TOUGH CALLS

AT&T and the **Hard Lessons Learned** from the **Telecom Wars**

DICK MARTIN

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To my wife and partner, Ginny.
She makes liars of those
who say beauty is only skin deep.

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Acknowledgments

Parts of this book have appeared in somewhat different form in the *Harvard Business Review, The Public Relations Strategist* of the Public Relations Society of America, and *The PR Encyclopedia,* scheduled to be released by Sage Publications in 2004.

Several of my former AT&T colleagues, especially Sue Fleming, Sheldon Hochheiser, and Bruce Brackett, searched their files and memories to help me keep dates, names, and events straight. Pat Pollino, who started at Western Electric with me several decades ago and today holds an impressive position at Mercer Management, provided the outside enthusiasm that I needed in order to get serious about this project. Most importantly, he introduced me to Paul Hemp at the *Harvard Business Review,* who convinced his colleagues that a PR guy from AT&T, of all places, might have something interesting to say—and then saw to it that I delivered the goods.

Paul and his colleague Andy O'Connell taught me the value of good editors. Ellen Kadin, at AMACOM, picked up where they left off, patiently helping me shape a book that would appeal to a broader audience than I first thought.

Several friends offered constructive comments and suggestions as I developed my manuscript. Ed Block provided the perspective of his own career directing public relations for AT&T. Gershon Kekst, one of the wisest PR counselors practicing today, helped me calculate the true meaning of my experience. Michele Tringali, who once handled public relations for AT&T's consumer long-distance business, helped me to better understand its intricacies and dynamics. Adele Ambrose and Burt Wolder helped me reinterpret several of the more significant experiences we shared.

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Mike Armstrong played no role in the writing of this book, although he saw a draft. He disagrees with my interpretation of some events and with many of my conclusions. But I must acknowledge his role in this story. I discuss his mistakes as well as my own in these pages. But no one should overlook the fact that he took on one of the greatest challenges in American business at a time in his life when he could have coasted into retirement in the glow of decades of achievement at IBM and Hughes Electronics.

Armstrong served his new company with integrity and courage. The same cannot be said of all the people upon whom he depended. I believe history will show that he had the right plan for AT&T and that, while some of the deals he approved were "fully priced," or badly structured, he might still have recovered if the company's biggest competitor had not engaged in three and a half years of fraud that distorted the markets and robbed him of the one thing he needed most: time.

Finally, I never would have finished this book were it not for the encouragement, patience, and prodding of my wife, Ginny, and my children, Christopher, Elizabeth, and Juli, as well as my daughter-in-law, Laura, and my cousin Marcel, all of whom gave me the courage to approach this story with candor and a degree of introspection that does not come naturally to me. My grandson, Sky, arrived around the same time as the first draft, so he has only had excerpts read to him. But I hope that someday this book will give him an idea of what "Gramps" was up to in the decade before he was born.

TOUGH CALLS

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Introduction

History is not what happened
but what is remembered of it.

—ALVIN VON AUW, *Heritage and Destiny*[1]

Gilded and Gelded

A golden statue of a winged youth, brandishing lightning bolts and draped in telephone cables, once perched on the roof of the old AT&T headquarters at 195 Broadway in lower Manhattan.[2] When AT&T decided to move uptown in the early 1980s, it lowered the statue, popularly called "Golden Boy," in order to place it in the lobby of the company's new headquarters on Madison Avenue.

No one was surprised that after being exposed to the elements for sixty-four years, Golden Boy needed to be regilded. But AT&T's chairman at the time, a courtly southerner named John deButts, was shocked to discover that the twenty-four-foot-tall statue was also anatomically correct—and of heroic proportions. Concerned that the statue would scandalize genteel Madison Avenue shoppers, deButts was said to have decreed that it be not only gilded, but also gelded.

Apocryphal or not, Golden Boy's gilding and gelding became a metaphor for AT&T's embattled history in the last decades of the twentieth century and a cautionary symbol for all companies in an era in which perception has become the hyper-reality within which they do business. While a rah-rah brother- and sisterhood of stock boosters and image consultants work to gild a company's image, guerrilla bands of special-interest groups and the business media geld them with countless little cuts. No wonder corporate America feels that it is under siege. CEOs, boards, and their advisers vacillate between the instincts of fight and flight. They don't know whether to jump on a soapbox and fight back or to hunker down in the hope that they won't be noticed.

In recent years, AT&T has been buffeted by these opposing forces as were few other companies. A widely admired icon of American business for more than a century, the company made some strategic blunders and couldn't seem to get its management act together. All of this was reported in gory detail. AT&T looked like the gang that couldn't shoot straight—unless it was to take a bead on its own foot.

Perception matters. Just ask the New York Stock Exchange's former CEO, Dick Grasso. In a matter of months, he went from the personification of corporate courage and resilience, following the September 11 attacks on the World Trade Center, to Exhibit A of unbridled corporate greed.[3] Even retired GE chairman Jack Welch discovered how quickly public sentiment could turn—even though he increased his company's market value more than 3,600 percent.[4]

Imagine, however, that you were unlucky enough to take the most visible job in an industry that was inexorably melting away, your biggest competitor felt free to slash prices because it was making up its financial results as it went along, and you had to do whatever you were going to do in five years or less. That's the situation that my former boss, Mike Armstrong, parachuted into in 1997. In a sense, this book is his story. But it's also the story of his predecessor, Bob Allen, although neither man would tell the tale quite this way. And its roots go even deeper in the company's history, through a series of crossroads that, as it turned out, led only into swamps and dead ends.

AT&T at the Crossroads

For most of the twentieth century, AT&T was literally "the phone company." It provided telephone service to 90 percent of the country's population as a regulated monopoly. In 1982, AT&T agreed to divest its local telephone companies, breaking up what was known as the Bell System, to settle a federal antitrust suit and to pave the way to resolving a slew of suits filed by competitors. In a sign of the direction that life was taking, in that same week, the government dropped a similar antitrust suit against IBM, and *Time* magazine named the personal computer its "Man of the Year." Telephony was yesterday's business.

The breakup was predicated on the idea that local telephone service was a natural monopoly, like water utilities, but long-distance service and equipment sales operated in competitive markets. The local Bell monopolies would continue to provide a dial tone, serving all long-distance carriers equally; consumers and businesses could buy equipment from anybody they chose and plug it into the telephone network, just as they could plug a lamp into the electrical grid; and AT&T, MCI, Sprint, and a host of smaller players would knock themselves out competing for people's long-distance business.[5]

Of course, the idea that these so-called monopoly and competitive market segments would remain forever separate was seriously flawed, as was AT&T's belief that, having shed two-thirds of its assets, 70 percent of its employees, and more than half its revenue, regulators would leave it alone to compete on an equal footing. Both federal and state regulators, who had not been party to the settlement, continued to overestimate AT&T's capacity to absorb pain, subjecting it to unique filing requirements and subsidizing its competitors in the name of protecting "infant industries." The judge supervising the breakup, Harold Greene, had no sooner gaveled the case to a close than the Bell monopolies petitioned to enter the long-distance business.

When Greene proved less than enthusiastic about letting monopolists into a business that already counted more than 500 competitors, the Bell companies went over his head and took their case to Capitol Hill. Because the breakup had been wildly unpopular with the public—which, though it liked the lower prices and innovation that the breakup spurred, hated the confusion of dealing with multiple companies and the irritation of telemarketing calls during dinner—the Bell companies found sympathetic ears inside the Beltway. Besides, the only thing Congress loves more than a complicated issue with rich proponents on both sides is stringing such an issue out over several legislative sessions and, especially, elections.

By 1994, AT&T's general counsel, John Zeglis, decided that the Bells were gaining the upper hand. Zeglis, a magna cum laude graduate of Harvard Law who was still boyish-looking well into his thirties, had helped try the 1974 antitrust case as one of the youngest partners in the history of the venerable Sidley & Austin law firm, AT&T's outside litigation counsel.

Zeglis moved to AT&T after the suit was settled and swiftly became the company's general counsel, overseeing its law department and government affairs. Few outsiders understood the nuts and bolts of the telephone business better—he had literally studied engineering diagrams of the telephone network in his trial preparation. He absorbed the intricacies of arcane regulatory accounting with the relish of the champion Trivial Pursuit player he is. And he approached debate with all the enthusiasm of the brightest kid in the class. As the ultimate gamesman, he calculated that it was time for AT&T to stand *for* something and not simply be *against* anything that the Bell companies proposed. (No one knew how much longer Greene—then seventy years old—would be on the bench, and the company's opposition to any kind of telecom reform legislation had begun to sound shrill and whiny.) AT&T would be *for* getting back into the local phone business it had been forced to leave when the Bell System was dissolved. And once it was in local telephone service, AT&T had no objection to letting the Bell companies into long distance. But not before.

AT&T's chairman at the time, Bob Allen, was decidedly skeptical about the whole idea of getting back into the local phone business. Among the top officers of AT&T in the mid-1990s, he alone had actually run a local telephone company. He knew how complicated it was, and he also knew that its profitability depended on cross-subsidies that would never survive in a competitive market. But as a tactic for postponing the inevitable, he was willing to argue for breaking the Bells' bottleneck on local service. So Zeglis and his lobbyists managed to turn the Bells' efforts to win permission to offer long-distance service into a legislated checklist of the conditions that they would first have to meet by opening their local markets to competition. The result was one of the most litigated laws ever passed by Congress—the Telecommunications Act of 1996.

AT&T in the Crosshairs

As those of us within AT&T understood only too well, the Telecom Act was a death sentence for stand-alone long distance, which accounted for 80 percent of AT&T's revenue and 100 percent of its profits (and then some, making up for losses in other areas). AT&T was living on borrowed time. While the Bells challenged the Telecom Act in court, effectively keeping AT&T out of their local markets, they pressed for further legislation to let them into long distance. And everyone knew that the Bells would eventually wear the regulators down and join the long-distance fray.

Thanks to Allen's 1996 divestiture of AT&T's equipment businesses, the company had the strongest balance sheet in the industry, with relatively little debt. Profits, for the moment, were at record levels.[6] But the crossroads through which the company had maneuvered put it in the crosshairs of competitors from the so-called New Economy, whose stock prices seemed untethered to anything as mundane as profits or even cash flow.

AT&T's serial efforts to diversify internationally and into new lines of business, on the other hand, were constrained by investors' fixation on growth in the company's earnings per share. New services, like the company's award-winning WorldNet Internet service, had their budgets cut so that the company could meet its earnings targets. One executive called it "the Grown Man Syndrome." We were like grown men in a sealed room with a dwindling air supply, he said. At some point, to save ourselves, we'd pinch a baby's nose.

Shaken by the storm clouds he saw forming, Allen's heir apparent, AT&T president Alex Mandl, jumped ship to join a start-up. The printing company executive hired to replace him, R. R. Donnelly's John Walter, was such an unlikely choice that he was dubbed "heir *un*apparent"[7] and was pushed out within nine months, costing AT&T about $25 million in severance payments. Embarrassed, the AT&T board of directors eased Allen aside and started looking for his successor. After a highly publicized three-month search, they settled on the man who many thought should have had the job the first time around.

C. Michael Armstrong arrived with sterling credentials, high-wattage energy, no entourage, and, at least initially, only the most basic play in the turnaround playbook—slash costs. Finding a longer-term fix for the company's broken business model would take more time. Implementing it would probably take longer than the five years on his contract.

All that we in public relations could hope to do was to give him time and space as he tried to reinvent the company and guide it toward a healthy future. We faced a classic public relations dilemma. We needed to convince employees, customers, the media, and Wall Street that the company, which was famous for being slow to change, was indeed changing—and fast. At the same time, in order to give the CEO a long enough runway to achieve strategic "lift," we needed to keep a low profile and avoid raising unrealistic short-term expectations. We managed the first task fairly well; unfortunately, it was at the expense of the second. And that was only one of our mistakes.

Why I Wrote This Book

Someone once said that experience comes from what you do; wisdom, from what you do badly. On that basis alone, I can share hard-won lessons in managing public relations for AT&T during one of the most tumultuous periods in its history. Even if I never made the same mistake twice, I still have enough mistakes to fill a book.

Daniel Kahneman, who won the 2002 Nobel Prize in Economics for path-breaking work in decision making, once said, "If I had one wish, it is to see organizations dedicating some effort to study their own decision processes and their own mistakes, and to keep track so as to learn from those mistakes."[8] I've tried hard in these pages to tell an unvarnished story without getting lost in the plumbing of an exceptionally complicated industry and company.

This book is titled *Tough Calls* because none of the choices that AT&T made during this period were obvious, except in hindsight. The same might be said of the calls made by the small army of AT&T watchers who kept track of the company's moves. The period following the passage of the Telecom Act of 1996 was exuberant, chaotic, and, in many ways, ineffable. Looking back, it's amazing how much we all got wrong, whether we were business leaders, professional investors, or the media.

This book focuses on mistakes, but it would be wrong to ignore what AT&T and its critics got right. AT&T's critics were correct in calling for more active board engagement in the company's succession planning. They were also correct in questioning some of the company's acquisitions (though not always for the right reason).

On the other hand, Bob Allen has seldom been credited with one of the most successful corporate acquisitions of the 1990s: AT&T's purchase of McCaw Cellular. Nor does he get much credit for restructuring the company at the precise moment when this would most benefit its equipment manufacturing business, putting that business under an exceptional CEO in the person of Henry Schacht and leaving AT&T with one of the strongest balance sheets in the industry.

Mike Armstrong, for his part, made a string of small acquisitions that expanded AT&T's wireless and data businesses. He built a $4 billion outsourcing business from scratch in less than four years. He cashed out of the wireless business at the precise top of the market. He reversed decades of revenue declines in his first two full years at AT&T, and, in fact, it was in the midst of his third year that MCI

WorldCom apparently resorted to accounting tricks to maintain the illusion of competitiveness. When Armstrong saw the industry turn, he was forthright in correcting his earlier forecast, while his competitors continued to trumpet financial results that they were manufacturing in their accounting departments. With all that, he delivered the earnings he projected in eighteen of the twenty quarters he led the company, even in the midst of an industry meltdown in 2001 and 2002.

Tough Calls

Of course, every CEO makes tough calls. As we shall see, Allen's and Armstrong's were made more difficult because the two men were sometimes caught in a web of outsized expectations, internal political games, and industry fraud. And the fog of war is not limited to the battlefield. Most major business decisions are made in a similar crucible of fast-changing, fragmentary, and conflicting data. Business decision makers are often just as torn between the success of their mission and the welfare of their troops. They suffer the same self-doubt, wishful thinking, and fear of failure. Their lieutenants are sometimes competent, sometimes conniving, and never completely transparent. If lives are seldom at stake in their decisions, the *quality* of lives certainly is, along with the prosperity of countless families and communities.

I've tried to capture how messy this period was for AT&T, lest anyone believe that the choices were obvious. But no one can adequately describe the unrelenting pressure to reverse a decline that had been gathering momentum for more than a decade.

I haven't told *all*, not only for reasons of space, but to honor personal confidences, protect the company's proprietary information, and also because some events, while perhaps titillating, were extraneous to my themes. During these years, I never made a secret of my plans to write about my experiences. All the quotes in this book are based on notes that I took at the time or in later interviews. When I quote people's thoughts, it is because at some point they told me what they were thinking.

This book is neither a pitch for sympathy nor an attempt at expiation. For all my mistakes, I am proud of my tenure at AT&T, and especially of the people with whom I worked. Nor is this an effort to shift blame. I was not a fly on the wall at meetings of AT&T's senior management; I had a seat at the table. I was a full participant in the decisions made between 1997 and 2002. For better or worse, I had my say, and if some of those decisions have proven less than brilliant, I can neither make excuses nor escape my share of blame.

Nor do I blame those who reported our misadventures for causing them, or even for aggravating them. With very few exceptions, the editors and reporters who covered AT&T in this period were honest and fair and gave us every opportunity to tell our story. A friend in the media reminded me that it's just as wrong to stereotype journalists as to stereotype businesspeople. You will find all kinds of reporters in these pages. If I seem to dwell on the few who were duplicitous or careless, it's because I learned more from them—just as I did from my own mistakes. Of course, I also realize that, while many journalists may agree with my observations about their profession, they will fight to the death my right to make them. After a career in public relations, my views will forever be suspect.

Public Relations

While I've tried to reexamine my corporate life with a clear eye and a nose for sour grapes, this is hardly the *Confessions of Saint Augustine*. It is a modest attempt to dispel a popular notion regarding public relations. If economics is the "dismal science," the practice of public relations in the 1990s came to be regarded as a kind of merry art, designed to incite sober people to spasms of irrational exuberance. Spin doctors became the high priests of the practice. Wordsmithing, glad-handing, and mud slinging became their sacraments.

AT&T's recent history demonstrates that public relations is not a tactic best left to specialists. It is a function of general management that a company's most senior leaders must embrace. Public relations, writ large, will be found not in a company's news releases or publicity stunts, but in its day-to-day operations and long-range strategic choices. There will be smaller PR lessons in these pages, if only because tactics can be informative in themselves. But the more significant lessons arose as we attempted to navigate the intersection of corporate and public interests, which is every executive's responsibility.

The business community now labors under a burden that historian

Daniel Boorstin first identified in American politics. Writing about the 1960 presidential elections, Boorstin noted that the communications media had put a higher premium on manufactured events—such as news conferences, photo ops, political debates, and such—than on the substance of public discourse. "Such 'pseudo-events,'" he wrote, "lead to emphasis on pseudo-qualifications."[9] Alas, that describes the focus of the business media in recent years almost perfectly. Meeting quarterly earnings expectations may be the ultimate "pseudo-event" in American business, conceived by sell-side analysts and propagated by media reaching for an easy headline.

And, as Boorstin observed in politics, reality eventually conformed to its manufactured version. The business scandals in the first three years of the millennium began as innocent-enough efforts to "manage earnings" and in some places escalated to wholesale fraud. Even companies that were scrupulous in their accounting practices sometimes mortgaged their future to meet short-term targets. And at least some of the productivity improvements of recent years came at the expense of real reductions in the quality of the extended product, as, for example, anyone who has tried to navigate his way through customer service telephone trees can attest.

Some in the business media have tortured themselves worrying about whether they should have been able to ferret through the phony accounting that was at the root of corporate scandals. (The answer is probably no.) But few have considered the second-order effects of the breathless coverage they gave the so-called New Economy. The Henry Blodgets and Jack Grubmans of the world are media creations on a par with the cast of *Queer Eye for the Straight Guy*.

Corporate Purpose

But a supple distortion behind the headline scandals is even more damaging in its ordinariness. Many business leaders, and their watchdogs, seem to have forgotten why public companies exist. Surely it is to create wealth, but not solely for companies' so-called owners. As business philosopher Charles Handy observed, there's a big difference between providing the financial backing for a company and "owning" it in the original meaning of the word. Further, he says that the idea that a company is a "piece of property" is an equally antiquated "hangover from earlier times." Rather, corporations are "communities, created with common purpose."[10]

That purpose, binds together not only a business's founders but also their successors; their employees, who contribute their energy and intellect; investors, who supply capital; the communities that provide a supportive environment within which the enterprise can prosper; and even their customers, who make purchases trusting that they will receive value in return.

Corporations exist to create wealth for all who provide their resources and bear the risks of their failure. Such wealth comes in the form of dividends, rising stock prices, jobs, careers, healthier communities, and valuable products and services. Sadly, many business leaders have myopically focused on one expression of wealth, an ever-rising stock price, and on a small subsegment whose fortunes rise and fall with the stock tables, professional money managers.

As in AT&T's case, such single-mindedness inevitably leads one to consider the company's shares as just one more form of "currency" to be used in the kind of financial engineering favored by investment bankers and deal lawyers. In time, even a hundred-plus-year-old company can lose sight of the broader publics who have a stake in it—its investors, customers, employees, and the communities in which they live and work. These "publics" are more demanding than ever because they have been ignored for so long, but their voices, if we will listen, are also clearer. We run into trouble when we concentrate on one voice to the exclusion of others or confuse their voices with the general clamor of the marketplace, with the gilding and gelding that passes for honest discourse.

1

Don’t Dance to the Music of Your Own Buzz

Public relations is not about polishing an image or creating buzz; it’s about building a long-term relationship between an institution and its stakeholders. As in any relationship, image and buzz can be powerfully intoxicating pheromones, but they can also make at least one of the parties feel cheap and used the morning after. A company’s clippings and the gyrations of its stock price are poor gauges of the relationship’s strength.

Armstrong Arrives

Mike Armstrong boarded an AT&T corporate jet for the first time on Sunday, October 19, 1997. The crew had been told that they were shuttling an important customer from Los Angeles to a meeting in New Jersey, and they pretended to believe it, even though they all knew that they were carrying AT&T’s new chairman and CEO.

When the plane landed in Morristown, New Jersey, and taxied to the AT&T hangar, the first person up the stairs and through the cabin door was the man widely believed to be Armstrong’s most serious rival for the job: John Zeglis, the company’s former general counsel and now its vice chairman. The two had never met, and Zeglis had volunteered to drive Armstrong in his own car to the Short Hills Hilton, where they would have a private dinner before the AT&T board of directors assembled on a 7:30 P.M. conference call.

Armstrong, who usually drives either a Porsche or a Harley, slid into Zeglis's Buick Roadster for the twenty-minute ride to the hotel.

Walter Elisha, the AT&T board member who had led the search, was already at the hotel, as was the man Armstrong would replace, Bob Allen. The board call had only two agenda items, electing Armstrong chairman and CEO and electing Zeglis president. Both decisions were foregone conclusions. So how the Armstrong-Zeglis dinner would go provided the only real suspense of the evening.

We had arranged for them to eat alone in a private room just down the hall from one of the conference rooms where we had gathered. Dinner was buffet-style, so there wouldn't even be a waiter hovering nearby. Zeglis had prepared by filling a yellow legal pad with lists of issues that Armstrong would have to address, people he would have to meet, and questions he would have to resolve. Zeglis later reported that the conversation flowed so naturally that he never got to his list.

When Allen, Elisha, and Zeglis went into another room for the board conference call that would end Allen's tenure as chairman and begin Armstrong's, I began briefing Armstrong on the announcement plan for the next day. It was scheduled from 7:30 A.M. to 8:00 P.M. in half-hour blocks that included a gathering of the company's senior management team, a conference call with financial analysts, a "town meeting" broadcast to AT&T employees around the world, a news conference, one-on-one media interviews, and live interviews on CNN, CNBC, and Bloomberg television.

It was a pretty standard AT&T PR plan, but as I ran through it, Armstrong looked at me with an intensity I hadn't felt since Sister Catherine of Siena caught me in the girls' coatroom. Armstrong is an imposing figure to begin with. He's six feet tall, and he still has the broad shoulders and barrel chest of the college football player he was more than forty years ago. He has the well-scrubbed, healthy complexion of an outdoorsman. His only concession to advancing years is male pattern baldness encroaching on carefully trimmed white hair. His default expression is a wide grin, and his voice is surprisingly soft, as if to compensate for a gaze that condenses from blue-eyed twinkle to laser intensity when he's really listening.

He was really listening as I ran through the schedule, and I couldn't tell whether he was thinking, "This guy's nuts" or "What the hell did I get myself into?"

My first question must have had him leaning toward the former:

"Before we get into anything else, let me ask you, who's your long-distance company?"

"Well, Hughes splits its traffic between . . ."

"No, no. I mean which company do *you* use . . . at home or when you're traveling. You know, *personally*?"

Now he *knew* I was nuts. He was about to risk his reputation by trying to turn around a $50 billion company that had been given up for dead by most serious investors, and his prospective PR guy was beginning a telemarketing pitch.

John Walter

What Armstrong didn't know—and what I could never forget—was that the last guy named AT&T's president and anointed as Allen's successor, R. R. Donnelly's John Walter, had been blindsided by a reporter who wanted to know who his long-distance company was. Flustered, Walter first tried to dodge the question. Pressed by reporters, who were already skeptical that a printing company executive could run—much less *save*—AT&T, he said that his wife made all those decisions and he had no idea. As reporters will, many of them used that bit of noninformation to demonstrate how little preparation he had for the job—why, he didn't even know the name of his own long-distance company. Run AT&T? He apparently couldn't even *spell* it. And so forth.

Armstrong, on the other hand, reached into the pocket of his sports coat, pulled out his wallet, and produced an AT&T calling card. "This is who I use," he said. "Is that the answer you were looking for?"

It was. And he answered the question exactly the same way the next day.

Armstrong would face more substantial questions, such as who had had the idea to make Zeglis president (he had), why he had taken the job (for the challenge), and what was he going to do first (listen). But most of the questions were predictable and, for perhaps the first and last time in his life at AT&T, whatever Armstrong said was taken at face value. He was not the "heir *un*apparent." He was, in fact, so anticipated that the latest issue of *Newsweek*, which came out before the announcement was made, had declared, "No one was confirming the reports. But by the time you read this, C. Michael Armstrong of