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'Low Profile' Developments In Telecommunications

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TELECOM LAW

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It's the mega-mergers that attract almost all of the media attention in areas of telecommunications, particularly in the last week with the announcement of AT&T's proposed acquisition of BellSouth. However, there are other recent activities in the telecommunications world that, while lower profile, still warrant a closer look.

A case that received little attention was decided in January by the U.S. District Court in the Northern District of Illinois, Eastern Division. *United Asset Coverage, Inc. v. Avaya, Inc.*, (no. CIV.A. 05C4350) provides an interesting look into the rationales and strategies used by large telecommunications equipment vendors (in this case, Avaya) as they sell their wares to end-users.

This case wasn't actually about the income generated by the equipment sale itself, but rather the ongoing maintenance charges, those perpetual fees which are essential to keep the system running and the money flowing.

In this case, the plaintiff corporation requested a preliminary injunction to prevent Avaya, one of the most well-respected and top-selling manufacturers of telecommunications hardware, from changing its policies regarding access to software used to maintain its embedded equipment. (As a refresher on this ever-evolving business, Avaya was a spin-off from Lucent Technologies, which was spun out of what was then called AT&T, along with what is now Lucent's research arm, Bell Labs.)

Regardless of pedigree, or for that matter, outcome, this case shines a bright light into the sales and pricing practices of not only Avaya, but the other large equipment managers as well.

United Asset Coverage, Inc. (UAC) is in the business of providing maintenance to Avaya customers (and customers with other installed telecommunications equipment) on a time and materials (T&M) basis. In many instances, an equipment end-user company can save money by choosing to plan for maintenance in this way, as opposed to having a long term maintenance contract which can address system problems and include periodic remote maintenance and installation of system upgrades.

While those who choose a T&M agreement, whether provided by the original vendor or a third party maintenance contractor, may save money, as a result of this case, it appears that customers who opt for the T&M maintenance program will be at the bottom of the list when it comes time for service.

In this case, UAC was in the business of buying T&M time from licensed Avaya maintenance providers and then reselling it to Avaya customers at a discount over the T&M rates charged by Avaya maintenance providers directly. UAC was able to do this because it purchased T&M time in bulk, thus taking advantage of a volume discount.

When Avaya limited access to software which was designed by use for only licensed Avaya service providers and customers, and which UAC had had at least minimal legal access to prior to this change in Avaya policy, UAC was no longer able to access Avaya's proprietary software and thus serve its customers in the best way possible.

Citing precedent from a case with local ties (*Eastman Kodak Co. v. Image Tech. Services, Inc.*, 504 US 453, 112 SCt 2072, 119 LEd2d 265 [1992]), UAC hoped to prevail based upon the theory that the manufacturer (in this case Avaya) had used "its control over an essential input as a means to monopolize the aftermarket for servicing its equipment and to crush competing service providers." As the court succinctly put it, "nothing could be further from the truth."

UAC based its claim on perceived anti-trust violations which it claims took place in July 2005 when Avaya took action to limit UAC's access to Avaya's proprietary software; software that was essential to those providing maintenance to Avaya's systems. Feeling unfairly shut out of the market, UAC demanded a preliminary injunction that would have forced Avaya to continue to make that software accessible.

The courts denied UAC's request because of UAC's failure to meet the thresholds required for a preliminary

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injunction: (1) plaintiff had no adequate remedy at law, (2) plaintiff will suffer irreparable harm if the preliminary injunction is denied, (3) the balance of harms favors the plaintiff, (4) plaintiff has a reasonable likelihood of success on the merits and (5) issuance of the injunction will not disserve the public interest. Also, in the court's view, the antitrust claims made had insufficient merit.

Anyone who has ever been involved in the negotiations for the acquisition of a telecommunications switch (PBX) knows that the process is confusing, complex and not without aggravation.

What the purchasers of telecommunications equipment like PBXs generally discern very quickly is that the follow-on maintenance agreement, which remains in place long after the purchase transaction has closed, can generate not only a significant stream of revenue to the vendor, but in all likelihood, a much higher return to the vendor in terms of profit than does the equipment itself.

As such, according to testimony quoted in the decision, vendors will often choose to break even on equipment cost in exchange for a profitable long-term maintenance agreement. Economists frequently refer to this as a razor and blade strategy. In fact, according to given testimony, in the last three years, Avaya's service revenues have averaged approximately $1.3 billion, of which 95 percent were attributable to maintenance contracts.

Given its significance to the bottom line, most vendors quote and push maintenance fees along with any proposed system sale. Usually a vendor who is selling maintenance will offer various levels of service ranging from intense remote monitoring and on-site replacement parts (and, for the largest customers, on-site technicians) to no maintenance at all, with a variety of options in the middle.

Vendors push very hard on the maintenance because in addition to the fact that it can be an essential component to a functioning telephone system, it is also the primary profit driver (and in all probability, a key component of the sales rep's commission). A savvy purchaser would be well-advised to estimate its maintenance requirements in advance of soliciting equipment so that he/she knows how forcefully to push back on the actual system cost.

Along these lines, it can also be very useful for a buyer to know how the account exec or sales rep is compensated, and how that compensation is related to the purchase of ongoing maintenance. Knowing this little bit of sales strategy is often enough to shift at least some of the power in the transaction from the seller to the buyer.

Martha Buyer is an attorney concentrating in the practice of telecommunications law. Her clients range from Fortune 500 companies to small family-owned businesses where she has provided a range of telecommunications consulting and legal services, primarily geared to support corporate end-users working with carriers and equipment providers. Buyer can be contacted at martha@marthabuyer.com.