DEPARTMENT OF JUSTICE

COMPETITION POLICY AND THE TELECOMMUNICATIONS REVOLUTION

Address by

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I appreciate the opportunity to deliver the keynote speech to this conference, and I am grateful to Denis Gilhooly for inviting me. I know that originally you hoped to have Vice-President Gore here and I am honored that you would ask me to fill in for him. The Vice-President, of course, has been the Clinton Administration's most eloquent and influential advocate of developing the National Information Infrastructure and the Global Information Infrastructure; he has articulated and shaped America's commitment to continue, indeed accelerate, the telecommunications revolution that is profoundly changing the lives of all Americans.

The subtitle of this conference is "Toward the Global Information Infrastructure," and the impressive roster of speakers and attendees underscores the fundamentally international nature of the telecommunications revolution. The "networked economy," if allowed to develop in a competitive environment unfettered by artificial restraints and unnecessary regulation, will literally connect all the nations of the world.

These connections will empower us and enhance freedom and democracy. Citizens will be able to communicate -- both send and receive -- information on a previously unimaginable scale. When you think about this, recall scenes from Nazi-occupied Europe of women and men crouched around the wireless, desperate to learn and tell the truth. Or think of citizens behind the Iron Curtain, searching the shortwave bands for Radio Free Europe or the BBC. And imagine how much more difficult any oppressor's job is when people yearning for freedom have access to fax machines and digital computer networks.

These connections will transform the way we live and work. For better -- although sometimes for worse -- we will be able to work effectively far from our offices. When schools and libraries are connected to the network, we will multiply the educational resources available to all of our children. A global information highway will enrich their learning experiences and better equip them for success in a complex world.

These connections will even save lives. Those who are sick in rural and outlying areas already are gaining access to the most advanced knowledge and care literally at the

speed of light without ever leaving their locale. Those who fall ill far from home will be able instantaneously to access their medical records. In fact, they may even have their bodies examined by their hometown doctor through these connections. Statistics will be gathered and the effectiveness of treatments evaluated through improved local, national and international databases.

And of course these connections will entertain and challenge us, with what we want to see, hear, play, or otherwise enjoy, when and where we want, with the highest quality connections.

These visions of a networked world are barely the tip of the iceberg. Some of these things are already happening on one scale or another. For those of you in the audience participating and taking risks to make them happen, I commend you. There will be more of you as well, because the telecommunications and information sector of our economy, which already accounts for nine percent of the nation's Gross Domestic Product, could double over the next decade, according to a recent study by the President's Council of Economic Advisers.

When he addressed the International Telecommunications Union in Buenos Aires last March, Vice-President Gore suggested five principles that should govern the development of the Global Information Infrastructure or GII. Those principles are 1) private investment; 2) market driven competition; 3) flexible regulatory systems; 4) non-discriminatory access; and 5) universal service. Each of these principles is vital to the development of the GII, and each has been adopted by the ITU.

I would like to focus my remarks on one principle in particular: market driven competition, which is central to facilitating the telecommunications revolution and to fostering innovation. One of the most important goals -- if not the most important goal -- that government can have as the telecommunications revolution proceeds is to promote an environment in which all firms in all parts of the industry have the maximum incentive to

innovate and to develop and deliver products and services of the highest quality, at the lowest cost. The key to achieving that goal is the stimulation of competition through intelligent antitrust enforcement and procompetitive legislation and regulation. In a word, government must encourage competition, wherever technologically and economically feasible.

With those ideas in mind, I would like first to discuss the indispensable role that antitrust enforcement has played in creating the conditions that led to the telecommunications revolution. Then, I would like to speak briefly about the need for and benefits of more competition and the role of intelligent merger enforcement in protecting and promoting competition.

The Origins of the Telecommunications Revolution

This telecommunications revolution that we are all witnessing and in which most of you are active participants -- the merging of voice, video and other data transmission and the proliferation of new telecommunications products and services -- has been one of America's leading technological and economic success stories. At bottom, the key reason is the creative genius of our scientists, engineers and businesses.

An indispensable element in freeing that creative genius to innovate and bring new products and services to market has been a public policy generally dedicated to promoting competition. Nowhere is this more evident than in the case of long-distance telephone services, where through the efforts over two decades of the Justice Department and Judge Harold Greene, and the work of the FCC, competition has made enormous progress.

Until the Department sued and eventually broke up AT&T, that company had a monopoly over this nation's telephone market. It was a regulated monopoly, to be sure, and one that in some ways served our country well. But it was also one that thwarted competition and inhibited innovation. New companies like MCI that wanted to provide

long-distance service could not do so effectively, because AT&T's local operating companies refused to provide interconnections to their local loops. Likewise, manufacturers of telephone equipment that wanted to sell products that were equally, if not more, innovative than AT&T's were hindered in doing so because AT&T had the incentive and ability, through its monopoly control of the local loop, to buy such equipment only from its wholly-owned subsidiary, Western Electric. Many of these conditions still exist in other countries today.

These practices halted when the Department of Justice, led by my antitrust professor in law school, William Baxter, concluded years of effort by obtaining a consent decree in 1982. The Modification of Final Judgment -- what we call the "MFJ" -- has since been administered with remarkable energy and wisdom by Judge Greene, to whom this nation owes enormous gratitude.

By increasing competition in various segments of the telephone industry, the MFJ has delivered the benefits that competition in other markets routinely guarantees: innovation, better products and services, greater efficiency, and lower prices. Consider that since the MFJ:

-- interstate long distance prices for the average residential customer have fallen in real terms by more than 50% without compromising universal service;

-- competition has stimulated the development of hundreds of innovative voice and data services (such as voice mail); and

-- competition in the telephone equipment market has ignited a virtual explosion in the development and sale of new products from which consumers can choose.

One result of the MFJ deserves particular mention at a conference devoted to the networked economy: the widespread implementation of fiber optic technology. Corning developed that technology in the early 1970s. But it languished, because AT&T -- free of competitive challenges -- had no incentive to replace its existing copper network. Now, spurred by a consortium of smaller carriers, MCI, Sprint and AT&T have each laid fiber

optic cable throughout much of the country. This cable is a large part of the backbone for the National Information Infrastructure and, when we speak of a "networked" economy, fiber optic cable is in large part the "network."

In short, the MFJ literally created the market conditions which led to private investment in fiber optic and the fiber optic network, and has enabled the United States to maintain its technological leadership in telecommunications. Nations that have stuck to the old monopoly model of telephone services, quite frankly, have fallen behind. The trend around the world, based in no small part on America's experience with the MFJ, is toward more competition in telecommunications.

The Need for and Benefits of Even Greater Competition

Now is certainly not the time, however, for America to rest on her laurels. Much more needs to be done to promote competition in telecommunications. For instance, competition has a long way to go in video services. To be sure, consumers now have an unprecedented degree of choice in video programming, as the spread of cable technology has introduced competition with traditional broadcasting. But, with a few exceptions, cable television operators enjoy monopoly franchises in each locality.

These monopolies, however, are not "natural," and I am confident that their days are numbered thanks to technology that is readily at hand. For example, a number of Regional Bell Operating Companies (RBOCs) have announced plans for upgrading their telephone networks to deliver video programming. Continuing advances in satellite television likewise promise a challenge to cable monopolies.

Competition also has yet to reach local telephone service. The RBOCs still carry more than 99% of local traffic in their respective service areas. Here, too, technological innovation offers foreseeable challenges to monopoly control. Just as telephone networks can be upgraded to provide video service, cable television systems are expected relatively

soon to carry telephone traffic. In addition, wireless services such as cellular and specialized mobile radio, while currently relatively expensive, are growing rapidly throughout the country. Shortly, the FCC will auction off additional spectrum for yet another form of wireless communication, Personal Communications Services (PCS). Still, it is important to keep in mind that these alternatives are largely prospective, they are not yet widely available and affordable, and it is not yet clear when they will be.

Technology by itself will not be enough to break down the barriers to competition in video and voice, for the simple reason that not all of the barriers are technical. Some of the most formidable, in fact, are legal. For example, existing law at various levels of government frustrates providers of cable and local telephone services from offering both services in full competition with each other.

At the federal level, the Administration actively supported telecommunications legislation that would have extended the benefits of competition far beyond the areas covered by the MFJ. That legislation would have effected the first comprehensive legislative reform since the passage of the Communications Act sixty years ago. It would have affirmed the MFJ's guiding principle of competition and constructed a telecommunications regime based on that principle by removing legal entry barriers and creating the conditions for competition in monopolized markets. Unfortunately, such reform will not occur this year.

In the absence of federal legislation, we will all watch closely to see whether the states remove regulatory barriers in order to increase competition. Some states already have taken great strides in this regard. In those states, elected officials and utility commissioners have begun to say yes to competition in local telephone service and other monopoly services. A couple of states are requiring effective unbundling and other necessary measures.

One promising example of procompetitive state activity is an agreement among Rochester Telephone, Time Warner and the New York Public Service Commission staff that will allow Time Warner to compete in the local telephone market in Rochester, New York.

After final approval of the agreement, Rochester Telephone will provide Time Warner, the local cable operator, with nondiscriminatory interconnection to the Rochester Telephone network. As a consequence, consumers in Rochester soon should have a choice of local telephone service providers, secure in the knowledge that customers of one provider can connect seamlessly with customers of the other. In fact, after the agreement was signed, another carrier announced that it will also provide local telephone service in the area. And in Rochester, long-distance carriers eventually will be able to gain access to their customers without having to depend solely on a local telephone monopolist.

Although there are promising developments in some states, such as the Rochester plan, other states have responded little or not at all to the challenge of increasing competition. Consumers across the country need and deserve the benefits that greater competition will bring. They deserve a choice among providers of local telephone service. We therefore hope and urge that all the States will respond to this important challenge.

Breaking monopoly holds on various segments of the economy and letting competition flourish are difficult tasks. But they are tasks that are vital to the economic health of the nation. Competition is critical to promoting innovation and providing consumers and businesses with better and more products at lower costs. Only through greater competition will we bring about the day when any company can offer any service to any consumer on a level playing field. And only through greater competition can government regulation be scaled back with no substantial possibility that any of today's monopolies will impede competition in adjacent markets.

I will note three areas in particular in which serious work remains before consumers will enjoy all the benefits of greater telecommunications competition.

First, as I suggested above, cable television and local telephone service are the most obvious markets in which more competition is necessary. Both are currently monopolized by existing providers, requiring government regulation to protect consumers from excessive

rates. Even though the technological advances that I have just mentioned may make it possible for competition to erode these monopolies and thus relax or end current regulation, government entry barriers themselves slow the advent of such competition.

Second, while several competitors have made significant inroads in long-distance telephone markets, there is always room for more competition.

Third, although telephone equipment is now probably the most competitive of the markets affected by the MFJ, there is room for additional competition.

Legislative reform would facilitate progress in some of these areas, and we will welcome constructive efforts to pass telecommunications legislation in the next Congress. In the meantime, we will continue to enforce the antitrust laws in those areas with vigilance and intelligence.

And let me stress one thing as forcefully as I can: In the absence of legislation, we will continue vigorous enforcement of the MFJ.

Enhancing Competition Through Merger Enforcement

A particular mechanism through which the antitrust laws enhance telecommunications competition is effective merger enforcement. One of the defining characteristics of this revolution is the accelerating pace of corporate mergers. Our host, Denis Gilhooly, has called this a "time of Jurassic industry merger." By that, I take it he means that we are witnessing an era in which huge corporations propose to merge -- and possibly also that those which do not adapt to rapidly changing conditions will go the way of the dinosaur.

A week does not go by without one or two major mergers or corporate alliances being announced and advertised as an ideal way to accelerate the building of the "information superhighway" by combining the unique talents and expertise of the partners in a single entity. In many cases, this may be true and the Division will not stand in the way of these transactions -- indeed, where they are neutral or procompetitive, the Division will

welcome them. But we draw the line, as the law requires us to do, against mergers that threaten to concentrate economic power in particular markets or erect barriers to entry so that prices are likely to increase if the merger, at least in its proposed form, is allowed to proceed.

Let me stress, however, that size alone is not a basis for challenging a merger. Congress drafted the antitrust laws in sufficiently general terms to delegate to the courts the task of developing an antitrust jurisprudence that is consistent with contemporary concepts of economic efficiency and consumer welfare. And the courts and federal antitrust enforcement agencies have accepted that responsibility. As a result, current antitrust law recognizes the economic concepts of economies of scale and scope, which may be relevant to large transactions.

Mergers involving telecommunications and computer firms can pose special problems for antitrust enforcement, because many of the firms in these industries, as I have noted, already have a dominant, or even monopoly, position. The seven RBOCs, for example, each currently have a monopoly in local telephone service. The same is true for almost all cable television firms in the markets they serve. Other high-tech firms also have substantial market power in various lines of business.

Firms that already are dominant in their markets surely know that neither the Division nor the FTC is likely to permit them to engage in "horizontal acquisitions" -- or purchases of direct competitors. As a result, many of the high-tech mergers we have seen so far involve firms that are dominant in one market joining with firms in related markets -- such as RBOCs proposing mergers with cable companies or telephone companies active in different geographic areas proposing mergers. One critical question posed by these mergers is whether they will allow the extension of dominance in one market into a second market, a particular danger where one of the firms is a regulated monopoly. If so, we as antitrust enforcers try to persuade the parties to revise their proposal or to accept appropriate

conditions designed to remove the anticompetitive effects of the transaction. If persuasion fails, we will sue to halt the merger entirely.

Two recent examples demonstrate how it is possible to prune the anticompetitive effects from otherwise lawful telecommunications mergers. Consider first the marriage between AT&T and McCaw Cellular -- one a dominant player in its market, the other a duopolist. AT&T has about 60 percent of the long-distance telephone market. McCaw carries about 30 percent of cellular traffic nationally, but in most of the localities that it serves, it carries closer to half the cellular calls. It is a duopolist by virtue of its possession of one of the two blocks of spectrum allocated to cellular use in each of its service areas. In seeking to acquire McCaw, AT&T clearly desired to provide seamless local and long-distance cellular service to customers.

As originally proposed, however, the merger posed unacceptable risks to competition in several markets. The Division therefore conditioned its approval of the merger on several important commitments by the parties. For example, under the consent decree signed by the parties, McCaw must provide AT&T's long-distance competitors with equal access to McCaw's subscribers. Likewise, the consent decree prohibits AT&T from offering its local and long-distance cellular services as a bundle; rather it must separately price each service.

The second telecommunications merger recently approved with important conditions is the agreement between British Telecommunications (BT) and MCI for BT to purchase a 20 percent interest in MCI and for the two companies to create a global joint venture. This transaction raised important telecommunications issues in an international context.

Like AT&T and McCaw, MCI wanted its equity partnership with BT in order to enhance its ability to offer seamless telecommunications services, but in this case on a worldwide basis. If BT did not have market power in telecommunications services in the United Kingdom, it is likely that neither the proposed equity investment nor the joint venture would have posed any competitive risks.

But in reality, BT was and remains the dominant telephone company in the U.K. By virtue of this dominance, the proposed transaction would give BT increased incentive and ability to favor its joint venture with MCI in pricing, interconnection, and possibly other ways -- all to the detriment of U.S. consumers and other global telecommunications providers. If such discrimination occurred, the price of telephone traffic between our two countries could increase. Accordingly, the Division approved the BT/MCI transaction only after obtaining the parties' agreement to a consent decree that sharply limits the potential for anti-competitive discrimination.

Of course, everything I have just said about AT&T/McCaw and BT/MCI is yesterday's news, but you are all people who don't stop thinking about tomorrow. So I would like to make several broad comments on the relation between competition policy and mergers in this industry to supplement the lessons from the transactions that the Antitrust Division already has reviewed.

Let me preface these comments by noting that we all talk about "the" information superhighway. In fact, a focus on any <u>one</u> highway is premature, if not downright inaccurate. There appear to be several highways in the works -- land-line telephone, land-line cable and various wireless technologies -- all competing to deliver voice, data and video content to businesses and homes around the country, and indeed around the world. No one really knows which of these highways will be successful. This is precisely what markets are for -- to let the firms that are now spending billions of dollars to build these highways fight it out, with the winners being those who offer the best combination of quality and price.

For those of us charged with enforcing the antitrust laws, at least three concerns are paramount. First, we don't want any highway owner that now has a regulated monopoly in its market to cross-subsidize -- that is, to pay for other highways by picking the pockets of captive customers. Thus, cable operators who want to enter telephone markets or local telephone companies who may eventually enter long-distance markets should fund their

expansion from the capital markets through unsubsidized debt or equity. Such entry by a monopolist into another market also may initially require post-entry safeguards, such as separation of the two operations and transparency in any dealings between them. Any other result would distort the marketplace in favor of monopolists, a totally unacceptable outcome.

Second, at least for the next several years, we should not allow the owner of any one highway in a given geographic area to merge with or buy out a competing highway. If, for example, local telephone companies were permitted to merge with their cable television competitors in the same service territory, the consumers in that territory would be deprived of the benefits of competing highways. This situation may change once technology affords consumers more ways to receive information in the home. But this is not the reality today. Until that reality changes, such mergers generally will be unacceptable under the antitrust laws.

Third, we will be equally watchful of mergers or joint ventures between owners of highways and owners of content. Such transactions pose the risk that the integrated entity could unreasonably foreclose highway access to competing content owners or unreasonably foreclose content access to competing highway owners. In such cases, we will be prepared either to block the merger or condition it on "equal access" requirements that prevent such discrimination, as we did with TCI's recent acquisition of Liberty Media.

Conclusion

In conclusion, let me say that I am immensely proud of the efforts of the Antitrust Division and Judge Harold Greene when I contemplate the changes wrought by the break-up of AT&T. Rarely, if ever, have the efforts of antitrust enforcers been so crucial to the development of entire industries and so dramatically and demonstrably improved the products and prices of goods available to all Americans. I have an unalterable faith that the telecommunications revolution begun by the AT&T consent decree will provide the greatest

benefits to consumers and businesses if the competitive principles that underlie the decree are applied broadly throughout the industry. To promote an environment in which competition flourishes is the goal of the antitrust laws, and the Clinton Administration is working hard to achieve that goal through intelligent antitrust enforcement and active support of legislation that will promote competition and innovation in this vital economic sector.