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## **Whatever Happened to the Baby Bells? Internationalization and De-internationalization in the Telecommunications Industry**

**Jason Whalley\* & Peter Curwen\*\***

### INTRODUCTION

Just after the turn of the millennium, the telecommunications industry made two assessments of the internationalization of the United States-based Baby Bells.<sup>1</sup> Chan-Olmstead and Jamison suggested that the Baby Bells had developed significant international footprints on the basis of which the Baby Bells could become global operators.<sup>2</sup> In

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1. The Baby Bells are also known as regional Bell operating companies (RBOCs) or regional holding companies (RHCs).

2. Sylvia Chan-Olmsted & Mark Jamison, *Rivalry Through Alliances*:

contrast, Ratner stated that “the Yanks are going” and argued that a lack of buyers could prolong their exit from Europe.<sup>3</sup>

Although Chan-Olmstead and Jamison<sup>4</sup> reinforced earlier comments made by the likes of Hausman<sup>5</sup>, Kupfer,<sup>6</sup> and Watson<sup>7</sup> it was Ratner’s prediction<sup>8</sup> that turned out to be the more accurate of the two. However, Ratner<sup>9</sup> herself underestimated the scale of de-internationalization that the Baby Bells would undergo. By 2006, the Baby Bells had retreated not only from Europe but also from Africa, Asia, and Latin America. The Baby Bells have sold virtually all of their international operations to once again focus solely on the United States market.

This paper provides an overview of the internationalization of the Baby Bells and analyzes why they have so enthusiastically embraced de-internationalization. With this in mind, the rest of the paper is structured as follows. Part I focuses on the Baby Bells, briefly describing the regulatory environment which led to their inception and development as major players in the domestic and international telecommunications markets. Part II describes the methodology used to measure the international investments of the Baby Bells and analyzes the growth and decline of their overseas presence. Part III posits that the Baby Bells have so dramatically changed their international strategies due to lagging financial returns, a changing regulatory environment, and the effect of various mergers and acquisitions within the industry.

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*Competitive Strategy in the Global Telecommunications Market*, 19 EUR. MGMT. J., 317, 328 (2001).

3. Juliana Ratner & Richard Waters, *Baby Bells Look for a Way to Go Home from European Trip*, FIN. TIMES, May 26, 2001, at 16.

4. Chan-Olmsted & Jamison, *supra* note 2.

5. Jerry A. Hausman, *The Bell Operating Companies and AT&T Venture Abroad While British Telecom and Others Come to the United States*, in GLOBALIZATION, TECHNOLOGY, AND COMPETITION: THE FUSION OF COMPUTERS AND TELECOMMUNICATIONS IN THE 1990S, 313 (Stephen P. Bradley, Jerry A. Hausman, & Richard L. Nolan eds., 1993).

6. Andrew Kupfer, *Ma Bell and Seven Babies Go Global*, FORTUNE, Nov. 4, 1991 at 118.

7. Sharon Watson, *US Carriers Go Overseas in Search of Telecom’s “Holy Grail”*, TELEPHONY, Dec. 20 1993, at 18.

8. Ratner & Waters, *supra* note 3.

9. *Id.*

### I. THE BABY BELLS

In early 1982, the chairman of AT&T announced that it had settled its long-running dispute with the Department of Justice.<sup>10</sup> This settlement, which technically altered AT&T's 1956 Consent Decree with the consequence that it was called the Modified Final Judgment (MFJ), required AT&T to divest its interests in twenty-two Bell Operating Companies (BOCs) that provided local telephone services.<sup>11</sup> In return, AT&T was freed from its 1956 Consent Decree obligations, thereby enabling it to enter new markets such as information services or those outside of regulated telecommunications.<sup>12</sup> The MFJ came into force at the start of 1984. .

The MFJ required the management of AT&T to develop detailed plans to implement the divestiture of its BOCs. These plans created seven Baby Bells holding companies, Bell Communications Research (Bellcore) to provide research services to the Baby Bells,<sup>13</sup> and transferred the directory publishing operations of AT&T to individual Baby Bells.<sup>14</sup> Thus, upon divestiture, each of the Baby Bells was composed of at least one BOC, the directory publishing operations of AT&T within its region, and a one-seventh stake in Bell

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10. For details of this dispute, which at its heart was centered on the uncooperative relationship between AT&T and new entrants such as MCI, see Richard H.K. Vietor, *AT&T and the Public Good: Regulation and Competition in Telecommunications, 1910-1987*, in FUTURE COMPETITION IN TELECOMMUNICATIONS 27 (Stephen P. Bradley & Jerry A. Hausman eds., 1989); PETER TEMIN, *THE FALL OF THE BELL SYSTEM* (1987); Marcellus S. Snow, *The AT&T Divestiture: A 10-Year Retrospective*, in, BEYOND COMPETITION: THE FUTURE OF TELECOMMUNICATIONS 207 (Douglas M. Lambertson ed., 1995).

11. See Snow, *supra* note 10, at 211-212. The MFJ also required that AT&T sell its stakes in two other, non-Bell, local telecommunication companies, Cincinnati & Suburban and Southern New England Telephone. *Id.*

12. See *id.* at 212.

13. Ownership of Bellcore was divided equally among the seven Baby Bells. MICHAEL CARPENTIER ET AL., TELECOMMUNICATIONS IN TRANSITION 25 (1992). A second role of Bellcore was to "serve as a coordination center for communication services with regard to national security interests and emergency services activities." *Id.* at 26.

14. Given that the overarching rationale of divestiture was to separate monopoly from competitive activities, it was thought that the directory publishing activities would remain with AT&T. However, as directory publishing revenues has been treated as BOC revenues for almost a decade prior to 1984, they were transferred to the Baby Bells where their revenues would help to reduce local charges. DAVID CHESSLER ET AL., NAT'L REG. RES. INST., UNREGULATED ENTERPRISES OF THE BELL REGIONAL HOLDING COMPANIES (1986).

Communications Research.<sup>15</sup> In contrast, the new-AT&T offered long-distance, manufacturing and research services organized in accordance with the Computer 2 enquiry.<sup>16</sup>

Although this division of AT&T's businesses resulted in a significantly smaller company, the new AT&T still had assets of \$35 billion.<sup>17</sup> In addition, each of the seven Baby Bells was a substantial enterprise in its own right. As shown in Table 1, the seven Baby Bells held assets ranging from \$14.4 billion to \$19.7 billion with revenues varying from \$7.8 billion to \$10.5 billion.<sup>18</sup> Covering fourteen states, US West was geographically the largest of the Baby Bells, while Pacific Telesis had the fewest number of states – two – within its territory. The remaining Baby Bells covered between five and eight states.

TABLE 1: THE BABY BELLS, JANUARY 1984<sup>19</sup>

Baby Bell	Revenues \$bn	Profits \$mn	Assets \$bn	Employees	No of states
Ameritech	9.0	1100	15.4	79,000	6
Bell Atlantic	9.1	1100	15.4	80,000	7
BellSouth	10.5	1500	19.7	99,100	8
Nynex	10.4	1100	16.2	98,200	6
Pacific Telesis	8.5	970	15.3	82,000	2
Southwestern Bell	8.0	1000	14.8	74,700	5
US West	7.8	950	14.4	75,000	14

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15. See CARPENTIER ET AL., *supra* note 13, at 25-26.

16. In 1997 the Federal Communications Commission launched an investigation, Computer 2 enquiry, to separate data communications services from data processing services. WINDOWS ON A NEW WORLD: THE THIRD INDUSTRIAL REVOLUTION 162 (Joseph Finklestein ed., Greenwood Press 1989). The Computer 2 enquiry required that basic services be separated from advanced services. As a result, AT&T on divestiture was comprised of two principal subsidiaries, AT&T Communications, responsible for long distance telecommunications within the United States, and AT&T Technologies. This latter company brought together Bell Laboratories with other companies such as AT&T International and AT&T Information Systems subsidiaries. See CARPENTIER ET AL., *supra* note 13, at 28; see also Vietor, *supra* note 10, at 83 for a full list of the businesses operated by AT&T Technologies.

17. Vietor, *supra* note 10, at 84.

18. CARPENTIER ET AL., *supra* note 13, at 22-23; Vietor, *supra* note 10, at 82. See generally Brian O'Reilly, *Ma Bell's Kids Fight for Position*, FORTUNE, June 27, 1983, at 62-69.

19. CARPENTIER ET AL., *supra* note 13, at 22-23; Vietor, *supra* note 10, at 82. O'Reilly, *supra* note 18.

As it was widely believed that the Baby Bells would act in an anti-competitive manner like their former parent company,<sup>20</sup> significant restrictions were placed on them.<sup>21</sup> The MFJ prohibited them from providing inter-exchange telecommunication services or information services, manufacturing or providing telecommunications products or customer premises equipment, and providing any other product or service, except exchange telecommunications and exchange access service that is not a natural monopoly service actually regulated by tariff.<sup>22</sup>

The Baby Bells could, however, apply for waivers that would allow them to enter new lines of business if they could demonstrate that they would not exercise monopoly power in these markets.<sup>23</sup> Unsurprisingly, the Baby Bells sought to limit these restrictions, by requesting waivers to enter a wide variety of new markets.<sup>24</sup> By dint of numerous waiver applications, the Baby Bells were able to remove some of the lines of business restrictions.<sup>25</sup> It was, however, only with the passing of the Telecommunications Act<sup>26</sup> in February 1996 that their entry into the inter-exchange and equipment manufacturing markets became a possibility.

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20. David Sappington, *Revisiting the Line-of-Business Restrictions*, 16 *MANAGERIAL AND DECISION ECON.* 291, 291-293 (1995); Kevin R. Sullivan, *Competition in Telecommunications: Moving Toward a New Era of Antitrust Scrutiny and Regulation*, in *FUTURE COMPETITION IN TELECOMMUNICATIONS* 124-125 (Stephen P. Bradley & Jerry A. Hausman eds. 1989).

21. Vietor, *supra* note 10, at 84.

22. *Id.*

23. Snow, *supra* note 10, at 212.

24. See Sappington, *supra* note 20 at 125.

25. Paul H. Rubin & Hashem Dezhbakhsh, *Costs of Delay and Rent-Seeking Under the Modification of Final Judgment*, in *DEREGULATING TELECOMMUNICATIONS: THE BABY BELLS CASE FOR COMPETITION* 107-11 (Richard S. Higgins & Paul H. Rubin eds. 1995).

26. Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified in scattered sections of 47 U.S.C.), *reprinted in* 47 U.S.C. §§ 151-614 [hereinafter Telecommunications Act].

TABLE 2: LINE OF BUSINESS RESTRICTIONS AND RELEASE DATES<sup>27</sup>

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Line of business restriction	Release date
Other non-regulated services	September 1987
Information services	July 1991
Inter-exchange telecommunication services	February 1996
Manufacturing products and CPE	February 1996

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The 1996 Act also stated that the Baby Bells were free to enter the long-distance market once they had satisfied a fourteen-point competitive checklist.<sup>28</sup> After an initial hiatus, when none of the Baby Bells were able to persuade regulators that their local markets were sufficiently competitive (one of the requirements of the fourteen-point checklist), the first long-distance application was granted in December 1999 in New York. Since then, all of the Baby Bells have been granted permission to provide long-distance services.<sup>29</sup>

As the regulatory framework changed, so too did the Baby Bells. Since their inception in 1984, the Baby Bells have expanded and diversified their markets and offerings as well as restructured their organizations. All of the Baby Bells expanded from the regional markets that they had inherited at divestiture into other parts of the United States, although some did so more vigorously than others.<sup>30</sup> US West, for example, expanded into dispersed parts of the United States through the purchase of cellular and cable-television franchises.<sup>31</sup> In contrast, Ameritech was more reserved in its expansion, preferring to focus on markets geographically contiguous to its five-state Great Lakes region, such as St Louis, Missouri, rather than on

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27. Jason L. Whalley, Foreign Direct Investment in Emerging Industries in Conditions of Market Imperfections: Telecommunications and the Case of the Regional Bell Operating Companies, 1984 – 1996 (Nov. 1999) (unpublished Ph.D. thesis, University of Strathclyde) (on file with author).

28. Telecommunications Act, *supra* note 26.

29. Peter Curwen, *For Whom the Bells Toll*, 5 INFO 81, 81-82 (2003).

30. Whalley, *supra* note 27.

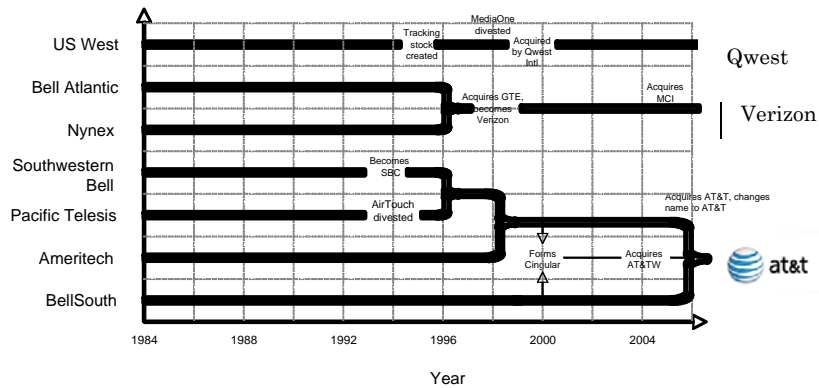
31. Tomo Noda & Joseph L. Bower, *Strategy Making as Iterated Processes of Resource Allocation*, 17 STRATEGIC MGMT. J. 159 (1996).

other parts of the United States.<sup>32</sup>

The Baby Bells also engaged in diversification. In the immediate aftermath of divestiture, the Baby Bells entered a wide range of new lines of business, and while some of these were related to their core telecommunications operations, others were not.<sup>33</sup> US West acquired a substantial property portfolio within its region while Nynex entered both the software and computer retailing markets. Bell Atlantic entered the computer industry, though most of its diversification appears to have focused on the leasing and financing markets. The expansion of the Baby Bells into non-telecommunications markets continued until the early 1990s, when regulatory changes and the continued disappointing financial results of many of the diversified investments resulted in reversal. As a consequence, by the late 1990s the Baby Bells had largely exited these businesses.

The Baby Bells also restructured themselves. The various restructurings that have occurred are shown in Figure 1, which highlights the complexity of a consolidation process that by early 2006, reduced the number of Baby Bells to three, namely Qwest (US West), Verizon Communications (Bell Atlantic, Nynex), and AT&T (Ameritech, BellSouth, Pacific Telesis, Southwestern Bell). The consolidation process that resulted in these three Baby Bells is explained below, with each of the three being addressed in turn.

FIGURE 1: BABY BELL RESTRUCTURING, 1984-2006



32. Whalley, *supra* note 27.

33. Whalley, *supra* note 27. The Baby Bells entered into a wide variety of new markets including, real estate, computer retailing, financial services, software development and liquefied petroleum gas distribution. *Id.*



After expanding outside of its region through both acquisitions and joint ventures, US West grouped all of its non-BOC operations together in 1995 into a new holding company called US West Media Group. Tracking shares in this new holding company were then issued pro-rata to all existing US West shareholders.<sup>34</sup> In addition, US West sold its domestic cellular operations to AirTouch Communications in April 1998 for \$5.9 billion which eventually became part AT&T Wireless, a joint venture between Verizon Communic Vodafone.

In 1997, the board of US West sought to formalize the separation of its BOC and non-BOC operations via a proposal to separate US West Media from US West. Prior to the actual separation, regulatory requirements necessitated the transfer of the fourteen-state directory publishing operations from US West Media to US West for \$4.75 billion in debt and stock. The domestic cable-television businesses, as well as all of the international operations of US West, were spun off as MediaOne in June 1998. AT&T subsequently acquired MediaOne in April 1999 for \$58 billion as part of its drive to become a key player in the U.S. broadband market.<sup>35</sup>

The spin-off of MediaOne meant that US West was almost the same as it was at divestiture in 1984; that is, a company providing local telephone and directory publishing services within its region. The revenue and earnings stability associated with both businesses made US West an attractive takeover target, especially to companies in search of revenues to fund expansion in other markets. After a short bidding war between two long distance operators, Global Crossing and Qwest International, US West succumbed to a \$51.3 billion takeover from Qwest International in June 1999. US West subsequently changed its name to Qwest.

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34. US WEST COMMUNICATIONS GROUP, 1995 FINANCIALS (1996). By issuing tracking shares, US West was able to create a stock that followed that performance of its non-BOC operations without separating ownership of these operations from the Baby Bell. If any dividends were paid, these would be funded by the non-BOC operations.

35. See PETER CURWEN & JASON WHALLEY, TELECOMMUNICATIONS STRATEGY – CASES, THEORY AND APPLICATIONS 78-99 (2004). The focus of AT&T at the time on the United States broadband market contributed to its decision to sell most of the international operations of MediaOne, a process that also helped AT&T recoup a substantial proportion of the cost. *Id.*

Bell Atlantic and Nynex are two Baby Bells whose fortunes became interwoven. Less than two months after the Telecommunications Act of 1996<sup>36</sup> became law, Bell Atlantic entered into a \$25.6 billion “merger of equals” with Nynex.<sup>37</sup> This consolidated its position in the northeast of the United States, and increased its stake to 50% in PCS PrimeCo, a cellular joint venture that eventually became part of Verizon Wireless. In July 1998, Bell Atlantic merged with GTE in a deal valued at \$67 billion, and on completion of the merger changed its name to Verizon Communications. Finally, after a short bidding war with Qwest, Verizon Communications acquired MCI in early 2005 for \$10.8 billion.

Through a variety of maneuvers, the remaining four Baby Bells consolidated to become AT&T. In late 1993, Pacific Telesis grouped together its non-regulated subsidiaries in PacTel Corporation and sold 14% of its stock to outside shareholders. Just a few months later, in April 1994, Pacific Telesis distributed its remaining stake in PacTel Corporation on a pro-rata basis to its existing shareholders. On completion of the spin-off, PacTel Corporation changed its name to AirTouch Communications. .

In April 1996, SBC Communications, formerly Southwestern Bell,<sup>38</sup> entered into a \$16.5 billion “merger of equals” with Pacific Telesis. During 1998, SBC Communications merged with two more telecommunication companies. In January 1998 it merged with SNET though given their relative sizes this was effectively an acquisition,<sup>39</sup> in May it merged with Ameritech in a deal worth \$68 billion.<sup>40</sup>

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36. Telecommunications Act, *supra* note 26.

37. BELL ATLANTIC CORP., 1998 ANNUAL REPORT (1999). In the “merger of equals” between Nynex and Bell Atlantic, Nynex became a wholly-owned subsidiary of Bell Atlantic and its shareholders received stock in Bell Atlantic. This qualified the merger as a tax-free reorganization, which meant that all financial accounts prior to the merger had to be restated as if they had been a single company all along. *Id.*

38. Southwestern Bell changed its name to SBC Communications in 1994, in part to downplay its geographical heritage.

39. Press Release, Southern New England to Merge with SBC Communications (Jan. 5, 1998), *available at* <http://www.att.com/gen/press-room?pid=4800&cdvn=news&newsarticleid=6492>. The disparity in size between SNET and SBC is illustrated by the distribution of shares in the merged company. Although the deal valued SNET at \$4.4 billion, its shareholders would hold 6% of the resulting company's shares while SBC shareholders would hold the remaining 94%. *Id.*

40. SBC COMMUNICATIONS INC., ANNUAL REPORT 1998 26 (1999).

In 2000, SBC Communications and BellSouth merged their domestic cellular operations to form Cingular Wireless, a 60-40 joint venture.<sup>41</sup> In October 2004, Cingular Wireless paid \$41 billion to acquire AT&T Wireless, one of the companies that emerged from the restructuring of AT&T just after the turn of the millennium.<sup>42</sup> This restructuring effectively saw AT&T divest its wireless and broadband operations and close its residential long-distance business to new customers in order to focus on the corporate long-distance market.

At the start of 2005, SBC Communications announced its intention to merge with AT&T in a deal valued at \$16 billion. When the merger was approved in November 2005, SBC Communications changed its name to AT&T. In March 2006 AT&T announced that it would merge with BellSouth in a deal valued at \$84 billion. Although both sets of shareholders have approved the merger, final approval is not expected until the latter part of 2006. Assuming that regulatory approval is forthcoming as anticipated, this merger will, as shown in Figure 1, reduce the number of independent Baby Bells to three: Qwest, Verizon Communications, and AT&T.

## II. THE INTERNATIONALIZATION AND DE-INTERNATIONALIZATION OF THE BABY BELLS

During the period that the Baby Bells underwent restructuring, their international ambitions and footprints also evolved. This is the focus of the remainder of the paper. The frequent name changes of the Baby Bells may cause confusion. To avoid this, the following convention is adopted in the rest of this paper: SBC is used throughout the period from 1984 to 2006, while Bell Atlantic and Nynex are used in conjunction with events occurring between 1984 and 1996. Between 1996 and 1998 Bell Atlantic/Nynex is used, whereas after 1998 Verizon is adopted.

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41. Press Release, BellSouth, SBC Create Nation's 2nd Largest Wireless Company with \$10.2 Billion in Revenues (Apr. 5, 2000), *available at* [http://bellsouth.mediaroom.com/index.php?s=press\\_releases&item=2688](http://bellsouth.mediaroom.com/index.php?s=press_releases&item=2688).

42. Press Release, Cingular Wireless, Cingular to Acquire AT&T Wireless, Create Nation's Premier Carrier (Feb. 17, 2004), *available at* [http://cingular.mediaroom.com/index.php?s=press\\_releases&item=520](http://cingular.mediaroom.com/index.php?s=press_releases&item=520).

#### A. METHODOLOGY FOR MEASURING INTERNATIONALIZATION

There is no consensus as to how internationalization should be measured. Dörrenbächer and Sullivan both suggest three broad categories of possible measurement indicators: structural, performance, and attitudinal.<sup>43</sup> According to Dörrenbächer, structural indicators are those that provide a picture of the international entanglement of a company at a given moment in time. Examples include the number of countries in which the company is present, as well as foreign assets as a percentage of total assets.<sup>44</sup> In contrast, performance indicators measure how well the company is performing abroad. Two such indicators are, according to Dörrenbächer, turnover and operating profit.<sup>45</sup> Sullivan suggests three possible measures: research and development intensity, advertising intensity, and export sales as a percentage of total sales.<sup>46</sup> Attitudinal measures focus on the relationship between the home country of the internationalizing company and its operations abroad. One possible measure is the amount of international experience senior management possess while another is the psychic dispersion of the international operations.<sup>47</sup>

Although a wide range of possible measures of internationalization have been suggested, some are easier to implement than others. In particular, the availability of data influences which measures are feasible and which are not. Moreover, the Baby Bells do not by any means describe their international operations in detail. As a consequence, it is hard to determine the exact size of their international operations in terms of capital invested, revenue, or subscribers. In addition, the data can also be inconsistent between years, not least because the Baby Bells regularly restate their accounts to reflect acquisitions and divestments as well as changing regulatory requirements. This is particularly problematic when restatements are made that affect several years, requiring a decision as to whether each year should be treated separately as reported at the time or whether the most recent sequence of

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43. See Cristoph Dörrenbächer, *Measuring Corporate Internationalisation: A Review of Measurement Concepts and Their Use*, 35 *INTERECONOMICS* 119 (2000); Daniel Sullivan, *Measuring the Degree of Internationalization of a Firm*, 25 *J. OF INT'L BUS. STUDIES* 325 (1994).

44. Dörrenbächer, *supra* note 43, at 120.

45. *Id.*

46. Sullivan, *supra* note 43, at 331.

47. *Id.* at 332.

data from the company should be used.

The international operations of the Baby Bells are also obscured by their consolidations with other businesses. Since 1984, these international operations have been consolidated with their diversified holdings, directory-publishing operations or with all non-regulated activities.<sup>48</sup> The inconsistency that occurs, both between years and between Baby Bells, complicates any attempt to undertake a longitudinal analysis of their internationalization. This inconsistency also means that a longitudinal financial analysis of internationalization in a manner similar to Daßler *et al*<sup>49</sup> or Gerpott and Jakopin<sup>50</sup> is not possible for the Baby Bells.

While financial data are not provided for all international operations, it is possible to calculate the balance between regulated and non-regulated Baby Bell revenues. However, non-regulated revenues can, depending on the Baby Bell, contain revenues from non-telecommunication activities such as property management or computer retailing, as well as directory publishing, domestic cellular, and international revenues.<sup>51</sup> Moreover, not only has the balance between regulated and non-regulated revenues changed over time but the portfolio of activities contributing to the non-regulated activities has also changed.<sup>52</sup> If the proportion of non-regulated revenue increases over time, this may be due to revenue growth in one of several revenue sources or a decline in regulated

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48. CHESSLER ET AL., *supra* note 14. The authors were surprised at the complex organizational structures that the Baby Bells adopted in the aftermath of divestiture given their previous arguments against structural separation. *Id.* at 54-59. The structures adopted effectively divided the Baby Bells into two; that is into the Bell Operating Companies and support services on the one hand and everything else on the other. The international investments of the Baby Bells would be included in this "everything else" category.

49. Thoralf Daßler et al., *Economic Performance in European Telecommunications, 1978-1998: A Comparative Study*, 14 EUR. BUS. REV. 194 (2002).

50. Torsten J. Gerpott & Nejc M. Jakopin, *The Degree of Internationalization and the Financial Performance of European Mobile Network Operators*, 29 TELECOMM. POLY 635 (2005).

51. See EDWIN ROSENBERG ET AL., NAT'L REG. RES. INST., REGIONAL TELEPHONE HOLDING COMPANIES: STRUCTURES, AFFILIATE TRANSACTIONS, AND REGULATORY OPTIONS 93-105 (1993) for a discussion of the relationship between regulation and revenues.

52. See Whalley, *supra* note 27.

revenues. In other words, non-regulated revenue is too broad a category to shed light on the Baby Bells' international investment revenue trends.

Due to the limited availability of data and the inherent inconsistency of much of what is available, the approach adopted here is to take data from the annual reports without considering any restatements that may subsequently occur. In other words, only data for the year just finished are taken from each annual report. All international investments that appear in annual reports are considered, and when constructing the international presence of each of the Baby Bells they are treated the same. In other words, no account is taken of the different scale of the international investments.

Although it is acknowledged that this means that two international investments with, for instance, vastly different revenues will be treated as identical when in reality they are not, such a stance has been adopted because data are incomplete. Quite simply, the annual reports of the Baby Bells do not provide sufficiently detailed data between 1984 and 2006 to determine the size of every international investment they made. Thus, while determinants of size such as subscribers, revenues and capital invested will be used where appropriate, no systematic attempt is made to compare the size of all of the Baby Bells' international investments.

Multiple investments in the same country are counted separately, primarily so that the number of separate investments made outside the United States for each Baby Bell can be ascertained. A second reason is that, on occasion, the Baby Bells have invested in several different lines of business within the same country. For example, US West invested in three different lines of business in the United Kingdom (UK).<sup>53</sup> In total, eight different lines of business are identified, namely: cable, cellular, content, data, equipment, fixed (which includes public telephone operators, second national operators, facilities management, long-distance, and international cable), paging and services (which includes directory and information services, software, alarms, and security services). However, when the number of countries is determined, multiple businesses in the same location are discounted.

Wherever possible the equity stake held by a Baby Bell in its international investment has been identified. For all but

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53. US WEST, UNLOCKING THE VALUE: INVESTOR'S HANDBOOK 38ff (1994).

sixteen investments, it has been possible to identify the equity stake held. Equity stakes are integral to calculating the proportionate subscribers of cellular investments. However, this is far from straightforward since not only is the number of subscribers often hard to ascertain but the equity stakes held by the Baby Bells also change between years and are inconsistently documented. Particular attention was paid to identifying holding companies so that the problems identified by Curwen<sup>54</sup> were avoided.

Although a number of investments were identified that in turn have subsidiaries, only the initial investment was included in the analysis. One reason for this was the lack of data that would enable all of the subsidiary investments to be tracked, while a second reason was that the minority stake in many of the investments limited the ability of the Baby Bells to influence management. However, determining how Cingular Wireless should be treated in the analysis is not straightforward. As a joint venture between two Baby Bells, Cingular could conceivably be included in the totals for both BellSouth and SBC. However, an argument can be made that since SBC is the majority shareholder Cingular should be included solely within its total. Ultimately, including Cingular within the totals for both Baby Bells would inflate the number of investments, and distort the subsequent analysis. Therefore, when this and SBC's merger with BellSouth were taken into account, Cingular and its various subsidiaries were included only within SBC's total.

## B. INTERNATIONALIZATION AND DE-INTERNATIONALIZATION

### 1. Total Number of International Investments

Figure 2 enables a series of observations to be made regarding the internationalization and de-internationalization of the Baby Bells. In the first place, the Baby Bells have collectively made 198 international investments between January 1984 and August 2006. There is considerable variation in the number of investments made each year; in some years only a handful of investments were made while in 1991 almost thirty investments were made. Hence, the "golden age" of

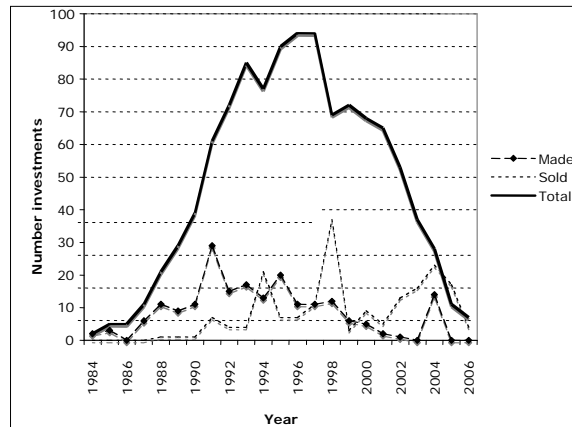
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54. Peter Curwen, *A Brief Illustrated Discourse on the Concept of "Large" in the Context of Mobile Telephony*, 7 INFO 76 (2005).

internationalization would appear to have been between 1991 and 1995. During these five years, ninety-three international investments were made with the result that the number of investments held peaked between 1996 and 1997.

A second observation is that from 1991 onwards the number of international acquisitions that the Baby Bells made gradually declined with the exception of two years, 1995 and 2004. The first exceptional year, 1995, falls within the “golden age” noted above while the second does not. The increase in 2004 was due to the acquisition by Cingular Wireless of AT&T Wireless that brought with it a large international portfolio located primarily in the Caribbean. Despite this seemingly significant international acquisition, relatively few subscribers were located outside of the United States.<sup>55</sup> Furthermore, in the year after acquiring AT&T Wireless, Cingular sold all of its international operations except one, partly to satisfy regulatory requirements arising from the acquisition and partly to exit markets in which it was no longer interested.

FIGURE 2: NUMBER OF INTERNATIONAL INVESTMENTS, JANUARY 1984 – AUGUST 2006



55. Although AT&T Wireless had 23,952 million proportionate (equity) subscribers at the end of December 2004, 22.1 million of these were located in the United States. The Caribbean accounted for just over 300,000 proportionate subscribers between them, while India accounted for 1.545 million.

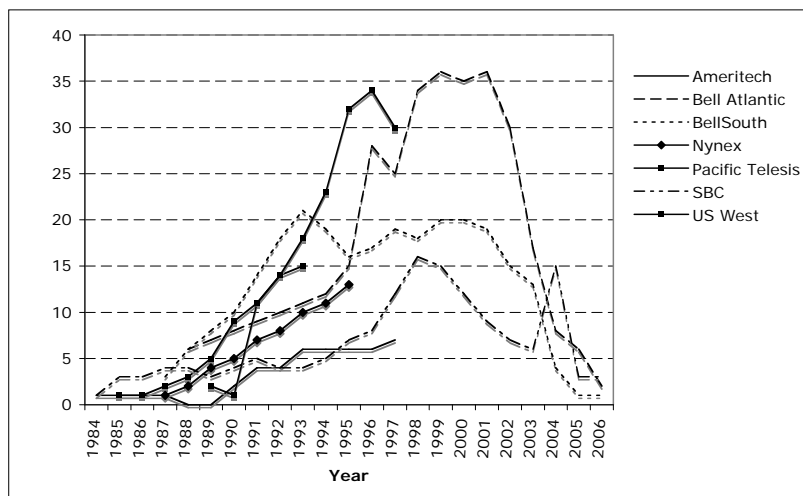


A final observation is that from 2000 onwards the Baby Bells sold more international investments than they acquired. In other words, their de-internationalization began in earnest during 2000. This is, however, slightly misleading as it ignores the de-internationalization associated with the divestments of AirTouch Communications by Pacific Telesis and of MediaOne by US West. Both of these divestments, in 1994 and 1998 respectively, reduced the overall number of international investments, though given the larger international portfolio of MediaOne its divestment was the more significant of the two. By September 2006, as a consequence of divestments and sales, the Baby Bells held just seven international investments between them.

## 2. NUMBER OF INTERNATIONAL INVESTMENTS BY INDIVIDUAL BABY BELLS

Figure 2 does not show the variation that exists between the Baby Bells in terms of the number of international investments that they made. From Figure 3 (below) it can be seen that the maximum number of international investments held by the Baby Bells ranged from seven by Ameritech to thirty-six by Verizon (Bell Atlantic on the Chart). However, the abrupt ending of lines for four Baby Bells signifies either the complete divestment of their international operations (Pacific Telesis and US West) or the year in which they merged with another Baby Bell with the consequence that their international investments were transferred to the new company (Ameritech and Nynex). When this is taken into account, the thirty-six investments held by Verizon are in fact the result of Bell Atlantic's mergers with Nynex and GTE. Thus, the largest number of international investments held by a *single* Baby Bell was thirty-four by US West in 1996.

FIGURE 3: NUMBER OF INVESTMENTS BY BABY BELL, 1984 – AUGUST 2006



Verizon Communications continued its international expansion until 2001 when it affected an abrupt volte-face. Beginning in 2002, Verizon sold, in all, thirty-three international investments so that by August 2006 just two were left.<sup>56</sup> The two that remain are a half share in Gibraltar-Nynex Communications and a 23.1% stake in Vodafone Italy.

SBC also increased its international footprint through its merger with Ameritech in 1998. The merger added seven new holdings, although its impact was partially offset by the sale of international investments within its existing portfolio as well as among the newly acquired operations. From 1998 onwards, SBC steadily offloaded its international investments, although its portfolio dramatically increased once more in 2004 with Cingular's acquisition of AT&T Wireless. However, this upturn was only temporary: Cingular sold two of the newly acquired investments in 2004, twelve in 2005 and has retained just the one in the United States Virgin Islands. It also continued to sell its original portfolio of holdings.

Figure 3 also shows that in the late 1980s and early 1990s, BellSouth was at the forefront of Baby Bell internationalization. BellSouth rapidly built the largest international portfolio. This resulted in a shift in its strategic priorities away from Australia - where it owned various paging businesses as well as a stake in Optus, the second national operator - and towards cellular markets. This resulted in a small decrease before it remained more or less steady until the turn of the millennium.

Another strategic change, this time in favor of Latin American cellular markets, resulted in a further withdrawal, primarily from Europe, as did BellSouth's exit from Brazil due to tougher-than-anticipated market conditions there. Although BellSouth had previously claimed that Latin America was a strategic priority along with broadband, long-distance and domestic wireless, it sold its Brazilian investments in March 2004 to Telefónica Móviles for \$5.85 billion.<sup>57</sup>

### 3. Line of Business Entered by Baby Bell

It is also possible to identify the different lines of business

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56. Although Verizon announced the sale of its operations in the Dominican Republic, Puerto Rico and Venezuela in April 2006, these were subject to regulatory approval that is in the process of being granted.

57. See BELL SOUTH, *CONNECTING TO WHAT'S IMPORTANT: (2001) ANNUAL REPORT TO SHAREHOLDERS* (2002).

that the Baby Bells invested in overseas. Eight lines of business are identified in Table 3. The first point that can be made is that one line of business, cellular, accounts for 40% of all the investments made by the Baby Bells, a figure that vastly exceeds cable, the second most popular line of business. Taken together, these two lines of business account for almost 60% of all the investments made. It is worth noting that although twenty-nine “fixed” and twenty-five “services” investments were made, these two categories are quite broad. Consequently, in the services category, directory publishing and information services are the two main sub-categories, while in the fixed category, investment in public telephone operators is the largest sub-category. Even if these sub-categories were separated out, the largest, public telephone operators would, at best, numerically have the same number of investments as paging and thus account numerically for only a small area of investment for the Baby Bells.

TABLE 3: BABY BELL INVESTMENT BY LINE OF BUSINESS<sup>58</sup>

	Ameri- tech	Bell Atlantic	Bell- South	Nynex	Pacific Telesis	SBC	US West	Total
Cable	-	3	1	3	2	3	18	30
Cellular	4	10	18	9	4	25	15	85
Content	1	2	-	-	-	-	1	4
Data	-	-	6	1	-	-	-	7
Equipment	-	7	-	-	-	1	-	8
Fixed	4	11	2	1	4	6	1	29
Paging	-	1	4	-	-	-	-	10
Services	2	5	3	5	7	4	4	25
Total	11	39	34	19	17	39	39	198

Secondly, the investment portfolios of four Baby Bells are bipolar. Ameritech, Bell Atlantic, Pacific Telesis and US West all have two lines of business that have received more or less the same number of international investments. For Ameritech, Bell Atlantic and Pacific Telesis the two lines of business are cellular and fixed whereas for US West is it cable and cellular.

58. AT&T INC., 2005 ANNUAL REPORT (2006). BELLSOUTH FOUND., CONNECTING TO WHAT'S IMPORTANT: (2001) ANNUAL REPORT TO SHAREHOLDERS (2002), BELLSOUTH FOUND., 2003 ANNUAL REPORT (2004), BELLSOUTH CORP., 2005 ANNUAL REPORT: THIS IS NOT A PHONE LINE... (2006).

US West stands out as the only Baby Bell to invest extensively in cable businesses overseas, accounting for almost two-thirds of all Baby Bell investments in that market. In contrast, BellSouth has overwhelmingly favored cellular, as has SBC. Although the difference between cellular and the other lines of business for Nynex is not as great, it does account for almost half of all the international investments that it made.

Broadly speaking, three-quarters of all the international investments took place during the 1990s which, when widespread liberalization and the introduction of competition are taken into account, is perhaps not surprising. What could be viewed as a surprise, however, is that the lines of business in which the Baby Bells have invested has changed over time. In the 1980s, three lines of business were preferred: equipment, paging and services. All eight equipment international investments were made by Bell Atlantic and SBC during the 1980s, while most paging and service investments also occurred during this decade. Both BellSouth and Pacific Telesis invested in paging businesses on a more or less equal basis, whereas several Baby Bells made service investments throughout the decade. During the 1990s, in contrast, investments took place in different lines of business. Investments in cable, which began at the end of the 1980s, continue throughout the decade to be joined by two other lines of business, cellular and fixed. Cellular investments accounted for 45% of all investments throughout the decade, and regularly constituted the single largest area of investment numerically in each year.

#### 4. International Expansion Through Merger Activity

Both Bell Atlantic and SBC have engaged in domestic mergers with companies that already had an established international presence of their own, resulting in often quite substantial changes to their international footprints in the process. Prior to its 1996 merger with Nynex, the internationalization of Bell Atlantic could readily be described as largely disappointing, albeit with two exceptions, TCNZ and Omnitel in Italy. While Bell Atlantic steadily expanded its international footprint, it was not until 1990 that it made its first significant investment overseas when it joined with Ameritech to acquire TCNZ for \$2.5 billion.<sup>59</sup> This was then followed three years later by an investment in Grupo Iusacell, a

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59. BELL ATLANTIC, 1991 ANNUAL REPORT 33 (1992).

Mexican wireless operator, and by investment in Omnitel, an Italian wireless operator, in 1994.<sup>60</sup>

TCNZ, Grupo Iusacell, and Omnitel are financially the three largest international investments made by Bell Atlantic. While TCNZ and Omnitel can be considered very successful international investments, the same cannot be said for Bell Atlantic's investment in Grupo Iusacell. In November 1993, Bell Atlantic invested \$520 million to acquire a 23% stake in the Mexican wireless operator, and invested a further \$524 million the following June to increase its stake to 41.9%. Although Bell Atlantic was initially very enthusiastic about this investment, problems were soon encountered and it was dragged into a corruption scandal involving the founding Peralta family. Subsequently, Bell Atlantic invested once more in Grupo Iusacell with the consequence that its total investment in the company increased to \$1.7 billion. Unsatisfactory growth by the company, as well as continued unfavorable economic conditions, eventually forced Bell Atlantic/Nynex to write-off \$957 million of its investment before selling its stake in the company in 2003.<sup>61</sup>

Bell Atlantic suffered other disappointments when internationalizing prior to its merger with Nynex. The Baby Bell participated in consortia in Australia, South Korea, and Taiwan, with those in Australia and Taiwan failing to win a cellular license while the alliance with Korea Telecom came to nothing.<sup>62</sup> With the sale of the European equipment businesses, the international footprint lacked geographical coherence and was generally regarded as "piecemeal".<sup>63</sup>

The merger of Bell Atlantic and Nynex helped to rectify this as the international footprint of Nynex complemented that of Bell Atlantic. The merger extended its international footprint into six new countries and complemented its existing presence in both Europe and Asia. For example, Nynex but not Bell Atlantic was present in Greece, and although both Baby Bells were present in the Czech and Slovak Republics, they operated

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60. BELL ATLANTIC, INVESTOR'S REFERENCE GUIDE 95 78ff (1996).

61. VERIZON COMMUNICATIONS, INC., DELIVERING THE NEW WORLD OF COMMUNICATIONS: 2003 ANNUAL REPORT 18 (2004).

62. C.D. WASDEN, NAT'L REGULATORY RESEARCH INST., A DESCRIPTIVE COMPENDIUM OF THE INTERNATIONAL ACTIVITIES OF MAJOR U.S. BASED UTILITY HOLDING COMPANIES 93-10 (1993).

63. *Looking for the Turnpike*, GLOBAL TELECOMM. BUS. (1994).

in different lines of business—directory publishing in the case of Nynex and cellular for Bell Atlantic.

The merger of Bell Atlantic/Nynex with GTE further expanded its international footprint. Perhaps surprisingly, the ten international investments of GTE were all located in countries in which neither Bell Atlantic nor Nynex were present, and included countries that Bell Atlantic had previously sought unsuccessfully to enter such as Taiwan. The two European investments, in Austria and Hungary, complemented the existing Bell Atlantic/Nynex investments as they were both geographically near and in a line of business in which the Baby Bell was already active, namely, directory publishing.

GTE also operated five fixed-wire investments in what can best be described as an eclectic range of countries. Two of these investments were located in the Pacific and one each in Canada, the Caribbean, and Latin America. The scattered nature of these investments broadened the resulting international footprint as much as the complementary European operations gave it coherence. Although additional international investments were made after the merger with GTE, these did not fill in the gaps, the most substantial of which was in Canada where the Baby Bell already had a presence. Given the limited nature of these additional investments, the merger between Bell Atlantic/Nynex and GTE could be viewed as marking the highpoint of the Bell Atlantic's internationalization.

SBC has also entered into mergers that have impacted its international presence. The internationalization of SBC can be divided into two periods on either side of 1995. Prior to 1995, SBC invested in four different lines of business, cellular, equipment, fixed-wire, and services. The businesses are located in a geographically diffuse set of countries including Australia, France, Israel, Mexico, and the UK. Notwithstanding this apparent lack of focus, Maney<sup>64</sup> described the international holdings as “brilliant” though it can be argued that this was primarily due to the investment in Telmex, the success of which has been described above.

After 1995, SBC focused most of its internationalization efforts on two lines of business, namely cellular and fixed-wire,

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64. KEVIN MANEY, MEGAMEDIA SHAKEOUT: THE INSIDE STORY OF THE LEADERS AND THE LOSERS IN THE EXPLODING COMMUNICATIONS INDUSTRY (1995).

although it did continue to invest across a broad range of countries. Although most of these investments were focused on the cellular market, in 1997 SBC acquired three stakes in fixed-wire operators, Golden Lines International (Israel), diAx (Switzerland) and Telekom South Africa (Republic of South Africa).<sup>65</sup> The merger with Ameritech in the following year added four more fixed-wire investments, but as the remaining stake in TCNZ was sold in 1998, the net addition to SBC's fixed-wire portfolio was three.<sup>66</sup> As all three investments were in Europe, the merger expanded SBC's European footprint.

Even though SBC made two more investments in fixed-wire operators, these were in contrast to the sale of fixed-wire investments that began in 1999 but mainly constituted sales during 2003 and 2004. As the sale of investments was not restricted to fixed-wire, 1998 effectively marked the high point of internationalization by SBC. The acquisition of AT&T Wireless by Cingular Wireless did expand its international footprint, albeit only temporarily as most operations were sold during 2004.

### III. WHY THE BABY BELLS DE-INTERNATIONALIZED?

The previous section has charted the internationalization and de-internationalization of the Baby Bells. By 1995, however the "golden age" of Baby Bell internationalization had come to an end. From the mid-1990s onward, the Baby Bells exited international markets to such an extent that by 2006 they collectively retained just seven international investments. Thus, the answer to the question "Whatever happened to the Baby Bells?" is quite simply, that the Baby Bells returned to their home market of the United States.

However, while this answer is an accurate description of what happened, it does not explain *why* the Baby Bells sold or divested almost all of their international investments. The de-internationalization of the Baby Bells can be explained through three inter-related issues, namely: the financial returns from internationalization, the changing nature of regulation within the United States, and domestic merger and acquisition activity.

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65. SBC COMM. INC., 1997 ANNUAL REPORT 45 (1998); WHALLEY, *supra* note 27.

66. See AMERITECH, ANNUAL REPORT 1998 28F (1999).

Although some of the international investments made by the Baby Bells proved to be very successful financially, there is little evidence to suggest that this was widespread. While the Baby Bells draw attention in their annual reports to the financial success of some of their investments, particularly their cellular and public telephone operator investments, they are largely silent as to the financial success of their international investments in data, content, equipment, paging and services.

Even though the annual reports of the Baby Bells do not provide sufficient detail to determine the financial success or otherwise of individual investments, they do provide some insight into the revenues and net income that the international investments of some of the Baby Bells generated.<sup>67</sup> These examples clearly demonstrate that whereas internationalization may generate reasonable revenues and net income, Verizon and BellSouth rely predominantly on their domestic businesses for these. In other words, the financial contribution of their internationalization, even at its peak, was not that substantial.

While the limited financial success of many of the international investments undoubtedly contributed to the Baby Bells' de-internationalization, the remaining two issues are of greater importance. As noted above, the MFJ imposed four lines of business restrictions on the Baby Bells. The Baby Bells were allowed to invest in other non-regulated services in 1987 and information services in 1991, though they had to wait until the Telecommunications Act of 1996<sup>68</sup> before they were released, albeit subject to a fourteen-point competitive checklist in the case of inter-exchange telecommunication services, from the remaining two restrictions. The lifting of these restrictions created new investment opportunities for the Baby Bells in the United States, though it is arguably the case that the most significant and attractive of these opportunities was entry into the inter-exchange market.

The Baby Bells were initially unsuccessful in their attempts at entering the inter-exchange market, not least because regulators at both the state and federal level felt that the local telephone markets served by the BOC were not competitive. Bell Atlantic and SBC were, however, successful in their attempts to expand their geographical footprint in the United States through merging with their fellow Baby Bells.

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67. VERIZON COMMUNICATIONS, INC. 2001 ANNUAL REPORT (2002); BELLSOUTH FOUND., 2003 ANNUAL REPORT 37 (2004).

68. Telecommunications Act, *supra* note 26.



Notwithstanding the increasingly onerous conditions placed on the Baby Bell mergers by the Federal Communications Commission (FCC), the mergers underlined the attractiveness of the inter-exchange market to the Baby Bells.<sup>69</sup> The Baby Bell mergers expanded both Bell Atlantic's and SBC's presence in the local telephone market, markets that they could link together once they were able to enter the inter-exchange market.

It is worth noting that Pacific Telesis and US West reacted differently to the Telecommunications Act of 1996. Pacific Telesis pre-empted the Act by divesting AirTouch Communications in 1994, thereby concentrating its attentions on its core California and Nevadan markets. At the same time, Pacific Telesis provided a wider range of services within these two states, thereby leading Maney to describe the strategy as "California First."<sup>70</sup> However, by the time the Telecommunications Act was passed this strategy had not been fully implemented, with the consequence that Pacific Telesis was weakened to such an extent that it was taken over by SBC for, in hindsight, a relatively modest sum.

US West also exited its non-BOC territory businesses, albeit after the Telecommunications Act had become law. In some respects, the decision of US West to divest its domestic cable business was surprising; it had regularly drawn attention to the UK where cable-television and telephony could be combined, and had made several domestic purchases of cable-television systems culminating with the \$10.8 billion purchase of Continental Cablevision in early 1996. However, section 652 of the Telecommunications Act prohibited a telephone company from owning more than 10% of a cable company providing service in the same area.<sup>71</sup> Thus, while the FCC did approve the merger, it required the cable systems of Continental Cablevision within the region served by US West to be divested. As a consequence, US West was unable to combine cable-

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69. For a detailed discussion of FCC merger policy and the conditions placed on the Baby Bells, see Jim Chen, *The Echoes of Forgotten Footfalls: Telecommunications Mergers at the Dawn of the Digital Millennium* (Univ. Minn. Law Sch. Legal Studies Research Paper Series, Paper No. 06-17, 2006).

70. MANEY, *supra* note 64, at 83f. In 1995 Pacific Telesis paid \$696 million for PCS licenses covering California and Nevada and invested in wireless cable-TV, as well. PACIFIC TELESIS, FACT BOOK (1995).

71. Telecommunications Act, *supra* note 26; *see also* Chen, *supra* note 69, at 31.

television services with telephony and achieved only limited synergies. Both of these factors contributed to US West's decision to divest MediaOne in 1998.

As the attention of the Baby Bells turned towards their domestic markets, the Baby Bells began to de-internationalize. If the passing of the Telecommunications Act in 1996 and the granting of the first Baby Bell entry into the inter-exchange telecommunication services market in 1999 are superimposed on Figures 2 and 3 above, we can see that the latter coincides with the beginning of their de-internationalization. As the Baby Bells exited international markets, they re-deployed the freed capital within their domestic markets, partly to acquire other companies and partly to improve their infrastructure.

### CONCLUSION

This paper has charted the internationalization and de-internationalization of the Baby Bells. All of the Baby Bells expanded internationally, making 198 international investments spread across eight different lines of business. However, both the number of investments made, and the lines of business favored, differ between the seven Baby Bells. The internationalization of the Baby Bells peaked in the mid-1990s, with de-internationalization coming to the fore after 2000. The Baby Bells have now sold all but seven of their international investments.

The de-internationalization of the Baby Bells highlights the continued importance of the home market. It is arguably the case that while the restrictive regulatory environment imposed by the MFJ encouraged the Baby Bells to internationalize, changes in this environment also encouraged their de-internationalization. The Telecommunications Act of 1996 allowed the Baby Bells to enter the inter-exchange market, while a liberal attitude to mergers/takeovers by the FCC allowed them to expand geographically. The Baby Bells did, albeit after a slight delay, enter the inter-exchange market and they did merge with one another. The de-internationalization of the Baby Bells contributed to the consolidation process by allowing capital invested overseas to be re-deployed within the United States. The end result was not only the effective abandonment of international telecommunications markets by the Baby Bells, but the creation of two vertically-integrated operators with national wireless footprints, namely, AT&T and Verizon Communications.