DEPARTMENT OF JUSTICE

STATEMENT OF

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Mr. Chairman and Members of the Committee:

I am pleased to be here today to testify on behalf of the Administration about the vital issue of telecommunications reform. I applaud this Committee and its leaders, Senator Pressler and Senator Hollings, for their attention and important effort to foster serious telecommunications reform. I understand that members of the Committee are formulating comprehensive legislative proposals, which are so far reflected in drafts.

The health and vitality of this important sector of the economy have received so much attention from this Administration not only because it will make a difference in the way our citizens live and work, but because it is critical to America's prosperity in the 21st Century. The key test for any telecommunications reform measure is whether it helps the American people by providing benefits to consumers and by spurring economic growth, including higher incomes and job creation. The Administration believes that the way to achieve those goals is through real competition. Real competition provides consumers with lower prices, higher quality and more choice -- as the history of long-distance competition illustrates. Real competition also is critical to the continuing competitiveness of U.S. companies, which will create jobs and power America's continued leadership as this sector grows at home and abroad. As the President's Council of Economic Advisers concluded last year, federal legislation along the lines urged by the Administration in its White Paper could add several hundred thousand new jobs here in three years.

The Administration's fundamental vision for the telecommunications future is simple to state, but breathtaking in its implications: Every company will be permitted to compete in every market for every customer. We want that day to come as soon as possible. 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. To paraphrase Thomas Jefferson, we cannot expect to be transported from monopoly to competition in a featherbed.

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 Administration is eager to work with members of both Houses of Congress to achieve this important goal. Until passage of such legislation, the Department of Justice will move forward under the Modification of Final Judgment to promote local telephone competition as a basis for easing the restrictions on the Regional Bell Operating Companies. But I cannot emphasize enough that moving forward in court is a second-best alternative. Comprehensive, competition-promoting reform legislation is by far the better course for the country.

In the balance of my testimony, I would like to cover three areas:

- First, I would like to put the discussion of telecommunications competition into context, by explaining how we got here and how the nation has benefitted from the competition in telephone markets that has occurred thus far;
- Second, I would like to suggest why providing even greater competition in both telephone and cable television markets is critically important for American consumers and industry;
- Finally, I will identify the fundamental challenges that policymakers face in promoting telecommunications competition.

The Break-Up of AT&T and the Telecommunications Revolution

The telecommunications revolution -- 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 economic climate of competition that nourishes the creative genius of 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. We should not forget, however, the hurdles that effectively slowed competition before the success in 1982 of the Justice Department's antitrust suit. Long after competition in long distance service and communications equipment became technologically and economically feasible, AT&T frustrated consumer choice and actual competition through abuse of its monopoly control over local networks.

This story is not merely a matter for the history books. It is a cautionary tale that illustrates the persistence of monopoly in telecommunications markets. And it refutes the unsubstantiated notion that telecommunication monopolies can only exist if the coercive power of government keeps out competitors. In fact, AT&T for many years proved itself quite adept, through use of its local monopoly, at keeping competitors out of the long distance and equipment manufacturing markets, in spite of the best efforts to the contrary of regulators, the Justice Department and the competitors themselves.

The Persistence of Monopoly

AT&T used the local monopoly to discriminate against competing long distance carriers in terms of the type, quality and price of interconnection with the local network, preventing most consumers from buying service at lower prices from AT&T's competitors and inconveniencing consumers who did. For instance, consumers who used a competitor had to dial 23 digits to complete a long distance call, while AT&T customers only had to dial ten or eleven digits. Similarly, consumers who preferred other manufacturers' equipment discovered that they could not connect that equipment to the local telephone network. Moreover, the Department found that AT&T's manufacturing subsidiary, Western Electric, was overcharging the Bell system for equipment. Because these overcharges contributed to the Bell Companies' rate bases, they had the effect of inflating the prices that captive ratepayers paid for phone service.

Competitors detected AT&T's anticompetitive conduct and fought it in the courts and before regulators. The result more often than not was one step forward, one step back -- incremental progress that rarely could keep up with AT&T's ability to find new ways of impeding access to the local networks or disadvantaging other equipment manufacturers. As long as AT&T controlled the strategic bottleneck of a local telephone monopoly, litigation and regulation could not hope to promote free competition in long distance and equipment markets or protect captive ratepayers from inflated prices.

Indeed, the problem was related partly to the nature of regulation itself. With regulation constraining rates and profits in the local market, AT&T had the incentive to use the local monopoly to increase profits in the long distance and equipment markets. As long as consumers had no choice of local service provider, structural separation that prevented the regulated monopolist from participating in the other markets was necessary to prevent the abuses that plagued the industry and thwarted competition.

Regulators and would-be competitors were not the only ones stymied by the problem of the AT&T telecommunications monopoly. The Justice Department sued AT&T twice, in 1913 and in 1949, before bringing the suit that resulted in the MFJ. Those first two efforts to protect competition in telephone markets ultimately failed, because the relief obtained was not comprehensive enough.

But the third time it worked. The case filed against AT&T in 1974 was a nonpartisan undertaking to vindicate the principle that underlies the antitrust laws and, indeed, our economic system: Open competition on the merits is superior to regulated monopoly. The Department began its investigation in the Nixon Administration, filed suit during the Ford Administration, then pursued the case through the Carter Administration and into the Reagan Administration, with AT&T fighting every inch of the way. AT&T ultimately came to terms with Assistant Attorney General Bill Baxter and agreed in 1982 to the entry of the consent decree that we now call the MFJ.

As you know, the structural separation of the local exchange from other telecommunications activities was the essence of the MFJ. It required AT&T to divest itself of its local exchange businesses, resulting in the creation of the seven Regional Bell Operating Companies, sometimes called the RBOCs or Bell Companies. These Bell Companies -- independent of each other and of AT&T -- retained local telephone monopolies within their respective regions, subject to the requirement that the Bell Companies provide consumers equal, nondiscriminatory access to the long distance company of their choice.

The complete divestiture of the Bell Companies from AT&T's long distance and equipment operations removed AT&T's ability to use the local monopoly to thwart competition in the long distance and equipment markets. The MFJ also removed the RBOCs' incentive to impede competition in those markets through its "line of business" restrictions, which continue to prohibit the Bell Companies from providing long distance services and from manufacturing communications equipment. These restrictions protect against the recurrence of the specific harm that the MFJ remedied -- use of the regulated local monopoly bottleneck to hurt competition in other markets.

The MFJ retained the historically complementary roles of the FCC and the Department of Justice. Since its creation in 1934, the FCC has had Congressionally assigned responsibility for establishing the "rules of the road" for the telecommunications industry. Therefore, after entry of the MFJ, the FCC established the specific rules for implementing the decree's equal access requirements and created a process by which consumers could presubscribe to their preferred long distance carrier, both vital to facilitating the competition made possible by the MFJ. The FCC has continued to help open the long distance and equipment markets to competition.

The Benefits of Competition

The MFJ has benefitted the country spectacularly. Separating the long distance market from the local monopoly has increased competition dramatically, as MCI, Sprint and hundreds of smaller carriers have vied 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 some 50 percent since the break-up. Because of these lower prices, 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 impact of this change cannot be measured, but it unquestionably is profound and has changed the nation for the better.

Improvements in quality have accompanied lower prices and increased output: 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.

In short, the MFJ has enabled the United States to maintain its technological leadership in telecommunications. Nations that have stuck to the old monopoly model of telephone services have fallen behind. That is why many are now trying to emulate us, rather than the other way around. But we also should never lose sight of the fact that there is always room for more competition; line-of-business prohibitions should continue only as long as necessary.

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 hopeful that their days are numbered thanks to technological advances. For example, a number of the Bell Companies 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. 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. The FCC has begun to 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. And even consumers who eventually choose to replace their local telephone company with a wireless or a cable-based alternative will continue to need to interconnect with the old phone company to complete most of their calls. The kind of competition that develops depends on the terms of that interconnection.

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 and economic.

Policy Challenges Ahead

Thus, the challenge confronting all telecommunications policymakers -- in Congress, in the Executive branch, and the states -- could not be more clear: To encourage greater competition throughout the telecommunications industry in a way that does not distort the marketplace or pose dangers to consumers. In particular, as long as the RBOCs have a monopoly over local phone service, they will have -- in the absence of the MFJ line-of-business restriction or adequate safeguards provided for by legislation -- the incentive and the ability to hurt competition in other markets through cross-subsidization and discrimination.

Ultimately, effective competition in local telephone markets will provide the best protection against the RBOCs' ability to leverage their local telephone monopolies into other markets. Until local telephone markets are competitive, entry tests and structural safeguards -- such as separate subsidiaries that help regulators analyze pricing, cross-subsidization and discrimination -- are necessary to ensure that local telephone customers are not charged with the costs of long-distance service and manufacturing and that the other markets are not distorted by the RBOCs' local monopoly.

Promoting Competition in Local Telephone Markets

Let me emphasize that the point is not how to keep the RBOC's out of other markets, but rather how to let them in as quickly as possible without endangering competition in those other markets. The way to achieve that goal is to promote real competition in the RBOCs' own local markets. At this point, there appears to be a growing consensus about the steps that are appropriate for fostering competition in the local telephone markets. First and foremost, of course, legal and regulatory barriers to competition must be removed. Comprehensive federal legislation is uniquely capable of accomplishing that step.

Other steps that are supported by the Administration and that are becoming widely agreed upon include:

- implementation of arrangements for mutual compensation and interconnection that allow entrants to compete on a level playing field with the RBOC;
- implementation of unbundling and other arrangements for resale of local services on terms that make competition in local markets feasible;
- implementation of local dialing parity;
- implementation of number portability so that customers can switch local service providers as easily as they already can switch long distance carrier; and
- implementation of arrangements for access to poles and conduits.

The Administration strongly supports the inclusion in legislation of such steps to open the local loop. Likewise, the Administration supports legislation that would give the FCC the responsibility for formulating, within a specified time after passage, rules for the implementation of steps to open the local loop. Although it is appropriate for states to have a role in actual implementation -- since one size may not fit all -- there still needs to be a national policy creating the basic framework.

The Administration supports provisions that would apply unbundling and interconnection requirements only to carriers with market power. Because the threat that concerns us arises from market power, it would be needlessly regulatory to apply requirements in the absence of market power. The Administration also believes that the RBOCs should be permitted in comprehensive legislation to offer "incidental" long-distance service to facilitate the provision of wireless, cable and certain other services, along the lines provided for in last year's bill, S. 1822.

Even though there is broad agreement on the necessity of these steps, however, there remains the question of when the Bell Companies should be allowed to offer long distance services and on what terms. At one extreme is the idea that the Bell Companies should not be allowed to foray into other markets, such as long distance, until after they experience enormous losses of market share in the local markets over which they now exercise monopoly control. This approach, however, could sacrifice for too many years any benefits in added competition and innovation that the RBOCs might be able to bring to the long distance and other markets. It also conflicts with our fundamental vision of allowing every company to compete in every market.

At the other extreme is the idea that restrictions on the RBOCs should be lifted on a certain, preordained date, no matter what actually happens in the marketplace. By assuming without any basis in experience that competition eventually will come to currently monopolized markets, this approach would seriously endanger the progress of the last ten years in opening the long distance market to competition.

We think neither extreme is correct. We support the middle ground of competition. In our view, it would be too great a risk to competition to let the RBOCs enter the long distance market immediately upon the first halting steps toward meaningful local competition. Entry should come only after an assessment made within 180 days of application in the market under a standard such as Section VIII(C), a responsibility that should be delegated to the Department of Justice, the agency that has applied that standard for many years.

Although the steps that I listed should foster the emergence of local competition, it would be unwarranted to assume that competition will in fact emerge or how fast it will emerge. On the one hand, the steps may not be sufficient. On the other hand, competition may flourish before some are fully accomplished. There simply are no guarantees as to whether and how fast local competition will develop. By applying this market-based test for long distance entry, we increase the incentive to open up local markets to real competition quickly and effectively.

The ultimate efficacy of these steps depends on the resolution of dozens and dozens of complicated implementation issues. To say that unbundling must take place, for example, begs the questions of the price of the unbundled network elements, the relation between those prices and the retail price of the bundled service and what sort of volume discount structure can be applied to either set of prices. The answers to these questions in turn will determine the marketplace effectiveness of the unbundling.

Some legislative proposals contemplate requiring resolution of implementation issues primarily through private negotiations between the RBOCs and would-be interconnectors, hopefully numbering in the hundreds and even thousands, with ultimate review by state commissions case-by-case, issue-by-issue to resolve disputes. Although the <u>option</u> of private agreement on interconnection is appropriate, we believe it would be a mistake to place primary reliance on such a mechanism and attempt to require it. It would be a lawyer's dream, replacing a unified, national approach with dozens or even hundreds of negotiations and administrative and perhaps court litigation in each state, each addressing new and complex issues. And if the fragmented negotiation approach is coupled with automatic RBOC entry into long distance on a fixed date, in the midst of all this will be a clock ticking inexorably toward RBOC long distance entry, without regard to the emergence of local competition.

The complexity of these implementation issues is exacerbated by the tremendous leverage that the RBOCs as monopolists would bring to any negotiations on interconnection terms. They can in myriad ways favor certain classes of competitors or individual competitors at the expense of others. They can resolve issues that matter to certain competitors and not others since companies have different needs. Smaller competitors in particular could have a difficult and expensive time negotiating and taking appeals.

The underlying point is that we cannot assume that taking some series of specified steps will result inevitably in the development of local competition. The real test will be what is happening in the marketplace itself: Have competitors been able to enter? Are they able to serve a variety of customers in the geographic area that the RBOC seeks to serve? Is the availability of such competing service expanding? Are competitors encountering significant barriers to such expansion?

The policy should not be a test based on market <u>share</u>, but a judgment, based on market <u>facts</u>, whether the RBOC entry presents a substantial possibility of impeding competition in other markets. The responsibility for making that judgment should be assigned to the

Department of Justice, based on the expertise in and understanding of competition in telecommunications markets that we have developed over the quarter of a century since the beginning of the AT&T investigation. Additionally, the FCC should review proposed entry under a public interest standard, based on the expertise and understanding of telecommunications that it has developed since its creation in 1934.

Legislation that does not include such a review of actual market developments risks putting the RBOCs' incentives entirely in the wrong place -- encouraging them to obstruct and delay the emergence of meaningful competition until the gun sounds to allow them to race into other markets. Then, still enjoying the advantages of a monopoly over local service, they would be in a position to reduce rather than increase competition in those other markets.

A penalty scheme alone may not appreciably change these incentives. Such a scheme entails a considerable amount of uncertainty as to whether there would be sanctions imposed and, if so, how significant penalties would be. The balance of uncertain high penalties against the certain and enormous financial benefit of keeping the local loop closed illustrates that the RBOCs retain the incentive of maintaining their control of local telephone. Moreover, given that the underlying requirements may be very qualified or worded in the negative, it may be difficult to prove a violation under any conceivably reasonable standard.

This is not to say that penalties should not be available to the FCC and to state regulators for failure to comply with interconnection requirements. It is to say that the stick of penalties is an inadequate substitute for the carrot of conditioning RBOC entry into long distance on the development of local competition. An excessive reliance on penalties would spawn more litigation and less interconnection.

If, on the other hand, the RBOCs must demonstrate to the Department real marketplace facts before they are allowed into long distance and to the FCC that it is in the public interest for them to enter long distance, they have incentives to cooperate in the opening of the local loop. The consideration of RBOC applications for entry by the two agencies, of course, should be simultaneous and subject to specified time constraints -- such as the 180-day period provided in the legislation last Congress -- in order to avoid unnecessary delay and uncertainty.

This approach enjoyed widespread, bipartisan support last year. The legislation that this Committee reported out on a 18-2 vote included an entry test to be applied by the Department of Justice, as did the bill passed by the House with more than 420 votes. A judicious combination of carrots and sticks is the best way to achieve our common goal of providing consumers the benefits of competition rather than the protection of a regulated monopoly.

Let me add, however, that omitting a market review from reform legislation does not mean that review will not occur. It means, rather, that such review will occur in the form of scores of AT&T-type antitrust suits filed in courts across the country. Resources that should be devoted to building the NII will be diverted to piecemeal litigation, which quite possibly will yield inconsistent results in the end -- assuming such litigation does end. That is why the Administration strongly supports a comprehensive national approach that takes advantage, in advance, of the Department's two and half decades of intensive experience of assessing competition telecommunications markets.

With regard to RBOC entry into equipment manufacturing, as opposed to long distance, there are a number of proposals. The dialogue on this issue is constructive in reaching our ultimate goal of allowing RBOC participation without threatening the burgeoning competition that exists in this segment of the industry. The Administration supports RBOC entry into manufacturing as long as it is accompanied by appropriate safeguards, including a strong requirement for use of a separate subsidiary. The Administration believes that the RBOC monopoly business should be separated from other RBOC businesses, but not that there need be multiple separate subsidiaries. The Administration also has supported a notification-and-waiting-period procedure under which an RBOC would submit relevant information about its proposal to the Department of Justice, which could investigate and sue to enjoin the proposed entry.

Promoting Competition in Video Services

Local telephone is not the only market in which reform can replace regulated monopoly with open competition. Legislation should encourage competition to cable television from other firms and technologies, which will reduce the market power that existing cable operators maintain in their markets throughout the country. Statutory and regulatory restrictions that prevent such competition should be removed, but in conjunction with appropriate safeguards and removal of all actual and effective legal barriers to cable company competition for local telephone service (and promulgation by the FCC of interconnection requirements). We encourage legislation that allows telephone company provision of video programming in their local service area upon removal of local telephone entry barriers and promulgation of interconnection requirements.

We recognize that the local telephone companies have challenged, with some success, the prohibition on providing video programming in their local service areas in court, even while enjoying, in most instances, continued protection of their local telephone monopolies from competition by cable operators. Nevertheless, comprehensive and balanced legislative reform with appropriate safeguards -- not piecemeal litigation -- is the fairest, most sensible and most orderly way to move forward.

The Administration endorses inclusion of provisions in the legislation that would prohibit telephone and cable television companies from acquiring each other within the same service territory. Public policy should promote competition between methods for delivering telecommunications services, and the existence of "two wires" going to each home remains crucial at this time to such competition. For this reason, the Administration believes that for a limited time there should be a general prohibition on mergers in the same service territory, subject to certain limited exceptions, such as for rural areas. Any exception should be subject to ordinary antitrust review. We look forward to working with the Committee on this issue.

Conclusion

The time has come to do what only effective legislation can accomplish: Move telecommunications policy out of the courtroom and into the hands of the two expert agencies charged with protecting the broad public interest in telecommunications (FCC) and competition in particular (DOJ, which helped launch the telecommunications revolution with its suit against AT&T).

The Administration looks forward to continuing to work with the Congress in a bipartisan fashion on an expeditious basis to provide the fair and competitive environment for the telecommunications industry that its participants and consumers deserve. The time to pass legislation is now. The nation needs a legal framework governing the telecommunications industry that promotes open competition as vigorously as possible. Removing existing legal barriers to entry in various markets is essential, but we should not ignore the lessons of history in this vital sector. Truly effective competition requires a truly level playing field, where no competitor is able to use its monopoly or market power in one market, such as local telephone services, to disadvantage competition in other markets. Ultimately, competition, not regulation -- and certainly not unfettered monopoly -- will provide the best guarantee of better quality, lower prices, more jobs, expanded export opportunities and more rapid innovation in the telecommunications industry.