AT&T Divestiture

The Major Structural Changes Brought about by the AT&T Divestiture

The terms of the Modification of Final Judgment (MFJ), which ended the Justice Department's seven-year antitrust suit against AT&T, required AT&T to divest itself of 22 local Bell Operating companies. AT&T retained full ownership of Bell Laboratories and AT&T Technologies (formerly Western Electric), as well as its minority interest in two local operating companies: Cincinnati Bell and Southern New England Telephone and Telegraph Company.

Under the terms of the MFJ, the divested BOCs continue to provide exchange telecommunications services and exchange access, as well as directory services, including the Yellow Pages. However, they are prohibited from providing interexchange transmission services, like message toll, WATS, interexchange private line, and foreign exchange. These services are now provided by AT&T Communications Inc. and the 22 local operating companies of AT&T.

The MFJ adopts a special def inition of the term "exchange" in order to distinguish between intraexchange and interexchange services. The agreement states in part that an exchange or exchange area

> ... shall encompass one or more contiguous local exchange areas serving common - social, economic, and other purposes, even where such conf iguration transcends municipal or other local governmental boundaries. [P. 7.]

Thus, the local exchange boundaries existing prior to the divestiture did not define the limits of the BOCs' service areas. Instead, each state was divided into one or more Local Access and Transport Areas (LATAs): the BOCs were allowed to provide toll, private line, and other existing "intercity" services within these LATA boundaries; while AT&T Communications, Inc., through its interexchange subsidiary, provided inter-IATA services. (However, under the provisions of Judge Greene's July 8, 1983 Opinion, the BOCs have been allowed to retain certain inter-LATA facilities used for official service.)

It is important to note that the divestiture agreement does not prohibit AT&T from also providing intra-LATA services. Depending upon the decisions of regulators during this process of reorganization, AT&T may be allowed to compete with the BOCs for certain service offerings within IATA boundaries.

The MFJ also required the transfer of the BOCs' investment in embedded customer premises equipment to AT&T Information Systems. Under the terms of the agreement originally proposed by the Department of Justice and AT&T, the BOCs were to be prohibited from manufacturing or providing telecommunications products or customer premises equipment. In his August 11, 1982 Opinion, Judge Harold Greene ordered that the proposed decree be modified to eliminate the prohibition against marketing customer premises equipment. Consequently, the operating companies, now that they are divested from AT&T, have the option of reentering the retail CPE market; however, they are initially precluded from manufacturing CPE, either directly or through a subsidiary.

The divestiture also eliminated the Division of Revenues process, in favor of tariffed access charges. In addition, the related independent company settlements process will be largely replaced by access charges. Furthermore, the decree calls for the termination of

the BOCs' License Contracts with AT&T, as well as their Standard Supply Contracts with Western Electric. In place of the centralized functions formerly performed by AT&T, the BOCs may

> "support and share the costs of a centralized organization for the provision of engineering, administrative, and other services, which can most efficiently be provided on a centralized basis." (MFJ, p. 3.) In addition, they were required to establish a centralized organization, in order to provide "a single point of contact for coordination of BOCs to meet the requirements df national security and emergency preparedness." (P. 3.)

MFJ did not Alter the Regulatory Status of Services that were to be Transfered from the Bell Operating Companies to AT&T or its Subsidiearies

There seemed to be some confusion about the impact of the divestiture agreement upon state and federal regulation of telecommunications services. For instance, many people mistakenly assumed that the MFJ deregulates the embedded customer premises equipment (CPE) which was transferred to AT&T under the terms of the divestiture agreement. This misconception is probably caused in part by the deregulation of new CPE by order of the Federal Communications. Commission in Docket 20828 (Computer Inquiry II).

In May 1980, the FCC released its Final-Decision in Computer Inquiry II, which ordered that all customer premises equipment be detariffed on March 1, 1982. In subsequent rulings upon reconsideration, the Federal Communications Commission revised its initial decision: it delayed the deregulation of "in-place," or embedded, CPE indefinitely and extended the date of deregulation of new CPE to January l, 1983. Hence, all CPE offered on or after January 1, 1983 was detariffed; CPE, already in place or in inventory as of that date, remained subject to regulation. The MFJ did not directly affect the regulatory status of this embedded CPE: although no longer owned by the BOCS, under the MFJ it would continue to be regulated. However, AT&T successfully used the divestiture as a factor in convincing the FCC to force all state commissions to detariff the embedded CPE, and to permit it to transfer the equipment to its unregulated terminal equipment subsidiary, AT&T Information Systems (formerly American Bell, Inc.), coincident with the divestiture. The latter organization was originally supposed to be fully separated from AT&T's regulated operations.

Likewise, the divestiture agreement did not change the regulatory disposition of inter-LATA telecommunications services. Although these services are offered by AT&T through its interexchange subsidiaries (rather than the BOCS) , they remain subject to federal and state regulation. In his discussion of the proper valuation of assets for purposes of the divestiture, Judge Greene was explicit about the decree's lack of impact on regulatory authority:

The proposed decree will not in any way disturb the authority of regulators to determine the proper valuation of assets regulated by their jurisdictions. For example, assets used to provide intrastate interexchange service will not be deregulated by the decree but will remain under regulation by the state commissions. These assets may simply be owned by a different corporate entity. [opinion, August 11, 1982, p. 133.]

Besides clarifying the regulatory status of services transferred to AT&T under the terms

of the divestiture agreement, Judge Greene's statement has important implications for regulatory commissions during this transitional period and beyond: the decree does not restrain the authority of state commissions (or the FCC) to accept or reject the valuation of assets and revenue and expense adjustments proposed by AT&T and the BOCs for purposes of the divestiture. Thus, the Commission may find, for example, that for regulatory purposes the value of assets remaining with the Company after the divestiture is not fairly calculated, under the terms of AT&T's Plan of Reorganization, as implemented by the Company and AT&T. If so, the Commission is free to make appropriate offsetting adjustments to the Company's rate base for ratemaking purposes.

Procedures Established for Implementing the Divestiture

The MFJ laid the basic groundwork for implementation of the divestiture and other provisions of the agreement. AT&T was required to submit a plan of reorganization to the Department of Justice within six months after the effective date of the MFJ. Several steps for implementing the terms of the divestiture agreement were mandated. First, the plan contains provisions for the transfer from AT&T to the BOCs of

> "sufficient facilities, personnel, systems, and rights to technical information to permit the BOC's to perform, independently of AT&T, exchange telecommunications and exchange access functions." (P. 2.)

Under the modifications ordered by Judge Greene on August 11, 1982, AT&T was also required to transfer to the operating companies the assets needed to "produce, publish, and distribute" the Yellow Pages.
Second, the plan provides directives for separating the BOCs' "facilities, personnel and books of account" between those used for exchange telecommunications, exchange access and directory functions, and those used for inter-LATA services and other functions, including CPE. Multifunction facilities used in both of these categories cannot be jointly owned by AT&T and the BOCS; however, the plan includes provisions for sharing these facilities through leasing arrangements or some other device.
Third, the MFJ required AT&T's plan of reorganization to include provisions for terminating the License Contracts and Standard Supply Contracts between the BOCs and AT&T (and its affiliates). Fourth, provisions for the actual divestiture, or transfer of ownership, of the separated exchange, exchange access, and directory portions of the BOCs' operations from AT&T to the operating companies were contained in the plan. AT&T submitted its proposed Plan of Reorganization on December 16, 1982. On April 20, 1983, the Court approved the majority of AT&T's proposed LATA boundaries. The remaining provisions of the 471-page Plan of Reorganization were approved by the Court on July 8, 1983, subject to the submission by AT&T of certain modifications required by the Court, which were subsequently provided. The Court formally approved the amended Plan of Reorganization on August 5, 1983. Besides these provisions for implementing the divestiture, AT&T's Plan of Reorganization contains guidelines for the sharing of multifunction facilities by the BOCs and AT&T. Under this plan, contracts are negotiated for each jointly used service or facility. These contracts include monthly charges to be paid by the nonowner of the facility to the owner. The charges are calculated according to a formula set forth in the Plan of Reorganization, and are based on the cost of the service or the facility, including the investment carrying costs.

The Modifications to the Proposed Plan of Reorganization that were Required by the Court in its July 8, 1983 Decision

Although the Court accepted most of the provisions of AT&T's proposed plan, it required changes and/or clarifications in several areas prior to the plan's final approval. The most important modifications were in four major areas. First, the Court noted that the proposed Plan of Reorganization did not directly address the issue of who should pay the costs incurred by the Bell operating Companies for providing "equal access" to interexchange carriers, and to reconfigure their local networks to conform to the new LATA boundaries. Judge Greene determined that under existing jurisdictional separations procedures, "[i]t is ... not certain that the operating Companies will be fully reimbursed through carrier access charges for their equal access and network reconfiguration expenditures." [Opinion, decided July 8, 1983, p. 18.] The Court concluded that because the decree anticipated that AT&T would transfer sufficient facilities to the Operating Companies to ensure equal access; because it now appears that the operating companies will instead have to undertake substantial new construction of their own; and because AT&T has throughout this proceeding assured the Court that access charges paid by the interexchange carriers would be the instrument which would prevent divestiture from causing increases in local rates, it is appropriate that AT&T should bear the ultimate risk if it turns out that its assurances are overly optimistic.

Consequently, in his July 8, 1983 Decision, Judge Greene ordered AT&T to reimburse the BOCs for any costs of equal access and network reconfiguration (including financing costs) which have not been recovered by January 1, 1994 through access charges imposed on interexchange carriers. AT&T subsequently filed a motion for reconsideration, requesting the deletion of that provision. In a Memorandum dated July 28, 1983, the Court denied this motion, but accepted a proviso proposed by AT&T which essentially relieves AT&T of its obligation to guarantee payment of these costs, if the operating companies fail to file carrier access charge tariffs designed to recover all costs included in the guarantee, or if state regulators refuse to adopt such tariffs.

The second important modification in the Court's July 8, 1983 Decision involves the use of the Bell name and logo. Under the plan endorsed by the Department of Justice and AT&T, the BOCs were to have exclusive rights to the Bell logo in the United States, but they were to use it only in connection with exchange telecommunications, exchange access, and directory advertising services; they were to be prohibited from using the logo in the marketing of customer premises equipment. The same restrictions were to apply to the operating companies' use of the Bell name. The BOCs were also required to attach a regional modifier to the Bell name (e.g., Southwestern Bell). In contrast, AT&T was to be allowed to use the Bell name, as well as the phrase "Bell System" on a national scale, as long as the modifier "American" was attached.

In his July 8, 1983 Decision, Judge Greene rejected this plan, concluding that the continued use of the Bell name by both the BOCs and AT&T would "lead consumers to believe that there is a continuing close connection between these entities or, worse, that they are all still components of the same company." (P.35) Consequently, he decided that AT&T should not be permitted to use the Bell name except in the context of Bell Labs and its overseas operations; he also permitted the BOCs to use the Bell name and logo in any CPE operations they chose to initiate.