calls—will be hardest hit by increasing local rates.

The result says Nickles, is that telephone rates "are going to rise faster," although he acknowledges that talk of a doubling or tripling in rates is a "political football."

Telephone rates "are going to rise faster," adds Nichols, although he acknowledges that the talk of a doubling or tripling in rates "gets thrown around like a political football."

The important point, many experts say, is that the decisions on phone bills won't be made at high levels in Washington, but in the trenches before state commissions. And while many of these commissions have beefed up their staffs and expertise in recent years, they still have a long way to go to handle the new demands imposed on them by divestiture, says Wally French, president of Regulatory Research Associates, a New Jersey consulting firm.

"It's going to be a crash course for many state commissions," he says.

Long-Distance Access Fee Delayed for 3 Months

By Michael Isikoff
Washington Post Staff Writer

The Federal Communications Commission yesterday delayed for three months its controversial plan to impose access charges for long-distance telephone service, including a $2 monthly fee on consumer bills that has drawn opposition in Congress.

The commission also delayed until April 1 action on the American Telephone and Telegraph Co.'s proposal for a $1.75 billion reduction in long-distance rates that would reduce the price of the average long-distance phone call by 10.5 percent.

The decision late yesterday to delay the access charges from Jan. 1 to April 1 stunned an industry already in tumult over the impending breakup of AT&T, still scheduled for Jan. 1. An AT&T spokesman yesterday called the action "unbelievable" and said the company was "astounded that it [the FCC] would have taken this action at this late date."

But the action was quickly hailed by congressional opponents of the access charge plan who have been working feverishly to pass legislation to hold down local phone rates.

The access charge has been under attack in Congress and from consumer groups ever since it was finally approved by the commission in July.

Under the plan, consumers would pay a fee starting at $2 a month, and businesses would pay $6. In addition, long-distance carriers would have to pay a whole new set of fees to interconnect with local operating companies.

The FCC had intended to eliminate longstanding "pricing distortions" in the telecommunications marketplace—principally, the subsidy paid by long-distance users to keep local rates artificially low and affordable. But critics contended that it would force local rates so high that it would jeopardize the concept of "universal telephone service."

FCC officials said yesterday the commission voted to suspend the plan in order to evaluate more than 43,000 pages of tariff filings and 160,000 in backup documents given to the agency earlier this month by AT&T and other telephone companies requesting new rates under the plan.

"We're fast readers, but we found that there were some fairly controversial issues in there and we wanted to give the staff more time to get them done," said Jack Smith, chief of the FCC's common carrier bureau. "This was a complete restructuring of the way AT&T charges its customers and other carriers."

Still, there was widespread speculation that the FCC was acting to cool mounting political pressure to modify its decision. Hours earlier, the House Commerce Committee had begun debate on major telephone legislation that would block some parts of the plan amid cries from consumer groups and state regulators that telephone rates could more than double next year from the combined effects of divestiture and the access charges.

Proponents of the legislation said yesterday that the three-month delay immediately makes their job easier since they were under pressure to pass a bill before Congress goes home for the year in November.

Under the legislation, sponsored by Rep. Timothy E. Wirth (D-Colo.), the $2-a-month access fee for long-distance service would be blocked permanently. In addition, it would create a "universal service fund" to cushion the impact of higher rates by providing subsidies to rural phone companies and the poor.

But FCC officials insisted yesterday that their decision had nothing to do with the congressional debate over the $2 fee, but rather with the mountains of paperwork related to another aspect of the plan—a new schedule of fees and charges that long-distance carriers, such as the new AT&T Communications Corp. and MCI Communications Corp., will have to pay the new local Bell operating companies.

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On the Line

Drive in Congress to Hold Down Phone-Rate Rises Stirs Big Debate Over Telecommunications Policy

By JEANNE SADDLER
Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON—Margaret Kelly of Madison, Wis., uses her telephone for business and pleasure; the 77-year-old Mrs. Kelly's "business" is making calls to arrange her church's monthly dinner for senior citizens. For pleasure, she frequently calls her friends.

Now, Mrs. Kelly faces a proposed phone-bill increase of about 80% to $21.40 a month. "If the rates go way up, I guess I could cut out the visiting and go to the 60-calls-a-month (economy-rate) plan," she says, "but I wouldn't like it."

Mrs. Kelly's frustration is shared by many consumers as they become aware of the widely predicted doubling or tripling of many local telephone bills after the restructuring of telephone services following the scheduled Jan. 1 breakup of American Telephone & Telegraph Co.

Polls show that most telephone consumers don't yet realize how their phone service will change—and how much their overall bills probably will rise. But when they find out, many irate telephone users are responding like Helen Hift of Monona, Wis.: "I write to whatever congressman comes on the radio and TV and appears to be on the consumers' side."

Thousands of Letters

Thousands of such letters—and the thousands more that are anticipated when phone users learn of the scheduled changes—are moving lawmakers to consider legislation that would hold down part of the expected increase in local telephone bills. The legislative proposals have set off a fierce lobbying battle with AT&T and deregulators lined up against supporters of congressional intervention, including not only consumer groups but also, surprisingly, some of AT&T's competitors.

But what some in Congress saw as a simple attempt to protect constituents has led to a complicated debate over the future of telecommunications. The debate pits the need for a universal public telephone network against private industry's race toward new systems capable of data and video transmission as well as telephone service. That competitive new era will bring advanced technologies and a system in which each user bears the full cost of his service.

"Two extremes have divided those of us in Congress studying the problem," says Democratic Rep. Edward Markey of Massachusetts, a member of the House Telecommunications Subcommittee. "We know that we can't turn back the clock to some nonexistent golden age of the phone system, and yet we have to ensure that the future comes at a price that's reasonable for the nation's residential consumers to pay."

Industry experts and consumer advocates alike say average telephone users will gain lower long-distance rates next year and additional benefits later from the new technologies. But critics charge that local customers are being forced to pay too much of the bill for the changes, which they say favor large corporations that are heavy users of long distance. Today, the House Energy and Commerce Committee will begin considering legislation to revise some scheduled phone charges. A bill pending in the Senate would delay the charges for two years.

FCC Decision

Congress can't do anything about the approximately $6 billion to $8 billion of rate-increase requests that local phone companies have put before state regulatory agencies. So both chambers are focusing on the Federal Communications Commission decision, also to raise local rates by having residential and business telephone users pay for access to long-distance services.

Currently, access charges are included in long-distance rates. But that system will be unworkable after Jan. 1, when AT&T's Bell System is split into independent local phone companies and AT&T retains only long-distance service. The FCC reasons that because the access charge represents the cost of the line between homes and the telephone company, local customers should pay for it. In 1984, access charges, whether or not users make long-distance calls, will be $2 a month for residential customers and could increase to between $5 and $8 monthly by 1990, depending on inflation. Business customers will pay up to $6 monthly for each line next year.

"The $2 access charge isn't going to cause anyone to stop using the telephone," an AT&T spokesman says. "The break-up of the Bell System is less than 90 days away; if Congress wanted to adopt the attitude that competition is not the answer, they should have done so 10 years ago." Deregulators say local rates won't go up as much as local companies have proposed because state regulatory agencies probably will approve smaller increases. And the FCC argues that by removing extra charges from long-distance services and allowing companies to compete, the cost of long-distance calls should decline by about 15% next year, and eventually by 35% to 40%.

Bypass Systems

The real impetus for access charges is the FCC's fear that if long-distance service remained over-priced, large companies would build their own telephone and data networks. New York City's Teleport facility on Staten Island is an example of such a so-called bypass system. If such systems become common, the FCC says, the public telephone network will lose revenue and deteriorate.

"You can't make the decision to open up the system to competition and then tell firms the local telephone company will charge them more than they'd pay elsewhere," says Albert Halprin, the author of the FCC access-charge order and now a private consultant. "You guarantee that they'll leave the system."

Opponents argue that the bypass threat is exaggerated. In a recent study, Congress's General Accounting Office agreed, saying that the FCC doesn't have the research on hand to prove its point.

Critics also argue that the FCC went too far in shifting costs to local customers. Not only will the planned $2 access charge for residential users increase phone bills, they contend, but other FCC changes plus huge local-rate increases could threaten the availability of phone service for many low-income, elderly and rural consumers.

Each of the decisions to increase phone charges "deals with a very legitimate problem," says Eric Schneidewind, the chairman of the Michigan Public Service Commission. "But taken together and happening all at once, they're a disaster. There was no thought given to how doing all these things at once would affect the nation's universal telephone service."

Michigan Forecasts

The Michigan commission estimates that next year between $9 and $12 will be added to the state's average local bill of $10.62. Commission officials say that with Michigan's high unemployment rate, the increase may cause 10% to 15% of telephone customers to cancel their service. But Michigan Bell says anyone with a phone now should be able to afford one next year.

Consumer advocates say higher local rates won't be offset by the drop in long-distance charges because most residential customers don't make enough long-distance calls. Samuel A. Simon, the executive director of the Telecommunications Research and Action Center, a citizens' lobbying group, says the biggest winners will be the 1% to 5% of the largest users of long-distance services—mainly big corporations—that account for 30% to 50% of long-distance revenues.

"The real question here is whether long-distance customers will make any contribution to the fixed cost of the local lines that they use," says Rep. Timothy Wirth, the Colorado Democrat who heads the House Telecommunications Subcommittee. Mr. Wirth drafted much of the telephone legislation that has been passed by that panel, and is to be considered by its parent Energy and Commerce Committee this week.

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OCT. 18, 1983
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"I've been saying for years that" long-distance users pay too much of the local cost, "and the industry loved that position, until somebody—the FCC—offered them the chance to pay none of it," Mr. Wirth says. "That only makes sense if you want to load some of your legitimate costs onto small local customers."

Bills' Provisions

The House bill proposes to eliminate about $1.9 billion of access charges for residential telephone users but to let stand $1.6 billion in business access charges. Under the measure, long-distance rates would still decline somewhat, its supporters say, because the bill expands an FCC system of charges against businesses that build private telephone networks. The measure also would require "lifeline" telephone service for the poor, though it doesn't require states to adopt income limits for such services.

A more cautious proposal passed by the Senate Commerce Committee would put a two-year moratorium on the FCC access-charge order and tell the commissioners to reconsider their decision and to report to Congress by March 1985. Like the House bill, the Senate version would affect only the residential charge.

AT&T has characterized both bills as attempts to create "chaos out of order" and has responded with a huge lobbying effort against the proposals. FCC Chairman Mark Fowler also opposes congressional action. He says the agency's decision will let states require basic "lifeline" service and establishes a general fund to subsidize telephone companies in high-cost rural areas.

Many consumer groups have embraced the House proposal. "It's a pretty darn good compromise," says Eugene Kimmelman of Congress Watch, a Ralph Nader group. "It cuts in half the extra costs that are now placed on long-distance service, and it provides local-service subsidies only for those who need them. In a different era, this bill would have been considered a major victory for industry. We're willing to view it as a victory for consumers, too, because we don't want to stop technology."

Switch in Positions

More surprisingly, MCI Communications Corp., the nation's second-largest long-distance telephone company, says it will support the Senate bill, and GTE Corp., the third-largest, is backing the House measure. The two companies have abandoned what had been the industry's united opposition to congressional action.

GTE's change of heart was good news to Sen. Bob Packwood, the chairman of the Senate Commerce Committee and the Senate's main proponent of legislation to reverse the access-charge order. "I think the members of my committee came to see that not everybody in the industry is against our bill," the Oregon Republican says. "It's pretty much AT&T and the Bell companies out there alone now."

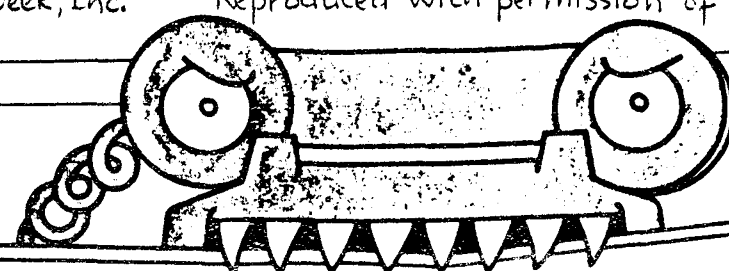
The competing long-distance companies, (GTE acquired the Sprint long-distance system last June) changed sides after realizing that the FCC order will increase their costs next year substantially more than they had expected. The companies are asking the FCC to change its mind, and MCI has asked a federal appeals court to reverse the agency's order.

Difficult Issues

But it is those kinds of disputes, along with complicated telecommunications policy issues, that Congress is finding intractable. Another difficult problem is determining which states' local telephone companies will qualify for subsidies from the FCC's so-called universal-service fund, established to help companies in high-cost rural areas. Some Northeastern states fear that under the FCC's plan, money would go to fast-growing states and not just to high-cost rural areas.

Congress knows that these issues mean little to people who will get higher local telephone bills no matter what's done in Washington. And consumer advocates say the average telephone user won't soon reap all the benefits of the changing telecommunications system.

"The benefits are that long-distance rates are being pressured down and that eventually consumers will be able to buy little computerized devices for their phones that will let them do their banking or shopping from home," Congress Watch's Mr. Kimmelman says. "The dilemma is that in the short run, the price of moving toward competition in the system will fall more heavily on the average consumer."



PHONE RATES: TAKING A BIGGER BITE

Local telephone companies are rushing to raise rates before the AT&T breakup. Some phone bills could double or triple overnight.

Holding company	State	Rate increase (in millions)	Average monthly increase per customer
NYNEX	New York Rhode Island	\$775 \$37.4	\$2.75 \$5.40
Pacific Telesis	California	\$1,229	\$7.25
Southwestern Bell	Texas Arkansas	\$1,360 \$137.9	\$8.60 \$7.50-\$10.70
U S West	Minnesota Arizona	\$78.2 \$109.5	\$6.19 \$8.94

Holding company	State	Rate increase (in millions)	Average monthly increase per customer
BellSouth	Tennessee Kentucky	\$279.7 \$163.2	\$12.75 \$14.82
Ameritech	Illinois Ohio Indiana	\$225 \$179 \$86.6	\$3.43-\$6.25 \$5.50 \$2.18-\$3.29
Bell Atlantic	Pennsylvania New Jersey	\$478.9 \$89.6	\$4.10-\$6.80 \$1.65

Christoph Blumrich, Cynthia Z. Rachlin—NEWSWEEK

Playing Chicken With Ma Bell

Congress is taking on AT&T in a last-ditch effort to check rapidly rising phone rates.

Changing the way Americans pay for telephone service was never going to be easy. Now Congress has turned the already bewildering revolution into a political battle royal. Less than 90 days before the court-ordered breakup of AT&T, a bipartisan coalition of lawmakers is valiantly struggling to save residential customers \$2 on their monthly phone bills—even though they simultaneously face a whopping \$7.24 billion in proposed local-rate increases. The 11th-hour effort has rallied consumer groups against the Federal Communications Commission, pitted AT&T against its competitors and amounts to what Alfred Kahn, former federal regulator, calls "a national game of chicken with the world's best telephone system."

The complex controversy actually has less to do with the breakup of AT&T than with the increased competition in the long-distance market that began years ago. Ever since the FCC allowed competitors into the long-distance field, it has been increasingly uneconomical for AT&T to continue its practice of subsidizing local telephone service from long-distance revenues. Beginning Jan. 1—the same day Ma Bell separates from its corporate children—the FCC will change the way local service is paid for. Long-distance rates will drop, but charges for basic local service will rise precipitously as local companies scramble to make up lost funds (chart). To help defray some local costs, the FCC plans to charge residential customers an additional \$2 each month—and business customers up to \$6—for local "access" to long-distance lines, whether or not they make long-distance calls. Gradually, residential customers would assume more of the burden, and their fees could rise to as high as \$12 a month by 1990.

Congress can do little to stop the rise in basic local rates but it can halt the FCC's access charges—and lawmakers are scrambling to get on the bandwagon. "They're seeing something that's real—a sharp increase in phone rates," says Rep. Timothy Wirth, a Colorado Democrat who waged the fight virtually alone last year and who now carries a sheet in his coat pocket to sign up eager cosponsors. Wirth's bill would repeal the residential access charge altogether, levy higher charges on business customers and long-distance carriers and

AT&T's Brown, Rep. Wirth: Squaring off

Bruce Hoertel Larry Downing—NEWSWEEK

establish a \$400 million "universal service fund" to keep down costs of residential service. A similiar bill in the Senate would delay residential access charges for two years. "It will be a dynamite issue in 1984," says Bob Packwood, chairman of the Senate Commerce Committee, who hopes to bring a bill to the Senate floor later this month.

'Widows': Consumer groups are fueling the congressional efforts, charging that access fees are unfair to those who make no long-distance calls and may force some low-income residents to forgo telephone service. "We have retired widows whose only income is from the coal mines, and that wasn't that much," says Jack Bentley, manager of the independent Delta County Telephone Co. in Paonia, Colo. "When you start adding \$2, \$3, \$4 extra a month, it will come out of what they pay to eat." The California Public Utility Commission has challenged the FCC's right to impose the access charges. AT&T long-distance competitors—including MCI, GTE and ITT—also oppose the FCC plan because of a provision setting the fees long-distance carriers must pay to local companies. Those fees, they say, are overly favorable to AT&T and would cost them as much as \$600 million next year. They, too, are likely to file suit against the plan unless the FCC reconsiders.

AT&T, meanwhile, has thrown its prodigious lobbying power against any efforts to tinker with the FCC formula. Noting pointedly that he spoke for the company's "3 million shareholders, our 1 million employees and our half million retired people," AT&T chairman Charles Brown last week pleaded with Congress not to confuse divestiture further. AT&T will repeat that message in a massive organized letter-writing campaign to lawmakers and a $1.5 million national advertising campaign beginning this week. More ominously, AT&T officials last week threatened to "reassess" their proposed 10.5 percent reduction in long-distance rates—and perhaps even raise long-distance charges—if the FCC's access plan is overturned.

Changing the access-charge formula clearly has its dangers. Both AT&T and FCC officials warn that business customers may drop out of the public telephone network if they are forced to bear more of the costs. Already, companies such as Citibank and Heinz USA, and even some government agencies, have built their own direct microwave links to long-distance switches, bypassing the local telephone companies. Big businesses make up the lion's share of telephone revenues—5 percent of Southwestern Bell's business customers, for example, provide 55 percent of its revenues—and as more of them leave the traditional telephone network, local companies will have to spread their costs over an even smaller number of users, forcing residential rates still higher.

'Zap': Congressional reformers counter that the Wirth bill would partially recoup such losses by charging business "bypassers" a separate fee. FCC officials, meanwhile, say their plan would waive access charges in hardship cases—and both sides predict a furious battle in the coming months. "AT&T is going to have more trouble on this one than it has had in the past," says Rep. Dick Cheney, a Wyoming Republican. "Members are going to fall all over themselves to zap the phone company."

For consumers, the real zap will come in basic local-service rates. The seven Bell System companies that will emerge from the breakup—as well as smaller, independent phone companies—have a staggering array of rate increases pending before state utility commissions, some doubling or tripling rates in the next few years. State regulators may scale back many of those requests, but they are under increasing pressure to let rates rise to keep local companies afloat. The local companies, in turn, are under pressure to let rates reflect the actual cost of providing service, usually for the first time. That change would hit customers particularly hard in states where regulators have kept rates artificially low. "The cost to provide flat-rate service in California is $29. We charge $7," says Gary McBee of California's Pacific Telephone & Telegraph Co., soon to become Pacific Telesis.

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Consumers have only just begun to fight the increases: 'A dynamite issue in 1984'

Telephone users in rural areas could be particularly squeezed by new pricing systems now being developed by many companies. Some are considering implementing "measured" rates for local calls that would differ depending on the duration, time of day and distance. Illinois Bell (soon to be part of Ameritech) has proposed a 5 percent rate increase for urban customers—and a 23 percent hike for rural residents. Surprisingly, there have been only scattered protests. "I don't think that most people really realize what this means at the bottom line," says Dennis Verkler of the Illinois Farm Bureau. "And they probably won't until they get their first bill."

Indeed, in a recent New York Times/CBS poll only 29 percent of Americans said they had read or heard enough to know how divestiture would affect them. Even when consumers get their first postdivestiture phone bill, it may be in as many as four parts—for basic local service (provided by the local company), for equipment rental (available from several sources), for AT&T long-distance charges and for a discount long-distance service such as MCI. Beginning later next year, customers can contract with their local phone company to be served by a single "primary" long-distance service. But AT&T last week announced plans to charge 75 cents for long-distance directory-assistance calls next year. Customers can save by buying their own phones, but there, too, they face a bewildering array of options, from purchasing their current phones for as little as $15 to buying fancier new equipment for $200 or more from any of some 17,000 retailers.

'Lifeline': Just how consumers' total telephone tabs will change depends on their calling habits. Given AT&T's proposed 10.5 percent cut in long-distance rates, customers who make more than $20 worth of long-distance calls will save money on long-distance bills next year, even with the $2 access charge. Poor and rural customers won't necessarily lose out on the savings, some experts say, since studies show they make a disporportionately high number of long-distance calls—perhaps to save the traveling expenses. Those customers who make few local calls may well save on local rates as well by opting for "measured service" plans. Even now, some companies offer discount "lifeline" services that provide residents with unlimited incoming calls for as little as $2.50 per month, with a nominal charge for each outgoing call. For those customers, the proposed access charge may indeed be the steepest rise in their phone bill next year.

Whether the coming revolution will improve the quality of phone service remains an open question. Neal Swearingen, an E.F. Hutton vice president, says that under divestiture, local companies as well as AT&T are free to diversify into new areas such as providing mobile phone service, intraoffice systems or computer-switching networks—all of which will help boost profits. "Competitive environments have traditionally meant better products and better services," he says. "It's going to get worse," counters Charles Robbins of International Data Corp., who says that for businesses that may have a half dozen types of phone services, "there's a coordination issue. You can't pick up the phone and call one person. The old times are over." On balance, most experts agree with Kahn, now at Cornell University, who says that "the gross present system of subsidization has to go" and that there are more efficient ways to handle those few customers who might be hurt in the transition. Even Kahn admits, however, that in 20 years "there is a real possibility we will say, 'What the hell did we do?' "

MELINDA BECK with CHRISTOPHER MA, WILLIAM J. COOK and GLORIA BORGER in Washington, DAVID L. GONZALEZ in New York and bureau reports

Long-Distance Fee Is Put Off By Senate Panel

By Michael Isikoff
Washington Post Staff Writer

The Senate Commerce Committee, sharply divided over how to deal with expected surges in telephone rates after the breakup of the Bell System, tentatively voted yesterday to delay for one year the Federal Communications Commission's recent order requiring residential telephone users to pay a monthly "access charge" for long-distance service.

The panel, however, was unable to agree on more comprehensive legislation prepared by its chairman, Sen. Robert Packwood (R-Ore.), that would have barred the access charge permanently and attempted to guarantee universal low-cost service for all telephone users. The committee will reconsider the issue next week.

An angry Packwood, who found himself outmaneuvered at the last minute by his own communications subcommittee chairman, Sen. Barry Goldwater (R-Ariz.), and abandoned by a majority of his panel, strongly opposed the one-year moratorium as inadequate, and charged that the FCC could circumvent it easily.

"This is not going to help the rural areas," added Sen. Ted Stevens (R-Alaska), who also opposed the moratorium. "We've knocked out the concept of universal telephone service."

The committee's action underscored the confusion and uncertainty surrounding telecommunications issues in the face of next January's court-ordered divestiture by American Telephone & Telegraph Co. According to some estimates, telephone bills in some states could triple.

In July the FCC approved long-distance access charges of $2 a month for residential users and $6 a month for businesses. The charges are to grow steadily for residential users and are expected to reach between $10 and $12 a month by 1990.

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The access charge is intended to end the long-standing pricing subsidy—currently estimated at $11 billion a year—by which long-distance rates have kept local charges artificially low.

With rising fears over the combined impact of divestiture and the access charge, both houses of Congress began considering legislation this summer that would preserve the subsidy and otherwise ensure that the poor, elderly and rural residents would not be priced out of telephone service.

Packwood's bill, for example, would create a $200 million "universal telephone service" fund, to be financed by levies on long-distance carriers and businesses that choose to bypass local telephone companies and use their own systems. The fund then would be used to subsidize local telephone companies that have especially high costs, such as those in rural or mountainous areas.

Similar legislation has been sponsored in the House by Rep. Timothy E. Wirth (D-Colo.), chairman of the House telecommunications subcommittee, which is scheduled to take it up next week.

AT&T and other telecommunications firms such as MCI Communications have lobbied against the bills. Yesterday's action showed, moreover, that there was little consensus on what should be done.

Sen. Frank Lautenberg (D-N.J.) argued that the industry is changing too rapidly for Congress to act in any comprehensive way right now. "We're moving along pell-mell into chaos here," he said in arguing against Packwood's proposal.

In addition, Goldwater, who conducted the communications subcommittee hearings on the Packwood bill, switched gears on Monday, sent out a brief letter to all committee members saying he opposed the bill, and then failed to show up at yesterday's meeting to explain why. Committee sources said that Goldwater's actions may have had more to do with personal pique at Packwood than substantive differences on the legislation itself.

Lautenberg then offered—and the committee by a 9 to 6 vote tentatively passed—the more limited amendment, which delays the access charge on residential users until Jan. 1, 1985, but leaves in place the charge on business users. Opponents such as Stevens said that the committee's "breathing time" will be little more than six months because, after that, congressional deliberations will be interrupted by two political conventions and a presidential election.

Why Your Phone Bills Will Soar

The breakup of Ma Bell will bring with it sharply higher charges to users—more than some people can afford.

Government efforts to spur competition in the telecommunications industry are producing an unwanted side effect: Sharply higher telephone bills for users of the nation's 108 million phone lines.

Consumers nationwide are facing annual increases of 40 to 50 percent in the cost of telephone service over the next two years. In some areas, rates could jump more than 300 percent.

By 1988, experts say, the average American family could be paying as much as $50 a month for telephone service, up from $10 today, in addition to long-distance charges.

The rapid escalation in the cost of telephone service stems from government moves to deregulate the telephone industry and the forced breakup of American Telephone & Telegraph Company, a corporate giant that has dominated the telecommunications industry for more than a century.

Consumers will feel the first impact on Jan. 1, 1984. That's the date set by the Federal Communications Commission, in a July 27 ruling, allowing local telephone companies to charge residential customers $2 a month to connect to long-distance lines—even if no long-distance calls are made.

Exception for Centrex. Business customers will pay $6 a month per line for the same service. But companies using Centrex, a system which provides multiple long-distance lines, will pay only $2 a month for each line. Companies that purchase private long-distance services and those that use data transmission will pay a separate monthly access fee of about $25 for each of those lines.

The FCC action amended an earlier ruling that would have allowed higher charges for residences, lower ones for business. It came less than a week after legislation was introduced in the House and Senate to slow rate increases. Hearings on the bills began July 28.

Analysts point out, however, that any legislation to emerge probably will merely soften, not prevent, future increases in the cost of telephone service. Already, local phone companies in 20 states have filed for rate hikes totaling 6 billion dollars. Examples:

- In Texas, Southwestern Bell Telephone Company has asked for a 1.7-billion-dollar increase that would boost the average monthly phone bill from $10 to $30 a month.
- California regulators are considering a 1.3-billion-dollar rate increase for Pacific Telephone & Telegraph. If the hike is granted, phone bills would rise from $7 a month to $18.
- Chesapeake & Potomac Telephone Company of Maryland is seeking a 218-million-dollar rise in its rates that would raise the average monthly bill to $21.30.

Behind the spate of requests for higher rates are efforts by local telephone companies to recover some 9 billion dollars in revenue they will lose at the end of 1983 when their ties with AT&T are severed as part of a court-ordered settlement of an antitrust case against the giant monopoly.

Phone-industry analysts explain that AT&T, under pressure from state regulators, has used earnings from long-distance lines to subsidize the cost of local service. With the loss of those subsidies, they add, consumers will be forced for the first time to pay for the actual cost of service.

In the future, consumers may be charged for each phone call according to the time of day, distance and length of the call, instead of a flat monthly rate for local service. This would benefit consumers who make few calls, while increasing the cost to those who use the phone extensively.

Playing Catch-Up

In years past, local phone rates may have looked like a bargain to many people, because rate increases did not keep pace with jumps in overall consumer prices.

1977=100

	Local Telephone Charges	Consumer Price Index
1977	100.0	100.0
1978	101.2	105.0
1979	100.6	116.8
1980	105.3	132.6
1981	117.3	146.4
1982	130.8	155.3
1983 (June)	141.8	160.2

Since 1981, however, local phone bills have risen faster than the consumer price index—a trend that's certain to accelerate with the breakup of AT&T.

USN&WR—Basic data: U.S. Dept. of Labor

Even so, some officials fear that the rapid run-up in local rates threatens the concept of universal phone service, and could force 10 to 15 percent of the nation's low-income families to drop telephone service.

"There are going to be a lot of people who won't be able to afford basic phone service," says Al Erwin, head of the Texas Public Utility Commission.

Hard hit, too, will be customers of small, independent telephone companies serving rural areas and small cities such as Monroe, Wis.; Moncks Corner, S.C., and New Braunfels, Tex.

Some independent phone companies now charging $6 a month or less for residential service have not had a rate increase in more than a decade because of hefty profits from toll calls.

Says Jack Herington, government-affairs director of the 1,432-member United States Independent Telephone Association: "Rates will probably double in the next four or five years for most of the rural companies. There'll be 200 or 300 percent increases in places that haven't had a rate increase in the last 15 years."

Heavy users leaving. Rate increases already are driving off some large customers of local phone companies as more businesses and big users of telephone service establish their own communications networks.

In Indianapolis, a private microwave system links 15 public-school buildings, thus depriving the local phone company of $700,000 a year in revenue. South Central Bell Telephone is losing an estimated $300,000 a year because Southern Railway has installed a private microwave system for direct communications between offices in Alabama, Georgia and Kentucky.

It's the threat of such competition that lies behind rate-hike requests. William Melody, a former FCC official who teaches communications in Vancouver, B.C., asserts that the phone companies are "milking local service to pay for the costs of upgrading local networks for data transmission."

Faced with the loss of revenue resulting from the government success in breaking up AT&T and encouraging competition, local telephone companies contend that they have no alternative but to boost rates.

Their efforts, however, are expected to arouse heated opposition in the coming months as Congress and state regulators feel the heat from consumers who believe that low-cost telephone service is a necessity, not the luxury it threatens to become. □

By RONALD A. TAYLOR

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