

UNREGULATED ENTERPRISES OF THE
BELL REGIONAL HOLDING COMPANIES

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March 1986

This report was prepared by The National Regulatory Research Institute (NRRI) with funding provided by participating member commissions of the National Association of Regulatory Utility Commissioners (NARUC). The views and opinions of the authors do not necessarily state or reflect the views, opinions, or policies of the NRRI, the NARUC, or NARUC member commissions.

EXECUTIVE SUMMARY

When the Bell Regional Holding Companies were formed as a result of the 1982 Consent Decree most observers were surprised to find that they had adopted elaborate corporate structures and business philosophies in which the provision of regulated telephone service was, in Judge Greene's words, "at best a pedestrian sideline." Regulatory bodies have been struggling to realign their practices in recognition of the new structure of the industry and new competitive realities. In support of this effort NRRI has released several reports¹ on aspects of the divestiture and the emergence of new entities in the communications industry. This report is the latest in the series.

The present report describes the regulatory consequences of the new corporate structures. In particular, it reports on the unregulated enterprises of the Regional Holding Companies; it does not deal with

¹David Chessler, Comments on the NYPSC/NECPUC Investigation of Relations Among Bell Operating Companies, their Regional Holding Companies and the Central Services Organization (Columbus: National Regulatory Research Institute, 1984). David Chessler, "Suggestions for a Sample Project Plan for an Investigation by a State Commissions into Relations Among a Bell Operating Company, the Central Services Organization, and Certain Other Entities," Report to the NARUC Committee on Communications (Columbus, National Regulatory Research Institute, February 28, 1984). David Chessler, Appropriate Strategies for Regulating the Bell Regional Holding Companies and Bell Communications Research, Inc. (Columbus: National Regulatory Research Institute, 1984). Jane L. Racster, Michael D. Wong, Jean-Michel Guldmann, The Bypass Controversy: A New Form of Competition in Telecommunications (Columbus: National Regulatory Research Institute, 1984). Vivian Witkind Davis, Michael D. Wong, Bryan K. Clark, A Review of the Current Status of the Regulation of Shared Tenant Services (Columbus: National Regulatory Research Institute, 1985). Jane L. Racster, The National Exchange Carriers Association (Columbus: National Regulatory Research Institute, 1985). David Chessler and Bryan K. Clark "NRRI Report: State Commissions Scrutinizing Yellow Pages Subsidiaries of the Bell Regional Holding Companies" NRRI Quarterly Bulletin, vol. 7, no. 1 (January, 1986), p. 1. Jane L. Racster, A Survey of State Pooling Arrangements (Columbus: National Regulatory Research Institute, 1986). David Chessler, Changing Directions for Structural and Accounting Approaches to Deregulation (Columbus: National Regulatory Research Institute, forthcoming, 1986).

the activities of the telephone companies except in passing. The report concentrates on present practice, rather than new legislation, although it tries to discern emerging trends. Some commissions and legislatures have reacted to the new situation by exempting the holding company activities and even some telephone company activities from regulation. Others have sought to broaden the powers of the regulatory bodies. These legislative and regulatory initiatives are not discussed, unless they have already been implemented.

The report also discusses in some detail the differing organizations and management styles of the new holding companies, with extensive treatment of the new unregulated and nongermane enterprises. Although it proved impossible to get detailed information about how successfully individual non-telephone company subsidiaries have been competing in the market, no Regional Holding Company claims that its competitive activities are profitable overall.

Information on the activities of the Regional Holding Companies comes from a variety of published and private sources, including a survey of state commissions which NRRI conducted in May through July, 1985. Information on the activities and attitudes of state commissions comes almost entirely from that survey.

For some years the FCC has been following a policy of deregulation in which it requires that the deregulated activities of the telephone companies be placed in a separate subsidiary. This is to reduce the risk that cross subsidy might burden the monopoly ratepayers or injure competitors. The FCC has found ample authority in the Communications Act to regulate holding companies. At times it has formally found them to be common carriers, arguing that they meet the definition of a resale carrier. Although the courts have sustained FCC regulation of firms that are common carriers by resale, they have not reviewed any order in which the FCC formally held a holding company to be a common carrier. The courts have sustained all regulations the FCC has seen fit to impose upon holding companies and non-telephone company affiliates of common carriers, ruling that no company can evade FCC regulation by reorganizing its corporate structure: the FCC can "pierce the corporate veil."

State statutes differ widely. Some state commissions have been successful in using authority over the transfer of public utility assets to influence the creation of subsidiaries by the Regional Holding Companies (as in California). Other commissions have been told that the utility can create subsidiaries without asking permission, but that the commission has discretion as to whether and how it may recognize those subsidiaries when setting rates for the common carrier (as in Minnesota). There have been some complaints (by the New England commissions, for example) that the creation of a multitude of

affiliates increases the complexity and cost of the regulatory process.

Much of the controversy seems to stem from a belief that the unregulated activities should be subsidizing local telephone service. Except for Yellow Pages advertizing where profit margins of twenty-five to thirty per cent are common, few of the new activities seem to have much potential for high profits, even if mechanisms could be established to divert some of the profits for the benefit of the common carrier's monopoly ratepayers. In particular, customer premises equipment (CPE) profits seem to have been illusory for years, with much of the alleged profitability stemming from mechanisms whereby CPE investment was a major vehicle whereby the local telephone companies shared in the profits of interstate toll service. Certainly, there is little evidence that any major segment of the CPE market is now profitable.

In the few instances where state commissions have made formal studies of diversification by the Regional Holding Companies they have found little benefit to the general public. It is perhaps for this reason that NARUC has been unable to proclaim a policy on diversification by telephone companies and their holding companies. NARUC has supported the provision of new services that are offered by the operating telephone companies as part of the telephone network. It has not, to date, supported the provision of services which are related to common carrier telecommunications by corporate affiliates of telephone companies, although NARUC has not opposed such services either. NARUC has not taken any action with respect to affiliates' activities when these are essentially unrelated to telecommunications.

State commission investigations have tended to concentrate on specific actions by the holding companies, although there have been some state commission investigations of the public benefits provided by the Regional Holding Companies and of the need for changes in regulatory practice. The overall investigations have found little public benefit from the creation of the holding companies, and much public detriment in the form of increased costs and complexity of the regulatory process. However, although the investigations that concentrated on individual issues may have found difficulty in accomplishing the solutions the commission initially sought, they have generally been able to find acceptable alternative methods of accomplishing the same effective end.

The provision of procurement and other services to the operating telephone companies by centralized service subsidiaries is not a new phenomenon. Indeed, it is difficult to distinguish the present arrangements from pre-divestiture practice in which service under the "License Fee Contracts" was provided by AT&T's General Departments (and Bell Telephone Laboratories). By the early 1980s the Bell Operating Companies were performing most procurement themselves, rather

than relying upon Western Electric as a jobber as they had in the past, but the use of centralized procurement entities by most of the Regional Holding Companies is a continuation or resumption of a long time practice of the Bell System. Depending on their "affiliated interest" statutes and general investigatory powers, most commissions seem to be finding ways of meeting their regulatory needs despite the new arrangements. However, in some instances this has required litigation or the threat thereof, and in other cases commissions have complained that the cost of conducting rate cases and other investigations has been increased by the new arrangements. If the centralized service subsidiaries begin to provide some services to third parties, an issue will arise of the extent to which cost savings due to the scale of operations caused by the telephone company ought to be repaid to the telephone company in lower prices, and the extent to which the cost savings might properly be appropriated by the holding company for its shareholders.

It is not possible to generalize about the attitude of utility commissions toward telephone company diversification. At NARUC meetings resolutions have passed that support germane diversification by the Bell Operating Companies (that is, for new services provided using the telephone network). However, more general resolutions in support of nongermane diversification by the Regional Holding Companies have not passed. Some commissions or commission staffs have issued reports claiming that utility diversification in general is not in the public interest. Other commission staffs claim that some of the constraints on the Bell Operating Companies make it difficult to sell established services (particularly when customers wish a single-source supplier), and so are not in the public interest.

This report concludes that there are difficulties with the nongermane activities of the Regional Holding Companies, and that the holding company structure makes it more difficult for state commissions to defend the public interest as they see it. It does not conclude that they are insurmountable. Constraints are probably more in the public interest than outright prohibitions. Since the report's subject is the unregulated activities of the Bell Regional Holding Companies, it does not discuss, except in passing, the new and improved services of the operating telephone companies, or whether the telephone companies themselves are competing effectively in the market.

The provision of research services to the Bell Operating Companies by BellCore has been controversial. The provision of such services by Bell Telephone Laboratories before divestiture was similarly controversial. State commissions questioned the true beneficiary of the research: was it the operating companies' ratepayers, or the unregulated manufacturing and other competitive interests of AT&T. An audit by the NARUC Staff Subcommittee on Accounts found some doubtful areas, in which the research appeared to benefit outside manufacturers or potential competitive activities of the Regional Holding Companies

(services that might eventually be offered through separate subsidiaries). Because the massive NARUC audit report is publicly available, only a general discussion is included in this present report. Another reason for not analyzing the BellCore situation in detail is that BellCore has not released its detailed formal response to the NARUC audit.

The Regional Holding Companies appear to be experiencing poor results in the CPE markets. While they are reluctant to talk about details, most of them claim to be emphasizing voice-data integration, which is a market that is not yet showing substantial sales. When pressed for customers' names, the Regional Holding Companies talk about companies to which they sold PBXs, or else which bought some computers in a computer store. As a result, it appears that overall, some ninety-five per cent of the Regional Holding Companies' revenues stem from local telephone services, including Yellow Pages.

Most of the Regional Holding Companies state that they are concentrating on particular niches in the CPE market. Most claim to be concentrating on office automation involving the integration of voice and data. Unfortunately, analysts claim, and some Regional Holding Companies confirm, the market for integrated voice-data communications has not developed as quickly as expected.

Even beyond the matter of the selection of a niche in the CPE market, there are persistent reports that some of the Regional Holding Companies have fragmented their sales forces to such an extent that they were unable to deal with customers effectively. Indeed, in some Regional Holding Companies the CPE subsidiaries were reported to be competing with each other. Other Regional Holding Companies (including Southern New England Telephone) have had to retreat from a national presence to a regional one. In 1985 there were many reorganizations of CPE sales forces in the Regional Holding Companies. If there is a trend, it is for the telephone and non-telephone activities of the Regional Holding Companies to be separated into operating groups, often with a separate subsidiary holding company (like Bell Atlantic Enterprises) to act as corporate overseer of the non-telephone activities.

The holding companies' difficulties selling CPE are such that one cannot conclude that if the separate subsidiary requirements were removed they would immediately increase their share of the market: Sales forces competing against each other, emphasis on integrated voice-data markets which have not had much acceptance by customers, and difficulty in coping with markets which are characterized by extensive price cutting, and thus require much flexibility and careful judgement. Indeed, telephone companies have been very effective in selling CENTREX service, despite restrictions on joint marketing of CENTREX with CPE which are intended to maintain the competitiveness of the CPE markets.

Cellular radio is in an anomalous situation. In some states it is a regulated common carrier activity. In others it is an unregulated competitive activity. Many states have not established their policies on the matter. Because the regulatory status of the cellular subsidiaries has not been determined in many states, although they appear to be telephone companies under federal law and some state laws, the present report, which is on unregulated activities, did not emphasize the cellular subsidiaries. As expected, given the need for substantial investments to provide cellular service and the recent dates of the FCC orders establishing the service, the Regional Holding Companies were just beginning to provide the service at the time of NRRI's survey of the state commissions (leaving little on which to report). Furthermore, the FCC divided the cellular industry into two segments, one firm in each market (or metropolitan area) owned by wire line carriers (generally a consortium of the telephone companies providing service in the area), and one owned by others.

In recent developments, just as this report was being written, some of the Bell Regional Holding Companies sought to acquire interests in the non-wire line cellular carriers outside their service areas. These acquisitions are subject to the approval of the Justice Department, the District Court with jurisdiction over the 1982 Consent Decree, and the FCC which established the two-provider policy, and which must rule on all radio license transfers under the Communications Act. At this writing, the Justice Department has not sought to prevent any of the acquisitions, although it has requested modifications of some of the terms of sale. The District Court has required that the Regional Holding Companies request "waivers" of the provisions of the Consent Decree, and has granted the waivers subject to severe restrictions, in some instances requiring partial divestitures and in others reducing the acquiring RHC to the status of a passive investor. The FCC has not been reported to have ruled on the transfers, or to have imposed its own conditions. Since these events are very recent, and most occurred after this present report was written (but before it went to the printer), the discussion of the most recent rulings is very brief and parts of it appear in different places in the report.

A major area of regulatory controversy has been the practice of most of the Bell Regional Holding Companies of collecting Yellow Pages advertizing revenues through a subsidiary and crediting only a portion of the revenues to the operating telephone company. The present report seeks primarily to explain how the Regional Holding Companies are approaching the Yellow Pages market and what the new developments are in Yellow Pages publishing, including the development of new media. Further detail on individual state actions on Yellow Pages is in another NRRI report.²

²David Chessler and Bryan K. Clark, "NRRI Report: State Commissions Scrutinizing Yellow Pages Subsidiaries of the Bell Regional Holding Companies," NRRI Quarterly Bulletin, vol. 7, no. 1 (January, 1986), p. 1.

Of the divested Bell Operating Companies, only those belonging to Bell Atlantic continue to provide print Yellow Pages directories themselves, including the collection of revenues for print advertising. The remaining holding companies transferred the Yellow Pages function to a non-telephone company subsidiary of the holding company. (The former "Associated Companies" of the Bell System, Cincinnati Bell and Southern New England Telephone, also retain Yellow Pages in the operating company.)

Other Regional Holding Companies provide a portion of the revenues to the operating companies through a contractual arrangement. Despite references in the court orders governing the divestiture to the purpose of retaining Yellow Pages in the Bell Operating Company side of the business (to support local service rates, and because having a plethora of suppliers rather than just a single AT&T would be more competitive), several of the Regional Holding Companies have sought to limit the extent to which the Bell Operating Companies share in the Yellow Pages revenues and particularly in the growth of those revenues. Thus, in NYNEX, BellSouth, Southwestern Bell, and U S West service territories, the Yellow Pages issue has been confrontational. Commissions have taken a variety of approaches, some of which are still in hearing and some others of which are now in litigation. These confrontational approaches include declaring Yellow Pages to be a tariffed service (as in Kansas), requiring the operating telephone company to reacquire Yellow Pages from the other subsidiary (as in Colorado), abrogating the contracts for the provision of Yellow Pages (reportedly in New York), and considering all Yellow Pages revenues when setting rates, regardless of the entity to whose books the Regional Holding Company happened to credit them (in many states, such as Minnesota). Requiring competitive bidding for acquisition of Yellow Pages publishing rights from the telephone company for a period of time is under consideration in some states (such as Wyoming). When it granted Pacific Telesis permission to create a Yellow Pages subsidiary the California Public Utility Commission stipulated that the revenues would be treated as operating income of the telephone company for rate making purposes. (It appears that in most other states the carrier did not require the commission's permission to move Yellow Pages operations to a subsidiary of its parent, but this is still in litigation in some states, such as Colorado.) So far, rulings on Ameritech's contracts hold them to be in the public interest.

In the body of the report there is an extensive discussion of electronic Yellow Pages, both by on-line data basis, and by computer media, such as tapes, flexible diskettes ("floppy disks"), and the new Compressed Digital disks ("CD ROMs"). Publishers of reference works in the print media see CD-ROMs (technically, these are similar to compressed digital phonograph records) as an extension of the normal print media, and are starting to increase rates for such reprint rights. To the extent that electronic editions of the Yellow Pages use the proprietary customer lists of the operating telephone companies, commissions will be concerned as to whether the telephone companies

are selling or leasing the rights to those lists at full market value. Several commissions have already had to evaluate whether telephone companies are receiving appropriate compensation in contracts for use of the lists, including compensation for increases in the values of the lists as advertizing revenues grow, and new media are created.

The competitiveness of the Yellow Pages market is also at issue. Southwestern Bell in particular has been developing new Yellow Pages "products" that compete for advertizing revenues with existing Yellow Pages of other telephone companies. It appears that customers evaluate Yellow Pages and certain other advertizing media as reference works: the more complete the better. Thus, we find that in most cities newspaper classified advertizing is nearly monopolized by one newspaper. We also find that several of Southwestern Bell's competitive ventures in Yellow Pages are in areas where Yellow Pages listings of the established telephone companies are scattered into several books: in New York there are separate business and consumers directories, and in Washington, D.C. separate directories are issued by the three companies serving the metropolitan area. The report concludes that the most complete directory in each market will be the most successful.

Some of the Bell Operating Companies are providing business referrals through directory assistance (Southern Bell) or a new service using WATS (New York Telephone). This, too, competes with both conventional and electronic Yellow Pages.

The effect of this diversification on the Regional Holding Companies is difficult to ascertain. A thorough search of press reports indicated that market analysts for major brokerage houses think that the potential for profitability and growth is greater in the regulated telephone business than in some markets such as CPE. Indeed, many analysts thought that the diversification was depressing the stock prices of the Regional Holding Companies, and statements to the contrary could not be found. Examination of the increase in the Regional Holding Companies' stock prices since divestiture is not conclusive. The nongermane, non-telephone activities of the Regional Holding Companies are only a small portion of the total company (generally less than five per cent, and certainly less than ten per cent). Table 1 summarizes the financial results of the Regional Holding Companies since divestiture. It is not conclusive as to whether the Regional Holding Companies which have been more aggressive at diversifying have had better or worse than average financial results. It is also not conclusive as to how the financial markets have evaluated the diversification as reflected in the stock price. However, as is pointed out in the report, it is sometimes difficult to distinguish between the rhetoric and the reality of RHC nongermane diversification. Particularly in the case of U S West, management's statements give the impression of substantial conglomerate activity, but, except for some real estate investments, it is difficult to find

TABLE 1

FINANCIAL RESULTS OF THE SEVEN BELL REGIONAL HOLDING COMPANIES

Company	Revenues (Billions)		Per Cent Chng.	Earnings Per Share			Return on Equity			1983 Price 12/31	1985 Price 12/1	Per Cent Change in Price	Per Cent Total Return Inc. Div.	
	9/30/84	9/30/85		9 Mos. Ending 1984	9 Mos. Ending 9/30/84	Pct. Chng. 9 Mos.	9 Mos. Ending 9/30/84	9 Mos. Ending 9/30/85	Per Cent Chng.					
Amerit	\$6.2	\$6.7	8.1%	\$10.17	\$8.10	\$8.49	4.8%	15.2%	15.2%	0.0%	\$66	\$99.125	50.2%	64.3%
Bell At	5.99	6.76	12.9%	9.94	7.51	8.25	9.9%	13.5%	14.2%	5.2%	65	99.50	53.1%	68.2%
BellSou	6.99	7.8	11.6%	4.28	3.06	3.60	17.7%	13.5%	14.9%	10.4%	28	44.625	59.4%	73.7%
NYNEX	7.06	7.65	8.4%	10.10	7.66*	7.92*	3.4%	13.78%	14.37%	4.3%	62	91.875	48.2%	63.0%
Pac Tel	5.8	6.3	8.6%	8.46	6.45	7.16	11.0%	13.5%	14.3%	5.9%	56	79.375	41.7%	56.5%
Southwest'n	5.3	5.9	11.3%	9.04	6.78	7.69	13.4%	13.2%	14.2%	7.6%	59	80.25	36.0%	50.6%
U S West	5.4	5.8	7.4%	9.24	6.61	7.23	9.4%	13.1%	13.6%	3.8%	56	83.125	48.4%	63.2%
Average			9.8%				9.9%	13.7%	14.4%	5.3%			48.1%	62.8%

Source: John Mulqueen, "Bell Regional Post Higher Revenues as They Battle into Their Third Year," CommunicationsWeek, November 25, 1985, p. C10.

Morton L. Brown and Daniel A. Burkhardt, "'Baby Bells'--Still Going Strong," Public Utilities Fortnightly, vol. 117, no. 1 (January 9, 1986), p. 41.
Author's Calculations.

*These were misprinted as 2.66 and 2.92 in Mulqueen. They were corrected by the author to the amounts shown.

evidence that an unusual amount of nongermane activity is actually taking place.

Anecdotal evidence that United Telecom's bond rating was lowered as a result of its diversification activities may not be applicable to the Bell Regional Holding Companies, whose diversification is actually limited in amount by the District Court. Financial analysis of the Regional Holding Companies should also compare them to General Telephone, where diversified activities are being balanced by profitable telephone companies. However, the present report has not compared the Bell Regional Holding Companies with the other telephone holding companies, including AT&T, even on an informal basis.

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Foreword

This report was prepared by the staff of The National Regulatory Research Institute (NRRI) using state-provided funding received by the NRRI from participating member commissions of the National Association of Regulatory Utility Commissioners (NARUC). The bylaws of The National Regulatory Research Institute state that among the purposes of the Institute are:

...to carry out research and related activities directed to the needs of state regulatory commissioners, to assist the state commissions with developing innovative solutions to state regulatory problems, and to address regulatory issues of national concern.

This report helps meet those purposes, since the subject matter presented here is of timely interest to regulatory agencies and to others concerned with current developments in the telecommunications sector.

Douglas N. Jones
Director

Introduction

When the Bell Regional Holding Companies (RHCs) were formed in the aftermath of the 1982 Consent Decree many observers were surprised that the RHCs chose elaborate corporate structures with many subsidiaries; surprised, in part, because AT&T and the Bell Operating Companies (BOCs) had been resisting the Federal Communications Commission's (FCC) efforts to force the use of separate subsidiaries for the provision of customer premises equipment and a variety of "enhanced" competitive or potentially competitive services. Indeed, the Regional Holding Companies are still trying to get the FCC to rescind its restrictions even while they are actively creating and acquiring new subsidiaries for a variety of "nongermane" enterprises (that is, activities that are not public utilities or closely related to public utilities).¹

The new corporate structures and nongermane activities of the RHCs forced public utility commissions to reexamine their regulatory practices and powers. Legislatures in several states have considered broadening the powers of the regulatory bodies. In other states holding company activities and even some telephone company activities have been exempted from regulation. It will be some time before regulatory practice stabilizes. Some markets (as economists use the term) that are now thought to be competitive will belie their early promise, forcing regulators to develop new methods to deal with "essential" services offered under near-monopoly conditions (perhaps two firms sharing a market; perhaps one firm retaining most of the

¹For a discussion of the circumstances under which utility managers and regulators will prefer separate subsidiaries or cost accounting techniques, see David Chessler, Changing Directions for Structure and Accounting Approaches to Deregulation, (Columbus: NRRI, forthcoming, 1986). (Hereinafter Structure and Accounting.)

market, with a few small firms competing for a small portion of the business in specialized segments). Other markets will become surprisingly competitive forcing regulators to find ways of "freeing" the public utility firms so the public may benefit from the lower prices and greater variety of services that competition brings.

In 1983 the New York Public Service Commission and the New England Conference of Public Utility Commissioners began an investigation of NYNEX, the Bell Regional Holding Company that controls the New York Telephone Company and the New England Telephone Company. NRRI was asked by the National Association of Regulatory Utility Commissioners' Committee on Communications to comment upon that investigation² and suggest issues and approaches that might be considered by other states contemplating investigations of their own RHCs.³ Later in the year, at the request of the Washington State Legislature, NRRI prepared a report⁴ which extended the earlier analyses by considering the regulatory and legal problems that arise when separate subsidiaries are established by public utilities, whether at the behest of their regulators or their corporate owners and managers.

For its 1985 program year NRRI planned two research projects on the structure of the telecommunications industry. One dealt with new

²David Chessler, Comments on the NYPSC/NECPUC Investigation of tions Among Bell Operating Companies, Their Regional Holding Companies and the Central Services Organization (Columbus: National Regulatory Research Institute, 1984). (Hereinafter Comments on NYPSC/NECPUC.)

³David Chessler, "Suggestions for a Sample Project Plan for an Investigation by a State Commission into Relations Among A Bell Operating Company, the Central Services Organization, and Certain Other Entities," Report to the NARUC Committee on Communications (Columbus: National Regulatory Research Institute, February 28, 1984). (Herinafter "Suggestions for an Investigation.")

⁴David Chessler, "Appropriate Strategies for Regulating the Bell Regional Holding Companies and Bell Communications Research, Inc. in New Directions: State Regulation of Telecommunications: Sympos Proceedings (Olympia: Washington State Legislature, Joint Select Committee on Telecommunications and University of Washington, Graduate School of Public Affairs, 1984); reprinted by NRRI (Columbus: National Regulatory Research Institute, 1984). (Hereinafter "Appropriate Strategies.")

entities in telecommunications markets. Under this aegis NRRI has published a report on state regulation of "smart buildings" (shared tenant services),⁵ and will release a series of papers on the economic theory applicable to telecommunications markets that are, in various degrees, competitive. The second project dealt with the Bell Regional Holding Companies, and includes the present report, a report on "Yellow Pages,"⁶ a comprehensive discussion of the use of accounting separations and separate subsidiaries for regulation (forthcoming)⁷ and reports on the National Exchange Carriers Association and the several state exchange carriers associations.⁸

The present report is intended as a recounting of the ways in which the seven (or nine⁹) Bell RHCs have organized their businesses and the extent to which they have chosen to engage in nongermane activities. It then describes the reactions of the state commissions to what the RHCs have done, with particular attention to the

⁵Vivian Witkind Davis, Michael D. Wong, Bryan K. Clark, A Review of the Current Status of the Regulation of Shared Tenant Services (Columbus: National Regulatory Research Institute, 1985). (Hereinafter Shared Tenant Services.)

⁶David Chessler and Bryan Clark, "NRRI Report: State Commissions Scrutinizing Yellow Pages Subsidiaries of Bell Regional Holding Companies," NRRI Quarterly Bulletin, vol. 7 no. 1 (January, 1986). (Hereinafter "Yellow Pages.")

⁷Chessler, Structure and Accounting.

⁸Jane L. Racster, The National Exchange Carriers Association (Columbus: National Regulatory Research Institute, 1985), and Status Report on Intrastate Pooling Arrangements and Alternative Toll Revenue Distribution Mechanisms (Columbus: National Regulatory Research Institute, 1986).

⁹Although they are not Bell Regional Holding Companies created to the 1982 Consent Decree, Cincinnati Bell and Southern New England Telephone (SNETCO) share many of the characteristics of the RHCs. Study of these two companies is instructive: although they are smaller than the other RHCs, they are free of the "line of business" constraints, so their activities may foreshadow the actions of the other RHCs as the others succeed in getting the constraints lifted. This foreshadowing is discussed in more detail below. Charts of corporate structures of the seven RHCs, Cincinnati and SNETCO are included as figures 1 through 9. Because of their bulk and the need to refer to them frequently, they are grouped in appendix A.

regulation or surveillance of corporate structure and intersubsidiary revenue flows, and the imputation of revenues from some nonutility subsidiaries to offset portions of the utility's revenue requirement.

The information on industry structure in this report comes from a combination of public and private sources. Originally it was intended to come mostly from analysis of annual reports to shareholders and Securities and Exchange Commission annual reports 10-K, and these are, indeed, primary data sources. However, the activities of the RHCs are changing so rapidly that we supplemented these public sources with review of announcements in trade publications like Telecommunications Reports and CommunicationsWeek, and conducted a survey¹⁰ of staff members of state commissions who deal with RHC matters. Originally, we had contacted the RHCs directly to get the annual reports and forms 10-K, but this approach proved so inefficient and cumbersome¹¹ that we were forced to photocopy the reports and forms in The Ohio State University's library¹² and obtain other information indirectly through regulatory commissions.

Nor has our difficulty in obtaining regulatory information about the RHCs been unique. Southwestern Bell unsuccessfully appealed the Texas PUC's order requiring filings on "affiliated interests," and the PUC was in the process of trying to obtain a contempt citation when a settlement was negotiated.¹³ There have been reports of similar

¹⁰The survey results are summarized in tables in appendix C and the survey form itself is in appendix B.

¹¹American Transtech, transfer agent for the RHCs, repeatedly stated it had mailed public documents. None ever arrived.

¹²We got a great deal of help from staff members at NARUC member commissions, for which we are grateful. We supplemented this help with commercial document services.

¹³Southwestern Bell's original pleading claiming that the filings would "expose business plans of its unregulated affiliates" was accepted by a hearing examiner, whose order was then overturned by the commission. The out-of-court settlement ultimately negotiated provides for omission of certain proprietary business information from the filings. "Bell Reaches Agreement with Texas PUC on New Ventures Information," State Telephone Regulation Report, October 24, 1985. p. 11.

occurrences involving other carriers including U S West. Indeed, a U S West attempt to overturn an FCC order requiring it to submit capitalization plans for unregulated operations (on the grounds that U S West is not, itself, a common carrier) was rebuffed by the U.S. Court of Appeals for the Seventh Circuit, which held that there was a legitimate regulatory interest¹⁴ so that although the commission lacks "comprehensive authority over holding companies"¹⁵ it is a "necessary and proper" action under 47 USC 154(i).¹⁶ As discussed elsewhere herein, there are several RHC challenges pending to the FCC's powers to investigate, require reports, and set conditions on RHC diversification. The new, post divestiture, lack of cooperation on the part of the BOCs has been remarked on by others: "[u]nfortunately, the BOCs would not release much of their data, so information had to be obtained primarily from other consultants. '[The BOCs] hear "NATA" and you can kind of hear the mental doors slam'."¹⁷

Information on the actions of the state commissions is taken entirely from the questionnaire NRRI distributed. Despite the expected difficulties in getting the questionnaire into the hands of the "right" respondent,¹⁸ NRRI got responses from some forty of the fifty-one state

¹⁴"...[T]o make sure that the equipment subsidiaries are not undercapitalized so that they do not become a drain on telephone company revenues.... The Commission has a legitimate interest in discovering whether the regional companies are using revenues from regulated telephone operations to support their unregulated equipment businesses." North American Telecommunications Association v. FCC, U.S.C.A. Seventh Circuit, 84-2216, 84-2853, 85-1425 (August 27, 1985), Slip Opinion, p. 18.

¹⁵Ibid.

¹⁶Ibid., p. 19.

¹⁷Peter Meade and Fredric Paul, "Interconnections," Communications-Week November 19, 1985, p. 47, contrasting the attitude of the BOCs with "manufacturers, all the big interconnects, and the top three or four independent telcos."

¹⁸Several of the questions asked whether certain services or activities were "regulated." Respondents were free to interpret "regulated." Some interpreted it to mean "tariffed," others to mean "subject to rate base rate of return regulation," still others to mean "offered by the regulated telephone company," and yet others

commissions that have jurisdiction over the telephone industry. Where we learned of commission dockets that would deal with jurisdiction over, regulation of, or recognition of revenues of the RHCs or nontelephone subsidiaries, we made arrangements to obtain copies of the decisions when they are released. These will be summarized in the NRRI Quarterly Bulletin.

The Intent and Effect of the Divestiture

The stated intent of the divestiture in the 1982 Consent Decree was to divide the telephone industry into two segments, one competitive or potentially competitive, and one monopolized and not potentially competitive. Very early, some critics suggested that competition in some portions of the "long distance toll" business (which had been retained by AT&T) might be very slow to develop, if it developed at all, while some portions of the "local exchange" business, retained by the Bell Operating Companies, might show fairly substantial amounts of competition in the near future. And, indeed, we were immediately inundated by the controversy over "bypass," a term that really means "competition in the provision of some service formally a monopoly of the telephone company." Simultaneously we were treated to the spectacle of the FCC attempting to further "level the playing field" for message toll services by randomly allocating customers who had not made an "election," presumably on the theory that the elaborate "equal access" provisions of the Consent Decree, which were causing billions of dollars in added and accelerated investments for local telephone companies, were not leading to "sufficiently competitive" toll markets "fast enough."

In fact, the Bell Regional Holding Companies quickly became active

interpreted "regulated" to mean "considered by the commission in determining the revenue requirement of the regulated telephone company." We have not generally tried to reconcile these definitions, except in one instance where a staff member used the term "regulated" in one of the latter two senses, and a commissioner, obviously using the term in one of the more restrictive senses, objected.

in competitive markets.¹⁹ The station equipment market appears to be relatively competitive (although market shares of the leading firms are high enough so that the Federal Trade Commission-Justice Department merger guidelines would appear to require that it be treated as "highly concentrated," and prohibit most mergers as tending to have anticompetitive effects).²⁰ Moreover, some have entered such competitive markets as the publication of business directories, and the retail sale and servicing of computers, either by starting new ventures or acquiring existing firms. Indeed, some of these ventures and acquisitions are in foreign countries. The arguments in favor of these ventures and acquisitions fall into two broad categories, both of which are versions of "economies of scope": these are natural extensions of existing activities and provide better utilization of plant, personnel and other resources; or these are markets that seem to be potentially related to future telecommunications markets (particularly information services and customer premises equipment) so there may be some future advantage to the activity even if none is apparent at present.

Advantages and Disadvantages of Competitive Activities of Utilities and their Holding Companies

The disadvantages of the entry of public utilities or public utility holding companies into competitive markets are twofold: competitive markets are more risky, raising the cost of capital to the firm and its customers; and resources, financial and even intangibles

¹⁹Southern New England Telephone (SNETCO) had begun to expand outside its service area, particularly for the provision of customer premises equipment (CPE) even before divestiture, and became fully active shortly after the Consent Decree was announced. Study of SNETCO's experience is particularly instructive, since in most respects it predates the other RHCs by about a year. An important difference between SNETCO (and Cincinnati Bell) and the seven RHCs that were created by divestiture is that the seven RHCs have many restrictions on their activities (particularly in toll, computer and "enhanced" services) stemming from provisions of the Consent Decree; these limitations do not apply to AT&T, SNETCO and Cincinnati Bell.

²⁰See Chessler, Structure and Accounting.

like management attention, are diverted, leading to poor service for the utility's customers. The argument that these competitive ventures are extraordinarily profitable and provide some "contribution" in support of monopoly services is sometimes made, but does not appear to be valid generally. For the competitive ventures to support monopoly services in any way some portion of their revenue would have to be considered operating revenue of the utility and applied against the revenue requirement. This is not being done by state commissions except in a few cases such as "Yellow Pages" revenues that had been treated as operating revenues in most jurisdictions for almost a decade before the divestiture and reorganization. Alternatively, the competitive activity and the monopoly activity would have to share some resource without increasing the amount of the resource required, thus reducing the monopoly revenue requirement. Again, this is rare, since most of the competitive activities are being offered through subsidiaries. The allegedly increased profitability of the competitive activities is unlikely to decrease the cost of capital to the enterprise, since economic theory maintains that in financial markets increased profitability occurs as a payment for increased risk or market power.

On the whole, commission experience with diversification by public utilities has not been good. The abuses of the 1920s led to the passage of the Public Utility Holding Company Act of 1935 which effectively forbade nongermane activities and vertical integration²¹ of electric utilities.²² With the merger movement of the 1960's came a flood of new abuses in regulated industries, primarily transportation

²¹When a firm is a major supplier of a subsidiary or parent corporation they are said to be "vertically integrated."

²²The classic treatment of the pre-1935 situation is James C. Bonbright and Gardiner C. Means, The Holding Company: Its Public and Its Regulation (New York: McGraw Hill, 1932). A good early treatment of the act is Robert H. Tucker, "The Public Utility Holding Company Act of 1935: Its Background and Significance," Southern Economic Journal, vol. iv, no. 4 (April, 1938), pp. 423-438.

and banking.²³ The Interstate Commerce Commission was forced to ask Congress for authority to regulate rail holding companies, and scrutinize transactions between railroads and other firms.

In telecommunications similar problems had not arisen. While there were some anticompetitive uses of market power by utilities, the financial abuses that led to poor service, high rates and bankruptcy of other utilities did not occur.²⁴ However, on April 20, 1982, Bell Canada restructured itself into a holding company with regulated and unregulated subsidiaries, effectively placing the unregulated activities outside the scope of regulation. In November, 1982 AT&T released its Reorganization Plan,²⁵ but it was not until afterwards that it was learned the extent to which the Regional Holding Companies would have similar structures, and, more importantly, seek to diversify into unregulated activities.²⁶ Controversy arose because some

²³See Manley R. Irwin and Kenneth B. Stanley, "Regulatory Circumvention and the Holding Company," Journal of Economic Issues, vol. vi, no. 2 (June, 1974).

²⁴See Chessler, "Appropriate Strategies," pp. 3-11.

²⁵AT&T, Plan of Reorganization, U.S. v. Western Electric Company, Inc. and American Telephone and Telegraph Company, Civil Action 82-0192, U.S. D.C. D.D.C., December 16, 1982.

²⁶AT&T, Information Statement and Prospectus, November 8, 1983, the document that conveyed information to shareholders about the stock distribution, described the new structures, long after the reorganization plan was approved on July 8, 1983. U.S. v. Western Electric Co., Inc., 569 F. Supp. 1057 (D.D.C. 1983). The RHCs' creation of subsidiaries for activities such as Yellow Pages, previously offered by the BOCs directly, is shown in this document. There is no indication, however, that the RHCs intended to engage in competitive activities other than the "exchange telephone service" to which the Consent Decree restricted them. The extent of the non-germane activities was hinted in some waiver motions late in 1983, but the full extent did not become apparent until a few weeks after the divestiture on January 1, 1984. As Judge Greene later said "No one connected with the negotiation, the drafting, or the modification of the decree envisioned that the Regional Holding Companies would seek to enter new competitive markets on a broad scale within a few months, let alone a few weeks, after divestitu[r]e [T]his court ... did not have the slightest belief or intention that ... the Regional Holding

activities which had previously been performed by operating telephone companies had been moved to direct subsidiaries of the holding companies, and perhaps from regulatory purview.²⁷ From the Federal perspective, the situation was not so serious. The FCC was following a policy of deregulation, anyhow. Furthermore, the FCC found ample powers in the Communications Act to regulate the activities of a holding company in the GTE case.²⁸ Indeed, recent court interpreta-

Companies would seek to transform themselves from custodians of the nation's local telephone service into conglomerates from which such services was as best a pedestrian sideline." U.S. v. Western Electric Co., Inc., 592 F. Supp. 846 (D.D.C., 1984), pp. 858, 859.

²⁷Chessler, Comments on NYPSC/NECPUC, "Suggestions for an Investigation," and "Appropriate Strategies." The New Directions: State Regulation of Telecommunications: Symposium Proceedings volume contains many papers on how state commission powers would have to be revised and enhanced to deal with the new structures. It should be pointed out that commissions in Delaware, the District of Columbia, New Jersey, Virginia, and West Virginia were reported to be holding that germane activities (such as Yellow Pages) are part of the operating company for consideration in rate cases, regardless of their position in the formal corporate structure. (See survey responses.)

²⁸As discussed elsewhere herein, the FCC held GTE, the holding company, to be a common carrier, similar to a resale carrier, and subject to section 214 of the Communications Act (the certificate of public convenience and necessity). The FCC's detailed justification for finding common carrier status for GTE is in Application of GTE Corporation to Acquire Control of Telenet Corporation, Memorandum Opinion and Order, 72 FCC 2nd 91 (1979) ("GTE-Telenet"). this order was never appealed. A similar determination that U S West and the other RHCs are common carriers was recently before the courts which ruled that, since the FCC has power to do what it did (mainly require reports) under the sections of the Communications Act, the courneed not find whether the FCC had, indeed, found the RHCs to be carriers. See Consolidated Application of AT&T for Transfers fo Interstae Lines, Memorandum Opinion and Order, 98 FCC 2nd 141 (1984), pp. 146, 152, 153 ("Consolidated Application"). See also Policy and Rules Concerning the funishing of CPE, Enhanced Services and Cellular Communications Services, CC Docket 83-115, Report and Order, 96 FCC 2nd 1117 (1983), pp. 1118 n. 3, 1146-1147 (subjecting the RHCs to common carrier rules), and 1151-1152 (ordering clause applying sections of the Communications Act [47 USC 154(i), 154(j), 201-205, 214, 220, 221, and 403] which apply to common carriers but not those [47 USC 215, 218, 219] which apply only to holding companies). (Hereinafter "CPE Policy.") The rulings of the court are discussed below.

tions of the FCC's powers have been so broad as to permit the FCC to substantially insulate telephone utilities from the nongermane activities of their holding companies.²⁹ Some states may lack comparable authority, but legislatures could find ways to grant it.³⁰

We now find the District Court which has jurisdiction over the Consent Decree wrestling with the question of whether to permit the RHCs to engage in these nongermane and competitive activities, particularly when it has been alleged that there has been a significant decline in the quality of telephone service since the divestiture.³¹ RHCs argue that the quality of telephone service is not a concern of the Court. Without getting into the question of the Court's jurisdiction in matters of regulated telephone services, if unregulated activities of the Regional Holding Companies are affecting regulated services, the Court may be the only body with jurisdiction over the unregulated activities, except for whatever implied jurisdiction the FCC or state commissions may find.

Thus it is the court that has been petitioned to restrict the nongermane activities of the RHCs, limiting their nongermane revenues to ten per cent of their revenues from the telephone business,³² and perhaps preventing them from offering common carrier cellular service outside their regular service areas.³³ The precise interpretation of

²⁹For a discussion of the breadth of FCC powers in a related context, see Richard McKenna, "Preemption under the Communications Act," Communications Law Journal, vol. 37, no. 1 (January, 1985), pp. 1-69.

³⁰See the discussion herein of the powers the FCC has claimed and courts supported. Also see Chessler, "Appropriate Strategies," pp. 13-17, 53-66; and Honorable Stanley York, "Proposed Telecommunications Legislation," in New Directions: State Regulation of Telecommunications, pp. V-1 to V-11.

³¹U.S. v. Western Electric Corp., 592 F. Supp. 846 (D.D.C. 1984). pp. 861-863.

³²U.S. v. Western Electric Corp., 593 F. Supp. 846 (D.D.C., 1984). p. 872.

³³Anna Zornosa, "Judge Greene Tells BOCs He Will Not Ease Restrictions," CommunicationsWeek, January 20, 1986, p. 1.

the restriction on "nongermane" activities has become controversial, since some of the activities the RHCs now consider nongermane may be subjected to utility regulation (cellular radio and, perhaps, shared tenant services come to mind), and others may be counted by some operating telephone company--the BOC (Yellow Pages comes to mind, but many other examples might be found). Furthermore, many of the nongermane activities are "startup" situations or otherwise unprofitable, so a revenue criterion is even harder to apply. (The unprofitability is substantial; Bell Atlantic reported that its competitive sector as a whole has lost money this year [when comparing this with results of other regional holding companies, all of which appear to be losing money on nongermane activities, note that Bell Atlantic did not put Yellow Pages and some other profitable activities into its competitive section].)

One major reason for undertaking this study is that the RHCs have shown a remarkable divergence in their strategies. Some have engaged in a wide variety of acquisitions and joint ventures. Others have preferred to extend existing activities into new fields. And some have done both. A state commission, in viewing some action of another commission for possible adaptation, should be aware of the differences among the RHCs, information that is difficult to acquire in any systematic way.

The Current Controversies with Respect to Structure and Activities of the RHCs

The present controversy over the structure of the RHCs involves their transfer of new ventures, traditional but nontelephone ventures, and even some telephone ventures into firms which are, nominally at least, beyond the reach of state regulatory commissions. The best known of these situations are the ones involving Yellow Pages and customer premises equipment, where activities that were ordered retained by the operating companies so that the revenues might support local rates were transferred to the regional holding companies where

any benefits redound to the shareholders.³⁴ While Yellow Pages is a historic "cash cow," with no significant competition in prospect, the profitability of CPE has always been doubtful³⁵ and appears a particularly poor prospect in today's more competitive environment.³⁶

The controversies over the new activities are twofold: they involve the diversion of RHC resources into activities which are not traditional for communications common carriers, which are outside their service territories and even overseas; secondly, where such expansions have occurred through acquisition the controversy as to whether risk to the ratepayer (particularly risk of diminished service quality) is being increased becomes particularly troublesome.

The third major controversy occasioned by the new RHC structures is the possible increase in certain headquarters expenses and the transfer of some activities such as purchasing, which were customarily

³⁴RHCs have claimed that this organization protects the telephone companys' ratepayers against the greater risks of inherently competitive activities. (See NYNEX response quoted in Chessler, Comments on NYPSC/NECPUC, pp. 34-35 and appendix page labeled "FILE NET #13." In fact, the structure appears to increase cost to the ratepayers (increased risk and volatility raise the cost of equity capital) compensating benefit (an appropriate share of the profits). "Standard and Poors" has downgraded United Telecommunications, Inc.'s notes, debentures, and preferred stock. The rating agency said that while United's regulated telephone operations remain financially strong the financing of the US Telecom subsidiary represents 'a growing for the parent and 'meaningfully raises United's overall risk'. "on the News," Telecommunications Reports, vol. 51, no. 36, September 9, 1985, page 34. (Emphasis in the original.) Evidence as to the way the financial markets view RHC diversification is discussed below. Only Bell Atlantic lets the telephone companies continue to provide directory advertising.

³⁵Economic Implications and Interrelationships Arising from Customer Interconnection, Docket 20003, 61 FCC 2nd 766 (1976), pp. 850-853, and 855-857 citing studies in New York, Vermont and Massachusetts, including the carriers' own EDC studies. See especially paragraphs 212 and 221 which conclude that CPC is being subsidized by other services.

³⁶Laurel Nelson-Rowe, "Two Years of Hard Lessons: Sonecor Cuts Back OA Effort after Stalled Push," CommunicationsWeek, August 26, 1985, p. 1, citing more competition and price cutting than expected. The issue of competition in the CPE market is discussed in more detail below.

done by operating companies, into headquarters groups. These problems do not differ in nature or degree from previous situations involving captive manufacturer and supply units or "license fee contracts" and precedents for appropriate state commission handling are decades old.³⁷

It is in the area of new activities that the RHCs show the greatest differences. Bell Atlantic has had a very active acquisition program, purchasing subsidiaries in the cellular radio, computer and CPE markets. Pacific Telesis has been doing the same. Both these companies have been active abroad, Bell Canada with its MAI computer retail chain in Canada, and Pacific Telesis with its Incomnet unit providing communications consulting in India and China.³⁸ An intermediate case is Southwestern Bell, which has acquired directory publishing operations from Contel and others, and is publishing directories in under contract to Telecom Australia.³⁹ Southwestern Bell is the only RHC to announce the publication of a competitive "Yellow Pages" directory in the territory of another telephone company.⁴⁰ As discussed below, Southwestern Bell had had the most

³⁷See Chessler, "Suggestions for an Investigation," p. 13.

³⁸"BOC Monitor," CommunicationsWeek, September 9, 1985, p. 10. "Incomnet" comes from Pacific Telesis' International "Intelligent Communications Networks."

³⁹John Mulqueen, "SW Bell Buys Directory Firm from Contel for \$120 Million," CommunicationsWeek, July 15, 1985, p. 1. Southern New England Telephone, as noted elsewhere, began its expansion a year earlier than the other RHCs. Like most of the other RHCs its expansion has been primarily internal, but unlike most of the others it attempted to become national rather than remain regional. (It has recently reverted to regional operations.)

⁴⁰It will be distributed to all residents and business in GTE's service territory in Pinellas County, Florida (St. Petersburg, Clearwater Tarpon Springs). "Notes in the News," Telecommunications Reports, vol. 51, no. 44 (November 4, 1985), p. 43. Southwestern Bell's purchase of the assets of New York Yellow Pages, Inc. a publisher of neighborhood "blue book" directories and trade-specific "Yellow Pages" may also represent additional competition for NYNEX's Yellow Page if Southwestern Bell Publications is able to put more

successful Yellow Pages operations of the BOCs prior to divestiture, and Yellow Pages advertizing is the most rapidly growing of the major media, with high profit margins of twenty-five to thirty per cent. Most of the other RHCs have been sticking closer to their service territories, and growing internally.

The RHCs seem to be finding a niche in the integrated voice-data portion of the CPE market. The size and growth of this market segment, and the effectiveness to date of the RHCs' approaches, are discussed below. Briefly, there is less customer interest than the RHCs had hoped, and some authorities think the RHCs have not approached the CPE market effectively.

A Digression on Offshore Activities

Prior to 1925 AT&T was quite active overseas, establishing telephone companies and manufacturing plants in Britain, Belgium and elsewhere. In that year it arranged an exchange of properties with ITT, whereby ITT got AT&T's foreign properties (hence ITT manufactures "Bell Telephone" equipment in Belgium), and AT&T got ITT's domestic telephone operations.⁴¹ Since then AT&T has not been active internationally, marketing Western Electric products through ITT⁴² until recently, and divesting itself of its holdings in Bell Canada over a period of years culminating in 1972. In view of AT&T's long history as a purely domestic company, regulators and others were surprised when a few of the divested Bell Regional Holding Companies showed interest in foreign markets.

resources into the operation than New York Yellow Pages, Inc. could. See "Southwestern Bell Publications Buys New York Yellow Pages, Ups Involvement in Venture," Telecommunications Reports, vol. 51, no. 33 (August 19, 1985), p. 8. Through acquisitions Southwestern Bell now has directory publishing operations in forty-five states. "SW Bell Unit Acquires Another Directory Company," CommunicationsWeek, October 14, 1985, p. 50.

⁴¹Anthony Sampson, The Sovereign State of ITT, (Greenwich, Conn.: Fawcett Crest, 1974), pp. 23, 101.

⁴²Sampson, ITT, p. 23.

If foreign operations, whether consulting, construction, or operational in nature, were purely peripheral to the principal business of the RHCs, and were clearly undertaken as "targets of opportunity," there might be less cause for regulatory concern. However, the Pacific Telesis Incomnet subsidiary appears to be exposing its parent to the high risks of the very volatile international consulting, contracting and construction markets, while Bell Atlantic's MAI Canada subsidiary is a permanent overseas operation. Even apart from the inherent risks of the businesses these companies are in, by their location they expose their parents to risks of exchange rate fluctuations: if the subsidiaries attain any substantial size this can only raise the cost of equity to the parent.

Apart from the exchange rate matter, which is an "insurable" risk, the main objections to the RHCs engaging in overseas operations appear to stem from unfamiliarity and preconceptions ("Bell is domestic only"), and the particularly high risk of some of the activities.

FCC Regulation of the RHCs

The FCC has power to regulate telecommunications holding companies. There are three principal sources of this power:

1. The FCC has direct power to investigate and require reports of holding companies, stemming from sections 215, 218, 219, 221 and 222 of the Communications Act (47 USC 215, 218, 219, 221, 222).⁴³ Section 4(i) allows the FCC to make and enforce rules pertaining to these powers. The full scope of these powers, while obviously substantial, is unknown since in most recent matters the FCC has chosen to exercise other powers.
2. The FCC has substantial "ancillary" power under sections 1 and 301 of the Communications Act (47 USC 151, 301). While it has been relying on these sections more for setting the pattern of regulation of common carriers than of holding companies, the FCC's seeming ability to use section 1 in particular to prevent state commissions from acting in ways that sections 2(b) and 221(b) (47 USC 152(b), 221(b)) seem to reserve to the states suggests

⁴³Section 222 applies to "record" carriers. In addition to Western Union, it might apply to some specialized and value added carriers.

that the FCC would be able to find in its general mandate⁴⁴ sweeping authority over holding companies as well.

3. The FCC has held that telecommunications holding companies, or at least those that derive a substantial portion of their revenues from ownership of communications common carriers, to be themselves common carriers.

It is the third approach, that of determining telecommunications holding companies to be common carriers, that the FCC has been relying upon for regulatory purposes. Thus, this brief discussion of recent FCC actions with respect to investigation and regulation of the Bell RHCs will concentrate on the FCC's finding holding companies to be common carriers.

The GTE-Telenet Decision

In 1979 GTE Corporation, a holding company owning several communications common carriers, a "service corporation" and some equipment manufacturing companies which did business as suppliers to those common carriers, sought to acquire Telenet Corporation, the parent of Telenet Communications Corporation, a common carrier. Neither GTE Corporation nor Telenet Corporation did itself provide communications services, and neither thought itself to be a common carrier. Nonetheless, the FCC held them to be common carriers, saying "[o]ur decision to require GTE and Telenet to file a Section 214 application and secure our approval before consummating the merger of a wholly owned subsidiary of GTE, of GTE, and Telenet, the parent of

⁴⁴"For the purpose of regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges ... and for the purpose of securing a more effective execution of this policy by centralizing authority ... and by granting additional authority with respect to interstate and foreign commerce in wire and radio communication...."
47 USC 151.

Telenet Communications Corporation, a certificated common carrier was based on an examination of the actualities of the transaction."⁴⁵

In its order on reconsideration quoted above, the FCC found that

... the Commission ... has interpreted "carrier" in the context of Section 214 to include persons seeking to enter the resale communications field.... GTE is a "carrier" in the sense in which that term has been consistently employed with respect to resale communications [and] [i]t is beyond dispute that our present policy would require GTE, if it were to enter the resale market directly or through a subsidiary, to file an application pursuant to Section 214 of the Act.⁴⁶

The FCC went on to claim that

Congress made the exercise of FCC jurisdiction turn upon direct and indirect control rather than corporate fictions.... Thus, [GTE] urges that GTE Corp. is not a "carrier" ... because it does not provide common carrier services itself, ... that it is not acquiring Telenet's facilities but only the ownership of the corporation itself; and that it will not operate Telenet's facilities because Telenet will remain a separate corporation.... It is legal sophistry to argue (1) that GTE, a company with over \$4 billion in telephone revenues is not a "carrier" because all of its revenues are derived through subsidiaries and the company itself has no assets, and (2) that a company does not acquire the assets of another company when it acquires all of its stock....

⁴⁵Application of General Telephone & Electronics to Acquire Control of Telenet Corporation, Memorandum Opinion and Order, 72 FCC 2nd 91 (1979). ("GTE-Telenet.")

⁴⁶GTE-Telenet, 72 FCC 2nd 91 (1979), pp. 95, 96, citing Resale and Shared Use, 60 FCC 2nd 261 (1976), p. 316. The definition of resale is *ibid.* pp. 271-274. "Value added" and "resale" carriers need not own facilities or have radio licenses; indeed, the FCC states that "brokers do not take actual control of the leased facilities (*ibid.*, p. 27) but "processors" do (*ibid.*, p. 274). The FCC noted that Western although regulated as a common carrier, was for the most part a "reseller" of facilities leased from the Bell System. (*ibid.*, pp. 266, 297 n. 73). This circumstance may provide a precedent for state commissions which have regulated Western Union even though it did not own physical facilities in the state.

[the FCC] is not free to "disregard [the] ... actualities in such intercorporate relations."⁴⁷

The FCC found that the "courts have repeatedly recognized that the" definition of "carrier" in 47 USC 153(h)⁴⁸ is "circular and unhelpful."⁴⁹ The FCC then analysed the legislative history of Section 3(h), incorporating by reference its discussion in Resale and Shared Use.⁵⁰ The FCC examined the legislative history of Section 214, and argued that it is broader than Section 1 (paragraphs 18-22) of the Interstate Commerce Act, from which it is derived.⁵¹

The FCC's extensive discussion of its powers over holding companies and the applicability of various sections of the Communications and Interstate Commerce Acts to particular factual situations may be relevant to some state commissions. So, too, may be

⁴⁷GTE-Telenet, 72 FCC 2nd 91 (1979), pp. 95-96, quoting Rochester Tel. Corp v. U.S., 307 US 125 (1939) and GTE's "Reply Memorandum in Support of Motion to Dismiss for Failure to State a Claim Upon Which Relief Can Be Granted," ITT v. GTE, (No. 2754, U.S.D.C., Hawaii): "The fact that GTE is a holding company did not prevent it from being subject to the jurisdiction of the ICC prior to 1934 and does not now prevent it from being subject to the jurisdiction of the FCC" (p. 23).

⁴⁸"'Common carrier' or 'carrier' means any person engaged as a common carrier for hire, in interstate or foreign communication by wire or radio ... except where reference is made to common carriers not subject to this Act; but a person engaged in radio broadcasting shall not, insofar as such a person is so engaged, be deemed a common carrier."

⁴⁹GTE-Telenet, 72 FCC 2nd 91 (1979), p. 97, citing NARUC v. FCC, 525 F. 2nd 630 (D.C.C., 1976), cert. denied 425 U.S. 992 (1976), NARUC v. FCC, 533 F. 2nd 601 (D.D.C., 1976).

⁵⁰60 FCC 2nd 261 (1976), pp. 305-307, noting that the decision to regulate resale carriers was affirmed on appeal. AT&T v. FCC, 572 F. 2nd 17 (Second Circuit, 1978).

⁵¹GTE-Telenet, 72 FCC 2nd 91 (1979), p. 99, quoting extensively from General Telephone Co. of the Southwest v. U.S., 449 F. 2nd 846 (1971).

the FCC's admission that "we have often proceeded 'under Section 214 and/or Section 310, without always stating clearly which [we were] relying on'."52

FCC Application of Common Carrier Regulation to the
Bell Regional Holding Companies

Although the FCC's actions in the GTE-Telenet merger were never appealed, the FCC considers them to be settled. More recently, the FCC has been consistent in holding the Bell Regional Holding Companies to be Common Carriers. These holdings have been appealed, and the results, while generally supporting the FCC's requirements, have not clearly supported the common carrier status of the RHCs as the basis for the FCC's actions.

In 1983, reconsidering the application of the separate subsidiary requirements for CPE, Enhanced Services, and Cellular Services to the divested Bell Operating Companies, the FCC said "[t]hroughout this order the term BOC is used interchangeably with the term Regional Bell Operating Company (RBOC) unless otherwise noted."⁵³ The ordering clauses stated that "...pursuant to ... 47 USC 154(i), 154(j), 201-205, 214, 220, 221 and 403 ... the provisions of ... 47 CFR 64.702 are applicable to NYNEX, Atlantic Bell Companies [sic], Bell South, Southwestern Bell, American Information Technology Corp., U.S.

⁵²GTE-Telenet, 72 FCC 2nd 91 (1979), p. 105. 47 USC 310 deals with transfers of radio licenses, and involves public interest reviews similar to those involved in 47 USC 214. "For reasons of administrative convenience" the FCC "routinely require[s] applicants ... to file both Section 214 and Section 308 applications." Ibid. (Section 308 deals with initial applications and renewals, and section 310 with transfers. Section 309 is procedural, dealing with the "public interest, convenience and necessity" [47 USC 309(a)] reviews required under section 308.)

⁵³Policy and Rules Concerning the Furnishing of Customer Premises Equipment, Enhanced Services and Cellular Communications Services by the Bell Operating Companies, 95 FCC 2nd 1117 (1983), p. 1118 n. 3.

West [sic], Pacific Telesis Group...."⁵⁴ Of the stated authorities, only 47 CFR 221 applies to holding companies; the other sections of title II apply to telephone companies. This order does not seem to have been appealed.

In 1984, reviewing the transfer of assets between AT&T and the BOCs to implement the Consent Decree, the FCC, relying on its GTE-Telenet Decision, held the Regional Holding Companies to be common carriers.⁵⁵ Relying upon the decisions of the District Court with jurisdiction over the 1982 Consent Decree, the FCC further argues that "the 'primary purpose' of the regional holding companies ... was to 'serv[e] the Operating Companies and facilitat[e] their telecommunications functions."⁵⁶ It is perhaps significant that Jeffrey Blumenfeld, while Chief of the U.S. v. AT&T Staff at the Department of Justice, expressed the view that, so far as the 1982 Consent Decree is concerned, the Regional Holding Companies are actually the operating telephone companies.⁵⁷ One may speculate as to whether the Bell Regional Holding Companies preference for calling themselves "Regional Bell Operating Companies" is an implicit recognition that they are actual operating telephone companies: AT&T was forced to divest certain local service telephone operations (not certain companies) and did so into seven corporations with twenty-one

⁵⁴Ibid., pp. 1150-1151.

⁵⁵Consolidated Application of AT&T and Specified Bell System Companies, 98 FCC 2nd 141 (1984), p. 152, modifying 96 FCC 2nd 18 (1983), p. 64, n. 142. ("Consolidated Application.")

⁵⁶"Brief for Appellee," U S West v. FCC, U.S. C.A. D.D.C., nos. 84-1448, 84-1451 (March 5, 1985), p. 3, n. 2, quoting "United States v. Western Electric Co., Inc., 592 F. Supp. 846 (D.D.C. 1984), p. 861. Many similar remarks can be found elsewhere in this order.

⁵⁷Chessler, "Appropriate Strategies," p. 35 n. 45, noting a remark by Mr. Blumenfeld at the "New Directions" Symposium. The justification for this view of the status of the RHCs as carriers seems to be that the Consent Decree established the RHCs to provide local telephone service, so they are "holding themselves forth in a common calling even if they actually provide the service through facilities owned by others (their own subsidiaries in the case at hand). See U.S. Department of Justice, Competitive Impact Statement, 47 FR 7170 (February 17, 1982), at p. 7174. Also U.S. v. AT&T, C.A. 82-0192, (D.D.C.), Slip Opinion January 13, 1986, pp. 2-3, n. 2.

subsidiaries.⁵⁸ AT&T avered that the "holding company structure ... will cause no change in the extent of state regulation of the BOCs...."⁵⁹

In its briefs in U S West's appeals of the "Consolidated Application" the FCC argues that it has authority under other sections of the Communications Act to regulate the RHCs, and that in particular its "statutory mandate could not be limited by the corporate structure that a company adopts to carry out its business purposes or by distinctions that are of no practical significance."⁶⁰ However, in its briefs the FCC now argues that it has not decided the issue of whether U S West is a common carrier,⁶¹ since "it 'saw no need' to decide the question at that time."⁶² The U.S. Court of Appeals in Washington dismissed U S West's appeal,⁶³ without finding whether or not U S West was a common carrier.

⁵⁸The Plan of Reorganization, U.S. v. Western Electric Co., Inc. D.C. (D.D.C.), Civil Action no. 82-1092, (December 16, 1982), speaks only of RHCs and BOCs; the term RBOC is not found therein. In the order ruling on the plan the court referred to "Regional Companies" and said "[e]xcept where the distinction appears to be significant, the Regional Companies and the Operating Companies will be referred to herein as the Operating Companies." U.S. v. Western Electric Co., Inc., 569 F. Supp. 1057 (D.D.C. 1983), p. 1062 n. 3. The "Information Statement and Prospectus" AT&T filed to inform shareholders of the stock distribution also uses the terms RHC and BOC (defined, p. 3), and "regional companies" (p. 1).

⁵⁹Plan of Reorganization, p. 451.

⁶⁰"Reply to Opposition to Motion to Dismiss," U S West, Inc., et. al. v. FCC, U.S. C.A. D.D.C., case nos. 84-1448, 84-1451 (February 1, 1985), p. 2 and p. 3, n. 2, quoting 56 Radio Reg. 2d. (P & F) 813, 822 (1984).

⁶¹"Brief for Appellee," U S West v. FCC, U.S. C.A. D.D.C., nos. 84-1448.

⁶²Ibid. p. 11, citing Consolidated Application, 96 FCC 2nd 18 (1983), p. 64, n. 142.

⁶³"B.O.C. Monitor," CommunicationsWeek, December 30, 1985, p. 12.

In a related matter the U.S. Court of Appeals for the Seventh Circuit recently ruled that the FCC has authority under the "necessary and proper" clause of the Communications Act, 47 USC 154(i) to require the submission of capitalization plans for separate subsidiaries, even though it was "denied comprehensive authority over holding companies" in the Communications Act.⁶⁴ Indeed, the court held "[b]oth the telephone line and the equipment attached to that line are within its regulatory reach, ... and the Commission cannot be prevented from regulating within its proper domain by the creation of paper entities; it can pierce the corporate veil in order to prevent frustration of its regulatory tasks."⁶⁵

The District Court's Attitude toward RHC "Diversification"

Within weeks of the divestiture (January 1, 1984) the Bell Regional Holding Companies began to petition the court to allow them to engage in activities which would otherwise be prohibited by one or another of the restrictions of the 1982 Consent Decree.⁶⁶ These petitions can be distinguished from the many petitions the court disposed of in late 1983.⁶⁷ The 1983 petitions dealt with services that were normally provided by local telephone companies at the time, but under conditions that appeared to violate one or another clause of the decree. These 1983 petitions were granted quickly.

⁶⁴North American Telecommunications Association v. FCC, U.S. C.A. 7th Circuit, nos. 84-2216, 84-2853, 85-1425, (August 27, 1985), Slip Opinion, pp. 18-19.

⁶⁵Ibid, p. 20, citing Computer & Communications Industry Ass'n v. FCC, 693 F. 2nd 198 (D.D.C. 1982), p. 213.

⁶⁶U.S. v. Western Electric Co., Inc., 592 F. Supp. 846 (D.D.C. 1984), p. 859, n. 47. Cf. *ibid.*, p. 858, expressing the astonishment of all parties that this should have occurred "before the implementation of equal access and before the companies' commitment to an efficient and economical telephone operation could be tested.

⁶⁷For example, see U.S. v. Western Electric Co., 578 F. Supp 643, 653, 658, and 662 (D.D.C., 1983).

The 1984 petitions were of a different nature. The RHCs were requesting permission to perform activities that had not been performed by Bell telephone companies before divestiture. The Justice Department commented that the petitions might amount to "'second phase' restructuring of the American telecommunications industry."⁶⁸ At the Department of Justice's suggestion the court established a general framework for dealing with the requests.⁶⁹ From the court's point of view there were two sets of issues: "whether the petitioning Regional Holding Company has made 'a showing' that 'there is no substantial possibility that it could use its monopoly power in the market it seeks to enter'";⁷⁰ and whether "the court should refrain from taking a restricted view of its responsibilities" or "should measure the potential effect of entry on the decree's overall objectives."⁷¹

The court's discussion of the potentially anticompetitive aspects of RHC diversification will not concern us here. However, the court devoted a great deal of attention to the potentially deleterious effects of RHC diversification upon telephone services. The court was at pains to point out that it had modified the decree "to permit the Regional Holding Companies to publish the Yellow Pages and to market customer premises equipment, and it stated that this was being done to ensure the viability of the local companies and to reduce upward pressures on local telephone rates ... [and] to provide that the plan of reorganization ... be ... approved by the Court."⁷²

The court waxed wroth at the RHCs, pointing out that none of the decree's architects

⁶⁸U.S. Department of Justice, "Memorandum," April 4, 1984, quoted in *U.S. v. Western Electric Co.*, 592 F. Supp. 846 (D.D.C., 1984), p. 850 n. 2.

⁶⁹*U.S. v. Western Electric Co.*, 592 F. Supp. 846 (D.D.C. 1984), p. 850 n. 2.

⁷⁰*Ibid.*, p. 851.

⁷¹*Ibid.*, pp. 851, 855.

⁷²*Ibid.*, p. 856.

had in mind that there would be many new Regional Holding Company ventures in such a relatively short time;⁷³ [and] this Court ... which ... drafted ... section VIII(C)--did not have the slightest belief or intention that within a very short period of time the Regional Holding Companies would seek to transform themselves from custodians of the nation's local telephone service into conglomerates for which such service was at best a pedestrian sideline.⁷⁴ Moreover, ... a wholesale departure from the status quo at this time would not be in the public interest....⁷⁵

The court cited several reasons for its conclusions, and most of these are of concern to regulators as well.

A principal problem is that the diversion of capital and managerial resources in the pursuit of outside ventures may impede the implementation of equal access....⁷⁶ Under the decree, the Operating Companies' basic responsibility is to provide local telephone service to the public. The Plan of Reorganization, in turn, established the Regional Holding Companies for the primary purpose of serving the Operating Companies and facilitating their telecommunications functions.... [The] programs the Regional Holding Companies are formulating, and the priorities the companies seem to be assigning to these programs, constitute a serious threat to their obligations....⁷⁷ Bell Atlantic argues that its waiver requests must be granted even if diversification into new business will raise the company's cost of capital and divert the attention of its management from providing telephone service....⁷⁸ To the extent that the Regional Holding Companies' future business goals are responsible for the current service failures, the present Opinion may assist them in redirecting their focus on their primary role as providers of

⁷³U.S. v. Western Electric Co., Inc., 592 F. Supp. 846 (D.D.C., 1984), p. 859.

⁷⁴Ibid., p. 859. (Footnotes omitted; emphasis supplied.)

⁷⁵Ibid., p. 860. (Emphasis in the original.)

⁷⁶Ibid., p. 860. "These careful predictions do not instill confidence that the capital and other resources of the Regional Holding Companies will be used to provide equal access and not for the pursuit of the outside ventures now being contemplated by these companies." Ibid. p. 861.

⁷⁷Ibid., p. 861. This stated purpose bears on the FCC's considering the RHCs to be common carriers.

⁷⁸Ibid., p. 862.

local telephone service.⁷⁹ Diversification is also believed to have a negative effect on local rates. The Regional Holding Companies must obtain the funds for their new ventures from somewhere, and ... [t]hese requests [for rate increases ... may stem from the need to raise capital for outside ventures, lavish advertising campaigns, and the construction of plants and hiring of staff suitable for what the Regional Holding Companies consider themselves to be--diversified conglomerates which are fast out-growing their modest and relatively pedestrian telephone origins.⁸⁰

The Regional Holding Companies assert that all these problems and fears are outweighed by the benefits they would derive from diversification, i.e., their ability to attract more capital and increase revenue.... [to] enhance its financial viability by reducing its overall risks ... [and] pass on its savings from lower capital costs to the ratepayers.... These arguments are erroneous in every respect.⁸¹ [T]here is no evidence the Regional Holding Companies' cost of capital would decrease as a result of diversification.⁸² Despite the representations now made by some of the Regional Holding Companies, it is unlikely that their new business ventures would produce supracompetitive profits which could be used for other purposes.... [i]f [they] were able to ... it would indicate that they were abusing their monopoly power.... [P]rofits would probably not exceed those earned by others ... and little ... would be left over to provide financial assistance to the companies' telephone operations.⁸³ [E]ven if the Regional Holding Companies could, somehow, reap significant profits from their outside ventures they would not use them to benefit their regulated telephone affiliates. In fact, the opposite appears to be true.⁸⁴ [T]he Regional Holding Companies contend than an

⁷⁹Ibid., p. 863. (Footnote omitted.)

⁸⁰Ibid., p. 863.

⁸¹Ibid., p. 863. (Emphasis supplied.)

⁸²Ibid., p. 863, citing the role of regulation in reducing risk to the utility. "Thus, to the extent that a Regional Holding Company raises funds jointly for both its competitive ventures and its regulated services, the cost of capital may be lower for the competitive venture (because it will be averaged with the lower capital costs of the utility) but higher for the regulated telephone services. The ratepayers will ... be subsidizing ... the competitive venture[s]."

⁸³Ibid., p. 864.

⁸⁴Ibid., p. 864, quoting RHC statements that the earnings of the Companies belong to the shareholders and are not automatically reinvested in the same enterprise.

enterprise which is narrowly limited in scope cannot attract the ... talent required for quality performance.... [T]he energies of the ... Regional Holding Companies could ... be directed toward improving local telephone service rather than pursuing extraneous ventures.... and continue to attract the talent they seek.⁸⁵

In ruling on the specific waiver requests the court said it would not consider requests to offer interexchange services until "the Regional Holding Companies lose their bottleneck monopolies and there is substantial competition in local telecommunications service."⁸⁶ "Similar considerations govern the appropriateness of entry of the Regional Holding Companies into the information services and equipment manufacturing markets."⁸⁷ Note that both Cincinnati Bell and Southern New England Telephone Company, which are not so restricted, have entered the interexchange market, the first as a reseller, the second as a facilities-based carrier.

State Commission Reactions to RHC "Diversification"

The actual and potential problems of these expansions and acquisitions are ones that state commissions are particularly ill-equipped to deal with. The FCC's powers of investigation (in sections 215, 218 and 219 of the Communications Act) and its implied powers (in section 1) may sufficient to enable it to force holding companies to give adequate resources to their common carrier subsidiaries, and even to restrict or eliminate nongermane subsidiaries which are burdens to the provision of "an efficient nationwide network." With its present policy of deregulation the FCC is unlikely to act until serious deteriorations in service have already occurred, even though poor service is likely to lead to long term (perhaps permanent) loss of markets by telephone companies through such forms of competition as "bypass."

⁸⁵Ibid., p. 866.

⁸⁶Ibid., p. 868. Note the reference to RHC, as distinguished from local service monopoly.

⁸⁷Ibid., p. 868.

It is difficult to characterize the reactions of the state commissions to RHC diversification. There are fifty-one commissions with jurisdiction over telephone, and forty-nine of them have jurisdiction over Bell Operating Companies.⁸⁸ Thus, it is not surprising that NARUC did not participate in the District Court's proceeding in early 1984 (discussed at length above) to set the rules for RHC requests for waivers of some of the provisions of the 1982 Consent Decree: no consensus has arisen.

In 1982, after the signing of the Consent Decree, but long before the extent of the nongermane activities of the divested RHCs became apparent,⁸⁹ the NARUC Committee on Utility Diversification released a report.⁹⁰ The report was occasioned by the activities of all types of utilities.⁹¹ FCC, Congressional and Justice Department actions were considered in the committee's 1982 report,⁹² as were the diversification

⁸⁸All local service in Alaska and Hawaii is provided by non-Bell companies. AT&T is a part owner of satellites and cables serving these states, but such interstate service is in the FCC's jurisdiction.

⁸⁹See above for Judge Greene's discussion of the surprise he and the other architects of the Consent Decree felt when waiver requests began to arrive within weeks of divestiture.

⁹⁰Honorable Stanley York, et. al., "Report of the Ad Hoc Committee on Utility Diversification," in Paul Rodgers, ed., Proceedings: Ninety-fourth Annual Convention and Regulatory Symposium, (Washington: National Association of Regulatory Utility Commissioners, 1983), pp. 863-996. The Committee was reconstituted and prepared a short report in 1984, limited to negotiations on proposed amendments to the Public Utility Holding Company Act of 1935. See Honorable Stanley York, et. al., "Report of the Ad Hoc Committee on Utility Diversification," in Paul Rodgers, ed., Proceedings: Ninety-sixth Annual Convention and Regulatory Symposium (Washington: National Association of Regulatory Utility Commissioners, 1985), pp. 1016-1024. (Hereinafter "1982 Report," 1982 Proceedings, "1984 Report," and 1984 Proceedings, respectively.

⁹¹"1982 Report," p. 867.

⁹²The "1984 Report" was limited to Congressional efforts to amend Public Utility Holding Company Act, which affects only electric and gas utilities, see p. 1016. Some of the reasons for the omission of telephone utilities from the Act are discussed in Chessler, Appropriate Strategies, pp. 2-5.

efforts of AT&T and the independent telephone companies, but, significantly, not the divested BOCs or RHCs.⁹³ Even so, the Justice Department placed the NARUC Committee's report⁹⁴ before the District Court in the 1984 proceeding on waiver requests, which the court quoted in its ruling.⁹⁵

Direct NARUC reactions to BOC and RHC diversification are harder to find. At the November, 1984 NARUC convention there were four floor resolutions pertaining to telecommunications of which two dealt with access charge and separations matters and one with customer-owned coin telephones. "Resolution Supporting Favorable Action by the Federal Communications Commission on Waiver Requests Filed by Certain Bell Operating Companies" dealt with BOC efforts to "expand their product line by offering complimentary [sic] new services such as Digital Termination Systems or by providing new product line [sic] offerings services not previously available such as Local Packet Switching with Protocol Conversion." Arguing that the availability of such services would "provide new revenue sources ... to support local service rates and ... minimize rate increases" NARUC urged the FCC to "expeditiously and affirmatively act."⁹⁶ Note that the NARUC action supported germane telecommunications activities of the BOC, that whether or not provided by separate subsidiaries could reasonably be considered "above the line" for regulatory purposes. The probability that such activities would prove sufficiently profitable to help provide rate relief for

⁹³"1982 Report," pp. 868, 909-928.

⁹⁴Reports of NARUC Committees do not represent policy positions of NARUC unless adopted by a resolution. See Rodgers, 1984 Proceedings, title page.

⁹⁵U.S. v. Western Electric Co., Inc, 592 F. Supp. 846 (D.D.C. 1984), p. 865, quoting Department of Justice Memorandum of February 21, 1984, p. 8, quoting in turn, NARUC Ad Hoc Committee on Utility Diversification, "Report," October, 1982, p. 81. "Regulators should not divert diversified earnings from shareholders to subsidize rates except as ratepayers may deserve a share of those earnings to the extent that ratepayers are put at substantial or identifiable a additional risk."

⁹⁶Rodgers, 1984 Proceedings, pp. 432-433.

local service is addressed above (quoting the District Court) and below (quoting press reports on RHC financial results to date). Review of the reports of the NARUC Executive Committee and Committee on Communications⁹⁷ indicates that while NARUC and its committees were investigating many aspects of the relationships among the BOCs, the RHCs and BellCore in 1984, no resolutions or reports dealing specifically with nongermane activities were considered. A resolution in support of legislation to permit BOCs to provide "information services" and to manufacture telecommunications equipment was approved by the Staff Subcommittee on Telecommunications in November, 1985, but the Committee on Communications tabled it for further study.⁹⁸

"State Commissions have at times restricted corporate reorganizations and have prevented the formation of holding companies (as in the case of Rochester Telephone--New York Public Service Commission Opinion 78-5)."⁹⁹ More recently, individual states have begun to examine the issues involved in RHC diversification. In 1984 the Washington Utilities and Transportation Commission (WUTC) held a symposium on state regulation of telecommunications. Several of the papers dealt in part with the changing industry structure and the regulatory problems posed by nongermane activities on the part of holding companies.¹⁰⁰ However, the principal thrust of most of

⁹⁷Paul Rodgers, "1984 Report of the Executive Committee," November 27, 1984, and Edward B. Hipp, et. al., "1984 Report of the Committee on Communications, in Rodgers, ed., 1984 Proceedings, pp. 491-564, and 741-833.

⁹⁸"Calls for Lifting Computer II, Some MFJ Restrictions on BOCs Highlight Discussions at Annual NARUC Convention, as Speakers Cite Need to Rethink Assumptions in Current Competitive Era; Enhanced Offerings Could Contribute to Local Rates, States Believe," Telecommunications Reports, vol. 51, no. 47, (November 25, 1985), pp. 4, 34.

⁹⁹"1982 Report," p. 910.

¹⁰⁰The seventeen papers and seven panel discussions were published as New Directions: State Regulation of Telecommunications (Olympia: Washington State Legislature, Joint Select Committee on Telecommunications; and University of Washington, Graduate School of Public Affairs, 1984).

the papers was on the need for selective deregulation in competitive situations. The Washington legislature did enact telecommunications legislation which empowered the WUTC to regulate all types of communications common carriers on a similar basis, as appropriate, and to deregulate telecommunications markets in which it found effective competition to exist.¹⁰¹ Although some of the papers at the conference dealt specifically with legislation to enable the WUTC to deal more effectively with telecommunications holding companies, the legislation that was passed did not deal with these issues.

The California PUC has issued a notice calling for hearings on utility diversification. The public staff prepared a report which concluded "[t]here are hardly any benefits to utility customers from increased utility diversification. Instead, increased diversification, especially within a holding company structure, presents a myriad of opportunities and temptations to holding company headquarters and affiliates to milk the resources of the utility. Public Staff has experienced only problems and pain in trying to investigate transactions between utilities and affiliates to assure that utility management and ratepayers are not being disadvantaged."¹⁰² (The public staff recommended that utility diversification should be "reversed," that the PUC should deny applications to create holding companies, that the PUC should "permit diversification only into related fields," and that this should be done only "through subsidiaries wholly owned and controlled by the regulated utilities."¹⁰³ The California PUC has not acted yet on the hearings.

In many states hearings have been held on specific issues of utility diversification, often in the context of rate cases. Some

¹⁰¹Sharon L. Nelson, "Washington State's New Regulatory Flexibility Act," Public Utilities Fortnightly, vol. 117, no. 1, January 9, 1986, pp. 29-33, at pp. 31, 32.

¹⁰²William R. Ahern, Director, Public Staff Division, "Position of the California Public Utilities Commission's Public Staff Division on the Regulation of Utility Diversification in California," (October 28, 1985), p. 1. ("Diversification in California.")

¹⁰³"Diversification in California," p. 1. (Emphasis supplied.)

states have held hearings on specific holding company issues stemming from the divestiture; where these were uncovered by NRRI's survey they are reported below. So far as can be ascertained, however, no state regulatory body has yet established an overall policy on telecommunications utility holding companies or on nongermane diversification by telephone companies.

So far as can be ascertained from the survey results, perusal of state commission orders, and press reports of commission actions, no state commissions are emulating the FCC by "ignoring" corporate structure. Commissions appear to be recognizing intercorporate divisions but asserting authority over the transactions that cross those divisions. Colorado's attempt to reverse the transfer of Yellow Pages assets, and New York's scrutiny (and reported cancellation) of the Yellow Pages contracts are examples of the later approach. The practice of "imputing"¹⁰⁴ Yellow Pages revenues which many states are following¹⁰⁵ might be interpreted as either approach: that is, as ignoring the corporate divisions or as asserting jurisdiction over transactions between affiliates. In the few instances in which the orders are clear as to what is being done, the latter approach seems to be being followed: the commission appears to be "correcting" an "improper" transaction.

Individual state regulatory commissioners have expressed views on the subject of RHC corporate structure and diversification. From reading commission orders and the trade press, and from conversations with individual commissioners we have drawn some tentative and admittedly subjective impressions. It appears that many see the RHCs trying to use separate subsidiaries to evade legitimate regulatory scrutiny. Some see RHC diversification into markets remote from

¹⁰⁴Using, for rate case purposes, an amount other than that shown the books of account of the carrier, whether the amount shown on the books of an affiliate or some other, calculated, amount.

¹⁰⁵See Chessler and Clark, "Yellow Pages."

traditional telecommunications as threatening the viability of basic local telephone service. However, many see operating telephone company diversification into markets that are closely related to the traditional position as the "gateway" to the telecommunications network as essential if the operating telephone companies are to survive, prosper, and continue to provide basic services at "affordable rates."

Current Experience with Respect to the RHCs

Divergent Corporate Strategies

With its acquisition of SORBUS and MAI Canada Ltd., both well established firms servicing electronic equipment including computers, and the Compushop chain of computer stores, Bell Atlantic would appear to be a prime example of a company diversifying into new fields. Yet, alone among the RHCs, Bell Atlantic has left Yellow Pages advertising revenues in to its operating telephone companies. At the other extreme, BellSouth, Southwestern Bell and U S West have moved telephone directory operations into a subsidiary of a subsidiary.¹⁰⁶ (Neither Cincinnati Bell nor Southern New England Telephone, which are being voluntarily divested by AT&T, has moved the provision of telephone directories from the operating telephone company.)¹⁰⁷

¹⁰⁶BellSouth National Publishing is a subsidiary of BellSouth Advertising and Publishing. Southwestern Bell Yellow Pages is one of several subsidiaries of Southwestern Bell Publications. West Direct is a subsidiary of Landmark Publishing, which is a subsidiary of U S West.

¹⁰⁷The New York Public Service Commission, reversing a hearing examiner appears to have decided that the contract by which New York Telephone transferred Yellow Pages to NYNEX's subsidiary is unreasonable, has "disapproved it, and said it will impute to New York Telephone revenues that would have been earned had the transfer not taken place." "NY PSC Says NYT Directory Publishing Transfer to NYNEX Subsidiary is not 'Reasonable'," Telecommunications Reports, vol. 51, no. 35 (September 2, 1985), p. 6. The text of this order has not yet been released. In Wyoming, the PSC staff recommended that Mountain Bell take competitive bids for rights to publish Yellow Pages; the

Consider, too, that to a far greater extent than the other RHCs, Bell Atlantic has been expanding into new fields by acquisition. Acquisition of other firms, whether competitors, suppliers, customers, or merely in related businesses, has been an unusual practice in the Bell System since the 1913 Kingsbury Commitment. Indeed, Bell Atlantic's re-entry into the CPE market was done through acquisition of established firms, Telecommunications Specialists, Inc., and Tricontinental Leasing Corporation. The other Bell companies have been more likely to expand into new markets through their internal resources and the establishment of new subsidiaries. For example, NYNEX opened its own chain of DATAGO computer retail stores in its service territory, and only recently expanded the chain to Rochester. New York, an independent enclave surrounded by New York Telephone service territory, and to Bell Atlantic's territory in New Jersey.¹⁰⁸ This is not to say that either approach is superior. Recently stock prices of "high tech" firms have been substantially below their highs, so Bell Atlantic may have viewed the amount it paid in excess of the asset value of the firms as a bargain compared to the high costs (and the opportunity cost of lost business while establishing a new subsidiary).

PSC has not yet acted. "Wyoming PSC Investigating Transfer of Bell take competitive bids for the rights to publish Yellow Pages; the Directory Assets to U S West," State Telephone Regulation Report, August 29, 1985, p. 10. The possible sympathy of the courts with these approaches is foreshadowed by a recent decision by the eighth circuit that white pages directories are copyrightable material; in dicta, this decision found a public interest in the support directory revenues are supposed to provide to local service. "U.S. Court, Reversing Lower Tribunal, Finds Telephone Company Directory Copyrightable," Telecommunications Reports, vol. 51, no. 38 (September 23, 1985), p. 17. Hutchinson Telephone Co. v. Fronteer Directory Company of Minnesota, Inc., U.S. C.A. Eighth C., No. 84-5129 (August 11, 1985, Slip Opinion), pp. 8-9. Similar strategies were suggested in Chessler, Comments on NYPSC/NECPUC, pp. 7-8, 33-35, and "Appropriate Strategies," pp. 24-27, 36-37, 57, 63-64.

¹⁰⁸"Notes on the News," Telecommunications Reports, vol. 51, no. 8 (September 23, 1985), p. 40. Fredric Paul, "Interconnections," CommunicationsWeek, November 25, 1985, p. 28. Although Bell Atlantic purchased Compushop Inc. in 1984, it has no sales locations in New Jersey.

However, one reason "high tech" stocks have been relative bargains recently is poorer than expected earnings growth. Indeed, many firms have reported losses and cutbacks. Most of the RHCs have not been reporting the operating results of their nongermane activities but have reported total company operating results and the results of their telephone company subsidiaries. The difficulty this practice creates for analysis lies in the telephone directory operations which are highly profitable. Southwestern Bell did report directory operations separately, and these amounted to almost ten percent of the holding company's net income.¹⁰⁹ Indeed, Southern New England Telephone's unregulated sales subsidiary, Sonocor Systems, has been closing sales outlets outside of the Northeast, and even closing computer and sales outlets in Connecticut, moving these to telephone company locations. Reportedly, these retrenchments are due to "red ink."¹¹⁰

Service and Supply Corporations

One of the ways the Bell Operating Companies benefit from being part of a larger organization is through the sharing of some corporate overhead functions. Many of these are of the sort formerly provided by AT&T's General Departments as part of the "License Fee Contracts." Others, such as procurement, were once provided by Western Electric, and more recently by the BOCs themselves, but are now (in most RHCs)

¹⁰⁹Net income was \$256.9 million in the third quarter, of which sales in 1984 of Yellow Pages directories contributed \$21 million. John Mulqueen, "All Seven Bell Holding Companies Report Higher Earnings for Quarter," CommunicationsWeek, July 22, 1985, p. 29. Historically, Yellow Pages publishing is very profitable, with margins of twenty-five to thirty percent. Recently Yellow Pages advertising has grown faster than every other advertising medium. John Mulqueen, "SW Bell Buys Directory Firm from Contel for \$120 Million," CommunicationsWeek July 15, 1985, p. 45.

¹¹⁰Laurel Nelson-Rowe, "Two Years of Hard Lessons: Sonocor Cuts Back OA [Office Automation] Effort after Stalled Push," CommunicationsWeek, August 26, 1985, p. 1.

provided by at least in part service corporations.¹¹¹ Indeed, of all the BOCs only Pacific Telephone continues to do all procurement for itself and its former subsidiary, Nevada Bell. At the other extreme, NYNEX, Southwestern Bell and U S West have completely centralized procurement in subsidiaries of the holding company, leaving no procurement organizations in the BOCs. The remaining RHCs have divided the procurement responsibility between centralized procurement organizations and the BOCs. In a few instances¹¹² separate service corporations do not exist, and such services are provided directly by the corporate parent. In a few other instances,¹¹³ some of the services are provided by subsidiaries of the telephone companies, while others (such as general oversight and strategic planning) are provided by the parent.¹¹⁴

The inclusion of the services and supplies corporation as a subsidiary of the operating companies in BellSouth and U S West has significant regulatory implications. Not only is it "easier" for state commissions to investigate subsidiaries of regulated companies than their holding company parents, but the question of costs and disallowances does not have to arise if the regulatory body "consolidates," using accounting methods, the service subsidiary with its operating telephone company parent. If the regulatory commission were to include the investment and expenses of the subsidiary in the revenue requirement, and treat the revenues (that is, the payments from the operating telephone company to the services subsidiary) as operating revenues, then, if all the services are allowable, and in reasonable amounts, there need be no regulatory effect from performing

¹¹¹Telephony's Directory and Buyers Guide, Eighty-ninth edition issue (Chicago: Telephony Publishing Corp., 1984), pp. 320-324 lists the names and authorities of purchasing organizations.

¹¹²SNETCO, and Southwestern Bell follow this pattern, and Pacific Telesis provides no centralized procurement services for its subsidiaries.

¹¹³BellSouth, NYNEX, and U S West follow this pattern.

¹¹⁴Cincinnati Bell has a supply subsidiary (which deals with the general trade as well), but CBI provides other corporate services through its parent holding company.

these services in a subsidiary. Where the services and supplies organization is not a parent or subsidiary of the operating telephone company, such consolidations lack so obvious an accounting basis. Still, accounting techniques can be used to consolidate the affiliates if the commission can adopt a legal basis for doing so. Naturally, the commission's authority to "pierce the corporate veil" is highly dependent upon its legislative mandate, but it has been done.¹¹⁵ As explained below, accounting can become a problem in the event of disallowances.

In this vein, when rumors arose that NYNEX proposed to have its procurement subsidiary, NYNEX Material Enterprises (NME), provide services and products to non-NYNEX companies, the New England Conference of Public Utility Commissioners wrote to the Justice Department.

NECPUC recommended that, since NME's profits would stem from the volume generated by purchasing for New York Telephone and New England Telephone, NME should be established as a cooperative or joint venture with the telephone companies, arguing "if NME's work was done on a cooperative or joint venture basis, those dividends would flow to NYNEX's operating companies, thus reducing their costs."¹¹⁶ Actually, treating the flow of NME's dividends as operating revenues would offset the telephone companies' revenue requirements; it would not affect their costs, in the sense of reducing their expenditures for equipment and supplies. It would increase the cash available to the utility for modernization or other purposes (as NECPUC argues), but (subject to their legal authority to do so) commissions could increase cash available to the utility by reducing its dividends to its parents. Most state commissions also have jurisdiction over securities issues by

¹¹⁵For further discussion see Chessler, Appropriate Strategies, includes a discussion of the Canadian Radio-Television and Telecommunications Commission's "principle of integrality." See also North American Telephone Association v. FCC, U.S. C.A. 7th C., nos. 84-2216, 84-2853, 85-1425 (August 27, 1985), Slip Opinion, pp. 18-19.

¹¹⁶Quoted in "NYNEX Procurement Subsidiary Should Be Joint Venture with Phone Firms, Regulators Say," Telecommunications Reports, vol. 51, no. 47 (November 25, 1985), p. 46.

regulated utilities, and might find use for this authority if they felt the utility were neglecting service quality. The New York PSC's order to New York Telephone to modernize its service offerings by providing additional services (to prevent bypass) is discussed below.

The six New England commissions petitioned the District Court to deny NYNEX's request for a waiver. They stated that NYNEX Material Enterprises (NME) gets substantial discounts from its suppliers, but sells to the telephone subsidiaries at approximately the market prices, earning "profit margins ... much higher than the rates of return allowed or earned by either operating company."¹¹⁷ The New England commissions pointed out that this might amount to an anticompetitive subsidy to NME. They recommended that NME be a subsidiary of the operating companies so that the profits would flow through to the ratepayers.¹¹⁸

In public utility lore there is a long history of corporate parents foisting expensive services of dubious value upon the utility, the costs to be recovered from ratepayers.¹¹⁹ While few particularly note-worthy examples of this can be pointed to in telecommunications, utility commissions have, from time to time, disallowed portions of the "License Fees" or other arrangements by which Bell and non-Bell telephone companies have compensated their parents, or "excess profits" earned by supply subsidiaries (generally defined as "more than the allowed return of the telephone company").¹²⁰ In addition, commissions

¹¹⁷"Opposition of All New England State Regulatory Commissions to the Request of NYNEX Corporation to Provide Procurement and Support Services to Unaffiliated Companies," U.S. v. Western Electric Company, C.A. No. 82-0192, D.C. D.D.C., January 15, 1986, p. 2. (Herein after "NECPUC Opposition.")

¹¹⁸"NECPUC Opposition," pp. 2-3.

¹¹⁹James C. Bonbright and Gardiner C. Means, The Holding Company: Its Public Significance and Its Regulation (New York: McGraw Hill, 1932).

¹²⁰The most recent example is In re New England Telephone and Telegraph Company, Vermont PSC Docket No. 5001, Order of December 13, 1985 at 55-62. Cited in "NECPUC Opposition," p. 5, which described it as "a labor intensive and inherently imprecise effort to create an after-the-fact cure for improper expenditures."

have, on occasion, audited specific expenditures and found that while they were lawful in nature and reasonable in amount, they were for the benefit of unregulated activities of the utility, and that charging them to the ratepayers was improper.¹²¹

Accordingly, the RHC provision of services and supplies to the BOCs, whatever the corporate structure, involves no new issues. The practice whereby BOCs purchase supplies from a corporate affiliate which charges a mark-up was investigated by the FCC in the aftermath of Docket 19129.¹²² One reason for the investigation was that when the purchases are capitalized the supply affiliate's profit is embedded in the rate-base, so the utility earns "a profit on a profit"--more than it would earn if it had purchased the supplies directly.¹²³ It is for this reason that some commissions have sought to reduce the ratebase by the profit earned by the supply affiliate, even if it was reasonable, and the FCC proposed to have purchases from affiliates debited to separate subaccounts of the plant accounts in the original Notice in the Uniform System of Accounts docket, 78-196.¹²⁴ Another

¹²¹The NARUC audit of Bell Communications Research is a recent example discussed below. Other examples involving AT&T and GTE date back nearly forty years, as discussed in the case of Western Electric. The FCC's investigation of AT&T in the Walker Report recommended disallowances, but the war intervened before any action was taken. The Walker report is discussed in Chessler, "Appropriate Strategies," pp. 8-9, and sources cited therein.

¹²²The FCC was never able to draw up rules for competitive procurement by the Bell System, to implement its decision in docket 19129 and recently cancelled the docket it had established in 1981. "B.O.C. Monitor," CommunicationsWeek, September 19, 1985, p. 16. "FCC Terminates Inquiry into BOCs Procurement Practices," NARUC Bulletin, no. 38-1985, September 23, 1985, p. 11, citing FCC Mimeo 85-496 September 9, 1985.

¹²³No such double profit is earned for supplies that are expensed. If the affiliate's return on investment is the same as the utility's, the cost to the ratepayer and return to the shareholder are the same as if the utility had purchased expensed supplies directly. The other reason for the FCC's action was to promote competition in the equipment markets by reducing AT&T's domination of the purchasing decisions. "FCC Terminates Inquiry," p. 11.

¹²⁴Notice of Proposed Rulemaking, CC Docket 78-196 (Revision of System of Accounts), 70 FCC 2nd 719 (July 21, 1978).

reason for opposing captive suppliers is that any practice of "forcing" the operating companies to purchase from a captive supplier (as alleged would reduce competition in the manufacturing and distribution of telecommunications equipment. This objection was a root of the antitrust suit that led to the divestiture.

Accounting in the Service Corporations is a problem. If some of the services must be disallowed in whole or in part, the commission must somehow determine the amount of disallowance. Because such disallowances are a possibility, the commission's interests would be better served if the services subsidiary has a "project cost" type cost accounting system for its major projects. The "budget decision packages" which the AT&T General Departments adopted in the late 1970s, largely at the behest of NARUC, might, with suitable refinements, be a basis for such accounting. Unfortunately, the state commissions (and the FCC for that matter) lack explicit legal authority to prescribe accounting systems for non-utilities. However, since regulatory bodies have rather broad authority to determine the form and nature of the evidence upon which they will base their decisions, state commissions can exert a great force of "moral suasion" upon the affiliate of the utility. Indeed, these circumstances appear to call for regional negotiations or even a regional generic hearing so that the several state commissions do not impose conflicting and irreconcilable accounting requirements upon the utility.

Bell Communications Research

In the course of the divestiture AT&T separated those activities that were of primary benefit to local telephone operations or the BOCs into a corporation variously called "The Central Services Organization," Bell Communications Research, and BellCore. BellCore's staff was taken from Bell Telephone Laboratories and the AT&T General Departments. It was said at the time that the functions being transferred to BellCore were those which should be provided

nationally,¹²⁵ or could be provided more efficiently by one research and standards setting organization than by seven.

Since BellCore is intended to be a national organization doing basic and applied research in telecommunications and helping set technical standards for the entire intercity network, an argument can be made that all local telephone companies, Bell and non-Bell, should be permitted or even required to purchase its stock and contribute to its "core" projects.¹²⁶ While BellCore is permitted by its charter to do research for non-RHC Bell companies, AT&T and the former "associated companies" (and presumably for the non-utility subsidiaries of the Regional Holding Companies), this has not, in fact, developed into a significant portion of its business.¹²⁷ But, before the divestiture, it was an argument with respect to Bell Telephone Laboratories, too, that it should be supported by a "tax" on the whole industry, and not just the eighty-two per cent served by Bell operating companies.

After the initial controversies as to whether BellCore was providing research for the benefit of the BOCs, the RHCs and their

¹²⁵The 1982 Consent Decree requires the divested BOCs to maintain a central organization to set network standards. Also, there is to be a central office to provide services to the Defence Department and other federal agencies.

¹²⁶Those projects which are of such a fundamental nature as to be of value to all BellCore's owners are designated "core" projects and participation is mandatory.

¹²⁷NARUC Multi-State Audit Team's Investigation of Bell Communications Research, Inc.: A Report to the Staff Subcommittee on Accounts, National Association of Regulatory Utility Commissioners, three volumes (Washington: National Association of Regulatory Utility Commissioners, 1985). See vol. 1, p. 5, 15-19, 43, 45, 55-56, 94-103. BellCore revenues from AT&T were \$7 to 8 million; from the former "associated companies," Cincinnati Bell, and Southern New England Telephone, \$24 to 25 million; and from others, \$20 to 21 million. Vol. 1, p. 45. BellCore believes that to do research or development for "third parties" (as distinct from collecting fees or royalties for third party use of research or development done for the RHCs) it would need a waiver from the District Court. Vol. 1, p. 99. (Hereinafter Audit Report.)

other subsidiaries, or even AT&T,¹²⁸ two of the RHCs, BellSouth and U S West tried to calm the situation by transferring their BellCore stock to their BOC subsidiaries. While this does improve the appearances of the relationships, the substance remains unchanged: the RHCs control BellCore. In five cases the control is direct; in two cases it is indirect, through RHC control of the BOCs. But it is this fact that the conglomerate RHCs control a research facility that is paid for by utility ratepayers that remains one of the most controversial aspects of the reorganization. Furthermore, the controversy has been exacerbated by one recent event: the aforementioned NARUC audit of BellCore.

The NARUC Committee on Accounts conducted an audit of BellCore. At this writing BellCore has not responded to the findings, but the report recommended three major "disallowances" and several minor ones. The first major point was that BellCore is conducting research into the provision of WATS-like services. Since the BOCs are not now permitted to provide interLATA services, and any eventual provision of such services by the RHCs may be through non-BOC subsidiaries, the audit report recommended that this research not be charged to BOC ratepayers. Secondly, BellCore is also conducting research into manufacturing quality control, since the BOCs are purchasers of equipment for which they must set standards of quality assurance. The audit report recommended that this cost be borne by the equipment manufacturers, who are ultimately responsible for the quality of what they produce. Thirdly, some of BellCore's research is "applied research" into products which is made freely available to manufacturers.¹²⁹

Cellular Subsidiaries

All the regional holding companies created subsidiaries to provide cellular services. In most instances these are subsidiaries of the

¹²⁸An unlikely eventuality, but one that was seriously considered.

¹²⁹Audit Report, vol. 1, contains summaries of the recommended disallowances at various levels of detail. The total expenditure in these three areas totaled about \$115 million. Vol. 1, pp. iii, 6.

holding company, rather than the operating telephone companies.¹³⁰ In some instances these are joint ventures with other "wire-line" telephone companies. Bell Atlantic acquired a subsidiary to provide paging services, as well. Before divestiture all Bell Operating Companies had provided mobile telephone and paging services using "conventional" technologies.¹³¹ Again, some structures are more convoluted than others: Cincinnati Bell created a "nonoperating" subsidiary, Cincinnati Bell Enterprises, and Cincinnati Bell Cellular Systems is a subsidiary of Cincinnati Bell Enterprises; and Bell Atlantic Mobile Systems and A Beeper Company Associates are both among the subsidiaries of the Bell Atlantic Enterprises subsidiary of Bell Atlantic.

However, the subsidiaries providing cellular telephone services appear to be communications common carriers, and hence regulated by state commissions to the extent states have the statutory power to do so, and regulation is not precluded by some future FCC preemption. While the corporate structure may require some innovative theories to permit any potentially "above normal" profits from cellular services to be used to keep down the rates for basic services provided by the BOC, such imputations should be possible for states wanting to make them. Whether there will be any substantially above normal profits is another matter: with two providers of cellular services in each market procompetitive policy on the part of the FCC and the state commission may reduce the rate of return in the various cellular markets to levels commensurate with the risks. Furthermore, local commission ratemaking

¹³⁰No RHC has made a cellular system a subsidiary of a BOC. Most BOCs have retained their conventional land mobile operations. Ameritech also has a mobile services subsidiary as a direct subsidiary of the RHC. U S West's Northwestern Bell BOC has a paging subsidiary. Only SNETCO did not have to establish a separate subsidiary for cellular but has effectively done so since it participates in a consortium with NYNEX and two independent telephone companies. Southern New England Telephone Co., Annual Report, 1983, p. 22.

¹³¹Federal Communications Commission, Statistics of Common Carriers, year ending December 31, 1982, table 16, line 180.

practice for the special forms of access required by cellular operators may, by careful selection of the costing theory to be used and judicious attention to the way the theory is applied, result in the local telephone companies collecting, in the form of access charges or intercarrier settlements, much of whatever above normal profits remain after competition.

The RHCs and Predivestiture AT&T

Many parallels can be drawn between the present structures of the regional holding companies and the predivestiture structure of AT&T. Before divestiture AT&T's principal subsidiaries were the Bell Operating Companies and Western Electric. There were some minor direct subsidiaries that provided services to the regulated sector (such as 195 Broadway Corporation and Empire City Subway Corporation) but most unregulated activities were subsidiaries of the Western Electric Corporation. For example, Teletype Corporation, Nassau Metals Corporation, Manufacturers Junction Railroad, and the Sandia Corporation fell into this category. The principal difference between AT&T and the other telephone holding companies was that AT&T alone was an operating company as well (through the Long Lines division). Since divestiture, only Cincinnati Bell and Southern New England Telephone Company follow this precise pattern.

At one time it was thought that the pattern the RHCs follow would essentially immunize the holding company from both antitrust and regulatory scrutiny: from antitrust scrutiny by claiming that the holding company was a utility; from regulatory scrutiny by claiming that the holding company was not an operating utility. A series of cases involving GTE in the 1970s showed that such a holding company could be subjected to the antitrust laws and the Communications Act as well. (Some of these are discussed above.) For a Bell Regional Holding Company today, the applicability of the Federal Communications Act and the FCC's jurisdiction is unquestioned; the controversies are over the extent to which state commissions can extend their jurisdic-

tions beyond the operating telephone companies in their states into the parent company and into subsidiaries which are not telephone companies.

Wisconsin in 1949 (Re Wisconsin Telephone Company, 80 PUR (NS) 482 (1949)), and California in 1954 (Re Pacific Telephone & Telegraph Company, 5 PUR 3rd 396 (1954)), in cases involving AT&T and Western Electric, established that a state could look into the affairs of an unregulated parent or affiliate to determine whether the prices charged for goods and services supplied the utility were reasonable.¹³² This scrutiny included the profits earned by the affiliate. However, the issue since divestiture and reorganization is state scrutiny of activities which may be competitive with regulated activities,¹³³ or which may involve redirection of revenues previously considered operating revenues,¹³⁴ or which may involve spreading the resources of the RHC into a variety of new markets which may strain the RHC's financial and managerial ability to provide good telephone service, and which may, by increasing the overall risk of the enterprise through establishment or acquisition of enterprises in highly competitive markets, raise the cost of capital to the utility.¹³⁵ The thrust of the following part of this report is on how the state commissions have begun to deal with the second set of problems. State adjustments

¹³²Many other states have investigated Western Electric's price, the prices charged by other affiliated manufacturers, and the prices charged by holding companies to their telephone company subsidiaries for management, financial, research and other services. While these investigations have not always resulted in disallowances, they established the principle of "piercing the corporate veil" where there may be a discernible effect upon utility rates or a "conflict of interest" between the utility and some other member of the holding company group. More to the point, they should be valid precedents for investigations of affiliates of a utility.

¹³³Cellular telephones compete with traditional mobile telephone offered by all Bell companies.

¹³⁴Examples are the profits from Yellow Pages advertising or provision of customer premises equipment.

¹³⁵Adjustments can be made to the estimated cost of capital to try to insulate the utility from the increased risk, but finance theory provides little help in doing so.

for the costs of services supplied to Bell Operating Companies by the RHCs and BellCore (then called the Central Services Organization) were summarized in the NRRI Quarterly Bulletin in April, 1984; services provided by central purchasing organizations and other entities that the RHCs may establish pose no additional problems for regulators.

The RHCs and Their Subsidiaries

The company descriptions that follow are taken from a variety of sources as shown in the footnotes. It is perhaps significant that respondents at the state commissions were usually unable to provide accurate descriptions of the corporate relationships of the Regional Holding Companies unless they did some research, checking with the carrier or its parent. Indeed, we sometimes found telephone company spokesmen had difficulty in accurately explaining their corporate structures. Furthermore, some of the RHCs are engaged in such aggressive programs of acquisition and reorganization that no published report can long remain accurate. Therefore, we must acknowledge that, despite careful cross-checking and updating, some errors may remain in what follows.

While many analysts seem to be of the opinion that the financial condition of the BOCs is good, there is some controversy as to the extent to which their diversification contributes to their financial soundness. In the words of Glenn Parfumi of Dean Witter Reynolds, "What's so wrong with the telephone business?" Pointing to regulated returns approaching fifteen percent on equity, "it's a great business. I'd Stop trying to be something I'm not."¹³⁶ Table 1 summarizes the recent financial results for the RHCs. The results themselves are discussed below.

In the aggregate, the RHCs still get about ninety-five per cent of their revenues from local service. Furthermore, they are reluctant to

¹³⁶Quoted in Janet Guyon, "Branching Out: Regional Phone Firms Press Diversification, Seek Changes in Rates: Otherwise They Fear Lost in Customers to Companies with New Technologies: Are They Reaching to Far?" Wall Street Journal, November 25, 1985, p. 1, at p. 22.

TABLE 1

FINANCIAL RESULTS OF THE SEVEN BELL REGIONAL HOLDING COMPANIES

Company	Revenues (Billions)		Per Cent Chng.	Earnings Per Share			Return on Equity			1983 Price 12/31	1985 Price 12/1	Per Cent Change in Price	Per Cent Total Return Inc. Div.	
	9/30/84	9/30/85		9 Mos. Ending 1984	9 Mos. Ending 9/30/84	Pct. Chng. 9 Mos.	9 Mos. Ending 9/30/84	9 Mos. Ending 9/30/85	Per Cent Chng.					
Amerit	\$6.2	\$6.7	8.1%	\$10.17	\$8.10	\$8.49	4.8%	15.2%	15.2%	0.0%	\$66	\$99.125	50.2%	64.3%
Bell At	5.99	6.76	12.9%	9.94	7.51	8.25	9.9%	13.5%	14.2%	5.2%	65	99.50	53.1%	68.2%
BellSou	6.99	7.8	11.6%	4.28	3.06	3.60	17.7%	13.5%	14.9%	10.4%	28	44.625	59.4%	73.7%
NYNEX	7.06	7.65	8.4%	10.10	7.66*	7.92*	3.4%	13.78%	14.37%	4.3%	62	91.875	48.2%	63.0%
Pac Tel	5.8	6.3	8.6%	8.46	6.45	7.16	11.0%	13.5%	14.3%	5.9%	56	79.375	41.7%	56.5%
Southwest'n	5.3	5.9	11.3%	9.04	6.78	7.69	13.4%	13.2%	14.2%	7.6%	59	80.25	36.0%	50.6%
U S West	5.4	5.8	7.4%	9.24	6.61	7.23	9.4%	13.1%	13.6%	3.8%	56	83.125	48.4%	63.2%
Average			9.8%				9.9%	13.7%	14.4%	5.3%			48.1%	62.8%

Source: John Mulqueen, "Bell Regional Post Higher Revenues as They Battle into Their Third Year," *CommunicationsWeek*, November 25, 1985, p. C10.
Morton L. Brown and Daniel A. Burkhardt, "'Baby Bells'--Still Going Strong," *Public Utilities Fortnightly*, vol. 117, no. 1 (January 9, 1986), p. 41.
Author's Calculations.

*These were misprinted as 2.66 and 2.92 in Mulqueen. They were corrected by the author to the amounts shown.

talk about their customers. When they do release names, it is almost always of a PBX purchase, or the sale of a few computers in a retail store.¹³⁷ The precise significance of The ninety-five per cent statistic is unclear, since some of the RHCs' revenues are from enhanced local network services, and much of the purportedly competitive revenues are from Yellow Pages. The reader should also keep in mind that no RHC now claims to make a profit from its new ventures. These points are discussed elsewhere, but should be borne in mind when comparing this "five per cent" with Judge Greene's limit of ten per cent of revenues from competitive and diversified activities. Still,

Wall Street is queasy for another reason. It likes the Bells' history of large profits that are guaranteed by regulators. So it's wary of the new risks they're taking. "The landscape is littered with bodies of independent telephone companies that thought they knew a lot about things other than the phone business," says Edward Greenberg, a Morgan Stanley & Co. analyst.¹³⁸

The CPE market is significant, both because it appears to be the largest of the competitive or nongermane markets in which the RHCs are active (although with a larger share of a smaller market the RHCs find Yellow Pages to be a bigger revenue producer). CPE is also, one of the two markets that some state commissions intervened with the District Court so that the BOCs might remain active in it to "support local rates." (Yellow Pages is the other.) The Court permitted the BOCs to reenter the market to promote competition; its reasons for doubting that there would be any support for local rates from competitive services like CPE are quoted extensively above.

CPE has been a particular disappointment. Sales have generally been below estimates. The RHCs have been claiming "start up," "growing pains," and "not expected," as explanations.

¹³⁷Mark Maremont, John Wilke, Jonathan B. Levine, James E. Ellis, Welch, "The Baby Bells Take Giant Steps: They've Gone Far Beyond and Want to Go Further. Should They?" Business Week, December 2, 1985, p. 94, at p. 95. Elizabeth Horwith and Ken Mayo, "RBOCS: The Regional Difference," Business Computer Systems, v. 4, no. 11 pp. 31-55, (November, 1985) at p. 33.

¹³⁸Maremont, "Baby Bells," pp. 95-96.

The mix of progress and problems encountered in 1985 has left industry watchers and some company officers wondering whether the promise of the regional companies becoming massive equipment distributors will ever be reality. Moving the businesses into the black still appears years away.¹³⁹

Industry analysts thought the RHCs had 5 to 8 per cent of the CPE market, with "heavy competition, extensive price cutting and low margins."¹⁴⁰ The North American Telecommunications Association study appears to have found the RHCs with somewhat higher market shares in 1984, about 12.5 per cent of the overall market, 14.5 percent in key systems, and 10 per cent in PBXs.¹⁴¹ However, NATA predicted that in 1985 the BOCs would still have only 5.2 per cent of the installed base in key systems.¹⁴²

"NATA charged that the BOCs are willing to absorb losses while building an installed base with unprofitably low prices."¹⁴³ Others said that the RHCs had to train personnel, rationalize their product lines (less emphasis on breadth and on integrated voice-data systems, more attention to providing a "growth path" for customers). Still, some manufacturers were reportedly looking for more RHCs to distribute their products.¹⁴⁴

Part of the RHCs' problem in the CPE market is their focus. As discussed below, most of the RHCs have been emphasizing integrated voice-data systems, a market segment that has not developed. Also,

¹³⁹Peter Meade and Laurel Nelson-Rowe, "Despite Big Plans, Most Regionals Still Learning What it Takes to Succeed in User Equipment," CommunicationsWeek, November 25, 1985, p. C13. (Hereinafter "Regionals Learning Equipment.")

¹⁴⁰Meade and Nelson-Rowe, "Regionals Learning Equipment," p. C13.

¹⁴¹Fredric Paul, "Interconnects Continue Downward Spiral: NATA: AT&T, BOCs Sap Market Share with Low Prices," CommunicationsWeek, November 25, 1985, p. 1, at p. 36.

¹⁴²Fredric Paul, "Time for Action for Beleaguered Interconnects," CommunicationsWeek, December 2, 1985, p. 19. The RHCs share of the installed base must be less than their share of current sales since they have been selling CPE only since divestiture, their previous installed base having been transferred to AT&T.

¹⁴³Paul, "Interconnects Continue Downward Spiral," pp. 1, 36.

¹⁴⁴Meade and Nelson-Rowe, "Regionals Learning Equipment," pp. C13-C14.

some of the RHCs have had difficulty developing the kind of price flexibility the CPE market requires. This point is also discussed below.

With the perception that much of the good financial performance of the RHCs is "[b]ouyed by steep cost cutting and healthy rate increases in many states,"¹⁴⁵ rather than the success of their nongermane activities the discussions below make some effort to consider the effect of those activities on the overall financial health of the RHCs.

Ameritech

With five BOCs, Ameritech is second only to Bell Atlantic in the number of telephone subsidiaries. It is one of the RHCs that most closely resembles the predivestiture AT&T. While operating groups are clearly visible on the organization chart as we have drawn it in appendix A, figure 1, Ameritech has not formalized this structure, except to the extent that it is reflected in its own internal managerial organization charts.¹⁴⁶

Like most of the RHCs, Ameritech has created both a publishing and a services subsidiary. The publishing subsidiary is not, at this writing, active in seeking new forms of revenue. It should be pointed out that in parts of Illinois, the Reuben H. Donnelley Corporation has published the Yellow Pages since Yellow Pages' inception some sixty years ago. Reuben H. Donnelley is unrelated to Ameritech and AT&T, and the terms of the contracts¹⁴⁷ for Yellow Pages Advertising would

¹⁴⁵Maremont, "Baby Bells," p. 96.

¹⁴⁶Ameritech does not have a "vice president of unregulated activities by any title recognizable as such. 1984 Annual Report, p. 45.

¹⁴⁷The pre-divestiture contract has not been available: it is not the files of the Illinois Commerce Commission and spokesmen for Ameritech have written to NRRRI calling it "proprietary." (NYNEX has filed Yellow Pages contracts as supplements to its their form 10-K reports to the SEC. NYNEX Corporation, 1984 Form 10-K, p. 27.) The current Illinois Bell contract, negotiated since divestiture and claimed to be even more favorable to the BOC is reproduced in appendix D. For a detailed analysis of state reactions to the Yellow Pages controversy see Chessler and Clark, "Yellow Pages Subsidiaries."

replay study for any state commission concerned as to whether an operating company, Bell or non-Bell is getting a "fair deal" from an affiliated publisher.

Ameritech created its own CPE sales organizations. One, Ameritech Communications, operates on a regional basis, supporting the CPE sales organizations of the five BOCs.¹⁴⁸ Except perhaps when dealing with "national accounts" these have not been active outside the service areas of the Ameritech companies. Financing and leasing is provided by Ameritech Credit Corporation. Wisconsin Bell has two subsidiaries, Wisconsin Bell Communications and 411 Comcorp which provide shared tenant services.¹⁴⁹ Ameritech has a joint marketing agreement on shared tenant telecommunications facilities in which Ameritech sells equipment and Satellite Business Systems Real Estate Communications Company (RealCom) sells communications lines.¹⁵⁰ In December, 1985 Ameritech acquired Applied Data Research, Inc., a producer of software for mainframe computers, and merged Ameritech Mobile Communications Sales, Inc. into its parent, Ameritech Mobile Communications, Inc.¹⁵¹

In April, 1985 the FCC reprimanded Ameritech for requiring additional capitalization from its CPE subsidiaries, accusing it of poor planning, but granting the request.¹⁵²

¹⁴⁸These use a close variant of the name of the Bell Operating Company, such as Illinois Bell Communications, Inc., which is active in Illinois Bell's service territory. Horwith and Mayo, "RBOCs" pp. 52, 54.

¹⁴⁹For further information see Davis, Clark and Wong, Shared Tenant Services. Such activity is precluded by a recent order of the District Court. Anna Zornosa, "Judge Greene Tells BOCs He Will Not Ease Restrictions," CommunicationsWeek January 20, 1986, p. 1, at pp. 2, 29.

¹⁵⁰Horwitt and Mayo, "RBOCs," p. 54.

¹⁵¹"Ameritech Moves Ahead with ADR Buy," CommunicationsWeek, December 16, 1985, p. 8, and Steven Titch, "Ameritech Mobile Folds Direct Sales Unit, Reshuffles Accounts," CommunicationsWeek, December 9, 1985, p. 7.

¹⁵²"B.O.C. Monitor," CommunicationsWeek, July 15, 1985, p. 10.

Indiana Bell claims to be the first telephone company "to develop and market software that computerizes information used by directory-assistance operators." It developed the software for its own use and will market it to other telephone companies.¹⁵³ As discussed below in the case of Cincinnati Bell which is actually in the software business, producing software for sale does not appear to be considered manufacturing ("manufacturing" is not defined in the Consent Decree), but a waiver is required to sell it, since it is not an "exchange service" nor "a natural monopoly service actually regulated by tariff."

Financially, Ameritech is reported to have "strong expense controls and growth in access lines"¹⁵⁴ but much of its growth in earnings seems to be related to increased depreciation rates.¹⁵⁵ Ameritech's 15.2 per cent return on equity was the highest of any RHC. Local service revenues grew only 2.5 per cent, so earnings growth of 5.3 per cent was attributed to maintenance expenses \$8 million below estimates.¹⁵⁶ It would appear that Ameritech's marketing played some role in the good performance in the views of the financial community:

Ameritech has maintained first place in return on equity through an excellent marketing strategy that is getting vertical growth off its existing network, [Mark] Beckwith [of Brown Brothers, Harriman] said. "They have put a lot of strategies in place that others are trying to get started," he said. The added services

¹⁵³"B.O.C. Monitor," CommunicationsWeek, September 30, 1985, p. 12.

¹⁵⁴John Mulqueen, "Analysts Express Satisfaction with Bell Holding Companies," CommunicationsWeek, October 21, 1985, p. 44. (Hereinafter "Analysts Express Satisfaction.")

¹⁵⁵John Mulqueen, "All 7 Bell Holding Companies Report Higher Earnings for Quarter," CommunicationsWeek, July 22, 1985, p. 29, at p. 31 (Hereinafter "Report Higher Earnings.")

¹⁵⁶John Mulqueen, "Bell Regionals Post Higher Revenues as They Battle into Their Third Year," CommunicationsWeek, November 25, 1985, p. C10, at p. C11. (Hereinafter "Regionals Post Revenues.")

do not require a lot of capital and after-tax operating margins are very high, he said.¹⁵⁷

Between divestiture and December 1, 1985 Ameritech's stock price increased by 50.2 per cent, above the 48.1 per cent average increase for the RHCs in the period.¹⁵⁸ The increase in stock price is one possible measure of how the financial markets view the company's performance.

Ameritech was the only RHC to attach revenue figures to its claims of success in Customer Premises Equipment sales. Richard Notebaert, Ameritech Communications national marketing and operations vice president claimed Ameritech "has already significantly passed last year's quoted goal of \$100 million in sales."¹⁵⁹ Despite Ameritech's role as equipment supplier to SBS Real Estate Communications Corp (in the shared tenant services market), "analysts count Ameritech as 'the company in the middle of the pack' in CPE sales efforts," criticising it for being "preoccupied with attaining a national presence instead of honing in on its regional customer base first."¹⁶⁰

While quality of service is reported to be good in Illinois and Indiana, there were complaints about installation and maintenance "glitches" from the commission staff in Wisconsin and from users in Ohio, and complaints about rate increases from users in Michigan.¹⁶¹

¹⁵⁷Mulqueen, "Regionals Post Revenues," p. C11.

¹⁵⁸Morton L. Brown and Daniel A. Burkhardt, "'Baby Bells'--Still Going Strong," Public Utilities Fortnightly, vol. 117, no. 1 (January 9, 1986), p. 41. (Hereinafter "Baby Bells.")

¹⁵⁹Quoted in Meade and Nelson-Rowe, "Regionals Learning Equipment," p. C14.

¹⁶⁰Meade and Nelson-Rowe, "Regionals Learning Equipment," p. C14.

¹⁶¹"BOCs Make the Grade on Services Despite Fears of Possible Rate Hikes," CommunicationsWeek, November 25, 1985, p. C2. (Hereinafter "BOCs Make the Grade.")

Bell Atlantic

Bell Atlantic's subsidiaries fall into three groups. One group consists of its seven telephone company subsidiaries (more than any other RHC) in three operating groups: the four C&P companies have shared headquarters operations for many years, Bell of Pennsylvania continues to provide many administrative services for Diamond State Telephone,¹⁶² and New Jersey Bell stands alone. Bell Atlantic is the only one of the seven RHCs in which the BOCs continue to provide printed directory advertising. Bell Atlantic has a headquarters group with two subsidiaries providing management services and (through its share of Bellcore) research.¹⁶³ The remaining subsidiaries are actually all held by Bell Atlantic Enterprises and are generally involved in the provision of customer premises equipment and computer services. (It also has a cellular company with operations in six cities.)¹⁶⁴ The acquisitions in particular are active outside the

¹⁶²Contrary to popular impression, none of the four Chesapeake and Potomac companies (C&P Telephone Company [which serves Washington DC], C&P of Maryland, C&P of Virginia, C&P of West Virginia) is a subsidiary of another, even though they "share" their president and most of their administrative and general departments and functions. Neither is Diamond State Telephone a subsidiary of Bell of Pennsylvania.

¹⁶³The service companies are Bell Atlantic Management Services and Bell Atlantic Corporate Services. Management Services provides services of particular interest to the operating telephone companies; it "provides staff support services in common for the telephone companies and assists them to attain the full advantage of economies of scale and to respond quickly as customer requirements change and new technology becomes available." These services include procurement, materials management, network planning, and operator services. It is in the Network Services Group. Corporate Services, in the Corporate Headquarters Group, "provides general administrative and corporate oversight services that benefit all Bell Atlantic companies ... [i]nclud[ing] ... accounting, auditing, legal services, ... shareholder relations, ... and tax planning...." Source: Bell Atlantic, Annual Report to Shareholders, 1984, inside front cover, pp. 4, 20; also responses to the survey. The stock in Bellcore is held by the parent. Source: Bell Atlantic, Annual Report SEC Form 10-K, March 27, 1985, for year ending December 31, 1984.

¹⁶⁴Bell Atlantic Mobile Systems. Bell Atlantic advertizement, CommunicationsWeek, July 22, 1985, p. 33. It is actually a subsidiary of Bell Atlantic Enterprises, a subsidiary of Bell Atlantic: see Bell Atlantic Annual Report Form 10-K, 1984, pp. 13, 15. In addition, Bell

particular are active outside the Bell Atlantic service area (MAI Canada sells computers and software in Canada). Indeed, except for Sorbus, which is a nation-wide provider of computer maintenance services, Bell Atlantic's computer sales and service subsidiaries operate entirely outside its service territory.¹⁶⁵

The controversies with respect to Bell Atlantic stem from its substantial program of acquisitions, its extensive operations outside its own service territory (despite that territory's being one of the fastest growing), and the highly competitive markets and high risks of some of its acquisitions. In particular, Bell Atlantic's commitment to data processing has been worrisome on two counts: the 1982 Consent Decree enjoins the divested BOCs and RHCs from entering the data processing industry,¹⁶⁶ and the segment of the industry Bell Atlantic

Atlantic Enterprises, through its Bell Atlantic Ventures subsidiary, acquired a majority interest in "A Beeper Company Associates," a provider of paging and mobile terminal equipment and a marketing agent and reseller of mobiles in some sixty cities, nationwide. Form 10-K, 1984, p. 15; Annual Report, p. 2. A Beeper Company's out of state operations may have to be divested as a result of the recent order of the District Court prohibiting BOCs from providing cellular radio or other basic exchange services outside their service areas, or shared tenant services. Anna Zornosa, "Judge Greene Tells BOCs He Will Not Ease Restrictions," CommunicationsWeek, January 20, 1986, p. 1. However, Bell Atlantic is reportedly seeking a waiver for paging services. See Anna Zornosa, "3 BOCs Move to Divest Extra-Regional Cellular Operations," CommunicationsWeek, February 10, 1986, p. 45.

¹⁶⁵MAI Canada has been mentioned. CompuShop Incorporated is a retail chain selling microcomputers in the Midwest, Southwest and West. Furthermore, Telecommunications Specialists (another acquisition) leases CPE primarily in Texas. (Bell Atlanticom Systems, which Bell Atlantic founded, provides CPE in the Bell Atlantic service territory, except for national and government accounts.) Tri-Continental Leasing, which was acquired and merged with the former Bell Atlantic Leasing Corporation, appears to operate primarily, but not exclusively, in Bell Atlantic's service territory for the benefit of Bell Atlantic's equipment providing subsidiaries.

¹⁶⁶As defined by the Consent Decree, provision IV.J., "information service" includes the maintenance of data bases and the sale of data processing services. The sale and maintenance of computer equipment is

is entering is highly competitive although analysts think Sorbus, one of the firms Bell Atlantic acquired, "has after-tax earnings in the twenty percent to thirty percent range."¹⁶⁷

Bell Atlantic's non-telephone subsidiaries were expected to lose money in 1985, on sales of \$400 or \$500 million.¹⁶⁸ Late in the year, Bell Atlantic spokesmen claimed all non-telephone operations except for the provision of equipment were profitable, and that revenues from equipment sales were "reaching the break even point." Donna Jaegers, a financial analyst with PaineWebber, thought that "Bell Atlantic's Tricontinental Leasing operation [was] 'fabulous'."¹⁶⁹ Bell Atlantic reports revenues from "directory advertizing, billing services and other" as operating revenues in its "Network Services Group." While these will likely amount to about a billion dollars in 1985, as of the second quarter they were about 10.3 per cent less than in 1984.¹⁷⁰ The corporation as a whole reported 14.2 per cent return on equity in 1985 (vice 13.5 per cent in 1984).

"The fundamentals of Bell Atlantic's telephone business are similar to Ameritech's but Ameritech's stock trades at a premium compared with Bell Atlantic's because of concern about Bell Atlantic's diversification efforts, analysts said."¹⁷¹ On the other hand, Bell Atlantic's

permitted, since it is indistinguishable from CPE. Resale of data bases and data processing services provided by unrelated third parties is a permitted, as is the sale of software. Again, it is hard to distinguish joint ventures for the distribution of a data base owned by an unrelated third party from common carriage.

¹⁶⁷Mulqueen, "Regionals Post Revenues," p. C12.

¹⁶⁸"Bell Atlantic Expects 1985 Profit to Reach about \$10.80 a Share," Wall Street Journal, August 23, 1985, p. 23. Mulqueen, "Regionals Post Revenues," p. C12.

¹⁶⁹Mulqueen, "Regionals Post Revenues," p. C12.

¹⁷⁰Bell Atlantic Corporation, Form 10-Q Quarterly Report for Quarter Ending June 30, 1985, p. 3. Net revenues of any of Bell Atlantic's groups cannot be determined from this statement.

¹⁷¹Mulqueen, "Regionals Post Revenues," p. C12. This would appear to indicate that diversification is, at least for the moment, raising Bell Atlantic's cost of capital, one of the possibilities which caused the District Court to condemn nongermane diversification by RHCs: see above.

stock price has risen 53.1 per cent since divestiture, the second largest rise among the RHCs: more than the RHC average of 48.1 per cent, or even Ameritech's 50.2 per cent.¹⁷² Indeed, Ameritech and Bell Atlantic's prices were almost identical (99 1/8, 99 1/2) on December 1, despite Bell Atlantic's having posted lower earnings per share in 1984 (\$10.17, \$9.94) and the first nine months of 1985 (\$8.28, \$8.25).¹⁷³

The cause of Bell Atlantic's improved financial condition, overall, was thought to stem mainly from a disproportionately large growth in business access lines, generating about \$50 per month in revenues, instead of the \$20 per month generated by residential lines.¹⁷⁴ However spokesmen for the company also pointed to efforts to control expenses.

As discussed elsewhere, Bell Atlantic's publication of Yellow Pages directories in the telephone companies has not posed problems for the regulatory commissions.¹⁷⁵ In Pennsylvania Reuben H. Donnelley Corp. had been publishing Yellow Pages. After a contract dispute, Bell Atlantic will begin publishing its own Yellow Pages directories (competing with Donnelley) in July, 1986.¹⁷⁶ The terms of Bell of Pennsylvania's contracts (which were not available to NRRI at this writing) might well repay study as benchmarks of the commercial value of being the official Yellow Pages purveyor. The results of the

¹⁷²Brown and Burkhardt, "Baby Bells," p. 41.

¹⁷³Brown and Burkhardt, "Baby Bells," p. 41. Mulqueen, "Regionals Post Revenues," p. C12.

¹⁷⁴Mulqueen, "Regionals Post Revenues, pp. C11-C12. "Bell Atlantic Expects net Profit," p. 21.

¹⁷⁵Actually, Bell Atlantic subcontracted the actual printing of the directories to an outside contractor.

¹⁷⁶Maremont, "Baby Bells," p. 96. The dispute is reportedly now in litigation. The reaction of the Pennsylvania commission is unknown, since the matter has not yet come before it: Bell of Pennsylvania has no rate cases pending.

competition between Bell Atlantic Management Services and Reuben H. Donnelley should provide an effective benchmark as to whether it is possible for even an established purveyor of Yellow Pages advertising who had dominated the market can compete effectively against the local telephone company. As discussed below, customers have a preference for a single, comprehensive directory. It should be noted that in almost all cities one newspaper carries practically all the classified advertising.

Within the Bell Atlantic "Enterprises Group," five companies comprise an "Information Products and Services Group."¹⁷⁷ Group president Brian J. Kelley was quoted: "We have all the pieces of the puzzle. Now we have to put all the pieces together. Sometimes that's a little tricky."¹⁷⁸ In addition to supplying much of the group's net revenue, Sorbus was expected to "lend clout" to the marketing efforts of other subsidiaries, such as Compushop. Bell Atlantic's "mission is to provide a single source for telecommunications, information processing, and retail computer products and repair services for small to medium size businesses in this country and in Canada."¹⁷⁹ Still, "analysts wonder how actively Bell Atlantic can continue to acquire without financial payback" and "while Bell Atlantic was the first ... to demonstrate Integrated Services Digital Network [ISDN]-compatible CPE ..., the company trails Ameritech in implementing the central office transmission equipment necessary to support ISDN CPE."¹⁸⁰

Bell Atlantic was generally praised by critics and users for providing "top-quality" phone service, but with complaints about

¹⁷⁷Bell Atlanticom Systems, MAI Canada, Sorbus, Telecommunications Specialists, Compushop. Annual Report, p. 44, Horwitt and Mayo, "RBOCs," p. 44.

¹⁷⁸Horwitt and Mayo, "RBOCs," p. 44.

¹⁷⁹Horwitt and Mayo, "RBOCs," p. 44.

¹⁸⁰Meade and Nelson-Rowe, "Regionals Learning Equipment," p. C14.

pricing and responsiveness to complaints. Some thought prices for business monopoly services were high, "inviting bypass," while others thought Bell Atlantic companies were shifting costs to the local exchange inappropriately.¹⁸¹

BellSouth

At the time of our survey, BellSouth had organized itself with its new and nongermane enterprises as direct subsidiaries of the holding company, with the major exception of BellSouth National Publishing which is a subsidiary of BellSouth Advertising and Publishing, the Yellow Pages supplier. At the end of 1985, however, BellSouth reorganized itself, following the Bell Atlantic pattern very closely.¹⁸² In appendix A, figure A-3A shows BellSouth before the reorganization, and figure A-3B shows BellSouth afterward, with the nongermane subsidiaries owned by BellSouth Enterprises.

BellSouth vice chairman William McCoy said "[t]here will be little change in the operations of the individual companies. BellSouth Enterprises will allow us to better focus on their needs." Chairman John Clendenin said that the holding company was necessary to give special attention to the daily operations of the companies. Donna Jaegers, a financial analyst at PaineWebber, thought the new structure was established to make more formal the separation between regulated and unregulated businesses, so regulators would be less likely to reach into the unregulated businesses due to the clearer demarcation.¹⁸³

In the discussion that follows we will treat the reorganization as cosmetic. In any event, it is too early to tell whether, contrary to

¹⁸¹"BOCs Make the Grade," p. C2.

¹⁸²BellSouth Corporation, Annual Report, 1984, pp. 3, 36, 53; Form 10-K, Annual Report, 1984, pp. 6-8, Survey responses. Also, "BellSouth Merges Unregulated Operations into Holding Company," CommunicationsWeek, December 30, 1985, p. 7.

¹⁸³"BellSouth Merges Operations," p. 7.

the expectations of both management and the financial community, there will be any real differences as a result.

Where BellSouth's corporate structure is unconventional is in its treatment of the service corporation, BellSouth Services: it is a subsidiary of the two operating telephone companies, Southern Bell and South Central Bell. Among the RHCs, only U S West uses a similar arrangement.

Like Ameritech, BellSouth established a CPE subsidiary, BellSouth Advanced Systems, directly under the holding company. This subsidiary "manages" South Central Bell Advanced Systems, and Southern Bell Advanced Systems, which are subsidiaries of their respective telephone companies.¹⁸⁴ A finance subsidiary, BellSouth Financial Services, was established to serve customers purchasing equipment from Southern or South Central Bell Advanced Systems, or other subsidiaries of BellSouth.¹⁸⁵ BellSouth Mobility provides cellular services in the Southeast region.

The inclusion of BellSouth Services as a subsidiary of the operating companies has significant regulatory implications, which are discussed above. It is "easier" for state commissions to investigate subsidiaries of regulated companies than their holding company parents.

¹⁸⁴Annual Report, 1984, pp. 16-17. The Annual Report and Telephony's Directory refer to the latter two as "divisions" of the telephone companies. They were originally so organized (even though they were managed by BellSouth Advanced Systems) but were transferred to the corporations on July 1, 1985. Annual Report Form 10-K, 1984, p. 6. The transfer was almost certainly at the orders of the FCC, although the original arrangement (a division of one corporate subsidiary "managed" by another corporate subsidiary) is almost unheard of in American business. Such an arrangement would have made it very easy for state commissions to treat as operating revenues any profits from CPE sales, while treating losses as nonoperating.

¹⁸⁵Annual Report Form 10-K, 1984, p. 6. The function of this subsidiary is not explained in the Annual Report to shareholders, although it is listed with the corporate officers on page 53.

The question of costs and disallowances need not arise if the regulatory body "consolidates" the service subsidiary with its operating telephone company parent or recongnizes the dividends as "operating income." Accounting can become expensive and tedious in the event a commission wishes to disallow some expenditures.

BellSouth has been "among the most conservative" of the RHCs in buying new companies. "Still, the company focuses on its local telephone business, which analysts say is the right strategy, since BellSouth has to commit more capital to its network because of all the growth" in its service area. "The company's stock has been the ... high flier [among the RHCs].... Its yield is also the lowest among the regionals. The company led all the regionals in return on equity in the third quarter with 15.2 percent, up from last year's 14.9 percent.¹⁸⁶ BellSouth's stock rose 59.4 per cent since divestiture, by far the highest of the RHCs. Its price per share, 44 5/8, is lmost exactly half that of Bell Atlantic, the RHC with the second greatest increase in stock price (53.1 per cent). However, BellSouth's earnings per share were only \$4.29 in 1984 and \$3.60 in the first nine months of 1985.¹⁸⁷ Comparing these results with those of Bell Atlantic, "the most aggressive in buying companies"¹⁸⁸ does suggest that the financial markets see diversification as raising the cost of capital.

BellSouth is reportedly now "No. 1 among the regionals in marketing PBXs" after a slow start in 1984. "According to analysts, BellSouth has studied and colselly focused on its region, resulting in strong sales of small switches and key systems." Its weakness seems to be in having too broad a product line and in failing to deliver

¹⁸⁶Mulqueen, "Regionals Post Revenues," p. C12.

¹⁸⁷Brown and Burkhardt, "Baby Bells," p. 41. Mulqueen, "Regionals Post Revenues," p. C12.

¹⁸⁸Mulqueen, "Regionals Post Revenues," p. C12.

integrated voice-data PBXs and computers, as promised.¹⁸⁹ Indeed, public statements by president Michael K. Harrell of BellSouth Advanced Systems indicate a regional strategy: "We intend to be a leader in providing voice, data, and office systems products in our area." Although a national accounts program exists, "[t]hats all we're going to do on a national basis at this point. We're not going to ... establish an office ... and compete for mid-size businesses in [other] markets."¹⁹⁰ BellSouth is trying to be a single source for integrated office systems, selling office automation to firms with fewer than one thousand employees.¹⁹¹ It has no plans to purchase or open retail computer stores (like Bell Atlantic and NYNEX). "Based on our examination of the business at this point, it doesn't make sense for us to do that. You tend to lose a lot of money."¹⁹²

Financial results for BellSouth Advanced Systems are unavailable. Indeed, the size of the sales force has not been released, although it is known that there are offices in thirty cities, twenty-one of which have facilities for demonstrations and training.¹⁹³ The "two principal subsidiaries, Southern Bell and South Central Bell, account for well over ninety-five percent of BellSouth's total revenues,"¹⁹⁴ and much of the remainder may well be from BellSouth Advertising & Publishing Corp. (BAPCO).

"BellSouth Advertising & Publishing Corporation has expanded into two important new markets, the publication of specialized directories

¹⁸⁹Meade and Nelson-Rowe, "Regionals Learning Equipment," p. C14.

¹⁹⁰Horwitt and Mayo, "RBOCs," p. 50.

¹⁹¹Horwitt and Mayo, "RBOCs," p. 50.

¹⁹²Horwitt and Mayo, "RBOCs," p. 52, quoting BellSouth Advanced Systems president Michael Harrell.

¹⁹³Horwitt and Mayo, "RBOCs," p. 50.

¹⁹⁴BellSouth, Annual Report, 1984, p. 2.

and the provision of directory services to other telephone companies."¹⁹⁵ Judging by the trade press, BellSouth National Publishing has not been very active thus far; certainly, not as active nationally and internationally as the Yellow Pages subsidiaries of Pacific Telesis and Southwestern Bell. Despite the statements in the annual reports, no national or special directories appear to have been announced.

Recently BellSouth announced that it has begun to see "directory assistance" as a profit center, because of increased charges and reduced allowances of "free" calls. It is considering several enhancements, including "a plan under which operators would provide customers with addresses, zip codes and even sales referrals."¹⁹⁶ Such a service could compete with paper Yellow Pages, and even with computerized "on-line" versions of Yellow Pages. The sales referrals, for example, might be sold as advertising, although it is not clear at which point such enhancements of directory assistance might become an "information service" prohibited by section IV.J. of the Consent Decree, or be considered something other than an "exchange telecommunications" or "a natural monopoly service actually offered under tariff," the limitations imposed by section II.D.3.

[A]pproximately forty-eight percent of BAPCO's billed revenues from directory advertising operations perviously carried on by [Southern Bell and South Central Bell] were paid as publishing fees ... for exclusive publishing rights in their respective francise areas. This provided approximately the same revenue requirements for local service as if such operations had remained with South Central Bell and Southern Bell.¹⁹⁷

The public perception of BellSouth's service quality seems to be good, with respect to technical and operational matters, and even with respect to billing. However, representatives of large users of both

¹⁹⁵Annual Report, 1984, p. 3. These other telephone companies are in the Southeast. See p. 16.

¹⁹⁶Steven Titch, "Directory Assistance Holds New Appeal," CommunicationsWeek, February 10, 1986, p. 8.

¹⁹⁷BellSouth, Annual Report Form 10-K, 1984, p. 11. No arrangement seems to have been made to compensate the BOCs for normal growth of Yellow Pages revenues.

the telephone subsidiaries claimed that the rate structures were promoting bypass. There is reportedly a perception among users and even commission staff that rates for many classes of service are poorly designed. Some users complained that BellSouth did not seem to be doing much to reduce costs.¹⁹⁸ Perusal of the trade press suggests that BellSouth spokesmen are making fewer claims of cost and labor force reduction than some spokesmen for other RHCs. However, this is difficult to verify: such statements can be found in annual reports to shareholders,¹⁹⁹ although they seem milder than equivalent statements by other RHCs in annual reports or press releases explaining quarterly operating results.

Cincinnati Bell

Because AT&T held only a minority interest in Cincinnati Bell, Inc. (CBI) and Southern New England Telephone Company (SNETCO), it was not required to divest itself of these "associated companies" (as they were then called) as part of the 1982 Consent Decree. None the less, AT&T arranged to have CBI repurchase stock it held, and sold SNETCO's stock in a secondary offering, thereby divesting itself of them. Since these companies were not defined as BOCs in the Decree, the Decree constrains their activities as it does AT&T's: they must not become information providers on their own networks until 1992. As a result of the anomalous situation of Cincinnati Bell and Southern New England, they are permitted to enter new markets and create new subsidiaries, germane and nongermane, without permission of the District Court. They may become interexchange carriers, and both have, albeit in different ways. Hence, they may be precursors of the other Bell Companies. It is well to recall, however, that the seven RHCs are taking very different approaches to new lines of business, so Cincinnati and Southern New England Telephone cannot be taken as models of what the RHCs would look like were it not for the constraints imposed by the

¹⁹⁸"BOCs Make the Grade," pp. C2, C6.

¹⁹⁹Southern Bell, Annual Report, 1984, p. 11. BellSouth Corporation, Annual Report, 1984, p. 3.

Decree. Indeed SNETCO has been much more aggressive than Cincinnati Bell about organizing new ventures; the difference in approach may be as great as the difference between NYNEX and BellSouth.²⁰⁰ Still, CBI and SNETCO are included in this report for two reasons: (1) comparison of their accomplishments with those of the RHCs may shed light upon the extent to which the Consent Decree is a real constraint upon the RHCs, preventing them from doing what they would want to; (2) they could begin their activities in 1983 or even 1982, so there is an additional year of experience to examine.²⁰¹

Some regulators consider Cincinnati Bell and Southern New England Telephone to be "Independent" telephone companies, and some expressed astonishment that we should include these companies in a report on the "Bell" Regional Holding Companies. The principal author has not observed CBI or SNETCO to have exhibited any great degree of independence in the past,²⁰² and the FCC would appear to agree, since

²⁰⁰While most analysts think Bell Atlantic has had the most aggressive diversification program, it has managed it through acquisitions of existing firms (and to a lesser extent Pacific Telesis and Southwestern Bell have also relied heavily on acquisitions for growth.) According to its "Quarterly Report to Shareholders," October 1, 1985, CBI's acquisitions in 1985 cost only \$8 million. p. 2.

²⁰¹This year is particularly important with respect to the subsidiaries providing CPE, and the experience of SONOCOR, SNETCO's subsidiary is especially interesting.

²⁰²In the early 1970s, SNETCO was the first to install Nippon Electric NC-23 crossbar PBXs for its customers, rather than Western Electric 457s. It was one of the first BOCs to use Nippon Electric NE-409 and Hitachi transportable central offices with a miniature crossbar switch, rather than Western Electric step-by-step transportable community dial offices. Still, Mountain Bell (at the time more than seventy percent owned by AT&T) was considered by many analysts to be more aggressive in purchasing non-Western Electric central office equipment, including the Japanese community dial offices. It is particularly difficult to think of any instance in which CBI exhibited "independence" before divestiture. The question of "associated company" independence is amenable to research, using the record of the antitrust case, but the principal author of this report is unaware of any that has been published.

it originally imposed upon both the same structural separations requirements it imposed on the twenty-one other BOCs, the subsidiaries of the RHCs. It must be admitted, however, that most press reports and analyses concentrate on the seven RHCs that own the BOCs that had been wholly owned by AT&T, and which are subject to continuing activity in the District Court. It must also be admitted that the FCC relaxed the structural separations requirements for the former associated companies in February, 1983, while it has not yet done so for the RHCs.

The activities of CBI and its subsidiaries have been in areas that AT&T concentrated in before divestiture: a full line of telephone service (including toll service as a reseller),²⁰³ supply and repair services for telephone companies,²⁰⁴ and research for telephone companies. Cincinnati Bell chose to organize its subsidiaries (appendix A, figure A-4) in a manner somewhat reminiscent of Bell Atlantic (appendix A, figure A-2) and the reorganized BellSouth (appendix A, figure A-3B). The newer and nongermane activities (including the cellular systems, most of which are "partnerships" with

²⁰³Cincinnati Bell Cellular Systems in partnership with Ameritech just begun operations. Cincinnati Bell Long Distance, under the "Choice" is a discount reseller in the midwest concentrating on high quality service to businesses. It is claimed that it "should make a positive contribution to corporate earnings by the end of 1985." Annual Report, 1984, p. 8.

²⁰⁴Cincinnati Bell Information Systems "manufactures" software. CBI makes no claims as to its profitability. Anixter-Cincinnati is a joint venture with Anixter Brother, a materials management firm in Illinois, providing warehousing and distribution services that were previously provided by Western Electric, but "half of its sales were with non-affiliated companies." It operates in Ohio and adjacent states. Material Recycling Company salvages telephone equipment for resale and scrap, "captur[ing] profits that had previously gone to outside vendors." Three-fourths of its revenues are from other telephone companies and other businesses. Both completed their first year with a profit. ComQuest is a product testing and research company for manufacturers of communications products and services, including use of CBI subscribers as a test market. It is claimed to have "exceeded its first year sales goal" and that it will "make a positive contribution to corporate earnings by the end of 1985." Annual Report 1984, p. 8.

Ameritech)²⁰⁵ are concentrated in Cincinnati Bell Enterprises. However, Cincinnati Bell Information Systems (developing software for the telecommunications industry) is directly under the holding company. It has provided billing software to three Bell RHCs, and provides billing services to the interexchange carrier, ALLTEL Communications. It "co-market[s] its products internationally ... with AT&T International."²⁰⁶ CBI's acquisition RESTORE Communications, Inc. is a small firm that repairs circuit boards for telecommunications companies. It is in Portland, Oregon, but CBI plans to open a service center in Cincinnati, and eventually in other major cities.²⁰⁷

CBI has remained closest to AT&T. "We decided to stick with our 100 years of heritage and continue to support AT&T. That makes us a one-source vendor for business customers computing and communications

²⁰⁵Cincinnati Bell, Inc., "Quarterly Report to Shareholders," July 1985, p. 3. Cincinnati Bell Long Distance "represent[s] Cincinnati Bell Cellular Service in marketing cellular mobile telephone service" in addition to providing message toll service. Idem.

²⁰⁶Cincinnati Bell, Inc., Annual Report, 1984, p. 6. It is also a "value added reseller" of AT&T computers. "Quarterly report, July 1, 1985, p. 3. Its newly acquired subsidiary, Creative Management Systems of McLean Virginia, sells call accounting software for PBXs ("Fortune 500 firms are its customers). Cincinnati Bell Information Systems hopes to market Creative Management Systems software to its customers, mostly telephone companies. "Quarterly Report to Shareholders," October 1, 1985, p. 2. One report said "Cincinnati Bell is permitted to manufacture the software because the divestiture agreement's prohibitions against manufacturing by Bell operating companies does not apply to the company." "Cincinnati Bell, Inc., Acquires Call-Accounting Software Firm," CommunicationsWeek, September 30, 1985, p. 40. However, in view of the activities of other RHCs (particularly Bell Atlantic or Indiana Bell) in the software business, it would appear that the architects and enforcers of the Consent Decree may not consider the writing of software to be prohibited "manufactur[ing] ... telecommunications products," even though it is not "exchange telecommunications [or] exchange access" and is not a natural monopoly service actually regulated by tariff." Consent Decree II.D.2. and 3. U.S. v. American Telephone and Telegraph Co Inc., 552 F. Supp. 131 (D.C. D.D.C., 1982), p. 227-228.

²⁰⁷Quarterly report to Shareholders, October 1, 1985, p. 2.

needs. The way we are is the way AT&T wants to be.... How does AT&T view us? Probably as just another one of their distributors."²⁰⁸ CBI's advantage is that its customers do not have to buy long-distance communications lines from one company, computers from another, telephone sets from a third, and communications lines within the state from a fourth. (AT&T is moving in this direction with the merger of AT&T Information Systems and AT&T Communications.)²⁰⁹ Indeed, CBI markets the entire AT&T Information Systems and AT&T Communications product lines: microcomputers, 3B minicomputers, Dimension 75 and 85 digital PBXs, communications and office automation software, voice-data workstations and peripherals from AT&T Information Systems; leased lines, Digital Displayphone Service, and WATS from AT&T Communications. CBI is the only telephone company in the country to do this.²¹⁰

Within its own service territory CBI has little CPE competition. "A few retail distributors in our area like MicroAge and ComputerLand, sell a few AT&T PC 6300s, but they don't sell the 7300 or 3B line. Sears has an AT&T contract but its nearest Business Center is in Dayton, Ohio. So there really is no one else around like us."²¹¹

CBI's role as a reseller of toll service in the midwest has an interesting aspect. Although the Consent Decree did not require CBI or SNETCO to provide "equal access," CBI began to "phase in" the program starting in the fourth quarter of 1984 and continuing over "several years."²¹² It found that "[t]he company's long distance business is benefitting from the availability of equal access in certain telephone company central offices."²¹³

²⁰⁸Horwitt and Mayo, "RBOCs," p. 55.

²⁰⁹Horwitt and Mayo, "RBOCs," p. 55.

²¹⁰Horwitt and Mayo, "RBOCs," p. 55.

²¹¹Horwitt and Mayo, "RBOCs," p. 55, quoting Tom Lloyd, manager of CBI's data communications division.

²¹²Annual Report, p. 4.

²¹³"Quarterly Report," July 1, 1985, p. 3.

CBI reported that it had lower earnings in the third quarter of 1985 than in the previous year, due to an increase in expenses, including depreciation. Unlike some of the other RHCs it made no claims of cost savings, or reduction in the labor force.²¹⁴ "The new businesses of Cincinnati Bell Enterprises are still growing in line with our projections. Revenues have increased dramatically but the burden of start-up costs continues to be a drag on their results. Some of the businesses are profitable; however, as a group these companies are not yet making a positive contribution to our earnings."²¹⁵

NYNEX

Although NRRI commented upon the NYPSC/NECPUC investigation of NYNEX,²¹⁶ the following analysis is based primarily upon our survey of the state commissions, examination of NYNEX's reports, the trade press, and other sources.

NYNEX claims it is "organized somewhat differently" from the other divested companies.²¹⁷ NYNEX Material Enterprises is a centralized purchasing and supply organization. Only Cincinnati Bell and U S West have such subsidiaries, and U S West's is a subsidiary of the operating companies, while CBI's is a wholesale supplier²¹⁸ to other telephone companies. Bell Atlantic and Pacific Telesis provide this "service" in their "management services" subsidiaries, which Bell Atlantic reports as part of the telephone group. NYNEX Business Information Systems is

²¹⁴"Quarterly Report to Shareholders," October 1, 1985, pp. 1, 5-6.

²¹⁵"Quarterly Report," July 1, 1985, p. 2.

²¹⁶Chessler, Comments on NYPSC/NECPUC.

²¹⁷NYNEX, Annual Report, 1984, p. 2.

²¹⁸NYNEX has applied for a waiver so that NYNEX Material Enterprise may be a supplier to the general trade. "NECPUC Opposition," discussed above.

similar to CPE subsidiaries of most other RHCs. DATAGO Computer Stores are retail outlets. Among the RHCs, only Bell Atlantic has retail computer stores (while BellSouth shuns the market). DATAGO has District Court permission to operate outside the NYNEX service area. NYNEX Development "will look for selected new business opportunities." It has done some international consulting.²¹⁹ NYNEX Development acquired Data Group, a publisher of management software and NYNEX Business Information Systems acquired Computer Solutions, a two-store retailer.²²⁰

NYNEX Information Resources is the Yellow Pages publisher. Apart from the publication of Spanish Language Yellow Pages it has recently announced one new product, an operator assisted Yellow Pages. like BellSouth's it is not reported to have expanded into new markets. Certainly it has not been as aggressive as Southwestern Bell, or even Pacific Telesis, U S West or BellSouth. The terms of NYNEX Information System's contract with New York Telephone have reportedly been criticised by the New York Public Service Commission, as discussed

²¹⁹Annual Report, 1984, p. 3.

²²⁰"B.O.C. Monitor," CommunicationsWeek, October 28, 1985, p. 12
Fredric Paul, "Nynex's Datago Unit Buys 2 Stores in Drive to Attain 19-Outlet Plan," CommunicationsWeek, November 11, 1985, p. 38.

²²¹Annual Report, 1984, p. 5. New York City Yellow Pages have had bilingual indices for some years. NYNEX now faces competition from Southwestern Bell, which plans to produce a single, complete, Yellow Pages directory in New York City. Reportedly customers are dissatisfied with New York Telephone's practice of publishing separate "consumer" and "business" Yellow Pages directories. Fredric Paul, "Southwestern Bell Heads East with Yellow Pages Marketing," CommunicationsWeek, February 17, 1986, p. 6. (Hereinafter "Southwestern Bell Heads East.") Obviously, if customers do prefer single directories it is because of a preference for completeness, and Southwestern Bell must get advertising from nearly all businesses if it is to succeed. Reportedly, Southwestern Bell is undercutting advertizing rates of local Bell companies by twenty-five to forty per cent, since it thinks it needs a twenty per cent market share to succeed. Idem. NYNEX's new operator assisted Yellow Pages, called "Hello Yellow," is being test marketed in Albany. It will accept paid advertizing, and will give customers two "listings" for each of 5,000 categories. Fredric Paul, "NYNEX Testing Operator-Assisted Yellow Pages Service," CommunicationsWeek, February 17, 1986, p. 11. Bell South's similar service is discussed above.

elsewhere herein, but no order has been released. The contract is public information²²² and may be compared with the Illinois Bell contract reprinted in appendix D.

Except for purchasing and supplies, all other technical, marketing, carrier, regulatory and legal services are provided by NYNEX Service Company.²²³ Originally, it was a subsidiary of the parent, like the service companies of Bell Atlantic or Pacific Telesis. However, on January 1, 1985 it was made a subsidiary of the telephone companies.²²⁴ As a wholly owned subsidiary of the operating telephone companies, New York Telephone and New England Telephone, it does not provide the regulatory problems of service corporations located in the parent or as direct subsidiaries of the parent. It owns the stock in Bell Communications Research. BellSouth and U S West have similarly located service subsidiaries.

NYNEX Mobile Communications provides cellular services only in the NYNEX service area. It markets "beepers" in New York State.

Financially, NYNEX's return on equity of 14.37 per cent²²⁵ is about average for the RHCs. It is reported to be "the most aggressive cost cutter among the regionals."²²⁶ The 48.2 per cent price change of its stock since January 1, 1984 is almost exactly average for the RHCs.²²⁷ The contributions, if any, of the nongermane activities to NYNEX's profitability are not systematically reported. However, Edwin Schreiner, general manager of the Datago division, said that he hoped the chain would become profitable in the second half of 1986.²²⁸ There

²²²The contracts between NYNEX Information Systems and New York Telephone and New England Telephone were filed as exhibits (10)(ii)(B)3 and (10)(ii)(B)4 to NYNEX's "Annual Report Form 10-K" for 1983, (File no. 1-8608). See, NYNEX, "Annual Report Form 10-K," 1984, p. 27.

²²³Annual Report, 1984, p. 19.

²²⁴"Annual Report Form 10-K," 1984, p. 3.

²²⁵Mulqueen, "Regionals Post Revenues," p. C12.

²²⁶Mulqueen, "Regionals Post Revenues," p. C12.

²²⁷Brown and Burkhardt, "Baby Bells", p. 41.

²²⁸Paul, "Datago Buys Stores," p. 38.

were also rumors that the reason Richard Santagati, president of NYNEX Business Information Systems, resigned late in 1985 was poor financial performance, but no evidence was available. NYNEX denied the rumors, but did not release financial information on the subsidiary.²²⁹

NYNEX was the first RHC "to open retail stores selling computers and telephone products together to business and home users." It "initiated the use of a single sales force for regulated and non-regulated products and services.... [T]he company's plan has been to integrate ... computers with PBXs.... But sources have said Nynex is finding those ambitious integration plans easier said than done."²³⁰ Even before Mr. Santagati's resignation NYNEX had done a major reorganization of its business subsidiary, relocating subsidiaries and personnel.²³¹ Thus, it is claimed that NYNEX's retail subsidiaries selling microcomputer products to small businesses and its subsidiary that sells minicomputer based office automation and large voice-data PBXs would constitute a complete office automation system, but "the two sets of sales and support people rarely communicate."²³²

Even so, NYNEX Business Information Systems' two major subsidiaries do have two centralized customer support centers (in Burlington, Mass. and White Plains, N.Y.) which keep records on all NYNEX customers, including those which "bought telephone services from the parent company or equipment from a BISC subsidiary." Customers can use an 800 number to order service changes, make billing inquiries, or ask general questions. The FCC has allowed NYNEX to provide "one stop shopping" for services and CPE through a single sales force. Thus Integrated Office Systems, the PBX and office automation subsidiary

²²⁹Union officials denied rumors that labor troubles caused the resignation. Donna Hefter, "Nynex BISC Chairman Santagati Abrupt Quits on 'Amicable' Terms," CommunicationsWeek, December 9, 1985, p. 4.

²³⁰Hefter, "NYNEX BISC Chairman," p. 4.

²³¹Horwitt and Mayo, "RBOCs," p. 23.

²³²Horwitt and Mayo, "RBOCs," p. 33. The same statement is made about Pacific Telesis's sales effort. *Idem*.

can offer comprehensive solutions, which may include CENTREX, office automation from Data General or Wang, and interpremises connections using a high speed integrated services digital network.²³³

There has also been a lot of publicity about Teleport, a "bypass" local service carrier in New York City specializing in high speed digital private lines which is owned by Merrill Lynch and Western Union. Still, the New York PSC had to order New York Telephone to provide some high speed digital private line services. The New York PSC believes that part of the bypass problem could be a perception that New York Telephone is not offering all the high speed services its customers want.²³⁴ In New England, bypass is a threat in Boston, but in rural Maine, New Hampshire and Vermont "old switches weren't being maintained" and New England Telephone has had to replace "outdated equipment with digital switches and fiber-optics." But there has been resistance to rate increases to pay for this modernization.²³⁵ In all, "assessments from interconnects and big users range from abysmal to very good, indicating ... that New England Telephone is somewhat erratic in serving the business community."²³⁶

Pacific Telesis Group

Pacific Telesis organized itself with most of its subsidiaries directly under the holding company, as shown on appendix A, figure 6. The nongermane subsidiaries report to a "group president, Pactel Companies," a position not found in Ameritech, for example, which has a similar structure. It is reminiscent of arrangements in Bell Atlantic (and the reorganized BellSouth) in which the nongermane subsidiaries are grouped into an "enterprises" corporation. (Subsidiaries are even organized into subgroups in Bell Atlantic and BellSouth.)

²³³Horwitt and Mayo, "RBOC," pp. 38-39.

²³⁴"BOCs Make The Grade," p. C6.

²³⁵"BOCs Make The Grade," p. C6.

²³⁶"BOCs Make The Grade," pp. C6-C7.

Locating Bell Communications Research and the service corporation, Pactel Services, as subsidiaries of the parent may present minor problems of regulatory reach. However, as noted elsewhere, California has long-established precedents for looking into the affairs of AT&T and Western Electric when these affected Pacific Telephone's expenses or rate base. Since Pactel Services is a "domestic" corporation, the regulatory problems caused by this structure should be minimal, except for the matter of allocating costs, which is never entirely trivial. Nevada Bell had always been a subsidiary of Pacific Telephone. With the reorganization it is now also a subsidiary of the parent holding company.

White and Yellow Page directory operations are in a Pacific Telephone subsidiary, Pacific Bell Directory. The California PSC approved this so that the revenues are "above the line." While this arrangement will not cause regulatory difficulties in California, it conceivably might in Nevada since Pacific Bell directory is a subsidiary of a company in another state. Pacific Bell Directory plans to introduce a Spanish language Yellow Pages in Los Angeles and a regional business buyers guide for purchasing agents in northern California.²³⁷ PacTel Publishing plans to produce "specialized regional, national and international directories for consumer and business markets." These include the American Hotel and Motel Association's Hotel and Motel Red Book, and the buying guide for the American Institute of Architects. Both these are established publications. PacTel Publishing purchased J.W.J. Enterprises, a small publisher of materials for convention and visitors bureaus of major cities,²³⁸ a move that appears related to the publication of the Hotel and Motel Red Book. PacTel Publishing wants to publish specialty newsletters and magazines, but none have been announced. Unless PacTel Publishing begins to produce directories that compete more directly with Pacific Bell Directory's Yellow Pages, the only regulatory issues

²³⁷Pacific Telesis Group, Annual Report, 1984, p. 21.

²³⁸Annual Report, 1984, p. 23.

will be those inherent in any any nongermane activities: risk and diversion of financial and managerial resources.

Pacific Telesis has several other subsidiaries that are of regulatory interest only to the extent that they increase the risk of the corporation (raising the cost of capital to the utilities) or divert resources away from the utilities. Pacific Telesis International has analysed a provincial telecommunications system for the People's Republic of China. It has acquired a British specialized carrier with a private network. It will consider joint projects with the National Telephone Company of Spain. It has offices in several countries around the Pacific, and won the contract for communications systems at the 1988 Seoul Olympics. Pactel Properties invests in "office and light industrial properties concentrated in California."²³⁹ Regulatory issues may arise from its provision of "real estate services to the PacTel Companies, including property development and sales lease brokerage," if it performs such services for Pacific Telephone or Nevada Bell.

PacTel Finance "provide[s] financial services to the PacTel Companies and their customers." It is providing lease financing for customers purchasing equipment from dealers and agents of PacTel Mobile Services. However, it intends to perform other financial services, such as equipment leasing.²⁴⁰ Its present activities are more limited than those of Bell Atlantic and BellSouth's finance utilities, which provide all the financing for their CPE customers.

PacTel Mobile Systems has two subsidiaries, and is trying to acquire a third. PacTel Mobile Access is the cellular radio licensee in several California markets. PacTel Mobile Services markets the telephone and terminal equipment, and resells cellular services.²⁴¹ PacTel Mobile Services appears to have a waiver of the recent District

²³⁹Annual Report, 1984, p. 23. Maremont, "Baby Bells," p. 94.

²⁴⁰Annual Report, 1984, p. 23.

²⁴¹Annual Report, 1984, p. 22.

Court ruling on the provision of telephone services outside the basic service area, so it may not have to cease its reselling operations in Texas and New York. PacTel has applied to acquire Communications Industries, Inc., which provides various mobile services outside the Pacific Telesis service area. Pacific Telesis agreed that if the merger were allowed it would divest itself of Communications Industries' manufacturing operations (prohibited by the Consent Decree), and its "non-wire line" cellular radio operation in San Diego which competes with PacTel Mobile Access's wire line cellular operation in that city. The Justice Department has backed the acquisition, which must be approved by the District Court under the Consent Decree, the FCC under title III of the Communications Act, and the California PUC.²⁴²

PacTel Communications Systems and PacTel InfoSystems correspond roughly to the Integrated Office Systems and Datago divisions of NYNEX Business Information Systems. PacTel Communications Systems sells communications systems from key systems through PBXs to business customers throughout California and Nevada. PacTel InfoSystems markets microcomputers, software, training programs, and communications systems. It maintains retail stores.²⁴³ Pacific Telesis's marketing efforts have been subjected to the same criticism as NYNEX's: the

²⁴²Steven Titch, "Justice Backs Waivers for PacTel's Takeover of Industries," CommunicationsWeek, December 16, 1985, p. 7. The FCC grants two licenses for cellular radio telephone companies in each "market" (major city): one to a telephone company that provides "line" telephone service (ordinary telephone service), and the second to companies that are not already in the telephone business. The two carriers are supposed to compete. Since the FCC must rule on all transfers of radio licenses, its approval must also be sought in this acquisition, although this is not mentioned in the story. Presumably, FCC approval would be hard to get if PacTel Mobile Access would be without a competitor in San Diego; the Justice Department objected to the acquisition until Pacific Telesis agreed to spin Communications Industries' San Diego cellular operation. Reportedly, US West has offered to buy the operation. See below, PacTel's waiver discussed in Anna Zornosa, "Greene OKs Waivers for PacTel to Buy Comm. Industries," CommunicationsWeek, March 3, 1986, p. 1, at pp. 1, 38.

²⁴³Annual Report, 1984, p. 22.

two sales forces are uncoordinated and do not communicate, although taken together the two product lines constitute a complete office automation system.²⁴⁴ NYNEX Business Information Systems has been reported to have instituted some efforts at joint selling, as noted above; no such efforts have been reported at Pacific Telesis, which still has two sales forces. Indeed, there have been reports that the two sales forces are selling competing products to each others customers.²⁴⁵

Other analysts have argued that "Pacific Telesis appears to prefer a network-first approach ... leveraging off its installed wires and central-office equipment to provide business services with a minimal [amount] of CPE. The company's recent announcement of its voice/data service for small business, called Project Victoria, is a reflection of this commitment." These analysts point out that while the CPE product lines of some RHCs may be too broad (as noted elsewhere herein), PacTel Communications limits itself to a single PBX and two key systems. "They don't invest their time or management resources on CPE because they believe network communications is the medium of choice."²⁴⁶

PacTel Communications does have a single 800 telephone number for telephone and computer support and product information.²⁴⁷ This is what NYNEX has recently instituted, but it does not include the complete database of all Pacific Telephone customers, regardless of subsidiary. Some reports suggest that Pacific Telephone may be putting a disproportionate amount of attention and perhaps funding into PacTel InfoSystems retail chain. There are also suggestions that while PacTel InfoSystems is trying to maintain its profit margins in an industry subject to heavy discounting, it is doing so in a manner too rigid for successful selling to corporate accounts.²⁴⁸ Similar criticisms are

²⁴⁴Horwitt and Mayo, "RBOCs," p. 33.

²⁴⁵Horwitt and Mayo, "RBOCs," pp. 42-43.

²⁴⁶Meade and Nelson-Rowe, "Regionals Learning Equipment," p. C15

²⁴⁷Horwitt and Mayo, "RBOCs," p. 42.

²⁴⁸Horwitt and Mayo, "RBOCs " p. 42.

made of other RHCs. See, for example, Southern New England Telephone, below.

For the most part PacTel Communications and PacTel InfoSystems have grown internally rather than through acquisitions, although PacTel InfoSystems did buy the eight store Byte Northwest Computer Shop chain in May, 1985.²⁴⁹

Financially, PacTel Communications claims 1985 went "very well" with "several multi-million dollar sales," "accomplish[ing] all the objectives of our business plan," but admitted there would be some repositioning of market strategy in 1986. Other analysts, such as William Rich of Northern Business Information, have said "PacTel Communications [CPE efforts] in 1984 were a dog and it was no better in 1985."²⁵⁰

Pacific Telesis as a whole has reduced expenses "dramatically." Maintenance expenses in 1985 were 3.6 per cent below the same period in 1984 (87.7 per cent lower in the third quarter!). It is the first RHC to have a new stock offering since divestiture, to retire debt and high cost preferred stock.²⁵¹ Divestiture had left Pacific Telesis with the highest debt ratio of the RHCs. Its return on equity has been 14.3 per cent in 1985, slightly below the RHC average of 14.42 per cent.²⁵² The price increase of its stock since divestiture, at 41.7 per cent, is below the group average of 48.1 per cent; only Southwestern Bell, at 36.0 per cent is lower.²⁵³

In terms of service, Pacific Bell and Nevada Bell have very different characters. Pacific Bell has been characterised by users as "an eager courtier [sic] of big business in a state where bypass remains a serious concern. Nevada Bell ... was sketched as a modern

²⁴⁹Horwitt and Mayo, "RBOCs," p. 42.

²⁵⁰Meade and Nelson-Rowe, "Regionals Learning Equipment," p. C15.

²⁵¹Mulqueen, "Regionals Post Revenues," p. C12.

²⁵²Mulqueen, "Regionals Post Revenues," p. C12.

²⁵³Brown and Burkhardt, "Baby Bells," p. 41.

but consumer-considerate telco, pursuing the philosophy of universal service." Pacific Bell has assigned service managers to each large user who are "on call twenty-four hours a day." Consumer advocates in California do not criticise the quality of local service, but complain of the attention being paid to business users. In Nevada, according to both the Public Advocate's office and the carrier the most common complaint seems to be high charges for extending service to remote areas. Complaints are few, however.²⁵⁴

Southern New England Telephone

Southern New England Telephone was an "associated company" of the old Bell System. AT&T owned a minority of its stock,²⁵⁵ but SNETCO was a signatory to all the contracts that tied the Bell System together: the license fee contract, the standard supply contract, the division of revenues contract. The reasons for examining Southern New England Telephone and Cincinnati Bell, the associated companies, are discussed in detail above. Briefly, because they were not subject to the constraints the Consent Decree imposed upon the twenty-one divested BOCs, the associated companies were free to enter the CPE market, including computer sales, at the same time AT&T did, in 1983. Neither did they have to relinquish their embedded base of CPE customers to AT&T. They are permitted to have interLATA and interstate operations (although the contracts by which they shared interstate facilities with AT&T and neighboring BOCs had to be renegotiated).

²⁵⁴"BOCs Services," p. C7.

²⁵⁵At divestiture AT&T owned twenty-four per cent of SNETCO's common stock, which it sold to the public in a secondary offering on May 2, 1984. United Telecomm purchased about 2.9 million of the 7 million shares AT&T sold, avowedly for "investment." Southern New England Telephone Company, "Second Quarter Report, 1984," inside front cover. Twenty-four per cent ownership of a corporation with the remaining shares widely dispersed would be considered by many as giving effective control. Ownership of 9.9 per cent of a corporation (as United Telecomm purchased) would not normally be so considered.

Like AT&T, Southern New England Telephone found the 1982 Consent Decree "liberated" it from the restrictions on data processing contained in the 1956 Consent Decree. Moreover, it did not have to ask the District Court for waivers of the terms of the 1982 Consent Decree to permit it to offer services other than local exchange service. It should be remembered that with operating revenues of \$1.2734 billion in 1984, it is far smaller than the smallest of the RHCs, Southwestern Bell, which had 1984 revenues of \$7.1913 billion.²⁵⁶

SNETCO was quick to take advantage of this situation, and on January 1, 1983, with the approval of the Connecticut Department of Public Utility Control, SONECOR Systems Division began operating in the competitive marketplace, providing equipment from a large number of suppliers. It also created a subsidiary, SONECOR Credit Corporation (of which it owns eighty per cent) to finance the sales.²⁵⁷ Since then it created subsidiaries for its fiber optics joint venture with CSX, the railroad, and a real estate corporation. In 1984 the Connecticut Department of Public Utility Control began a proceeding as to the structural and operating separations and conditions it should impose

²⁵⁶Southern New England Telephone Company, Annual Report, 1984, p. 27. Southwestern Bell Corporation, Annual Report, 1984, p. 23.

²⁵⁷SNETCO, Annual Report, 1983, pp. 17-22. SONECOR FiberCom is an activity prohibited to the RHCs by the 1982 Consent Decree's restrictions on their offering interLATA services. SONECOR Voice Messaging Division is markets Tigon Corporation's electronic "mailboxes" for storage and forwarding of voice messages. (Annual Report, 1984, p. 10.) This too, is forbidden to the RHCs as "information service," but AT&T (and SNETCO) may offer it since they do not own or control the information. "'Information Service' means the offering of a capability for ... storing information which may be conveyed by telecommunications" Consent Decree, clause IV.J., U.S. v. American Telephone & Telegraph Co., 552 F. Supp. 131 (D.D.C., 1982), p. 229. SNETCO documentation is vague as to whether certain CPE and interexchange operations are technically divisions or subsidiaries. This vagueness extends to SNETCO's recent filings with the Connecticut DPUC, discussed below. We show them as subsidiaries, since organizations that include retail stores and joint ventures must operate as corporations, even if some of their management is performed in a division of the parent. See SNETCO Responses to Interrogatories by Rolm Corporation, and SNETCO Responses to Interrogatories by Division of Consumers Counsel, Connecticut Department of Public Utilities Docket 83-12-15: ES: BBM, SNETCO Petition on Diversification, September 19, 1985.

diversification.²⁵⁸ SNETCO recently filed a proposal to establish a holding company for all its communications businesses,²⁵⁹ but the department has not acted upon it.

SONECOR FiberCom Corporation is part owner of the LIGHTNET partnership with CSX Communications, a subsidiary of CSX Corporation (the parent of the Chesapeake and Ohio railroad). Most of the customers are interexchange carriers, and are part owners or have long term leases. LIGHTNET has asked the FCC and the Florida PSC for rulings that it is not a common carrier. U.S. TeleCom Communications is the largest customer, and a primary contractor for construction.²⁶⁰ This relationship with U.S. TeleCom (and SONECOR FiberCom's continuing need for external financing to complete LIGHTNET) is interesting in light of U.S. Telecom's having purchased SNETCO's stock at the secondary offering, but no relationship between the events has been shown.²⁶¹ AT&T Technologies is the major equipment supplier, which is interesting in light of AT&T Communications being a major competitor.

²⁵⁸Southern New England Telephone Company, "Annual Report Form 10-K" 1984, p. 2.

²⁵⁹"Connecticut DPUC to Consider Approval of SNET Reorganization Plan," State Telephone Regulation Report, vol. 3, no. 18 (September 26, 1985), p. 8.

²⁶⁰"Annual Report Form 10-K," 1984, p. 9.

²⁶¹United Telecommunications Inc., recently issued debentures which convertible into Southern New England Telephone Company stock at \$49.275 per share, about a 20.25 per cent premium over SNETCO's recent stock price of \$41. (United Telecom bought the stock for \$20.80.) United Telecom had to pay only 9.75 per cent interest on the debentures, rather than about 12 per cent had they not been convertible. Some analysts thought United used SNETCO's stock rather than its own because SNETCO is a stronger company than United, but there are other advantages for United: it gets the SNETCO stock off its books at a profit, sells SNETCO's stock without depressing the price, and lowers the interest rate it must pay. SNETCO's debt has a AA rating from Standard & Poor's Corp., while S&P recently lowered its rating of United's debt from BBB plus to BBB. (The convertible issue in question is rated BBB minus.) "S&P said that United's regulated telephone operations are still strong, but that paying for its U.S. Telecom Inc.'s long-distance operation is a growing burden for the whole corporation." "United Telecom: SNET Stock to Cut Charges on Offering," CommunicationsWeek, September 9, 1985, p. 32.

SONECOR Systems has not been successful. After the first year of operations SNETCO said "[w]e expected the division to post a slight profit on its first year of operations. Instead, it posted a moderate loss. We ... took prompt corrective measures. Although we are well-positioned against competitors ... fewer [large] customers purchased equipment ... than we had projected."²⁶² After the second year SNETCO said

[o]ur diversified telecommunications group, as is to be expected of start-up businesses, continues to post losses and will probably not be profitable in 1985. New competitors have crowded into communications markets, squeezing profit margins.... [C]osts exceeded revenues.... We've sharpened our market focus ... [a]nd we're reorganizing the division with a focus on cost control and force reduction.²⁶³

In fact, SNETCO's diversified telecommunications group, consisting of SONECOR Systems, SONECOR FiberCom Corp., SONECOR Cellular, SONECOR Voice Messaging, SONECOR Credit Corp., and SONECOR Real Estate Corp. lost \$7.5 million in 1983 on sales of \$15.1 million, and \$20.9 million in 1984 on sales of \$52.6 million.²⁶⁴ Dean Witter Reynolds estimated the losses on unregulated operations at \$8.4 million after taxes in the first half of 1984, and \$15 million in the first half of 1985.²⁶⁵ The diversified telecommunications group represented an investment of \$76.7 million at the end of 1984 (exclusive of advances), and further investments of \$16 million, plus short-term external financing, were anticipated in 1985.²⁶⁶

In February and again in mid-1985, SNETCO retrenched significantly. After several management changes at SONECOR Systems, it

²⁶²Annual Report, 1983, p. 18.

²⁶³Annual Report, 1984, pp. 2, 16.

²⁶⁴Annual Report, 1984, p. 36.

²⁶⁵Horwitt and Mayo, "RBOCs," p. 55.

²⁶⁶"Annual Report Form 10-K," 1984, p. 9. SNETCO's total assets in 1984 were \$2.2696 billion, of which \$1.804 billion was net telephone plant.

closed Chicago and California offices and limited itself to the Northeast (its most distant office is now in Philadelphia). It reduced staff from 800 to 625. It also moved its sales offices out of shopping malls into SNETCO locations. Although it had been trying to market integrated voice-data systems, like the other RHCs, the division's president said "I don't think customers are ready to buy integrated voice-data systems. That's what we've found in the market. There just has not been the public acceptance ... we thought would come."²⁶⁷ Indeed, analysts thought that unregulated operations, including SONECOR Systems and LIGHTNET had lost \$8.4 million after taxes in the first half of 1984 and \$15 million in the first half of 1985, with most of the losses due to the equipment operation.²⁶⁸ Reportedly, SONECOR was bidding several hundred dollars per line more for PBXs than its competitors, even on identical configurations. Northern Telecom terminated the distributorship, supposedly because of low sales volumes, although Northern officials would not comment.²⁶⁹

SONECOR thinks its finances should improve. It estimates 1985 sales to be 35 per cent higher than 1984 sales which were in the \$50 million range. As manager of integrated systems Joseph Scozzafava says

we think this is great for a start-up business. You have to expect to lose money initially. And we hope to be profitable by 1986. The problem is that people were looking for us to be profitable by 1984. Who's profitable now? AT&T sure isn't. The problem is that early on the press gave us a glamorous image that we're now finding hard to live up to in a market with RBOCs. Yes, the RBOCs are tough competitors, but we plan to beat them.²⁷⁰

²⁶⁷Laurel Nelson-Rowe, "Two Years of Hard Lessons: Sonecor Cuts Back OA Effort after Stalled Push," CommunicationsWeek, August 26, 1985, pp. 1, 6. As noted elsewhere, most of the RHCs have stressed integrated voice-data systems, and none have found much of a market for such integrating.

²⁶⁸Nelson-Rowe, "Sonecor Cuts Back," p. 6. SNETCO refuse to release figures for SONECOR Systems, but it was reported that they had expected profits of \$6 million in 1985. Idem.

²⁶⁹Nelson-Rowe, "Sonecor Cuts Back," p. 6.

²⁷⁰Horwitt and Mayo, "RBOCs," p. 55.

Since SNETCO never moved Yellow Pages from the telephone company, there have been no regulatory problems with respect to revenues. In 1984 SNETCO said it was introducing new community directories, and new guides for attorneys and dentists (it already had special guides for restaurants and physicians). Directory revenues in 1984 increased 15.4 per cent in 1982, 17.0 per cent in 1983 and 16.7 per cent from 1983, due to "advertising rate increases and increased sales volume."²⁷¹

SNETCO has made claims about its efforts to cut costs in telephone operations, including freezing pay scales, but unlike other BOCs, it increased the number of employees in 1984.²⁷²

In 1983 SNETCO admitted to service problems with respect to responsiveness to customers. In both 1983 and 1984 SNETCO cited a number of efforts to improve responsiveness, both in service (repairs, moves and rearrangements) and in the market (more services and choice).²⁷³

Southwestern Bell

Southwestern Bell Corporation is the only RHC with but a single telephone subsidiary, Southwestern Bell Telephone Company. Its customer premises equipment subsidiary is Southwestern Bell Telecom. It intends to introduce a line of "high function cord and cordless telephones" into the "nationwide consumer retail market." Southwestern Bell Mobile Systems, was the first Bell company to have all its cellular radio systems operating.²⁷⁴ Asset management, Inc., a real estate subsidiary, is not active yet.²⁷⁵ Southwestern Bell's interest in Bell Communications Research is owned directly by the holding company.

²⁷¹Annual Report, 1984, pp. 12, 23. The recent filings with the Connecticut DPUC, discussed above, provide for subsidiary for Yellow Pages.

²⁷²Annual Report, 1984, pp. 8, 18, 23.

²⁷³Annual Report, 1983, pp. 4, 13-14. Annual Report, 1984, pp. 8-10.

²⁷⁴Southwestern Bell Corporation, Annual Report, 1984, p. 5.

²⁷⁵Survey responses.

Southwestern Bell Publications has been extremely active in the Yellow Pages markets nationally. On January 1, 1984 Southwestern Bell transferred all Yellow Pages operations to Southwestern Bell Publications; accruals of revenues and expenses for directories published after that date would not be recognized by the telephone company.²⁷⁶ This arrangement is different from those of the other RHCs, whose directory subsidiaries continue to pay the telephone company for rights to the customer lists. See, for example, discussions of Ameritech, BellSouth, and NYNEX herein. As discussed below, when determining the revenue requirement in rate cases, commissions have been taking a variety of approaches to "imputing" an "appropriate" level of Yellow Pages revenue to the operating telephone company, and are not necessarily relying on accounting. Kansas, which reports that it is treating Southwestern Bell's Yellow Pages as a rate-regulated service (see below) is unusual.

Southwestern Bell was "the Yellow Pages sales leader for the Bell System each of the six years before divestiture. The average annual growth rate for directory revenues was seventeen per cent for the period." These directories are now published by Southwestern Bell Publications, and Southwestern Bell does not publicly disclose revenues of subsidiaries other than the telephone company.²⁷⁷ Communications Trends, a market research house, estimated Southwestern Bell's Yellow Pages revenues in 1984 at \$740 million.²⁷⁸ A Southwestern Bell spokesman said that in the second quarter of 1985 Southwestern Bell earned \$21 million "from sales of Yellow Pages directories published in 1984."²⁷⁹ (This is apparently the amount Southwestern Bell Corporation continued to credit Southwestern Bell Telephone Company for Yellow

²⁷⁶Southwestern Bell Corporation, "Annual Report Form 10-K," 1984, pp. 4-5.

²⁷⁷Annual Report, 1984, pp. 12, 16.

²⁷⁸John Mulqueen, "SW Bell Buys Contel's Directory Publishing Unit," CommunicationsWeek, July 15, 1985, p. 1, at p. 45.

²⁷⁹John Mulqueen, "All 7 Bell Holding Companies Report Higher Earn for Quarter," CommunicationsWeek, July 22, 1985, p. 29.

Pages Revenue earned prior to creation of Southwestern Bell Publications.)²⁸⁰ Southwestern Bell Publications began with the following subsidiaries in 1984. AD/VENT Information Services had a contract to produce directories for the telephone company in Australia. It also sells other printed promotional and directory material. Others were AD/VENT Grafx (which does graphic design for the other subsidiaries), Southwestern Bell Media (which owns the copyright and produces and distributes the directories), and Southwestern Bell Yellow Pages (which was the subsidiary that sold the advertising).²⁸¹ Southwestern Bell Publications began to acquire Yellow Pages operations. It acquired Mast Publishing from Continental Telecom, Inc. It acquired J.C. Blake, a publisher of Yellow Pages directories, guides for the armed forces and for tourists, maps, and directories for government agencies. It bought New York Yellow Pages, a small publisher of neighborhood directories. It also acquired fifty per cent of AMDOCs, Inc. which develops publishing technology.²⁸² Analysts say that "Southwestern Bell's aggressive move into high-margin directory publishing could prove to be the most profitable of all the regionals' diversification efforts."²⁸³

Southwestern Bell Publications has also introduced new products. For example, the Southwestern Bell Media subsidiary has begun publishing directories in other service areas, as discussed elsewhere

²⁸⁰"The Telephone Company will continue to recognize decreasing revenue and expense in 1985 as Yellow Pages directories produced prior to December 31, 1983 are replaced by updated directories." "Annual Report Form 10-K," 1984, pp. 4-5.

²⁸¹Survey Results. Annual Report, 1984, p. 12. Capitalization plans for the furnishing of Customer Premises Equipment and Enhanced Services, FCC Mimeo 85-28, February 4, 1985, Appendix G, pp. 4-5. White pages are produced by the telephone company.

²⁸²"SW Bell Unit Acquires Another Directory Company," CommunicationsWeek, October 14, 1985, p. 50. Southwestern Bell Corporation, "Southwestern Bell Publications Buys San Diego Publisher," Press Release, September 27, 1985.

²⁸³Mulqueen, "Regionals Post Revenues," p. C12.

herein. It has also begun publishing several editions of the "Silver Pages" directories of firms offering discounts to senior citizens, with sections on services available to the elderly and a "slick magazine" on health and other topics. Most publications will distribute these through senior citizens organizations. Other RHCs, such as Ameritech and BellSouth are using logos to identify businesses offering such discounts. The president of Ameritech Publishing, Leo F. Egan, is quoted: "With that type of identification in the local Yellow Pages, why do you need a second book like Silver Pages?" Southwestern Bell's "research in St. Louis [its own service territory] shows seventy-one per cent of all seniors have Silver Pages in their homes, and fifty-one per cent say they used it at least once within three months of receiving it."²⁸⁴

Southwestern Bell has a major effort to publish Yellow Pages directories in Eastern Markets including New York, Baltimore and Washington, D.C. Reportedly, Southwestern Bell wants a twenty per cent market share, and is discounting advertising rates by twenty-five to forty per cent. It is also publishing single directories in markets where customers must now consult several directories to get a comprehensive listing of all companies. These points are discussed elsewhere herein.

While Southwestern Bell has been "leading from its strength" by expanding as aggressively in the Yellow Pages business as Bell Atlantic has in CPE, it has not neglected the CPE market by any means. Southwestern Bell Telecom now has two divisions. The Business Systems Division markets key and PBX systems, and "is becoming a major competitor in the office integration marketplace." To sell better in the mid-west, it acquired "certain assets of COMCOA, Inc., a Kansas Telecommunications Company." The second division is the Freedom Phone Division, "launched through to acquisition of the rights to the Freedom Phone

²⁸⁴James Ellis, "Southwestern Bell Grows by the Book--the Yellow Pages," Business Week, December 2, 1985, p. 101. For information on Southwestern Bell's eastern Yellow Pages, see Fredric Paul, "Southwestern Bell Heads Fast with Yellow Pages Marketing," CommunicationsWeek, February 17, 1986, p. 6.

product line from Electra Company..... These products will be distributed on a national basis through quality retail stores." Southwestern Bell/ISI--Information Systems Integrators began as a "separate consulting unit,"²⁸⁵ but has since been merged with the Business Systems Division.²⁸⁶

Southwestern Bell is not yet actually active in the office automation business, and when it does enter it will keep its product line narrow. "We definitely plan to get into the office automation market sometime in 1986.... We plan to tie the products we offer to certain [unnamed] vertical markets and user areas with a well-defined need for voice-data communications applications, like manufacturing and service."²⁸⁷ In fact, "[a]nalysts chided the company for lack of a computer line," and faulted it for poor performance selling PBXs. "Eastern Management Group ranked them fifth among BOCs." The depressed state of the agriculture and oil industries were also cited as reasons for poor sales performance. However, claims that state regulation is "tough" in the region should not have been a factor, since CPE is deregulated.²⁸⁸

Southwestern Bell Telecom has been active as a supplier to the shared tenant services companies. it has "a multimillion-dollar contract with Electronic Office Centers of America, Inc.," which will buy \$20 to \$50 million worth of PBXs and other equipment. Electronic Office Centers said "[w]e've been working on cooperative marketing in some of the shared-tenant areas." Electronic Office Centers has buildings in Chicago, Dallas, and Pittsburgh.²⁸⁹ Although the District Court has refused to grant waivers so that RHCs may go into the shared

²⁸⁵Annual Report, 1984, p. 14.

²⁸⁶Meade and Nelson-Rowe, "Regionals Learning Equipment," p. C15.

²⁸⁷Horwitt and Mayo, "RBOCs," p. 54, quoting Jack Zaloudek, executive vice president of the Business Systems Division.

²⁸⁸Meade and Nelson-Rowe, "Regionals Learning Equipment," p. C15.

²⁸⁹Horwitt and Mayo, "RBOCs," p. 54.

tenant services business, there is no apparent objection to their acting as CPE providers, even outside their service areas.

In 1985 Southwestern Bell had to quadruple the capitalization of Southwestern Bell Telecommunications from \$47.7 million to \$200 million. Southwestern Bell said it needed the money to purchase its CPE inventory and fixed assets rather than leasing them. The FCC granted the request because the amount, \$200 million, is small relative to the \$3.9 billion construction program of Southwestern Bell Telephone, but the FCC accused Southwestern Bell of "poor business planning."²⁹⁰

Financially, Southwestern Bell's 14.2 per cent return on equity is among the lowest. It ties Bell Atlantic's, and only U S West's is lower (at 13.6 per cent). Southwestern Bell is coping with a depressed local economy in Texas, and most of its new access lines are residential, which produce less revenue. It has reportedly "not been aggressive enough in cutting its payroll" since its chairman "fears that if Southwestern Bell lets many people go it will lose experienced personnel that it might later need."²⁹¹ Southwestern Bell's stock has gone up in price only 36 per cent since divestiture, by far the worst performance among the RHCs.²⁹² It has been hurt by the slow progress of a rate case in Texas, and uncertainty about the National Exchange Carriers Association pools (it is a "high cost" company and a net recipient).²⁹³ There appears to be a general perception that "state regulators in the region are among the toughest in the country."²⁹⁴ All of these considerations may be affecting the price of the stock.

Southwestern Bell "prides itself on placing top priority on the local exchange and providing dependable and affordable plain old telephone service. A company spokesman said "we provide local

²⁹⁰B.O.C. Monitor, "CommunicationsWeek", July 15, 1985, p. 10.

²⁹¹Mulqueen, "Regionals Post Revenues," p. C12.

²⁹²Brown and Burkhardt, "Baby Bells," p. 41.

²⁹³Mulqueen, "Regionals Post Revenues," p. C12.

²⁹⁴Meade and Nelson-Rowe, "Regionals Learning Equipment," p. C15.

service. That's our mission." Big users complain that Southwestern Bell is "jealously guarding its exchange turf to the detriment of competition and new technologies." The director of the Arkansas state Department of Computer Services said "the primary thing to understand is that of all the Bell operating companies, Southwestern Bell is probably the most conservative. The conservatism is almost provincial at times." Interconnects have been challenging Southwestern Bell's tariffs and other restrictions, both at the federal and state levels. They also report slow response to complaints about line problems, leading to a poor working relationship with vendors. But for basic services Southwestern gets high marks. There is a perception in some states, such as the Arkansas Attorney General's Office, that it favors residential customers with low rates, and that it is very good at responding to complaints: very few reach the Attorney General. In other states, Kansas, Oklahoma, and Texas, state officials all mentioned continuing complaints about customer billing and service, despite Southwestern Bell's well-thought-of "Tele-Help" program of brochures and advertizements to reduce customer confusion.²⁹⁵

U S West

U S West is the smallest of the RHCs in assets and revenues and has only four telephone companies, Mountain Bell, Northwestern Bell, Pacific Northwest Bell, and Mountain Bell's small subsidiary, Malheur Home Telephone Company. Yet appendix A, figure A-9, shows the most elaborate structure of any of the regional holding companies.

If there is unique direction being taken by U S West in diversifying, it is commercial real estate. Several RHCs are stressing real estate to one degree or another, but "U S West is pushing the hardest. It already has a \$70 million portfolio of outside properties. [It] has spent \$74 million for two commercial lending companies."²⁹⁶

²⁹⁵"Regionals Make The Grade" pp. C7, C16.

²⁹⁶Maremont, "Baby Bells," p. 100.

But most of U S West's diversification has been through in-house development rather than acquisition.²⁹⁷

Landmark Publishing publishes telephone directories through its U S West Direct subsidiary. (The disputes over the transfer of Yellow Pages in Colorado, Minnesota and Wyoming are discussed elsewhere.) NewVector Communications provides cellular service within the region, and has proposed international ventures. (U S West has offered to buy the San Diego non-wire line cellular system from Communications Industries as part of Pacific Telesis's purchase of that company. This is subject to the District Court's willingness, discussed elsewhere, to grant waivers for operation of cellular radio outside the service area.) U S West Information systems was formed in August, 1985, by merging Interline Communications (a nationwide service company, offering management, installation and repair of major CPE installations) with FirstTel Information Systems (which sold and serviced business telecommunications equipment in U S West's service area, plus California and Nevada), plus small CPE subsidiaries of the telephone companies.²⁹⁸ U S West Financial Services provides leasing and sales financing to customers. BetaWest properties is the commercial real estate subsidiary. NeTech Communications is unique among the RHCs, providing internal telecommunications to the the other subsidiaries.²⁹⁹ Netech was apparently intended to be the nucleus of U S West's re-entry into interLATA telecommunications, but such re-entry has been foreclosed by the District Court for the indefinite future: certainly until equal access is a reality.

Like BellSouth, U S West originally located the service and supply subsidiaries (including Bell Communications Research) as subsidiaries

²⁹⁷Mark Ivey, "The 'Cowboy' Leading the Charge at U S West," Business Week, December 2, 1985, p. 96, at p. 97.

²⁹⁸Horwitt and Mayo, "RBOCs," p. 46.

²⁹⁹U S West, Annual Report, 1984, inside front cover, except for information on reorganization of CPE offerings.

of the operating companies, thereby probably avoiding some of the controversies that have attended NYNEX's structure. However, U S West further divided Northwestern Bell and Mountain Bell, creating holding companies for each, and then relocating some of their operations (such as real estate and paging) outside the telephone companies. More recently, U S West merged Spurs West, the procurement arm for two of its BOCs into U S West Material Resources, the procurement subsidiary for all U S West.³⁰⁰

While U S West says "Landmark Publishing ... intends to pursue other opportunities in the publishing industry," none have been announced. U S West Direct pays the BOCs "publishing fees for exclusive use of logo and directory rights."³⁰¹

NewVector Communications will install a cellular radio system in the Gulf of Mexico and design and manage one in Costa Rica.³⁰² These appear to be the only U S West overseas activities. Unlike Bell Atlantic, Southwestern Bell, and Pacific Telesis, it has not operated outside its service territory in the United States,³⁰³ although it has made an offer for a non-wire line system in San Diego.

U S West's CPE subsidiaries have had "disappointing" performance, and as noted above were reorganized in August, 1985, from a decentralized pattern reminiscent of Ameritech to a highly centralized structure. U S West chairman Jack McAllister has indicated that reorganization will delay until 1986 the profitability of all U S West's new subsidiaries.³⁰⁴ Through the Interline division, U S West is active in thirty-six states. (Interline does not provide equipment, but does do upgrades and third-party maintenance.) The Business Sales and Services division is the single point of contact for most business

³⁰⁰"B.O.C. Monitor," CommunicationsWeek, December 2, 1985, p. 16.

³⁰¹Annual Report, 1984, pp. 6, 11.

³⁰²Annual Report, 1984, p. 7.

³⁰³Anna Zornosa, "3 BOCS Move to Divest Extra-Regional Cellular Operations," CommunicationsWeek, February 10, 1986, p. 45.

³⁰⁴Horwitt and Mayo, "RBOCs," p. 46.

customers. It was segmented along product lines (indeed, in different subsidiaries, some of which competed for sales of the same products) before the reorganization, but is now organized into three groups: one for U S West's service territory, one for California and Nevada, and "Strategic Accounts" to reach national accounts, shared tenant services customer and the federal government.³⁰⁵ Unlike NYNEX and Bell Atlantic, but like BellSouth, U S West does not plan to enter the retail computer market.³⁰⁶ Before the reorganization there were apparently real problems with U S West's CPE sales efforts. The most notable was an installation of a "private network exchange" PBX from Ztel, Inc., for the government of Utah which had to be abandoned when it did not provide all promised features and the manufacturer went bankrupt. While U S West's spokesmen say the reorganization gave a "finer market focus" and allowed a "more coordinated effort," outside analysts say it is too soon to tell whether the reorganization is a success.³⁰⁷

By any objective standards U S West's diversification efforts have been conventional and even conservative compared to some other RHCs. This is at marked contrast with the company's rhetoric. Jack A. McAllister, the chairman, "constantly rails against the evils of monopoly and regulation, ,,, advocates wholesale deregulation of nearly every phone service ... [a]nd ... was the first to call for changes in the [Consent Decree]."³⁰⁸

U S West has gotten some pricing flexibility for telephone services, but critics charge that its "strategy could leave U S West without its customary guaranteed rate of return--and vulnerable to an array of competitors." A "top official" at another RHC said "their philosophy is that competition is good, therefore do it. But sometimes that isn't smart business sense. This is not the time for uncon-

³⁰⁵Horwitt and Mayo, "RBOCs," p. 46.

³⁰⁶Horwitt and Mayo, "RBOCs," p. 48.

³⁰⁷Meade and Nelson-Rowe, "Regionals Learning Equipment," p. C15.

³⁰⁸Mark Ivey, "The 'Cowboy' Leading the Charge at U S West," Business Week, December 2, 1985, p. 96.

trolled, cowboy kind of competition. This is the time to get ready for competition."³⁰⁹

Donna Jaegers of PaineWebber compared U S West's diversification with Southwestern Bell's move into Yellow Pages: "relatively stodgy. But at least [Southwestern Bell] are doing it full speed. Their saying, 'let's do this and not look back' will probably pay off more than what U S West has done by saying 'let's get into this and that and whatever looks good.' In the future there are always second thoughts with that kind of approach and there is always restructuring."³¹⁰

John Bain at Shearson Lehman Brothers called U S West "definitely one of the more innovative" holding companies, noting "the history of innovation and diversification by telephone companies is not exactly cheering news to investors, so it is not clear whether this management style is good or bad."³¹¹

U S West chairman McAllister says "the days of building fortresses and trying to hide behind them are over." It is reported that "by 1990 he hopes to get fifty per cent of his revenues from unregulated businesses, up from ten per cent this year."³¹² The ten per cent obviously includes revenues from Yellow Pages, since as noted, none of U S West's new subsidiaries are profitable. (A statement in the 1984 Annual Report [p. 3] that three of the unregulated corporations "were profitable for the year," appears to refer to directory publishing, real estate and financial services.) In 1984, "new, unregulated companies" provided 4.7 per cent of total revenues.³¹³

U S West's financial results are about average. The price of the stock increased 48.4 per cent since divestiture, slightly above the RHC

³⁰⁹Ivey, "U S West," pp. 96-97.

³¹⁰Mulqueen, "Regionals Post Revenues," p. C12.

³¹¹Mulqueen, "Regionals Post Revenues," p. C12.

³¹²Ivey, "U S West," p. 97.

³¹³Annual Report, 1984, p. 3.

average of 48.1 per cent.³¹⁴ Its return on equity of 13.6 per cent for the nine months ending September 30, 1985 is the lowest of the RHCs, and shows the least improvement by far compared with the same period the previous year. On the other hand, its return on equity of 14.8 per cent for the third quarter is a substantial improvement over the previous year.³¹⁵

Service quality is reported to be good, except where it is completely unavailable in remote locations. Complaints generally had to do with rates, including an effort to get mandatory local measured service in Oregon (delayed by the legislature until July, 1986 at the earliest), and high rates in Utah. Northwestern Bell's rate increases seem to have aroused "some ire," and a state users group in Minnesota said local rates have gone up one-third since divestiture, which has drawn protests from consumers groups. The most common complaint is that U S West is concentrating too much on city customers. In Utah the Consumer Services Office pointed out that some customers still have only eight-party services available, and some have no service, but that Mountain Bell did not begin to extend service until ordered to do so by the commission. A similar problem occurred in Wyoming, but the commission there said the BOC has been "very cooperative," and the commission in Montana said this "perennial problem" should be solved by next year.³¹⁶

State Commission Actions with Respect to RHC Subsidiaries

In June and July 1985 NRRI conducted a combined mail and telephone survey of state commissions. In all, there were forty usable responses. While these responses are summarized below, a certain caution must be exerted in using the results. In particular, a

³¹⁴Brown and Burkhardt, "Baby Bells," p. 41.

³¹⁵Mulqueen, "Regionals Post Revenues," p. C12.

³¹⁶BOCs Make The Grade," p. C16.

commission's statement that an activity is unregulated may refer only to traditional rate base regulation applied directly to the subsidiary. In some instances it appears that commissions are applying non-traditional regulation, or are applying the regulation indirectly through the operating telephone company. The responses to the survey are summarized in Appendix C, table C-1.

Corporate Structure

Because the 1982 Consent Decree and the reorganization plan were orders of federal courts, state commissions were unable to influence the transfer of functions, lines of business, or assets to the regional holding companies. In other circumstances (that is, when the utility is not acting in response to a court order) many commissions do have legal authority to regulate the disposal of assets³¹⁷ and discontinuance of service by the utilities they regulate.³¹⁸ Furthermore, the court ordered all assets to be valued at net book cost for accounting purposes.³¹⁹

Thus, state commission reaction to the new organizational structure has necessarily been indirect. Commissions have investigated the valuation of the transferred assets for ratemaking purposes, and

³¹⁷The importance of this authority is shown by the case of the Bangor and Aroostook Railroad which transformed itself into a holding company and disposed of many assets. When Bangor Punta, the holding company, disposed of the railroad, the railroad's buyer, First Boston Corporation, sued the seller for having "stripped" the assets. As a result of the Bangor and Aroostook situation and a similar one involving the Penn Central Railroad, the ICC asked Congress for additional powers to directly regulate rail holding companies, transactions among affiliates of holding companies, and even transactions between regulated firms and outside suppliers. Manley R. Irwin and Kenneth B. Stanley, "Regulatory Circumvention and the Holding Company," Journal of Economic Issues, vol. vii, no. 2 (June 1974), pp 398, 404.

³¹⁸For examples of state commissions using these powers in such matters as the transfer of Yellow Pages, see the Colorado, Minnesota and New York actions discussed herein.

³¹⁹U.S. v. American Telephone and Telegraph Co., Inc., 552 F. Supp. 131 (D.C. D.D.C., 1982), pp. 204-205.

the reasonableness of the contracts between the telephone utility and its affiliates.³²⁰ They have also consolidated operating revenues of unregulated, nonutility, affiliates with operating revenues of the telephone company for rate making purposes.³²¹

State commissions do not generally consider that they have authority over the activities of holding companies. Thus, their attempts to restrict the nongermane activities of the Bell Regional Holding Companies have centered upon petitions to the District Court with jurisdiction over the Consent Decree. The FCC, on the other hand, has taken a very active stance, even seeming at times to declare holding companies to be common carriers.³²²

In 1979, the FCC held GTE, then a conglomerate holding company owning several operating telephone companies (some of which were fully subject to FCC jurisdiction and some of which were "connecting carriers" under 47 USC 152(b)(2)), manufacturing suppliers to the telephone industry, and manufacturers of consumer products, to be a common carrier subject to section 214 of the Communications Act.³²³ This order was not appealed to the courts.

³²⁰See, for example, the Illinois and New York investigations of the Yellow Pages contracts discussed herein.

³²¹According to the NRRI survey, at least with respect to Yellow Pages this is the practice in all states in the Bell Atlantic Region, except possibly Pennsylvania which did not respond, but which has no current rate cases and granted little of the requested relief in the most recent case. For citations to specific orders see Chessler and C "Yellow Pages."

³²²*U S West, et al. v. FCC, U.S. C.A. D.D.C. nos. 84-1451 and 84-1448* (involving an FCC order which imposed conditions upon facilities authorizations, making the authorizations conditional upon the treatment of costs incurred by the former BOCs) and GTE's acquisition of Telenet in 1979. "D.C. Appellate Court Hears Oral Arguments on Whether FCC has Decided Issue of the RHCs' Common Carrier Status, and Whether Divestiture Costs Ruling Will Harm Independent Telcos," *Telecommunications Reports*, vol. 51, no. 43 (October 28, 1985). The nature and legal basis of the FCC's rulings are discussed at length above.

³²³*GTE-Telenet, 70 FCC 2nd 2249 (1979), reconsidered, 72 FCC 2nd 91 (1979)*. Section 214 of the Communications Act, 47 USC 214, provides for construction permits; essentially it requires findings of

In 1984, reviewing the transfer of assets between AT&T and the BOCs to implement the Consent Decree, the FCC treated the Regional Holding Companies as common carriers,³²⁴ since "the 'primary purpose' of the regional holding companies ... was to 'serv[e] the Operating Companies and facilitat[e] their telecommunications functions'."³²⁵ The FCC argues that its "statutory mandate could not be limited by the corporate structure that a company adopts to carry out its business purposes or by distinctions that are of no practical significance."³²⁶ Most recently, however, the FCC claimed that it has not decided the issue of whether U S West is a common carrier,³²⁷ since "it 'saw no need' to decide the question at that time."³²⁸

Diversion of Yellow Pages Revenues

Of the forty commissions responding to this survey, only six considered Yellow Pages to be a regulated activity.³²⁹ Four considered

"the public convenience and necessity" which amount to findings of public utility status. The FCC's powers under section 214, including its power to impose conditions upon carrier actions and extract penalties for violations of the conditions, are much greater than the equivalent powers under sections 215, 218, 219, 221, and 222, which apply to holding companies.

³²⁴"Consolidated Application of AT&T and Specified Bell System Companies," 98 FCC 2nd 141 (1984), p. 152, modifying 96 FCC 2nd 18 (1983), p. 64, n. 142.

³²⁵"Brief for Appellee," U S West v. FCC, U.S. C.A. D.D.C., nos. 84-1448, 84-1451 (March 5, 1985), p. 3, n. 2, quoting "United States V. Western Electric Co., Inc., 592 F. Supp. 846, 861 (D.D.C. 1984).

³²⁶"Reply to Opposition to Motion to Dismiss," U S West, Inc., et. al., v. FCC, U.S. Court of Appeals for the District of Columbia Circuit, case nos. 84-1448, 84-1451 (February 1, 1985), p. 2 and p. 3, no. 2, quoting 56 Radio Reg. 2d. (P & F) 813, 822 (1984).

³²⁷"Brief for Appellee," U S West v. FCC, U.S. C.A. D.D.C. nos. 84-1448, 84-1451 (March 5, 1985), p. 2.

³²⁸Ibid., p. 11, citing, "Consolidated Application" Order, 96 FCC 2nd 18 (1983), p. 64, n. 142.

³²⁹The definitions of "regulated" used by staff members responding to the survey were not probed. They appear to range from the filing of

advertising to be regulated and three considered publishing to be regulated. In addition, two commissions were planning action (hearings) on the status of Yellow Pages and publishing, and one on the status of advertising. At the time of the survey two commissions were requiring the inclusion of Yellow Pages, advertising and publishing in a rate filing, and three were requiring annual reports for Yellow Pages. It appears that most of the states that are formulating policies for the treatment of Yellow Pages revenues are doing so in the context of rate cases rather than special proceedings.

Changing Yellow Pages Technologies

Yellow Pages may be provided by new technologies in the future, either through on-line databases³³⁰ or through the distribution of computer media,³³¹ and the BOCs are beginning to provide printed

rates (in Kansas, for example), to consideration of the revenue when deciding the rates for other services (in most states). For further information see Chessler and Clark, "Yellow Pages." In at least one instance, a survey respondent took "included in the revenue requirement" or "provided by the regulated telephone company" to mean regulated, while a commissioner from the same state preferred to limit the use of "regulated" to refer to more restrictive definitions. We have adjusted the survey results to the commissioner's preferences.

³³⁰Several national and local on-line Yellow Pages-like databases are available as discussed below. These do not now appear to be using telephone company provided lists (except as some may be re-entering data from printed directories). Telephone company involvement in on-line provision of information that the telephone company provide itself is prohibited (Consent Decree, Provisions II(D)(1) and I V(J) cf. VIII(B) and VIII(D), U.S. v. American Telephone and Telegraph Co., 552 F. Supp. 131 (D.D.C. 1982), pp. 227, 229, 231). "Rental" of the lists to an unrelated company is permitted, either for a flat fee or a royalty. In any event, on-line distribution of business information is expensive, and many business databases that do not require constant updating are being distributed in other ways, discussed below.

³³¹RHC distribution of Yellow Pages in computer form might be restricted by the Consent Decree (see above), but the RHCs are free to charge others for the right to do so. (U.S. Department of Justice, Competitive Impact Statement, 47 F.R. 7170 (February 17, 1982), p. 7176 n. 24.) As noted below, the prices charged for rights to distribute reference publications in "machine readable" form are increasing substantially.

Yellow Pages directories outside their normal service areas.³³² At the time of the survey no state commission had had to address the question of determining operating revenues in light of the changing nature of the service.³³³

At present the provision of Yellow Pages databases over telephone lines which was discussed extensively in the District Court's order approving the Consent Decree³³⁴ appears to be relatively limited.³³⁵ There are some local and national databases, the most extensive of which seems to be the "Electronic Yellow Pages" on Dialog. Electronic Yellow Pages is reported to be compiled from 4,800 telephone books and other directories³³⁶ and updated semiannually. It is divided into ten databases, and includes an on-line index. Various kinds of sorting (such as by ZIP code) are possible, although "[s]ubject retrieval is

³³²See, for example, notes on Southwestern Bell's acquisitions and expansions, above.

³³³BellSouth's turning "directory assistance" into a profit center consideration being given to providing "sales referrals," is discussed above. See Steven Titch, "Directory Assistance Holds New Appeal," CommunicationsWeek, February 10, 1985, p. 8. It would clearly compete with print and "electronic" Yellow Pages (if allowed), and as operator services are presently provided and accounted for, it would be, "above the line" operating revenue. NYNEX has announced what it calls an "adjunct service" to paper Yellow Pages in which it will charge advertizers for listings and customers will call an 800 number for referrals to businesses. Fredric Paul, "NYNEX Testing Operator Assisted Yellow Pages Service," CommunicationsWeek, February 17, 1986, p. 11.

³³⁴U.S. v. American Telephone and Telegraph Co., Inc., 552 F. Supp. 131 (D.C. D.D.C., 1982) pp. 193-194.

³³⁵Other electronic services have also been slow to develop. "Despite plenty of optimism, banking by modem is off to a sputtering start. By the end of 1985, only about 60,000 computer owners around the country had signed up.... Bank of America ... in November 1983 ... predicted ... 25,000 customers in its first 12 months.... More than two years later fewer than 21,000 intrepid customers subscribe...." John Eckhouse, "On-line: Moneylink--the Home Banking Connection," PC World vol. 4, no. 2 (February, 1986), pp. 305-308.

³³⁶The recent District Court ruling, discussed elsewhere herein, that telephone directories are subject to copyright may affect royalty payments, if the lists of subscribers are copied directly.

limited to certain specified SIC codes," rather than the full list of subject headings used in paper Yellow Pages.³³⁷ Dialog can be accessed directly or through Mead Data Central's NEXIS. Subscribing to NEXIS costs \$50 per month, the "connect charge" is \$20 per hour, telecommunications charges are \$8 per hour on Telenet or \$12 an hour on WATS, and searches cost \$9 each (plus \$3 for each modification).³³⁸ Costs of subscribing directly to Dialog depend on the database searched. Fees range from \$15 per hour to \$300 per hour, with most between \$50 and \$90 per hour. (Electronic Yellow Pages is currently \$60 per hour.) Telecommunications charges using Telenet, Tymnet or Uninet are \$6 to \$8 per hour. Volume discounts are available.³³⁹

Similar databases compiled by Dun and Bradstreet are available on Dialog. Search is by SIC code.³⁴⁰ Standard and Poor's list of 3,000 corporations is available on CompuServe. Searches cost \$0.25 per company profile, plus CompuServe's charges of \$12.50 to \$15.00 per hour during the business day, or \$6.00 to \$12.50 per hour in the evening and on weekends. Telecommunications charges through Telenet or Tymnet cost \$10 per hour during the business day and \$2 per hour at other times.³⁴¹

³³⁷Barbara Newlin, Answers Online: Your Guide to Informational Data Bases (Berkeley: Osborne McGraw Hill, 1985), pp. 45-46. A Dialog marketing representative said she believed searches by telephone directory classification as well as SIC code are now possible. "SIC code" means "Standard Industrial Classification code." It is based on the primary industry of the firm or plant, and is not a specific list of the products or services produced.

³³⁸Newlin, Answers Online, pp. 221-222.

³³⁹Newlin, Answers Online, pp. 170-171. Dialog marketing representative, telephone conversation, February 12, 1986.

³⁴⁰Newlin, Answers Online, pp. 37-38.

³⁴¹Newlin, Answers Online, pp. 42-43, 146.

As a consequence of the high costs of performing on-line searches of databases their use is still limited. "The primary attraction of online database services is the immediacy and the specialized nature of the data they provide."³⁴² They are most useful for databases that are updated frequently or where complex searches are required. A typical search of a complex data base averages about 10 minutes for an experienced librarian, at a minimum charge of about \$18 per search on NEXIS.³⁴³ Obviously, if the database were available on a local computer the search could be done more cheaply, and this is becoming a practical alternative for databases that are not updated frequently.³⁴⁴

Business lists from Yellow Pages are now available in a variety of formats, including magnetic tape and IBM PC diskette. Commercial vendors advertize lists "for any Yellow Pages title" nationally or for individual states, "from more than 4,800 telephone directories covering the entire U.S."³⁴⁵

Recent advances in recording technology have resulted in the "CD-ROM" ("compact disk read only memory") digital recording, on a disk read using a laser. Vast amounts of data may be stored on each of

³⁴²Gary Stix, "Plug into Online Services: the Only Barrier Between a Researcher and a Mountain of Facts May Be Online Costs," Computer Decisions, vol. 17, no. 23 (November 19, 1985), p. 68.

³⁴³Stix, "Online Services," pp. 70-72.

³⁴⁴Databases that are updated frequently are another matter entirely. Some attorneys say "[w]e're all waiting for the first malpractice suit for failure to access the most up-to-date information," that is, "failure to use computers in researching a case." James Evan, "Trends: Malpractice for Modem-Shy Lawyers," PC World, vol. 4, no. 2 (February, 1986). p. 313.

³⁴⁵American Business Lists, Inc., "Business Lists from the Yellow Pages [Advertisment]," Wall Street Journal, February 12, 1986, p. 2. Conventional mailing lists and labels and "on-line information retrieval" are also available.

these disks, which are inexpensive to produce and distribute. At present 560 megabytes of data may be stored on a single disk, which is more than enough for an entire encyclopedia.³⁴⁶ "There are nearly 50 large data collections already on CD-ROM disks. They range from years of back issues of newspapers to complete stock market histories, and from dictionaries to scientific reference works."³⁴⁷ Reportedly Phillipe Kahn, the publisher of microcomputer software (Borland International)

has to scramble to lock up the electronic rights to the world's most popular reference works before the publishers realize what he's doing and jack up their prices.... [O]ne of Borland's initial ready-to-run reference disks will be a national business Yellow Pages.... [S]ince each call to AT&T's directory assistance operators now costs fifty cents, a bundled Lightning and electronic [Y]ellow [P]ages package should pay for itself in a year or less. And Borland will provide periodic updates for the [Y]ellow [P]ages....³⁴⁸

³⁴⁶Jim Forbes, "Microsoft Calls March Seminar to Promote CD-ROM Technology," InfoWorld, vol. 7, no. 49 (December 9, 1985), p. 5. Disks with twice that capacity are expected soon, which "could easily hold twenty major reference books." "Lightning Strikes: Borland International has Earned a Reputation For Shaking Up the Industry with High-Quality, Low Priced Business Software; the Company's New Information Retrieval Utilities Promise to Stun the Marketplace," PC Magazine, vol. 4, no. 25 (December 10, 1985), p. 113, at p. 117.

³⁴⁷Jerry Pournelle, "Comdex Dull? Only in the Eyes of Some," InfoWorld, vol. 7, no. 49 (December 9, 1985), p. 27. The disks are "nearly indestructable" and can be manufactured "in quantity for about \$5 each." Idem. A "complete CD-ROM package," disk drive, software and Grolier Publishing's Electronic Encyclopedia, has been advertized for \$995. The encyclopedia alone is \$199. Activenture Corporation "Get Ready for the Information Revolution [advertizement]," InfoWorld vol. 8, no. 6 (February 10, 1986), p. 12. Activenture does not use Borland International's "Lightning" software or data compression technique discussed below. CD-ROM disk drives for the IBM PC are currently available for \$845 to \$2395. Mark J. Welch, "Manufacturers to Propose CD-ROM File Standard," Infoworld, vol. 8, no. 5 (February 3, 1986), p. 1, at p. 6.

³⁴⁸"Lightning Strikes," p. 117. "Lightning" is Borland International's computer program for quick retrieval of information stored on any kind of computer disk in a proprietary condensed format.

Changing Commission Treatment of Yellow Pages

Yellow Pages has not been a regulated activity in the past, although most states have included it in operating revenues for some portion of the past decade. Thus, it has served to offset a portion of the revenue requirement.

Since the Yellow Pages were the fastest growing major advertizing medium for the past decade, with revenues of \$5 billion nationally in 1984, and is highly profitable, with operating margins of twenty-five to thirty per cent,³⁴⁹ the importance is obvious. Still, at least one independent advertizing consultant recently told an advertising seminar at the North American Telecommunications Association show to put advertizing money into three media, newspapers, Yellow Pages, and direct mail. He further told the managers of interconnect companies that comprised his audience to use directories within twenty miles of their locations, and to avoid untested new directories in favor of directories published by the Bell operating companies or Reuben Donnelley Corporation.³⁵⁰

In the course of the reorganization, the Bell RHCs moved Yellow Pages activity out of the operating companies. Most of the RHCs "compensated" the operating companies with guaranteed contractual payments for a period of time.³⁵¹ In a recent series of cases some commissions are beginning to reject these contracts. In a few instances commissions have sought, thus far with mixed success, to block transfers of the assets. There are clear precedents, however,

³⁴⁹Mulqueen, "SW Bell Buys Contel's Unit," p. 45.

³⁵⁰"Interconnections," CommunicationsWeek, December 9, 1985, p. 26, quoting Tom Hannaher of the one-man firm Hannaher, Nobody & Nobody.

³⁵¹The similarity to the arrangement rejected by the court when of by AT&T in the original version of the Consent Decree is obvious. See U.S. v. American Telephone and Telegraph Co., Inc., 552 F. Supp. 131 (D.C. D.D.C., 1982) pp. 193-194.

that despite the subsidiary structure, commissions may consider Yellow Pages revenues in determining the revenue requirements, and may restate those revenues to what they "should" be.³⁵²

The "arms length" contract between Reuben H. Donnelley and Illinois Bell has been found by the Illinois Commerce Commission to be in the public interest.³⁵³ Since few, if any, other commissions have made such findings with respect to RHC Yellow Pages contracts, we have reproduced the contract in appendix D.

In Pennsylvania, Bell Atlantic has decided to produce its own Yellow Pages in competition with Reuben H. Donnelley Corp., the long-time Yellow Pages publisher in the state.³⁵⁴ The terms of the contracts that caused the dispute were not available to NRRI at this writing, but they might well repay study as a benchmark of the commercial value of being the "official" Yellow Pages publisher. The results of the competition might provide an indication of the feasibility of even a well established firm competing effectively with a telephone company in its own service area.

³⁵²No final commission order has been sustained yet, but only one has been partially overturned. Minnesota's Statute did not permit it to block the asset transfer, but it can use any amount for operating revenues in rates cases. Colorado's statutory authority to block the asset transfer is more specific, and its order is now being appealed. "Some State Commissions Blocking Yellow Pages Asset Shifts as BOCs Cry Foul," State Telephone Regulation Report vol. 3, no. 20 (October 24, 1985), p. 2. Some of the more significant of these orders are discussed elsewhere herein.

³⁵³Petition for Consent to a Directory Agreement, Illinois Commerce Commission Docket 84-0359, August 22, 1984. The commission ruling cited substantial revenues guaranteed for fifteen years, and Illinois Bell's collecting 7.5 per cent of any growth in revenues over the proceeding year. Slip opinion, pp. 1-2. If controversy arises in the future, it will likely be over the reasonableness of Illinois Bell's collecting only 7.5 per cent of the revenue growth, and Donnelley's right to Illinois Bell's customer lists for a fixed fee for two years after termination of the contract: \$10 million per year may be reasonable now, but no-one can predict the value of the dollar in the year 2000.

³⁵⁴Maremont, "Baby Bells," p. 96. The dispute is reportedly in litigation.

Customer Premises Equipment

In the original version of the 1982 Consent Decree the Bell Operating Companies were prevented from providing customer premises equipment. The final version relaxed this prohibition, not for the stated reason that profits from the provision of CPE would help support the basic (residential) services, but to promote competition in the CPE market.³⁵⁵ The mechanism of such support was unclear, since the CPE market was becoming competitive and competition tends to lower rates of return to the cost of capital. Furthermore, FCC rules requiring separate subsidiaries for the provision of CPE would make it difficult for state commissions to consider CPE as operating revenues of the telephone company; certainly it would require a specific order to recognize the revenues of a subsidiary.

More recently it became obvious that for a BOC to market its CENTREX services in competition with large PBXs, and its network services in competition with "bypassers" or competing carriers, the BOC would have to be as free as its competitors to bundle terminal equipment and network services in providing customers with a "solution." Thus, the FCC permitted BOCs to provide such "bundles" as the prime contractor, so long as the terminal equipment subcontractor is an unrelated third party selected by competitive bid.³⁵⁶

With only two circumstances that might be considered exceptions³⁵⁷ commissions consider CPE subsidiaries to be deregulated or outside

³⁵⁵Indeed, the court expressed skepticism that the provision of CPE would provide above normal profits in a competitive environment. U.S. v. A.T.&T., 552 F. Supp. 131 (D.D.C. 1982), pp. 191-193, 224.

³⁵⁶This is distinct from FCC orders permitting RHC equipment subsidiaries and unrelated third parties to act as sales agents for BOC network services. "FCC Denies NATA's Request for Reconsideration of 1984 'Sales Agency' Order, but Sets New Guidelines to Prevent Abuses; Ameritech, NYNEX Plans Rejected, Refiling Allowed," Telecommunications Reports, vol. 51, no. 44 (November 4, 1985), p. 8.

³⁵⁷Revenues for CPE provided under CENTREX tariffs in Wisconsin are considered as belonging to the regulated business, even though no CPE tariffs are filed. CPE consulting and installation services considered to be regulated, untariffed operating revenues ("above the line") in Kansas. Questionnaire, question 2.0.

their jurisdiction. The only state activity shown on the NRRI survey was legislation to permit further deregulation (in Oregon).³⁵⁸ In particular, only two states reported that they were considering imputing any CPE-related revenues as an offset to the revenue requirement.

Contracts

The services being provided to the Bell Operating Companies by the Regional Holding Companies, subsidiaries of the Regional Holding Companies (such as "service corporations" or Yellow Pages subsidiaries), and BellCore are provided in accordance with contracts.³⁵⁹ In some instances state commissions have begun to investigate the RHC contracts to determine whether they are in the interest of the BOCs.

The largest such investigation was the multi-state NARUC audit of BellCore.³⁶⁰ This found that certain activities of BellCore which

³⁵⁸Obviously, this reflects the FCC's total preemption of the state in the regulation of CPE.

³⁵⁹The BOCs continue to get certain services from AT&T under contract. These include help with "equal access," and the services of American Trans Tech (stock transfers). We have mentioned experience which suggests that American TransTech's services may not be of normal commercial quality. More seriously, in view of the reported wide problems with lost and "misinterpreted" service orders for "equal access" selection of long distance carriers, states might wish to investigate whether these contracts were fairly negotiated (at arm's length), whether the BOCs are receiving proper value, and whether the contracts adequately indemnify the BOCs for direct and consequential damages from AT&T's errors and omissions. Recently it was reported that AT&T has been slow in producing software to enable the BOC's provide equal access for inWATS ("800") service, forcing the BOCs to make extra expenditures to provide lower quality inWATS access. Anna Zornosa, "Interim 800 Service to Cost Millions, Satisfy Few," CommunicationsWeek, February 10, 1986, p. 1, p. 32.

³⁶⁰There have been multi-state investigations of nearly all the RHCs as well; those which dealt also with BellCore are discussed in the report of the NARUC audit. "Audit Report," vol. 1, pp. 7-8. There have been multistate investigations of New England Telephone, Mountain Bell, Southern Bell and several of the Bell Atlantic Companies which

were paid for by the BOCs appeared to be for the primary benefit of the RHCs or even outside suppliers.³⁶¹

The contracts for the provision of Yellow Pages directories (and the payment of royalties on the advertising therein to the BOCs) have been controversial since the creation of the Yellow Pages subsidiaries.³⁶² After investigation Illinois found that the contract among Illinois Bell, Ameritech Publishing, and Reuben H. Donnelley (the long-time publisher of Illinois Bell's Yellow Pages Directories) was reasonable.³⁶³ However, the New York Public Service Commission is reported to have ruled that New York Telephone's contract with NYNEX Information Resources was not in the public interest.³⁶⁴ The staff of the Wyoming PSC recommended that the contract between Mountain Bell and U S West Direct be canceled, and the assets put up for competitive

included investigation of the holding company. NRRI commented on an early stage of the NYPSC/NECPUC investigation of NYNEX. See Chessler, Comments on NYPSC/NECPUC and "Suggestions for an Investigation." A full treatment of the more recent investigation is beyond the scope of this report.

³⁶¹It is not obvious why BellCore should perform work benefitting manufacturers of telephone equipment. Possibly in the past Bell Telephone Laboratories (an ancestor of BellCore) performed such research for Western Electric but charged it to BOC-funded projects, (see Report, " vol. 1, pp. 54-56) and the BellCore projects in dispute "historical artifacts" reflecting past arrangements. BellCore has not yet responded in detail to the "Audit Report." BellCore's letter response is in "Audit Report," vol. 1, pp. 25-31, and includes brief justifications.

³⁶²Cf. David Chessler, Comments on NYPSC/NECPUC and "Suggestions an Investigation."

³⁶³Illinois Bell Telephone Company Petition for Consent to a Directory Agreement, Illinois Commerce Commission Docket 84-0359, Slip Opinion, August 22, 1984.

³⁶⁴The written order has not been released yet. This discussion based upon press reports of the commission meeting. See, for example, "Some State Commissions Blocking Yellow Pages Asset Shifts as BOCs Cry Foul," State Telephone Regulation Report, vol. 3, no. 20 (October 24, 1985), p. 2.

bid.³⁶⁵ As noted, NRRI published a fuller analysis of the Yellow Pages matter in the Quarterly Bulletin.

Contracts for the provision of other service to the BOCs, such as general corporate oversight, purchasing of equipment and supplies, and related matters are routinely investigated by state commissions and the orders that result are reported in the Quarterly Bulletin. Therefore, to limit the length of the survey, NRRI did not include questions about these subsidiaries.

Cellular, Mobile and Paging Subsidiaries

As noted above, by the rules under which it awarded licenses for Cellular mobile telephone services the FCC practically forced applicants to form consortia. In order to form a consortium the Cellular service had to be provided by a separate subsidiary so that the members of the consortium can share ownership. In addition, the FCC imposed, first upon AT&T and then upon the BOCs, a specific separate subsidiary requirement.³⁶⁶ While the FCC has been relaxing its requirements for separate subsidiaries, the shared ownership of many of the licenses ensures that the cellular subsidiaries will retain a high degree of separation from the parent holding companies and the sibling operating telephone companies.

Telephone companies have long operated land mobile telephone services and paging services, usually without creating subsidiaries. In addition, independent operators have provided services which competed with the telephone company. There were few available frequencies, and so there was congestion, poor service and long waiting lists for service in major markets. The paucity of available frequencies and the FCC's methods of allocating them ensured the

³⁶⁵"Some State Commissions Blocking Yellow Pages Asset Shifts as BOCs Cry Foul," State Telephone Regulation Report, vol. 3, no. 20 (October 24, 1985), p. 2.

³⁶⁶Cellular Communications Systems, 86 FCC 2nd 469 (1981), 89 FCC 2nd 58, 90 FCC 2nd 571 (1982). Policy and Rules Concerning the Furnishing of Customer Premises Equipment, Enhanced Services and Cellular Communications Services by the Bell Operating Companies, 95 FCC 2nd 1117 (1984), pp. 1120, 1121, 1150-1151.

existence of multiple providers of these services in most markets. Land mobile and paging services were regulated by the same state commissions that regulate wire line telephone companies.

Under the Cellular order³⁶⁷ two providers of cellular service were established in each market, one associated with the telephone company and one independent. It is not expected that there will be the shortage of frequencies that caused the long waiting lists for service in the land mobile service. Hence, although there will be at most two providers of cellular service,³⁶⁸ the effective level of competition may be higher than at present in the land mobile service.

At present the FCC has proposed to preemptively prohibit state regulation of paging services.³⁶⁹ Without speculating on how the FCC may decide, and how states may react to FCC action or changing markets we may review the present regulatory status of the services. Seventeen of the commissions responding to the NRRI survey assert regulatory jurisdiction over cellular land mobile, and fourteen assert jurisdiction over other mobile services. Twelve commissions do not regulate cellular services and eleven do not regulate other mobile services. Three commissions have no jurisdiction over cellular and two have no jurisdiction over other mobile services. Two commissions have taken no action with respect to cellular, and one has action planned. One commission has taken no action with respect to other mobile services and one has action planned.

At present, then, regulation of the mobile services is a matter of state law and commission policy. Since the conventional mobile services are very small, and the cellular services are just beginning operations, no state appears to have made any decisions about whether (and how) to consolidate the cellular and wire-line (telephone company)

³⁶⁷Cellular Communications Systems, 86 FCC 2nd 469 (1981), 89 FCC 2nd 58, 90 FCC 2nd 571 (1982).

³⁶⁸Resale is possible. The circumstances under which resellers of a telecommunications service should be considered effective competitors are complex and controversial, and will not be discussed here.

³⁶⁹Preemption of State Entry Regulation, CC Docket 85-89, FCC mimeo 85-147 (May 17, 1985).

subsidiaries of the RHCs for ratemaking purposes (such as consolidation of the revenues and revenue requirements). To the extent that FCC policy is successful and the cellular mobile service is competitive, there may be no large profits that would stimulate state commissions to study the matter.³⁷⁰

Cable Television

Only one commission staff respondent said that the commission regulates Cable Television (CATV). Fourteen said the commission does not regulate it, two said the commission had no jurisdiction,³⁷¹ five planned no action, one had action planned, and seventeen did not respond. Since the date of the NRRI survey the FCC, in Cox Cable Communications, Inc.,³⁷² preempted all state "prior certification" of communications common carriage by CATV companies. The decision has been appealed.³⁷³ The CATV companies in Colorado have since petitioned the FCC for total deregulation, and the FCC accepted comments but it has not yet designated the matter for hearing.

Long ago the FCC preempted most state rate regulation of CATV companies when they are providing one-way "broadcast-like" services. We will not repeat the history of the FCC, the Congress and the courts limiting the regulatory authority of the states in CATV matters.

³⁷⁰Remember, however, that when the properties are bought and sold, any "profits" above the cost of capital will be reflected in the selling price, so that the purchaser will always appear to be earning no more than a "normal" rate of return unless a "first original cost" (cost to the first public utility using the asset) concept of asset accounting is adopted.

³⁷¹Some states and the District of Columbia have commissions other than the Public Utility Commission to regulate CATV. NRRI made no effort to contact these commissions, since our primary focus was on the regulation of communications common carriage, including services of the CATV companies that might compete with telephone companies.

³⁷²File no. CCB-DFD-83-1, FCC mimeo 85-455 (September 5, 1985).

³⁷³NARUC v. FCC, U.S. C.A. D.C.C., No. 85-1584 (September 5, 1985).

Suffice to say that we were interested in state regulation of CATV companies that are competing with the local telephone company in the provision of two-way voice or data communications. In view of the uncertain status of state regulation of CATV companies in light of the Cox Cable pre-emption, no further analysis of the survey responses to these questions is merited.

Videotex and Computer Utilities

Videotex is one method of distribution of information over telephone lines. It differs from most "on-line" services, such as CompuServe, Dow Jones News Retrieval, or The Source, in permitting the transmission of pictures as well as text. AT&T has been one of the principal developers³⁷⁴ of the North American Presentation Level Protocol, the American and Canadian version of the "standard" now being used by the French telephone system³⁷⁵ (PTT) to distribute "information services" (including on-line "Yellow Pages") to households.³⁷⁶ AT&T, CBS, and Knight-Ridder Newspapers conducted experiments in New Jersey and Florida, but these are now ended.

In view of the involvement of telephone companies in these services, and in view of the likelihood that extensive use of such services would "require" the "modernization" of much telephone plant, particularly on the "local loop," NRRI asked if any state regulates these services. None does.

It should be recalled that under the Consent Decree the BOCs may not provide "information services" (although they may provide "information access"--the connection to the services), and AT&T may

³⁷⁴Another is the Canadian Ministry of Communications.

³⁷⁵The British have a similar, but incompatible system. It is no such widespread use as the French one.

³⁷⁶The goal is to have all households served. The PTT provides the terminal "free." For a recent description of the French system s Thane Peterson, "Why the French are in Love with Videotex: the Government Gives Free Terminals to Households and That's Making Information Service a Big Business," Business Week, January 20, pp. 84-85.

not provide the services until 1989.³⁷⁷ Even so, Pacific Telesis has sponsored much research on the use of a single copper local loop (twisted pair) for the simultaneous carriage of multiple voice and data signals. It appears to be permissible for a BOC (or RHC) and an information vendor to jointly develop such a service, provided the BOC's role is limited to common carriage, and there is no attempt to "tie" together the "information service" provided by the other vendor with the "information access" provided by the BOC. No such efforts came to light.

Joint Ventures and New Ventures

The RHCs have announced a variety of joint ventures with other firms. In addition, the BOCs have a plethora of contractual relationships with other subsidiaries of the RHCs, some of which (such as Yellow Pages) might be considered "joint ventures" in some states. Commission staff members in three states indicated that joint ventures are regulated.³⁷⁸ In thirteen states they were said to be unregulated.³⁷⁹ In three states no action was planned, but in one state action

³⁷⁷Telephone company involvement in on-line provision of information the telephone company itself provides is prohibited (Consent Decree, Provisions II(D)(1) and IV(J), cf. VIII(B) and VIII(D), U.S. v. American Telephone and Telegraph Co., 552 F. Supp. 131 (D.D.C. 1982), pp. 227, 229, 231). Even in the matter of white and Yellow Pages directories, where the information is developed for other purposes. Direct Bell telephone company distribution in "computer readable" form might violate the decree, although licensing the data to others for information would be permissible. (U.S. Department of Justice, Competitive Impact Statement, 47 F.R. 7170 (February 17, 1982), p. 7176 n. 24.)

³⁷⁸It was unclear from the responses whether the regulation was limited to the Cellular Radio joint ventures or to more general statutory authority over all contracts made by a public utility.

³⁷⁹Which does not necessarily preclude the state commission from investigating whether contracts between the utility and other affiliates are "arm's length," as the California respondent noted.

state action was planned.³⁸⁰ Twenty of the respondents did not reply to the question.

Responses to the question on regulation of new ventures were similar. The respondents in three states reported that new ventures were regulated,³⁸¹ while thirteen said they were not. Two respondents reported that their commissions lacked jurisdiction, and three reported that their commissions had not planned any action on the matter. In Washington the issue was scheduled to be addressed as part of the overall investigation in a rate case. Eighteen respondents did not answer the question.

In view of the extensive controversy attendant upon the RHCs' requests for waivers, and the strong language the court used in its order setting forth the principles for dealing with the requests,³⁸² it is perhaps surprising that the state commissions have not been more active in investigating the new ventures of the RHCs. Undoubtedly, the perceived lack of direct jurisdiction over holding companies is responsible. The deterioration in service quality discussed above cannot be directly attributed to RHC diversification, notwithstanding Judge Greene's comments quoted above.³⁸³ With the FCC monitoring the

³⁸⁰The State of Washington planned to look at all aspects of the holding company as part of a telephone rate case.

³⁸¹It is not clear whether the Cellular Common Carrier was meant.

³⁸²See above for extensive citations to and quotations from U.S. v. Western Electric Co., Inc., 592 F. Supp. 846 (D.D.C. 1984).

³⁸³Moreover, he sees the problem as continuing. "During hearings last August, Judge Green said there was a 'strange gap' between the public desire to have good local telephone service at reasonable rates and 'the almost frenzied efforts of the regional holding companies to diversify and to concentrate on outside opportunities.' He suggested that the Justice Department investigate whether the companies are abiding by conditions attached to their permissions to diversify. Janet Guyon, "Branching Out: Regional Phone Firms Press Diversification, Seek Changes in Rates: Otherwise They Fear Losing Customers to Companies with New Technologies: Are They Reaching too Far?" Wall Street Journal, v. 66, no. 31 (November 25, 1985), p. 1.

capitalization plans for cellular, CPE and "enhanced service" affiliates, and the court limiting the overall level of nongermane activity,³⁸⁴ state commissions have apparently had no cause to apply their jurisdiction over utility finances to the issue.

³⁸⁴To ten per cent of RHC revenues, see above.

APPENDIX A

ORGANIZATION CHARTS OF RHCS

Figure A-1
Ameritech Organization Chart

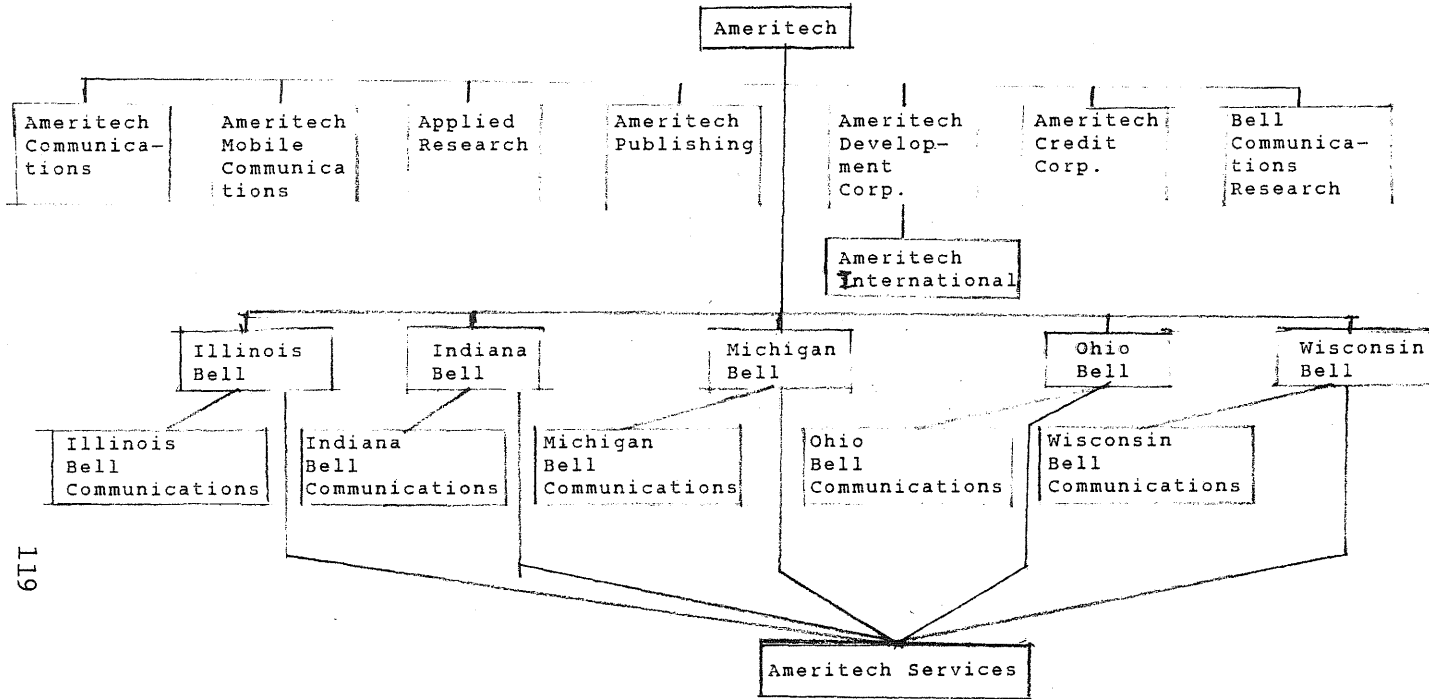


Figure A-2

Bell Atlantic Organization Chart

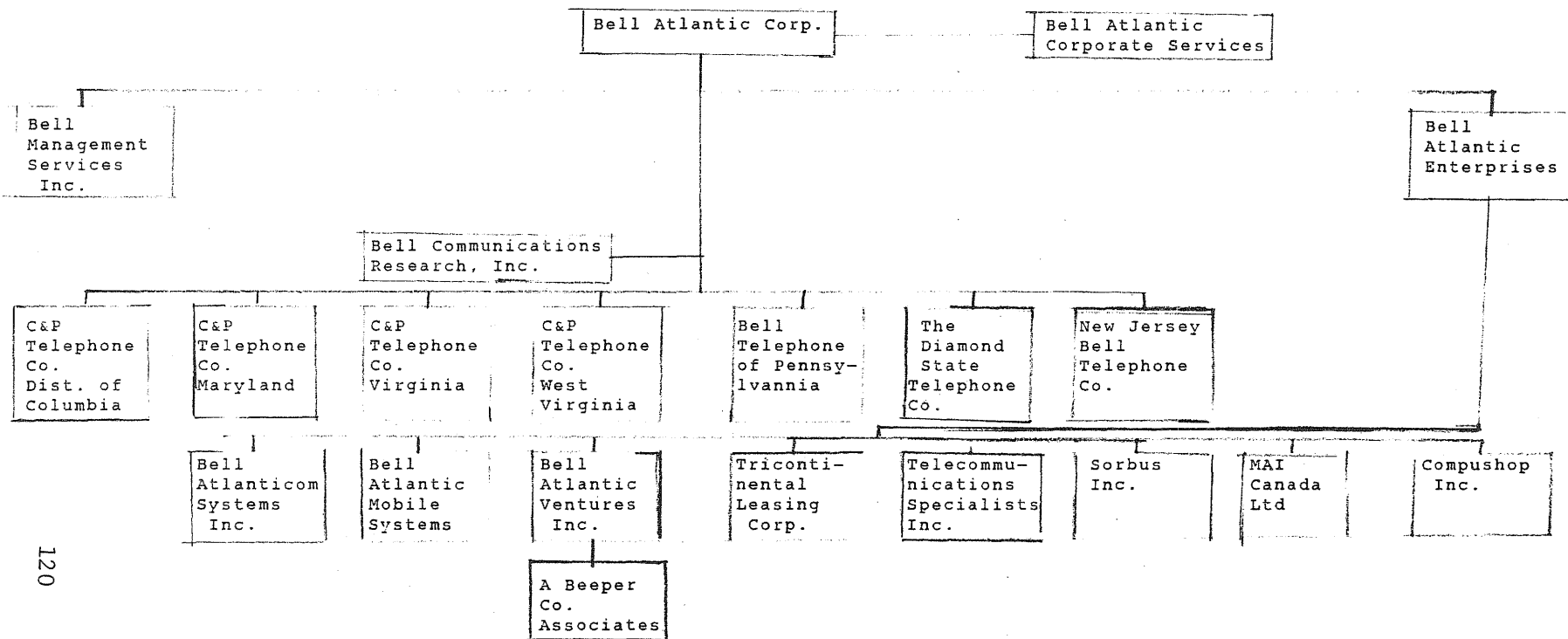


Figure A-3A

BellSouth Organization Chart At The Time Of The NRRI Survey

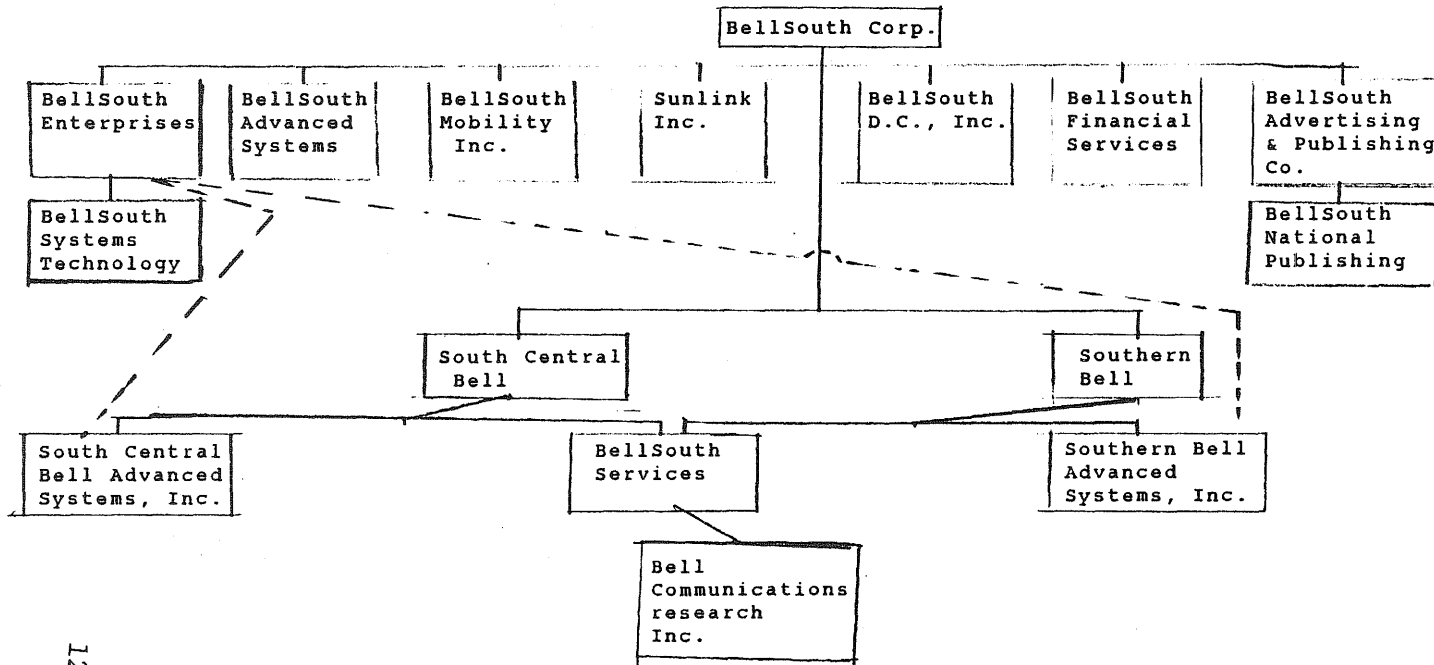


Figure A-3B

BellSouth Organization As Required January 1, 1986

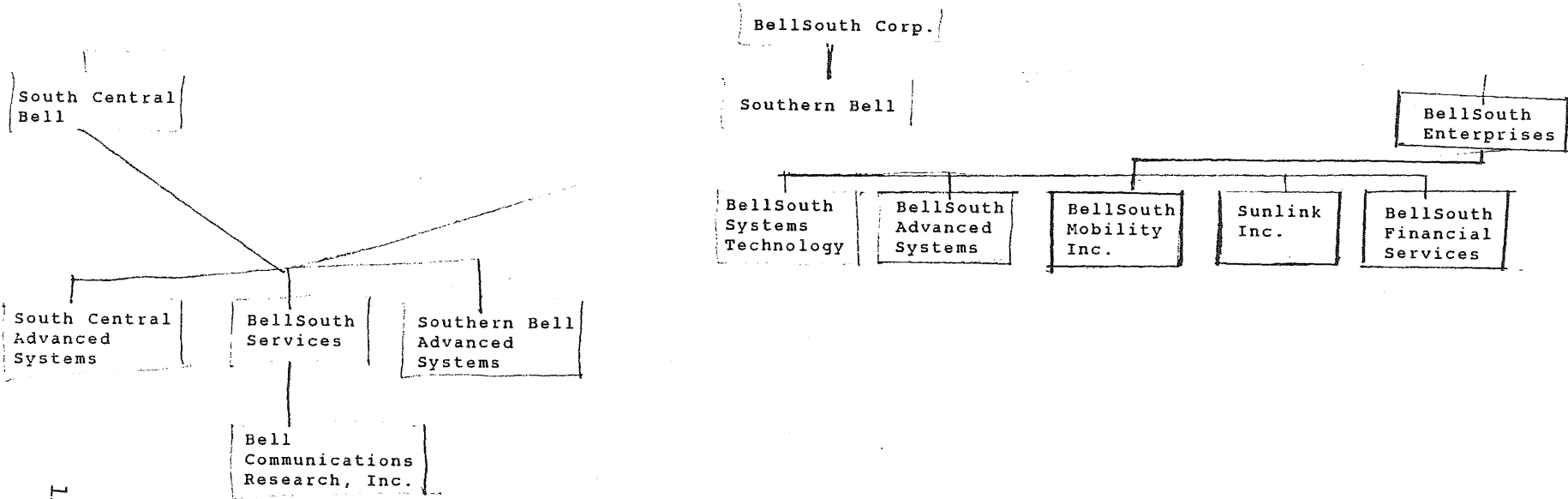
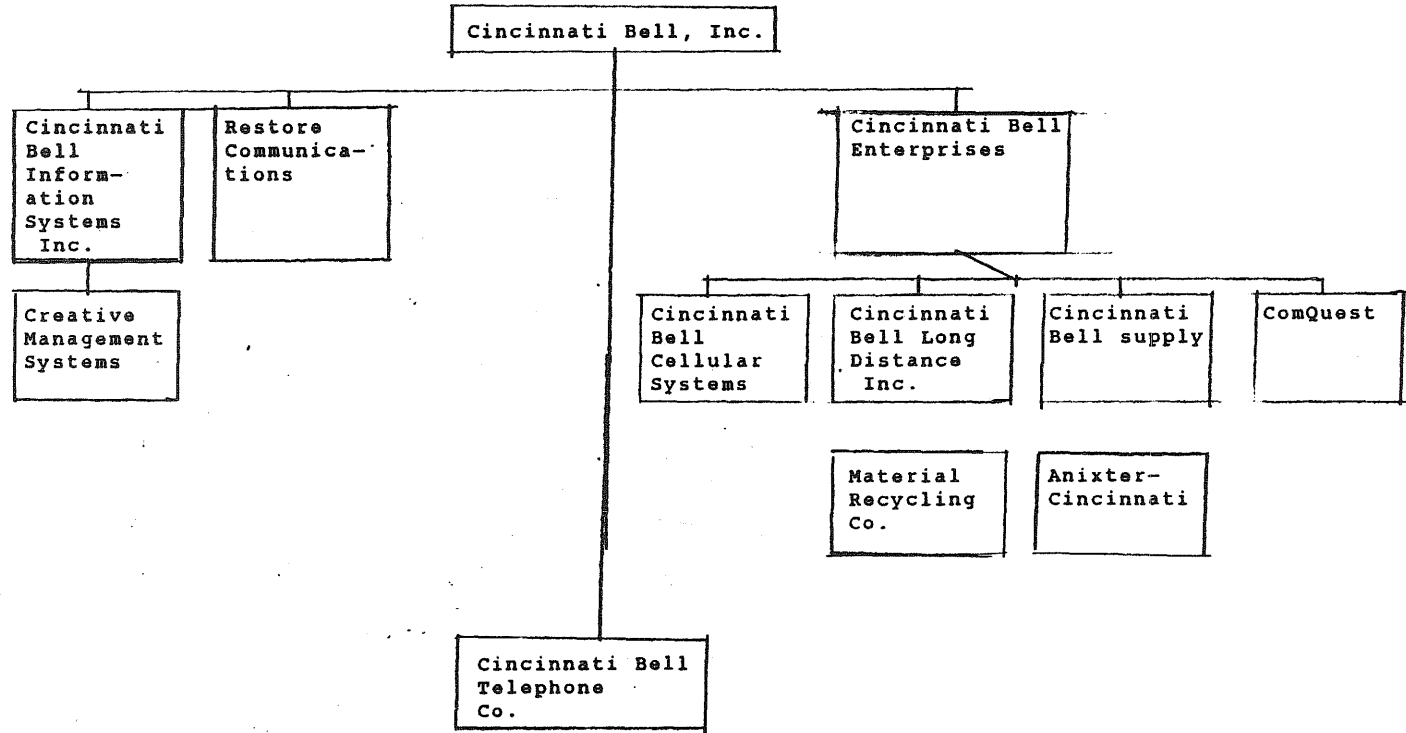


Figure A-4

Cincinnati Bell Organization Chart



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Figure A-5

NYNEX Corporation Organization Chart

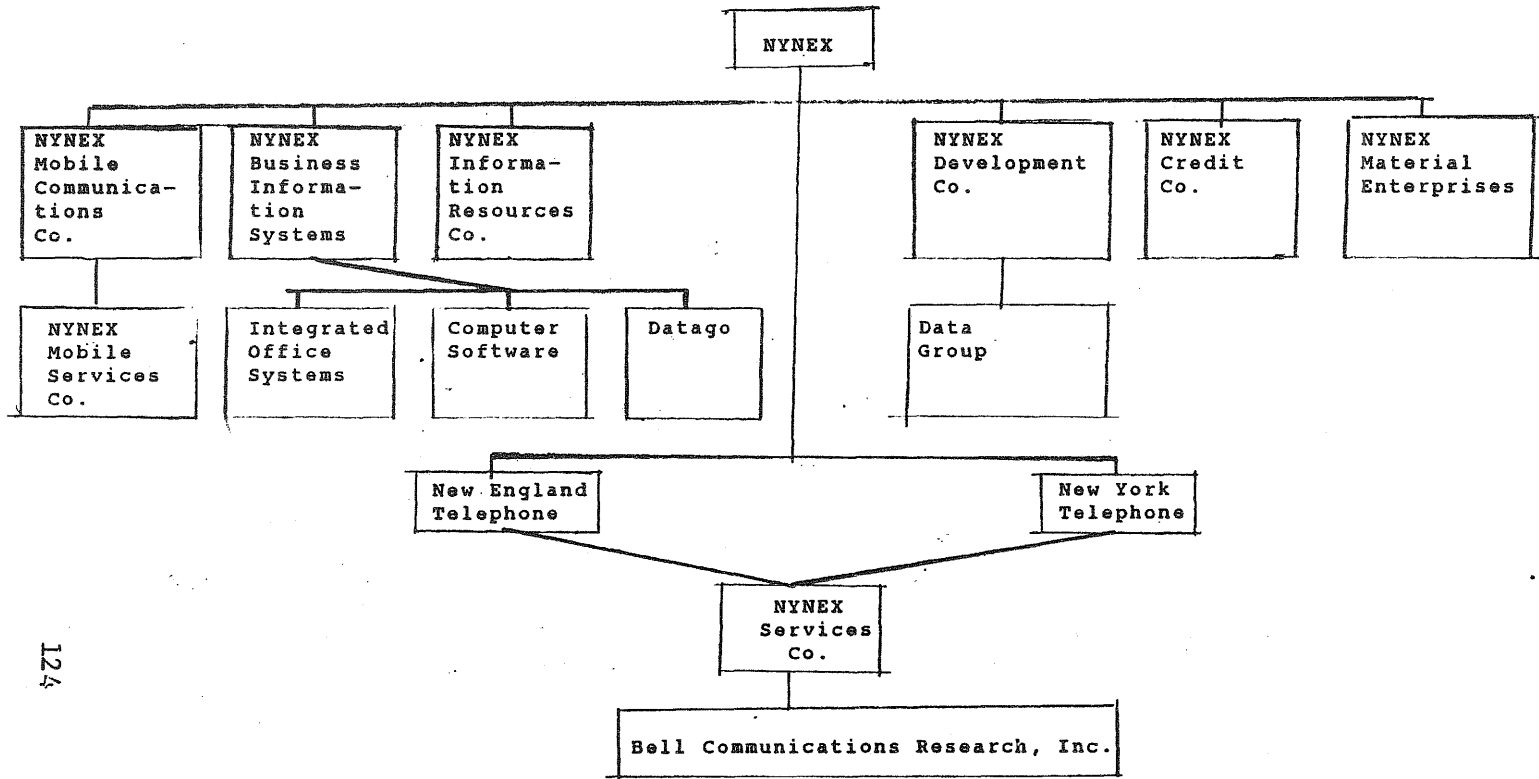


Figure A-6

Pacific Telesis Group Organization Chart

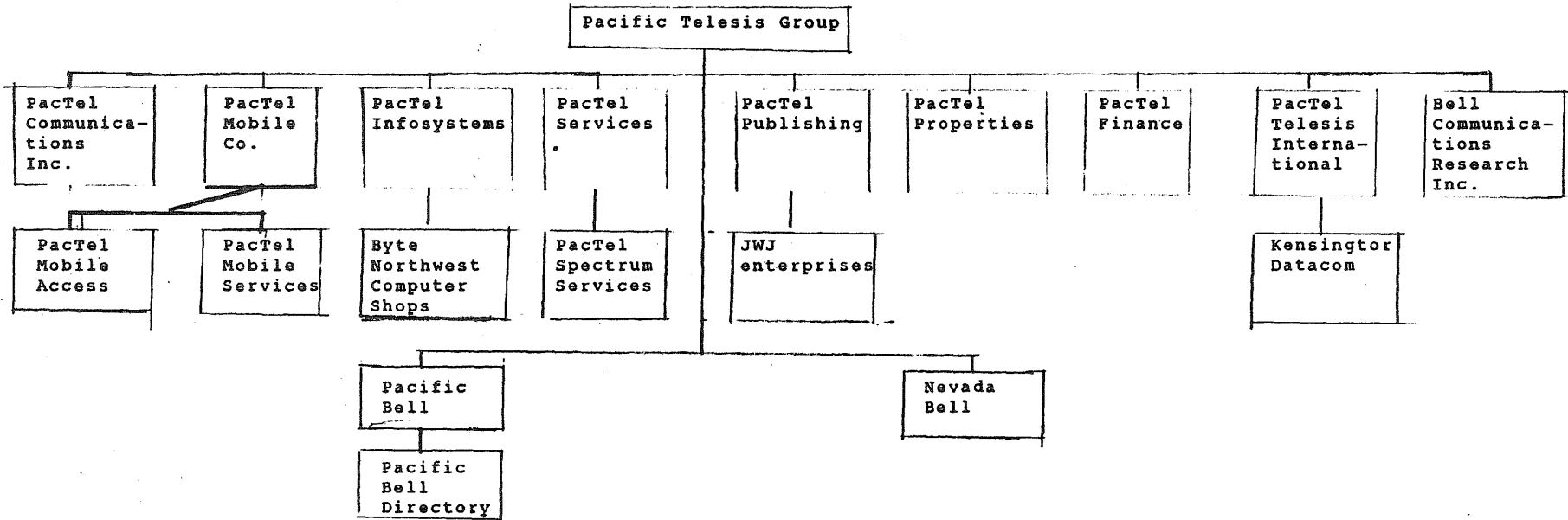


Figure A-7

Southern New England Telephone Company Organization Chart

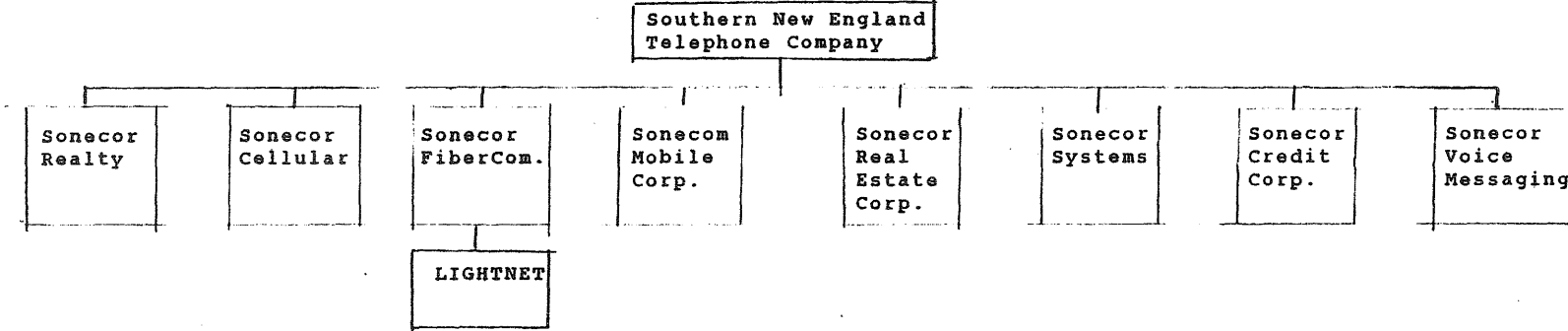


Figure A-8

Southwestern Bell Corporation Organization Chart

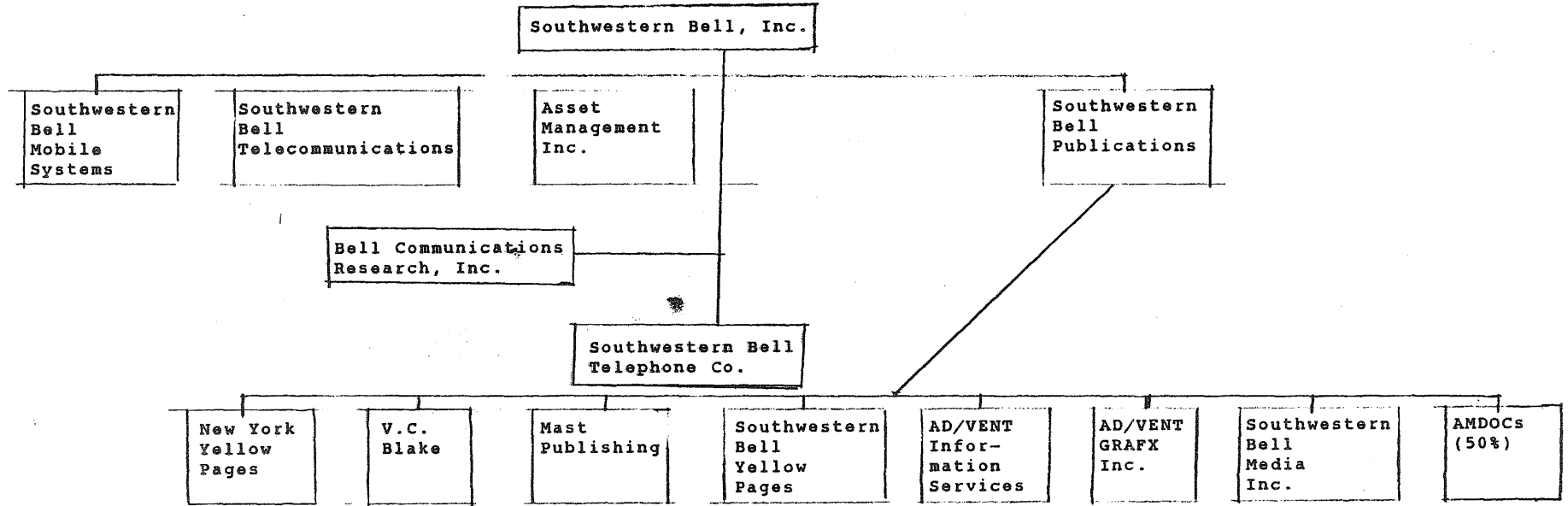
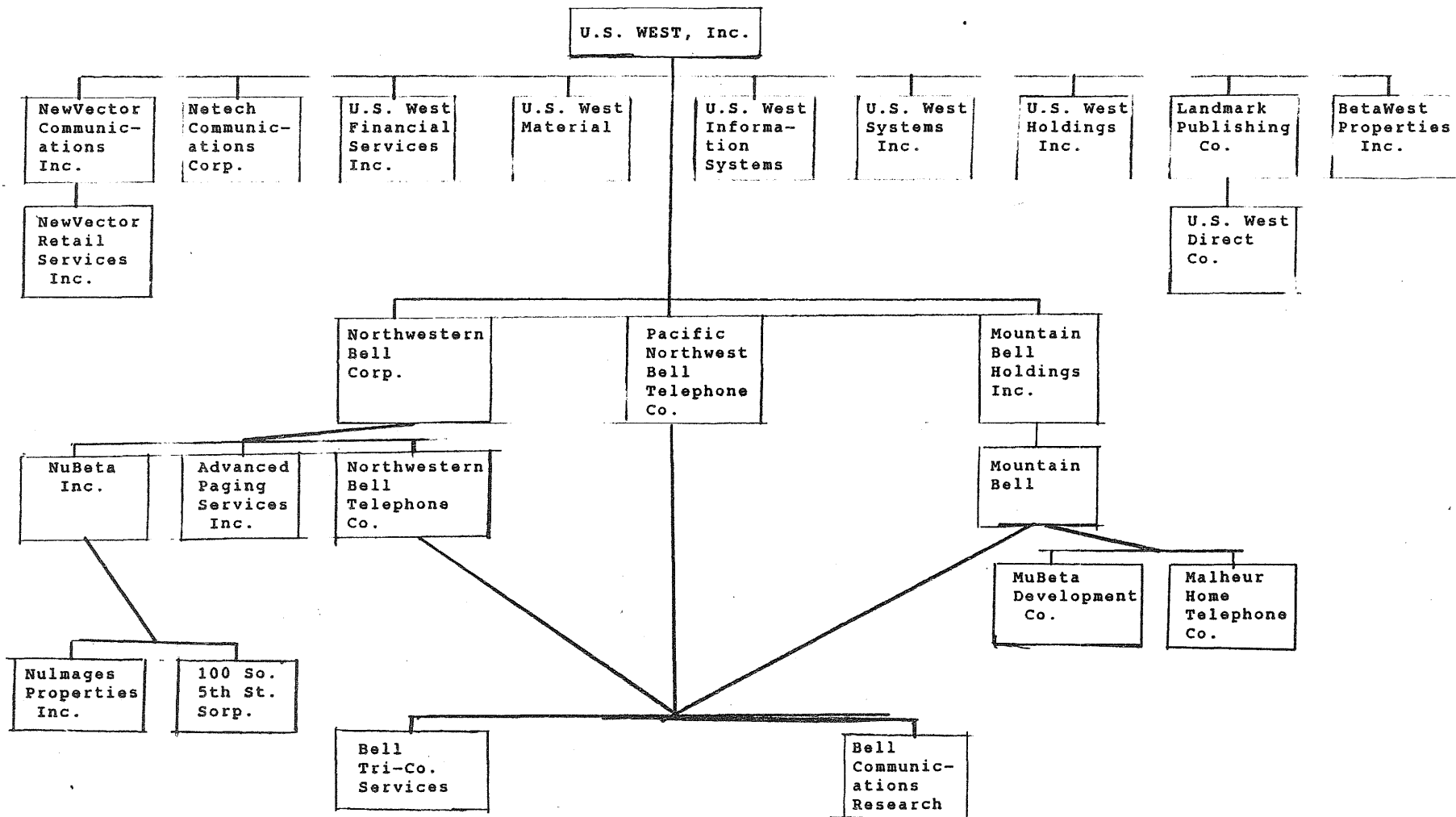


Figure A-9

U.S. West Organization Chart



APPENDIX B

THE SURVEY INSTRUMENT

5/7/85

NRRI Survey on RHC Subsidiary Activity

Name: _____ Date: _____

Commission: _____

Phone: _____

The NRRI is conducting a state-by-state telephone survey of activities of the Bell Regional Holding Company subsidiaries. This questionnaire is concerned with the activities of the unregulated and "non-traditional" subsidiaries, that is, those subsidiaries involved in the provision of non-traditional telecommunications services or those which are not now subject to regulation.

The results of this survey will be published soon, and copies will be sent to your commission.

1.0) What are the activities of the unregulated or "non-traditional" Bell RHC subsidiaries in your state?

Name of Subsidiary

Yellow Pages: _____

Advertising: _____

Publishing: _____

CPE sales: _____

CPE consulting/
installation: _____

Finance/leasing: _____

Real Estate: _____

Cellular: _____

Mobile: _____

CATV: _____

Videotex or computer
utilities: _____

Joint Ventures: _____

Other/New Ventures: _____

2.0) What is the regulatory treatment of non-traditional subsidiary activity in your state?

Activity	Regulated	Not Regulated	No Jurisdiction	No Action/Not Addressed	Action planned or Underway (If yes, go to 2.1, if no, action go to 2.2)	Other Action (Legislation, Judicial, etc.) (Please elaborate)
Yellow Pages						
Advertising						
Publishing						
CPE sales						
CPE consulting/ installation						
Finance/leasing						
Real Estate						
Cellular						
Mobile						
CATV						
Videotex or computer utilities						
Joint Ventures (name or type)						
Other/New Ven- tures (Type of activity)						

2.1) If action is planned or underway, please indicate the type of action.

Activity	Action in Progress								Remarks
	Hearings Planned	Docket Number and Date Opened	Hearings in Progress	Hearings Completed	Awaiting Order (Date Due)	Prelim. Order & Date	Final Order & Date	Other Action	
Yellow Pages									
Advertising									
Publishing									
CPE sales									
CPE consulting/ installation									
Finance/leasing									
Real Estate									
Cellular									
Mobile									
CATV									
Videotex or computer utilities									
Joint Ventures (name or type)									
Other/New Ven- tures (Type of activity)									

2.2) If regulated, to what extent are the non-traditional subsidiary activities regulated?

Activity	Annual Report Filing	Other Report Filing	Rate Filing or approval	Other
Yellow Pages	_____	_____	_____	_____
Advertising	_____	_____	_____	_____
Publishing	_____	_____	_____	_____
CPE sales	_____	_____	_____	_____
CPE consulting/ installation	_____	_____	_____	_____
Finance/leasing	_____	_____	_____	_____
Real Estate	_____	_____	_____	_____
Cellular	_____	_____	_____	_____
Mobile	_____	_____	_____	_____
CATV	_____	_____	_____	_____
Videotex or computer utilities	_____	_____	_____	_____
Joint Ventures (name or type)	_____	_____	_____	_____
_____	_____	_____	_____	_____
Other/New Ventures	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

2.3) What actions, if any, are being taken in your state on yellow pages revenues? Revenues of other subsidiaries?

Yellow Pages
No Action _____
Hearings Planned _____
Hearings in Progress _____
Hearings Completed _____
Preliminary Order _____
Final Order _____
Docket Number _____
Date Opened _____
Schedule _____

Other Subsidiaries
No Action _____
Hearings Planned _____
Hearings in Progress _____
Hearings Completed _____
Preliminary Order _____
Final Order _____
Docket Number _____
Date Opened _____
Schedule _____

Comments: _____

3.2) Is there a "requirement to serve" for non-traditional subsidiaries in your state? (i.e. may these subsidiaries elect whether or not to serve any potential customer who requests service at management's discretion?)

Yes _____ No _____ Don't know _____ RHC Subs. only _____

3.3) If a Bell RHC regulated subsidiary and an unrelated second party were to have a joint venture, would this be treated differently from a similar activity the regulated Bell subsidiary may engage with one of the RHC's unregulated subsidiaries?

Comments: _____

5.0) Do you have any reports or filings which might be of interest on subsidiary activity?

Yes _____ No _____ Don't know _____

[If yes] Would you please send copies of these documents?

We pose the following questions to update our previous survey on multi-tenant shared services and smart buildings. (A summary of the results of the previous survey was published in the April Quarterly Bulletin.)

6.0) What is the current status of action in your state on multi-tenant shared services smart buildings?

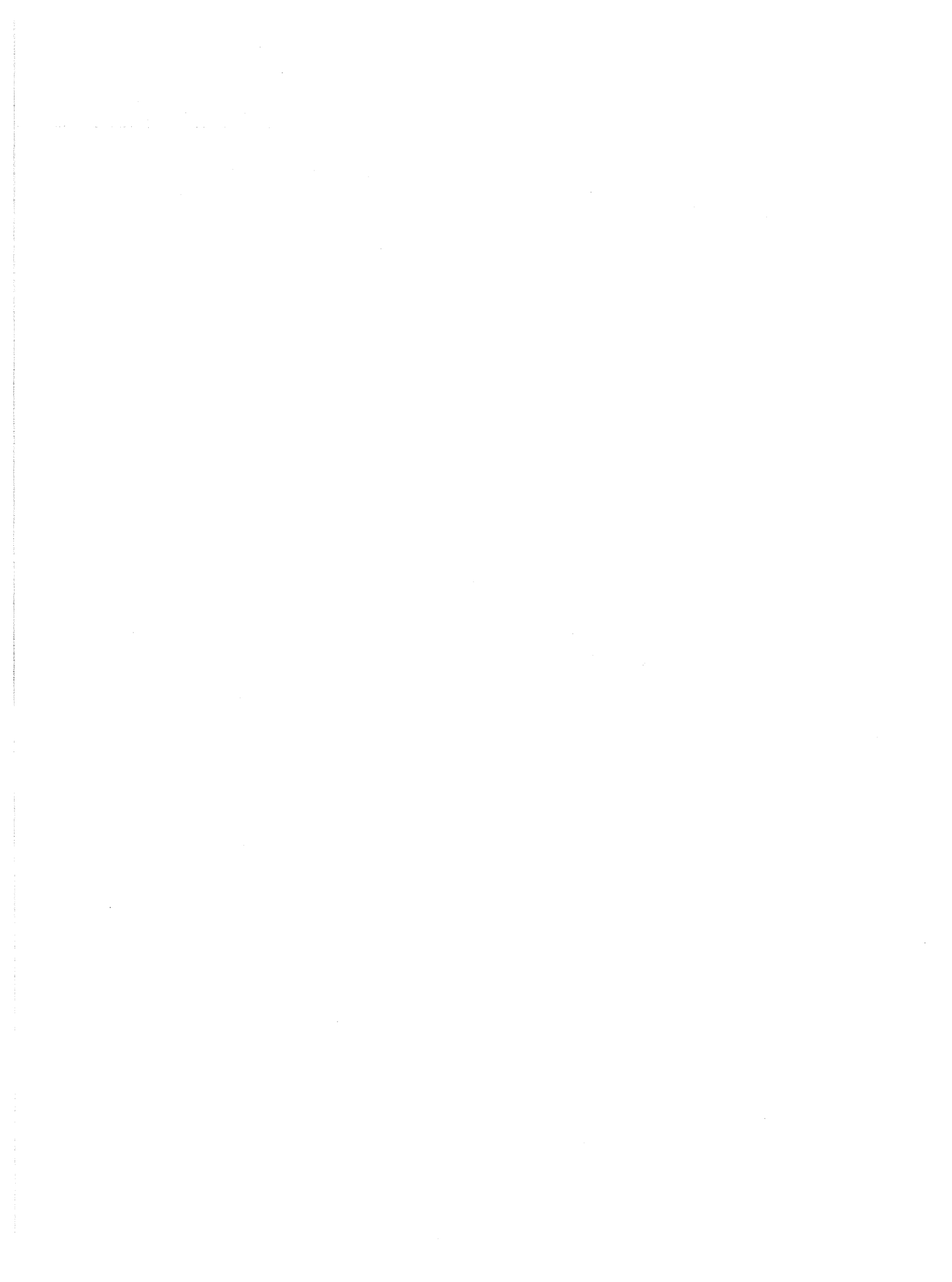
No Action _____
Hearings Planned _____ Schedule _____
Other action planned _____ Schedule _____
(Specify types _____
of action) _____

Docket Opened _____ Docket Number _____
Date Opened _____
Hearings in Progress _____ Schedule _____
Hearings Completed _____ Date Completed _____
Awaiting Action _____ Schedule _____
Type of Action _____

Preliminary Order _____ Date Issued _____
Reference # _____
Final Order _____ Date Issued _____
Reference # _____

Comments: _____

Address: David Chessler, Ph.D. (614) 422-9404
NRRI
2130 Neil Avenue
Columbus, Ohio 43210



APPENDIX C

STATE COMMISSION AUTHORITY AND ACTIONS

TABLE C-1

REGULATORY STATUS OF REGIONAL HOLDING COMPANY
ACTIVITIES AS OF THE DATE OF NRRI'S SURVEY

ACTIVITY		NORTHEAST	MID-ATLANTIC	SOUTHEAST	GREAT LAKES	SOUTHWEST	NORTHWEST	PACIFIC	TOTAL
YELLOW PAGES	REGULATED	1	0	1	1	1	2	0	6
	NOT REGULATED	4	1	3	3	3	5	2	21
	NO JURISDICTION	0	1	0	1	0	0	0	2
	NO ACTION	0	0	0	0	1	1	0	2
	ACTION PLANNED	0	0	0	0	0	2	0	2
	OTHER ACTION	0	0	0	0	0	0	0	0
	N/A	0	4	1	0	0	2	0	7
ADVERTISING	REGULATED	1	0	0	1	2	0	0	4
	NOT REGULATED	3	2	3	3	1	5	2	19
	NO JURISDICTION	0	1	0	1	0	0	0	2
	NO ACTION	0	0	0	0	0	2	0	2
	ACTION PLANNED	0	0	0	0	0	1	0	1
	OTHER ACTION	0	0	0	0	0	0	0	0
	N/A	1	3	2	0	2	4	0	12
PUBLISHING	REGULATED	1	0	0	1	1	0	0	3
	NOT REGULATED	3	2	3	3	3	6	2	22
	NO JURISDICTION	0	1	0	1	0	0	0	2
	NO ACTION	0	0	0	0	0	2	0	2
	ACTION PLANNED	0	0	0	0	0	2	0	2
	OTHER ACTION	0	0	0	0	0	0	0	0
	N/A	1	3	2	0	1	2	0	9
CPE SALES	REGULATED	0	0	0	1	0	0	0	1
	NOT REGULATED	5	3	4	3	4	8	1	28
	NO JURISDICTION	0	3	0	1	1	1	1	7
	NO ACTION	0	0	0	0	0	1	0	1
	ACTION PLANNED	0	0	0	0	0	0	0	0
	OTHER ACTION	0	0	0	0	0	1	0	1
	N/A	0	0	1	0	0	1	0	2
CPE CONSULTING/ INSTALLATION	REGULATED	0	0	0	1	1	0	0	2
	NOT REGULATED	5	3	4	3	3	8	1	27
	NO JURISDICTION	0	3	0	1	1	1	1	7
	NO ACTION	0	0	0	0	0	1	0	1
	ACTION PLANNED	0	0	0	0	0	1	0	1
	OTHER ACTION	0	0	0	0	0	0	0	0
	N/A	0	0	1	0	0	1	0	2
FINANCE/LEASING	REGULATED	0	0	0	0	0	0	0	0
	NOT REGULATED	2	1	2	4	3	6	1	19
	NO JURISDICTION	0	2	0	0	0	0	1	3
	NO ACTION	0	0	0	0	0	2	0	2
	ACTION PLANNED	0	0	0	0	0	1	0	1
	OTHER ACTION	0	0	0	0	0	0	0	0
	N/A	3	3	3	1	2	3	0	15
REAL ESTATE	REGULATED	0	1	0	0	0	0	0	1
	NOT REGULATED	2	0	3	4	3	6	1	19
	NO JURISDICTION	0	2	0	0	1	0	0	5
	NO ACTION	0	1	0	0	0	2	1	4
	ACTION PLANNED	0	0	0	0	0	1	0	1
	OTHER ACTION	0	0	0	0	0	0	0	0
	N/A	3	2	1	1	1	2	0	10

TABLE C-1
(continued)

REGULATORY STATUS OF REGIONAL HOLDING COMPANY
ACTIVITIES AS OF THE DATE OF NRRI'S SURVEY

ACTIVITY		NORTHEAST	MID-ATLANTIC	SOUTHEAST	GREAT LAKES	SOUTHWEST	NORTHWEST	PACIFIC	TOTAL
CELLULAR	REGULATED	3	3	1	3	3	2	2	17
	NOT REGULATED	1	2	2	1	1	5	0	12
	NO JURISDICTION	0	1	0	0	1	1	0	3
	NO ACTION	0	0	0	0	0	2	0	2
	ACTION PLANNED	0	0	0	0	0	1	0	1
	OTHER ACTION	0	0	0	0	0	0	0	0
	N/A	1	0	2	1	0	1	0	5
MOBILE	REGULATED	0	4	1	4	3	1	1	14
	NOT REGULATED	2	1	1	1	1	4	1	11
	NO JURISDICTION	0	0	0	0	1	1	0	2
	NO ACTION	0	0	0	0	0	1	0	1
	ACTION PLANNED	0	0	0	0	0	1	0	1
	OTHER ACTION	0	0	0	0	0	0	0	0
	N/A	3	1	3	0	0	4	0	11
CATV	REGULATED	0	0	0	0	0	0	1	1
	NOT REGULATED	1	2	2	3	2	4	0	14
	NO JURISDICTION	0	0	0	0	1	1	0	2
	NO ACTION	4	0	0	0	0	1	0	5
	ACTION PLANNED	0	0	0	0	0	1	0	1
	OTHER ACTION	0	0	0	0	0	0	0	0
	N/A	0	4	3	2	2	5	1	17
VIDEOTEX/ COMPUTER UTILITIES	REGULATED	0	0	0	0	0	0	0	0
	NOT REGULATED	1	1	2	3	2	4	1	14
	NO JURISDICTION	0	1	0	0	0	0	0	1
	NO ACTION	0	0	0	0	0	2	1	3
	ACTION PLANNED	0	0	0	0	0	1	0	1
	OTHER ACTION	0	0	0	0	0	0	0	0
	N/A	4	4	3	2	3	5	0	21
JOINT VENTURES	REGULATED	0	0	1	1	0	1	0	3
	NOT REGULATED	2	0	2	2	2	4	1	13
	NO JURISDICTION	0	0	0	0	0	0	0	0
	NO ACTION	0	0	0	0	0	2	1	3
	ACTION PLANNED	0	0	0	0	0	1	0	1
	OTHER ACTION	0	0	0	0	0	0	0	0
	N/A	3	6	2	2	3	4	0	20
OTHER/NEW VENTURES	REGULATED	0	1	0	0	0	2	0	3
	NOT REGULATED	2	1	2	3	1	4	0	13
	NO JURISDICTION	0	2	0	0	0	0	0	2
	NO ACTION	0	0	0	0	0	2	1	3
	ACTION PLANNED	0	0	0	0	0	1	0	1
	OTHER ACTION	0	0	0	0	0	0	0	0
	N/A	3	2	3	2	4	3	1	17

Source: Survey results

APPENDIX D

ILLINOIS BELL YELLOW PAGES CONTRACT
WITH REUBEN H. DONNELLEY CORPORATION

DIRECTORY AGREEMENT

THIS AGREEMENT, entered into this 27th day of July, 1984 by and among The Reuben H. Donnelley Corporation, a Delaware corporation, hereinafter referred to as "Donnelley," Illinois Bell Telephone Company, an Illinois corporation, hereinafter referred to as "The Telephone Company," Ameritech Publishing of Illinois, Inc., an Illinois corporation, hereinafter referred to as "API/IL," Ameritech Publishing, Inc., a Delaware corporation, hereinafter referred to as "API," and AM-DON, a partnership between Donnelley and API/IL, hereinafter referred to as "The Partnership," which was formed pursuant to an agreement dated July 27, 1984, hereinafter referred to as the "Partnership Agreement";

WITNESSETH, that,

WHEREAS, Donnelley is in the publishing business and desires, on terms set forth herein, to publish Yellow Pages in telephone directories of The Telephone Company and to publish certain types of advertising in (i) the alphabetical sections of such telephone directories, (ii) the Regional White Pages Directories and (iii) the Chicago Alphabetical Directory of The Telephone Company; and

WHEREAS, Donnelley also desires, on terms set forth herein, to publish city-wide Chicago Yellow Pages Classified Telephone Directories and to publish neighborhood directories

comprised of groupings of areas and districts within Chicago, Area-Wide Yellow Pages Classified Directories elsewhere within Illinois, Street Address Directories, the Chicago Visitor's Guide, the Health Care Industry Directory and the Bradley University Student Directory, in formats agreed to among Donnelley, The Telephone Company and The Partnership; and

WHEREAS, The Telephone Company is willing and able, on terms set forth herein, to furnish the basic business telephone listing information and all business service order activity, including additions to, deletions from and changes in the basic business telephone listing information, hereinafter referred to as "updates," for such directories, hereinafter, except for the Regional White Pages Directories and the Chicago Alphabetical Directory, collectively referred to as "The Directories"; and

WHEREAS, The Telephone Company is willing and able, on terms set forth herein, to provide and publish alphabetical or "White Pages" sections to be co-bound in certain of The Directories which contain Yellow Pages published by Donnelly and White Pages published by The Telephone Company, hereinafter sometimes referred to as the "Co-Bound Directories"; and to provide and publish the Regional White Pages Directories and the Chicago Alphabetical Directory of the Telephone Company; and

WHEREAS, The Telephone Company is willing and able, on terms set forth herein, to provide directory operations services; and

WHEREAS, The Telephone Company is willing and able, on terms set forth herein, to provide billing and collection service for The Partnership with respect to advertising placed in The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory; and

WHEREAS, API/IL is willing and able, on terms set forth herein, to provide or arrange for the printing of, composition for, purchasing of paper for, and delivery of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory.

NOW THEREFORE, in consideration of the premises and of the mutual covenants herein contained, it is agreed as follows:

CLAUSE 1 - TERM OF AGREEMENT

This Agreement becomes effective upon its approval by the Illinois Commerce Commission and the entry of an order in the form of Exhibit B to the settlement agreement attached as Exhibit F, in accordance with Clause 26, and remains in effect until December 31, 1994 with the understanding that The Telephone Company has the exclusive option to extend the term of this Agreement to December 31, 1999. The Telephone Company must give Donnelley written notice on or before April 30, 1993 if The Telephone Company intends to exercise its option to extend the term of this Agreement to December 31, 1999. In the

event Donnelley does not receive the written notice on or before April 30, 1993, this Agreement will terminate effective December 31, 1994.

The parties hereto acknowledge that as of the date of this Agreement, there is an agreement between Donnelley and The Telephone Company dated August 26, 1975, with amendments, hereinafter referred to as the "1975 Yellow Pages Directory Agreement," regarding the publication of classified telephone directories in Illinois. The parties hereto agree that, except as to Clause 3 and Clause 21 of the 1975 Yellow Pages Directory Agreement, the 1975 Yellow Pages Directory Agreement will expire in accordance with its terms except that the last directories to be published under the 1975 Yellow Pages Directory Agreement will be those directories which are scheduled to be completely delivered by December 31, 1984. The city-wide Chicago Yellow Pages Classified Telephone Directories scheduled to be delivered in December of 1984 and January of 1985, hereinafter sometimes referred to as the "1985 city-wide Chicago Yellow Pages Classified Telephone Directories," and all activities of the parties to this Agreement regarding those directories are subject to and governed by this Agreement and not the 1975 Yellow Pages Directory Agreement. The last paragraph of Clause 3 of the 1975 Yellow Pages Directory Agreement is to remain in effect until twenty (20) months before this Agreement terminates, at which time it becomes null and void. Except as

otherwise provided in Clause 20 of this Agreement, information provided by The Telephone Company to Donnelley under Clause 3 of the 1975 Yellow Pages Directory Agreement is to be used by Donnelley during the term of this Agreement only to publish The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory. Clause 21 of the 1975 Yellow Pages Directory Agreement, and the parties' rights and obligations thereunder, shall become null and void on the date this Agreement becomes effective except (i) that the reserves provided for in that Clause 21 shall be treated as provided in the last sentence of Clause 21 of the 1975 Yellow Pages Directory Agreement, except that the promotional reserve shall be terminated effective September 30, 1984 such that costs attributable to promotional activities performed after that date may not be charged against that reserve and that the uncollectibles reserve shall be terminated effective December 31, 1984 such that advertising or lease charges deemed after December 31, 1984 to be uncollectible may not be charged against that reserve, and (ii) The Telephone Company retains whatever rights it may have, other than its rights under Clause 21 of the 1975 Yellow Pages Directory Agreement, for any breach of the 1975 Yellow Pages Directory Agreement by Donnelley. Except as otherwise stated in this paragraph, The Telephone Company and Donnelley also agree that (i) all money payable by The Telephone Company to Donnelley under the 1975

Yellow Pages Directory Agreement and (ii) all money payable to The Telephone Company by Donnelley under the 1975 Yellow Pages Directory Agreement, are to be paid respectively by The Telephone Company and Donnelley.

All expenses incurred at any time by any of the parties hereto which are incurred with respect to The Directories, the Regional White Pages Directories or the Chicago Alphabetical Directory published, manufactured and delivered under this Agreement, and reimbursement for such expenses, shall be governed by this Agreement.

In the event this Agreement terminates effective December 31, 1994, (i) there will have been eleven (11) editions of the city-wide Chicago Yellow Pages Classified Telephone Directories published under this Agreement and (ii) the last issues of The Directories, Regional White Pages Directories and the Chicago Alphabetical Directory published under this Agreement will be the city-wide Chicago Yellow Pages Classified Telephone Directories whose delivery is scheduled to begin in December of 1994 or January of 1995. In the event this Agreement terminates effective December 31, 1999, (i) there will have been sixteen (16) editions of the city-wide Chicago Yellow Pages Classified Telephone Directories published under this Agreement and (ii) the last issues of The Directories, Regional White Pages Directories and the Chicago Alphabetical Directory published under this Agreement will be

the city-wide Chicago Yellow Pages Classified Telephone Directories scheduled to be delivered in December of 1999 or January of 2000. In the event this Agreement terminates effective some date other than December 31, 1994 or December 31, 1999, the last issue or issues of The Directories, Regional White Pages Directories and the Chicago Alphabetical Directory published under this Agreement will be the issue or issues for which, in the ordinary course of business, delivery to consumers has begun by the date on which this Agreement terminates.

This Agreement, during its initial term and any extension thereof, may be terminated only if any party hereto materially breaches this Agreement and such material breach has not been cured within thirty (30) days of the party's receipt of written notice of the material breach from any of the other parties. In the event the material breach has not been cured within such period, the party giving notice of the material breach has the right (1) to terminate this Agreement upon notice to the other parties hereto effective twenty (20) months immediately following receipt by the other parties hereto of the notice to terminate or (2) to attempt to have this Agreement specifically performed or to pursue other equitable or legal remedies with respect to such material breach instead of terminating this Agreement. Termination of this Agreement pursuant to this provision shall not preclude any legal or equitable remedies otherwise available for breach of this Agreement.

The parties hereto agree that any material breach by a party to this Agreement may not be used by an affiliate of that party to terminate or attempt to terminate this Agreement.

The parties agree that, except as permitted in this Agreement, including Clause 20, or by The Partnership, and except that The Telephone Company may sell business and residential listings to third parties, none of the parties, nor any of their affiliates, shall during the term of this Agreement be involved in any fashion with the publishing or manufacturing of any directories substantially similar to The Directories, The Regional White Pages Directories or the Chicago Alphabetical Directory for distribution primarily in those portions of the State of Illinois in which The Telephone Company is licensed or franchised to provide primary telephone service. The word "affiliate" as used in this Agreement means as to each party a corporation, company, trust, firm or other entity which, directly or indirectly, controls, or is controlled by, or is under common control with, such party.

CLAUSE 2 - PUBLISHING OF THE DIRECTORIES, DIRECTORY OPERATIONS, COPYRIGHT AND COVERS

During the term of this Agreement, Donnelley shall publish and copyright in its name issues of the Yellow Pages in the Co-Bound Directories, the city-wide Chicago Classified Telephone Directories, classified sections of the Chicago neighborhood directories, Area-Wide Yellow Pages Classified

Directories, Street Address Directories, the Chicago Visitor's Guide, the Health Care Industry Directory and the Bradley University Student Directory at approximately equal twelve (12) month intervals, except that Four or More Color Advertising Insert Sections in The Directories will be copyrighted in the name of The Telephone Company or its designee.

The word "publish," to describe Donnelley's activities with respect to The Directories, shall mean, but not by way of limitation, the following: (1) selling advertising, with the exception of the National Yellow Pages advertising that may be sold by Donnelley or any other member of the National Yellow Pages Service Association ("NYPSA") or other selling agencies which perform the function of a NYPSA selling agent, and with the exception of Color Advertising sold in Four or More Color Advertising Insert Sections in The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory; (2) compiling; (3) promoting usage and the sale of advertising; (4) handling claims and handling uncollectibles; (5) preparing art for advertisers; (6) leasing Street Address Directories; and (7) handling other miscellaneous publishing matters.

Donnelley shall publish certain types of advertising in the White Pages of the Co-Bound Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory. In such instances, the word "publish," to describe

Donnelley's activities with respect to these directories, shall mean, but not by way of limitation, the following: (1) selling advertising, (2) handling claims and handling uncollectibles, (3) providing information required to insert advertising into the Regional White Pages Directories, the Chicago Alphabetical Directory, and White Pages of the Co-Bound Directories and (4) handling other miscellaneous publishing matters.

Donnelley shall design and copyright in its name and API/IL will cause to be so printed the covers of the city-wide Chicago Yellow Pages Classified Telephone Directories, the Chicago neighborhood directories, Area-Wide Yellow Pages Classified Directories, Street Address Directories, the Chicago Visitor's Guide, the Health Care Industry Directory and the Bradley University Student Directory.

During the term of this Agreement, The Telephone Company shall publish and copyright in its name, or in the name of its designee, the alphabetical sections (White Pages) for those issues of The Directories which have White Pages, the Regional White Pages Directories and the Chicago Alphabetical Directory at approximately equal twelve (12) month intervals.

The word "publish," to describe The Telephone Company's activities with respect to the alphabetical sections which are in The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory shall mean, but not by way of limitation, the following: (1) compiling; (2)

composing; (3) inserting advertising from information received from Donnelley; (4) providing plate-ready media to API/IL for printing; and (5) handling other miscellaneous White Pages publishing matters.

During the term of this Agreement, The Telephone Company shall provide directory operations services relating to The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory.

The term "directory operations services," to describe The Telephone Company's activities with respect to The Directories, the Regional White pages Directories and the Chicago Alphabetical Directory shall mean, but not by way of limitation, the following: (1) maintaining, enhancing and developing data bases for basic business and residential telephone listing information and updates required to publish The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory; (2) maintaining, enhancing and developing data bases which provide information to support the delivery of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory; (3) maintaining, enhancing and developing systems with respect to the data bases described in (1) and (2) in this paragraph; and (4) providing computer resources required to support the tasks identified in (1), (2) and (3) in this paragraph.

The Telephone Company, or its designee, shall design and copyright in its name, or in the name of its designee, the

covers of the Co-Bound Directories (except for the Chicago neighborhood directories, the Yellow Pages and covers of which shall be designed by and copyrighted in the name of Donnelley), the Regional White Pages Directories and the Chicago Alphabetical Directory.

The names "Reuben H. Donnelley, Publishers," "Illinois Bell," with the Bell logo, and "Ameritech Bell Yellow Pages," with the walking fingers logo, are to appear on the covers (and spines, if practicable) of all of The Directories. The (i) names "Reuben H. Donnelley" and "Ameritech," which are to have equal prominence, (ii) the terms "Publishers" (appearing immediately beneath "Reuben H. Donnelley"), and "Bell Yellow Pages" (appearing immediately below "Ameritech"), which are to have equal prominence, (iii) the name "Illinois Bell," which will have greater prominence than the names and terms identified in (i) and (ii) respectively in this paragraph, and (iv) the Bell logo, which is to appear next to the name "Illinois Bell," and their general locations, relative sizes of type, and type styles are to appear on the covers (and spines, if practicable) of the Co-Bound Directories in the format set forth in Exhibit A to this Agreement or such other format upon which Donnelley, The Telephone Company and API/IL all agree.

The names (i) "Reuben H. Donnelley, Publishers," (ii) "Illinois Bell," with the Bell logo, (iii) "Ameritech Bell Yellow Pages," with the walking fingers logo, and (iv) "Red

Book" are to appear on the covers (and spines, if practicable) of the city-wide Chicago Yellow Pages Classified Telephone Directories, the Chicago neighborhood directories and Area-Wide Yellow Pages Classified Directories. In addition to the names and logos identified in this paragraph, the red band associated with the name "Red Book" is to appear only on the covers (and spine, if practicable) of the city-wide Chicago Yellow Pages Classified Telephone Directories. The names "Reuben H. Donnelley, Publishers," "Illinois Bell," with the Bell logo, "Ameritech Bell Yellow Pages," with the walking fingers logo, and "Red Book," with the red band, where applicable, and their general locations, relative sizes of type and type styles are to appear on such covers (and spines, if practicable) of those directories in the formats set forth in Exhibits B and B1 respectively to this Agreement or such other formats upon which Donnelley, The Telephone Company and API/IL all agree.

The names (i) "Reuben H. Donnelley, Publishers," (ii) "Illinois Bell," with the Bell logo, and (iii) "Ameritech Bell Yellow Pages," with the walking fingers logo, and their general locations, relative sizes of type and type styles are to appear on the covers (and spines, if practicable) of the Street Address Directories, The Chicago Visitors' Guide, the Health Care Industry Directory and The Bradley University Student Directory in the format set forth in Exhibits B2 to this Agreement or such other format upon which Donnelley, The Telephone Company and API/IL all agree.

The statement "Published with the permission of Illinois Bell Telephone Company" followed by Donnelley's name, address and telephone numbers and the statement "in cooperation with Ameritech Publishing of Illinois, Inc." followed by its address only will appear on the first page of the yellow pages in The Directories. The statements and their general locations, relative sizes of type and type styles are to appear in the format set forth in Exhibit C to this Agreement, or such other format upon which Donnelley, The Telephone Company and API/IL all agree.

On each page of the Yellow Pages in each of the issues of The Directories, Donnelley's name will appear along with such phrase to be selected by Donnelley to reflect that Donnelley holds the copyright in its own name with regard to the Yellow Pages. On each page of the White Pages in each of the issues of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory, The Telephone Company's name, or the name of its designee, will appear along with such phrase to be selected by The Telephone Company to reflect that it holds the copyright in its name with regard to the White Pages.

Unless The Telephone Company agrees otherwise, each issue of The Directories will contain public service information on the inside front cover and in other parts of that issue of The Directories similar to the public service information contained in the analogous issue of the directories published under the 1975 Yellow Pages Directory Agreement.

CLAUSE 3 - INFORMATION FURNISHED BY THE
TELEPHONE COMPANY

The Telephone Company, or its designee, shall furnish to Donnelley during the term of this Agreement The Telephone Company's basic listing information and current updates for use in the issues of The Directories. The Telephone Company shall not be required to furnish any basic listing information or updates which by tariff or current practice must be kept private or withheld from publication in any of the issues of The Directories.

Similarly, Donnelley shall not publish in The Directories or give out any information concerning any listings designated as "non-published" or "non-listed" on service orders which will be sent to Donnelley if Donnelley is selected by API/IL to deliver issues of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory. Donnelley shall not solicit any such listings in connection with the sale of advertising.

Except as permitted in Clause 20 herein, all records, lists of names, telephone numbers, and other data furnished by The Telephone Company directly or through its designee hereunder shall be used by Donnelley, its agents or employees for the performance of its publishing obligations under this Agreement only, and shall be used for no other purpose, except when specifically approved by The Telephone Company. Subject to

Clause 20 herein, The Telephone Company shall have the right to enforce this provision by injunction, in addition to any other remedies which it may have.

The Partnership may use the information furnished by The Telephone Company under this Agreement for such other purposes as may be agreed to by The Partnership, so long as such use shall not interfere with the proper and efficient furnishing of telephone service by The Telephone Company, and shall not adversely affect the relationship between The Telephone Company and its customers and the public.

CLAUSE 4 - LISTINGS TO BE INCLUDED FREE IN YELLOW PAGES

Unless otherwise requested by the subscriber to business telephone service, Donnelley shall make every reasonable effort to provide without charge in the Yellow Pages of The Directories under a classification in the approved heading structure best describing the subscriber's business, one light-face listing representing the primary listing of each subscriber to business telephone service as accepted by The Telephone Company for publication in the White Pages sections of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory. Donnelley does not insure or guarantee to subscribers to business telephone service that all such listings will be so included, correctly or otherwise, and shall not be liable under this clause or any other clause

of this Agreement for any errors or omissions with respect to such listings. This Agreement is not intended to and does not give rise to any rights to anyone other than the parties hereto and their affiliates.

CLAUSE 5 - CONTROL OF DIRECTORIES

As publisher, Donnelley shall formulate all policies relating to directory advertising in The Directories. However, as shall be determined by The Telephone Company from time to time, any and all policies so formulated shall not interfere with the proper and efficient furnishing of telephone service by The Telephone Company, and shall not adversely affect the relationship between The Telephone Company and its customers and the public.

CLAUSE 6 - MANUFACTURING AND DELIVERY, ASSIGNMENT OF CONTRACTS AND MONIES TO BE PAID TO API/IL

During the term of this Agreement, API/IL shall be responsible for, or shall select contractors, referred to herein as "manufacturing and delivery contractors," which will be responsible to API/IL for: (1) the printing of The Directories, the Regional White Pages Directories and Chicago Alphabetical Directory and their covers; (2) the composition for The Directories; (3) the purchasing of paper for The Directories, the Regional White Pages Directories and Chicago Alphabetical Directory; (4) the creation, maintenance and printing of maps

within The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory; (5) the delivery of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory, the five above-stated functions hereinafter referred to as "manufacturing and delivery"; and (6) other responsibilities of The Telephone Company hereunder which may be assigned by The Telephone Company to API/IL or responsibilities which The Partnership may assign to API/IL.

The Partnership shall reimburse API/IL for its reasonable costs and expenses which are directly attributable to manufacturing and delivery, including the amounts, if any, API/IL pays to manufacturing and delivery contractors, and general and administrative costs and expenses, which include insurance, hereinafter collectively referred to as "Manufacturing and Delivery Costs."

Inasmuch as Manufacturing and Delivery Costs (except for the costs of printing, paper, delivery and composition, hereinafter referred to as "Determinable Costs") are incapable of exact computation at the time each issue of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory is manufactured and delivered, Manufacturing and Delivery Costs, other than Determinable Costs, shall be estimated by API/IL each year during the term of this Agreement, based upon current manufacturing and delivery experience, and provided, along with Determinable Costs for that year, to The Partnership.

In consideration for manufacturing and delivery, API/IL shall be paid by The Partnership within thirty (30) days after The Partnership receives an invoice from API/IL for charges relating to printing, paper, delivery or composition. In further consideration for manufacturing and delivery, API/IL is to be paid by The Partnership on the twenty-fifth (25th) day of each month during each year of the term of this Agreement an amount equal to one-twelfth (1/12) of Other Costs. As used in this paragraph, the words "Other Costs" mean the annual estimate of Manufacturing and Delivery Costs, less Determinable Costs for the same year.

As soon as the actual Other Costs for the preceding year shall have been determined, API/IL shall pay or be paid the difference between the estimated and actual Manufacturing and Delivery Costs within thirty (30) days of such determination.

API/IL shall determine the policy under which The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory are to be distributed, including the number of copies of each of the issues of those directories which is to be delivered.

The Telephone Company, The Partnership and Donnelley agree to provide to API/IL such information as API/IL requires for the provision of the above services, at times and in such detail so that API/IL can effectively carry out its obligations under this Clause.

Subject to the approval of the parties to the contracts, The Telephone Company hereby assigns to API/IL and API/IL accepts, all of The Telephone Company's rights and obligations under the contracts identified in Exhibit D to this Agreement.

CLAUSE 7 - COST OF COMPILING

The cost of compiling shall be the actual cost thereof, allocated as set forth below. Such actual cost shall include: (1) wages of Donnelley's compilation employees up to and including compilation department management as are properly chargeable to The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory; (2) the cost of handling for publication directory advertising sold by Donnelley, other telephone companies, NYPSA members, or other selling agencies that perform the function of a NYPSA selling agent; plus (3) all other properly chargeable compiling costs, including general and administrative costs and expenses, which include insurance, chargeable in accordance with Donnelley's customary accounting practices. With respect to the cost of compilation, other than allocated general and administrative expenses and fees, such compilation costs shall consist of the following:

<u>Department Name</u>	<u>Percent of costs of department attributable to compilation</u>
Compilation-Terre Haute	100
Compilation-Chicago	79
Copy Center	100
Central Files-Terre Haute	100
Manuscript	100
Ad Revision	75
SOS-Metro	28
SOS-Springfield	28
Operations Support	80
MPS Team	68
Publishing Services	73
Local Trade Mark	46
NYPS Publishing	100
Production Sorting	50
Office Services-Terre Haute	73
Coordinator Co-Op	45

It is understood that this list may be revised by Donnelley by addition or deletion of items or through revision of the above percentages. Any such change will be subject to an annual review and agreement by The Partnership's auditing firm. Donnelley is obligated to advise The Partnership's auditing firm of any material change in the aforementioned list of departments or the percentages applicable to each of the departments.

Expenses related to compilation services provided to other users who use facilities, functions and resources used to compile The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory shall be excluded from compilation costs. Such excluded costs will be identified annually by Donnelley and provided to The Partnership's

auditing firm. The calculation in determining such excluded costs shall be made consistent with existing 1984 procedures, except as modified by The Partnership.

The costs of compiling to be allocated to and paid by The Partnership to Donnelley shall also include an amount which shall provide a fee to Donnelley which, after provision for Federal Income Taxes, is equal to three percent (3%) of the costs of compiling, exclusive of the fee, hereinafter referred to as "the 3% compilation fee." The term "provision for Federal Income Taxes" as used in Clause 7 and Clause 8 means the total of the highest normal tax and surtax rates as applicable from time to time to corporations under the Internal Revenue Code.

Inasmuch as the costs of compiling are incapable of exact computation at the time each issue of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory is published, such costs each year during the term of this Agreement, including the 3% compilation fee, shall be estimated by Donnelley and provided to The Partnership based upon current compilation experience.

As soon as the actual compiling costs for the preceding year shall have been determined, Donnelley shall pay or be paid the difference between the estimated and actual compiling costs within thirty (30) days of such determination.

CLAUSE 8 - DONNELLEY'S COST OF HANDLING CLAIMS
AND HANDLING UNCOLLECTIBLES

The Telephone Company shall refer to Donnelly all customer claims on account of error or omission relating to advertising or business listings in The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory for such action as Donnelly determines is necessary. Also, The Telephone Company shall forward each month to Donnelly information regarding all advertisers from whom The Telephone Company deems it cannot collect outstanding advertising charges using its collection methods and practices set forth in Clause 13 for such action as Donnelly determines is necessary.

Seventy-seven percent (77%) of Donnelly's actual costs of handling claims and handling uncollectibles relating to advertising or business listings in The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory shall be borne by The Partnership and twenty-three percent (23%) of such actual costs shall be borne by Donnelly.

The costs of handling claims and handling uncollectibles chargeable to The Partnership and Donnelly shall consist of: (1) actual costs of the Donnelly departments which are engaged in those activities, including general and administrative costs and expenses, which include insurance; plus (2) a fee to Donnelly which, after provision for Federal Income

Taxes, is equal to three percent (3%) of the total costs of handling claims and handling uncollectibles, exclusive of the fee, hereinafter referred to as "the 3% handling fee."

Inasmuch as the costs of handling claims and handling uncollectibles are incapable of exact computation at the time each issue of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory is published, such costs each year during the term of this Agreement, including the 3% handling fee, shall be estimated by Donnelley and provided to The Partnership based upon current claims handling and uncollectibles handling experience.

As soon as the actual costs for the preceding year have been determined, the appropriate parties shall pay or be paid the difference between the estimated and actual costs within thirty (30) days of such determination.

CLAUSE 9 - DIRECTORY PROMOTION

During the term of this Agreement, Donnelley shall be responsible for providing all advertising and advertising service designed to promote the use of and advertising in The Directories, and advertising in the Regional White Pages Directories and the Chicago Alphabetical Directory, except that The Telephone Company, at its sole expense, has the right to promote the use of the White Pages. The Partnership is to approve any advertising before it is placed. Except as determined by The Partnership, in no event shall the annual amount

to be treated as a cost of promotion of The Directories, and advertising in the Regional White Pages Directories and the Chicago Alphabetical Directory exceed two and one-half percent (2-1/2%) of the yearly net issue value. The term "net issue value" as used herein means the total amount of advertising which Donnelley sells for all of the issues of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory delivered in any year during the term of this Agreement, adjusted by subtracting the amount of allowances granted and revenue not billed due to disconnection of telephone service, hereinafter referred to as "phone-outs," with respect to all of the issues of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory delivered in the preceding year. For purposes of this paragraph, the city-wide Chicago Yellow Pages Classified Telephone Directories shall be considered to be delivered in the year in which their delivery is completed. Donnelley shall bear ten percent (10%) of the promotion costs and the remaining 90 percent (90%) of the promotion costs shall be borne by The Partnership.

Inasmuch as the costs of providing advertising and advertising services to promote use of and advertising in The Directories, and advertising in the Regional White Pages Directories and the Chicago Alphabetical Directory are incapable of exact computation at the time each issue of such directories is

published, such costs each year during the term of this Agreement shall be estimated by Donnelley and provided to The Partnership based upon current promotion cost experience.

As soon as the actual costs for the preceding year have been determined, the appropriate parties shall pay or be paid the difference between the estimated and actual costs within thirty (30) days of such determination.

All audiovisual and print advertising to promote the use of or advertising in The Directories (except for filler in The Directories, which shall not require the use of the name "Illinois Bell") and advertising in the Regional White Pages Directories and the Chicago Alphabetical Directory are to include the names (i) Illinois Bell, with the Bell logo; (ii) Ameritech Bell Yellow Pages, with the walking fingers logo; and (iii) Reuben H. Donnelley, with the word "Publishers," all of which are to be displayed in a manner consistent with the treatment of covers in Clause 2. Where practicable, in the judgment of The Partnership, all radio advertising to promote the use of or advertising in The Directories or advertising in the Regional White Pages Directories or Chicago Alphabetical Directory is to include in the closing or sign-off message the names "Illinois Bell," "Ameritech Bell Yellow Pages" and "Reuben H. Donnelley, Publishers," or such variation thereof which is agreed upon by The Partnership.

Notwithstanding anything to the contrary in the preceding paragraph, The Telephone Company, at its sole expense, has the right to promote the use of the White Pages.

CLAUSE 10 - COST OF UNCOLLECTIBLES AND OTHER
ADJUSTMENTS TO REVENUE

Seventy-seven percent (77%) of all of The Partnership's loss of revenue due to uncollectibles, if any, plus the actual costs, other than Donnelley's costs which are paid in accordance with Clause 8, of handling each delinquent advertiser, and all expenses for collection agency commissions, attorneys' fees, court costs, and any other legal expenses involved in collection, shall be borne by The Partnership and twenty-three percent (23%) shall be borne by Donnelley.

Seventy-seven percent (77%) of all amounts recovered on advertising charges which previously had been deemed uncollectible shall be remitted to The Partnership and twenty-three percent (23%) of such recovered amounts shall be retained by, or if collected by another party remitted to, Donnelley.

All expenses paid for Reciprocal Advertising commissions and National Yellow Pages advertising commissions are to be borne entirely by the Partnership. As used in this paragraph, the term "Reciprocal Advertising commissions" means advertising commissions for advertising sold by Donnelley and others in The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory for advertisers located

outside those portions of the State of Illinois in which The Telephone Company is licensed or franchised to provide primary telephone service. As used in this paragraph, the term "National Yellow Pages advertising commissions" means commissions for advertising sold by Donnelley or any other member of NYPSA or other selling agencies which perform the function of a NYPSA selling agent.

CLAUSE 11 - COST OF LEGAL EXPENSES, SETTLEMENTS AND JUDGMENTS

Seventy-seven percent (77%) of the costs of all obligations incurred by The Telephone Company, Donnelley, API/IL, or any of them related to any claims, settlements, costs, including attorneys' fees, judgments and decrees, concerning Yellow Pages and advertising in the White Pages in The Directories, in the Regional White Pages Directories and the Chicago Alphabetical Directory shall be borne by The Partnership and twenty-three percent (23%) of such costs shall be borne by Donnelley. Any other obligations incurred by Donnelley, The Telephone Company, API/IL, or any of them related to any claims, settlements, costs, including attorneys' fees, judgments and decrees arising out of any obligations under this Agreement, excluding litigation between the parties to this Agreement, shall be borne by The Partnership.

Inasmuch as the costs related to claims, attorneys' fees and other collection-related costs, settlements, judgments

and decrees are incapable of exact computation at the time each issue of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory is published, such costs each year during the term of this Agreement shall be estimated by Donnelley and provided to The Partnership based upon current legal cost experience.

As soon as the actual costs for the preceding year have been determined, the appropriate parties shall pay or be paid the difference between the estimated and actual costs within thirty (30) days of such determination.

CLAUSE 12 - ALLOWANCES AND UNCOLLECTIBLES LIMITATION

Anything herein to the contrary notwithstanding, Donnelley's responsibility during the first year of this Agreement for allowances and uncollectibles with respect to advertising sold by Donnelley shall not exceed an amount equal to 4.79 percent of the total amount of advertising sold by Donnelley for issues of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory delivered in 1985.

In 1986 and for each subsequent year, the limitation percentage shall be the lower of (a) the prior year's limitation percentage plus an additional one-half percent (.5%) or (b) the percent determined by adding the adjustments for allowances and uncollectibles with respect to advertising sold by

Donnelley for issues of The Directories, The Regional White Pages Directories and the Chicago Alphabetical Directory delivered in the prior year and dividing the result by the total amount of advertising sold by Donnelley for issues of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory delivered in the prior year plus an additional one-half percent (.5%).

For purposes of this Clause, each edition of the city-wide Chicago Yellow Pages Classified Telephone Directories shall be considered to be delivered in the year in which its delivery is completed.

CLAUSE 13 - BILLING AND COLLECTING

The parties agree that it will be a convenience to advertisers if the billing and collecting of charges for advertising and related charges are handled by and included on the telephone bills sent by The Telephone Company in connection with its regular monthly billing for telephone service. Therefore, the parties agree that The Telephone Company, as agent for The Partnership, is to perform such billing and collecting responsibilities. In addition, The Telephone Company will bill and collect for National Yellow Pages advertising in The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory in the manner and form which at the time of billing is the generally accepted procedure in use for billing of this type.

The Telephone Company shall bill and, except as otherwise herein provided, attempt to collect all charges for advertising and related charges in The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory. The Telephone Company in collecting for such charges may follow the same standard collection methods and practices used in collecting for telephone service, with such modifications as may be necessary to apply those standard practices to directory advertising. In addition to billing for advertising in The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory, The Telephone Company will bill and collect from The Telephone Company's service customers for Reciprocal Advertising. As used in this Agreement, the term "Reciprocal Advertising" means advertising sold by Donnelley and purchased by The Telephone Company's service customers in directories other than The Directories, the Regional White Pages Directories and The Chicago Alphabetical Directory.

Donnelley shall furnish The Telephone Company with a record showing the telephone number and the amount to be billed for each new advertiser and for each advertiser whose billing changes with a new issue of any of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory. Donnelley shall specify any changes to be made for any reason in monthly billings thereafter.

CLAUSE 14 - MONIES TO BE PAID TO THE PARTNERSHIP

All revenues from: (i) the sale of advertising in The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory (except for revenue from Four or More Color Advertising Insert Sections which is subject to Clause 22); (ii) Reciprocal Advertising; and (iii) leasing of the Street Address Directories, are the property of The Partnership.

On the twentieth (20th) day of each month during the term of this Agreement, The Telephone Company shall remit to The Partnership the amount of money billed by The Telephone Company during the prior month for advertising and related charges with respect to: (i) advertising in The Directories, the Regional White Pages Directories, the Chicago Alphabetical Directory (exclusive of any amounts billed for Four or More Color Advertising Insert Sections subject to Clause 22); (ii) Reciprocal Advertising; and (iii) leasing of the Street Address Directories, less an amount equal to a percent of the money billed by The Telephone Company during the prior month reflecting the estimated uncollectibles. Such percent is to be determined annually by The Telephone Company based upon current uncollectibles experience. The term "uncollectibles" as used in this Agreement excludes phone-outs and allowances.

Donnelley will remit to The Partnership each month during the term of this Agreement an amount equal to twenty-three percent (23%) of the amount of uncollectibles estimated

by The Telephone Company in accordance with the preceding paragraph less any estimated uncollectibles relating to National Yellow Pages advertising.

By March 31 following each calendar year during the term of this Agreement, the parties, with the assistance of The Partnership's auditing firm, are to determine, as accurately as possible, the amount of revenues collected during the preceding calendar year from: (i) advertising sold in The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory (except for revenue from Four or More Color Advertising Insert Sections which is subject to Clause 22); (ii) revenues from Reciprocal Advertising; and (iii) revenues from the leasing of the Street Address Directories, hereinafter referred to as "Amount Collected," and the amount of uncollectibles, including any uncollectibles relating to National Yellow Pages advertising, as well as it can be determined, for the preceding calendar year. If the Amount Collected exceeds the amount remitted by The Telephone Company to The Partnership, from and including February 20th of the preceding calendar year through and including January 20th of the current calendar year, The Telephone Company shall pay The Partnership the difference within thirty (30) days following the determination of the difference. If the amount remitted by The Telephone Company to The Partnership, from and including February 20th of the preceding calendar year through and including January 20th of the current calendar year, exceeds

the Amount Collected. The Partnership shall pay The Telephone Company the difference within thirty (30) days following the determination of the difference. If the amount of uncollectibles, as described above in this paragraph, exceeds The Telephone Company's estimate of such uncollectibles, including the estimate for uncollectibles relating to National Yellow Pages advertising, hereinafter referred to in this paragraph as "the Estimate," Donnelley shall pay The Partnership twenty-three percent (23%) of the difference between the uncollectibles and the Estimate within thirty (30) days of the determination of the amount of uncollectibles. If the Estimate exceeds the amount of uncollectibles, The Partnership shall pay Donnelley twenty-three percent (23%) of the difference between the amount of uncollectibles and the Estimate within thirty (30) days of the determination of the amount of the uncollectibles. The payments made pursuant to this paragraph are to be adjusted in accordance with any subsequent information which becomes available to the parties.

CLAUSE 15 - MONIES TO BE PAID TO THE TELEPHONE COMPANY

In consideration for The Telephone Company's furnishing of information under Clause 3 of this Agreement and its providing billing and collection service under Clause 13 of this Agreement, The Partnership agrees to pay The Telephone Company forty-nine million, five hundred thousand dollars

(\$49,500,000) in installments of three million dollars (\$3,000,000) on March 31, 1985, three million dollars (\$3,000,000) on June 30, 1985, twenty-one million, seven hundred and fifty thousand dollars (\$21,750,000) on September 30, 1985 and twenty-one million, seven hundred and fifty thousand dollars (\$21,750,000) on December 31, 1985. Beginning in calendar year 1986, and in each calendar year thereafter for the balance of the term of this Agreement, The Partnership agrees to pay The Telephone Company seventy-five million dollars (\$75,000,000). Each calendar year payment of seventy-five million dollars (\$75,000,000) is to be made in four equal installments on March 31, June 30, September 30 and December 31 of each year. During the twelve (12) month period immediately following the date on which this Agreement terminates, The Partnership shall pay The Telephone Company thirty-seven million, five hundred thousand dollars (\$37,500,000). This payment will be made in four equal, quarterly installments within such twelve (12) month period, the first quarterly installment being payable three (3) months following the date this Agreement terminates.

In further consideration for The Telephone Company's furnishing of information under Clause 3 of this Agreement and its providing billing and collection service under Clause 13 of this Agreement, The Partnership agrees to pay to The Telephone Company any and all gross profits in excess of the first thirty-

six million dollars (\$36,000,000) gross profits but not in excess of thirty-seven million, eight hundred thousand dollars (\$37,800,000) gross profits derived by The Partnership from advertising in the January 1985 city-wide Chicago Classified Telephone Directories, plus one-third (1/3) of the gross profits in excess of the first thirty-seven million, eight hundred thousand dollars (\$37,800,000) but not in excess of the first forty-one million, four hundred thousand dollars (\$41,400,000) gross profits derived by The Partnership from advertising in such Directories. The payment identified in this paragraph is to be made on March 31, 1986. The total payment identified in this paragraph will not exceed three million dollars (\$3,000,000). For purposes of this paragraph, the term "gross profits" shall mean the gross advertising billings related to such Directories less expenses directly attributable to such Directories including, but not limited to, selling commissions, compilation expenses, claims and uncollectibles handling costs, Manufacturing and Delivery Costs, directory operations services costs and estimated uncollectibles, allowances, phone-outs, legal and promotion costs.

In further consideration for The Telephone Company's furnishing of information under Clause 3 of this Agreement and its providing billing and collection service under Clause 13 of this Agreement, beginning with respect to the calendar year 1986, and with respect to each calendar year thereafter during

the term of this Agreement, The Partnership agrees to pay The Telephone Company an amount equal to seven and one-half percent (7-1/2%) of the difference between the total revenues received by The Partnership in a calendar year: (1) from advertising in The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory; (2) revenues from Reciprocal Advertising; and (3) revenues from leasing of the Street Address Directories, and the total of such revenues and charges received by The Partnership in the immediately preceding calendar year, hereinafter referred to as the "Additional Annual Payment." It is understood that for purposes of calculating the Additional Annual Payment with respect to calendar year 1986, the amount of revenue deemed to have been received by The Partnership in 1985 will be increased by the amount of revenue collected by The Telephone Company in 1985 with respect to directories published under the 1975 Yellow Pages Directory Agreement.

It is agreed by The Partnership that notwithstanding the possibility that there could be less charges and revenues collected by The Telephone Company in one calendar year than in the prior calendar year, beginning in the year 1986 and each year thereafter during the term of this Agreement, The Telephone Company is to be paid by The Partnership no less than seventy-five million dollars (\$75,000,000). The first Additional Annual Payment to The Telephone Company is to be made on April 1, 1987 with respect to calendar year 1986 and

the other Additional Annual Payments are to be made on April 1st of each year thereafter with respect to each preceding calendar year during the balance of the term of this Agreement.

Notwithstanding any of the other terms in this Clause 15, in the event this Agreement terminates before December 31 of any calendar year, The Partnership agrees to pay The Telephone Company for that year in which this Agreement terminates: (a) that percent of the seventy-five million dollars (\$75,000,000) which is equal to the percent resulting from dividing the number of days during which this Agreement is in effect in the year in which it terminates by 365; plus (b) seven and one-half percent (7-1/2%) of the difference between the revenues received by The Partnership for advertising and charges for The Directories, the Regional White Pages Directories, the Chicago Alphabetical Directory and from Reciprocal Advertising during the period of time this Agreement is in effect in the year in which it terminates and such revenue from such advertising and charges received by The Partnership during the like period of time in the previous year.

In addition, for the time this Agreement is in effect, The Partnership shall reimburse The Telephone Company its reasonable costs and expenses, including general and administrative expenses, which include insurance, if any, properly chargeable, in accordance with The Telephone Company's accounting procedures, to the publishing of the White Pages and for

providing of directory operations services for certain of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory (not otherwise reimbursed to API/IL under Clause 6).

Inasmuch as the costs of publishing White Pages and of providing directory operations services are incapable of exact computation at the time each issue of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory is published, such costs each year during the term of this Agreement shall be estimated by the Telephone Company and provided to The Partnership based upon current White Pages publishing and directory operations services experience.

In consideration for publishing the White Pages and providing directory operations services, as described in Clause 2, The Telephone Company is to be paid by The Partnership on the twenty-fifth (25th) day of each month during each year of the term of this Agreement an amount equal to one-twelfth of the annual estimate as set forth in this Clause.

As soon as the actual White Pages publishing and directory operations services costs for the preceding year shall have been determined, The Telephone Company shall pay or be paid the difference between the estimated and actual publishing and directory operations services costs within thirty (30) days of such determination.

CLAUSE 16 - MONIES TO BE PAID TO DONNELLEY

In consideration for its publishing of the Yellow Pages in The Directories and advertising in the White Pages of the Co-Bound Directories and in the Regional White Pages Directories and the Chicago Alphabetical Directory Donnelley is to be paid by The Partnership (a) twenty-three percent (23%) of the gross value of advertising, excluding art preparation charges, sold by Donnelley in each issue of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory, less twenty-three percent (23%) of the loss of revenue related to the prior year's issue published under this Agreement or, where applicable, under the 1975 Yellow Pages Directory Agreement due to phone-outs and allowances, and (b) seventy percent (70%) of the art preparation charges billed to advertisers for advertising sold by Donnelley in The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory. In consideration for publishing the Street Address Directories, Donnelley is to be paid by The Partnership twenty-three percent (23%) of the gross value of leasing payments for each issue of such Directories.

For each of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory, Donnelley is to deliver to The Partnership in the month in which delivery of each issue of such Directories is scheduled to be completed, or such earlier date as The Partnership determines, an invoice

which reflects the amounts due Donnelley, as hereinabove described. Payment is to be made to Donnelley within thirty (30) days of The Partnership's receipt of an invoice from Donnelley. Nothing in this Clause affects the amount of money which Donnelley is to remit to The Partnership for uncollectibles in accordance with Clause 14.

In consideration for Donnelley's compiling of The Directories, claims handling, uncollectibles handling, directory promotion, and handling of legal matters, as described in Clauses 7, 8, 9, and 11, Donnelley is to be paid by The Partnership on the twenty-fifth (25) day of each month during the term of this Agreement an amount equal to one-twelfth (1/12) of the annual estimates of the costs to be borne by The Partnership relating to those activities.

CLAUSE 17 - DEFENSE - INSURANCE

While Donnelley does not insure or guarantee (1) that all listings will be included, correctly or otherwise, in The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory, (2) that all applications for advertising will be accepted, or (3) that no error will be made in inserting such advertising, it is recognized that suits may be instituted or claims filed against any of the parties with respect to The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory. In such event,

notwithstanding anything to the contrary in Clause 4, Donnelley shall defend such suits or claims, except for suits or claims relating to (i) free listings in the White Pages and (ii) Four or More Color Advertising Insert Sections, not only on its behalf but also on behalf, and in the names of, The Telephone Company, API/IL and The Partnership in connection with any claims, demands and suits arising directly or indirectly from, or by means of, any errors, omissions, refusals to accept advertising, or misuse of information, claimed or actual, concerning any issues of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory, provided that the costs, including reasonable attorneys' fees, incurred by Donnelley to so defend, and the liability for any settlement, judgment or decree resulting from suits or claims concerning any of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory will be borne by The Partnership and Donnelley as provided in Clause 11. As used herein, the word "defend" means that Donnelley will retain counsel to defend not only its interests but also The Telephone Company's, API/IL's and The Partnership's interests in regard to such suits or claims, and will make its best efforts to have The Telephone Company, API/IL and The Partnership dismissed, if any of them is made a party, from the proceedings related to such suits or claims.

Donnelley further agrees to defend and carry adequate public liability, property damage and workmen's compensation insurance, fully to protect The Telephone Company, API/IL and The Partnership from any claims, demands, claims under the Worker's Compensation Act and suits arising by reason of injury to, or death of, persons, or damage to property (including employees and property of The Telephone Company, API/IL and The Partnership) occasioned by Donnelley's publishing of the Yellow Pages in The Directories, or advertising in the White Pages of The Directories, the Regional White Pages Directories or the Chicago Alphabetical Directory.

Donnelley shall carry adequate property damage, fire and theft insurance on all property of The Telephone Company, API/IL and The Partnership, including records and directories, which may at any time be in Donnelley's possession by reason of this Agreement.

API/IL agrees to defend and carry adequate public liability, property damage and workmen's compensation insurance, fully to protect The Telephone Company, The Partnership and Donnelley from any claims, demands, claims under the Worker's Compensation Act and suits arising by reason of injury to, or death of, persons, or damage to property (including employees and property of The Telephone Company, The Partnership and Donnelley) occasioned by API/IL's manufacturing and delivery of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory.

API/IL shall carry adequate property damage, fire and theft insurance on all property of The Telephone Company, The Partnership and Donnelley, including records and directories, which may at any time be in API/IL's possession by reason of this Agreement.

The Telephone Company agrees to defend and carry adequate public liability, property damage and workmen's compensation insurance, or retain the risks fully to protect Donnelley, API/IL and The Partnership from any claims, demands, claims under the Worker's Compensation Act and suits arising by reason of injury to, or death of, persons, or damage to property (including employees and property of Donnelley, API/IL and The Partnership) occasioned by The Telephone Company's publishing of the White Pages in certain of The Directories, the Regional White Page Directories and the Chicago Alphabetical Directory and providing directory operations services.

The Telephone Company shall carry adequate property damage, fire and theft insurance on all property of Donnelley, API/IL and The Partnership, or retain the risks for loss of or damage to such property including records and directories, which may at any time be in The Telephone Company's possession by reason of this Agreement.

CLAUSE 18 - NOTICES

Notices and agreements provided for herein shall be signed as follows: for Donnelley, by the Vice President and General Manager; for The Telephone Company, by the General

Manager-Number Services; for API/IL, by its President; for API, by a Vice-President; and for The Partnership, by a person designated by The Partnership. Any notice or agreement given hereunder shall be in writing and shall be conclusively deemed to have been received and to be effective on the date on which delivered to the office of the recipient, or if sent by registered or certified mail, on the third business day after the day on which mailed.

CLAUSE 19 - OWNERSHIP OF COMPUTER SOFTWARE JOINTLY DEVELOPED BY THE TELEPHONE COMPANY AND DONNELLEY

Ownership of all computer software developed by Donnelley and The Telephone Company for the purpose of compiling and/or composing The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory, part of the cost of which was borne by The Telephone Company, shall, when this Agreement terminates, vest jointly in The Telephone Company and Donnelley. Twenty months immediately preceding the date on which this Agreement terminates, and at the request of The Telephone Company, Donnelley shall reproduce and deliver to The Telephone Company, copies of all programs, documentation, and other materials which are a part of the above described computer software.

The Telephone Company and Donnelley agree that this computer software is proprietary and, except as otherwise stated in this Clause, neither party shall loan, sell, or

otherwise disclose the contents of the software during the term of this Agreement without prior written consent of the other developing party. The Telephone Company agrees that Donnelley may utilize the software for purposes of compiling and/or composing directories within the prior Illinois-Cincinnati Region (now called the Midwest Region) of Donnelley and under contract to Donnelley on the effective date of this Agreement, and any directory or group of directories, subsequently contracted to Donnelley by other telephone companies during the term of this Agreement, whose annual value at the time of acquisition does not exceed \$5,000,000. The term "time of acquisition," as used herein, shall mean the effective date of any contract between Donnelley and any other telephone company, and the term "annual value," as used herein, shall mean the annual value of all advertising appearing in the directory or directories.

A party's interest in utilization of the software for compiling and/or composing any other directory or group of directories shall require written consent of the other party except that Donnelley or The Telephone Company may use the software for compiling and/or composing any other directory or group of directories to be distributed primarily outside of the states of Illinois, Indiana, Ohio, Michigan and Wisconsin without having to obtain consent from the other so long as the other is given notice of such use, is paid a fee in accordance with this Clause and every six months during the term of this

Agreement is advised of the directories being compiled and/or composed with the use of the software. The information provided by either party pursuant to the preceding sentence is to be treated as confidential. It is understood and agreed that where consent is required, once such consent has been given, the party initiating the request for consent shall pay or arrange to have paid within twelve (12) months of the effective date of the new contract, to the other party, a one-time fee to reimburse that other party a portion of the developmental expense paid for by that other party. Such fee will be determined based on the annual value at the time of acquisition of the directory or group of directories for which the specific consent was given, as follows:

<u>Annual Value</u>	<u>Percent of Applicable Share of Developmental Costs to be Paid as Fee</u>
Up to \$5,000,000	0%
\$5,000,000 to \$9,999,999	6%
\$10,000,000 to \$14,999,999	9%

For each additional increment of \$5,000,000 of annual value in excess of \$10,000,000, an additional 3% of applicable costs will be reimbursed, to a maximum of 33% reimbursement of applicable costs for each contract.

The total developmental costs for the jointly-developed software are \$1,988,965 for The Telephone Company and \$2,721,465 for Donnelley. Total cumulative payments to either party based on the formula above are not to exceed the amount

reflected above as the respective party's share of costs in developing the software. If either party's share of costs has been fully repaid, future expanded use of this software by the other party during the term of this Agreement will be, except as otherwise provided in this Clause, by mutual consent but without there having to be a fee paid to the party whose share of costs has been fully repaid.

In any instance under this Clause where written consent is required to be obtained by either party, the other party agrees not to unreasonably withhold or delay the giving of such consent.

From and after the date on which this Agreement terminates, Donnelley and The Telephone Company are free to use, sell to others or disclose the contents of the joint developed software without the other's consent and without having to pay a fee or make any other payment for the right to use, sell to others or to disclose the contents of the jointly developed software.

CLAUSE 20 - TERMINATION

Between twenty (20) months and eighteen and one-half (18-1/2) months prior to the date on which this Agreement terminates, regardless of the reason for such termination, Donnelley is obligated to turn over to The Telephone Company, or its designee, the information in tangible form (including

documents, copies of which are to be turned over to The Telephone Company, or its designee, and the originals of which are to be retained by Donnelley) which is then in the possession or control of Donnelley or any of its affiliates (except for budget, personnel, and internal Donnelley financing information) and which is then being used by Donnelley or any of its affiliates in connection with or in any way to facilitate the publication of The Directories, the Regional White Pages Directories or the Chicago Alphabetical Directory, without exception or regardless of who developed, paid for, or supplied the information, hereinafter referred to as "Information." The parties agree that, as of the time this Agreement comes into effect, such Information is limited to: (a) all directory advertising contracts, advertising program applications and associated copy sheets; (b) all billing records; (c) all speculative art; (d) all specifications data; (e) all headings lists and pending heading requests; (f) all sales assignment records, edited so as to exclude only the names of Donnelley employees; (g) all canvass sales results data; (h) all records and lists relating to potential advertisers; (i) all pending and existing National Yellow Pages Association contracts, advertising program applications, and data; (j) all pending and existing reciprocal records, contracts, advertising program applications and data; (k) all customer service records including completed and pending claims; (l) all records of pending litigation; (m)

all Co-op and unpublished trademark file records and orders;
(n) all standards and ethics material; (o) all marketing plans and programs; (p) all market research data; (q) all 'mechanical files', including the advertising specifications and artwork in such files; (r) all page mechanicals; (s) all veloxes and ad materials; (t) the listing control file, which contains all telephone listing information which The Telephone Company has provided to Donnelley under this Agreement, and the advertiser master file; and (u) all software to which The Telephone Company is entitled under Clause 19 (which at the time of the effectiveness of this Agreement consists of the MIDAS system) and all system, application, and utility software used by Donnelley or any of its affiliates or which is owned or controlled by Donnelley or any of its affiliates but used by a third party in processing Information to be turned over to The Telephone Company, or its designee, under this Clause. The parties recognize that the Information to which The Telephone Company or its designee is entitled under this Clause may change over time because of changes in operational methods and technology. Accordingly, The Telephone Company, or its designee, will be entitled, at the time Donnelley's obligation to turn over Information to The Telephone Company or its designee becomes effective, to copies of any replacements, enhancements, or functional equivalents of the Information and Donnelley is to retain, and is free to make any use it deems fit of, the

originals of the Information. To the extent that the Information Donnelley must turn over to The Telephone Company, or its designee, under this Clause becomes integrated with other information, Donnelley shall either segregate a copy of the Information it must turn over to The Telephone Company or its designee under this Clause or turn over that Information as integrated with other information to The Telephone Company or its designee.

The Telephone Company or its designee shall have the right to use immediately the Information turned over by Donnelley under this Clause for the purposes of: (i) selling advertising in and publishing classified and White Pages directories; (ii) disseminating business information which is classified by business and which contains the same or generally the same business advertising and listing information contained in The Directories except that the business advertising and listing information are to be conveyed through an electronic means, hereafter referred to as "disseminating electronic business information," or (iii) any purpose for which Donnelley may use information it has obtained from The Telephone Company under this Agreement (including business and residential listing information which Donnelley has the right to purchase from The Telephone Company pursuant to this Clause from and after twenty months prior to the date on which this Agreement terminates) or the 1975 Yellow Pages Directory Agreement.

Except for Information which is disposed of in the ordinary course of Donnelley's business, Donnelley agrees, as to the Information which it is obligated hereunder to turn over to The Telephone Company or its designee, that it will maintain such Information and will not dispose of or transfer to any third party any of such Information without keeping adequate copies thereof. Donnelley shall not, during the period between twenty (20) months before this Agreement terminates and the time by which Donnelley has satisfied its obligations to turn over Information to The Telephone Company or its designee, dispose of any Information without the written consent of The Telephone Company.

Donnelley warrants that all persons who lease or license information, including, but not limited to, software, and any substitute therefor or replacement thereof, which is being used in connection with or in any way to facilitate the publication of The Directories, the Regional White Pages Directories or the Chicago Alphabetical Directory as of twenty (20) months before this Agreement terminates will, at The Telephone Company's request, lease or license such information to The Telephone Company, or its designee, provided that the party is at the time of such request by The Telephone Company still supplying such information to Donnelley to be used by Donnelley or any of its affiliates in connection with the publication of The Directories, the Regional White Pages Directories or the Chicago Alphabetical Directory.

If at the time Donnelley is obligated to turn over Information to The Telephone Company, any supplier of information, including, but not limited to, software, and any substitute therefor or replacement thereof, which is being used in connection with or in any way to facilitate the publication of The Directories, the Regional White Pages Directories or the Chicago Alphabetical Directory as of twenty (20) months before this Agreement terminates, declines to lease or license such information to The Telephone Company or its designee, Donnelley agrees that it will not use such information, including, but not limited to, software, and any substitute therefor or replacement thereof, to publish post-termination directories until either (i) the supplier provides such information to The Telephone Company or its designee, or (ii) until The Telephone Company advises Donnelley that The Telephone Company has found an alternative source for such information. The Telephone Company agrees that Donnelley's agreement not to use information, as set forth in this paragraph, is The Telephone Company's only remedy for any breach, alleged or actual, of Donnelley's warranty set forth in the preceding paragraph.

If the Information to be turned over to The Telephone Company or its designee is stored on paper or in a form that is not computer readable, Donnelley shall furnish The Telephone Company or its designee copies of all materials containing such Information, with the copies to be organized in the same manner as the originals. Donnelley and The Telephone Company shall

divide equally the cost of making such copies. If the Information to be turned over to The Telephone Company or its designee is stored in a form that is computer readable, Donnelley shall furnish The Telephone Company or its designee such Information in computer readable form according to reasonable specifications, both in terms of the instructions and in terms of the time by which such computer readable Information must be provided by The Telephone Company or its designee. Any dispute as to the reasonableness of such specifications, both in terms of the instructions and in terms of the time in which such computer readable Information shall be provided, shall be subject to resolution under the arbitration procedures contained in this Clause.

In resolving such dispute, if any, the arbitrator shall determine what specifications would be reasonable and the time required to develop such specifications. However, in no event shall such a dispute relieve Donnelley of its obligation to turn over Information under this Clause to The Telephone Company or its designee.

Donnelley shall cooperate in developing interface programs to permit such Information to be transmitted. The Telephone Company shall bear the reasonable cost of developing such interface programs. The Partnership shall bear the cost of transmitting Information which is in a form that is computer readable.

In the event of any dispute between the parties as to Donnelley's aforementioned obligations to turn over Information, and upon request of either Donnelley or The Telephone Company at any time between eighteen and one-half (18-1/2) and sixteen and one-half (16-1/2) months prior to the date this Agreement terminates, the matter in dispute shall be submitted for arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association. In deciding whether Donnelley has fulfilled its aforementioned obligations, the arbitrator shall determine whether Donnelley has used its best efforts to turn over the Information to The Telephone Company or its designee. Donnelley shall bear the burden of proving that it used its best efforts to turn over the Information to The Telephone Company or its designee. In order to satisfy its obligations to provide The Telephone Company with Information, except for Donnelley's obligations to (i) provide copies of Information, (ii) create interface programs to transfer computer readable Information, or (iii) segregate Information from other information, Donnelley is not obligated, and shall not be required, to purchase or create information to discharge its obligation to turn over Information under this Clause. The arbitrator shall not find that Donnelley has failed to comply with its aforementioned obligations to turn over Information if Donnelley does not turn over to The Telephone Company or its designee Information which Donnelley has inadvertently lost, provided that Donnelley shall have the burden of proving to the

arbitrator that Donnelley has inadvertently lost such Information. If Donnelley locates such Information at any time, whether before or after the date this Agreement terminates, it must turn over such Information to The Telephone Company or its designee.

The arbitrator shall determine prior to fifteen (15) months before the date this Agreement terminates whether Donnelley has complied with its aforementioned obligations to turn over Information. If the arbitrator determines that Donnelley has turned over all of the Information, such determination shall constitute his ultimate decision. If the arbitrator determines that Donnelley has failed to turn over Information, he shall state with particularity what Information Donnelley has not turned over to The Telephone Company. Donnelley shall have the opportunity in the next thirty (30) days to cure the breach of its aforementioned obligations to turn over Information as determined by the arbitrator. After Donnelley has had such an opportunity, the arbitrator shall reach an ultimate decision as to whether Donnelley has complied with its aforementioned obligations to turn over Information.

With respect to any matter which is subject to arbitration under this Clause, the arbitrator's ultimate decision shall be final, may not be appealed and shall be completed and an order with respect to the decision entered prior to fourteen (14) months before the date this Agreement terminates. Judgment on the arbitration order may be entered in any court of

competent jurisdiction, including the United States District Court for the Northern District of Illinois.

Between twelve (12) and ten (10) months prior to the date on which this Agreement terminates, The Telephone Company, through its regular billing process, but at The Partnership's expense, shall send a notice in the form attached hereto as Exhibit E, telling each of the advertisers with which or whom Donnelley has entered into Advertising Program Applications to place advertisements in The Directories, the Regional White Pages Directories or the Chicago Alphabetical Directory (the "Applications") that Donnelley will not use those Applications as the basis to obligate the advertisers to place advertising in the directories published by Donnelley to be delivered after the date on which this Agreement terminates, that The Telephone Company, or its designee, will be publishing directories to be delivered after the date on which this Agreement terminates which will compete with directories which Donnelley will publish to be delivered after the date on which this Agreement terminates, and that representatives of Donnelley and The Telephone Company, or its designee, will be contacting the advertisers regarding entering into future applications or contracts. The notice shall be on plain paper and shall not bear any letterhead, identifying marks, addresses or telephone numbers. Donnelley agrees that it will be bound by the representations contained in the notice (which will be signed by

Donnelley) and that Donnelley will not use the Applications as the legal basis to obligate an advertiser to place advertising in directories published by Donnelley to be delivered after the date on which this Agreement terminates. Donnelley further agrees that during the term of this Agreement it will neither enter into any contracts with any advertisers nor change its Applications with advertisers from the form in which they exist as of the date this Agreement becomes effective in a manner which would frustrate the intent of this paragraph. Donnelley represents that, as of the date this Agreement becomes effective, it has no contracts with or applications from advertisers which would frustrate the intent of this paragraph. Notwithstanding the foregoing provisions of this paragraph, both Donnelley and The Telephone Company, and their respective affiliates, may use the information contained in the Applications in publishing and soliciting advertisements in directories to be published by Donnelley, The Telephone Company, or their respective affiliates, to be delivered after the date on which this Agreement terminates.

The Telephone Company agrees to supply to Donnelley during the entire term of this Agreement, including the last twenty (20) months of the term of this Agreement, The Telephone Company's basic listing information and current updates. The Telephone Company agrees to supply API/IL, at API/IL's option, The Telephone Company's basic listing information and current

updates during the last twenty (20) months of this Agreement's term.

Any time within twenty (20) months before the date on which this Agreement terminates, Donnelley, by giving not less than ten (10) days written notice to The Telephone Company, may elect to purchase and receive from The Telephone Company, and, if Donnelley does so elect, The Telephone company agrees to sell and provide to Donnelley, on a continuous basis for a period of twelve (12) months immediately following a date set forth in the notice, which date shall not be later than ten (10) days after the date this Agreement terminates, in computer readable form, the names, addresses, telephone numbers and business classifications for all business telephone subscribers of The Telephone Company, including updates, in the same manner, frequency and format in which it is supplied to Donnelley under this Agreement or in any improved or enhanced manner used or developed by The Telephone Company, as Donnelley elects, hereinafter referred to as "business listing information".

Any time within twenty (20) months before the date on which this Agreement terminates, Donnelley, by giving not less than ten (10) days written notice to The Telephone Company, may elect to purchase and receive from The Telephone Company, and, if Donnelley does so elect, The Telephone Company agrees to sell and provide to Donnelley, for a period of twelve (12) months immediately following a date set forth in the notice.

which date shall not be later than ten (10) days after the date this Agreement terminates and, if Donnelley has elected to receive business listing information, shall not be different than the date on which Donnelley begins to receive such business listing information, in computer readable form, according to reasonable specifications provided by Donnelley to The Telephone Company in the notice, the name, address, telephone number, professional designation, if any, community and any other information concerning every telephone subscriber of The Telephone Company which or who normally appears in the White Pages of The Telephone Company, for selected communities or groups of selected communities designated by Donnelley from time to time, with the understanding that such residential listing information is to be the most current available information which The Telephone Company has at each time during the twelve (12) months in which The Telephone Company delivers residential listing information to Donnelley, hereinafter referred to as "residential listing information." If Donnelley elects to receive residential listing information classified by selected communities or groups of selected communities within Illinois, Donnelley shall bear the reasonable costs, if any, of classifying the residential listing information by the communities selected if such classification has not already been performed by The Telephone Company.

In the event Donnelley elects to purchase any business or residential listing information, or both, for the

twelve (12) month period described above, Donnelley agrees to pay The Telephone Company a total of ten million dollars (\$10,000,000) for such business or residential listing information, or both, payable in equal monthly payments over the twelve months immediately following the date of the first delivery to Donnelley of any listing information under this Clause. The ten million dollar (\$10,000,000) payment is not to be reduced should Donnelley elect to purchase less than all of the listing information which it is entitled to purchase under the two preceding paragraphs. Should Donnelley elect to purchase no listing information from The Telephone Company under the two preceding paragraphs, it is not obligated to pay the ten million dollars (\$10,000,000) or any portion thereof.

Within the twelfth (12th) month immediately following the date on which this Agreement terminates, Donnelley, by giving not less than ten (10) days written notice to The Telephone Company, may elect to purchase and receive from The Telephone Company, and if Donnelley does so elect, The Telephone Company agrees to sell and provide to Donnelley, in the same manner in which it was provided during the term of this Agreement, or in any improved or enhanced manner used or developed by The Telephone Company, as Donnelley elects, business listing information on a continuous basis for a period of twelve (12) months immediately following a date set forth in the notice, which date shall not be later than twelve (12) months immediately following the date on which this Agreement terminates.

Within the twelfth (12th) month immediately following the date on which this Agreement terminates, Donnelley, by giving not less than ten (10) days written notice to The Telephone Company, may elect to purchase and receive from The Telephone Company, and, if Donnelley does so elect, The Telephone Company agrees to sell and provide to Donnelley, in the same manner in which it was provided during the term of this Agreement, or in any improved or enhanced manner used or developed by The Telephone Company, as Donnelley elects, residential listing information, as designated by Donnelley from time to time, for a period of twelve (12) months immediately following a date set forth in the notice, which date shall not be later than twelve (12) months immediately following the date on which this Agreement terminates. If Donnelley elects to receive residential listing information for such twelve (12) month period, classified by selected communities or groups of selected communities within Illinois, Donnelley shall bear the reasonable cost, if any, of classifying the residential listing information by the communities selected if such classification has not already been performed by The Telephone Company.

In the event Donnelley elects to purchase business or residential listing information, or both, for a twelve (12) month period, immediately following the first twelve (12) months after this Agreement terminates, Donnelley agrees to pay to The Telephone Company a total of ten million dollars

(\$10,000,000) for such business or residential listing information, or both, payable in equal monthly payments over the twelve months immediately following the date of the first delivery to Donnelley of listing information for such twelve (12) month period. The ten million dollar (\$10,000,000) payment is not to be reduced should Donnelley elect to purchase less than all of the listing information which it is entitled to purchase under the two preceding paragraphs. Should Donnelley elect to purchase no listing information from The Telephone Company under the two preceding paragraphs, it is not obligated to pay the ten million dollars (\$10,000,000) or any portions thereof.

For each twelve (12) month period after twenty-four (24) months following the date on which this Agreement terminates, so long as such twelve (12) month period ends prior to January 1, 2005, Donnelley, by giving not less than ten (10) days written notice to The Telephone Company, may elect to purchase and receive from The Telephone Company, and, if Donnelley does so elect, The Telephone Company agrees to sell and provide to Donnelley, in the same manner in which it was provided during the term of this Agreement or in any improved or enhanced manner used or developed by The Telephone Company, as Donnelley elects, the business listing information or the residential listing information, or both, as designated by Donnelley, for a twelve (12) month period immediately following a date set forth

in the notice. If Donnelley elects to receive residential listing information for such a twelve (12) month period, classified by selected communities or groups of selected communities within Illinois, Donnelley shall bear the reasonable costs, if any, of classifying the residential listing information by the communities selected if such classification has not already been performed by The Telephone Company.

For each such twelve (12) month period Donnelley chooses to purchase business listing information or residential listing information, or both, Donnelley agrees to pay The Telephone Company in equal monthly payments over that period an amount equal to the national average market value for similar business listing information or for similar residential listing information, or both, as Donnelley chooses.

The national average market value for either the business listing information or residential listing information, or both, depending upon which Donnelley chooses to buy, is to be determined by a representative of a national accounting firm who is to be selected by The Telephone Company and Donnelley. In the event that Donnelley and The Telephone Company cannot agree on such a representative, Donnelley and The Telephone Company are each to select one representative of a national accounting firm. The two representatives are then to select a representative from a national accounting firm which at the time of the selection is not engaged by either Donnelley

or The Telephone Company or any affiliate of either, hereinafter referred to as "a or the representative", to determine the national average market value for similar business listing information or for similar residential listing information.

The representative is to make a separate determination as to the national average market value for business listing information and for residential listing information, hereinafter referred to as "market value," depending upon whether Donnelley chooses to purchase either the business listing information or residential listing information, or both. The determinations of the market value by the representative are to be on a statistically sound sample basis and, to the extent reasonably possible, based upon prices paid for listing information for geographic areas, including Illinois, which have communities of the sizes and populations which are reasonably comparable to the geographic areas for which Donnelley is purchasing business listing information or residential listing information from The Telephone Company. In determining market value for similar business listing information or residential listing information, the representative may take into account, among other things: (i) prices paid by any affiliate of The Telephone Company either to The Telephone Company or to any affiliate of The Telephone Company; (ii) prices paid by any third party to The Telephone Company or any of its affiliates; (iii) any law or regulation which sets or discusses the manner

in which prices are to be set; and (iv) any judicial or administrative decision which sets or discusses the manner in which prices are to be set, for similar business listing information or residential listing information. Under no circumstances is Donnelley to pay for the business or residential listing information an amount greater than that paid by any affiliate of The Telephone Company to The Telephone Company or any of its affiliates for reasonably comparable business or residential listing information.

For each such twelve (12) month period, Donnelley may choose not to buy either the business listing information or the residential listing information, or both, either because it has no need for such or because it does not agree with the market value for such listings as determined by the representative. In either case, upon thirty (30) days notice, if practicable, and if it is not, within a reasonable period of time, Donnelley is entitled to purchase either the business listing information or residential listing information, or both, in any other twelve (12) month period, not ending after December 31, 2004.

In the event Donnelley intends to use the business or residential listing information for the purpose, in addition to the purpose of publishing classified or White Pages directories, of disseminating electronic business information or any other use permitted under this Agreement, then Donnelley is to so state in its notice of election to purchase the business or

residential listing information. The representative is to determine whether the market value of the business or residential listing information is dependent on the use or uses to which the listing information is to be put and will advise Donnelley and The Telephone Company of the additional value, if any, which the market places on one's opportunity to use the listing information for such purposes other than publishing classified or White Pages directories, hereinafter referred to as "premium payment". Donnelley will have the right to elect either to make such premium payment to use the business or residential listing information for such additional purpose or purposes or to pay the market value and limit its use of the business and residential listing information to assist it in publishing directories. Should the representative find that there is no premium payment, Donnelley need pay only the market value and may use the business or residential listing information for any purpose permitted under this Agreement. The representative's determination as to market value and premium payment, if any, of the business listing information or residential listing information shall be final, may not be appealed and is to be completed and an order with respect to the determination entered no later than ninety (90) days following Donnelley's request that the representative make such a determination. Judgment on the representative's determination may be entered in any court of competent jurisdiction, including

the United States District Court for the Northern District of Illinois.

The market value and premium payment, if any, for such business listing information or residential listing information are to be redetermined for each twelve month period (so long as such twelve month period ends prior to January 1, 2005) by a representative, using the same process described above in this Clause, in which Donnelley elects to purchase from The Telephone Company either the business listing information or residential listing information, or both. The cost of the representative's service is to be borne by Donnelley and The Telephone Company jointly.

Donnelley agrees that it may not resell the business and residential listing information it purchases pursuant to this Clause and that it may use such business and residential listing information only for: (1) selling advertising in and publishing classified and White Pages directories; (2) disseminating electronic business information; (3) any purpose for which such listing information is being used by any party (including affiliates of The Telephone Company) which has obtained that listing information from The Telephone Company or any of its affiliates; and (4) such other uses as may be consented to by The Telephone Company, provided, however, that The Telephone Company shall not unreasonably withhold its consent. The Telephone Company shall not be deemed to be acting unreasonably if it withholds its consent for any use that is unlawful.

for Donnelley or if The Telephone Company is prevented by tariff or other law from so consenting.

If Donnelley uses the business and residential listing information for any purpose other than publishing classified or White Pages directories, whether or not such use or uses require the consent of The Telephone Company, Donnelley must give The Telephone Company notice of such use or uses in sufficient detail to permit The Telephone Company to understand the nature of such use or uses and, if applicable, to permit the representative to determine the premium payment for such use or uses.

Except as otherwise agreed upon by The Partnership, as permitted pursuant to Clause 3, before twenty (20) months prior to the date this Agreement terminates, Donnelley may not use any information it obtains from The Telephone Company under this Agreement for any purpose other than publishing The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory under this Agreement. After twenty (20) months prior to the date this Agreement terminates, Donnelley may use the information it has previously received from The Telephone Company under this Agreement for the purpose of publishing classified and White Pages directories and disseminating electronic business information or any other purposes for which it may use the listing information it has the right to purchase under this Clause.

Neither Donnelley nor any of its affiliates shall have the right to require The Telephone Company or its designee to return the Information which Donnelley turns over to The Telephone Company or its designee under this Clause. Neither The Telephone Company nor any of its affiliates shall have the right to require Donnelley to return the listing information or other information received by Donnelley under this Agreement or the 1975 Yellow Pages Directory Agreement. Nothing in this paragraph shall nullify the restrictions on the use of such information or listing information contained in this Clause.

Upon termination of this Agreement, and if Donnelley elects to use the service, The Telephone Company agrees to provide Donnelley for each twelve month period, so long as such a twelve month period ends prior to January 1, 2005, with billing and collection service, comparable to the billing and collection service which has been provided by The Telephone Company to The Partnership during the term of this Agreement, at a price comparable to that charged by The Telephone Company to others for such billing and collection service, for advertising and related charges for directories published by Donnelley to be delivered after this Agreement terminates. If The Telephone Company is not then providing such a service to anyone other than The Partnership or to an affiliate of The Telephone Company, a representative, selected in the same manner as described above in this Clause, is to determine the market

value of the billing and collection service to be provided Donnelley. The representative's determination is to be made using the same guidelines and methods provided in this Clause with respect to business and residential listing information. The representative's determination as to the market value of the billing and collection service shall be final, may not be appealed and is to be completed and an order with respect to the determination entered no later than ninety (90) days following Donnelley's request that the representative make such a determination.

Judgment on the representative's determination may be entered in any court of competent jurisdiction, including the United States District Court for the Northern District of Illinois. The market price for such billing and collection service is to be redetermined for each twelve month period, so long as such a twelve month period ends prior to January 1, 2005, by a representative, using the same process described above in this Clause, so long as Donnelley elects to purchase from The Telephone Company such billing and collection service. The cost of the representative's service is to be borne by Donnelley and The Telephone Company jointly. Donnelley shall pay The Telephone Company monthly for the provision of such billing and collection service.

Donnelley may choose not to purchase such billing and collection service from The Telephone Company for any twelve

(12) month period either because it has no need for such service or because it does not agree with the market value for such service as determined by the representative. In either case, Donnelley is entitled to purchase the billing and collection service in any other twelve (12) month period ending prior to January 1, 2005.

Beginning twelve months prior to the date this Agreement terminates, but not before then, any party hereto or its affiliates may advertise on television, radio, billboards or through any other mass media that it intends to publish or will be publishing directories following the termination of the Agreement. Until the later of (i) nine months prior to the date this Agreement terminates or (ii) three months after The Telephone Company or its designee has received, in a form satisfactory to The Telephone Company or its designee or found satisfactory by an arbitrator, all of the Information to which The Telephone Company, or its designee, is entitled under this Clause, neither Donnelley nor The Telephone Company, nor any of their affiliates, may (a) solicit (other than through mass media advertising) advertisers to place advertisements in directories which that party intends to begin publishing during or after the term of this Agreement and to deliver following the date on which this Agreement terminates, or (b) enter into contracts or applications with advertisers to place advertising in such directories. In addition, even if solicitation for

such directories would be permissible under the preceding sentence, neither Donnelley nor The Telephone Company, nor any of their affiliates, may solicit (other than through mass media advertising) any advertisers to advertise in directories designed for use in a particular geographic territory and to be published by any party hereto or any of its affiliates for delivery after the date this Agreement terminates, or enter into contracts or applications with advertisers to place advertising in such directories, until ten (10) days after the final sales close date with respect to the last issue of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory to be published under this Agreement designed for use in the same geographic territory.

Except as provided in the fourth paragraph of Clause 1 with respect to the city-wide Chicago Yellow Pages Classified Telephone Directories, Donnelley will publish under this Agreement only those issues of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory which are scheduled to begin to be delivered before this Agreement terminates. Donnelley will not conduct any solicitation of any advertisers or undertake any other publishing activities with respect to any of the issues of The Directories, the Regional White Pages Directories, or the Chicago Alphabetical Directory which are not scheduled to begin to be delivered before this Agreement terminates.

Donnelley is to receive payment for the life of each issue of any of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory as to which it has substantially performed its responsibilities hereunder (provided that it was entitled under this Agreement to publish or sell advertising in that issue), including each of those directories whose life extends beyond the date on which this Agreement terminates. Donnelley is not entitled to any payment as to any issue of any of those directories as to which it has not substantially performed its responsibilities hereunder.

Neither The Telephone Company, nor API/IL, nor any of their affiliates, may represent to anyone that it or they are the "publishers" of the Yellow Pages in The Directories published under this Agreement. The Telephone Company, API/IL and any of their affiliates may represent that they are the "publishers" of the White Pages and Four or More Color Advertising Insert Sections in The Directories, the Regional White Pages Directories, and the Chicago Alphabetical Directory.

Neither Donnelley nor its affiliates may represent to anyone that it or they are the "publishers" of the White Pages and Four or More Color Advertising Insert Sections in The Directories, the Regional White Pages Directories or the Chicago Alphabetical Directory. Donnelley and its affiliates may represent that they are the "publishers" of the Yellow Pages in The Directories.

The Telephone Company, API/IL and their affiliates may not use the tradename "RED BOOK" or the names "Reuben H. Donnelley," "Donnelley" or "Donnelley Yellow Pages" or any trademark, tradename or service mark of Donnelley in connection with publishing any post-termination directories. Donnelley and its affiliates may not use the name "Illinois Bell," "Illinois Bell Yellow Pages," "Ameritech," "Ameritech Bell Yellow Pages," or any trademark, tradename or service mark of The Telephone Company, API/IL or any of their affiliates in connection with publishing any post-termination directories. Each party and its affiliates or designees may use in connection with their post-termination directories any name, trademark, tradename or service mark based on their companies' names, even if those names, trademarks, tradenames, or service marks had been used in connection with The Directories, the Regional White Pages Directories or the Chicago Alphabetical Directory published under this Agreement.

All parties hereto and any of their affiliates may use yellow colored pages and generic terms such as "Business to Business," "Consumer Yellow Pages," "Yellow Pages," and "Let Your Fingers Do the Walking," and the Walking Fingers logo or any facsimile thereof in any directories published or delivered after the termination of this Agreement.

No party hereto, or any of its affiliates, may use any copyright, trademark, tradename, or license to prevent any

other party hereto or any of its affiliates from using advertisements that appear in any of the issues of The Directories, the Regional White Pages Directories or the Chicago Alphabetical Directory in directories to be published by any party hereto or any of its affiliates for delivery after this Agreement terminates, or from publishing such directories; except that neither The Telephone Company nor its affiliates may use the terms "Redbook," "Reuben H. Donnelley," "Donnelley," "Donnelley Yellow Pages," or any phrase incorporating those terms in identifying or promoting directories published by The Telephone Company or by any of its affiliates to be delivered after the date this Agreement terminates, and neither Donnelley nor any of its affiliates may use the terms "Illinois Bell," "Illinois Bell Yellow Pages," "Ameritech," "Ameritech Bell Yellow Pages," or any phrase incorporating those terms in identifying or promoting directories published by Donnelley or by any of its affiliates to be delivered after the date this Agreement terminates. Each party and its affiliates shall be permitted to use the contents of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory (including advertisements) in its post-termination directories. Each party and its affiliates, shall clearly identify on the cover of all post-termination directories that that party, or its affiliate, is the source of such directories. Neither Donnelley, nor its affiliates, nor The Telephone Company, nor

its affiliates, shall use Directory covers copyrighted by the other, or the other's affiliates. In Donnelley's Applications with advertisers, it will not seek to obtain for itself or an affiliate the copyrights over the advertisements placed in The Directories, the Regional White Pages Directories or the Chicago Alphabetical Directory. Neither The Telephone Company nor its affiliates will seek to obtain the copyrights over the advertisements placed in The Directories, the Regional White Pages Directories or The Chicago Alphabetical Directory.

The Telephone Company, API/IL and their affiliates shall not reproduce or depict the covers of the (a) city-wide Chicago Yellow Pages Classified Telephone Directories; (b) Chicago neighborhood directories; (c) Area-Wide Yellow Pages Classified Directories; (d) Street Address Directories; (e) the Chicago Visitor's Guide; (f) the Health Care Industry Directory; and (g) the Bradley University Student Directory, published under this Agreement in advertising any directories which The Telephone Company, API/IL or any of their affiliates publish for delivery after the termination of this Agreement. Donnelley and its affiliates shall not reproduce or depict the covers of any issue of The Directories not identified in the preceding sentence, the Regional White Pages Directories, or the Chicago Alphabetical Directory in advertising any directories which Donnelley or any of its affiliates publish for delivery after this Agreement terminates.

The rights and obligations of the parties under this Clause 20 are unconditional and enforceable regardless of the manner in which this Agreement is terminated or the basis for such termination. The parties agree that there would be no adequate remedy at law if any party were to breach its obligations under this Clause and that injunctive relief would be an appropriate remedy to enforce any party's rights under this Clause.

CLAUSE 21 - RESPONSIBILITIES RELATING TO TERMINATION

On and after the date on which this Agreement terminates, The Telephone Company is to continue to bill and collect for advertising, including Reciprocal Advertising, and Street Address Directory lease charges and remit to The Partnership the payments for such advertising and lease charges relating to The Directories, the Regional White Pages Directories, the Chicago Alphabetical Directory, and Reciprocal Advertising on the twentieth (20th) day of each month for the balance of the life of each of the issues of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory consistent with the procedure set forth in Clause 13. Any additional payments received by The Telephone Company with respect to such advertising and lease charges after the life of each of such issues are to be remitted promptly to The Partnership.

Payments due Donnelley pursuant to this Agreement which are due as of, but which have not been paid to Donnelley

on, the date on which this Agreement terminates, are to be paid to Donnelley by The Partnership within thirty (30) days of The Partnership's receipt of an invoice from Donnelley for such payments.

Payments due The Telephone Company pursuant to this Agreement which are due as of, but which have not been paid to The Telephone Company on, the date on which this Agreement terminates, are to be paid to The Telephone Company by The Partnership within thirty (30) days of The Partnership's receipt of an invoice from The Telephone Company for such payments.

Payments due API/IL pursuant to this Agreement which are due as of, but which have not been paid to API/IL on, the date on which this Agreement terminates, are to be paid to API/IL within thirty (30) days of The Partnership's receipt of an invoice from API/IL for such payments.

On and after the date on which this Agreement terminates, Donnelley is to continue to take such reasonable actions to (1) collect advertising and lease charges; (2) handle claims; and (3) handle settlements, judgments and legal matters, relating to The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory in a manner consistent with its obligations under Clauses 8, 11 and 17. The costs incurred to conduct such activities are to be paid in accordance with Clauses 8, 11 and 17. Any delinquent

advertising or lease charges collected by or through Donnelley are to be remitted promptly to The Partnership, less 23% thereof.

CLAUSE 22 - COLOR ADVERTISING SECTIONS

Donnelley agrees that, if requested by The Telephone Company or its designee, Four or More Color Advertising Insert Sections will be bound into The Directories published under this Agreement. The term "Four or More Color Advertising Insert Sections" as used herein, means separate, nonclassified four (4) or more color advertising sections, hereinafter referred to as the "Color Advertising Sections." There shall be no more than one Color Advertising Section in each of the issues of The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory. The Color Advertising Sections shall be inserted either before or after the Yellow Pages in The Directories. The Telephone Company or its designee has sole discretion to determine whether to insert Color Advertising Sections and, if so, where in the Regional White Pages Directories and the Chicago Alphabetical Directory. The color of the paper of the Color Advertising Sections shall not be yellow. The Color Advertising Sections will contain advertising that tells the directory user about products and services and must cross reference the user to the classified heading section of the directory to find where to obtain the products and services. This requirement relating to cross

references may be modified if agreed to by Donnelley prior to the publication of the issues of The Directories which will contain the Color Advertising Sections. Donnelley agrees to provide, upon request by The Telephone Company or its designee, all required cross reference information needed to print the Color Advertising Sections. Requests for cross references must be made by The Telephone Company or its designee within the time periods and guidelines established by the Partnership's publishing schedule.

The Telephone Company, or its designee, agrees that (i) no more than twenty (20) percent of the value of all advertising in the Color Advertising Section in each issue of The Directories will be derived from local advertisers and (ii) no more than twenty (20) percent of the advertising space in each Color Advertising Section will be purchased by local advertisers.

As to each of The Directories in which The Telephone Company or its designee chooses to insert a Color Advertising Section, The Telephone Company agrees to provide Donnelley a list of the names, addresses and telephone numbers of the advertisers in each of the Color Advertising Sections along with the advertising units which each advertiser has placed in the Color Advertising Section before the Color Advertising Section is inserted in any of The Directories. If either of the limitations stated in the prior paragraph is exceeded, The

Telephone Company or its designee will determine, at its sole risk, which advertising is to be eliminated from the Color Advertising Section to meet such limitations. The Telephone Company or its designee will furnish such information and Donnelley will respond thereto within sufficient time so as not to interfere with the schedule governing the publishing of The Directories.

As used in this paragraph, the term "local advertisers" means advertisers whose advertising reach is primarily within the State of Illinois.

Donnelley agrees to provide, upon request by The Telephone Company, directory specifications, standards, headings and ethical requirements for use in the publishing of the Color Advertising Sections only.

The Telephone Company, or its designee, agrees that the profits from advertising in the Color Advertising Sections will be payable to The Partnership when in, and effective at the beginning of, any calendar year, the advertising revenues from the Color Advertising Sections in The Directories exceed the reasonable costs directly attributable to such Color Advertising Sections. In such event, for such calendar year and for each year thereafter during the term of this Agreement, and as to each Color Advertising Section inserted in any issue of The Directories published during that time, the revenues from the Color Advertising Sections will belong to, and the reasonable

costs directly attributable to the Color Advertising Sections will be borne by, The Partnership.

Donnelley agrees that the profits from its Illinois editions of the "New Connections" magazine distributed primarily in Illinois, hereinafter referred to as "New Connections," will be payable to The Partnership when in, and effective at the beginning of, any calendar year, the advertising revenues from New Connections exceed the reasonable costs directly attributable to New Connections. In such event, for such calendar year and for each year thereafter during the term of this Agreement, and as to the editions of New Connections published during that time, the revenues from New Connections will belong to, and the reasonable costs directly attributable to the editions of New Connections will be borne by, The Partnership.

Either The Telephone Company, or its designee, or Donnelley is entitled, at The Partnership's expense, to have audited annually by The Partnership's auditing firm the financial results of New Connections and of the Color Advertising Sections, respectively, to satisfy themselves regarding the profitability, if any, of New Connections and Color Advertising Sections. In the event of a dispute between the parties regarding the financial results of the Color Advertising Sections or of New Connections for any calendar year, such dispute shall be resolved by The Partnership's auditing firm, whose decision will be final and not subject to appeal.

CLAUSE 23 - SCHEDULING

The Partnership, subject to The Telephone Company's obligation by tariff to provide White Pages, is to determine the annual Schedule under which The Directories, the Regional White Pages Directories and the Chicago Alphabetical Directory will be published in such detail that the parties can effectively discharge their obligations under this Agreement. The Telephone Company shall provide to API/IL White Pages in plate-ready media in accordance with the schedule.

API/IL is to develop from time to time detailed schedules that provide for the flow of media between the parties hereto and the manufacturing and delivery contractors to insure that API/IL and the manufacturing and delivery contractors coordinate the performance of their responsibilities under this Agreement with The Telephone Company's and Donnelley's performance of their obligations under this Agreement. The schedules developed by API/IL are subject to the approval of The Telephone Company and Donnelley.

CLAUSE 24 - AUDITING

Each of the parties hereto shall keep complete and accurate records reflecting each item of cost or expense incurred by it in connection with the performance of its obligations under this Agreement and which is charged to The Partnership, hereinafter referred to as "Records." Each year during the term of this Agreement, The Partnership's auditing

firm, at the request of either partner of The Partnership, shall have the right to inspect the Records of another party upon not less than thirty (30) days written notice to that party. Each party agrees to provide reasonable access to its premises for purposes of such inspection at reasonable business hours, and to provide The Partnership's auditing firm with the Records it seeks to review.

The parties hereto agree that The Partnership's auditing firm may examine, in its discretion, any Records of the party as may be necessary for the auditing firm to verify that all amounts of costs and expenses incurred by the party for which it is charging The Partnership are accurate, reasonable and directly attributable to the performance of the party's obligations under this Agreement and for which The Partnership is charged. The auditing firm making the examination, if it deems such actions to be necessary or appropriate, may consult with and make inquiries of the party's officers and employees and the independent public accountants serving the party whose Records are being examined. The Partnership's auditing firm shall also have the right to examine any workpapers, schedules, memoranda or other documentation prepared by the party's independent public accountants which are reasonably related to the subject of the examination.

Each of the parties shall treat any information learned as a result of any examination under this Clause as confidential.

Should the auditing firm determine that a party's cost or expense which has been charged to The Partnership is not accurate, reasonable or directly attributable to the party's performance of its obligations under this Agreement, the auditing firm is to give written notice to that effect to The Partnership and to the other parties hereto promptly, describing the amount by which the party is found to have overcharged The Partnership. The party will have thirty (30) days from its receipt of the notice within which to repay The Partnership the amount of the overcharge or to appeal to the auditing firm. Should the party choose to appeal, it will have sixty days from the time it received the notice to present its position to the auditing firm as to the notice of overcharge. The auditing firm is to make a decision as to the appeal within sixty (60) days from its receipt of the notice of appeal. The partners of The Partnership and the party appealing may all participate in the appeal. The decision of the auditing firm with respect to the party's appeal will be final and not subject to further appeal.

CLAUSE 25 - API GUARANTEE - OTHER MATTERS

API hereby guarantees the prompt and complete performance of all of API/IL's obligations described or contemplated

under this Agreement as it currently exists and as it may from time to time be amended in accordance with its terms. This guarantee includes the payment of all damages, costs and expenses which may become recoverable by Donnelley from API/IL. API also agrees that in the event API/IL is dissolved or otherwise unable to perform as a partner in The Partnership, API (or an affiliate of API acceptable to Donnelley) will assume promptly and perform completely all of API/IL's obligations as a partner under The Partnership Agreement and will assume API/IL's role as partner immediately to prevent the dissolution of The Partnership by reason of API/IL's dissolution or inability to perform as a partner in The Partnership. API agrees to indemnify and hold harmless Donnelley and its parent company, The Dun & Bradstreet Corporation, from and against damages to them caused by API/IL, including, but not limited to, API/IL's failure to perform its obligations under this Agreement, its causing, for whatever reason not induced by Donnelley, dissolution of The Partnership, or API/IL's liquidation, dissolution or other termination.

This guarantee shall continue in full force and effect for the duration of this Agreement and thereafter to the extent any rights or claims of Donnelley continue to exist with respect to API until such rights or claims have been completely satisfied.

Any modification of the terms of this Agreement or of any other contract contemplated by this Agreement including,

without limitation, the Partnership Agreement, executed by Donnelley and API/IL shall not in any way relieve API of its guarantee hereunder. For purposes of this guarantee, any such modification will be treated as if it had been in existence from the date of this guarantee.

API hereby waives notice of any nonperformance or nonpayment of API/IL of any of API/IL's obligations or liabilities arising under or related to this Agreement.

This guarantee shall inure to the benefit of Donnelley and The Dun & Bradstreet Corporation and their successors and assigns, and shall be binding on API, its successors and assigns.

CLAUSE 26 - REGULATORY APPROVAL

This Agreement becomes effective only upon: (1) approval by the Illinois Commerce Commission of the business transactions contemplated under this Agreement between The Telephone Company and API/IL, API and The Partnership; and (2) upon such approval, the entry by the United States District Court for the Northern District of Illinois of an order substantially in the form of Exhibit B to the settlement agreement attached hereto as Exhibit F.

CLAUSE 27 - FORCE MAJEURE

If any party hereto shall be prevented from performing any of its obligations under this Agreement because of any

act of God, lockout, strike or other labor dispute, riot or civil commotion, act of public enemy, law, order or act of government (whether federal, state or local) or other similar event beyond the party's control, hereinafter referred to as a "force majeure event," then that party shall be excused from performing any of its obligations which are so prevented. However, the party so excused is responsible for performing those obligations, of which it had been relieved due to the force majeure event, as soon as the force majeure event has ceased to prevent the party's performance.

CLAUSE 28 - RELATIONSHIP TO OTHER AGREEMENTS

This Agreement is to be interpreted in connection with the Partnership Agreement.

CLAUSE 29 - PRIOR DRAFTS

The parties agree that prior drafts of this Agreement are entirely immaterial and may not be considered, cited or relied on by anyone (including, but not limited to, the parties, their agents and representatives, any arbitrator, The Partnership's accounting firm or any court) for the purpose of construing or interpreting this Agreement.

CLAUSE 30 - WHERE NOTICES AND OTHER COMMUNICATIONS ARE TO BE SENT

Any notices, consents or other communications hereunder shall be sent as follows (unless such addresses are modified by any of the parties):

if to Donnelley:

The Reuben H. Donnelley Corporation
Prudential Plaza
130 East Randolph Drive
Chicago, Illinois 60601

Attention: Vice President and General Manager

with a copy to: The Dun & Bradstreet Corporation
Attention: William H. Buchanan, Esq.
299 Park Avenue
Thirty Fourth Floor
New York, New York 10171

if to The Telephone Company:

Illinois Bell Telephone Company
225 W. Randolph
Chicago, Illinois 60606

Attention: General Manager-Number Services

with a copy to: Vice President-General Counsel
Illinois Bell Telephone Company
225 W. Randolph
Chicago, Illinois 60606

if to The Partnership:

The Reuben H. Donnelley Corporation
130 Prudential Plaza
Chicago, Illinois 60601

Attention: Vice President, General Manager

and

Ameritech Publishing of Illinois, Inc.
225 North Michigan 16th Floor
Chicago, Illinois 60601

Attention: Secretary Treasurer

with copies to: Ameritech Publishing, Inc.
31100 Plymouth Road
Livonia, Michigan 48150

Attention: Operating Vice President

and

Ameritech Publishing, Inc.
100 East Big Beaver Road
15th Floor
Troy, Michigan 48083

Attention: Vice President-General Counsel

if to API/IL:

Ameritech Publishing of Illinois, Inc.
225 North Michigan
Chicago, Illinois 60601

Attention: Secretary Treasurer

with a copy to: Ameritech Publishing, Inc.
100 East Big Beaver
Troy, Michigan 48083

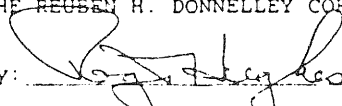
Attention: President

if to API:

Ameritech Publishing, Inc.
Vice President-General Counsel
100 East Big Beaver
Troy, Michigan 48083

IN WITNESS WHEREOF the parties hereto have caused
their respective representatives duly authorized the day and
year first above written to sign this Agreement on their behalf.

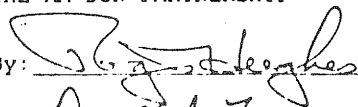
THE REUBEN H. DONNELLEY CORPORATION

By: 

ILLINOIS BELL TELEPHONE COMPANY

By: 

THE AM-DON PARTNERSHIP

By:  FOR RHD

By: Donald J. Freyer for API/IL

AMERITECH PUBLISHING OF ILLINOIS, INC.

By: Donald J. Freyer

AMERITECH PUBLISHING, INC.

By: Donald J. Freyer

