



DEPARTMENT OF JUSTICE

ANTITRUST ENFORCEMENT AND THE TELECOMMUNICATIONS REVOLUTION: FRIENDS, NOT ENEMIES

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I want to start with a confession. I am a telecommunications neophyte, having only recently learned how to use the Internet. But I know from my job and from casual reading in my spare time (what little of it there is) that the United States -- and indeed the world -- is in the midst of a telecommunications revolution that will have profound consequences for every aspect of our lives.

At the global level, telecommunications helped end the Cold War. The former communist countries could not control the flow of information about life in the West that personal computers and television made possible. Ultimately, political freedom itself spilled over from West to East.

Within the United States, telecommunications products and services are powering economic growth. According to the Council of Economic Advisers, firms engaged in the information services sector of our economy -- including computers, software, telecommunications services and equipment -- accounted for nine percent of the nation's Gross Domestic Product in 1993. Assuming the Administration's telecommunications reform proposals are enacted by the next Congress -- a subject I will discuss at the end of this speech -- this share could double over the following decade.

Meanwhile, advances in telecommunications have been transforming our daily lives. I find it difficult to remember life without fax machines or e-mail, both of which have dramatically speeded up communications on the job. Some of you may already feel the same about videoconferencing, which may be

standard practice in relatively few companies now but surely will be common throughout the economy in just a few short years.

In our homes, the telecommunications revolution has already dramatically lowered long-distance telephone rates, while bringing dozens of video channels to our television sets. Millions of Americans are now also using on-line information services and the Internet to communicate with each other, with a growing number of libraries and other data bases, and with people around the world.

The future promises even more video interactivity. Once they are fully built out, fiber optic highways and satellites will do for video what copper wire did for voice: allow individuals to interact with others rather than just to passively receive information or entertainment.

These are not just pie-in-the-sky predictions. By the time the FCC completes its auction, investors are likely to have plunked down billions of dollars for spectrum rights that will enable providers to deliver these services to the public.

The question I have been asked to address today is what are the public policy issues that are raised by the spread of computer and video based interactivity? There are many and I certainly do not feel competent to address them all.

Instead, I'd like to concentrate on two very simple, but powerfully important, objectives the public should want government policymakers to achieve as the telecommunications revolution proceeds.

First, policies should be in place to assure that firms in all parts of the industry -- those building the infrastructure and those developing the information and other "content" that will travel over it -- have the maximum incentive to innovate and to develop and deliver products and services of the highest quality at the lowest cost.

Second, we should all be interested in having the telecommunications services that are generated made available widely throughout our society, and not just to the fortunate few. Information networks have positive "externalities": the more people hooked up to the networks, the more valuable the hookups are for each participant.

Moreover, information is what economists call a "public good". We educate our children, at public expense, by giving them the information and skills they will need to lead productive lives because it is in everyone's interest that all kids grow up to be responsible adults. Similarly, we provide libraries, also at public expense, so that knowledge is made freely available to the entire public.

Now that technology is revolutionizing the way information is delivered -- over wires, over the air, and through computers - - it is vitally important that all citizens continue to have at least some type of access to the information services of the modern age. This does not mean that everyone should be entitled to order movies on demand in their homes, at subsidized rates. But it does mean that great attention will have to be paid to assuring that all of us have some basic level of access to the

services and information that will be delivered over the information highways of tomorrow.

I want to suggest that there is one thing of overriding importance that the federal government can do to achieve those two critical goals of providing incentives for innovation and encouraging widespread availability of new telecommunications services. And that one thing is assuring that competition governs the telecommunications marketplace.

This is an objective shared by all of the government agencies responsible for telecommunications policy: the Federal Communications Commission, the Department of Commerce and the Antitrust Division of the Department of Justice. In the rest of my remarks today, I want to explain why competition is so important and how, in concrete terms, the Antitrust Division in particular has promoted and will continue to promote innovation in the telecommunications industry by protecting the competitive process.

The Importance of Competition

The notion that competition is critical to the development of telecommunications services has not been, and may still not be, universally accepted. For decades following the invention of the telephone, for example, it was widely assumed that telephone service was a natural monopoly. Public policymakers embraced this assumption by allowing AT&T to run the nation's telephone network free from competitive challenge.

More recently, some parties have suggested that the need for standards in computer-based systems is incompatible with

competition. For example, Bill Gates has asserted that Microsoft's operating systems for personal computers have become industry standards and thus have characteristics of natural monopoly.

While each of these arguments in support of natural monopoly may be superficially appealing, on closer examination neither justifies the rejection of the central role of competition that they both imply.

Consider first the claim of natural monopoly in the telephone business. This notion was roundly rejected when the Department of Justice and Judge Harold Greene forced the breakup of AT&T in the early 1980's. The breakup was not a universally popular move, even inside the Reagan Administration. In fact, according to published accounts, President Reagan himself and Secretaries Baldrige and Weinberger believed that the AT&T monopoly was a national treasure that should not be broken up. But William Baxter, then the Assistant Attorney General for Antitrust and now Professor Emeritus at Stanford Law School, insisted that only by divesting the regional telephone monopolies from AT&T's long-distance monopoly would long-distance competitors to AT&T have a fair chance to hook up to local telephone networks.

Professor Baxter and Judge Greene were right. Look what has happened since the breakup:

--Over 100 companies have entered the long-distance telephone market, knocking AT&T's share of that business down from 100 percent to 60 percent. Real residential long-distance

rates have fallen by about half, in part due to the increased competition. While the long-distance market could use even more competition -- AT&T, MCI and Sprint today account for about 90 percent of the business -- the entry of so many firms rebuts the view that long-distance telephone service is a natural monopoly.

--A less well recognized, but potentially even more important, product of the AT&T breakup is that it helped unleash the fiber optics revolution, making possible the exciting range of telecommunications we are discussing at this conference. As I suspect many of you know, Corning Glass helped invent fiber optic cable and attempted to sell it to AT&T in the early 1970's. But AT&T was a monopolist and must have been less than enthusiastic about ripping up its existing copper wire network in order to replace it with fiber.

It wasn't until AT&T was broken up that the use of fiber optics really took off. In part, this was because AT&T, Corning and others that were working on fiber optics were able by then to bring down the costs so that fiber became cheaper than the microwave technology that was once thought to be the main competitor to copper wires. But the breakup itself almost certainly pushed things along. New entrants into the long-distance telephone business, like Sprint, MCI and their smaller competitors turned to Corning to provide fiber optics. Eventually, AT&T was forced to install fiber itself in order to match the quality and cost of its competitors.

Now that long-distance telephone markets have rejected the natural monopoly model, the next candidate for competition is the

local telephone business. Today this market is virtually monopolized by the Regional Bell Operating Companies (RBOCs), which carry more than 99% of the local traffic in their regions. But tomorrow the local market may look very different.

It is possible, if not likely, that within a few years the coaxial cable owned by cable television operators will be delivering local telephone traffic, just as they are doing today for nearly 400,000 customers in the United Kingdom. In addition, a variety of wireless technologies -- including cellular, specialized mobile radio, and the new personal communications services portions of the spectrum -- could create powerful competition to land-line telephone service.

Of course, cable and other forms of competition to the RBOCs' local telephone monopolies will arrive only if state and local regulators permit them to compete. So far only a few states have taken steps to remove essentially all of their restrictions to entry into the telephone business. I will have more to say later about the need for other states to eliminate these artificial and unnecessary entry barriers.

Meanwhile, what about the claim that the need for standards leaves little room for competition? This argument is flat wrong. It may well be true that once a standard has been accepted in the marketplace -- such as the QWERTY layout on a typewriter -- competition is no longer possible. But, with the one qualification I will discuss shortly, we must assure that competition will continue to govern the development of standards themselves.

Microsoft proves this point. As you all surely know, Microsoft gained a monopoly in operating systems for personal computers in the 1980's by successfully marketing DOS and Windows, which became industry standards. There was nothing unlawful about this.

But then the company adopted certain licensing practices -- "per processor" licenses that taxed competing operating systems, lengthy terms, and large minimum commitments -- that effectively froze competing operating systems out of the original equipment market, the largest channel for distributing this type of software. The Justice Department sued Microsoft because these practices (coupled with restrictive non-disclosure agreements imposed on developers of applications software) unlawfully entrenched the company's monopoly and thereby deprived competitors of a fair shot at becoming the next standard. Microsoft has signed a consent decree, which if approved by the District Court for the District of Columbia, will level the playing field in the PC operating systems market.

The Microsoft case teaches an important lesson. It is perfectly legitimate to "own" a technology or product that becomes a "standard," but it is against the law to erect barricades to competing, would-be standards. This proposition is especially important in high-technology industries, where rapid innovation may create frequent opportunities for new standards to replace old ones. If the owners of the old standards are allowed to use any means to block entry of the new, then innovation itself will be discouraged and consumers will lose.

The one qualification to the proposition that competition should govern the development of standards is that in some cases, it may be in society's interest for competitors to agree on standards -- or, in effect, to act as a joint venture in standards creation. For example, manufacturers may lawfully cooperate to set quality standards, saving regulators the time and expense of certification. A number of bodies in the telecommunications and computer fields perform similar functions.

But even in these cases, the standards joint venturers must not abuse their legitimate collaboration to distort the competitive process. Thus, standards-setting bodies should be open to all parties who meet reasonable criteria for membership. In addition, the standards-setting process must be a fair one, and not serve as a device simply for preventing new competitors or new standards from entering the market.

In sum, competition must remain as the central governing principle for the information age. Competition will best promote continued innovation. Competition will guarantee consumers the lowest prices for telecommunications and information services. And by securing low prices, competition is an essential means for promoting the widespread availability of these services.

If there is any doubt about these propositions, you need only look across both oceans. Europe and Japan have continued to follow the state-directed, monopoly model in telecommunications for years and now find themselves behind the U.S. Thus, The Wall Street Journal (August 15, 1994, p. 1) recently reported how Japan's telephone monopoly, NTT, was far behind the U.S. regional

telephone companies in laying fiber optic cable. The editors of The Economist (August 13, 1994, p. 13) have taken European governments to task for sheltering their telecomm giants from both domestic and foreign competition. It is not hard to understand why. One study recently reported in the Wall Street Journal (September 30, 1994) projects that an end to telephone monopolies in Europe would not only lower prices but improve quality by 40 percent.

The benefits from telecomm competition are being recognized closer to home. Canada's telecomm regulators in September took a major step toward promoting competition by freeing the telephone companies to go into video, while opening up local telephone markets to competition from cable television operators and other sources. If the United States wants to continue to lead the world in telecomm innovation, it must act soon to move in a direction similar to Canada's -- that is, to clear away the remaining obstacles to fair and effective competition throughout the telecommunications industry. I will return to this theme at the conclusion of my remarks.

Preserving and Promoting Competition Through Antitrust Enforcement

Along with the Federal Trade Commission, the Antitrust Division is charged by federal law with protecting and promoting competition. What I'd like to do now is discuss several ways in which the Division recently has been fulfilling this mandate that affect the future of telecommunications.

Merger Enforcement: One of the defining characteristics of the current revolution in the telecommunications field is the dizzying pace of corporate marriages. It seems that not a week goes by without one or two major mergers or corporate alliances being announced, each advertised as an ideal way to accelerate the building of the "information superhighway" by combining the unique talents and expertise of the two partners in a single entity.

In many cases, this may be true and the Division will not stand in the way of these outcomes. 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.

Mergers involving telecommunications and computer firms can pose special problems to those of us who have to enforce the antitrust laws. This is because many of the firms in these industries already have a dominant, or even monopoly, position. The seven RBOCs, for example, each currently have a monopoly in local telephone service, as I have already indicated. 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 are already dominant in their markets surely know that neither the Division nor the FTC is likely to permit them to engage in "horizontal acquisitions" -- that is, purchases of direct competitors. As a result, many of the high-tech mergers we

have seen so far involve the marriages of firms dominant in one market with firms in related markets -- such as RBOCs proposing mergers with cable companies, telephone companies active in different geographic areas proposing mergers, and so on. The critical question posed by these mergers is whether they will allow one or both of the firms with dominance in one market to extend its market power to a second market (a special danger where the acquiring firm is a regulated monopoly). If so, we as antitrust enforcers try to persuade the parties to revise their proposal or to accept appropriate conditions that can remove the anticompetitive effects of the transaction. If this 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. The first is the marriage between AT&T and McCaw Cellular, both dominant players in their respective markets. As noted earlier, AT&T still has about 60 percent of the long-distance telephone market; McCaw carries about 30 percent of the nation's cellular traffic but, in a number of regions around the country, around 50 percent of local cellular calls. In seeking to acquire McCaw, AT&T clearly wanted to provide seamless local and long-distance cellular service to customers.

Without any conditions, however, this proposed merger posed risks to competition in several markets. Under their original proposal, the parties wanted to be able to market to their customers a combined long-distance/local service cellular package

without giving them a choice of another long-distance carrier. Given McCaw's market power in various localities and AT&T's market power in long-distance, this proposal could have significantly distorted competition in the long-distance market by diverting customers away from other long-distance companies based on factors other than quality or price, further entrenching AT&T's already dominant position in long-distance.

To address this problem, the Division conditioned its approval of the merger on McCaw's providing competing long-distance carriers with equal access to McCaw's subscribers (just as the Regional Bell Operating Companies now are required to do for long-distance traffic on their land-line traffic and as the Department has proposed they be required to do if they are allowed to provide long-distance service in connection with their cellular traffic). In addition, the consent decree that the parties signed prohibits AT&T from offering its local and long-distance cellular services as a bundle; it must instead separately price each service.

The AT&T/McCaw merger also posed a threat to competition in local cellular markets. AT&T currently is the dominant manufacturer of equipment for cellular carriers, including many of the RBOCs that compete with McCaw. Given the nature of cellular systems, once a carrier begins purchasing a particular brand of equipment, it gets "locked-in" for some period of time to that brand. The danger posed by the merger is that AT&T could exploit this fact and its position in the cellular equipment market by raising prices or denying or delaying the delivery of

parts and other services to RBOCs that aggressively competed with McCaw in local cellular service. Knowing this, rival cellular carriers and AT&T/McCaw could develop an implicit understanding to keep cellular prices high.

The consent decree prevents this result by prohibiting AT&T from such conduct. In addition, it addresses the lock-in problem in particular by allowing, under certain circumstances, cellular equipment customers of AT&T to sell back their equipment to AT&T, if they want to, at cost minus a reasonable allowance for depreciation.

The second telecommunications merger approved subject to important conditions is the purchase by British Telecommunications of a 20 percent interest in MCI, as well as the creation of a global joint venture between the two companies. 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 unlikely that either the proposed equity investment by BT in MCI or the joint venture would pose any competitive risks.

But these were not the facts before us. BT was and remains the dominant telephone company in the U.K. And by virtue of its dominance, the proposed transaction would give BT incentives and the ability to favor its joint venture with MCI in pricing,

interconnection, and possibly other ways -- all to the detriment of U.S. consumers of other global telecommunications providers. If this occurred, then the prices on telephone traffic between our two countries could increase.

Accordingly, the Division approved the BT/MCI transaction only on several conditions. Most important, the parties agreed to publish detailed information about the terms and conditions of services that BT provides to the joint venture and MCI. This information will give ammunition to any disfavored competitors to lodge complaints with regulatory authorities in either the U.S. or the U.K. Such a "transparency" provision is less intrusive and less costly -- but no less effective -- than direct regulation.

In addition, the consent decree prohibits BT from providing to either the joint venture or MCI confidential information about other international telecommunications providers. And the parties agreed that if a significant act of discrimination in favor of the joint venture or MCI occurs in the future, the Department may seek modification of the decree to strengthen its non-discrimination provisions.

What about future mergers in the telecommunications industry? I can't be too specific because a number are pending now before the Division. I will, however, offer several broad comments on the relation between competition policy and mergers in this industry.

As you know, there has been much talk about "the" information superhighway. In fact, it is premature to focus on any one highway because there appear to be several in the works -

- land-line telephone, land-line cable, and various wireless technologies -- all competing to deliver voice and video content to businesses and homes around the country. No one really knows which of these highways will be successful. That is what markets are for -- to let the firms that are now spending billions of dollars to build these highways fight it out.

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. Thus, cable operators who want entry into telephone markets, or local telephone companies that may eventually gain entry into long-distance markets (a subject I will take up shortly), should fund their expansion only from the capital markets (those who purchase debt or equity) and not from their captive customers. The same is true for regulated telephone companies wanting to offer video and other services. To allow any other result is to permit the marketplace to be tilted in favor of monopolists, to the detriment of consumers.

Second, at least for the next several years, we shouldn't 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, neither firm would any longer have the incentive to develop and supply the new interactive services that consumers have been promised. This situation may change once technology affords consumers more

ways to receive information in the home. In the meantime, however, it is prudent to prohibit cable-telco marriages (of firms operating in the same service areas) for a reasonable period -- the Administration has suggested five years.

Third, we will be especially watchful of mergers or joint ventures between owners of highways and owners of content. Such transactions may create strong incentives for the integrated entity to foreclose the access of competing programmers to the highways. 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.

Removing Barriers To Entry: It is one thing to prevent mergers that threaten to choke off competition. It is another to ensure that such competition is allowed to take place.

Current law, however, largely presumes that certain telecommunications markets should be monopolized and therefore insulated from new entry. Thus:

--Unless the Supreme Court holds federal law to be unconstitutional (as three federal courts have done), local telephone companies are barred from offering video services in their service territories;

--As I noted earlier, local telephone companies are legally insulated from competition in all but a few states;

--The Modified Final Judgment (the consent decree governing the AT&T breakup) prohibits the RBOCs from competing in long-distance telephone services.

As you know, Congress came very close this year to enacting comprehensive legislation that would have paved the way for erasing each of these barriers to entry and thus aggressive competition. The Clinton Administration worked closely with the Congress to achieve passage of this legislation and intends to continue that partnership next year. In the meantime, the Administration urges the states to remove their barriers to entry into the local telephone business, as states like New York, Wisconsin, and Illinois have already done (or about to do).

Competition is vital if America is to maintain its leadership in telecommunications technologies and services. Competition also will best advance the goal of universal service, since competition will encourage providers to lower their costs and thus their prices to consumers.

Still, there is no escaping the fact that even a vibrantly competitive telecommunications marketplace will not deliver its services to all consumers. Some will lack the income to buy. Others may be too costly for private suppliers profitably to serve.

The most efficient (and least distorting) way to fill in these gaps is to provide subsidies to those who would otherwise not be able to purchase competitively priced telecommunications services, funded by all common carriers of telecommunications services. The legislation considered by Congress this year would have directed the appropriate federal and state regulatory bodies to move in this direction. The Administration will work with the

Congress next year to assure that any telecommunications package that is enacted will do the same.

Conclusion

My message today has been a simple one. Monopolies in telecommunications are dead or dying. This is good news, for only through vigorous competition will the telecommunications revolution we are now witnessing bring its full benefits to American consumers. The Antitrust Division is working hard to ensure this result. We hope that Congress will assist us in this task by soon enacting the comprehensive telecommunications legislation that is now so sorely needed.