AT&T: CEO Succession

by Ghen Marchese

At AT&T Corp., the Board appointed a new CEO and then “fiddled in comfortable obscurity while a once great company lost its way.” The handling of the succession of AT&T’s former CEO and Chairman Allen was dubbed “a monumental miscue and humiliating public lesson in what not to do if you are a director on a board... How could AT&T’s directors fail to act more decisively and quickly?”

Appointing the new chief executive is only the first step of the CEO succession process. Often considered a Board’s single most important responsibility, this process should unfold over time as a Board monitors the new CEO’s performance, eventually decides it is time to replace that CEO, and proactively leads the search for a new CEO. The AT&T Board simply stood by – year after year, failure after failure, and immense costs for the company and its shareholders – before belatedly stepping in.

CEO Allen’s Fears

The AT&T Board appointed Robert E. Allen as the new Chairman and CEO in April 1988. He was to succeed James Olson, who had suddenly succumbed to cancer. Mr. Allen had joined AT&T in 1957, just out of college, as a rank-and-file employee. He rose to Chief Financial Officer in 1983, Chief Executive of AT&T’s computer unit in 1985, and became AT&T President and Chief Operating Officer in 1986.

In one of his first public statements as AT&T CEO, Allen announced that earnings for 1988 would rise at the same 15% rate posted for the first quarter. “Lackluster,” however, was how analysts saw the company’s earnings: revenue had grown only a paltry 2.8%, and AT&T would have had a virtually flat 1988 first quarter if it had not benefited from lower tax rate and interest charges, and if the 1987 first quarter had not understated earnings and revenues from its long-distance business because of overpayment of connection charges to local phone companies. “It will be real hard,” an analyst added, “to show anything even close” to a 15% growth in earnings for 1988.

At $26.88, AT&T stock was down 28% from a year earlier. For the first four months of 1988, AT&T stock had continued to show a downward trend, while the Dow Jones had gained more than 100 points. And shareholders were agitating for an increase in the quarterly dividend, stuck at $1.20 per share since 1984.

When the Board announced Mr. Allen’s appointment, the Dean of Fordham University’s Business School commented: “As a shareholder, I hope Bob Allen will be known for improving the profitability of the company and starting it on the road to being the great company I think it can be.” Allen was indeed facing several major challenges.

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1 Assistant Professor Marchese prepared this case as the basis for class discussion rather than illustrate either effective or ineffective handling of an administrative situation. The events presented are based on publicly available information reported in the company’s SEC filings and Wall Street Journal articles.


**Competition.** Long-distance service, AT&T's core business and cash cow, accounted for 43% of its revenue and 90% of its profit. While AT&T dominated the residential long-distance market, it had begun to hurt in the much more lucrative corporate accounts: market share, due to strong competition based on service and price, was down to 60% from 77% in 1986, and kept sliding. In rapid succession, the company had lost to MCI Communications and Sprint, its main competitors, major clients whose contracts with AT&T had ranged from tens to hundreds of millions of dollars. "If the slide in long distance isn't turned around," an AT&T executive warned, "basic financials are at stake."6

Allen took several major steps to fight off the competition. AT&T, a company that used to take pride in selling gold-plated service at higher prices, was now running promotional discounts that made some services less expensive than competitors'. Thousands of sit-around staffers were sent out to the field to sell, and the company started to roll out new services tailored to customer demands.

Allen also announced a plan to catch up with the competition on the equipment front. MCI, the No. 2 long-distance company, had been all-digital for years. Sprint, the No. 3 company, was not just all-digital but all-fiber. AT&T was still all-analog. Allen's plan involved writing down $6.7 billion worth of equipment and spending $6 billion to make its network all-digital, which meant that 1988 would show the first ever loss for AT&T. "I'm not pleased to report the first loss in our history," said Allen, "but it's the right thing to do. It demonstrates to investors, the marketplace and our customers that we're willing to take major steps to stay on the forefront."7

In 1992, four years into Allen's CEO tenure, analysts continued to see red flags in AT&T's long-distance market. Its 6% annualized growth in long-distance traffic volume for 1992 was less than half that of MCI. Revenue had continued its downward trend, slipping about 1% in the fourth quarter. And the company's residential business was losing ground fast, as successful programs by MCI and other competitors were taking customers and traffic away from AT&T. Allen called the 1993 first quarter, which showed a 1% decline in long-distance traffic volume and a paltry 5% growth on a year-to-year basis, "a relatively good quarter," and maintained that "AT&T was beating back the competition."8 The competition, however, was continuing to fare much better than AT&T. MCI, for instance, showed a 13% volume growth and a 12% revenue increase.

In 1996, eight years into Allen's tenure as CEO, AT&T's long-distance business didn't look much better. Its growth rate was a third of that of MCI and Sprint, and smaller players were starting to eat AT&T's lunch.9 Analysts cut their ratings on AT&T stock, and predicted for AT&T a year of low, single-digit revenue growth and modest earnings. When AT&T indicated that its 1996 third quarter earnings would drop 10-14% from year-earlier levels, the stock plummeted almost 10%.

"AT&T is in a jam," analysts emphasized. "We used to hear about lower earnings because of AT&T restructurings and charges, but now AT&T is saying the core business is weak, and that's alarming ... it's yet another indication that AT&T is not getting its act together competitively."10

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Allen acknowledged that the loss of customers from AT&T’s long-distance service was “disturbing,” but he insisted that he had “never seen a time of greater opportunity” for the company. AT&T, he added, was on the right track to attack such new markets as the Internet. Sprint and MCI, however, had already strong Internet services while AT&T was still missing its Internet voice. With 80 million consumers linked to its globe-girding network, AT&T could have been a leader in Internet services, but it hadn’t articulated any Internet-specific strategy. “With the Internet growing like kudzu,” analysts observed, “AT&T’s inertia couldn’t be timed worse.”

AT&T was still “way behind the competition on all fronts,” analysts emphasized, and missing opportunities every day more. Allen admitted to having made some “strategic blunders.” AT&T stock was trading at $37 shortly before Allen took over and, more than eight years into his CEO tenure, it was trading at about $35.

**International Expansion.** When Allen became CEO, AT&T was still having a hard time establishing a significant presence in foreign markets, a company’s goal since the early 1980s, and still received 91% of its revenue from domestic markets. To establish a strong international presence, Allen announced, was “one essential pillar” of his plan for the company’s growth strategy. Growth rates in the U.S., Allen explained, weren’t enough to sustain the business for an extended period of time. “It’s a healthy business, now. But to keep it that way, you need to experience growth elsewhere.”

AT&T had been attempting to establish itself overseas through international partnerships. But that strategy, Allen observed, though a good way to hit the ground running, didn’t allow AT&T to strengthen its international presence at a fast enough rate. He thus decided to change AT&T’s international strategy from forming business partnerships to building its own operations. “Customers are after our name and technology,” he explained. AT&T started to set up its own commercial offices all over Europe, scout acquisitions, and push for dramatic shifts in its international alliances. AT&T didn’t plan to drop the existing alliances but wanted to play a more powerful role.

By 1996, AT&T’s international presence was still far from significant. The company was in a remarkable retreat in Europe, where the 27,000 employees it had there at one point during Allen tenure had dwindled to less than 1,000. On October 16, 1996, AT&T announced to be well on its way to merging with a European partner, Unisource NC, creating a new pan-European company with over $1 billion in sales. Only that AT&T and Unisource had promised the same thing back in 1994, and that effort had been undermined by a string of defections by clients and high-level executives. One large business partner, France’s Cie. Generale des Eaux, had broken an agreement with AT&T and formed a venture with British Telecom. Apparently, AT&T was unwilling to invest enough cash to make a serious entry into the French market. The CEO of Generale disclosed that executive turmoil at AT&T-Unisource had played a major role in his decision to break off that deal: “we know who we are dealing with at BT.”

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11 See supra, at 10.
13 See supra, at 7.
Back in the early 1990s, Allen had repeatedly predicted that half of AT&T's revenues would come from outside the U.S. by the end of the decade. Evidently, analysts commented, "Allen has turned out a complete failure on that count." 

**Computer Business.** By January 1989, AT&T was still "a communications elephant learning to dance in computing." In personal computers, AT&T had stopped making its own machines; its line of minicomputers failed to make inroads, capturing only a tiny 2% of the market. "We've had execution problems," commented the head of the computer unit. In April 1989, Allen announced that he fully expected the computer business to be profitable in 1990. But by the end of 1990, it was still losing more than $120 million annually.

The fix for the computer business, Allen decided, was to be sought externally. AT&T launched a hostile bid for NCR Corp., which had $6 billion in revenue and solid profits. It was meant to give AT&T instant credibility and the opportunity to cut its losses by transferring most of its operational needs to the profitable NCR. It was also meant to provide a major foothold in the international market, as NCR was one of the longest-established U.S. companies in Europe and one of its top computer vendors. The bid marked "AT&T's confession of failure in its own computer business," which was to be handed over to NCR to "keep or scrap as NCR executives see fit."

Allen disregarded the written warning of NCR's Chairman Charles Exley: "As I explained in detail to your Board of Directors, the history of mergers in the computer industry is one of disasters. The acquisition of NCR by AT&T would only add to a list of failures ... [yet] I'd be asking us to bail out AT&T's failed strategy," and that would "seriously hammer NCR's strategy." The market's verdict was also negative: AT&T stock fell almost 10% to $30.125. The bid ended the two-year long company-wide debate on whether to quit AT&T's loss-ridden computer business. "Strategically," Allen explained, "it was necessary for AT&T to be a communication company with computing skills."

AT&T engaged in an effort to remove the NCR Board, and its proxy campaign succeeded in ousting four directors. On May 7, 1991, NCR agreed to be acquired by AT&T for $7.4 billion, creating a computer company with "enormous resources - and uncertain prospects." By 1992, NCR, now part of AT&T, started to show disappointing results: a 16% decline in revenue for the first quarter of 1992, and for the 1993 second quarter showed a 75% drop in operating profit, with revenue up a measly 2%.

If not for NCR's results, AT&T's net for 1995 first quarter would have been 7% higher. For the second quarter, the loss at NCR, wider than analysts expected, expanded to $89 million, its largest ever, from a $14 million loss a year earlier, and from $143 million red ink in the year's first quarter. AT&T announced that it expected NCR to end 1995 with more than $600 million in the red. The computer unit had become a drag on earnings, halving AT&T's overall profit growth. "NCR is a Dog with a capital D, and instead of adding value, it subtracts value from AT&T."

With these results, AT&T couldn't convince the market that its stock should have traded much higher than $50: it closed 1994 at $50.25, and 1993 and 1992 at.

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18 See supra, at 17.
19 See supra, at 7.
20 See supra, at 7.
respectively, $32.50 and $50.25. "We have felt that the stock, which had done nothing for a long time was worth $80 or 90," an investment manager said. 25 It was being held down by worries about AT&T's not well focused businesses and weak computer arm, which drained cash from core operations and delayed spending on other programs.

In July 1995, Allen announced a plan that would slash NCR's expenses and lay off 20% to 44% of NCR's 4,500 employees. 26 Such radical actions were "long overdue," analysts commented. 27 In September, Allen said AT&T was getting rid of the ailing computer unit - which had received $4.92 billion in cash transfers from parent AT&T and accumulated over $3 billion in losses - as a part of a plan of breaking AT&T into three publicly traded pure plays. This plan involved also jettisoning its potent equipment business to focus tightly on its communications mainstay. "The complexity of trying to manage these different businesses," Allen explained, had begun to "overwhelm the advantages of our integration ... the market value of AT&T was being buried." 28

NCR had turned "from a wart to a cancer." 29 Wall Street greeted the breakup with an ovation, pushing the stock up 11%. Investors viewed the new broken-up AT&T as "AT&T unchair ed." 30 The voluntary break-up plan, analysts commented, was "a tacit admission that Mr. Allen's original vision - a vertically integrated empire of computers and communications - was a costly failure." 31

Employee Morale. Upon becoming CEO, Allen announced a company-wide hiring freeze, the closing of some factories, and 6,000 job cuts by 1990. "We have to stay agile," Allen explained, "to go after earnings growth with a sense of urgency." 32 But AT&T had done its math none too well. Only about a month later, in October 1988, Allen announced that the layoffs would increase to 9,000; in December 1988, the number had escalated to an additional 16,000. Calculations of the ripple effects of the installation of the all-digital network were said to be the source of these revisions. Analysts pointed out that Allen was seeing a fallout from "not thinking things through." These announcements, taking place in the already fragile balance of massive yearly layoffs that had become the norm at AT&T since 1984, were flying in the face of Allen's self-defined biggest task: "getting 300,000 people focused on customers and winning in the marketplace," and did much to hurt employee morale even further.

"Every job at AT&T is at risk, every day," said a company spokesman. A technician said he wore a button with Allen's picture crossed by a red line. "We all do," she said. "He's the one we hate the most." Some of Allen's own managers said his dispassionate style hurt morale, and added that "a lot of us are saying: 'The hell with the company.'" Having angry employees, who felt stabbed in the back, analysts pointed out, was hurting quality. Big clients griped that massive layoffs were hurting service, and AT&T was "jeopardizing its reputation for reliability." 33 Allen himself admitted to making some "wrong moves" in his approach to job cuts.

28 See supra, at 25.
30 See supra, at 25.
34 See supra, at 7.
In January 1996, AT&T announced the largest single workforce cutback in U.S. corporate history: 40,000 jobs over three years, bringing the total cuts to more than $125,000 over a decade. "This is a big number — a very, very big number," an analyst commented, "a lot bigger than Wall Street had been anticipating. Cutbacks like this throw the organization into chaos." Many workers, a manager commented, are so preoccupied with the latest cutbacks they can't focus on their work.

Mr. Allen had put 125,000 workers out of a job and AT&T had underperformed both its peers and the S&P 500 for three years in a row, yet he had never taken a pay cut. Instead, following the news of 40,000 layoffs, and in a year when AT&T barely broke even, the Board rewarded Allen not only with continued employment but also with the biggest compensation package of his career — it included a hefty bonus, a tenfold increase in options, and made him "the very symbol of executive compensation excess." Activist institutional investors, as a gesture of dissatisfaction with the Board, planned to withheld votes for re-election of certain AT&T directors.

An employee complained: "He still keeps his job and gets a bonus. If I had that kind of performance review, I wouldn't even have a job any more." A Salomon analyst wondered: "What has he built ... since he became chairman eight years ago?" An AT&T manager echoed: "What have we done right over the last several years? Name one thing." Ask the Board for some answers.

Succession Planning at AT&T

The decision to appoint Mr. Allen as CEO, outside director Warner told reporters, was not the result of a succession planning process overseen by the Board but of a conference call with Mr. Allen's dying predecessor, Mr. Olson — who told directors that Allen was "his natural successor, should anything happened" to him. Other than that call, two weeks before Olson's death to cancer, Mr. Warner said, the Board had made "no contingency plans." This Board's passive stance with respect to CEO succession planning continued through most of Allen's tenure as CEO.

Allen's Insider: Allen was AT&T President when he was appointed CEO in 1988. He told the Board that the President post he had just vacated didn't need to be filled. The Board obliged. Only in 1995 was a President finally named. Allen recommended to the Board Alex Mandl, chief of AT&T Communication Services business, for the President post. The Board ratified the choice. Mr. Mandl's promotion made him the No. 2 executive and "the top candidate" to succeed Allen. He was scheduled to officially become president of the new broken-up AT&T on January 1, 1997. Though their apparent, Mr. Mandl was never heir in fact.

Allen refused to designate him as his chosen successor. The 61-year old CEO continued to declare that he had no intention of retiring until he reached age 65, and increasingly often made it clear that Mr. Mandl was not a shoo-in. He even muddied the issue more by creating a new Chairman's Office that elevated the status of CFO Miller and General Counsel Zeglis. Allen, with Miller and Zeglis, charted the three-way
The breakup of AT&T without including Mr. Mandl in the planning; and Mr. Allen began focusing harder on the core long-distance business that would maintain the AT&T name. Mr. Mandl, who had overseen the core business, unhappily told associates: “I’m not even the chief executive of my own business – Bob Allen is.”

Mr. Mandl, eager to succeed Allen, was growing increasingly impatient in such a situation, especially because he was receiving no assurances from the Board. Only ten months after his appointment as President, AT&T was again without a No. 2: Mr. Mandl resigned to accept a CEO post at another company, thus leaving AT&T with no one in sight to succeed Allen. Mandl had proven himself an excellent, and surely difficult-to-replace, top executive. The news of his departure caused an almost $2 drop in AT&T stock, reflecting the uncertainty about AT&T’s future leadership. Hardly could have Mr. Mandl’s departure been timed worse, as the following month AT&T was set to start the three-way breakup.

**Allen’s Outsider.** AT&T announced its intentions to turn outward for a new President, and hired the search firms Spencer Stuart and Korn/Ferry. Allen’s age, 61, and the fact that the most desirable candidates were already running their companies or were strong No.2s in line for the top job, clearly indicated that AT&T was seeking Mr. Allen’s successor as CEO – which meant that the Board should have been in charge of the search. According to the headhunters, however, Mr. Allen had taken charge of the search, explaining that to recruit a President and a COO was a matter for the Board and Bob Allen, and “probably Bob Allen even more so. But to recruit a successor as CEO as a successor is clearly a board matter. The board isn’t yet involved in this search.”

Having narrowed the search to about a half dozen prospects, headhunters said that several CEOs on the short list would not consider the position unless they were publicly designated as Mr. Allen’s successor. Asked whether he would be willing to designate a new hire as the next AT&T chief, Mr. Allen was circumspect. “We’ll cross that bridge when we see it, and if it’s the right person, then that’s not a scenario we’d rule out. But that depends,” adding that such matters were up to the Board. “If God came along and wanted to be CEO,” he said, “I think I’d be flexible.”

Expectations of an earlier end to Allen CEO tenure were mounting due to results that continued to disappoint. In September 1996, AT&T had issued a profit warning: earnings per share for the third quarter of 1996 would fall 10% below expectations. The warning crowned a bad year for AT&T: the stock was once again stuck in the mid-$30s, and investors, increasingly impatient with Allen’s leadership, were “fleeing AT&T’s stock.”

A senior VP of Liberty Investment, which had just sold the last of its 700,000 AT&T shares, exploded: “They have been sailing around rudderless. Bob Allen needs to get the hell out.” The opinion was widely shared that Allen’s decade of multi-billion dollar restructurings and massive downsizings had been “a failure.” especially when measured against the revenue, profit, and global expansion of AT&T primary rivals. The Board, however, continued to support Allen and his choices.

On October 24, 1996, AT&T announced that John Walter, CEO of printing company R.R. Donnelley & Sons, would become AT&T new President and COO. Directors were first told by Allen the identity of the leading candidate in mid-September.

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44 The Wall Street Journal, “AT&T’s Search for President Appears to Have Narrowed to Three Prospect,” October 11, 1996.
and the hunt ended on October 15, when directors interviewed Mr. Walter during a Board dinner in New York. Mr. Walter would be serving in the No. 2 slot until Mr. Allen retired in January 1998, two years earlier than he had planned. Allen, long reluctant to step down early, said he had agreed only as the price of attracting a talented successor.

Analysts complained that, at a time of big turmoil in the telecommunication industry, choosing as Allen's successor an industry outsider whose background was limited to printing Yellow Pages, seemed like "an insulated, boardroom decision done without any sensitivity to the changes in the telecom industry. On a scale of one to 10, this is a one." On the news, AT&T stock fell almost $2. They were asking "Why did AT&T choose John Walter?" "John Who?" Again, ask the Board.

By nominating an outsider, the Board passed over—and alienated—some of AT&T's most senior executives. Joseph Nacchio, chief of AT&T's $26 billion a year consumer business, who expected to be considered for the job and had been "openly resentful" about the Board's choice, resigned in December 1996. "Losing Mr. Nacchio," analysts commented, was "very significant, when you consider that he is the most capable executive AT&T has, and he ran two of its biggest businesses." It remained unclear why Allen picked the inexperienced Walter over the telecom star Nacchio, and why the Board went along with it. In one more indication that AT&T was having "a hard time holding on to its senior team," AT&T CFO Richard Miller, one of the several senior executives also bypassed, announced that he would leave by the end of March.

In his few months at AT&T, Mr. Walter "blew into AT&T like a cool autumn wind," bringing his own style, much more open and communicative with managers and employees at all levels than Allen had ever been. "Senior managers were loving the guy," commented an analyst. "I'd never seen AT&T's group act so coherently and from the same song sheet as they were this year." Mr. Walter had already been acting as AT&T's de facto CEO. "I didn't come here to be No. 2," he said.

As Mr. Walter grew in the company and he continued to obtain increasingly favorable press coverage, Mr. Allen, whose reputation had been damaged by years of bad investments and competitive misfires, was growing resentful and mistrustful. Insiders said Allen had AT&T phone records checked, looking for any calls that Mr. Mandl may have made on the sly to reporters. Allen was presenting increasingly critical reviews of Mr. Walter's performance to the Board during private sessions with the outside directors. He would accuse Mr. Walter of missteps ranging from not backing the chairman's strategies to talking to reporters. The Board listened.

In July 1997, Allen's hand-picked successor John Walter abruptly resigned after the Board said it wouldn't name him CEO as planned by January 1, 1998. This decision, which capped the "unusually public drama played out in the executive suites of AT&T," stunned analysts, as the the Board had hired Walter only nine months earlier after a high-profile search. The Board also took the extraordinary step of airing its low opinion of Walter in a conference call with reporters: Mr. Elisha declared that Mr. Walter lacked "the intellectual leadership" to run AT&T. The Washington Post noted: "The board felt that Walter wasn't bright enough to be chairman. Which makes you wonder how bright the 30-board was in October when it hired him after an extensive search."
That Witter was dumped, insiders said, was just one more sign of "a problem that has plagued AT&T chairman during his nine-year reign," that is, "Mr. Allen's inability to get along with his No.2."51 That was also why for eighth years he had refused to name a President. A senior executive added that Allen "very reluctantly" agreed to accelerate his own retirement by two years, but "when the day for that happened got closer he didn't want to give up the reins," and all of this "with his Board's full compliance."

Walter lifted the job much richer, as he received $33 million for his 9 months of service at AT&T. The costs to the company and its shareholders, however, were far more substantial than this already substantial pay expense. Walter's exit left AT&T "adrift" at a time when it could "least afford to be distracted:" under intense attack in virtually all of its markets, and its international strategy in disarray. Director Elisha, while acknowledging that Allen had become a "lighting rode of blame" for AT&T's malaises, defended him as "doing a terrific job under very trying circumstances."52

The Board Wakes Up. The Board had given Allen free rein in the search for Walter, and agreed to a gradual transfer of power; it also didn't interfere when he thwarted Walter's efforts to assert himself. Criticized as one of the most passive boards, the Board had supported Allen for years as he eliminated more than 100,000 jobs, incurred billions of dollars in losses in a disastrous misadventure in computers, and ultimately split AT&T in three, stripping it of deep management talent and some of its greatest assets, including its equipment arm Lucent. It forgave "myriad excuses," but "lost patience at the end, prodded by some newer members less loyal to Allen and one final humiliation: Allen's engineering the ouster of his own chosen successor."53

Named for two years in a row one of the ten "worst Boards of Corporate America" by Business Week's annual corporate governance scorecards, the Board had now to launch "yet another search" for Allen's successor - only that it now vowed to have taken command of the search. AT&T had to lose two President-CEO successors in a year, and incur enormous costs, before the Board would take on its key responsibility.

Allen is Lame Duck: The Board Takes Over CEO Succession

At AT&T 1997 annual weekend gathering for the Board and senior management, at the Greenbrier resort in West Virginia, Allen lost the faith of Mr. Elisha, his biggest supporter on the Board, who had steadfastly defended his tenure as recently as two months earlier. After a brief strategy review session, outside directors asked Allen to leave the room so they could discuss CEO succession plans. Allen had not expected to be cut out of the deliberations. He stormed out of the room, commandeered one of the AT&T vans waiting to take directors back to their private jets, and went straight to Greenbrier Valley Airport. He boarded the AT&T jet, leaving the other executives to find their way home.

After Allen left the Board meeting, directors started reflecting on Allen's nine-year tenure and built a case against him rather quickly. The meeting soon "took on the pall of a funeral",54 as directors started to go around the room asking for one another's views. The newest directors - George Fisher, CEO of Eastman Kodak; Kenneth Derr, CEO of

51 See supra, at 49.
53 See supra, at 52.
Chevron; and Ralph Larsen, CEO of Johnson & Johnson—said Mr. Allen had to go and relinquish his board seat to make way for a new leader. With the Walter incident, Allen had written "the last chapter of his tenure" and earned "lame-duck status."  

The Board took full command of the search and put Mr. Allen "out of the process entirely." It dropped Mr. Allen from the search committee, and planned to keep from him many details of the search. A committee of outside directors—Messrs Elisha, Derr, Mchenry, Larsen, and Wyman—was created to conduct the new CEO search. The Board also decided that the next candidate would become CEO immediately, and announced that AT&T would look for its next CEO both inside and outside the company.

Insider Revisited. Years of turmoil and brain drain in the executive ranks had left a senior bench practically bare, with John Zeglis, the company's vice-chairman and general counsel, as "the last man standing." Zeglis was increasingly gathering support from the company's directors and senior executives. However, he was likely to be a "highly controversial" choice. Over the nine years of Allen's tumultuous stewardship of AT&T, Zeglis had been his closest confidant, the guy whose advice Allen always sought who always had Allen's ear. He was thus "the ultimate insider," and would be very likely to be identified with the company's problems. Also, while many executives inside and outside the company praised his intelligence and internal political and strategic skills, he had never run a company before.

To his credit, Zeglis had begun running AT&T operations worldwide after Walter's exit, and by all accounts was doing a good job. He further helped himself at a gathering of the board and senior executives, when he presented a series of new strategic initiatives, including a bold plan to franchise the AT&T name to other carriers, a merger with another major telecommunication player, and a global Internet play with Microsoft or another major partner. AT&T stock rose $2 as share after his franchising strategy drew headlines, but the Board, though positively impressed by the plan, reserved judgment on whether to approve it for the same reason that many big decisions were "on ice at AT&T these days: the Board hadn't yet decided on the new CEO.

Outsider Revisited. The Board narrowed the search to Mr. Zeglis and a handful of outside CEOs, the latter from a short list that the two headhunters hired by AT&T had used for the process that had led to the appointment of Mr. Walter. Back then, Allen had personally led the search, interviewing candidates and selecting just one, Walter, to present to the Board. Some directors were reportedly miffed that "Mr. Allen didn't bother to recommend any of the other candidates. The new search committee, which didn't include Allen, asked the headhunters to find out whether the top prospects on that list were still available. Michael Armstrong, CEO of Hughes Electronics, and Richard Brown, a former Bell executive and CEO of Cable and Wireless, were the top two prospects available.

By September 1997, Mr. Brown had taken himself out of the running by signing a new employment contract with Cable & Wireless for another three years. Mr. Armstrong, the highly regarded chief of satellite giant Hughes Electronics, a unit of General Motors, emerged as the front-runner among the outside CEO candidates.

Mr. Armstrong had been down this path before, in the summer of 1996, when Mr. Allen had interviewed him for the AT&T President post. The personal chemistry

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between the two was less than good, and it became worse when Armstrong said that he wouldn’t take the job unless Allen agreed to step down as CEO a few months after his arrival — an exchange that Allen never passed on to the Board. Back then, Armstrong was more available. He had now been busy restructuring Hughes, including spinning off its multi-billion dollar defense business, and he was scheduled to begin a roadshow in November to pitch the newly restructured Hughes to institutional investors. These circumstances would make it difficult for Armstrong to just up and leave. Thus, some AT&T directors discussed a “particularly startling” scenario to land Armstrong: make a multi-billion dollar bid for Hughes. This plan, supported by AT&T’s director Wyman, also a director of Gilat and its Hughes unit, would have the added benefit of giving AT&T advanced technology and a thriving satellite-TV business.

Thus, it’s time around, the price of luring Mr. Armstrong was likely to be extraordinarily high, not only in the form of the Hughes acquisition, but also on the compensation front. Mr. Armstrong had now a lucrative multi-year contract with his current employer, and AT&T board would have to make him whole for that foregone income. “It’s much more complicated this time,” Mr. Armstrong commented.

By October 1997, as the hunt for a new CEO was dragging into its third month, AT&T seemed paralyzed. Directors, according to one person close to the search, were afraid to approve any new strategy for AT&T, whether it be a merger or a new marketing alliance, because they didn’t know yet who would be the new CEO, and especially if they ended up choosing an outsider, “they didn’t want to stick the new guy with a plan he didn’t devise.” This situation left the company unable to wage any counterstroke just when there was turmoil in the telecommunication industry. AT&T’s No. 1 share of the long-distance market, which had already been slipping for a decade, was increasingly threatened by the Baby Bells’ expected entry into the business. Worldcom’s $30 billion bid to acquire MCI, AT&T’s biggest rival, put pressure on AT&T to reignite merger talks with SBC. But again, any major decision was on ice because the board was reluctant to dictate any major new course before deciding who would be in charge of pursuing it. If the frenzy of dealmaking continued, analysts noted, whoever arrived in as AT&T’s CEO could end up missing the opportunity to buy assets to fight a raft of much fortified rivals. AT&T risked being left behind, passé next to the alliances that were being formed.

The Board’s Choice. The Board scheduled to meet in New York on October 15, with the goal of making a final decision on who would succeed Allen at the helm of the company. The search had split AT&T’s Board into two factions, one that favored giving Zeglis the top job, and the other that favored bringing in an outsider like Armstrong.

The Board faced an especially difficult choice.58 If they picked Mr. Inside, the untested Vice Chairman Zeglis, they risked inciting the wrath of some big shareholders who saw the bogy lawyer as a mere extension of AT&T’s embattled chairman Allen. But if they went outside and tapped a superstar, they could lose Zeglis, who had let it be known that he might walk if he were passed over for the top job, and possibly a cadre of senior executives who supported him. Losing Zeglis would be especially damaging to AT&T: he had become its chief strategist, and he was also the most able and experienced legal expert at a time when AT&T’s key operational concerns had been regulation and now telecoms laws might impede the company’s ability to boost earnings and expand beyond its long-distance franchise.

Director's were eager to find a way to keep Zeglis while overcoming the issue of his relatively limited experience. One option that emerged during the meeting was to make him President and COO, with the promise to rise to the top job within two years. To implement this course of action, the Board was considering a Solomonic solution: to bring in Armstrong, 59, as Chairman and CEO immediately, and convince Mr. Zeglis, 50, to stay as COO apparent. This solution, however, didn't seem to have many chances of sitting well with Armstrong, as he would be unlikely to accept the job for only two years. On his part, Zeglis showed reluctance to have to prove himself before winning assurance to become CEO – as the Board had already reneged on such a promise in the very recent Walter incident. Allen was also opposed to bringing in Armstrong and keeping Zeglis as No.2: Allen had rejected Armstrong for the job before and, insiders reported, didn't want to be overruled by his board; also, handing the company to his long-time faithful lieutenant would be a more dignified and legacy-like exit for him.

Another alternative, strongly advocated by Allen, and one that would be the easier path on many counts, was for the Board to recruit an elder statesman to act as a caretaker while Mr. Zeglis served an apprenticeship in the No. 2 role. A former AT&T director, Henry Schacht, and a current AT&T director, Wyman, were among the candidates willing to act as a transitional non-executive chairman to chaperon Zeglis. In talks with directors, Mr. Zeglis had seemed to be more amenable toward paying second fiddle for a while to an elder statesman, while he would find much more objectionable to do so with Armstrong or any other outside senior executive.

The Board, reminded almost daily by the press that its decisions, or lack thereof, had generated an unnecessary and indeed very costly CEO succession crisis, was "under enormous pressure to make this a slam-dunk CEO appointment." Each of the successor alternatives that emerged during that Board meeting— to pick Mr. Inside, or Mr. Outside or any such combination as Mr. Inside-Mr. Outside or Mr. Inside-Elder Statesman— had considerable advantages and disadvantages. The outside directors sat to evaluate the potential costs and benefits, both short- and long-term, of each of those alternatives. In the meantime, insiders remarked, AT&T remained "like an unguided missile, with no one to direct where to strike. Or when." The Board was well too aware that not one more day could go by without a new CEO.

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99 See supra, at 55.
60 See supra, at 55.


<table>
<thead>
<tr>
<th>Director</th>
<th>Committee Service</th>
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<tr>
<td>Robert E. Allen</td>
<td>Executive Committee, Chairman</td>
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<tr>
<td><em>Director since 1984, age 61</em></td>
<td>Proxy Committee, Chairman</td>
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<tr>
<td>Chairman and Chief Executive Officer of AT&amp;T (1988- ). Chairman and Chief Executive Officer of A &amp; T since 1988. Trustee of Mayo Foundation; Bristol-Meyers Squibb Co.; Chrysler Corporation; and PepsiCo, Inc.</td>
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<td>Kenneth T. Derr</td>
<td>Audit Committee, Member</td>
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<tr>
<td><em>Director since 1995, age 60</em></td>
<td>Compensation and Employee Benefits Committee, Member</td>
</tr>
<tr>
<td>Chairman and Chief Executive Officer of Chevron Corporation since 1989, Director of Chevron Corporation, Cilicorp, and Potlatch Corporation.</td>
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<td>M. Kathryn Eickhoff</td>
<td>Audit Committee, Member</td>
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<tr>
<td><em>Director since 1987, age 57</em></td>
<td>Finance Committee, Member</td>
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<tr>
<td>Walter Y. Elsha</td>
<td>Directors and Public Policy Committee, Chairman</td>
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<tr>
<td><em>Director since 1987, age 64</em></td>
<td>Finance Committee, Member</td>
</tr>
<tr>
<td>Chairman since 1983 and Chief Executive Officer since 1981 of Springs Industries, Inc. (textile manufacturing). Director of Springs Industries, Inc. and Cummins Engine Company, Inc.</td>
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<td>George M. C. Fisher</td>
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<td>New Director, age 56</td>
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<tr>
<td>Ralph S. Larsen</td>
<td>Audit Committee, Member</td>
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<tr>
<td><em>Director since 1995, age 58</em></td>
<td>Finance Committee, Member</td>
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<tr>
<td>Chairman and Chief Executive Officer of Johnson &amp; Johnson since 1989. Director of Johnson &amp; Johnson; New York Stock Exchange, Inc.; and Xerox Corporation.</td>
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<tr>
<td>Donald F. McHenry</td>
<td>Audit Committee, Member</td>
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<tr>
<td><em>Director since 1986, age 60</em></td>
<td>Compensation and Employee Benefits Committee, Member</td>
</tr>
<tr>
<td>President of IRC Group (international relations consultants) since 1981: University Research Professor of Diplomacy and International Relations, Georgetown University, since 1981. Director of Bank of Boston Corp. and its subsidiary, Fiancile Beecham Corp.; and Smith Paper Co.</td>
<td>Directors and Public Policy Committee, Member</td>
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1 Source: AT&T Corp. Definitive Proxy Statement, filed in February 1997.
# Exhibit 1 – cont’d
## AT&T Board of Directors

<table>
<thead>
<tr>
<th>Name</th>
<th>Position Details</th>
<th>Committee Assignments</th>
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<tbody>
<tr>
<td>Michael L.overn</td>
<td>Director since 1984; age 65; President Emeritus and Chancellor Kent Professor of Law at Columbia University; President (1980-1993), President of Shubert Foundation, Director of Seaca Co., and Warner-Lambert Company.</td>
<td>Audit Committee, Chairman, Member; Finance Committee, Member; Proxy Committee, Member</td>
</tr>
<tr>
<td>John R. Walter</td>
<td>Director since Nov. 1, 1996; age 49; President and Chief Operating Officer of AT&amp;T since November 1996; Chairman and Chief Executive Officer of R.R. Donnelley &amp; Sons Company (1989-October 1996); Member International Advisory Council, Singapore Economic Development Board; Director of Abbott Laboratories; Dayton Hudson Corporation; Deere &amp; Company.</td>
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<tr>
<td>Thomas H. Wyman</td>
<td>Director since 1981; age 67; Senior Advisor, SBC; Chairman of S.G. Warburg &amp; Co. Inc. (1992-1996), and Vice Chairman of S.G. Warburg Group plc (1993-1995) (investment banking); Chairman and Chief Executive Officer of CBS Inc. (1983-1988), William H. Donaldson Faculty Professor, Yale School of Management (1987-1990); Director of General Motors Corp. (U.K.); Hughes Electronics Corp.; and Zeneca Group plc.</td>
<td>Compensation and Employee Benefits Committee, Chairman; Directors and Public Policy Committee, Member; Executive Committee, Member; Proxy Committee, Member</td>
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