DEPARTMENT OF JUSTICE

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Concerning H.R. 1555, The Communications Act of 1995

It is an honor to testify before this subcommittee concerning legislation to promote greater telecommunications competition. I am grateful to you, Chairman Fields, to Congressman Markey and to this subcommittee for holding this hearing and exercising leadership in this important area. Given my role in enforcing the Nation's antitrust laws, I will focus my remarks on issues relating to competition in the telecommunications business, especially issues arising in connection with the Modification of Final Judgment (MFJ), which governs the actions of the Regional Bell Operating Companies (Bell Companies).

H.R. 1555 takes on one of the fundamental obstacles to greater telecommunications competition by seeking to open to real competition the monopoly over local telephone service that each of the seven Bell Companies and other local telephone monopolists have in their respective regions. The bill also would allow telephone companies to compete against cable companies. We commend you for these efforts. Opening cable and telephone monopolies to competition was also a cornerstone of the legislation passed last year by the House and sponsored by Congressman Markey and Chairman Fields.

We believe that the provisions in H.R. 1555 for unbundling the local network and providing for interconnection among networks are important for making significant progress toward greater local competition. But we have serious concerns about several aspects of the bill. Our serious concerns with deregulating cable monopolies before there is competition to challenge them will be addressed by Mr. Irving. We also are concerned about the absence of a market-based assessment of the effects that Bell Company entry into long distance and manufacturing would have on competition in those markets before such entry is allowed -- which I will discuss in more detail in a moment. We look forward

to working cooperatively with the members of this subcommittee and with Congress to resolve these concerns and pass comprehensive, pro-competitive telecommunications reform.

Our fundamental vision for the telecommunications future is simple to state, but breathtaking in its implications: Any company will be permitted to provide any service to any customer. We want that day to come as soon as possible, because increased competition in telecommunications will benefit consumers, spur economic growth and innovation, promote private sector investment in an advanced telecommunications infrastructure and create jobs. We would be naive, however, if we expected an uncomplicated transition from the regulated monopolies that characterize many segments of the telecommunications industry to fully competitive markets.

Vice-President Gore put it best at the Federal-State-Local Telecommunications Summit held earlier this year: "Competition is always better than monopoly. But monopoly power must never be confused with competition. Two enemies of competition are monopoly power and unwise government regulation. We must remember, after all, that the goal we seek is real competition. Not the illusion of competition; not the distant prospect of competition."

There is today, we believe, a broad, bipartisan consensus in favor of moving telecommunications policy out of the courts and into the statute books so that Congress, representing the public, can craft the kind of comprehensive framework for competitive telecommunications that the nation deserves.

The key test for any telecommunications reform measure is whether it helps the American people. To meet this test, it must be effective in opening all telecommunications

markets to competition, including -- first and foremost -- currently monopolized markets. And it must ensure that monopolists cannot harm consumers and competition in the transition to competitive -- and then deregulated -- markets.

If we unleash monopolists rather than achieve real competition, American consumers and businesses will pay higher prices and have less choice. We would have less innovation and lower quality. We could lose our position of international leadership in telecommunications, and American businesses could lose a competitive edge. Real competition enables -- and must precede -- real deregulation.

In the balance of my testimony, I would like to do the following:

- put the discussion we are having today in a useful framework, by explaining how we got here and, in particular, how the nation has benefitted from the competition in telephone markets that has occurred thus far;
- discuss the significant progress that H.R. 1555 makes toward opening local markets to competition;
- discuss the difficulty of relying solely on a checklist approach to opening the local market; and
- discuss the need for an assessment of actual marketplace facts before allowing the Bell Companies into long distance to ensure that such entry does not unravel a decade of progress in opening the long distance and telecommunications equipment markets to competition.

The History of the Bell System Decree

It is appropriate to begin with some history, because the competition that we have today in long distance and equipment manufacturing is a relatively recent phenomenon, made possible by DOJ's landmark antitrust case against the Bell System. That case, as you know, was a completely nonpartisan undertaking. It began with an investigation that was initiated in 1969 during the Nixon Administration, accelerated with the filing of the case

in 1974 in the Ford Administration and was pursued vigorously through the Carter and Reagan Administrations until it was settled in 1982 by my former law professor, William Baxter, President Reagan's Assistant Attorney General for Antitrust. That historic settlement resulted in the entry of the MFJ, which dismantled the Bell System's vertically integrated telephone monopoly.

The seven Bell Companies were created by the MFJ and each has a monopoly over local telephone service in its respective region. The MFJ restricts the Bell Companies from entering the long distance and equipment manufacturing markets. These line-of-business restrictions grew out of the central issue in the case: the ability of the local monopoly to impede competition in those other markets.

Before it was broken up, the Bell System used its control over local telephone service to maintain monopolies in long distance and equipment manufacturing. See United States v. AT&T, 552 F. Supp. 131, 162 (D.D.C. 1982), aff'd sub nom., Maryland v. United States, 486 U.S. 1001 (1983). Long after competition in long distance service and communications equipment became technologically and economically feasible, the Bell System abused its control of the local bottleneck to frustrate consumer choice and actual competition.

As Judge Harold Greene, who presided over the eleven month trial of the case and who continues to administer the terms of the MFJ, has explained, it was control of local exchange service

> that gave the Bell System its power over the competition. That control enabled the System to foreclose or impede interconnection to its network of lines of its long distance competitors and of equipment produced by its manufacturing rivals. It also made possible the subsidization of one activity with the profits achieved in another.

United States v. Western Elec. Co., 673 F. Supp. 525, 536 (D.D.C. 1987), aff'd in relevant part, 900 F.2d 283 (1990). In other words, control of the regulated local monopoly bottleneck gave the Bell System the incentive and the ability to discriminate against competitors in other markets in the terms, price and quality of interconnection with the local network and to shift costs from unregulated markets to the regulated local market, where they were passed on to local ratepayers.

Until the success of the Department's suit, regulation and litigation had not been effective in breaking through that local bottleneck. The Bell System proved itself adept at devising new ways to use the bottleneck to hurt competition in other markets more quickly than the courts and regulatory agencies could order solutions. Among other things, the Bell System used its monopoly profits to hire legions of lawyers to make sure that any proceeding that challenged any aspect of the monopoly was bogged down in endless proceedings. For example, the struggle to allow telephone customers the right to use their own equipment on their own premises, rather than being forced to purchase that equipment from the Bell System, spanned decades -- from the beginning of the Hush-a-Phone litigation in the 1940s to the break-up of the Bell System in 1984, which finally resulted in open competition in customer premises equipment. See, e.g., United States v. AT&T, 552 F. Supp. at 162-63 (discussing a portion of this struggle -- the Bell System's use of "protective connecting arrangements" to discourage the use of competitors' equipment).

The Benefits of Competition After the MFJ

The MFJ addressed the problem of the local monopoly bottleneck and promoted competition in the long distance and equipment manufacturing markets by strictly

separating the local monopoly from those markets. Because the local monopolies were barred from competing in the long distance and equipment manufacturing, they had significantly less incentive to impede competition in those markets. Competition in those two markets subsequently exploded. The result has been dramatically lower prices, better quality and more choice for American businesses and consumers.

MCI, Sprint and hundreds of smaller carriers vie with AT&T to provide long distance service to businesses and residences. The New York Times recently reported that in 1994 more than 25 million residential customers changed long-distance carriers -- spotlighting the MFJ's incredible success in bringing real choice to consumers. Residential long distance rates have fallen more than 50 percent since the break-up of the Bell System. The United States now has four fiber optic networks spanning the country, another by-product of competition. Incidentally, AT&T lagged behind its competitors in building a fiber optic network -- not surprising given that monopolists often are not the most innovative companies. These networks make possible all kinds of new services and enhance others, including the Internet. Similarly, businesses and consumers enjoy lower prices, more choice and better quality in communications equipment, as competition has eroded AT&T's power in that market and forced it to compete for customers.

Because of lower prices and better quality, Americans are communicating with each other, by phone, fax and computer, more than ever before. We are closer to each other and in better touch with each other, for business and pleasure, because of the MFJ and its benefits.

The challenge facing the Nation today is to move forward by expanding competition without losing the hard-won benefits in the markets in which competition has flourished

since the entry of the MFJ.

Allowing the Bell Companies into Long Distance

Section VIII(C) of the MFJ provides that any Bell Company may obtain a waiver of the line-of-business restriction as soon as it can show that there is no substantial possibility that it could use its monopoly power to impede competition in the market it seeks to enter. Judge Greene has granted over 250 such waivers. In fact, just last month, Judge Greene approved a waiver request made by all the Bell Companies and supported by the Department that will allow the Bell Companies to provide long distance services to their wireless customers. The core restrictions on the Bell Companies' entry into long distance for landline customers and into equipment manufacturing remain, however.

Comprehensive telecommunications reform should have the goal of removing these restrictions and allowing the Bell Companies to enter those markets, in keeping with our vision of a future in which any company will be permitted to provide any service to any customer. The trick, of course, is to ensure that removing the restrictions does not result in the re-creation of the old Bell System, this time on a regional rather than a national basis, complete with the incentive and the ability to impede competition in the long distance and manufacturing markets. Seven separate monopolies, each controlling one large region of the United States, would be scant improvement for the cause of competition over a single national monopoly.

And there should be no doubt that the Bell Companies' bottleneck still exists. Customers simply have no choice for local service. In fact, in the vast majority of states, it is illegal for would-be competitors to offer a local dialtone. To be sure, some companies

have made in-roads in offering alternative means of access to long distance carriers for certain business customers. And imaginable technological developments may eventually provide a basis for widespread competition in the future. But that competition is not here yet.

Let me stress that concern about the potential for the Bell Companies to use their control over the bottleneck to impede competition in other markets is a bipartisan concern. For example, William Baxter, President Reagan's Assistant Attorney General for Antitrust and the architect of the MFJ, recently warned that Bell Company entry into long distance while the local bottleneck still exists "will greatly diminish competition in [the long distance] market and will harm consumers." He concluded that a Bell Company "should not be permitted to provide long distance services until it has met the MFJ's VIII(C) test by demonstrating that there is no substantial possibility that it could use monopoly power in a local exchange market to impede competition in the long distance market it seeks to enter." (Emphasis in original.)

Opening Local Markets to Competition

H.R. 1555 takes on this fundamental obstacle to greater telecommunications competition by seeking to break through the local bottleneck. It aims to open up local telephone markets by requiring the Bell Companies to "unbundle" their networks while preempting existing local and state restrictions on entry by competitors. In the process, Bell Companies and other local telephone monopolies would be compelled to provide interconnection to other firms that want to use the "local loop" to provide local telephone services.

The Administration supports those provisions of H.R. 1555 that seek to open the local loop. We believe that the Bell Companies and other local telephone monopolies should be required to unbundle and fairly price each element of their local monopoly service at technologically and economically feasible points. Such disaggregated unbundling, coupled with fair pricing, is a critical precondition for establishing truly effective competition in the local telephone market.

By requiring that the Bell Companies must fully implement unbundling and interconnection before they may originate interLATA telephone calls in region, that number portability be implemented so that customers can change carriers without having to change phone numbers, that intraLATA toll dialing parity must be provided, that actual and effective legal entry barriers must be removed, among other requirements, H.R. 1555 takes important steps to open the local market to competition. H.R. 1555 also makes an important contribution by recognizing the importance of having facilities based competition as a condition to allowing the Bell Companies into long distance.

The bill also would clear the way for cable and telephone companies eventually to compete vigorously against each other in the same markets. We endorse reform that would permit existing cable and telephone companies to offer both video and telephonic services in the same geographic areas. We would welcome even stronger provisions to prohibit telephone and cable television companies from acquiring each other within the same service territory, subject to certain exceptions. It is crucial that public policy promote competition between methods for delivering telecommunications services.

I would add with respect to price regulation in local markets that the Administration believes that the bill should not dictate to the States which form of rate regulation best

protects State consumers under the different circumstances and levels of competition that develop in each State. Such mandates could result in higher telephone prices for consumers in some states.

The Problems with Relying on a Checklist

The checklist in H.R. 1555 includes many of the steps for interconnection and unbundling that are widely considered necessary for opening local telephone markets to competition. But it does not address critical pricing issues necessary for competition to emerge. Further, there is no experience on which to judge whether these steps will be sufficient to allow the development of local competition. Nor is there a reason to believe that any checklist drawn up in advance can anticipate the myriad implementation issues that effective unbundling and interconnection will entail. The reality is that there is little actual experience in this country -- or indeed anywhere in the world -- with what can only be described as an exceedingly complicated undertaking. It is a myth that a simple formula can guarantee competition and replace the need for an expert analysis of real marketplace competitive developments.

To begin with, the actual terms and conditions of interconnection and unbundling are critical. For example, if loops are priced too high in relation to the retail price of the bundled local exchange service, it will be uneconomic for even the most efficient competitor to connect Bell Company loops to the competitor's ports to offer service in competition with the Bell Company. One therefore cannot simply assume that competition will occur as a result of unbundling.

Similarly, requiring Bell Companies to agree to interconnect with other carriers, to

terminate traffic originating from a competing carrier and destined for a customer on the Bell Company's network, and to send traffic to other carriers when Bell Company subscribers wish to call competitors' subscribers does not by itself resolve a competitor's imperative need to be able to offer its customers the ability to make calls to or receive calls from Bell Company customers. If the Bell Company's prices to terminate calls from subscribers of competing networks to called parties on the Bell Company network are unreasonably high, competition could be seriously hindered.

The importance of such implementation issues is highlighted by H.R. 1555. The bill requires interconnection "on just and reasonable terms and conditions." Likewise, unbundled network elements must be provided "at just, reasonable and nondiscriminatory prices," while resale of network elements cannot be subjected to "unreasonable" restrictions. Such terms are necessarily vague, because there is no way in on earth that legislation could specify in advance exactly what terms should be applied.

But that is precisely my point. The only way to give meaning to such necessarily vague terms is to assess the actual competitive results of the terms and conditions that are adopted. Without such an assessment, a local telephone monopolist could argue that a term is "just and reasonable" or "not unreasonable" even though it does not facilitate the emergence of competition. Moreover, given the presence of numerous such terms with similar qualifications, there is the real danger that an accumulation of such qualified terms may fall short of the goal of facilitating the emergence of competition.

Vagueness also poses the risk of diluting the concept of facilities based competition. Although the bill recognizes the importance of such competition, it says nothing about what type of facilities are contemplated or the magnitude or reach of such competition.

"Facilities based competition" could well exist without the vast majority of customers having any real choice of local carrier and without such competition providing any protection to competition in the long distance market.

The shortcomings of relying on a checklist approach are exacerbated by the absence of post-entry safeguards such as requiring a separate subsidiary for the Bell Companies' long distance and manufacturing operations. If Bell Company entry into those markets does occur before the development of meaningful competition in local markets, the absence of such safeguards will impair the ability of regulators to detect and attempt to remedy anticompetitive conduct by the Bell Companies.

In sum, complex implementation issues are inevitable during the attempt to open local markets to competition. At this point, no one knows for certain how soon, or whether, entry into the local market will occur on a significant scale. Every scenario for the emergence of competition assumes continuing dependence upon the incumbent Bell Company, at least for interconnection and in many cases for loops and perhaps other network elements as well. This continuing dependence means that competition will involve complex business relationships and numerous pricing and technical issues, any one of which can prevent competition from emerging. It is thus critical that steps to open the local market be accompanied by incentives for the Bell Company to cooperate in ensuring the effectiveness of such steps. The way to create those incentives is with a requirement that actual marketplace conditions be examined after the implementation of unbundling and interconnection and before a Bell Company is allowed to offer interexchange services.

The Need for a Department of Justice Role

The responsibility for making such an examination should be assigned to the Department of Justice. DOJ is the agency with competition expertise, the agency whose unwavering focus is on the protection and promotion of competition. It has effectively enforced the antitrust laws in the telecommunications industry on a completely nonpartisan basis throughout this century, including, of course, bringing the suit that dismantled the old Bell System.

This focus on competition is fundamentally different than the technical, regulatory focus of the FCC. The two agencies complement each other; they are not substitutes. Under H.R. 1555, the FCC has a purely regulatory role, limited to verifying that the steps specified in the bill have been taken. But such a test does not obviate the need for a market-based analysis by the Department of Justice. As long as we agree that competition must be our guide, the most common-sense approach is to include a direct, decisionmaking role for the competition agency. Adding such a DOJ role, given the limited responsibilities assigned to the FCC under H.R. 1555, would not result in duplication. The FCC would review compliance with the checklist; DOJ would analyze and assess the development of competition in the market.

DOJ has supplemented its basic expertise in markets and competition with specific experience and expertise in telecommunications. Over the past decade, it has assisted Judge Greene in administering the MFJ -- through Republican and Democratic Administrations alike -- by reviewing over 350 requests for waivers under Section VIII(C), an average of about one every two weeks. Many of the most recent waiver requests have involved complex issues related to the competitive impact of the Bell Companies' provision of long distance services or equipment manufacturing.

In addition to reviewing requests for waivers, the Department has worked diligently with Bell Companies and other industry participants in searching for ways to remove the line-of-business restrictions consistent with protecting competition in markets that the Bell Companies seek to enter. Last month, the Department asked Judge Greene to modify the MFJ to permit a limited trial of interexchange service by Ameritech, one of the Bell Companies, in two LATAs in Ameritech's service area, once Ameritech faces actual local exchange competition and there are substantial opportunities for additional local exchange competition in the trial territory.

The proposal builds on the idea that one possible basis for lifting the line-of-business restriction is the existence of local competition. It already has had an effect in promoting competition, as last week AT&T announced its plans to compete with Ameritech in providing local service in the trial area. The Department's motion was filed along with a stipulation by Ameritech and AT&T that the modification is in the public interest. The proposed modification represents an unprecedented consensus of industry participants, originating from a proposal by a Bell Company and now supported by major long distance competitors, local competitors, state regulators and consumer groups. In the process of reaching that consensus, the Department deepened its already extensive expertise in telecommunications competition and its understanding of the competitive implications of Bell Company entry into long distance.

In short, the Department's experience in working with the MFJ uniquely positions it to assess what is actually happening in the market and whether there is a danger that entry by the Bell Companies could impede competition in other markets.

The only principled basis for concern about a DOJ role is whether it will inject

unnecessary delay into the process of deregulation. This concern is utterly misplaced with regard to telecommunications legislation, as any DOJ review can be required to be completed within a specified period after filing of a Bell Company application -- as it is by a bill that has been proposed by Congressman Hyde. DOJ would be required to make its determination by a date certain; it is as simple as that. Congress can require it, it did so in the legislation reported by this subcommittee last year and that is what those bills do.

The idea that DOJ review would cause unnecessary delay to Bell Company entry into long distance is a smokescreen that obscures the truth: DOJ review will not slow Bell Company entry into long distance unless such entry would be harmful to competition and thus undesirable for American consumers and businesses. Entry will be permitted as quickly as possible consistent with the appropriate entry test established by Congress.

No consideration of this question is complete, however, unless it also considers the long term savings in time and money of DOJ review. Bell Company entry that occurs without assurances that the entry presents no substantial possibility of impeding competition in long distance will invite the proliferation of complex, expensive antitrust and other suits under federal and state law, suits that will consume resources better spent on competing to offer American businesses and consumers better service and higher quality. Having DOJ apply a marketplace test as a condition to entry will avoid this waste.

Finally, a DOJ decisionmaking role has enjoyed overwhelming, bipartisan support in the past, including just last year in this subcommittee and in the Commerce Committee. The bill reported by this subcommittee last year with a DOJ role passed the House with more than 420 votes, and similar legislation was approved by the Senate Commerce Committee by a vote of 18-2. It is an intelligent, effective approach to putting consideration

of competitive facts and analysis at the center of our telecommunications reform efforts. It puts the interests of American consumers and businesses first.

Conclusion

I am proud that our country and this Congress have the courage to take on the tough issue of telecommunications reform. It took a lot of courage to break up the Bell System's vertical monopoly and allow competition into the markets for long distance and equipment manufacturing. But we did and as a result we now lead the world in telecommunications.

The easy thing, of course, would be for us stay where we are today. That, however, is not the American way. We welcome the challenge of striving toward a future of open telecommunications markets. But let us confront that challenge in the wisest way possible, and that is by making real competition our guide. We look forward to working with Congress to craft the kind of comprehensive telecommunications reform that the Nation deserves and that can and will lead the Nation to prosperity in the 21st Century.