LC 14.2/2: IP 257 T

6-11-87

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

TELEPHONE INDUSTRY ISSUES
IP257T

The U.S. telephone industry continues the complex transformation it began in earnest on January 1, 1984, as a result of the divestiture of the American Telephone and Telegraph Company. The former 22 local Bell operating companies are now seven independent regional phone companies. These "Baby Bells" are actively seeking permission to enter into more and more non-phone businesses.

Customers remain confused and angered by the restructured telephone industry. They have found themselves with rising local rates, declining long-distance rates, access charges, installation and repair delays, lengthy telephone bills, and do-it-yourself installation. Increasing rates have raised concerns about universal telephone service. A large number of major companies are now "bypassing" local and/or long-distance phone companies and are establishing their own communications networks.

This Info Pack presents an overview of current issues associated with the deregulation of the U.S. telephone industry and includes a summary of the A.T.&T. divestiture.

Members of Congress desiring additional information on this topic may call CRS at 287-5700.

Congressional Reference
Division

NORTHERN KENTUCKY UNIVERSITY
LIBRARY

0187

GOVERNMENT DOCUMENTS
COLLECTION

FCC Orders AT&T to Cut Rates Further

Long-Distance Reductions Will Take Effect on New Year's Day

By Bill McCloskey
Associated Press

The government yesterday ordered American Telephone & Telegraph Co. to reduce rates an additional $650 million to $700 million, bringing a scheduled New Year's Day long-distance price cut to almost $1.9 billion, or 11 percent.

Federal Communications Commission Chairman Mark S. Fowler said a large portion on the new reductions will come in the night and weekend time periods to benefit people who make long-distance calls from home.

AT&T's competitors said earlier they will reduce their long-distance rates to remain competitive.

The cuts were made possible in large part by reductions in the rates long-distance companies pay local phone companies for making the connection between an individual phone and the long-distance company's switching center.

Part of the cost of those circuits is now paid by each customer as a monthly $2 subscriber line charge.

Even with that $2 cost, the commission estimates that any customer who makes $4.65 a month in long-distance calls will save money on out-of-state toll calls, compared with 32 months ago when long-distance rates started to drop.

Fowler also predicted local rates generally will remain flat in 1987 and might be reduced in some states.

A survey by the Consumer Federation of America, released yesterday, said that for residential customers the reductions in long-distance rates have not made up for increases in local rates during the past three years since the breakup of the Bell System on Jan. 1, 1984.

Fowler said long-distance rates have come down 30 percent since the breakup. Local rate increases vary state by state, but on average are up about $5 a month, compared with rates in late 1983.

With New Year's Day football games in mind, Fowler estimated a five-minute call from Pasadena, Calif., site of the Rose Bowl, to the Ann Arbor home of game participant Michigan would cost $1.68, compared with $2.53 three years ago.

Fowler also revealed that November Census Bureau figures show 92.3 percent of all homes have telephones, a slight increase over the 92.2 percent reported four months earlier.

The number has been inching up from 91.4 percent since the figures were first gathered three years ago, but Fowler said FCC statisticians now believe the increase is "statistically significant" and not just a quirk in the number-gathering.

AT&T already had planned a price cut of 8.1 percent, or $1.2 billion, for 1987.

AT&T spokeswoman Edith Herman outlined roughly how the additional savings will be distributed:

- Calls made between 11 p.m. and 8 a.m. or on weekends before 5 p.m. Sunday would come down about 5.9 percent. A 2.7 percent reduction had been proposed.
- Rates for WATS lines used by businesses to accept toll-free calls from customers were ordered down by 5 percent, more than double the rate reduction AT&T had planned.
- Weekday rates, for calls made between 8 a.m. and 5 p.m., were slated for an 11.6 percent cut, but under the commission-ordered reduction the cut will be 14.5 percent.
- Calls between 5 p.m. and 11 p.m. are scheduled for a 9.3 percent price cut, compared with AT&T's proposed 6.2 percent reduction.

AT&T officials said the total reduction will be $1.86 billion to $1.9 billion, in the 11 percent range. Exact figures will be filed by AT&T at the FCC later.

The commission deferred, for at least a month, AT&T's proposed 4 percent increase in the cost of private lines businesses use to make out-of-state connections between computers, telephones or radio and television studios.

The commission estimated that the lower rates will encourage 200 billion minutes of long-distance calling next year, up from 150 billion minutes in April 1984.

Increased use of existing lines and switches will make the telephone network more efficient, the commission ruled and it ordered AT&T to factor in those savings in setting its new rates.

The FCC said AT&T overestimated some costs and the commission refused to allow AT&T to pass on to customers certain other costs.

WASHINGTON POST DEC. 31, 1986 E2

© 1986 The Washington Post Company. Reproduced by the Library of Congress, Congressional Research Service with permission of copyright claimant.

Phone Bills Found Up 20% Since Breakup

By Elizabeth Tucker
Washington Post Staff Writer

Despite deep cuts in long-distance phone rates, consumer telephone bills have risen 20 percent since the breakup of the Bell System three years ago, the Consumer Federation of America said in a study released yesterday.

Local residential phone bills, which include a charge of $2 a month for access to the long-distance network, have increased from an average of $10.55 per month to $15.40 per month, said the study by the Washington consumer group.

Interstate long-distance service rates have fallen 17 percent since the Bell System breakup, based on surveys by the Bureau of Labor Statistics, the CFA study said. Long-distance rates for in-state calling have increased 4 percent. But the cost of local telephone service, which includes the monthly long-distance access charge, installation, the telephone, local usage charges and taxes, has increased 39.8 percent.

"Many of the promises that accompanied the restructuring of our telephone system have failed to reach the American consumer," said Gene Kimmelman, legislative director for the CFA. "We were told that widespread, cutthroat competition would drive down telephone prices and bring information-age gadgets and services to all consumers. Instead, consumers must pay significantly more to get the same old service they had prior to the break up."

Because most residential customers do not make a large number of long-distance calls, the average consumer's bill has gone up by about 20 percent, said Kimmelman.

Overall, telephone bills rose 20 percent during the past three years when overall inflation was only 9 percent, the study noted. In contrast, overall telephone bills rose 24.2 percent between 1980 and 1983, when inflation totaled a much higher 17.5 percent, the study said.

Since the Bell breakup, state regulators have granted telephone companies about $5.5 billion in rate increases. The phone companies' profits—which are set by state regulators and closely tied to interest rates—are running 2 to 4 percentage points higher than other utilities and most competitive businesses, said Kimmelman.

"Regulators need to initiate rate decreases, which they are not doing," he said. "We ought to be entering an era of utility rate reductions because we've got inflation at the lowest rate in 20 years, and that has not been worked into the public utility rate-making process."

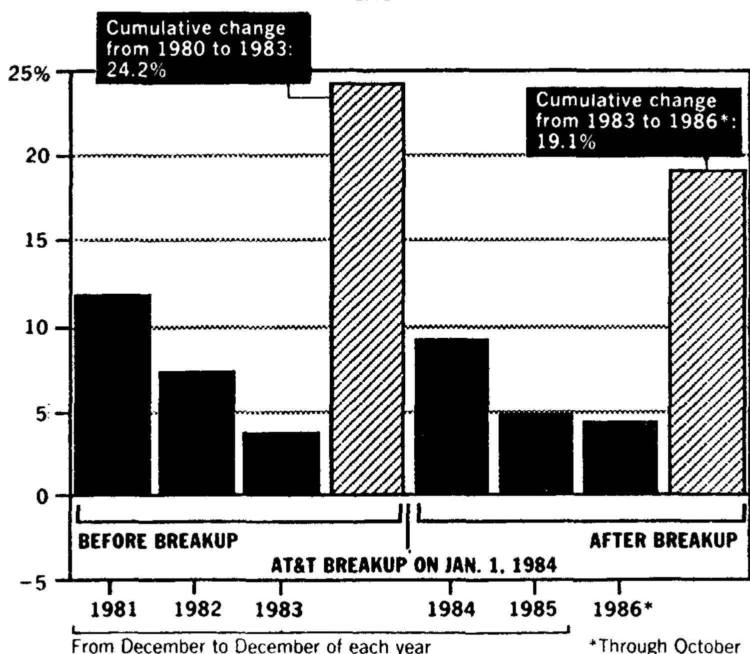
The CFA claims telephone companies have charged ratepayers about $3 billion too much for each of the last two years.

Officials at the Federal Communications Commission yesterday declined comment on the study because they had not seen it. One FCC official said 1981 through 1984 "were turbulent years" for consumers of telephone service.

"Since 1984, trends are looking very very good," the official said. "We wouldn't expect any future state increases of any magnititude, and the long-distance rates have been coming down," he said.

FCC officials said long-distance rates have fallen about 23 percent since the Bell System breakup due to increased long-distance calling, which spreads costs over a larger base of users, and pricing adjustments in the long-distance industry.

The trend is expected to continue, they said. AT&T, which dropped prices more than 6 percent in the summer, will announce a rate cut of more than 6 percent today, officials said.



THE WASHINGTON POST

TUESDAY, DECEMBER 30, 1986 E3

© 1986 The Washington Post Company. Reproduced by the Library of Congress, Congressional Research Service with permission of copyright claimant.

AT&T Will Lay Off 27,400 In New Move to Cut Costs

By Michael Schrage
Washington Post Staff Writer

NEW YORK, Dec. 18—AT&T today announced plans to lay off 27,400 employes—the largest such reduction in the company's history—and said it would take a $3.2 billion reduction in earnings as part of the telecommunications giant's struggle to fit costs to its new, deregulated role in the economy.

"We are doing what we said we were going to do—resize, reshape and refocus our business," said AT&T Chairman James E. Olson at a press conference here, describing the actions as a "positive development" that "clears the deck" for the company's future growth.

The layoff announcement follows a similar elimination of 24,000 jobs at the company last summer and, when this round is complete, will bring AT&T's work force to between 290,000 and 295,000. That is a reduction of about 20 percent from the 374,000 AT&T employed in 1984.

AT&T has been struggling to adjust to operating in a competitive environment and to delivering on the promises of growth and technological leadership held out when it and the local telephone companies were separated.

"The best way to strengthen our core business [such as long distance phone service and telecommunications switching equipment] is to attack the cost structure," said Olson.

See AT&T, A14, Col. 1

WASHINGTON POST
DEC. 19, 1986
A1, A14

© 1986 The Washington Post Company. Reproduced by the Library of Congress, Congressional Research Service with permission of copyright claimant.

AT&T to Lay Off 27,400, Take $3.2 Billion Charge

AT&T, From A1

"We've got to reduce the break-even point.

"We are not on the verge of pulling out of any major market segments," he said, "but I cannot say with certainty that, two or three years from now, we will have the same plants that we have today." Olson, who said that the benefits of the moves will appear in 1988, compared the steps to restructuring efforts taken by other large corporations as they seek to reduce their costs in a sluggish economy.

"AT&T is doing this for one reason and one reason only," said Jack Grubman, a Paine Webber analyst who tracks the company. "Business stinks and will continue to stink, probably through 1988. They're incredibly forthright to say that positive results won't happen until 1988."

"It was a blockbuster announcement," said James McCabe of Donaldson Lufkin & Jenrette, who is cutting his earnings forecast for the company.

Separately today, International Business Machines Corp. said that roughly 10,000 of its domestic employes had elected to accept early retirement under a special retirement option. That is twice as many as IBM had stated as its goal when the plan was announced this fall and, when combined with retirement incentives in IBM's international operations, could cost the company $250 million in after-tax earnings.

According to Sanford C. Bernstein analyst Richard Martin, that could save the world's largest computer company between $600 million and $700 million a year.

The company also said it sees no noticeable improvement in the business climate and plans new cost reduction efforts next year.

AT&T, which, like IBM, is competing in a troubled information processing marketplace, has seen the size of its work force drop dramatically since the breakup of the Bell System nearly three years ago.

According to AT&T President Robert Allen, roughly 30 percent to 40 percent of the employes affected by the proposed layoffs have been notified. The majority of the 27,000-plus workers will be off the AT&T payroll by early 1987.

About 11,000 of the proposed layoffs will be from management levels, said Olson. According to contracts, those laid off by AT&T will enjoy preferential hiring treatment by the seven regional Bell operating companies.

The Communications Workers of America, the union representing 155,000 AT&T employes, criticized the timing of the announcement, just a week before Christmas, and claimed that AT&T had given the union different information about the job cuts than it gave the public, The Associated Press reported.

The announcement was a "gross overstatement and unduly alarming," union spokeswoman Francine Zucker said.

The $3.2 billion charge against earnings will result in a loss for the fourth quarter but allows a "small profit" for the year. Roughly $2 billion of the charge is related to inventory writedowns and consolidations and not to the layoffs.

The cutbacks indicate that AT&T continues to face realtively slow growth in its core business and needs to cut costs to generate increased profits.

"The key problem in this company is that they don't know how they're going to get growth," says Paine Webber's Grubman.

During the early stages of the Bell System breakup, AT&T planned to use its strong technology base and national presence to compete with such industry leaders as IBM and Digital Equipment Corp. in the computer marketplace. Freed from regulatory constraints, AT&T was going to generate new business in this information processing market.

However, the computer industry slump, combined with AT&T's own inability to create and market products effectively, led to roughly a billion dollars of losses over the last three years. "Our appetite was too broad and too large," acknowledged AT&T's Allen. "... Also the market was rather weak and sick to go into either as a new entrant or as a major strategic force."

Consequently, after a series of meetings this fall, AT&T decided to reduce its ambitions in the information processing industry. AT&T has gone outside to Olivetti, a partner, to recruit a new manager for its computer operations. While AT&T says it will continue to sell minicomputers and personal computers, it will now focus on providing "networking" expertise that will allow companies to link disparate computer systems together so they can communicate.

Allen confirmed that AT&T did negotiate to acquire all of Electronic Data Systems, the General Motors data processing subsidiary formerly run by Ross Perot, which does have considerable networking skills. Reports of such negotiations were hotly denied by GM.

Shopping Spree

Baby Bells Diversify Into Non-Phone Areas, Spark Much Criticism

Regional Firms Are Accused Of Unwise Acquisitions, Using Subsidies Unfairly

Growth Is Needed, They Say

By JOHNNIE L. ROBERTS
Staff Reporter of THE WALL STREET JOURNAL

Several months after U S West Inc.'s birth in the breakup of the Bell System, two seasoned miners offered it an intriguing proposition: Would the regional Bell telephone concern like to buy a valley in the Rocky Mountains?

The miners held precious-metal claims there and thought that a business park would be a good use of the surrounding land. Itching to diversify, Denver-based U S West listened to the proposal before spurning it.

"Just because they had an idea that sounded offbeat didn't mean we'd kick them out the door," a U S West spokesman says, adding: "We aren't interested in limiting ideas for diversifying."

And diversify it has, along with the six other regional Bell telephone holding companies that American Telephone & Telegraph Co. divested itself of. Ten days after the breakup on Jan. 1, 1984, Bell Atlantic Corp. announced a proposal to buy a leasing company. That set off a continuing binge of acquisitions by the seven regional companies. They have been buying Yellow Pages publishers, cellular-telephone properties, computer stores, software companies, financial-services concerns and real estate. So far, the spree has cost an estimated $3.5 billion; and that doesn't include ventures started from scratch and acquisitions valued at less than $100 million.

Still Looking

"We are actively seeking acquisitions," says Sam Ginn, Pacific Telesis Group's vice chairman.

But regulators, consumer groups, securities analysts and potential Bell competitors are growing increasingly uneasy. Their concerns vary. Some analysts contend that the Bells, in their headlong rush to diversify, may be paying too much for acquisitions. Some competitors accuse them of "cross subsidizing" the new businesses with revenues from their telephone monopolies, with phone customers picking up the tab. Potential competitors such as newspaper publishers fear that the Bells will enter new electronic-based information services in which the regional companies will have an unfair advantage because of their phone networks.

Most serious of all, industry analysts, consultants and others wonder whether the Bells really know what they are doing. One critic says the seven companies' non-telephone operations lost almost $1 billion in 1985; the companies themselves are generally secretive about financial details. The doubters note that never before did Bell executives—nurtured in the 100-year-old monopoly culture of Ma Bell—manage diverse businesses, face competition, map strategy or acquire companies.

Management Problem

"They have little understanding of how to compete in most industries because their management team comes from a single industry," says Craig Boyce, an industry consultant and investment banker.

Bell-company officials say their critics are off base and, at this early stage of the diversification efforts, are unfairly speculating about eventual results. In their own defense, the officials say the acquisitions are largely related to communications and, therefore, are conservative moves. "We aren't buying popcorn stands," says Robert Pope, vice chairman of Southwestern Bell Corp. Bell managers add that the new, diversified operations and the telephone companies are separated to preclude cross subsidies. "We refuse to use our leverage in the monopoly," says Howard Doerr, a U S West executive vice president.

The heavy losses at the non-telephone operations are narrowing sharply, Bell officials say. With non-telephone revenues ranging from a few hundred million dollars to about $1 billion at each of the companies, the non-phone operations will begin contributing significantly to earnings next year or in 1988, the Baby Bells say. At Bell Atlantic, whose efforts are regarded as among the more successful, non-telephone operations will provide as much as 40% of earnings growth this year, says Raymond Smith, vice chairman and chief financial officer.

Outgrowth of Decontrol

The acquisition drive stems from the deregulation of telecommunications. The Bell System breakup left the Bells to provide local phone service on a regional basis. But they see diversification as essential because, they say, lucrative parts of that business face competition. Also, phone profits face slowing growth and can't exceed limits set by regulators.

"These companies are going to increasingly feel a sense of urgency to diversify," says Jack Grubman, a PaineWebber Inc. analyst.

Thus, the deal-making proceeds apace. Bell Atlantic, the most acquisitive regional, bought a real-estate portfolio in September and completed acquisition of a second leasing concern in October—a total outlay of $290 million. Speaking to analysts last month, Mr. Smith hinted at acquisitions in computer software and financial services.

Meanwhile, Southwestern Bell reaffirmed its controversial plan to acquire Metromedia Inc.'s cellular-telephone and

Please Turn to Page 24, Column 1

WALL STREET JOURNAL
DEC. 10, 1986 pp. 1, 24

© 1986 Dow Jones & Company, Inc. Reproduced by the Library of Congress, Congressional Research Service with permission of copyright claimant.

Shopping Spree: Baby Bells Move Into Many Non-Telephone Areas

Continued From First Page

paging interests for $1.2 billion. It also agreed to buy related cellular interests for about $200 million more. At Nynex Corp., a daring plan to buy a transatlantic long-distance business is moving forward. Last July, the company paid an estimated $100 million for International Business Machines Corp.'s computer stores.

"We look at six to 12 situations in any given week," says Robert Runice, U S West's president for commercial development. U S West is rumored to be looking at E.F. Hutton Group Inc., a big securities firm.

So far, the Bells haven't made any huge mistakes. They have spurned proposals for acquisitions far afield such as oil and gas properties, a furniture maker and a metals fabricator.

Nonetheless, doubts are growing among securities analysts, who note the unenviable diversification record of non-Bell telephone companies, such as GTE Corp. AT&T's reversals in the computer market have forced it to reemphasize its core communications business. Telephone concerns have had "tremendous difficulty identifying markets," says Eileen Polsky, an analyst at Drexel Burnham Lambert Inc. "A lot of companies would be more profitable today if they hadn't pursued some of their diversification efforts."

As deals dry up in areas familiar to the Bells, "you have to call into question their ability to analyze potential acquisitions not within the confines of telecommunications," PaineWebber's Mr. Grubman says.

Lingering Questions

Questions still linger over Nynex's acquisition of the 83 IBM Product Centers, now renamed Nynex Business Information Centers. "How much more does Nynex know about operating those stores than IBM?" Mr. Grubman asks. Even Mr. Smith, whose Bell Atlantic acquired the smaller Compushop computer-store chain, expresses skepticism about telephone companies' prospects in computer retailing. "We are all testing to see if the business-center strategy is sustainable, and the jury is still out. That is why we bought a small company at a low price—$21 million for 60 stores," Mr. Smith says.

Delbert Staley, Nynex's chief executive, says outsiders don't understand its strategy. "The problem is people assume we're in it purely for computer retailing," he says. He adds that through the acquisition, Nynex gained "a national presence" that can help it reach business customers and distribute products and services.

Almost from the start, some critics have contended that the Bells pay too much for acquisitions. Edward Greenberg, an analyst at Morgan Stanley & Co., says the $215 million that Ameritech paid for Applied Data Research Inc., a software concern, was an "astronomical" price. Analysts made the same charge following Bell Atlantic's $175 million acquisition of Sorbus, its computer-maintenance unit, and U S West's $120 million acquisition of Applied Communications Inc. Each company contends that it paid a full but fair price.

Outmaneuvering Other Bidders

But the issue of overpaying is looming ever larger in the wake of Southwestern Bell's $1.2 billion cellular-phone and paging transaction. The transaction arose when the company preempted a planned auction of the holdings of Metromedia, whose principal owner, John Kluge, wanted to liquidate for estate and tax purposes. With the move, Southwestern outmaneuvered 30 or so potential bidders, including two of the Big Three auto makers, AT&T and two other Bells that also sought a preemptive bid—U S West and Pacific Telesis, sources say.

Southwestern's original proposal, a $1.65 billion offer, included a "crown jewel" corridor in the Northeast encompassing cellular properties in Boston, New York, Philadelphia and Washington-Baltimore. Subsequently, New York and Philadelphia were dropped because of legal problems at Metromedia, and the price was reduced. But the initial price is still being questioned. Says James M. Piepmeier, Ameritech's director of corporate development: "We ran a number of investment models on those properties and had some difficulty getting anywhere near" the initial figure.

Although the acquisition will dilute earnings, Southwestern defends it as a strategic move, a chance to land choice properties unlikely ever to go on the block again. "We look at this as offering us an opportunity to get into the national paging and cellular businesses," the company's Mr. Pope says. "There is some value in fulfilling a long-term strategy."

Bell critics and backers alike say acquisition prices have been climbing partly because the Bells have been bidding against one another. The Bells deny this but concede that the same acquisition prospects are often offered to several of them.

Big Profits Anticipated

Bell officials expect the new businesses to be highly profitable even though, under federal regulations, non-telephone revenue must be kept to no more than 10% of the total. By 1991, "a company we acquired in 1986 should be earning at a level that will be as good as or better than any alternative investment," including the phone companies, Bell Atlantic's Mr. Smith says.

But some Bell competitors, citing the losses at those operations, are bringing charges of cross subsidies. The telephone concerns "are corrupting the ratepaying process, using the revenues of the local service monopoly to fuel an ambitious acquisition binge," Edwin B. Spievack, the president of the North American Telecommunications Association, said in testimony earlier this year before a congressional subcommittee. The group's members make or distribute telecommunications gear and thus compete with the Bells' unregulated units that sell such equipment.

Utility regulators also are concerned about the potential for cross subsidies. A subcommittee of the National Association of Regulatory Utility Commissioners said it found evidence of cross subsidies during a recent investigation. The panel's report noted "concern that the [Baby Bells] are draining off the capital of the [telephone companies] to finance their growth into unregulated operations and that the integrity of basic service is threatened."

Contention Denied

Bell officials deny cross subsidizing non-telephone operations. The holding-company profits, much of which are invested in non-telephone operations, belong to the stockholders, they say. "It sure as hell doesn't belong to the ratepayers," declares U S West's Mr. Doerr, who adds that phone customers get top-notch service for a fair price. "Whatever we do with the profits, the only people we have to answer to are the shareholders," he adds.

Like other Bell executives, Mr. Doerr says the companies are reinvesting heavily in telephone service. U S West put $1.7 billion into it this year, he says.

Complaining competitors, Bell officials say, simply want the Bells relegated solely to the local telephone business. But diversification is imperative, they add.

"You need to have an engine that motivates the growth of the organization," says Carl E. Horn, Ameritech's senior vice president of corporate strategy. "If you don't grow, you tend to die."

AT&T COMPANY
550 Madison Ave.
New York, NY 10022
Telephone: 212-605-5500

AMERITECH CORPORATION
225 W. Randolph St.
Chicago, IL 60606
Telephone: 312-750-5000

BELL ATLANTIC CORPORATION
1600 Market St.
Philadelphia, PA 19103
Telephone: 215-963-6000

BELLSOUTH CORPORATION
675 W. Peachtree St., N.E.
Atlanta, GA 30375
Telephone: 404-420-8600

NYNEX CORPORATION
222 Westchester Ave.
White Plains, NY 10604
Telephone: 212-395-2121

PACIFIC TELESIS GROUP
140 New Montgomery St.
San Francisco, CA 94105
Telephone: 415-882-8000

SOUTHWESTERN BELL CORPORATION
1010 Pine St.
St. Louis, MO 63101
Telephone: 314-247-9800

US WEST INC.
7800 E. Orchard Rd., Suite 200
Englewood, CO 80111
Telephone: 303-793-6500

US WEST
Mountain Bell
Northwestern Bell
Pacific Northwestern Bell

Ameritech
Ohio Bell
Indiana Bell
Michigan Bell
Illinois Bell
Wisconsin Telephone

NYNEX
New England Telephone
New York Telephone

Pacific Telesis
Nevada Bell
Pacific Telephone

Southwestern Bell

Bell South
Southern Bell
South Central Bell

Bell Atlantic
New Jersey Bell
Bell of Pennsylvania
Diamond State Telephone
Chesapeake & Potomac Telephone Companies (4)

Source: American Telephone and Telegraph Company (A.T.&T.)　　December 1986

F.C.C. Drops a Restriction Against Bell Concerns

By REGINALD STUART

Special to The New York Times

WASHINGTON, Nov. 25 — The Federal Communications Commission today dropped its rule requiring the Bell telephone companies to use separate companies to sell telephone equipment.

The regulatory panel said that the costs to the companies of the rule "are high" and that the public interest would be "served better" by granting the companies flexibiity in this line of business.

Competition Expected to Heat Up

The practical effect of the decision, made in a 5-to-0 vote, is that telephone customers will again be able to order telephone equipment when they order new service.

The decision, which could save the Bell companies millions of dollars in administrative and sales costs, is likely to heat up competition in the telephone equipment sales business. It comes just five months after the F.C.C. dropped a similar rule for the Bell companies covering the marketing and sale of "enhanced services," including call answering and message storage.

The response to the commission's decision from the Bell companies was predictably enthusiastic. U S West, the Denver-based holding company for Bell systems in the Rocky Mountain region, called the panel's action a "very positive" step that recognizes the need of the Bell companies for flexibility in dealing with their customers and equipment needs.

The Bell Atlantic Corporation, the Philadelphia-based holding company for Bell companies in the Middle Atlantic States, praised the commission's action as a "long-needed step in the right direction."

The two separate subsidiary rules were rooted in decisions by the F.C.C. in 1971 and 1980 aimed at promoting competition by restricting the ability of the American Telephone and Telegraph Company to dominate certain lines of business by marketing through its local service companies.

When A.T.&T. was broken up three years ago under a Federal court consent decree, the separate subsidiary rules carried over to the seven new regional holding companies that were created to operate the local Bell telephone companies.

Under the rule abolished today by the F.C.C., for example, the Bell operating companies were required to set up separate companies with separate staffs to market and sell telephone equipment. Customers of the Bell companies could not be steered to those subsidiaries, and the subsidiaries could not be subsidized by revenues from regulated phone services.

In voting to drop its separate subsidiary rule regarding equipment sales, the commission issued a set of "safeguards" that it said would protect rate payers and competitors of the Bell companies. They are similar to the provisions governing the marketing and sale of enhanced services.

The commission will require accounting measures aimed at detecting and deterring any Bell company from using the rate base to subsidize the sale of telephone equipment. The Bell companies have to accord their non-Bell competitors the same access to the network that they would accord Bell employees in cases where access to the network is required to complete an order for equipment.

The commission also authorized independent equipment-sales companies to act as sales agents for Bell services.

N.Y. TIMES
NOV. 26, 1986
D2

© 1986 The New York Times. Reproduced by the Library of Congress, Congressional Research Service with permission of copyright claimant.

Easing of Limits on Bell Firms' Activities Is Suggested in Report for Justice Agency

By Bob Davis
Staff Reporter of The Wall Street Journal

WASHINGTON – A report commissioned by the Justice Department suggests that many restrictions on the former Bell telephone companies no longer make sense, a source familiar with the report said.

The report by consultant Peter Huber provides ammunition for proponents of allowing the regional telephone companies to manufacture telephone equipment and to provide certain computer and long-distance services. Currently, the regional telephone companies are barred from those fields as a result of the consent decree that broke up American Telephone & Telegraph Co.'s Bell System in January 1984.

A Justice Department spokesman didn't discuss details of Mr. Huber's report, but said that it will form the basis for recommendations that the department is required to make to federal Judge Harold Greene in mid-January. The spokesman said the department didn't have any immediate plans to release the report before then.

The Justice Department hasn't yet formed its recommendations, but telecommunications industry officials expect it to suggest some easing of the restrictions on the phone companies. Earlier this year, the Justice Department and the Federal Communications Commission helped write a bill introduced by Senate Majority Leader Robert Dole (R., Kan.) that would shift jurisdiction over telecommunications policy from Judge Greene to the FCC. Congress recessed without acting on the legislation.

The Huber report has been a subject of intense speculation in the telecommunications field, partly because Mr. Huber, a lawyer and former engineering professor, has given few indications of his views during the year he spent researching the 600-page document.

The report was designed as an economic analysis, and the Justice Department spokesman said he believes it doesn't contain any firm recommendations. Instead, he said, it analyzes whether sufficient competition and regulatory safeguards are in place to warrant allowing the regional telephone companies to enter new fields. "That doesn't mean people can't find preferences in the report" by evaluating the analyses, he added.

The source familiar with the report said it argues that market conditions may be ripe for allowing the regional phone companies to sell gear ranging from large telephone switches to consumer headphones.

Large telephone switches require $1 billion and 10 years to develop, according to the report, so the phone companies would have little edge over such suppliers as AT&T. Consumer telephones, on the other hand, have been widely available from a variety of suppliers and the phone companies would have little ability to dominate that market.

Similarly, the report makes a case for allowing the regional phone companies to sell long-distance service to large business customers. The phone companies have been banned from providing long-distance service because of fears they would undercut competition by shifting costs to residential customers.

But large business customers can construct their own telecommunications networks, the report indicates, and so could bypass a local phone company abusing its position. Residential customers don't have similar power; the report indicates it may make sense to prohibit the regional phone companies from providing long distance to these customers.

The report also analyzes the market for seven computerized services, such as storing messages or providing burglar-alarm service through the telephone. The report noted there is enough competition to allow the regional companies to enter some of these fields, but the source wouldn't specify which ones.

The report indicated that phone companies could be allowed to provide services that are usually included on private telecommunications networks—apparently services like electronic mail, voice-message storage and others.

In New York, a spokesman for AT&T declined to comment on the report, saying company officials hadn't seen it yet. But he noted AT&T has consistently opposed easing of restrictions on Bell companies in supplying long-distance services or making telephone equipment—AT&T's two main businesses.

Spokesmen for some of the Bell companies, which generally have favored relaxation of the rules, also declined to comment. "We haven't seen (the report) either," said a spokesman for Chicago-based Ameritech. "But we're hopeful it will spur regulators and policy makers to remove the anti-competitive shackles preventing us from competing and better serving customers."

WALL STREET JOURNAL
NOV. 19, 1986
p. 14

© 1986 Dow Jones & Company, Inc. Reproduced by the Library of Congress, Congressional Research Service with permission of copyright claimant.

BARRON'S
October 27, 1986,
pp. 6-7, 35-36

Muscle and Moxie

The Bell Regional Companies Have Plenty of Both

By LAWRENCE J. TELL

THEY used to be called the Baby Bells, but at nearly three years of age, they hardly fit that image any longer. The seven regional holding companies that now control AT&T's 22 former local telephone subsidiaries have emerged, muscles rippling and able to leap their original territorial boundaries and core business in a single bound. Though they still bear striking resemblances to each other, retaining as they do the right to display the familiar Bell logo, they also have been developing personalities that are quite distinct.

At the outset—the break-up of the Bell System on Jan. 1, 1984—the seven companies inherited different regional turfs but a compelling similarity of outlook, style and business opportunities. Even more compelling: All seven have done exceptionally well by their shareowners. Total return for the group, including both stock-price appreciation and dividends paid, has averaged better than 30% annually (see table). About the worst an investor could have done by holding shares in one of the regionals since divestiture was to double his money. The best performers, Bell South and Nynex, returned almost $2.35 for every dollar invested.

Atlanta-based Bell South, which serves the high-growth Southeast region, was expected to outperform the pack. But there have been surprises, too. An unexpectedly strong boom in the communications-laden service industries near New York and Boston propelled Nynex, which runs local phone companies there, to record growth in customer lines and calling volume. Likewise, Bell Atlantic, which serves the Atlantic seaboard from New Jersey to Virginia, saw usage of its most profitable business services zoom. "We may not be the Sun Belt but we certainly are the phone zone," crows Vice Chairman Raymond Smith.

To a great extent, geography has been destiny for the regionals. And the proclivity of utility regulators in the 50 states to adapt to new competitive forces in the telecommunications industry is a major element in the companies' comparative performance.

Nearly three years after the AT&T break-up, however, other distinguishing features among Ma Bell's brood are gaining importance. Quarterly earnings reports are beginning to show the impact of strategies to pare costs and avert "bypass" of the local phone network by competing suppliers of bulk communications services. And the wide-open challenge of diversification is reshaping seven Bell siblings into seven distinctly different competitive businesses. In short, they aren't just local phone companies any more.

Take Southwestern Bell, which swiftly moved to capitalize on a traditional strength: putting out voluminous directories. The St. Louis-based company is building a nationwide publishing operation, primarily through acquisitions. It now produces more than 1,100 directories in 46 states, among them one of the industry's most hotly competitive new ventures: a Southwestern Bell Yellow Pages for Manhattan (that's New York, not Kansas), due out in January.

In New York, at least, competitive pressures led Nynex to take defensive steps, among them mounting an expensive promotional push and offering Yellow Pages advertisers more space for the same price, otherwise known as price-cutting. "Directories are very high-profit-margin operations. Whether it was Southwestern Bell or XYZ Co., we knew we were going to have competition," asserts Tony Parra, director of investor relations for Nynex.

Other regionals are expanding their publishing operations as well. US West, which covers its 14-state region with 300 telephone directories, followed the acquisition route. It bought national phone and city directory publishing firms that put out about 500 books in mid-sized markets. Ameritech is staying primarily within its five-state region, but the Chicago-based company is seeking profitable new niches, such as producing industrial directories and travel guides. PacTel Publishing, a Pacific Telesis unit, publishes convention and visitor guides in 13 states.

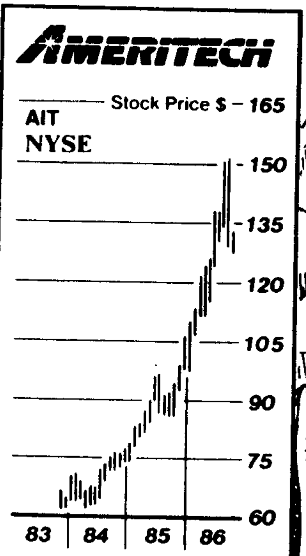
Bell South bought L.M. Berry & Co., an ad sales agent for classified phone directories. "We haven't chosen head-to-head competition with a local telephone company. We've chosen to serve them through L.M. Berry," explains C. Sidney Boren, Bell South's vice president for corporate planning.

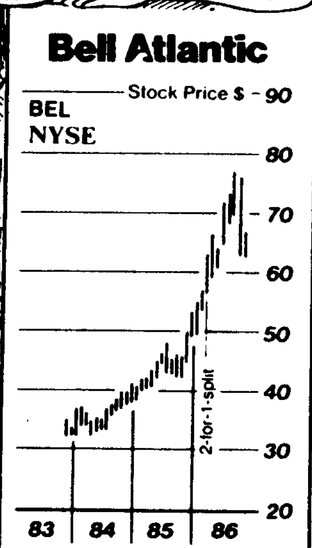
Cellular mobile-telephone service is fast becoming another battleground for sibling rivalry among the former Bells. The AT&T divestiture decree gave each local phone company one of two cellular licenses available in each market. The outside competitor, which must bid for its license in this regulated "duopoly," is called the "non-wireline" company. Several regionals are snapping up non-wireline licenses beyond their turf, especially in the most promising dense, urban markets.

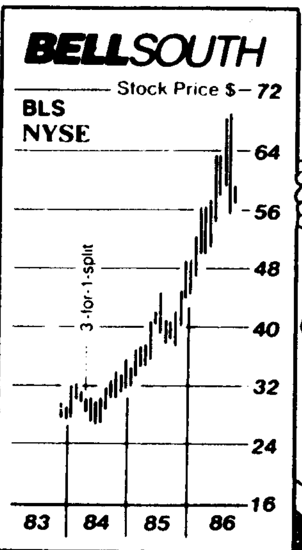
The most dramatic evidence of territorial expansion came last June, when Southwestern Bell announced its $1.2 billion purchase of Metromedia's cellular and paging operations. When the deal closes, probably by year's end, Southwestern Bell Mobile Systems will cover cellular markets with a greater combined population than any competitor's. (Metromedia's nationwide paging business, another fast grower in the "personal communications" line, is the nation's biggest, too.) Southwestern Bell will own major cellular stakes in Chicago, Boston, Baltimore-Washington and other urban areas where the quickest profits in cellular are expected to be made.

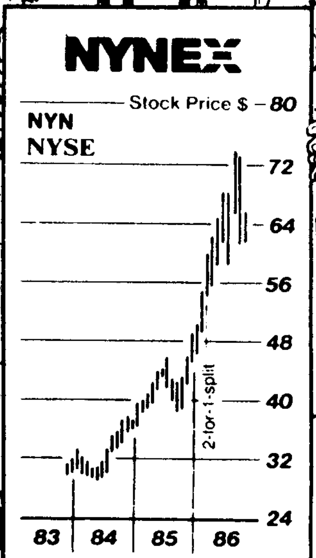
The purchase puts Southwestern in direct competition with other regionals. In Chicago, for example, Southwestern will be the non-wireline firm battling head-to-head against Ameritech, whose Illinois Bell unit pioneered cellular service for the Bell System. Other cellular battles are shaping up: Pacific Telesis jumped into Southwestern's Dallas market with an acquisition last February. US West, in turn, owns a San Diego cellular license. Despite the competition,

© 1986 Dow Jones & Company, Inc. Reproduced by the Library of Congress, Congressional Research Service with permission of copyright claimant.

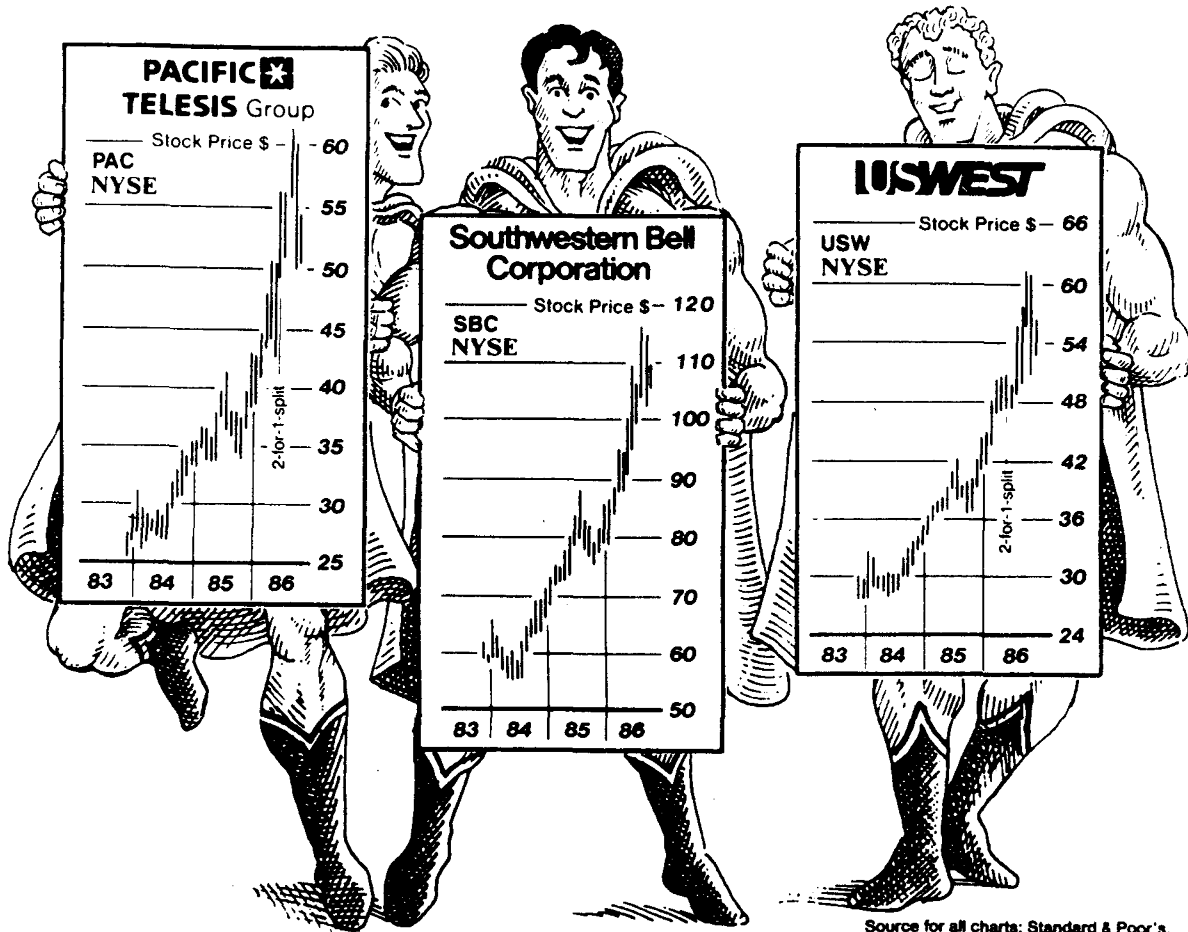








Illustrations: Marty Norman



Source for all charts: Standard & Poor's.

all the Bell regionals foresee a profitable future in the mobile-phone business, which industry estimates see growing 600%-700% by 1990 from a base of 325,000 customers last year.

It takes hefty amounts of capital to build a cellular operation—whether by acquisition or construction. Plowing huge sums into a competitive, high-growth business has unaccustomed side effects for the typical investor in telephone utility shares. The Metromedia deal offers an example: Southwestern Bell's earnings will suffer a 5%-5½% dilution over the short term. And borrowings to pay for the $1.2 billion purchase initially will add about 3½ percentage points to the company's debt ratio, reports Robert Dickemper, vice president for strategic planning. That ratio stood at 42.9% last month. "We bought a system that's up and running," he explains. "This is one of the fast-growing segments of the telecommunications industry, and we bought a stream of cash flows that were of value to us." But company officials won't disclose revenues or operating results from the cellular business.

In addition to publishing and cellular, most of the regionals are vying to sell computer and telecommunications equipment nationwide, to both corporate and retail customers. Nynex, for instance, owns a nationwide string of 100 business-equipment retail stores, thanks to its purchase of the 33-state IBM Product Centers chain. Pacific Telesis and Bell South, among others, are marketing their communications expertise overseas. PacTel's international unit is stressing business opportunities in Asia, with contracts in hand to advise South Korea on telecommunications services for the 1988 Olympics, to install a paging system in Bangkok and to play a role in the rapid modernization of China's phone system.

Other regionals are crafting profit centers out of real estate and financial-services units created to serve internal company needs. US West's BetaWest Properties more than doubled its holdings this year, to $690 million. The parent's local phone companies currently occupy about 60% of the leased space, but the unit is prospecting in some of the region's overbuilt markets for new deals. "We've been generating accounting losses, but the cash flow is tremendous," says investor-relations manager Wayne Wolberg. In fact, US West recorded a $12 million net gain on a property sale in the second quarter ended in June.

Another US West sub finances computer leases and receivables, with 75% of its $600 million in assets coming from deals with outside customers. US West is now seeking permission to offer insurance and brokerage services through its finance unit, but has yet to disclose specific plans. (The break-up decree

currently requires court approval for each new business venture, and bars the regionals from manufacturing equipment or selling information-processing services. The companies are lobbying hard in Washington to scale back those rules (see accompanying story, page 37).

Revenues from each company's diversified ventures aren't disclosed, but it's certain they're overshadowed by phone company operations—by a factor of about 10. And for most ventures, profits are a year or more away. Still, new enterprises are transforming the look and feel of these companies, and they'll be engines of growth, if they succeed. Estimates from Bell Atlantic, which has the most aggressive new-venture strategy, are that up to 50% of the company's year-to-year earnings gain in 1987 will come from its non-telephone units.

The flip side, of course, is that profitability from the regulated telephone business is on a slower growth curve. As a result, each Bell regional is trying to create the right combination of new ventures and regulatory flexibility to keep competitive risks down, returns high and the investor happy.

In fact, the most recent earnings reports from the Bell regionals indicate a slackening of profit gains. The companies posted an average 6.2% rise in earnings for the three months ended Sept. 30, vs. 10.7% in the year-earlier period. That trend could indicate that easy profitability gains from cost-cutting measures have run their course.

Edward M. Greenberg, Morgan Stanley's telephone analyst, is revising his earnings estimates based on the latest quarterly results. He's scaling back his previous projections of an average 7% rise in earnings next year to 3%-5%. Few prognosticators have yet to calculate precise figures for each company, although John Bain of Shearson Lehman Brothers is leaving intact the generally higher numbers for 1987 profits that he released earlier this month.

Against that backdrop, future performance will depend more heavily on the new ventures and competitive strategies each of the regionals has chosen. A closer look at the companies highlights how each has coped and fared as divestiture's third anniversary nears.

AMERITECH

As did all the regionals, Ameritech slashed its workforce to trim costs. The number of telephone employees has dropped nearly 20% since divestiture, giving Ameritech the second-best ratio of employees to phone lines in service, after Bell Atlantic.

Flexibility in pricing, thanks to deregulation measures by several states in which Ameritech operates, has given the company new tools to compete and sell enhanced services to its bread-and-butter business customers. Illinois Bell, for

Continued on Page 35

The Bell Regionals: Selected Financials

Company	Symbol	Assets	Common Equity	9-Mo. Return on Equity	Per-Share Book Value	Avg. Shares Outstanding 3rd Quarter	9 Mo. Thru Sept. 30 Revenues	Net Income	Earnings Per Share	Annual Dividend	Recent Price	Yield	Total Return[3]
Ameritech	AIT	$18,566.1	$7,611.4	15.1%	$79.09	96.2	$6,986.7	$861.0	$8.90	$7.08	128⅛	5.5%	34.5%
Bell Atlantic[1]	BEL	20,298.5	8,227.8	14.2	41.24	199.5	7,318.1	895.2	4.48	3.60	63⅜	5.7	34.1
Bell South[2]	BLS	25,645.5	11,055.7	15.3	34.94	315.7	8,624.1	1,227.7	3.94	3.04	56⅛	5.4	35.1
Nynex[1]	NYN	21,499.9	8,750.4	14.3	43.17	202.6	8,385.5	921.6	4.55	3.48	61⅜	5.6	35.4
Pacific Telesis[1]	PAC	20,027.1	7,681.1	14.9	35.70	215.2	6,789.9	842.0	3.92	3.04	51⅛	5.9	32.0
SW Bell	SBC	19,702.7	7,660.4	13.1	76.90	99.6	5,887.7	741.5	7.44	6.40	105	6.1	29.9
US West[1]	USW	18,393.3	7,197.8	13.5	37.94	189.8	6,233.9	718.4	3.78	3.04	53⅝	5.7	34.2

Source: company reports. All figures in millions except per-share data. [1]Adjusted for 2-for-1 split. [2]Adjusted for 3-for-1 split. [3]Since divestiture on 1/1/84, annualized.

Muscle

Continued from Page 7

example, can price new services based on the actual cost of providing them, without first going to the regulators for approval.

Aside from its 20% stake in a Canadian cellular company, the company hasn't gone outside its region to build or buy a mobile telephone operation. Publishing and finance units are profitable, though their scale is more modest than similar operations are at other regionals. Other holdings include Applied Data Research, a major IBM-computer software outfit in Princeton, N.J. Unregulated operations, taken as a whole, should show some profit in 1987, says William H. Springer, chief financial officer. By 1988, he figures that 30%-50% of annual growth in earnings will come from non-telephone operations.

The company's return on equity so far this year, 15.1%, is nearly the best among the regionals. But earnings growth has slowed. For the first nine months, Ameritech's net rose 3.8%, to $861 million. On a per-share basis, profits gained 5% to $8.90 a share. Nonetheless, Springer expects to maintain an average 6%-8% growth rate in EPS, which would put '86 earnings in the $11.60-$11.90 range, vs. $11.02 last year, and next year's earnings around $12.50 or so.

BELL ATLANTIC

For sheer size and speed, Bell Atlantic's diversification has been the most aggressive. Companies in its enterprises group sell minicomputers throughout Canada; distribute telecommunications gear in Texas and provide computer maintenance nationwide. It's building a financial-services group, spurred most recently by the purchase of Greyhound Capital Corp., a computer-leasing firm with offices in four European capitals.

Bell Atlantic is in the enviable position of earning close to its allowed return on equity from its telephone companies. However, that makes profits from new ventures all the more important for future growth. Net income for the nine months ended Sept. 30 climbed 8.7% to $895.2 million, or $4.48 a share. The Street is looking for full-year earnings of about $6 a share, vs. $5.47 last year. For '87, estimates had been running around $6.35 a share. Revenues rose 8.3%, to $7.3 billion, while revenues from the enterprise units jumped 53%, to $440.1 million, for the first nine months of the year.

Bell Atlantic won't reveal further financial details of the growing enterprises group, other than projecting a profitable 1986. Vice Chairman Raymond Smith has his sights on significant contributions to net income in coming years. Profits from non-telephone units will "approach 50%" of the company's year-to-year gain in earnings in 1987, he says. That doesn't include the highly profitable directory publishing operation, which Bell Atlantic, unlike other regionals, doesn't include in the enterprise group.

BELL SOUTH

The Atlanta-based regional was blessed with pole position at the starting gate: strong growth in phone demand, mod-

Continued on Next Page

14

Muscle

Cont. from Preceding Page

ern plant and lower-than-average costs. Bell South—and its holders—profited. Earnings grew at a 13% annual clip after divestiture, while the 35% annual return to shareowners led the Bell family.

Unlike its siblings, which trumpet new ventures, Bell South stresses its more conservative approach. "We don't even like to call it diversification, because that implies somebody's planning to build a conglomerate," says Boren, Bell-South's vice president for planning. "And we don't intend to do that."

Nonetheless, the company is moving into national directory sales, bought 40% of a cellular and paging business in London and established an in-house real-estate unit, Sunlink, that is "open to new projects," says Boren.

Bell South's year-to-date showing is impressive: Profits climbed 13.2% in the nine months ended Sept. 30, to $1.228 billion, or $3.94 a share. For '86, net of about $5.25 a share looks safe, compared with $4.69 in '85. Street estimates for next year run in the $5.25-$5.50 range.

NYNEX

The service industry boom in the Northeast, as noted, helped drive Nynex's revenues to unexpected heights. Meanwhile, workforce reductions and debt-shedding helped shave expenses. The combination gave Nynex the best operating ratio (22.4% gross margin) of the Bell regionals last year, even though the company's expenses and employee count per phone line were the highest of the lot. How did that happen? Nynex's business customers, from Wall Street to Boston's high-tech outposts, are more intensive users of the company's network.

Regulators in New York are traditionally tough on Nynex's New York Telephone unit in its war against the bypass threat. But the company did win the right to expedited treatment on "episodic" pricing of competitive services. A company spokesman says regulators are living up to their self-imposed 10-day deadline on such requests.

Profits for the most recent nine-month stretch gained 13%, to $921.6 million, or $4.55 a share. Profits for the year could top $6, vs. $5.42 a year ago. For 1987, $6.40-$6.50 has been the estimate on the Street.

PACIFIC TELESIS

Regulatory concerns in California had always hurt the company's largest unit, Pacific Telephone. Although somewhat better treatment followed the company's divestiture from AT&T, the company has fared less well than its siblings in pushing deregulation schemes. For example, the state's regulators have rebuffed the company's novel plan for a freeze on residential rates through 1990, in exchange for flexible pricing on competitive business services. Currently, the company is contesting a staff recommendation that would roll back phone rates by as much as $233 million annually, retroactive to last March. The bottom line would take a $109 million hit each year under the proposal, the company estimates. An unrelated refund case could also hurt current earnings by an unspecified amount.

However, Pacific Telesis starts from a far stronger financial position in its current regulatory clashes than ever before. A balance-sheet restructuring trimmed the company's debt ratio to 43%, from nearly 50% at divestiture. Reductions in preferred shares outstanding shaved the annual payout from net income to those holders by almost two-thirds.

Pacific Telesis led the Bell siblings in profit growth during the first nine months of 1986, with net income up 16.8% to $842 million, or $3.92 a share. Its return on shareowner equity rose to 14.9%, vs. 13.2% in 1984. The year's per-share net should wind up in the $5-$5.10 range, vs. $4.54 a year ago. For 1987, earnings should come in at around $5.50 a share.

An 11% jump in non-telephone revenues over the nine-month stretch reflected gains in directory advertising and the unregulated PacTel Cos, a collection of cellular, international and equipment-sales subsidiaries that are not yet profitable.

SOUTHWESTERN BELL

The big jump into cellular, by its deal with Metromedia, was the single largest new-business foray of any regional. Southwestern Bell, however, had good reason to look beyond its own territory. Its five-state region—which covers Texas, Oklahoma, Arkansas, Kansas and Missouri—has suffered through hard economic times. From being one of the nation's fastest-paced telecommunications markets before divestiture, the region's telephone-service growth rate now hovers near the national average.

Southwestern Bell's 13.1% return on equity in this year's first nine months was the lowest of any Bell regional. "We're still underearning our authorized rate of return," admits Michael Kaufman, vice president for finance. "It's been a tough economic environment. But I believe we've seen the worst."

For the most recent quarter, ended Sept. 30, revenues were essentially flat: $1.963 billion, vs. $1.966 billion in 1985 (excluding nonrecurring items connected with prior years' directory sales). But net income gained 8.5% to $257.5 million, or $2.58 a share, as the company kept tight control on operating expenses. For the year's first nine months, profits are up 4.5% over the prior period, with net income of $741.5 million, or $7.44 a share, vs. $708.8 million, or $7.12 in 1985, excluding nonrecurring items. The year's per-share net should come in at about $10.20, vs. $10 in 1985. For 1987, earnings should wind up in the $10.50-$10.70 range.

US WEST

Also faced with a difficult economic climate in its 14-state region, which stretches from Washington state to Minnesota and south to Arizona and New Mexico, US West is relying on productivity improvements to maintain earnings growth. But costs of an early-retirement program, which helped shrink the workforce at its telephone units by 5,700 employees in 1986, have depressed this year's results. Return on equity for the first nine months—13.5%—is well below the regionals' average. For the latest quarter, however, the figure jumped to 15%.

Year-to-date net income of $718.4 million, or $3.78 a share, is 4.4% above 1985's nine-month stretch, on a per-share basis. Analysts see profits for the year of about $5.10-$5.20 a share, and around $5.60 in '87, compared with $4.84 a year ago. To maintain its target of 8% annual growth in earnings, US West will "need help" from its stable of diversified businesses, a company spokesman says. The group—which includes cellular, equipment sales, directory publishing, real estate and financial services—isn't profitable yet, he added.

* * *

For every super hero in comic book lore, there's a way to neutralize the hero's incredible powers. For Superman, it was exposure to Kryptonite. For the Bell companies, it could be the rigors of competition. From the evidence so far, however, it appears that tight-fisted operating management, nimble forays into new ventures and favorable economic conditions are potent antidotes. ■

Washington Is Still Watching the Bell Regionals

WASHINGTON—Nothing is more important to the regional Bell holding companies than the federal government.

The federal Department of Justice helped to create them in the settlement of the AT&T antitrust case; a federal judge controls their performance under the antitrust consent decree; the Federal Communications Commission has power over their services and prices; the Congress writes laws that affect all the others.

If anything, the pace of change and the power of the government over the companies are likely to increase in the remainder of the 'Eighties.

Deregulation is still at the top of many Washington agendas. FCC Chairman Mark Fowler recently renewed a proposal for a deregulation experiment: Some states, he said, should try allowing telephone companies to charge any rate and offer any service. Even though basic telephone service is usually considered a natural monopoly requiring government regulation, Fowler said the experiment would require "open network architecture" in which Bell company competitors would have equal access to the local telephone network.

Critics of deregulation say rural areas and poor people would lose service, but Fowler said residential rates might fall in the long run. He said 10 states, which he would not name, had expressed some interest in an experiment, which could begin as soon as 1989.

But deregulation has its foes on Capitol Hill, and some key lawmakers, among them Chairman John Dingell of the House Energy and Commerce Committee, don't trust Fowler to protect their vision of the public interest. Thus there is great controversy over another proposal for sweeping realignment of the regulatory powers.

Senate Majority Leader Robert Dole has sponsored a bill to end Federal Judge Harold Greene's supervision of the companies under the AT&T consent decree, handing all the judge's power over to the FCC.

Issues such as permission to enter unregulated businesses and the terms for entry would be lodged entirely with the FCC, where Chairman Fowler leads a majority that would be more sympathetic to ventures such as equipment manufacturing, electronic publishing and information services.

Judge Greene, who is supposed to make a formal review of the consent decree early next year, has said he believes the FCC was unable to supervise the old AT&T and that the commission would bring back seven little communications monopolies to replace the old big one.

"The regional companies with their vast financial power could crush their smaller competitors, which do not have huge rate bases from which to finance competitive ventures," Greene explained recently. He said the current FCC philosophy that price should be related to cost overlooks "other values" such as protecting companies and consumers "who can't function that well in a purely competitive environment."

Those in businesses that the Bell companies might enter if restrictions were loosened oppose the Dole bill; the Bell companies enthusiastically support it.

Even within the current regulatory structure there are new developments likely to press change on the Bell companies:

- AT&T and the Bell companies are pressing the FCC and state regulators for permission to earn higher rates of return, although the presumption, in a time of falling inflation, would be for a rein on profits. Indeed, the FCC slightly lowered the companies' authorized rate of return on interstate service for 1987 and 1988, from the 12.75% of 1986 to 12.2% for AT&T and 12% for local carriers.
- The U.S. Supreme Court ruled last summer that the FCC may not pre-empt the state regulators' powers to set depreciation schedules—a key item on every phone company's expense sheet. In an effort to keep reported profits high, and phone rates low, many state regulators dictated low annual depreciation charges.
- The "Computer III" decision, which sets ground rules for telephone companies to provide "enhanced" communications using computers to store, modify or create messages and data, is in its early development. Bell companies, AT&T and their competitors are wrangling over the types of services each can provide, the requirements for open access of competitors to the network and the business restrictions designed to prevent unfair competition.

* * *

Bypass, which is the effort of major business customers to obtain direct connections to long-distance carriers without using or paying local company service, is a growing problem for the companies. And access charges, the FCC attempt to keep big customers on line by charging many smaller customers a few dollars a month, is a consumer issue of increasing strength.

—Thomas G. Donlan

© 1986 Dow Jones & Company, Inc. Reproduced by the Library of Congress, Congressional Research Service with permission of copyright claimant.

FCC Chairman Calls for Deregulating Some Local Phone Firms in 3-Year Test

By Bob Davis
Staff Reporter of The Wall Street Journal

WASHINGTON – Federal Communications Commission Chairman Mark Fowler proposed a three-year experiment to almost completely deregulate local telephone companies in certain states.

During the experiment, telephone companies would be free to raise rates and enter new businesses without advance approval from state or federal regulators. "It's time to step away from regulating local exchange companies," Mr. Fowler said. "Everyone will be better off."

Mr. Fowler's proposal seems certain to boost a growing movement among state regulators to lift restrictions on local telephone companies. So far, 15 states have adopted deregulation plans and at least 11 others are considering such measures.

Plan Goes Further

But Mr. Fowler's plan goes further than nearly all the state measures, which generally deregulate only a handful of services.

The FCC proposal also seems sure to generate controversy. Under the plan, telephone companies would be free to eliminate subsidies for local residential phone service, a move that Mr. Fowler acknowledged would cause rates to rise, at least initially. "There are many states where residential rates are way below water, and they would have to come up over time," he said.

Gene Kimmelman, legislative director of the Consumer Federation of America, said Mr. Fowler is involved in a "zealous pursuit of deregulation almost at any expense." He said full deregulation would lead to large and "perpetual" rate increases.

Proposed in Law Review

The deregulation proposal is contained in a law review article written by Mr. Fowler and two other FCC officials, Albert Halprin and James Schlichting. The FCC released the article at a news conference. In 1982, Mr. Fowler used a law review article to advance ideas on television deregulation that the agency later adopted.

The FCC chairman said lifting restrictions on local telephone companies would spur competition and technological innovation. At the news conference, he mentioned a number of services that he said companies might offer to provide over telephone lines, such as burglar alarms and fire alarms, if regulations were lifted.

By expanding telephone use, deregulation ultimately could slow residential rate increases or perhaps reduce rates, Mr. Fowler said. "To the extent that other services are shot down that (phone) line, it provides us with some reason to believe we can make local residential rates go backward," he said.

States Show Interest

So far, more than 10 states have expressed some interest in adopting the plan, Mr. Fowler said. But the experiment faces many obstacles.

Mr. Halprin said the experiment wouldn't begin until 1989 or 1990 at the earliest. At that time, telephone companies would have to assure competitors that they would provide the competitors with equal access to the phone network.

In addition, federal Judge Harold Greene currently bars the former Bell telephone companies from offering information services envisioned by Mr. Fowler, and deregulation has become controversial in some states.

Bruce Fein, a former FCC general counsel, accused Mr. Fowler of trying to avoid some political heat by aiming his proposal at the states. "Fowler is calling for deregulation efforts at the state level that he refuses to make at the federal level," Mr. Fein said. "It's chutzpah."

WALL STREET JOURNAL OCT. 15, 1986 p.22

© 1986 Dow Jones & Company, Inc. Reproduced by the Library of Congress, Congressional Research Service with permission of copyright claimant.

Many States Deregulate Telephone Rates, Hurting Residential Users in Short Run

By Bob Davis
Staff Reporter of The Wall Street Journal

Telephone deregulation is sweeping the states, promising consumers new technology while threatening to drive up rates.

Fifteen states have adopted deregulation plans and at least 11 more are considering such measures. The laws generally allow telephone companies to charge what they want for certain services.

The big winner in deregulation is big business; the loser, at least in the short term, is the residential customer. States and the federal government say they are eliminating rate subsidies for local residential calls and rural phone systems. Telephone companies are using the additional revenue to cut the rates they charge businesses for long-distance and other services.

Deregulation "can't work unless residential prices go up," says Fred Konrad, an official at the Illinois Bell unit of Ameritech. "That might seem harsh, but free-market pricing means you can't have subsidies."

Advocates maintain that competition will limit rate increases in the long run and spur innovation. But critics charge that decontrol is a smokescreen obscuring huge rate rises.

Phone-company lobbyists press two main arguments for deregulation. They say the companies' monopoly power—the original rationale for regulation—is waning because of increased competition. And the lobbyists promote a trickle-down theory of telephone economics.

Phone companies must be free to reduce commercial rates, this theory goes, or else big businesses will bypass local telephone networks and build their own. A study by the General Accounting Office, Congress's research arm, says bypassing "could significantly revise local telephone company revenues."

Phone companies say that if they lose business revenue, other customers must make up the difference. In other words: Deregulation helps everyone by helping the companies keep business customers.

Some state regulators agree with the companies' thinking. "Imperfect competition is better than imperfect regulation," says Cale Case, a telecommunications analyst for the Illinois Commerce Commission. "Every market will seem like the height of imperfection, but it will work better than regulation."

But some people see more harm than good in deregulation. Gene Kimmelman, the legislative director of the Consumer Federation of America, says rate increases aren't justified, because the regional Bell companies are hugely profitable. The coalition of consumer groups claims those companies have overcharged consumers more than $3 billion since the 1984 breakup of American Telephone & Telegraph Co. (The companies deny that.)

State telephone deregulation "is an amazing sleight of hand" that will lead to more overcharges, Mr. Kimmelman adds.

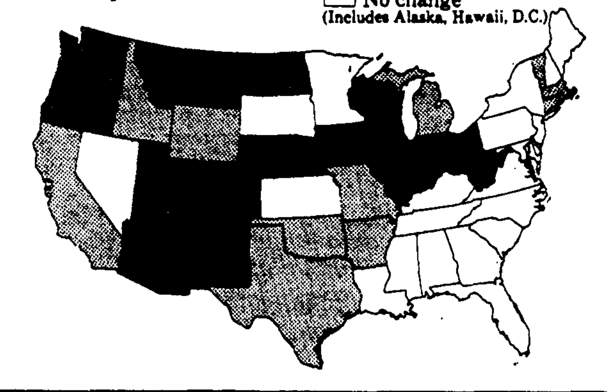
Many regulators oppose deregulation. In Idaho, a deregulation bill cleared the Senate but died in the House. Perry Swisher, the state's top regulator, says the bill would have dismantled subsidies protecting rural communities.

In other industries, Mr. Swisher says, "deregulation has hurt us already: We don't have airline access in small communities; we don't have railroad service." He vows, "We don't intend to let this happen with telecommunications."

Jack MacAllister, the chairman of U S West Inc., a regional phone company, dismisses the critics as "regulators who don't want to walk away from their job."

In any case, the push to deregulate seems to be too strong to derail for long. AT&T and the regional phone companies have dispatched dozens of lobbyists to state capitals to push deregulation. Local residential rates have risen roughly 25% to 35% since the AT&T breakup (in part to offset deregulated interstate rates, which have dropped about 20%). Some states fear even steeper increases in local rates. That provides fertile ground for lobbyists who claim state deregulation would hold down rate increases in the long run.

"We have been hyper-involved," says Gerald Lowrie, AT&T's chief lobbyist. "In Illinois we had one person who, I think, didn't even return home weekends when the legislature was in session." Persistence paid: AT&T now can charge any rate for non-local intrastate calls in Illinois. It says it has such authority in 15 states.



State deregulation plans vary sharply. Washington state has authorized two smaller long-distance companies to set their own rates—but, at least for now, it still regulates the in-state rates of giant AT&T. Iowa says long-distance rates shouldn't be deregulated, but it permits Northwestern Bell, a unit of U S West, to set rates for private lines and a switchboard service called Centrex.

Vermont hasn't deregulated, but its top regulator, V. Louise McCarren, urges what she calls a "social contract." Under the plan Vermont would deregulate all phone rates but those for local residential calls. In return, Nynex Corp.'s New England Telephone unit would accept a formula for residential rate increases.

But critics charge that this type of plan actually builds inflation into residential rates. California regulators thus shelved a social contract proposed by Pacific Telesis Group's Pacific Bell unit and instead reduced telephone rates.

Nebraska has adopted perhaps the most sweeping deregulation plan. Over the objection of state regulators, the legislature deregulated long-distance rates and freed Northwestern Bell to set rates for local service. Regulators can step in only if local rate increases are more than 10% a year or if 2% of Nebraska phone customers petition for an investigation.

Gov. Robert Kerrey says the law will encourage telecommunications companies to operate in Nebraska and will lead to an explosion of communications services. But Harold Simpson, a Nebraska regulator, predicts disaster. "How do you force good service if you don't have a handle on rates?" he asks. The Public Service Commission is suing to have the law declared unconstitutional.

Meanwhile, some federal and state regulators say decontrol in most states seems inevitable. To deflate arguments that the poor would be hurt by higher local rates, the Federal Communications Commission has established a "lifeline" telephone subsidy. Seven states and the District of Columbia have adopted the program, which gives a $4-a-month price cut to low-income residents. Other states, including California, have established similar programs.

WALL STREET JOURNAL SEPT. 19, 1986 p.25

© 1986 Dow Jones & Company, Inc. Reproduced by the Library of Congress, Congressional Research Service with permission of copyright claimant.

Calling Long Distance: User Vote Shows Strong Support for AT&T...

By FRANCINE SCHWADEL
Staff Reporter of THE WALL STREET JOURNAL

When Paul C. Seitz was asked to pick a long-distance phone company last year, the 36-year-old accountant from Wilmington, Del., spent "all of about a minute" pondering his options. Then he chose American Telephone & Telegraph Co., the carrier he had always used. With AT&T, he explains, "I knew what I had. The other companies were question marks."

Millions of Americans have made the same call. In the big wave of balloting that started two years ago and ends Sept. 1, roughly 75% of the voters so far have chosen AT&T to provide long-distance service to their home or business. And a recent Wall Street Journal/NBC News poll indicates that feelings like Mr. Seitz's are largely responsible for the outcome: Half of the 1,565 respondents who expressed a preference for one of the phone firms cited familiarity with AT&T as the most influential element in their choice.

For the most part, the tallies suggest an impressive victory for AT&T. But there is also evidence that some of its rivals, which now number about 500, are making inroads in certain areas. MCI Communications Corp. and US Sprint Communications Co.—the second- and third-place finishers, respectively—claim to be winners too, and with some justification. Although they remain relatively small, both were able to double their market shares as a result of the vote. MCI now has 8%; US Sprint, which was created last month by the merger of the long-distance units of GTE Corp. and United Telecommunications Inc., has about 4%.

"We gained an awful lot of customers," says Charles Skibo, US Sprint's president.

Disproving Skeptics

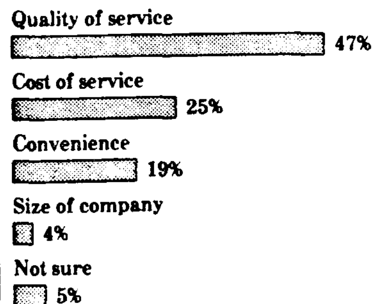
AT&T's success in the balloting, which by Sept. 1 will have involved roughly 70% of phone users, runs contrary to some people's expectations that the company would suffer a severe drubbing. At the start of the process, an outgrowth of the 1984 breakup of AT&T's Bell System, some analysts predicted that the company's market share might drop to as low as 60% from about 90% just before the breakup. The theory was that people would desert AT&T in droves once federally mandated "equal access" enabled them to enjoy cheaper service without having to dial extra digits.

But the results indicate that customers didn't vote their pocketbooks in anywhere near the numbers that some observers thought they might. AT&T still holds an estimated 80% of the market. "People will pay an extra buck or two a month for a known commodity," concludes William Walbert, a research analyst at the Gartner Group in Stamford, Conn.

Another reason for AT&T's strong showing, according to William G. McGowan, chairman of MCI, is that most of AT&T's competitors failed to make the capital investments necessary to wrest large chunks of business away from AT&T. (He contends, however, that MCI is meeting its target of winning 10% to 15% of the votes, doing best among small and medium-size businesses.)

But AT&T didn't succeed solely because of the weakness of its competitors. To the amazement of naysayers, it transformed itself into a marketing powerhouse, joining MCI and, to a lesser extent, Sprint, in a broad marketing blitz. Together, the three companies spent an estimated $300 million on advertising alone.

AT&T's efforts, however, were clearly the most extensive. It went after heavy users with special pricing packages and such incentives as discounts on restaurant meals and exercise classes. It took to the airwaves with a series of TV commercials featuring the actor Cliff Robertson, who stressed AT&T's quality and reliability and suggested that its competitors weren't up to snuff. AT&T even went so far as to prepare special materials to appeal to such diverse markets as military personnel, people in the process of moving and various ethnic groups.



Source: The Wall Street Journal/NBC News poll, conducted Aug. 11-12.

"They presented a very powerful, professional message," says Howard Anderson, president of Yankee Group, a Boston-based market research firm.

Still, some people didn't buy AT&T's message. Maurice Tannenbaum, a 41-year-old hair salon owner in Philadelphia, says he picked MCI without even considering AT&T. "I don't like AT&T," he explains. "I think it's a monopoly—and I've been treated rudely in the past."

AT&T describes such defectors as "innovators." In other words, the company says, they tend to be the first on their block to try new products. Amy Francis, a senior analyst at Yankee Group, likes to think of them as "people who hate the corporate giant" or "people who drive foreign cars."

AT&T's competitors also attract more customers under 50 years of age than those who are older, according to the Journal/NBC News poll. And they are winning more customers with annual household incomes that exceed $50,000 than those with lower incomes, the poll indicates. Not surprisingly, both of these groups tend to be heavy users of long-distance service.

Indeed, of the customers that AT&T's rivals are attracting, a higher percentage are the most-valued residential customers: those who spend hours at home calling faraway friends and relatives. AT&T, for example, says that only 16% of its home-phone customers run up long-distance bills of more than $25 a month; MCI says almost 40% of its residential users are in that category.

Regional Loyalties

In some parts of the country, meanwhile, regional loyalties have created static for both AT&T and its two major rivals. Teleconnect Co. of Cedar Rapids, Iowa, for example, is one of several small phone services that have shown surprising strength. Teleconnect claims to have come in second in some of the cities it serves, grabbing the votes of as many as 40% of customers. Says Dekkers Davidson, a telecommunications-policy analyst at the U.S. Commerce Department in Washington: "There isn't a monolithic marketplace."

Who then are AT&T's customers? According to the company, they cut across all age groups and market segments, making it difficult to describe a typical customer. Ms. Francis of Yankee Group calls them people who are "risk averse" or "traditionalists" or "those who drive American cars."

Many figure they don't spend enough on long-distance service to justify switching. For example, John O'Shaughnessy, a 52-year-old executive at a brokerage in Tucson, Ariz., says one of AT&T's competitors would have to offer "very substantial" savings—say, 50% off his family's typical monthly long-distance bill of $30—for him to sit up and take notice. (While discounts of that magnitude were once possible, the price advantage for most of AT&T's competitors has narrowed in recent years to the 10% range.)

Still, AT&T did win some talkative customers who could probably save by switching. Mary Johnston, a 27-year-old telecommunications consultant in Boston whose monthly long-distance bills average $50 to $100, admits she voted for AT&T "primarily out of laziness" and "not wanting to deal with the potential for problems." She says she stopped using a rival service a few years ago after being billed for calls that weren't completed, adding: "I don't fly People Express anymore either."

WALL STREET JOURNAL AUG. 22, 1986 p. 19

© 1986 Dow Jones & Company, Inc. Reproduced by the Library of Congress, Congressional Research Service with permission of copyright claimant.

(continued)

...But Phone-Marketing War Continues, With Emphasis Now on Quality, Service

By JANET GUYON
Staff Reporter of THE WALL STREET JOURNAL

One battle may be just about over, but the war rages on.

As Sept. 1 approaches–the date by which some 50 million telephone customers will have chosen their long-distance company–rival carriers are gearing up for a second onslaught, trying yet again to win a larger share of a market still dominated by American Telephone & Telegraph Co.

But in contrast to the past two years, during which customers have been asked to choose on the basis of cost, the players will be touting everything *but* their rates. Instead, they will be focusing on service, special features and quality of transmission, as well as paying more attention to business customers.

"Now that this industry is settling out, it's being faced with marketing," says Harry Thompson, executive vice president, marketing and sales, for Argo Communications Corp., a small New Rochelle, N.Y.-based long-distance carrier. "The guys who can listen to customers more clearly and package products accordingly, and do it with some swiftness," will probably be more successful, he says.

New Rules

The main reason for the shift is a simple one. Because of changes imposed by the Federal Communications Commission on the industry's cost structure, AT&T's competitors can no longer undercut its prices by 50% or more. On average the price differential has shrunk to 12%; in some cases, it's less than 5%. Understandably, such companies as MCI Communications Corp. and US Sprint Communications Co., the biggest challengers to giant AT&T, are changing tactics.

For instance, US Sprint's latest television ads urge viewers to try the "fiber optic sound quality of US Sprint . . . where every fiber optic call sounds like you're right next door." Three out of five callers, the ads say, can tell the difference and prefer the clarity of US Sprint to AT&T.

AT&T, however, uses fiber optics too. And currently only about 15% of US Sprint's calls actually travel from beginning to end along fiber-optic lines, which enable voice and computer signals to be transmitted as pulses of light. The rest of the calls go over a hybrid microwave, cable and satellite transmission system. (As a result of protests by AT&T, Sprint has dropped its reference to the company as a provider of scratchy-sounding long-distance calls.)

Indeed, some of the advertised differences aren't all that great. "A lot of it is marketing hype," says Duane Heidel, vice president, telecommunications, for Marriott Corp., the hotel chain. "But they have got to sell service some way. They can't sell off cost, so they have to sell off quality."

Attributes other than price tend to be more important to businesses than to residential customers, so companies are also courting big and medium-size companies. Overall, business customers account for most of long-distance revenue.

Like the shift away from promoting low rates, the emphasis on business marks a sharp change from the past two years, when the companies vied for residential customers. At the time, the publicity surrounding equal access–which would enable many customers to use 1-plus-area-code dialing with whichever long-distance service they preferred–gave the carriers a unique opportunity to sign up residential customers.

'THEY have got to sell service some way,' says a telecommunications executive. 'They can't sell off cost, so they have to sell off quality.'

With business as the main target, AT&T's rivals promise a variety of marketing programs to garner customers after Sept. 1. US Sprint, for example, is holding a sale: Businesses and residents who sign up with the company through Sept. 30 will get a 10% discount on service for the first year. The move provoked a protest from MCI, which complained to the FCC that US Sprint was selling below cost and that its sale discriminated against current users, but the complaint was dismissed. MCI now says it may borrow the idea and give discounts to its new customers.

In addition, the companies are likely to start advertising for the first time that it really doesn't matter which company is chosen initially; customers can still use any company they want by dialing the carrier's special five-digit code.

In California, US Sprint is testing a campaign advertising its five-digit code for customers who want to try its service to the Far East. Based on test results, "we are considering a wider program," says a US Sprint executive. Some of the companies also say they may pick up the $5 charge that customers normally would have to pay to switch carriers.

"I think you're about to see in the telephone industry all kinds of ways of doing things" says Charles Skibo, the newly appointed president of US Sprint and a former MCI executive. He sees his company's seven-month, $70 million fiber-optic campaign as the telephone industry's answer to the Pepsi-vs.-Coke ads.

But marketing the quality of phone service is trickier than selling the taste of soft drinks. And selling to businesses is often further complicated by the committee method of making decisions. "It's damn hard to climb into someone's head and find out what they think they are talking about when they talk about quality and value," says Howard Crane, MCI's senior vice president, corporate affairs. "It's damn harder when the decision maker isn't just an individual but a chain of individuals."

For their part, big corporations say that, with less price competition, they will judge carriers on how attentive their salesmen are, on how often lines go down, on any special pricing arrangements and on new products, such as high-capacity lines that can send voice and computer communications on one wire.

Weighing Various Needs

Of course, individual needs will remain a factor. "If I (were) an investment banker, I (would) want top-quality circuits, and today, most of those companies lean toward AT&T," which is thought to have the most reliable service, says David Rappaport, the Arthur Andersen & Co. partner in charge of telecommunications consulting. "But if I'm a manufacturing company, or some kind of retailer where the traffic is mostly internal, I might put up with a few more busy (signals) and hissing."

Despite its lead in the customer balloting, AT&T isn't standing still either. Employing many of the strategies it has successfully used to retain its long-distance customers, the company plans after Sept. 1 to start selling long-distance service packaged with telephone and computer equipment.

"There is absolutely no player in the marketplace that can make that kind of offer today," says John Wood, a division manager in AT&T's Business Markets Group.

Meanwhile, residential customers may get a new type of bill that more clearly shows what calls they made and allows them to pay on credit. AT&T also promises more strategies aimed at demographic groups; for instance, "the technocratic elite," tend to be impressed by ad pitches emphasizing AT&T's Bell Laboratories heritage.

© 1986 Dow Jones & Company, Inc. Reproduced by the Library of Congress, Congressional Research Service with permission of copyright claimant.

Bell Firms Say Ruling Lets Them Buy Phone Concerns Outside Their Regions

By JOHNNIE L. ROBERTS
Staff Reporter of THE WALL STREET JOURNAL

The seven regional Bell telephone companies, in the wake of a federal appeals court ruling, say the way is now clear for them to acquire independent telephone companies in each other's territories.

One of the regional concerns, Bell Atlantic Corp., Philadelphia, said it has studied such acquisitions "and will continue to look for attractive opportunities" in other regions. But it didn't identify any specific candidates among local telephone companies that aren't owned by other Bell companies.

The six other Bell companies said that, while the door has opened, they currently don't plan to enter other regions to acquire local telephone companies. Already, the regional companies offer mobile cellular-telephone and Yellow Pages services and sell telephone equipment outside their own territories.

But some securities analysts believe that the Bell concerns are playing their cards close to the vest. In the long term, the analysts said, the Bell companies will find it attractive to acquire smaller independents outside their regions. They believe the Bell companies will focus first on concerns with service areas contiguous to their own territories.

"It isn't real political for the Bells to say, one week after the ruling, that they are going to go out and buy every mom and pop telephone company overnight," said Jack Grubman, an analyst with PaineWebber Inc.

In a unanimous decision last Friday, a three-judge panel ruled that the Bell concerns didn't need the permission of federal Judge Harold Greene to offer certain local communications services outside of their operating territories. The decree under which the Bell system was broken up in 1984 doesn't include any "explicit or implicit geographic restriction" on the companies' efforts to offer such services, the panel ruled.

Interpretation Challenged

The ruling came after Bell Atlantic, San Francisco-based Pacific Telesis Group and Denver-based U S West Inc. challenged Judge Harold Greene's interpretation of the breakup decree. Judge Greene, who oversees compliance with the decree, had ordered several Bell concerns to halt certain cellular and paging operations outside their territories because they failed to get the court's permission.

Initially, industry officials and analysts believed the ruling would make it easier for the Bell concerns mainly to expand into mobile-telephone and paging operations, directions in which they have been going. "I don't think the implications of the decision have been thought through," said John Sodolski, president of the United States Telephone Association, the trade group for the Bell concerns and some 1,400 non-Bell companies.

Nonetheless, Mr. Sodolski added, several of the trade group's officials now believe last week's ruling also allows the Bells to acquire independent concerns.

Firms Big and Small

Independent telephone companies, which range from mom-and-pop operations to GTE Corp., the largest independent, provide more than 20% of the nation's local telephone service, the trade association said. The 22 local phone companies owned by the Bell regionals provide the rest.

For now, the Bells say they intend to keep it that way. "We wouldn't want to rule out" telephone company acquisitions, "but you don't see us at the racetrack ready to take off on that particular strategy," said Richard Callahan, vice president of U S West's nonregulated businesses, including mobile telephones.

"My interpretation would be, yes, we could go in and buy other telephone companies," said a spokesman for Atlanta-based BellSouth Corp., adding, "We don't have any intention of doing it."

Any such move by the regional phone companies would still need federal and state regulatory approval.

Chicago-based Ameritech also said it doesn't plan any telephone-company acquisition, despite the freedom granted in the ruling. Anthony Parra, shareholder-relations director for New York-based Nynex Corp., suggested that the company is more interested in diversifying than in expanding its basic local telephone business. Paul Henson, chairman of United Telecommunications Inc., the nation's second-largest independent telephone company, adds: "All seven don't seem to be trying to concentrate" in the local telephone business.

Question of Costs

Edward Greenberg, an analyst with Morgan Stanley & Co., said a phone-company acquisition would be extremely costly because the independent companies, like the regionals, generally have been highly profitable. And some independent concerns are engaged in other businesses that clearly are out of bounds for the regional firms, such as information services.

While agreeing that such acquisitions would command high premiums, a Bell Atlantic spokesman said the company is on the prowl. The most attractive candidate must be "well capitalized and profitable," he added.

PaineWebber's Mr. Grubman said that acquiring independent phone companies "is going to be where the opportunities are for the regionals." Big corporations, which are the Bell regional companies' best customers, are moving away from cities and building offices farther out in areas where independents traditionally have operated. Also, small phone companies can't afford the investments to upgrade their networks with the latest technology. "It makes sense," Mr. Grubman said. "They (the Bells) know this business cold. They don't need anyone to tell them what to do."

Robert Morris III, an analyst with Prudential-Bache Securities Inc., said the court ruling could cause the companies eventually to redefine what local communications services are. For example, he said, one regional concern may be able to enter another's territory and simply provide a group of large companies with direct access to long-distance companies, bypassing the local Bell telephone company.

"In certain markets, the outsider may be able to come in and provide such a service, charge less for it than the local phone company and make more money," Mr. Morris said. "To me, that is where the opportunities are."

THE WALL STREET JOURNAL

AUG. 22, 1986 p. 3

© 1986 Dow Jones & Company, Inc. Reproduced by the Library of Congress, Congressional Research Service with permission of copyright claimant.

Phone Rate Increases Found Below Dire Predictions of '84

By ANDREW POLLACK
Special to The New York Times

SAN FRANCISCO, June 13 — When the Bell telephone system was broken up two and a half years ago, some phone industry executives, government officials and consumer advocates predicted that local rates would double or even triple, forcing telephones out of many homes.

Such dire predictions have not come to pass.

"They've increased, but not nearly as much as we expected," said Bruce Hagen, commissioner of the North Dakota Public Service Commission and chairman of the communications committee of the National Association of Regulatory Utility Commissioners.

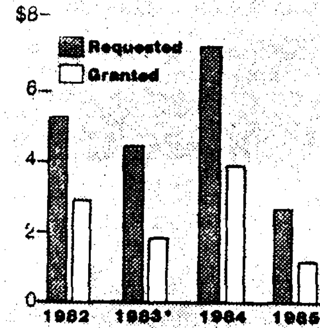
First of two articles on phone rates and service since deregulation.

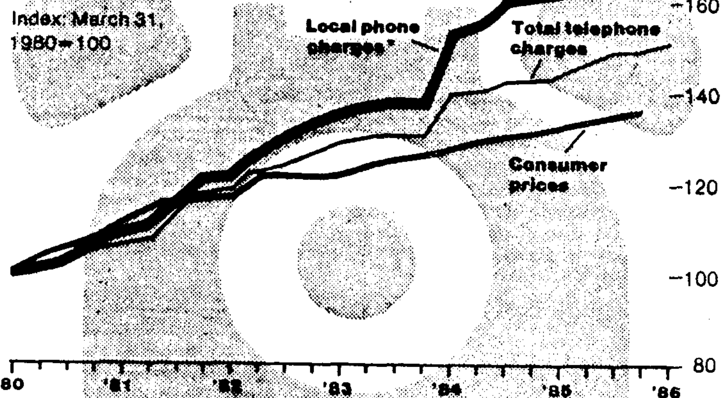
Gene Kimmelman, legislative director for the Consumer Federation of America, said the rise in rates had not been minimal, however. "It's been sigificantly above inflation," he said, but conceded that people had not dropped telephone service, as his group had projected would happen. "To be honest, we painted the worst-case scenario and it hasn't been that bad."

Since the American Telephone and Telegraph Company spun off its seven regional operating companies on Jan. 1, 1984, local rates for residential service have increased an average of 45 percent by one estimate. And while that has been substantially more than the rate of inflation, Census Bureau statistics show that there has been no decline in the number of households with telephones — even among households with yearly incomes of less than $5,000.

The reasons are numerous: Federal regulators have delayed shifting more costs from long-distance to local service; states have been reluctant to grant all the rate increases requested, and phone companies have cut costs and in effect subsidized some of the cost of

Continued on Page D4, Column 1





THE NEW YORK TIMES, MONDAY, JUNE 16, 1986 A1, D4

© 1986 The New York Times. Reproduced by the Library of Congress, Congressional Research Service with permission of copyright claimant.

New York Times, June 16, 1986

Continued From Page 1

basic phone service with income from special services.

Some consumer groups, however, say that the threat of steep rate increases is not over. One disturbing factor, they say, is the push for further deregulation of rates. Nebraska recently decontrolled local rates, and many other states are considering doing so. Deregulation, consumer groups say, would permit phone companies to raise rates at will.

For the short term, however, the worst of the rate rises seem to have passed. As of last March 31, $755 million in requested increases were pending before state commissions, according to the Federal Communications Commission, down substantially from $3.8 billion in March 1985 and $7 billion at the time of the Bell breakup.

A Supreme Court decision last month, which upheld the authority of state regulators to control the way phone companies depreciate their equipment, could also help hold down rates, officials say. States can have phone companies recover their costs of capital equipment over a longer period than the Federal Government had wanted, thereby lessening the need for rate increases.

Broader Deregulation

The dire predictions that preceded divestiture were actually tied not only to the breakup but also to the broader deregulation of the telephone industry that was changing the traditional rate structure of the Bell System.

Although some consumer advocates disputed it, phone companies, as well as many regulators, had long said that local phone rates were subsidized by revenues from long-distance calls to assure that almost everyone could afford a telephone, a concept known as "universal service."

But with the A.T.&T. divestiture and increasing competition in the long-distance business, both the phone companies and regulators said that such subsidies would have to end. If they ended in full, local rates would have to double or triple, according to statements made at the time of the breakup by telephone industry officials, utility regulators and consumer groups.

Several factors, however, have prevented this from happening. A key one has been political opposition, which has forced the F.C.C. to delay and scale back its plans for so-called access charges. These charges are intended to shift more of the cost of local service to the local user.

The commission initially proposed a $2 monthly fee in 1984, with an increase to $6 in a few years. But the fee reached $2 only this month and will not rise without additional study.

State commissions also have not granted all the requests sought by the phone companies. And in at least one case, the California Public Utilities Commission recently ordered Pacific Bell to cut rates.

Another factor preventing large rate increases is the slowing of inflation and the decline in interest rates. Moreover, the local phone companies have performed much better financially than expected and have cut costs substantially. Some companies have been able to get extra revenue from special services, such as call-waiting, which allows a person to temporarily interrupt a call to answer another one on the same line.

The Consumer Federation of America estimates that, as of early this year, rates for unlimited residential service had increased by 35 percent since the A.T.&T. breakup. With the additional $1 access fee that took effect on June 1, the total increase would be closer to 45 percent.

This rise comes on top of similarly large increases in the early 1980's, when deregulation was already bringing about extensive rate changes.

New York's Increases

In New York City, the basic rate for untimed message service, which does not include charges for the calls themselves, has risen 47 percent, to $9.25 a month, from $6.29 at the time of the divestiture. The increase includes the $2 access fee.

In California, where most people have a flat rate for unlimited local calling, the rate rose from $6 in 1980 to $7 in 1983, and now is $10.25, including the access fee, an increase of 70 percent since 1980 and 46 percent since divestiture.

In some states, particularly those that are more rural, increases have been greater. Vermont's flat rate, for example, has risen from $10.55 in 1980 to $13.70 in 1983, and now is at $20.15, including the $2 access charge.

The authorities say that, despite these increases, few people have dropped phone service because it is simply too valuable and because the total cost is still relatively small.

More Households Have Service

Data from the Bureau of the Census show that the percentage of households with telephone service has actually increased a bit, to 92.2 percent, from 91.4 percent in November 1983, just before the divestiture.

Some consumer groups say that, although people have not dropped phone service, they have been hurt by the rate increases. Surveys commissioned by the American Association of Retired Persons show that 20 percent of people over 55 have had to cut back on phone usage.

Evidence about phone cancellations by low-income groups is less conclusive than that for the population at large. Figures for households with less than $5,000 in annual income show the percentage of households with phone service dropping from 71.7 percent in November 1983 to 71.1 percent last March. But Terry Monroe, a policy analyst for the Commerce Department's National Telecommuni-

New York Times, June 16, 1986
(continued from previous page)

cations and Information Administration, said the drop was not statistically significant.

Part of the reason why low-income groups have not canceled phone service is that some states have adopted "Lifeline" plans that provide basic service for these groups for a low rate.

Given the political resistance to raising local rates, some phone companies are beginning to shift their strategies and to pull back from their insistence that rates rise to cover costs. Instead, they are offering to keep basic residential rates from increasing rapidly in exchange for concessions from regulators.

"It's better to eliminate all the causes of political concern over rates if in return they can be freed of restrictions to get into new businesses," said Samuel A. Simon, a Washington consumer attorney who has also been a consultant to phone companies.

Pacific Bell's Proposal

Pacific Bell, which serves California, recently proposed to essentially freeze basic residential rates through 1989. In exchange, the company wants a more streamlined rate-setting process, the ability to set prices more flexibly on phone services other than the basic service, and more freedom to go into new businesses.

Michael A. Revelle, executive director of state regulatory matters for Pacific Bell, said the company needed to be able to react more quickly in a competitive market. "The ability to have long and protracted rate hearings to adjust to conditions that are changing daily is just not going to cut it in the long term," he said.

Mr. Revelle added that the company believed that, if it was given a freer hand, it could generate enough extra income to continue subsidizing local rates. Indeed, Pacific Bell's proposal indicates that basic rates for unlimited service would stay at the current $10.25 for most customers through 1989 and only reach $12.25 by 1995.

New York State Plan

The New York State Public Service Commission recently approved a similar arrangement, in which the New York Telephone Company promised to limit the increase in the basic local rate to $1 for two years in return for more streamlined regulatory procedures.

Some consumer groups, however, are suspicious of the plans, especially after hearing phone companies say for years that local rates would have to rise to cover costs. Consumer advocates fear that phone companies are offering temporary assurances about local rates to achieve deregulation, after which they will be free to change rates at will.

"I think these rate agreements are similar to a wolf in sheep's clothing," said Richard Kessel, executive director of the New York State Consumer Protection Board, which is seeking to overturn the New York plan. Mr. Kessel added that the plan "short-circuits the regulatory process" and allows New York Telephone to raise rates without having to face the public scrutiny and unfavorable publicity that accompanies a formal rate proceeding.

Officials say that telephone rates are likely to remain a volatile issue for years. "We have not seen the end of the fallout of deregulation and divestiture," said John Marks, chairman of the Florida Public Service Commission.

Tomorrow: Obtaining service and repairs continues to be among the main telephone problems.

Installation and Repairs Top Phone Problems

By ANDREW POLLACK

The nation's telephone service is gradually recovering from the confusion that followed the breakup of the Bell System two and half years ago, according to industry and government officials and consumer groups. But a number of experts say that some inconveniences and customer confusion remain and that certain aspects of service may never be as good as before the breakup.

The main problems continue to be obtaining new service and having repairs performed. Consumers now have to deal with separate companies for their local and long-distance service and they may have purchased their telephones from still another company, leaving it up to the individual to determine whom to call for repairs when there is a breakdown.

Several Companies Involved

Businesses generally find that it takes longer to have such services as private lines and WATS lines installed, because several phone companies must now be involved in filling such orders. And while installation has improved since the months immediately after the breakup of the Bell System on Jan. 1, 1984, it is still not as fast as it was before then, according to business users and the American Telephone and Telegraph Company.

The physical quality of telephone transmissions, by contrast, does not seem to have been affected. Some customers suspect they are now more likely to have a call blocked because all circuits are busy or to experience static on the line, but available data indicate that the quality of transmission remains as high as it was before and, in some cases, higher.

Government officials who monitor phone service say that over all, they

Continued on Page D5, Column 1

N.Y. TIMES JUNE 17, 1986 A1, D5

© 1986 The New York Times. Reproduced by the Library of Congress, Congressional Research Service with permission of copyright claimant.

Continued From Page 1, Section 1

have seen no signs that the phone system has deteriorated. "We've seen nothing to suggest the industry isn't doing its job in giving good quality of service," said Susan O'Connell, legal assistant to the chief of the common carrier bureau of the Federal Communications Commission.

In New York State, "telephone service has never been better," said Neil Swift, head of the communications division of the Public Service Commission, which only a few years ago was critical of the New York Telephone Company's service.

Indeed, at least some phone users and industry experts contend that the competition fostered by the Bell breakup has proved beneficial in several ways.

In the wake of the divestiture and other industry deregulation, they note, there has been increased competition in long-distance service, forcing rates down, and in providing customer equipment. Even local telephone service has seen the beginnings of competition from technology that allows big customers to bypass the local phone system. Accordingly, some customers maintain, a number of telephone companies have become more attentive to their needs.

"You could wait days for repairs of lines and now it's a matter of hours," said the telecommunications vice president of a California retailer. "If you're the only game in town, there isn't the necessity to be so responsive."

In fact, state regulatory commissions have generally not found an increase in the number of complaints about phone service.

New York Times, June 17, 1986 (continued from previous page)

Consumer Perception Cited

But many consumer groups feel that in general, it is now more cumbersome to obtain new service and repairs. "I think if you look at a technical definition of quality of service, it hasn't gone down," said Samuel A. Simon, a consumer lawyer active in telephone industry affairs. "But from a consumer's point of view, there's no question they perceive it has gone down."

"In general, people feel the system is much more confusing and much more frustrating," said Patricia Clark, a spokesman for the Illinois Citizens Utility Board, a consumer group.

Consumers once merely had to get in touch with the local phone company, which would install whatever lines were needed and repair any problem. Now, the phone is rented or purchased from A.T.&T. or another phone manufacturer. If the local phone company is called in to make repairs and determines that the problem is in the phone, and not in the line, the customer will be charged for the visit — and the phone will not be fixed.

Second of two articles on telephone changes since deregulation.

"The biggest complaint we've gotten on service is repairing equipment," said Richard Kessel, executive director of the New York State Consumer Protection Board.

Need to Choose and Adjust

Consumers also find it difficult to choose long-distance services and to adjust to the new system, according to consumer groups. They are being asked to designate a long-distance company as their primary carrier. If they do not choose, they are assigned a carrier by the local phone company.

Large corporations, which have more complex telecommunications needs, experienced the most noticeable problems immediately after the breakup. There were long delays in the installation of services used by businesses, particularly private lines that tie two locations together directly, bulk discount WATS service, toll-free 800 service and digital circuits for computer communications.

Such delays occurred because A.T.&T. and the local phone companies that it spun off were having trouble coordinating the provision of those services. In some cases orders were lost or misplaced in the confusion. Moreover, a huge order buildup occurred, both because of a 1983 strike and because customers rushed to get their orders in before the breakup.

F.C.C. Halted Monitoring

As time passed and coordination improved, such problems subsided enough so that the F.C.C. has stopped monitoring the situation. But because several phone companies are involved in providing these special services, installation speed has not returned fully to pre-divestiture levels and some phone users think it never will.

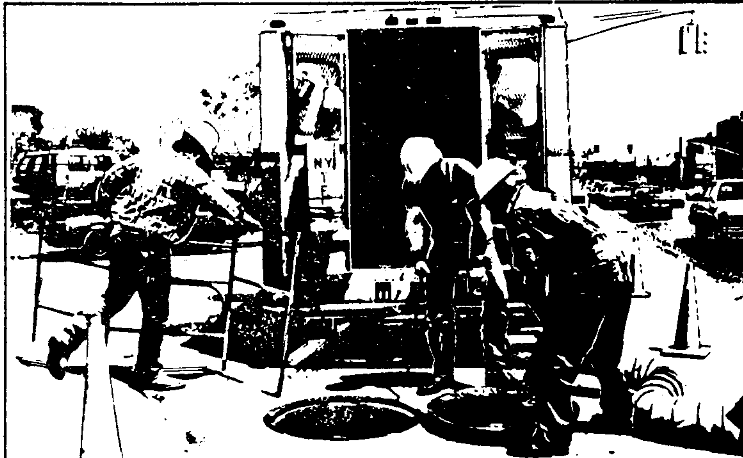
Before the breakup, for instance, A.T.&T.'s target was to have a private line installed in 28 working days, according to a spokesman for the company. After the breakup, the goal became 48 working days, and at first, the company usually could not even meet that target. Now, he said, the target has been reduced to 39 days and the company meets the goal most of the time.

The same is true for installation of WATS, which stands for Wide Area Telecommunications Service. The goal before divestiture was 7 to 12 working days for installation, and that rose to 22 working days after the breakup. Now the goal is back down to 15 working days, still not as fast as before the breakup. But installation delays might increase again because of the current strike against A.T.&T.

Disagreements on Bills

Although corporations have seen many more services become available because of competition sparked by divestiture and deregulation, they have also had to take a more active role in planning, running and repairing their telephone operations. "You've got to be your own telephone company," said Robert Bennis, manager of communications systems for the Westinghouse Electric Corporation.

Mr. Bennis said that it had become



Installing a Line: How Long It Takes

Goals set by A.T.&T., in terms of maximum number of working days needed to install a line.

Private Line

	Days
Before divestiture*	28
Divestiture to September 1985	48
Since September 1985	39

WATS Line**

	Days
Before divestiture	12
Divestiture to January 1985	22
Since January 1985	15

*Jan 1, 1984, date A.T.&T. spun off 22 Bell operating telephone companies.
**Wide Area Telecommunications Service, a high-volume service for business.

Source: American Telephone and Telegraph Company

The New York Times/June 17, 1986

harder for companies to keep track of their bills because of constant changes in service, and that Westinghouse had had disagreements with the phone companies over bills. "There's a margin of error greater than we can live with," he said.

Both A.T.&T. and the local Bell companies say the physical quality of phone transmission does not seem to have deteriorated. In a survey of the staffs of state utility commissions, 14 commissions said they did not perceive that the quality of long-distance service had declined, while only four said they thought it had declined and 11 said they could not tell, according to Rowland Curry, acting director of engineering of the Texas Public Utility Commission, who conducted the survey.

Some say that transmission quality has actually improved because of technological innovations.

Phone companies, for instance, are gradually shifting to transmitting information as digital pulses of light through optical fibers, rather than using analog, or wave-like, signals traveling by copper wire or microwave. Such digital light-wave transmissions are not subject to the same static and interference that sometimes affects conventional transmissions. A.T.&T., for its part, is switching to a new, more flexible way of providing alternative routes for calls when the main circuit is occupied.

Still, even if A.T.&T. and the Bell companies say quality is high, they no longer control the entire system. Consumers are starting to buy inexpensive phones or using inexpensive long-distance services that provide lower-quality service than the Bell companies' system. To the extent that happens, the average level of quality goes down.

Long-Term Concerns on Quality

Experts say long-term concerns about the quality of the phone system remain. One concern is that, with many different vendors providing service and equipment, it becomes much more difficult to set standards, to make sure all equipment can interconnect.

Yet another question is whether the various phone companies will continue the investments necessary for high-quality service. Some may be diverted by more lucrative businesses. Others may lack the financial means.

Some officials say one worrisome development in this regard is a recent Supreme Court decision that restores to the states authority that had been assumed by the F.C.C. to regulate how phone companies depreciate their equipment. States can order slower depreciation to keep telephone rates from rising.

But this could also deny phone companies the money necessary to modernize and maintain their facilities, allowing the phone system to deteriorate in the way many a mass transit system has. One result, some experts say, is that there may be sharper regional differences in phone quality than there have been in the past.

© 1986 The New York Times. Reproduced by the Library of Congress, Congressional Research Service with permission of copyright claimant.

Phone Role Of States Is Upheld

F.C.C. Loses In High Court

By STUART TAYLOR Jr.

Special to The New York Times

WASHINGTON, May 27 — The Supreme Court today rejected an effort by the Federal Communications Commission that would have led to more rapid rate increases for intrastate telephone service in many states.

The F.C.C. wanted telephone companies to shift to shorter-term depreciation for computing intrastate rates. The commission uses that method to compute interstate rates.

The 5-to-2 decision, which will affect virtually every phone company in the nation, was a victory for phone regulators in 23 states. It was a defeat for many phone companies as well as a setback for the deregulatory policies of the commission, which had sought to pre-empt state depreciation rules for phone plant and equipment.

Unrealistic Rules Seen

The commission had argued that many state regulators, seeking to hold down intrastate rates in the short run, had refused to allow phone companies to use realistic rules for depreciating plant and equipment in computing the costs on which their rates were based.

This was hindering modernization of the phone industry, would lead to higher costs and rates in the long run and was contrary to Federal policy, the commission asserted.

But the Court, without passing judgment on these policy concerns, ruled that Congress had authorized the commission only to prescribe depreciation rules with respect to rates charged for interstate service, not to pre-empt state depreciation rules used in setting intrastate rates.

Differences on Depreciation

Justice William J. Brennan Jr.'s majority opinion held that, even though both interstate and intrastate calls went through the same plant and equipment, the states could prescribe depreciation rules for intrastate service different from those set by the commission for interstate service.

Reversing a Federal appellate decision, the Court held that the commission had exceeded its authority under the Communications Act of 1934 when it ordered phone companies in 1983 to disregard state depreciation rules and to use the same depreciation methods in setting intrastate rates that it had adopted in 1980 and 1981 for interstate service.

The commission's new rules were designed to make depreciation periods shorter, in line with the rapid obsolescence of much phone plant and equipment, and to encourage companies to buy new equipment to keep abreast of rapid improvements in communications technology.

Mark S. Fowler, the commission's chairman, said today that the decision was "unfortunate" because "state-of-the-art depreciation is the key to an information age telephone network." But he added that the commission was still free to "stay its pro-

Continued on Page D5

Continued From First Business Page

competition course" on interstate matters, and that the effect of today's decision would be limited by the fact that several states are now "leading on the road to deregulation" in tandem with the commission.

Depreciation rules have an important effect on phone rates because they determine how rapidly companies in the capital-intensive phone business can recover the costs of plant and equipment by including those costs in their rate base.

The Communications Act created what Justice Brennan called "a system of dual state and Federal regulation over telephone service." It authorized the commission to regulate interstate and international phone rates, including depreciation rules. But, as Justice Brennan stressed, it also specified that the agency had no jurisdiction over "intrastate communication service," even though the same equipment was used by the same carriers for both interstate and intrastate calls.

He also said Congress had given the commission no power to impose on the states its view that the depreciation rules used by many states would frustrate "vital nationa llcies, including timely recovery of capital invested in telephone equipment," with a severe impact on the interstate communications network.

The four consolidated cases, Louisiana Public Service Commission v. F.C.C., Nos. 84-871, 84-880, 84-1054 and 84-1069, started as an appeal by public service commissions in Louisiana, California, Florida and Ohio from the F.C.C. to the United States Court of Appeals for the Fourth Circuit. That court upheld the commission, but today the Supreme Court reversed its ruling.

Chief Justice Warren E. Burger and Justice Harry A. Blackmun dissented, without stating their reasons. Justices Lewis F. Powell Jr. and Sandra Day O'Connor did not participate.

In other business-related cases, the Court also took the following actions:

N.Y. TIMES
MAY 28, 1986
D1, D5

New Phone Company Twist

Taking Part in Bypass Trend

By ERIC N. BERG

Not long ago, the Langley Air Force Base outside Norfolk, Va., resolved to cut its long-distance phone bill. So telecommunications experts at the base began planning to have a microwave radio system installed to link the base directly to its long-distance carrier, the American Telephone and Telegraph Company.

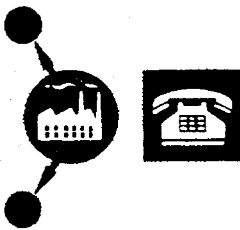
That was bad news for the Chesapeake and Potomac Telephone Company of Virginia. For years, Chesapeake and Potomac had provided the base with local phone service, including access to long distance. Now, the military was proposing to bypass Chesapeake and Potomac, depriving the phone company of nearly $1 million a year in long-distance connection charges.

The result was surprising. Rather than lose Langley's business entirely to a bypass company, Chesapeake and Potomac decided to enter the bypass business itself. It won a contract to build the link to A.T.&T. that the Air Force desired. The Air Force now leases that link from Chesapeake and Potomac.

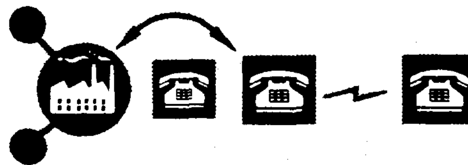
"Our dilemma was losing every nickel of the business or losing some," recalled William M. Newport, an executive vice president of the Bell Atlantic Corporation, the regional holding company that owns Chesapeake and Potomac. "We came back with a proposal to build a fiber-optic link, and the customer stayed with us."

Telephone Bypass: How Three Types Work

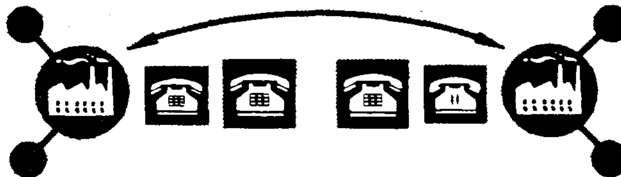
LOCAL BYPASS
A business connects two or more of its own buildings in the same city and bypasses the local telephone company.



LONG-DISTANCE ACCESS BYPASS
Big customers use their own facilities to link their telephones to long-distance companies' facilities. These users bypass the local phone company.



TOTAL BYPASS
A company connects its buildings in different cities through a satellite network, bypassing both local and long-distance lines.



The New York Times / March 11, 1985

Competition Brings Change

That, moreover, was not the first time that Bell Atlantic decided to bypass its own network rather than lose a giant customer. In fact, throughout the United States, almost all of the seven regional phone companies formed from last year's breakup of the Bell System are finding that in the increasingly competitive communications world they, too, must resort to unconventional practices to retain business — even if it means bypassing their own networks.

"We're no longer on the all-or-nothing approach," said Robert A. Morrow, a spokesman for the Southern Bell Telephone and Telegraph Company, the Atlanta-based subsidiary of the BellSouth Corporation, one of the other regional companies. "If there is the possibility for some revenue, we're going to pursue it."

Jack B. Grubman, a telecommunications analyst at Paine Webber Inc., the Wall Street concern, said: "The Bell companies know that life can't go on as it has."

In a survey of 400 of the New York Telephone Company's largest customers conducted last year by Touche, Ross & Company, the accounting firm, a third of the 316 customers responding said they were already bypassing the local utility and an additional 17 percent said they planned to by the end of this year.

A spokesman for Touche, Ross said this translated into a phone company

Continued on Page D3

N.Y. TIMES
MARCH 11, 1985
D1, D3

© 1985 The New York Times. Reproduced by the Library of Congress, Congressional Research Service with permission of copyright claimant.

New York Times, March 11, 1985

Continued From First Business Page

revenue loss of $34 million in 1984, with a projected loss of $67 million this year and $110 million in 1986.

Between 1980 and 1984, Touche, Ross said, 88 bypass systems were installed in the state, bringing the total to 119.

In California, an estimated one-third of the Pacific Telesis Group's top 275 corporate customers are engaging in some form of bypass.

Under the current pricing system, long-distance companies such as A.T.&T., the MCI Communications Corporation, GTE Sprint and Allnet Communications Services Inc. pay fees, known as access charges, to connect to local customers. As things stand, however, those charges are held artificially high to subsidize local service. The high access charges, in turn, translate into high costs of long distance for customers, particularly for corporations, which use long distance heavily.

Not surprisingly, then, many corporations are deciding to cut their long-distance costs by bypassing the local network and hooking directly into long-distance carriers. By doing this, they avoid paying the subsidy, and instead pay only the actual cost of the connection.

Big Savings Seen

Gerald L. Mayfield, a vice president of the DMW Group Inc., a telecommunications consultant, estimates that a large corporation bypassing the local network can shave 11 cents a minute off the average cost of a long-distance call of 32 cents a minute. With monthly phone bills of large companies often above one million minutes, Mr. Mayfield said, the monthly savings through bypass can easily exceed $100,000.

For the Bell companies' management, a big challenge over the last few months has been how to respond to this threat. Some, such as Pacific Telesis, which provides local phone service in California and Nevada, have long argued that bypass undermines the Bell companies' financial well-being. It says it has therefore refused to get into the bypass business. Others have chosen to play down bypass, saying that to discuss it would only hasten an exodus from the conventional phone system.

One Bell executive, who requested anonymity, said, "It's just not in my competitive interest to discuss it." Another said, "The more awareness I create of this practice, the more awareness there is of the pricing disparities that exist."

Indeed, in New York, the Nynex Corporation recently proposed revamping New York Telephone's rates to slow bypass, particularly in Manhattan. But the primary thrust by the Bell companies has been to provide bypass services themselves rather than fight the trend.

Last year, for example, the International Business Machines Corporation wanted more rapid communications between two of its North Carolina offices. Ordinarily, Southern Bell would have linked the offices with a private line tied into a phone company switching center.

When I.B.M. indicated it wanted a direct link and would go anywhere to get it, Southern Bell installed a fiber-optic cable that bypasses Southern Bell switching centers entirely.

Similarly, when the Harris Corporation wanted to connect two Florida offices, Southern Bell again acted solely as a construction contractor, laying communications cable outside the regular Southern Bell system.

"It was either getting some revenue through putting in that cable or getting none whatsoever," said Mr. Morrow, the Southern Bell spokesman.

Private Wire Service

Some Bell companies say that, in a sense, they have always been in the bypass business. The Mountain States Telephone and Telegraph Company, for instance, has always provided private wire service for its business customers.

It considers that a form of bypass since private wires, while going through a local office, do not involve the switching that most calls do. Increasingly, Mountain Bell's private wires have not been wire at all but coaxial cable and microwave, both of which circumvent Mountain Bell's existing plant.

"We provide the transmission media, and the corporations put their electronics — telephones and switches — on either end," said James B. Grisenti, a spokesman for Mountain Bell, the Denver-based subsidiary of the U S West Corporation. "Our view is that half a loaf is better than none."

Wall Street takes a similar view. In general, analysts say that as long as the current pricing system remains intact, the Bell companies would be foolish to sit idly and watch business inevitably drift away.

"If the local company does not offer the most economic communications solution, someone else will," said Laura Peck, a communications analyst at L.F. Rothschild, Unterberg, Towbin. "If it means bypassing their own network, they must do it."

But even supporters of bypass by the Bell companies agree that bypass is not nearly as profitable as the Bell companies' traditional business of connecting customers to long distance through a switching center.

Robert J. Hudzik, a spokesman for the Illinois Bell Telephone Company, a subsidiary of Ameritech, estimates that revenue drops by 40 percent when a long-distance connection is made through bypass rather than in the normal way. Mr. Mayfield of DMW says the revenue drop can be even greater.

But the real solution for phone companies, telecommunications experts say, is to bring long-distance prices more in line with costs, therefore removing the incentive to bypass. Slowly that is happening. Beginning this June, for instance, consumers will pay a $1-a-month extra charge on their local phone bills so that the access fees paid by long-distance companies can fall $1 and long-distance rates can fall too.

In the meantime, said Mr. Grubman of Paine Webber, the phone companies "have figured out a way to make the best out of a bad situation."