MITCHELL | HAMLINE School of Law

William Mitchell Law Review

Volume 10 | Issue 3 Article 6

1984

Deregulation and the AT&T Divestiture: A Competitor's Perspective

Robert D. Alton

DEREGULATION AND THE AT&T DIVESTITURE: A COMPETITOR'S PERSPECTIVE

ROBERT D. ALTON†

I. INTRODUCTION

An American need only travel abroad to realize that the United States has the world's best telephone service. After the system has served the American public well for many years, why change it or tinker with it? Before the American Telephone and Telegraph Company (AT&T) divestiture, only members of the telecommunications industry raised this question. Nevertheless, as consumers feel the full effect of telecommunications deregulation and as political pressures on legislative representatives increase, the question will be repeated many times.

The Federal Communications Commission (FCC), the Justice Department, and the judiciary have mandated deregulation and competition in the telecommunications industry.[1] What was formerly one integrated, regulated monopoly system is now divided into three separate businesses: (1) customer premises equipment, including telephones, key systems,[2] private branch exchange equipment (PBXs),[3] and inside wire; (2) local exchange service,

† Mr. Alton is Vice President and Financial Director for the Contel Service Corporation.

1. *See* United States v. American Tel. & Tel. Co., 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom.* Maryland v. United States, 103 S. Ct. 1240 (1983); *In re* MTS & WATS Mkt. Structure, 93 F.C.C.2d 241 (1983) [hereinafter cited as *Access Charge Order*], *recon. granted,* CC Docket No. 78-72, FCC 83-356 (released Aug. 22, 1983) [hereinafter cited as *Reconsideration Order*], *further recon.,* CC Docket 78-72, FCC 84-36 (released Feb. 15, 1984) [hereinafter cited as *Further Reconsideration Order*].

2. A key system is a small switchboard used by many businesses. Key systems often have intercom and telephone capabilities.

3. PBX consists of on-site switching equipment that reduces costs by minimizing the number of lines necessary to handle many calls and telephones. *See* Cornell, Pelcovits & Brenner, *A Legacy of Regulatory Failure,* REG., July-Aug. 1983, at 40-41.

including the cable and central office switching equipment connecting a customer to the telephone network; and (3) the long-distance or toll network. The FCC and the judiciary found competition desirable and beneficial to consumers in both the customer premise and toll businesses. Time will tell whether the local exchange business will be conducive to the introduction of competition.

Realignment of the telecommunications industry is proceeding rapidly. The telecommunications environment for the present and future has been fashioned. AT&T's "natural monopoly" of the past, although well-intentioned, was inconsistent with a free enterprise economy. Nevertheless, it has served this nation's social and economic development well.

AT&T's monopolization of the telephone business occurred by design. In enacting the Communications Act of 1934,[4] Congress foresaw the social and economic benefits of a nationwide integrated telephone network. This monopoly system eliminated unnecessary duplication of equipment and provided quality universal telephone service at an affordable price.

Since the telephone business is labor and capital intensive, huge sums of money were required to build and maintain the telephone network. To provide the universal service mandated by the Act, telephone service had to be affordable. Telephone companies and regulatory agencies usually priced long-distance service and telephone terminal equipment above cost, thereby subsidizing basic local telephone rates and maximizing the number of telephone customers on the network.[5]

This solution, however, also created problems. When a product or service is priced significantly above cost, high profits invite competitors to enter the market, undercut the price, and take away business. This has occurred in the long-distance and customer premise equipment markets.[6] This Essay discusses the impact of

4. *See* 47 U.S.C. §§ 151-609 (1976). *See generally* B. SCHWARTZ, THE ECONOMIC REGULATION OF BUSINESS AND INDUSTRY 2373-546 (1973) (legislative history of the Act).

5. *See Universal Telephone Service Preservation Act of 1983: Joint Hearings before the Committee on Commerce, Science, and Transportation, United States Senate, and the Committee on Energy and Commerce, House of Representatives,* 98th Cong., 1st Sess. 1-2 (1983) [hereinafter cited as *Joint Hearings*]; MacAvoy & Robinson, *Winning By Losing: The AT&T Settlement and Its Impact on Telecommunications,* 1 YALE J. REG. 1, 36 (1983).

6. For a thorough discussion of how market forces have and will affect the communications industry, see Baker & Baker, *Antitrust and Communications Deregulation,* 28 ANTITRUST BULL. 1 (1983).

competition in these markets and suggests appropriate responses for competitors.

II. Customer Premise Equipment

Has competition in the customer premise equipment business benefited the consumer? If consumer benefit means more suppliers and types of telephone terminal equipment, the answer is a resounding yes. In the past, consumers had few, if any, options for suppliers of telephones, key systems, or PBXs. Telephone companies were franchised to offer telephone equipment in their specific service areas. The number of businesses now offering telephone equipment is staggering. For example, there are over five pages of telephone equipment suppliers listed in many major metropolitan yellow pages.

These companies should view deregulation as an opportunity rather than an obstacle. Deregulation has opened new markets with greater potential for growth and earnings. Some companies have made acquisitions that enhance their services and products and increase profitability.

In the wake of deregulation, suppliers of communications equipment must recognize the need to change their attitudes toward their customers. In the past, these companies may have been more concerned about pleasing regulators than customers. Deregulation and competition require that a customers' business not be taken for granted. Quality products must be offered at competitive prices.

As a result of deregulation, communications companies are no longer confined to their franchised service areas. There are new opportunities to sell complete communications systems, including telephone terminal equipment, to major universities, municipal governments, and manufacturers. More companies will now be able to compete successfully with established providers of business systems.

As new markets are entered, suppliers of communications equipment must recognize the need to withdraw from traditional but marginal business endeavors, including the provision, installation, and repair of residential telephones. This market has been the most costly and labor intensive area of the telecommunications business. As telephone companies withdraw from these traditional markets, however, customers will become responsible for the installation and repair of this equipment.

III. COMPETITIVE LONG-DISTANCE SERVICE AND ITS EFFECT ON LOCAL RATES

Competition in long-distance service began in the 1970's when companies such as Southern Pacific Communications and Microwave Communications, Inc. (MCI) entered the market. Before competition, the price of toll service was set on a nationwide average so that a ten minute weekday call traveling one hundred miles cost the same amount no matter where the call originated or was received. Historically, this pricing practice covered much of the telephone industry's largely fixed cost of providing service. High-volume toll users contributed more than the true cost of their use, thereby reducing the price of basic telephone service below its true cost.

Long-distance competitors viewed this subsidization as an opportunity to offer less expensive long-distance service to high-volume customers. The FCC promoted competition by requiring "other common carriers" to pay fees for accessing local exchange company facilities which were lower than fees paid by AT&T.[7]

In its December 1982 Access Charge Order, the FCC ordered a shift in cost from long-distance carriers to local exchange companies over a five-year period.[8] The Access Charge Order would have required local exchange companies to begin charging all customers for access to the interstate interexchange network in January 1984.[9] Initially, the monthly charges would have been $2.00 for residences and $6.00 for businesses.[10] Each long-distance call would have been billed as in the past, but customers would pay the access charge even if they did not use the interexchange network. Toll access charges would have increased during the subsequent years, but interstate toll rates were predicted to decline anywhere from fifteen to forty percent.[11] The frequent user of interstate toll service would have benefited most from this change in

7. *See* United States v. American Tel. & Tel. Co., 552 F. Supp. at 161-62.

8. *See Access Charge Order, supra* note 1, at 284. For a discussion of the affect of the AT&T divestiture on low-income consumers, see Nickolai, *The AT&T Divestiture: For Whom Will the Bell Toll?,* 10 WM. MITCHELL L. REV. 507 (1984).

9. *See Access Charge Order, supra* note 1, at 244. The proposal to charge all customers for access to the interstate interexchange network has received harsh criticism. *See, e.g.,* Wilson, *Telephone Access Costs and Rates,* PUB. UTIL. FORT., Sept. 15, 1983, at 19; *see also Reconsideration Order, supra* note 1, at 6 ("We are aware of the fears of some parties that the flat rate end user charge may itself cause some residential subscribers to disconnect their telephone service.").

10. *See Reconsideration Order, supra* note 1, para. 33.

11. *See Joint Hearings, supra* note 5, at 70.

pricing. The FCC has, however, recently issued an order delaying the implementation of access charges.[12] Nevertheless, the transition to a competitive telecommunications marketplace is likely to result in rising costs for residential customers.

In response to the rising cost of local telephone service, communications companies must invest in new technologies[13] for providing telephone services. These investment programs should include computer applications, digital switching, and fiber optic cable. Digital equipment processes calls faster, requires less maintenance and floor space, and makes sophisticated customer services possible. One of the more significant advantages of digital switching is the ability to provide usage-priced local service, also known as local measured service. Local measured service gives customers the opportunity to control their local telephone bills. With competition shifting costs from toll customers to residential business, the industry must provide an alternative to traditional flat rate pricing.

IV. Conclusion

The transition from a fully regulated business to a competitive environment presents challenges to all telephone companies. The process is painful but exciting. The challenges present new opportunities. To take advantage of these opportunities, the entire telecommunications industry must shrug off its regulatory mentality, increase its flexibility, and become more willing to accept risk. In this posture, the telecommunications industry will work and grow.

12. *See Further Reconsideration Order, supra* note 1, para. 4. For a complete discussion of the FCC access charge, see Brown, Hershkowitz & Banks, *An Analysis of Current Initiatives in the FCC and Congress,* 10 Wm. Mitchell L. Rev. 459 (1984).

13. *See* Hamilton, *Implications for Economic Regulation of Cable Television,* 10 Wm. Mitchell L. Rev. 434 (1984) (discussing new telecommunications technology).