# AT&T DIVESTITURE: WHAT HAPPENED, WHY DID IT HAPPEN, AND HOW WAS THE CONSUMER AFFECTED?

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AT&T Divestiture: What Happened,

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# CHAPTER I

# INTRODUCTION

## Nature and Justification of the Problem

Divestiture, according to Webster's Third New International Dictionary (Gove, 1976, p. 663), means "the compulsory transfer of title or disposal of interests (as stock in a corporation) upon government order." This is the legal term for what occurred on January 1, 1984 when the American Telephone and Telegragh (AT&T) monopoly was dissolved. This divestiture was the result of the largest antitrust suit in history, a suit filed by the United States Justice Department in 1974. At the time of the breakup AT&T was the biggest company in the world. Its assets of $150 billion accounted for almost 4% of the total assets of the 500 companies listed as the largest in the country. The size of the company and its monopolistic tendencies opened it to scrutiny from regulators.

The Justice Department filed its first lawsuit against AT&T in January 1949 alleging that AT&T violated the Sherman Antitrust Act. The government demanded that AT&T's subsidiary Western Electric be separated from the Bell System (Seelman, 1984). A compromise was reached whereby limiting AT&T's communications activities while making patents available for all. In return AT&T was allowed to retain Western Electric. In November 1974, the Justice Department filed its second suit, once again citing the Sherman Antitrust Act; this suit, ending in 1982, resulted in the breakup decree. Officially starting January 1, 1984 AT&T was divided into eight separate entities. AT&T assumed the role of providing long-distance service while the seven remaining entities fulfilled the local service. In exchange, all were allowed into otherwise prohibited enterprise areas (Baida, 1985). But was the public interest served by the divestiture? Did the consumer benefit from the breakup? Has the breakup affected the consumers' rates and service? Is the consumer still confused?

## Purpose of the Report

The purpose of this report is to explore the current literature concerning the AT&T divestiture to determine if, in fact, the divestiture has benefited the consumer, AT&T, and/or the government. It is written from a neutral standpoint rather than taking an industry or consumer focus. The information and quotations are not meant to reflect the views of the author, but rather to put the information in such a way the reader can draw his/her own conclusions of the effects and benefits of the divestiture. This information can be used by consumers to clarify just what did happen in the breakup, why it happened, and how the telephone industry is now structured. Often times when an individual has a better understanding of why a certain event occurred they are better able to cope with problems that might arise from the event. Hopefully, this study will provide the reader with such an understanding.

# CHAPTER II

## REVIEW OF LITERATURE

### History of AT&T

"The most drastic discontinuity in the history of any major U.S. industry," or even "the largest corporate event in history," the breakup of the biggest and quite possibly the best, example of industrial organization in the world: the American Telephone and Telegraph Company (AT&T) (Toffler, 1985, p. 6). With this statement Toffler gives a glimpse of what the AT&T divestiture meant to the company, the government, the public, and the world itself. AT&T was unquestionably one of the great corporations in history. Toffler states that unlike the banking empires of the Middle Ages or the great trading companies of the Mercantile Age, AT&T was born into the Industrial Age. Its enormous success sprang from a profound understanding of the social environment in which it had to operate. Theodore Vail and the other founders of the Bell System knew, whether intuitively or consciously, where the industrial system was heading and what made it tick. Knowing these things, they were able to shape AT&T into an institution perfectly adapted to its time and place. That is, it was perfectly adapted in a business sense, however, it failed to observe the governmental constraints put forth in the Sherman Antitrust Act. To understand this unique company and examine why it was dismantled, the initial concept and structure needs to be examined.

Alexander Graham Bell had great vision for his invention of the telephone even in its early stages. He clearly foresaw a universal communications network, and what this network would involve. In a letter written in 1878, he spelled out the details with remarkable accuracy:

> It is conceivable that cables of telephone wires could be laid underground or suspended overhead, communicating by branch wires with private dwellings...I believe in the future...a man in one part of the country may communicate with another in a distant place (Pool, 1981, p. 156).

Bell and his supporters believed in his system and this new invention that would carry Bell's new company to heights never before dreamed of. His early supporters were a merchant named Thomas Sanders and a prominent Boston lawyer named Gardiner Greene Hubbard. These two Massachusetts men had capital to invest and in 1875 signed a written agreement with Bell whereby furnishing half the money for Bell to work on inventions related to telegraphy (Baida, 1985). In return for their investment the three men would share any resulting patents.

On the morning of February 14, 1876, Hubbard filed the patent application on Bell's behalf for his new invention, the telephone (Baida, 1985). U.S. Patent No. 174,465 , generally considered the most valuable patent ever issued, was granted to Alexander Graham Bell on March 7, 1876; Bell was twenty-nine years old. On July 9, 1877, the early written agreement known as the Bell Patent Association was superseded by the Bell Telephone Company with Hubbard as trustee in full charge of business affairs. In the year that Gardiner Greene Hubbard was trustee, he made two notable contributions (Seelman, 1984). The first contribution, was that, instead of selling telephones, National Bell, as the company was known, would lease them to licensed parties for a royalty. This leasing and licensing system led to the basic premise AT&T would follow throughout its growth: instead of selling telephones National Bell would sell "service."

Hubbard's second contribution was the hiring of Theodore Vail. According to Baida (1985), Vail was a man of great vision and drive. He was made the general manager of a new company that was formed to handle the business development of the telephone. When Vail began work as general manager on July 1, 1878, there were approximately ten thousand Bell telephones in service. When he retired in 1919, there were nearly eight million.

A significant event, one that would shape the telecommunications industry for the next three-quarters of a century, took place for the new company in 1879. National Bell won a patent infringement case against its chief competitor, Western Union. Western Union agreed to get out of the telephone business and turn over its facilities to National Bell. In exchange Western Union would receive 20% of National Bell's receipts from telephone rentals. As a result, the settlement gave National Bell a monopoly in the telephone business in the United States and laid ground for a merger of AT&T and Western Union.

Theodore Vail became the first president of the new company organized and incorporated in 1885 called the American Telephone and Telegraph Company. Under its charter, the mission was one of long-distance service and in its first 15 years AT&T was commonly called the Long Distance Company (Baida, 1985). The corporate charter embodied a vision of a global telecommunications system as did Vail's ideas for when the Bell patents would expire. "What we wanted to do," he said later, "was get possession of the field in such a way that, patent or no patent, we could control it" (p. 71).

The early 1900s might have been a prognosis of what to expect from the future 1984 divestiture. As the patents expired more than a thousand local exchanges were established throughout the country. Many towns had two telephone companies and two systems; a few had three (Seelman, 1984). As the consumer found out then and as similarly occurred in the 1980s, this increased competition resulted in lower prices just as economics texts say they should (Jaffe, Schlesinger, and Stertz, 1986). "Economic theory says that businesses are better at making efficient decisions than government...Efficiency, the theory goes, cuts costs, which cut prices" (Jaffe, Schlesinger, and Stertz, 1986, p. 1). Regardless of lower prices, Pool (1981) says this increased competition also created waste, inconvenience, and confusion for the consumer.

AT&T displayed astounding growth and innovations during the 1920s. The company was an early pioneer in every facet of the new communications media: radio, television, and sound pictures. AT&T, by 1929, was the first corporation to generate annual revenues of more than $1 billion. However, in a series of famous essays (DeMott, 1983), Vail put forth the idea that fatter profits are not the be-all and end-all of a corporation. Service counts more, he wrote, "...and the Bell System could deliver it best by being a regulated monopoly that struck a balance between public and private interests" (p.62). Vail sounded the motto in 1908 that dominated AT&Ts position until the current divestiture: "One system, one policy, universal service" (p. 62).

Vail set the standards for the AT&T operating companies that would make them a juggernaut during the first 50 years of the twentieth century, but that also led to competitive sluggishness in the 1960s and 1970s (Seelman, 1984). He established a unified research and development operation (Bell Laboratories), and built a strong central staff of managerial generalists. He insisted that the companies coordinate their business policies and adhere to uniform technical standards. These standards proved to be inadequate for the revolution in telecommunications with the ever changing marketing, new technology and the subsequent increased competition in the field (Toffler, 1985).

Monopoly to Vail meant that AT&T would have U.S. telephone service mostly to itself in exchange for submitting its rates to federal and state regulatory authorities for approval (DeMott, 1983). Vail saw "no serious objection" to this regulation provided it was "independent, intelligent, considerate, thorough, and just" (Baida, 1985, p. 73). On the other hand, he did object to government ownership. "All monopolies should be regulated," Vail said. "Government ownership would be an unregulated monopoly" (p. 74). Vail saw the telephone industry as a natural monopoly, whose strong centralized organization, common theme and single minded goal would best serve the public. A private telephone monopoly with its unique telephone carrier lines, maintenance, switching centers, policy making, price structure, etc, being established and monitored from a central command structure would minimize any waste while maximizing efficiency. Competition on the other hand according to Vail would produce nothing but waste and inefficiency as was demonstrated when the Bell patents expired. However, government ownership, not private ownership, of telecommunications industries, operating as unregulated monopolies, tends to be the standard throughout the world. As Kleinfield (1981, p. 4) says, "In a country indissolubly wedded to free enterprise, AT&T stands as a corporate enigma, being a regulated monopoly and the only major phone company in the world not owned and run by a national government." The one time the government nationalized the telephone and telegraph companies during World War I, long-distance rates rose 20%, local rates went up, and AT&T operated at a deficit of $13 million dollars (Baida, 1985).

In July, 1934, the Federal Communications Commission (FCC) was replaced by the Interstate Commerce Commission as the agency with jurisdiction over telecommunications. It promptly launched an investigation of AT&T. The Commission recognized AT&T as a monopoly, regulated under the Communications Act of 1934. Seelman (1984) reports the Act instructs the FCC, state and public service commissions, and the telephone industry to interact and provide universal telephone service regardless of how profitable a customer is to serve. This goal according to Johnson:

> ...has been realized largely through the implementation of three strategies: monopoly, cost averaging, which has afforded cross-subsidization among routes and services; and a single system responsible for provisions of end-to-end service to ensure efficiency and reliability (1978, p. 127).

Today, with universal service achieved, regulators, legislators and the courts have looked more and more to competition, rather than regulation, to decide what services and equipment will be provided and how they should be priced. The Bell System had operated a truly national system, accessible to all, at a very low cost (Guinn, 1984). It was run with a degree of efficiency that was recognized around the world as the standard of excellence in telecommunications. Yet, if the AT&T system was as good as Guinn indicates, why was AT&T broken up? Before exploring that question it must first be established what happened as a result of divestiture.

## Divestiture: What Happened

"In all Industrial history, whether in the U.S. or the world, no company has undergone a more complex and excruciating process of restructure" (Toffler, 1985, p. 6). With this quote, Toffler set the tone for what took place on January 1, 1984. The word divestiture, according to Baida seems inadequate as a description of the corporate equivalent of a "many-limbed giant ripping off limb after limb, flinging the pieces in all directions, and leaving the landscape littered with big, bleeding hunks of its former self" (1985, p. 65).

The divestiture of AT&T was not something that took place over night or over a year. The first lawsuit, filed by the U.S. Attorney General in January, 1949 alleged that AT&T had violated the Sherman Antitrust Act and asked that its' immense manufacturing subsidiary, the Western Electric Company, be separated from the Bell System (Seelman, 1984). The suit was settled in January, 1956 by a consent decree that spelled out terms that both the government and AT&T declared to be acceptable. In the end, AT&T agreed to confine its activities to common carrier communication services and government projects, to manufacture only products needed by Bell companies and by the government, to make all its existing patents available to anyone without charge, and to make all future patents available on reasonable terms. In exchange for these concessions, the government allowed the company to keep Western Electric.

Although AT&T claimed a moral victory, the government had put AT&T on notice that they were being watched closely. This scrutiny did not seem to deter AT&T in its drive in conquering new frontiers. As its Bell Laboratories turned out patents at an ever increasing rate, the company's profits grew accordingly. In 1972, however, Fortune magazine (Toffler, 1985) reported that stockholders' equity and higher profit margins began to shrink. They concluded, according to Toffler, that "the largest companies have exceeded the size at which their operations would yield optimum profit, i.e., that size increasingly involves diseconomies of scale" (1985, p. 122). In other words, the largest corporations, to include AT&T, had grown too large to be efficient and cost effective. During this same time period, Toffler submitted his contracted report to AT&T, titled Social Dynamics and the Bell System (Toffler, 1985). His mission was to study AT&T and determine where their "new direction" should be. The report essentially stated AT&T should breakup its system so as to be a more competitive force in the exploding telecommunications industry. "While it seemed unlikely that top management was going to react officially to it, Xerox copies began to circulate unofficially through management. It became a [samizdat] document - a piece of dissident literature" (p. 12).

The Justice Department filed its second suit in November, 1974 again citing the Sherman Act charging AT&T, Western Electric and Bell Laboratories with conspiracy to monopolize the telecommunications industry. The monopolization was "accomplished thru an abuse of market power in the equipment and service telecommunications market" (Enis and Sullivan, 1985, p. 128). In 1978 the FCC ordered competition for regular service of long-distance as well as private line service. This initial long-distance telephone competition was mainly artificial according to Welles (1986). Many of the new entrants existed only because the FCC mandated discounts on local phone network connection fees. Once these discounts were eliminated the smaller companies were too. This cancelling of discounts even hurt the larger competitors such as MCI Telecommunications (MCI) and Sprint because of its reduction of the competitors' price edge over AT&T.

Judge Harold Greene conducted more than 18 months of hearings, pretrial discovery and major filings by the parties. Not until January

1981 did the trial begin (Enis and Sullivan, 1985). William Baxter, the first Assistant Attorney General for Antitrust in the Reagan Administration negotiated the settlement with AT&T. It was argued that "consumers were forced to buy from the monopolist. Thus, if AT&T were able to exclude rivals or potential rivals as competitors, it would be in a position to raise and maintain prices above competitive levels" (Areeda and Turner, 1975, p. 697). Baxter said midway through the trial, "If one argues for divestiture, one argues that the cross-subsidy problem is terribly important, that the vertical integration economies probably are not very great, and that regulatory supervision is unwanted and more deregulation is possible" (U.S. Senate, 1981, p. 27). This cross-subsidy according to Temin and Peters (1985), was the enabler and incentive for AT&T to subsidize its competitive long-distance services with revenues from its regulated local monopolies. Coincidently this was the solution prescribed by the Communications Act of 1934 for the ability to produce "universal service" (DeMott, 1983, p. 62). The Communications Act (Temin and Peters, 1985) had prescribed the use of high long-distance rates to subsidize local service in order to make the telephone service affordable to as many consumers as possible.

As the case lanquished in the judiciary system it was apparent a settlement was needed and wanted on both sides. AT&T wanted to catch up with the communications revolution, especially in the computer field which it was unable to do because of its status as a regulated monopoly (Sloan, 1984). Competitors were anxious to get a bigger portion of AT&T's phone market (Temin and Peters, 1985). The Reagan Administration wanted it ended, too (Enis and Sullivan, 1985). On January 8, 1982, the Justice Department and AT&T came to an agreement to break up the Bell System. Charles L. Brown, AT&T's Chairman announced that the company had agreed to divest itself of the local telephone exchanges to settle the seven-year-long antitrust suit. As Brown said, "We seized the initiative. We now have our fate in our own hands" (O'Reilly, 1983, p. 63).

The agreement was officially known as the Modification of Final Judgement in that it vacated and replaced the Final Judgement or Consent Decree of 1956 (Enis and Sullivan, 1985). Besides having to divest itself, AT&T was prohibited from using the name Bell and forced to abandon the bell-shaped symbol that had identified it to the public for decades. O'Reilly (1983, p. 61) said, "The dismemberment dwarfs the 1911 splitup of Standard Oil." AT&T executives had to devise new strategic planning guidelines, create new ventures, restructure the new organizations, and come up with new names to match. The chairman of one local Bell company said, "It's like taking apart a 747 in midair and making sure it keeps flying" (p. 62).

The final outcome split the company into a national long-distance carrier (which kept the name AT&T) and 22 local operating companies, grouped into seven comparably sized Regional Holding Companies (RHCs), better known as the Baby Bells (Lockwood, 1987). The regionals, under the agreement, may not manufacture telephones, switch-boards, and other "customer premises" equipment. In return AT&T was allowed into unregulated endeavors such as the computer industry.

Brown admits that the settlement with the government was a retreat from AT&T's longtime resistance to a breakup. "Divestiture was not our idea," he said, "and we think it is wrong from the standpoint of the country's interests" (DeMott, 1983, p. 62). But the alternative seemed bleaker: "Time was not on our side. The Government's determination to restructure the Bell System would have gone on for years, draining our energy and preventing us from planning our own future" (p. 62). Rather than cling to the past, Brown was eager to get on with the "exciting" task of building the new AT&T. It does not matter whether the company was never proven guilty or not, because as Brown said, "The ship has left the dock" (p. 62). While Brown states the feelings of the industry, Howard Anderson, a well-known authority in telecommunications research gives the consumer's viewpoint:

> The next five years will surprise us too. There will be price wars, a vast array of competing technologies and complex choices to be made. Consumers will benefit from the revolution with better service, cheaper prices and more control. Consumers will be the engineers of their own custom-designed communications centers (Wellborn, 1984, p. 61).

In August 1983, Judge Greene gave final approval to the divestiture agreement. But what really led to this point? We know AT&T had wanted to expand into some unregulated industries and competition was wanted in the phone market both by AT&T's competitors and the government. We know that AT&T had become a monopolistic giant. But were there additional reasons which contributed to the breakup? Why did it happen?

## Why Did Divestiture Have to Happen

After the government spent $400 million on an antitrust suit many people are still asking why the breakup took place? Why did the government force the divestiture of AT&T when according to Guinn (1984), we already had the best telephone system in the world? Toffler says the answer is simple:

> A telephone system, even if it is the best in the world, is simply not good enough...Any country...needs decentralized, high speed, high-capacity networks for moving vast amounts of compu-

> ter data, video images, and other kinds of messages, along with voice-to-voice telephone communications...a truly 21st century communications system could not be built by an oversized, over-centralized, overconstrained organization of the kind AT&T was before the great breakup (1985, p. 127).

Although Toffler is not a telecommunications expert, he is well respected for his insight of future economic events, as depicted in his books Future Shock and The Third Wave, and for that reason his viewpoint is given.

By 1970 the basic problem of AT&T was one of supply and demand; too much demand for new phone service and not enough AT&T facilities to accomodate all the new customers. The result had been horrendous delays and breakdowns. Many of its more powerful customers, according to Coll (1986), lashed back at AT&T, publicly criticizing, even ridiculing the giant monopoly for its arrogance and incompetence. This criticism startled the public, making them wary of AT&T's size. AT&T Chairman Brown disputes this incompetence statement. "If we're not competent," he says, "I wonder why the competitors are trying to get Congress and the Federal Communications Commission to restrict us in various ways. We must be making a mark somewhere, or the competition wouldn't be so frightened" (DeMott, 1983, p. 64).

As was stated earlier, Vail and his successors believed that a monopoly in communications best served the public interest, but the government did not believe it (Enis and Sullivan, 1985). Their decision to break up AT&T was made as representatives of the public and hopefully as guardians of the public interest. Sivy (1986) said that lowering costs and increasing customers' choices were the ostensible justification for the breakup. A truer reason might be that the company's size and monopolistic tendencies opened it to attack. Such tendencies involved putting pressure on banks to deny credit to the independents, and putting pressure on politicians to deny franchises or to grant them only with burdensome conditions attached (Seelman, 1984). These tactics caused the Bell system to be called a "ruthless, grinding, oppressive monopoly" (Baida, 1985, p. 73). In the range of its influence, in assets, and in its impact on the daily lives of ordinary people, AT&T dwarfed not only other companies but also nations.

To gain a better prospective of the company's size a few facts should be pointed out. By the end of the 1940s, AT&T had annual operating revenues of $2.9 billion (Bell, 1970). It employed more than half a million workers, paid $21 million in annual dividends to 83,000 shareholders accounted for the lion's share of the market for all communications services, and was, by any measure, one of the largest private corporations in the world (Toffler, 1985). In 1950, there was only one primary communications manufacturer in the United States, Western Electric, with annual sales of $840 million (Bell). In 1972, AT&T owned more than 90% of outstanding common equity in 18 of the 21 principal telephone companies (Toffler). At the time of the divestiture, AT&T had $155 billion in assets. It was bigger than General Motors (GM), Mobil, Ford, General Electric (GE), International Business Machine (IBM), Xerox, Coca-Cola and Exxon combined (DeMott, 1983), and it was the second largest employer in America, behind only the government (Toffler).

Lockwood (1987) says the government was obviously worried by the size and power of the telephone giant, however, the antitrust suit revolved around two glaring abuses. One was that AT&T bought almost all the equipment needed from its own manufacturing subsidiary, Western Electric. The second abuse was that firms like MCI were not getting the connections they needed, or were getting them only slowly and expensively (Lockwood, 1987). The government kept trying, through the FCC, to inject competition in a piecemeal fashion. Brown said, "We kept saying you can't inject little pieces of competition into a monopoly setup without realizing that there's going to be a major upheaval eventually" (Zuckerman, 1984C, p. 59). This government goal to create competition for the purpose of regulating costs was apparently clear to AT&T. Charles Brown's question in August 1980, "Why are we fighting to keep our local monopoly?" preceded an obvious (to Chairman Brown) conclusion:

> If profit and loss in the phone industry now depended on costs, not regulatory accommodation, then the smart thing to do would be to jettison AT&T's most costly, least profitable subsidiaries, the local operating companies, and retain its high technology profit centers, Western Electric, Long Lines, and Bell Labs. The inter-intra split (Coll, 1986, p. 274).

DeMott (1983) concludes that the Bell System in the end, was done in by the rush of technology. The system's structure could not contain or protect itself against better and cheaper ways of allowing people to reach out and touch someone. Toffler put it another way when he said AT&T's ability to make decisions "...by the book...may well be disastrous in a novel, fast-changing environment in which the problems are themselves novel and fast-changing" (1985, p. 68). AT&T saw these problems coming and began to prepare for the new AT&T to emerge.

No one individual can point to just one reason for why the divestiture took place. It was not because of the company's size, perceived incompetence, desire to lower costs and increase customer choices, or its inability to keep up with technology. Nor was it because AT&T was a monopoly, for, according to Enis and Sullivan (1985, p. 130), "a monopoly alone is not per se unlawful. Monopoly power together with anticompetitive conduct is the essence of a Section 2 violation" of the Sherman Antitrust Act. And "if a dominant firm (such as AT&T) extends its market share by blocking or excluding competition through such anticompetitive practices as predatory pricing, lease-only policies, and exclusive buying arrangements it has crossed the line of legality" (Enis and Sullivan, 1985, p. 130). AT&T had been under scrutiny since the turn of the century, and in the end it took 35 years and two long lawsuits for the government to cut Ma Bell down to size (Baida, 1985). Now we need to take a look at how these pieces landed and how the new structure appeared to consumers.

## Post Divestiture: The New AT&T

January 1, 1984 the Modified Final Judgement took effect. At that time AT&T, the largest corporation in the world, was divided into eight companies, each of which had total assets of $14 billion or more. Guinn (1984) stated that when Forbes updates its lists of 500 largest U.S. corporations, these eight companies all will be in the top 10%. The new AT&T, the largest of the companies, with its approximately $35 billion in assets is still as big as Mobil, and twice as large as General Telephone and Electric (GTE), its nearest competitor. The physical task of dividing the Bell System's assets among the new companies, from whole telephone exchanges down to trucks, repair equipment, paper clips and brooms was gigantic (Harris, 1985). Inside the operating companies the developments were just as bizarre (Zuckerman, 1984A). Phone company officials in some old Bell System facilities set up barriers to separate operating company employees from those working for the new AT&T (DeMott, 1984). Said James Quinlan, plant manager for the newly formed Ameritech: "If the lawyers had their way, this place would be divided up with six-foot concrete block walls and rolls of barbed wire on the top" (DeMott, 1984, p. 53). The looming post divestiture question was what was the new structure and direction of AT&T?

"AT&T...seemed to get the better end of the divestiture deal" (Harris, 1985, p. 98). As Harris points out, the new company structure was made up of five parts. The reconfigured AT&T's largest part consisted of the long-distance phone service division, an expanded version of the old Long Lines. Other parts are Western Electric, the large manufacturer that makes equipment for the telephone companies; Bell Labs, which serves the Bell System's research and development needs; American Bell, which markets equipment and communications services to business and residential users; and AT&T International, an overseas marketer of equipment and services. These divisions traditionally have generated, if only indirectly in the case of Bell Labs, about two-thirds of old Ma Bell's profits. In addition to receiving one-third of the assets and two-thirds of the revenues, AT&T is allowed to enter the market of most unregulated businesses such as the unregulated customer-premises equipment and computer services (Harris, 1985).

It must be noted that although AT&T is no longer a monopoly and can compete freely in some fields, it will continue to be partly regulated. Intrastate long-distance rates and the fees paid to local phone companies that perform services for AT&T are regulated in each state by state regulatory commissions (Enis and Sullivan, 1985). Interstate long-distance rates are handled by the FCC (Hall, 1984). AT&T's competitors, by contrast, have relatively little regulation. While these aforementioned unregulated fields are highly lucrative the long-distance service is still the backbone of the company and the turf AT&T must protect at all costs (Gold, 1985). This long-distance market has become a bruising battleground where a host of companies are trying to take business away from AT&T. Tradition bound Bell had to move fast to keep up with the increasingly competitive telecommunications industry. As one analyst said, "AT&T has to realize that they are in the real world" (DeMott, 1984, p. 53). The most aggressive competitor has been MCI which, since 1969, has been permitted by the FCC to offer long-distance service in competition with AT&T. However, Wasinski (1987) points out Wall Street and the media love AT&T in long-distance.

The long-distance competitors have a slight edge on AT&T when it pertains to phone rates and the reason is simple. Cost of operating AT&T's long-distance business has risen because the firm now must pay a fee to the local companies that complete its calls, while competitors are not required to do so (Harris, 1985). In addition to this long-distance threat, the company found itself rapidly losing ground in its core business service. Business customers generate almost 60% of MCI's revenues, and a similar proportion of AT&T's (Lockwood, 1987). The large business customer base had been a monopoly for AT&T prior to the divestiture, but its competitors are now beginning to chip away at AT&T's stronghold. It must be understood though that even with an almost totally unregulated advantage, "AT&T's competitors face a Goliath possessed of universal brand awareness and the resources to spend hundreds of millions of dollars every year to enhance that awareness" (Welles, 1986, p. 53).

Both MCI and U.S. Sprint chalked up heavy losses in 1986: MCI lost $448 million due to reorganization and the scrapping of analogue equipment. In its first six months of existence, Sprint lost $356 million before taxes. AT&T, meanwhile, is quietly upgrading its own network. It spent $2.5 billion in 1987 while writing off $3.2 billion to cover 32,000 redundancies, resulting from the savings in manpower, and the scrapping of some old equipment. While AT&T strives to become more competitive in other markets, it can rely on steady growth of its long-distance business. There is a limit, however, to how well AT&T can do. Already the telephone side of the company is close to the new 12.7% ceiling set by the FCC for the rate of return on interstate calls.

The most interesting competitive economic confrontation to come out of the telephone divestiture is the head-on confrontation between AT&T and IBM. AT&T was freed to enter the computer market in full force and was thought to have the size and resources to match IBM. But according to Gold, "...AT&T is caught in the chicken-and-egg dilemma: It's hard to sell...PCs because there's not much...software. And there won't be much software until more...PCs are sold" (1985, p. 190). Like most computer competitors, to help alleviate this problem, AT&T has followed suit and made their systems IBM compatible. Part of AT&T's computer problem was timing, it leaped into computer sales just as business was turning down (Sivy, 1986). Its computer operations lost at least $1 billion in 1986 and analysts are asking whether AT&T will ever become the information-age titan envisioned after the breakup, or if it will remain little more than a huge phone company (Keller, 1986). Despite all these problems AT&T is going ahead in the computer field and expects to earn a profit by the end of 1988. Comments Jean Yates, Chairman of Yates Ventures Inc., a Palo Alto, California market researcher: "Judging from the company's performance thus far, I have no doubt that AT&T will be one of the top three computer manufacturers by 1995" (Harris, 1985, p. 100). Under new Chairman Jim Olson, AT&T has become an efficiently run telecommunications network. He accomplished this by cutting costs, strengthening their core businesses, and bolstering its growth in complete computer and communications systems to U.S. and International customers (Huber, 1987). AT&T has adapted a classic marketing strategy of first underselling the competition and establishing a customer base then widening the product line. The government can continue to hold AT&T's profits down while trying to invoke competition, but they cannot alter the basic economies of an industry which has enormous start-up costs and diminishing marginal costs, especially with new technology (Lockwood, 1987).

"Charlie Brown brought the ship out of the harbor," says Robert J. Casale, a partner at Kiddler, Peabody & Company and a former AT&T executive, "It's Jim Olson's job now to sail it" (Keller, 1986, p. 49). These words along with the following prophetic statement by former Chairman Brown reveal the real nature and structure of the "new" AT&T post divestiture:

> A new enterprise which will carry forward and build upon the character, the traditions, the achievements which Bell's invention, Vail's master plan and the Morgan group's money launched on a mission which proved so ambitious that its ultimate achievement-nearly a century later-came to be regarded by government authorities as an intolerable over-achievement (Tunstall, 1985, p. 73).

The new AT&T was only part of this new enterprise. The other part consists of the seven Regional Holding Companies (RHCs) which we will now examine.

## The Regional Holding Companies

Prior to divestiture there were 22 local Bell telephone companies operating under the AT&T mantle. Upon the breakup taking place, the 22 companies were divided geographically and economically equal among seven regional holding companies (RHCs), each with its own officers and boards, and each with responsibility for establishing the regional corporate structure (Enis and Sullivan, 1985). The seven holding companies created by the AT&T divestiture were hardly struggling newborns (O'Reilly, 1983). Each RHC armed with years of experience in providing local phone service, began independent life as multibillion-dollar entities. As was stated earlier, all rank among the top 10 of <u>Fortune's</u> 500, and the smallest of the firms, U.S. West, is larger than the nation's biggest electric utility, Pacific Gas & Electric (Hall, 1984). The 22 local Bell telephone companies have continued much as before the breakup, collecting revenues from Yellow Pages, mailing bills to customers, and providing phone service in all states except Alaska and Hawaii, which have independent firms (Hall, 1984). The RHCs are free to tread where no phone company had ever gone before, into almost any nonregulated business, except manufacturing telephones, certain kinds of information processing, and toll or long-distance services (Harris, 1985).

Although the seven regionals' assets, revenues, and customer bases are roughly the same, their history, geography, leadership, growth rates, and political and regulatory environments have stamped them with unique personalities (O'Reilly, 1983). As Bell planners expected the RHCs have to compete on cost, since most agree that neither AT&T nor the RHCs have a technological advantage. A brief synopsis of each RHC is necessary to get a full picture of the post divestiture telecommunication industry (Hall, 1984): NYNEX in the Northeast has 51% of AT&T's shares. BELL ATLANTIC is a tightly centralized company with seven local telephone companies in the Atlantic states and an aggressive taste for unregulated ventures. AMERITECH of the Midwest set the early profit pace, with the regionals' highest return on equity its first year of existence. Atlanta based BELL SOUTH is the biggest RHC. SOUTHWESTERN BELL is the most modern of the seven but has been the most cautious in diversifying. U.S. WEST is the 14 state Western regional that spreads over 43% of the continental U.S. but holds a bare four percent of AT&T's shares. Finally, PACIFIC TELESIS, is located in high-growth areas with a subscriber base that is very receptive to new products and services, has been the least profitable Bell company.

To open phone service to greater competition, the divestiture agreement provided that the regions be carved into geographical sections called local access and transport areas (LATA's). A regional is forbidden to carry traffic between the LATAs in its territory; that business is reserved for long-distance carriers like AT&T and MCI. Huber (1987) says the companies hate this present system, whereby they are obliged to hand over this long-distance traffic flowing within their territories. In addition to not being able to compete in this long-distance market, the RHCs also have lost subsidies from long-distance service. This loss of subsidies runs about $3.3 billion in revenues they formerly received from AT&T. Before the breakup about 37 cents from each dollar in revenues from long-distance charges was put back into the local companies. Now the RHCs get nothing.

As regulated utilities operating in near-monopoly markets, the regionals, like the old AT&T, face little business risk. Shareholders thus can feel secure. Initially demand for the RHC's stock was weak, as investors preferred to gamble on AT&T's more glamorous, high-tech hopes. The regionals have been very steady though. Their high profits and rock-solid dividends have made them the clear stocks of choice for the conservative income-oriented investor who once found similar refuge in AT&T (Peavy and Scott, 1986). On average, the regionals now yield 8.2%

yearly dividends, nearly twice the rate of Standard & Poor's 500 stock index (Peavy, 1986). For the moment the RHCs look far healthier than anyone else in the telecommunications business. While the rate of return they can make on their assets from local operations is fixed by state regulators, it averages 14% at the moment, comfortably above bank lending rates (Huber, 1987).

This report has looked at the AT&T divestiture from the companies' viewpoint thus far. We have implied how the consumer was affected. Now we will take a more indepth look at how the consumer was affected?

## Post Divestiure: How the Consumer Was Affected

"The Bell breakup and its reverberations will have profound - and often uncomfortable - effects on every person who makes or receives phone calls in the U.S for the rest of this century" (Sloan, 1984, p. 79). One of the reasons for the Bell breakup was to create competition. The reasons why, how, and in what way competition was created have already been discussed in earlier chapters. Whether this competition really came about is still up for debate, but the breakup did create more players. Since the divestiture and the government's efforts to create competition in the telecommunications industry, about 350 long-distance companies and hundreds of manufacturers of telecommunications equipment have entered the race (Wasinski, 1987). The key for these competitors according to Wasinski "...is to look as much like AT&T as they can in their business mix so that AT&T's price restructurings won't hurt them " (p. 20).

The consumer was and still is concerned about the divestiture and its effects on them. The news media stressed the biggest impact to consumers is the telephone price changes. Dorothea White, 86, a widow living alone in Los Angeles worries: "I think it'll make my phone bills go up. I don't really see why they had to break it up. It was a good system, and it seemed to be working" (DeMott, 1983, p. 61). In fact it is still a good system albeit a little more confusing. The consumer must recognize the relative economic value of being connected with the rest of the world, 24 hours a day, 365 days a year (DeMott, 1983). Telephone service has always been one of the best bargains, in the home or office; price increases have lagged far behind inflation. Thomas Bolger, the new Chairman of Bell Atlantic, is fond of pointing out that the prices of other commonplace products like a Chevrolet have increased about 1000% since 1940, while the average basic monthly U.S. telephone rate has gone up from $3.67 to just $11.38 during that same period, or about 210% (DeMott, 1983). Phonefacts (1986) says that the best telephone service in the world has become so dependable that the consumer takes it for granted. Although this is an obviously biased source the reader would have difficulty finding many consumers that would deny this statement.

Money (Sivy, 1986) interviewed specialists inside and outside AT&T, analyzed AT&T and its competitors, and examined obscure but vital phone company documents at state and local levels.

> Our conclusion: over the next decade, not only will phone bills on average be higher than they are now and service poorer, but also large parts of the nation's phone network seem likely to deteriorate to the point where they will be second rate, at least by the standards to which most Americans are accustomed (Sivy, 1986, p. 79).

Telephone rates have gone up for local service as have calls to distant points within states, along with what some consumers (DeMott, 1983) call sharp escalations in fees for local directory assistance, telephone line installation and pay telephones. In Pennsylvania, rate increases for local service rose from 12% to 45% in most areas. Residential rates in Kansas are $1.35 a month higher while in Baltimore they have gone up $4.67. Closer to home, fees for long-distance calls between Oklahoma's two area codes have jumped 30% (Zuckerman, 1984B). Nationwide the average residential phone bill is almost 20% higher since divestiture (Cooper and Kimmelman, 1986). Cooper also says that unprecedented earnings and rapid equipment depreciation by the RHCs have resulted in excessive charges to local consumers of over $3 billion per year.

Upon the breakup, the RHCs asked public utility commissions for huge rate increases, arguing that the loss of the national monopoly would increase the financial risk of telephone companies and that growing competition would expose them to even greater risk. Since the breakup, state regulators have approved rate increases for the RHCs resulting in about $5.5 billion in new revenue (Kimmelman and Cooper, 1986). These increases seem to be somewhat excessive for the consumer. With the general rate of inflation throughout the economy at less than nine percent since divestiture the overall local bills, including recurring monthly charges, local usage charges, phone costs and installation charges have increased four times faster than the general rate of inflation. The average total residential bill including all local and long-distance charges has increased more than twice as fast as inflation (Cooper and Kimmelman, 1986). Although these price increases are alarming to the consumer they are just the beginning of what the divestiture has done to the consumer. Possibly the clearest thing about the breakup of AT&T is the confusion.

Most of the public was bewildered about the breakup. Polls conducted in 1983 showed that only one in five persons knew what was going to happen to the phone system (DeMott, 1983). William McKeever, telecommunications analyst at Dean Witter Reynolds confessed: "Everybody is confused. The customers are thoroughly confused. The employees are confused. The companies are confused. So are the regulatory commissions, the unions and the stockholders. And so am I" (DeMott, 1984, p. 52). The biggest business change ever made in this country also touched off one of the biggest explaining jobs ever. To aid perplexed customers the local phone companies set up "Let's Talk" and "We Can Help" phone lines. Thousands of other people stood in lines at company offices, confused over everything from 'do they have to turn in their phones', to 'who do they call for service.' To add to this confusion is the billing process. Instead of receiving a single monthly bill for phone service, consumers may now get three or more: one for local service, another from one of AT&T's proliferating competitors for long-distance tools, and one from AT&T Information Systems for the lease of telephones. Another consumer problem is the service. "Out of all the assets of the Bell System...the Spirit of Service may be the asset hit hardest by divestiture" (Baida, 1985, p. 79). As has been already shown, one type of phone service has always helped pay for another. That kept phone costs down and within almost everyone's reach, but also led to price inequities. By redistributing funds to high-cost telephone service, the traditional separations and settlements process made possible universal service. Gold (1985) says that while MCI makes its sales pitch on the basis of price, AT&T continues to sell service and reliability. Some feel this service has changed, being somewhat less convenient and more depersonalized. The competitions' lower rates have lured away customers despite inferior connections, but people are willing to accept inferior service if it is cheap enough. But a recent Gallop Poll indicates though that most customers believe their local telephone company is providing high quality service at reasonable prices (Phonefacts, 1987).

Another issue for consumers is equipment. The most common question asked early on was, "Do I have to buy my phone?" Consumers could either rent it or buy it from AT&T or turn it in and replace it with a phone from another supplier. Statistics show an increase in phone ownership from 20% in 1983 to 55% in 1986 (Phonefacts, 1986). At present, only the phone equipment market is fully competitive and totally deregulated. Customers can choose among scores of different phones at thousands of stores. As a result of this competition, variety has increased and price has decreased. With equipment comes failures and subsequent repairs. Consumers may not be aware that the local phone company will no longer come out to their homes and repair anything that is wrong with their telephone service free of charge. Unfortunately, many people discover this after they have paid $50 per hour to have a phone company maintenance person come to their home to tell them that the phone company can not fix the problem with their phone service. Consumers need to know that different entities are responsible for each different component of telephone service, and it is up to the local companies to provide this information to the consumer.

Thanks to its reputation as a preeminently safe stock, AT&T was the most popular stock for small investors. The new AT&T, in contrast is a stock for investors who seek capital gains and are willing to gamble that the company can successfully make the transition from a regulated monopoly to a highly competitive enterprise (Chen and Merville, 1986). Whether the final price structure for AT&T will be competitive is left up to each consumer and investor to decide. As Zuckerman says, "It clearly is a more risky stock now" (1984C, p. 60). Peavy and Scott (1986, p. 268) states, "Before divestiture, the individual local exchanges (LECs) usually received AT&T's Aaa/AAA bond ratings. After the divestiture, the LEC's debt stands alone and...the LEC's were downgraded by both Moody's and Standard and Poor (S&P)." On the other hand, the divestiture has been a stock market bonanza for the RHCs. From 1984 to 1986 RHCs stock prices increased by an average of about 90%, which is almost twice as fast as the Dow Jones industrial index, the New York Stock Exchange Index, and the Standard and Poor Composite Index (Peavy and Scott, 1986). Cooper and Kimmelman says "...this phenomenal performance is excessive and it has come at the expense of ratepayers" (1986, p. 13). The RHCs in defense of their high rates of return say it is because the current rates are only making up for regulatory lag (Kahn, 1983). However, as was shown earlier even though inflation has stayed relatively stable, their rising costs and subsequent rates have not. One of the reasons for these increases is the access charge.

Most consumers did not know that prior to the breakup their local service had been subsidized by the long-distance profits. After divestiture to help make up for part of the loss of the subsidy, the customers pay local phone companies for access to long-distance lines. AT&T's competitors also pay these charges, but their changes are discounted 55% (Enis and Sullivan, 1985). To justify the discount, the competitors use a multi-digit code to connect a telephone into a non-AT&T service. This access charge amounts to $2 a month for residential customers and $6 a month for a business line, regardless of whether they make or receive any long-distance calls. "In the event that the operating company is unable to produce the same quality or type of service as it does to AT&T, the access charge is to reflect this discrepancy" (p. 132). It is estimated that these access charges cost customers $3.3 billion a year which makes a sizeable impact on low-income people (Sivy, 1986). Two studies, one in Pennsylvania, the other in Michigan, found that between two-thirds and three-quarters of all residential customers ended up with higher bills as a result of the imposition of the access charge (Cooper and Kimmelman, 1986). One way around the access charge, at least for the large volume consumer, is the bypass.

AT&T, the RHCs and other firms vie for business where phone lines are in heavy use, and neglect areas where they are not. More and more large corporate phone users, disgusted with increasing rates and access charges, are building their own private data and voice networks, otherwise known as bypass. By building microwave dish antennas and aiming them at communication satellites, they can legally bypass public phone systems. When large users cast off the burden of helping pay for the local network by bypassing the facilities, the operating companies are forced to raise bills to small and individual consumers. "Estimating bypass is difficult, but most calculations show that it threatens 10-15% of the revenues of the local operating companies" (Huber, 1987, p. 20). Because of these lost revenues prices are now being driven toward costs.

"Basic phone service...has never paid its own way" (<u>Telecommunications in Transition</u>, p. 3). Telephone service had been too cheap, for too long, with costs spread unevenly (Welles, 1986). Until the breakup, long-distance rates were artificially high and helped subsidize local service. During the regulated monopoly era the rates were based on a phone company's average cost of serving customers, but now rates are based on what the traffic will bear above actual costs. So that costs would be paid by the consumer using the line, the FCC ordered a monthly charge, called a subscriber line charge, for local users. In conjunction with this charge the long-distance rates dropped correspondingly. There is also an industry trend toward making consumers pay for each call. This is already in place in some states as a low cost alternative and is called local measured service (LMS). This gradual transition to cost-based pricing has not set favorably with the consumer. As Guinn reports:

> Asking people to buy a service at just what it costs to provide it would ordinarily touch off a round of cheers from consumers. But not when they've become accustomed to getting it far below cost. We seem to have conditioned Americans to believe there is a 'public right' to telephone service provided at less than cost (1984, p. 365).

The local telephone service never has paid its own way (DeMott, 1983, Seelman, 1984, Baida, 1985, Enis and Sullivan, 1985, and Temin and Peters, 1985). The large rates of return of capital for AT&T was from long-distance service as well as the sale and leasing of equipment, which then subsidizes the local service. As a result of divestiture the consumer will have to bear the cost increase in order to retain "universal service" (Guinn, 1984).

"Despite the assumptions of the divestiture, long-distance telecomons cries out to be a monopoly" (Lockwood, 1987, p. 10). With the divestiture long-distance competition has become very aggressive (Sivy, 1986). Immediately following the breakup, the competitors were notorious for poor service, bad connections and multi-digit codes. They blamed their problems on AT&T saying they gave them poor-quality connections. H. Brian Thompson, MCI Senior Vice-President, said: "AT&T has the Cadillac. Our connections are a Chevette...We have taken a lousy connection and made something of it" (Sivy, 1986, p. 82). On September 1, 1986 the competitors were given equal access (Cooper, 1986), meaning they now have the same dialing procedure as AT&T, but their access discount was consequently cut. According to Huber (1987), the discount rates went down from 50% to 5-15%. With this equal access and consequent discount reduction the competitors will now have to charge rates close to AT&T's to make profits, which is more bad news for the consumer.

The last effect on the consumer deals with the low income subscriber. Telephone bills are escalating, with dire warnings that the poor, the elderly, the handicapped, and many rural people may be forced to drop out of the network. There are consumer groups that support the formation of a national universal service fund (Cooper and Kimmelman, 1986). Some states have lifeline rates which permit a very limited number of outgoing calls and an unlimited number of incoming calls for a small fee. The American Association of Retired Persons argues that LMS will prevent the elderly from using the telephone as a social instrument (Seelman, 1984). The fact of the matter is that many consumers can not afford telephone service now, regardless of the purpose or need. In a door-to-door survey of low-income residents in nine states and the District of Columbia, over one-quarter of the households did not have phone service, and the vast majority stated that high cost was the reason. In California, a state with lifeline service for $1.50 per month, 28% of households surveyed still did not have service, but this time because many were unaware of the program (Gilbert, 1987). As we have seen time and time again, one of the most difficult groups of people to educate about phone service options are those households without telephones because they can not be reached through phone bills or customer mailing lists. Therefore, it would be up to the operating companies to initiate a program to reach these individuals and inform them of any changes.

# CHAPTER III

## Summary and Conclusion

Local phone service provides consumers with a vital link to their communities, families, friends, and crucial services. Indeed telephone service has probably become a necessity for the industrial nations to exist (Reinking, 1987). In the last few years, the telephone industry has undergone fundamental changes that have drastically affected all aspects of telephone service, however, AT&T still enjoys a virtual monopoly in the huge toll-free, big business, and overseas markets. In this author's opinion the divestiture may have even helped AT&T to retain a firmer grasp in these areas. Once AT&T was freed of having to service the local telephone market, they were able to streamline their operations, personnel, and maintenance, hence creating a more efficient network (Keller, 1985). Toffler (1985) had said that one of AT&T's problems was that it was too big to serve everyone effectively. The new pared down AT&T can concentrate on the services that have historically been their money makers (Coll, 1986), while making AT&T a more efficient telenet-work. With this efficiency and reduction of obligation, rates should have gone down accordingly, but the rates still are not a bargain for some consumers (Cooper and Kimmelman, 1986). Analyst Fritz Ringling of Gartner Group Inc., a consulting firm, believes that AT&T will eventually become a "deregulated monopoly" that will, in effect, set prices and whose competitors "will exist only at AT&T's good graces because it doesn't want another antitrust suit...Competition as the FCC envisioned it hasn't worked" (Welles, 1986, p. 52). Consumers are seeing this presently in their rates. Reduction of long-distance rates have been more than offset by increases in local rates. AT&T by not having to subsidize local service is now able to channel their long-distance revenues into other business ventures. Because of this loss of subsidies, the local operating companies contend they need rate increases (Richardson and Grazer, 1987). "The new Bell companies managed to raise local rates and individual company profits sharply with arguments flatly predicting the most dire consequences from divestiture" (p. 230). These increases took place even though they were directly contradicted by Judge Greene who said "there is nothing in the breakup that would dictate higher costs" (Barger, 1985, p. 64). So how was AT&T able to persuade the regulators a rate increase was necessary? Two reasons: the language and numbers they used (Barger, 1985). AT&T and the Bell companies argued that "they had nothing to do with the breakup, that it was Washington's fault. And if we don't get higher rates, the best phone system in the world is going to deteriorate and so we need to have higher rates in order to maintain the quality of telephone service" (p. 165). The companies also used overwhelming numbers like "the 1.7 billion dollar breakup, the 1 billion dollar a year construction program, and the 5.5 billion dollars in invested capital" (p. 165). Through intimidation the telephone companies are able to receive their increases while causing the consumer to seek assistance from consumer groups for help. Even though these increases may not seem significant to some middle class consumers, they are a definite worry to others (DeMott, 1983).

In addition to retaining a firm grasp in the aforementioned areas, AT&T now is able to explore and invest in the computer industry, satellite telecommunications, and a host of other ventures previously forbidden. These new industries help to add to the financial base of AT&T which aids its' research, resulting in newer technology. This steady income and constant upgrade puts added pressure on the other long-distance companies to keep pace. "Fairly consistently over the last several years, public opinion polls have found that consumers believe that AT&T's rates are between 18 and 20% more expensive than those of companies such as MCI and Sprint" (McEldowney, 1987, p. 53). To test the validity of the publics opinion McEldowney conducted a survey to compare what the total cost would be for 24 calls from various long-distance carriers. "The range between AT&T and the least expensive was only $1.25 compared to $6.11 in May of 1985" (p. 53).

"Dating back to 1-1-84, consumers have been confronted with having to make one decision after another about a service that they took for granted" (McEldowney, 1987, p. 52). Whether to lease or buy their phones "created a sense of uneasiness and even fear" (p. 52). Next, consumers had to select a long-distance carrier. Many were unsure how to choose a carrier and therefore took no action and let the local companies choose for them. The Bell operating companies were directed to send ballots to all of their customers but were not ordered to provide any comparative information or even any tips on what factors should be considered in picking a long-distance company. In addition no help is given the consumer on whether to choose a flat rate cost scale or use the local measured service (LMS). "Complex LMS rate designs only add another kind of public confusion" (Richardson and Grazer, 1987, p. 232). This confusion prohibits some consumers from making the most cost effective choice for their means. The telephone industry wants desparately to go to the LMS system full time but is meeting strong resistance from the consumer. "1985 was the target year for completing the successful nationwide implementation set in the 1970's by the old Bell System...and only 2-4 percent of the residential customers have been added to the LMS roles in the past decade" (p. 230). "LMS success appears to require either eliminating flat rate options altogether or raising the flat rate to prohibitive heights" (p. 230). This author agrees with Reinking that "both flat and measured local telephone service should be provided. The consumer then has the individual choice and can match his or her purchase with the benefit received" (1987, p. 225).

While consumers for the most part have learned to adjust, and in some cases, benefit from the changes in the industry, many consumers remain confused and uncertain about their new choices and obligations. As a consumer this author is still confused concerning the maintenance of the in-home telephone system, and would have to call the local exchange and ask for guidance as to whom to call for service and hope the information received was correct. Should the consumer have to worry about such things? This author says no. The local companies should provide this type of information in advance. "With varying degrees of success consumer groups around the country attempted to fill the vacuum" (McEldowney, 1987, p. 52), but overall the consumer is probably still confused.

Divestiture was supposed to hold great promise for telephone subscribers, but for most consumers that promise remains largely unfulfilled. The consumer still has one company for local telephone service, and even though there are a variety of long-distance companies to choose from, the prices do not vary a great deal. The days of price wars as consumers saw in the early days of divestiture are gone. The differences in the companies are only cosmetic, and superficial at best. Virtually every company now has fiber optics as well as other new telecommunications features, and as quickly as another new feature is developed, all the companies quickly have it. With all this new technology present there is still only a few practical substitute products for basic residence telephone service, i.e. CBs, ham radios, etc.

> The significance of the lack of substitutes for telephone service is merely to tie together the other aspects of demand. If there were reasonable alternatives for this necessary product, the policy issues would be simple - consumers would choose between the alternative products and competition would flourish (Reinking, 1987, p. 225).

So what advantage did the divestiture create? Simply, it attempted to breakup an illegal monopoly which was restricting competition although some people disagree. Former Senator Barry Goldwater, normally a fan of freer markets and less government regulation, said: "We're going to be sorry that we tampered with a system that was functioning well. I wish this divestiture had never happened" (DeMott, 1983, p. 60-61). This author disagrees though. The divestiture was needed and justified. Businesses should be alerted that they can not run rampant while failing to consider the effects they might have upon the consumer. The telephone industry has an obligation to provide good quality service at a fair price, and what that fair price will be is up to the consumer to dictate.

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