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Competitive Policy in Communications Industries:
New Antitrust Approaches

PREPARING FOR COMPETITION IN A DEREGULATED TELECOMMUNICATIONS MARKET

By

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First, I want to say that I'm delighted to be here today and I'm grateful to Joe Sims and Phil Verveer for having invited me. I can tell from reading the program and looking at the impressive array of speakers that this has been a comprehensive and informative conference on some cutting-edge issues in the communications industry. In fact, when I realized that I was going to be the last person to speak I was reminded of Adlai Stevenson's quip in a similar situation when he said, "We're at the point in the program where everything that could be said has been said but, unfortunately, not everyone has had a chance to say it." So, I'm especially appreciative that so many of you have stayed around to hear my closing remarks and I hope that, despite the odds, I may be able to add something to the overall discussion.

Let me start by stating the obvious: what we're going through right now in the communications field is truly extraordinary. Technology, globalization, and last year's legislative, executive, and administrative actions have come together to create an environment of rapid change, great opportunity, and considerable risk. We all know that ten years from now things will be very different in the communications industry; we just don't know how they'll differ. From our perspective at the Antitrust Division, we have one, overarching goal -- to maximize competition. To be more concrete about that, as I see it, the ideal result would be a variety of different conduits -- be it wire, wireless, cable, or what have you -- that link people with all kinds of content -- be it voice, video, audio, computer, and so on. But envisioning an ultimately desirable competitive market structure is not the difficult part here; what's really hard is how we get there in a market that's transitioning from regulation to competition. And that is the journey that we in the Antitrust Division have embarked upon -- at a somewhat dizzying pace, I might add, since the passage of the 1996 Telecom Act a little more than a year ago.

Before I focus in on some of the specifics, let me give you a sense of the breadth of what we're dealing with. In the first place, we've seen a flood of radio mergers now that the 1996 Act has authorized far more liberal ownership rules. I'm advised that there have been over a thousand such mergers in the past year and about 150 of them have been brought before the Division, principally through the Hart-Scott-Rodino process, but also through independent inquiry in several non-reportable transactions. We've conducted extensive investigations in many of these cases and, to date, we've sought divestitures in a handful of mergers. And while that's important, in terms of the economy the real story here is how much concentration is occurring. In short, the concentration envisioned by Congress is taking place, no doubt allowing the industry to achieve some important efficiencies. And so long as this consolidation doesn't erode competitive opportunities in any market -- and, with the application of sound antitrust principles as a guide, I don't think it will -- then these mergers may ultimately strengthen the position of radio in the overall communications industry. And, frankly, that's all to the good.

Beyond radio, we're also experiencing consolidation in other areas of the communications industry. The FCC is still evaluating what limits to place on broadcast ownership but, in other areas, we've already seen significant movement. There's been a major Bell Company/cable merger -- U.S. West/Continental Cable -- which the Division cleared with some modification to the original deal. And we've also seen three major telephone mergers -- SBC/Pactel, which we cleared without objection several months ago, and Bell Atlantic/NYNEX and MCI/British Telecom, which are both still pending before us. These cases raise important questions about potential competition, and also about international interconnection where market conditions may differ significantly in different

countries and we have expended, and will continue to expend, considerable time and energy analyzing them and other such mergers that may come before us in the future.

Now, in the time that remains, I'd like to focus in on one particularly challenging aspect of this journey through the communications industry and that is the deregulation of telephone services in this country. This was probably the most significant part of the 1996 Act and it raises enormously difficult questions, questions that we at the Division have, to some degree, been dealing with under the Modified Final Judgment, or the "MFJ," that resulted in the break-up of AT&T and the creation of seven Regional Bell Operating Companies, or "RBOCs," as they are called, with severe restrictions on what they could do beyond providing local telephony within their own service areas. As a result of that lawsuit, there can be little doubt that the Nation has seen significantly improved long distance competition, accompanied by the innovation and downward pressure on prices that results from such competition. That is not to say that everything's perfect in long distance -- even more competition would certainly be welcome -- but it's important to recognize how far we have come when we have three well-established competitors, hundreds of other resellers, and four fiber-optic systems wiring the country, with a fifth in progress. I can tell you from my personal dealings with officials from other countries that, as a result of the AT&T case, the U.S. is positioned for global competition in a way that is the envy of our current trading partners -- whose telephone companies will be our future competitors, I might add.

But now we are charged with taking the next steps -- in particular, the Congress, together with the leadership provided by the Clinton Administration, established a statutory framework that is designed to open up local telephone markets to competition and that would also allow the local companies to move into in-region, long distance service for the first time. The goal of this process

is to have full-scale competition in telephony throughout the nation. In a nutshell, consumers should have as many as possible, but at least several, local options, long distance options, and, ultimately, combined local and long distance options (one-stop shopping, if you will). Once again, knowing where we want to get is the easy part; it's getting there that's hard. And to accomplish that goal, the statute puts in place a variety of interrelated steps and assigns responsibility to three separate agencies -- the FCC, the various state regulatory commissions, and the Department of Justice. This mix of players, I would suggest, sensibly reflects the fact that telephone regulation has historically been a shared function of the FCC and the state agencies and, quite naturally, both of them are necessary to the deregulatory process as well. And we also belong there, essentially because the goal of the process is competition and we have expertise in that area generally and with respect to telephony, in particular, because of our extensive involvement in the AT&T case.

The vision of the 1996 Act was premised on a simple formula: if the regulatory environment were different, the market for local telephone service -- previously thought to be a "natural monopoly" -- would be subject to the discipline of competition, bringing down prices and increasing quality and choices for consumers. On this point, there was widespread agreement, supported by the experience of several states in paving the way for competition in the market for local telephone services. Building on that experience in 1995, the Antitrust Division, along with Ameritech, AT&T, and many other parties proposed, on a trial basis, a waiver of the MFJ, allowing Ameritech to offer in-region, long distance service in return for compliance with some measures designed to open its local market to competition and a demonstration that actual competitive opportunities were expanding. This proposed waiver, like the 1996 Act, contemplated the creation of new, facilities-based, local service as a way to bring real competition to the local telephone

market. The Act seeks to do this on a much broader scale, and in so doing, calls for a series of transitional steps. Getting these steps right is no easy task, and although they may not immediately lead to the type of comprehensive facilities-based service that we hope to see over time, we all realize that we should not let the perfect be the enemy of the good here.

As I see it, then, implementing the deregulatory vision set out in the 1996 Act involves four basic things: (1) a set of rules that will allow new entrants into local markets -- the so-called interconnection rules adopted by the FCC last August and which have now been stayed in significant part by the Eighth Circuit; (2) another set of provisions that establish the criteria necessary to facilitate local competition and with which the RBOCs must comply before they are allowed to provide long distance and one-stop shopping services; (3) access reform, designed to reduce the price paid to local carriers for originating and terminating long distance calls so that this price will reflect the actual cost of providing the service; and (4) a universal service plan that will eventually replace the implicit subsidies contained within the current regulated telephone service system with explicit and competitively neutral subsidies. As to this last point, I should quickly explain that the current system requires some users to pay above-cost rates to subsidize other users who are served at rates below cost; the 1996 Act calls for these implicit subsidies to be made explicit and to be paid for through a competitively neutral universal service fund. Until we fully implement this mandate, some local exchange carriers (or LECs, as they are called) may be required to bear the costs of serving these customers at uneconomic rates and/or we will continue to see inefficient pricing and entry signals which will tend to distort competitive opportunities and thereby hurt consumers.

Now, as I see it, the paradox of this kind of deregulatory effort is that it depends upon a series of regulatory steps -- all taken, to be sure, in the name of deregulation -- and those regulatory steps, in turn, can significantly affect the long-term prospects for full-scale competition in telephony. There is no formula or equation that one can look to in order to get these things right. They involve the exercise of discretion by government agencies, which in turn requires careful, sound judgments. And, given that these predictive judgments are necessarily based on incomplete information, we should all be somewhat humble in second-guessing those who have to make the calls. Interestingly, the Fifth Circuit, quoting Justice Cardozo, made just this point about a quarter of a century ago in a case evaluating an FCC regulation prohibiting telephone companies from offering cable service in their regions, explaining that:

> [i]n a complex and dynamic industry such as the communications field, it cannot be expected that the agency charged with its regulation will have perfect clairvoyance. Indeed, Justice Cardozo once said, "Hardship must at times result from postponement of the rule of action till a time when action is complete. It is one of the consequences of the limitations of the human intellect and of the denial to legislators and judges of infinite prevision."[1]

Against the backdrop of this call for humility, let me now go on to highlight the problems in making the necessary regulatory judgments by examining the four transitional steps that I just mentioned. First, in order to get even some local competition, at least for some period of time, competing carriers will have to either purchase service from the LEC at wholesale and attempt to compete with the same LEC by reselling at retail or it will have to use the LEC's facilities -- switches, loops, and the like -- in whole or in part. In either case, someone has to set a price for the product -- be it wholesale service or the unbundled elements. That price in turn can have

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[1] General Telephone Co. of Southwest v. United States, 449 F.2d 846, 863 (5th Cir. 1971) (quoting Benjamin Cardozo, The Nature of the Judicial Process 145 (1921)).

important repercussions -- set too high, it can unfairly burden new entrants and make local competition impossible; and set too low, it can give new entrants a competitive advantage at the expense of the incumbent LEC. What this all means is not just that one of these companies may make a little (or even a lot) more than the other but that long-term competitive conditions can be seriously affected by these pricing decisions. This particular concern has led to the Eighth Circuit litigation in which the incumbent LECs are challenging the FCC's pricing methodology (as well as the Commission's authority to impose a certain pricing methodology to begin with). Fortunately, at least from our point of view, most of the States have followed the Commission's pricing methodology and so, while the litigation goes forward, the actual prices for wholesale and unbundled elements may not be materially different regardless of who ultimately prevails in the Eighth Circuit. I say that's fortunate from our point of view because we supported the FCC's approach as a sound pricing methodology for stimulating efficient local entry.

The second area where some difficult regulatory decisions must be made in this deregulatory process has to do with the issue of when a particular RBOC is permitted to enter the long distance market. Under the statute, this is a state-by-state determination, made by the FCC, with key inputs from the state regulatory agencies and the Department of Justice. Here, too, you can readily see the significance of the trade-offs in the regulatory decision. If you let the RBOC into long distance prematurely, two bad things can happen. First, you may undermine the chance to ensure a competitive local market since, once in long distance, the RBOC's incentive to cooperate with its competitors will diminish -- if not altogether, at least significantly. And second and derivatively, a premature entry into in-region, long distance service gives the RBOC an unfair advantage in the offering of one-stop shopping since it can readily combine its local

service with one of several long distance services easily available to it in the marketplace, while its potential competitors may not have nearly so easy a time combining their long distance service with local service that has heretofore been unavailable to them. On the other hand, if you keep the RBOC out of long distance for too long a period, you risk giving the long distance carriers an undue competitive benefit, since only they are able to offer customers both local and long distance service for the period of time that the RBOC is denied entry, thereby giving them a first mover advantage. Not surprisingly in this environment, both kinds of carriers -- local and long distance -- feel very strongly about the timing of RBOC entry into long distance, even to the point of purchasing significant advertising to make their respective cases.

For our part at the Antitrust Division, the issue of RBOC entry into long distance has been a special focus. Under the statute, we are expressly charged with evaluating each of the fifty state applications and our competitive assessment must be given "substantial weight" by the FCC. What is probably most notable about the process is that we are authorized to make our assessment "using any standard the Attorney General considers appropriate." Now, given that broad swath, the first thing we needed to do is to establish a concrete standard so that applicants would know in advance how we'd be evaluating them. We also needed to relate our standard to the other, specific provisions of the statute -- such as the 14-point checklist, the Section 272 separate-subsidiary requirements, and the Track A and Track B entry provisions, as well as the public interest test that the FCC is charged with applying. In order to meet this challenge, we engaged in an extensive inquiry, soliciting comments from all interested parties and meeting with virtually all the affected players. We received almost seventy-five comments and have met with countless industry officials.

The upshot of this process has been to reach the following conclusion: Our basic standard is that, before an RBOC should be allowed to enter long distance, it must be able to demonstrate that its market is truly open (which, I should make clear, is different from saying its market is fully competitive). Before I put meat on the bones of that standard, let me first say how we think it integrates with the remainder of Section 271. We believe that the other provisions -- the checklist, the facilities-based requirement, the separate-subsidiary requirement, and the option of Track B -- are all necessary, though not sufficient, to support entry. These requirements, almost as their names imply, involve fixed points but, by themselves, are not sufficiently dynamic to ensure that real competition can take place. That's where we think our approach comes into play: we view it as the dynamic part of the equation, looking to ensure that the wholesale support systems for opening up local markets are not simply claimed to be in place, but that they will actually work in fact, are scalable, and have been benchmarked, so that competition will be real and not merely theoretical. We think this approach is the best way to ensure competitive effectiveness, which we take to be our express charge under the statute, and we think it dovetails nicely with the "public interest" standard that the FCC is charged with applying in making the ultimate decision under 271 whether to approve a particular application. More broadly, we believe that our approach fits well within the overall statutory scheme adopted by Congress, nicely blending the fixed and dynamic requirements to reach an effective result.

Now, let me add a few words about how we will apply this standard to RBOC applications under Section 271 of the Act. Our preference, though we recognize that it may not always occur, is to see actual, broad-based -- i.e., business and residential -- entry into a local market. This kind of entry requires not only appropriate agreements between the RBOCs and

their potential competitors, but also the wholesale support systems necessary to ensure that when a current customer is switched from the RBOC to the new competitor, the switching process occurs quickly and effectively, so that the customer is satisfied and its new phone company is not blamed for messing up the transfer -- or that, after a customer has been switched and she needs any services, such as repair of her phone line, she gets it from the RBOC in a timely and effective manner. The truth is that, no matter how effectively systems are designed and even assuming complete good faith on the part of the RBOC, this kind of transition can have a lot of bugs in it. Once we see successful full-scale entry, however, then we will have reason to believe that the local market is open to competition. This approach doesn't require the shift of any particular amount of market share; nor should it take very long once there is true broad-based entry into the RBOC's market. Rather, using a metaphor that I've become quite fond of, we just want to make sure that gas actually can flow through the pipeline; and the best way to do that is to see it happen.

This approach -- i.e., looking for tangible entry -- also has two additional virtues: first, once there is such entry, the new entrant certainly should have an incentive to make the process work, since any new customers that are ill-served will blame the new entrant. This will mean that the new entrant is not likely to be gaming the system and, if there are problems, the reason will be that the local market, for some real-world reason -- malign or benign -- just isn't ready for competition yet. And second, if broad-based competition appears to be working smoothly, as we certainly hope it does, it will establish a benchmark against which future, post-RBOC entry into long distance, performance can be measured. In other words, if competitors can obtain what they need, and what they are legally entitled to get, from the RBOC prior to its entry into long

distance, but not after it, then we will have reason to suspect that something is wrong and we will be able to pursue appropriate remedial action.

Now, an even harder problem arises when the RBOC claims that it's done everything it can to make entry opportunities fully available but, for some reason, no new entrant has decided to go forward in a significant way. In these circumstances, we will attempt to determine what the problem is. And, purely at the level of speculation, one could imagine a variety of explanations. For example, the prices being charged by the RBOC could be too high to allow effective competition any time soon or its systems may be too uncertain for the new entrant to take the risk of large-scale entry, or the RBOC may not be cooperating with its competitors by providing the necessary wholesale support systems. On the other hand, it may be that, despite reasonable interconnection terms, fully available support systems, and so on, it simply may not make economic sense for a new entrant to come into any given market on a large-scale basis. Or, a more elaborate version of this problem may be that, if the long distance carriers think they are better off preventing the new competition by the RBOC in their market and also think that the best way to achieve this result is to stay out of the local markets, they may simply choose not to enter. On the third hand, if you will, it may be that some other factor -- such as a state statute or local regulation -- is making large-scale entry infeasible or, at least, very unattractive. These are some possibilities, and I'm sure there are others as well.

In any event, we will carefully examine the facts in any case where there isn't full-scale entry to determine what's actually going on. In such circumstances, of course, we will ultimately have to make a fact-based determination on a case-by-case basis. But I want to be very clear about one thing: we will pay careful attention to see whether any party is trying to

game the system for its own parochial reasons. And, if we think that's what's going on, be assured that we'll take appropriate action. We don't have any dog in this fight -- just a desire to ensure full-scale competition in telephony in an enduring fashion. Once that occurs, the market can pick the winners and losers.

Let me now quickly turn to the last couple pieces of this deregulatory puzzle -- access reform and universal service. These areas, which are related, also raise long-term competitive concerns. Lowering access charges to cost is desirable in a competitive market but, in the process, there are at least a couple of things you need to be alert to -- first, you want to ensure that no one gets an undue competitive advantage during the transition process; and second, you need to make sure that the incumbent LEC is fairly compensated for any implicit subsidies in the system that it has to bear and which have previously been supported by above-cost access charges. That is where the universal service funding system kicks in. It is designed to pick up these kinds of subsidies so that, as I said earlier, competition can go forward without unfairly burdening those players that have to bear the costs of such subsidies.

These kinds of issues can be enormously complex -- first, how do you sort out implicit subsidies as well as any historic costs that a LEC is entitled to recover in a way that is fair; and, second, how do you then collect the money necessary to pay these costs through a competitively neutral system. If you've seen the FCC's Notice of Proposed Rulemaking on Access Charges -- a rulemaking that is ongoing as we speak -- you probably have some idea of how complicated this whole process is. The Commission has raised important questions about rate structure, about rate levels -- including possible market-based as well as prescriptive methods for dealing with these levels -- and about rate de-averaging, which means allowing different access charges

for different customers. Anyway, the trick is to do this in a way that hastens competitive opportunities but that is fair to all parties. I am confident that the Commission will do just that.

One final point to remember as we move into a deregulated environment is that the Telecom Act explicitly keeps the antitrust laws in force. This serves not only to guard against any anticompetitive consolidation, but also against any other practices that violate the antitrust laws. Once regulation begins moving off center stage, we are prepared for the possibility that antitrust enforcement may be necessary to ensure full and fair competition in these markets. Especially in network industries, questions of exclusive dealing, control over essential facilities, and the use of market power can raise significant antitrust concerns. As a result, I intend to make sure that the Division keeps fully abreast of the developments in the marketplace and is ready to take any action necessary to prevent abuses of market power or other anticompetitive practices.

Let me close by emphasizing that, while I've tried to accurately portray at least some of the difficulties set in motion by last year's Telecom Act, I'm very optimistic about the endeavor we have embarked upon. I've seen some recent stories in the press complaining that consumers haven't yet received the benefits of the 1996 Act but, frankly, I think such expectations are unrealistic. We've had a regulated system of telephony in this country for over a century; it won't be deregulated in a year and even after it is deregulated, it'll take time for competition to ring all the fat out of the system so that consumers truly get the best service at the lowest prices. But, if we stay the course, I'm confident that we will ultimately realize how wise this legislation was and how much it will benefit our people. I say that because history has taught us, time and time again, that deregulation is difficult and transitions can be costly, but if our Nation's

economy is to be as strong as it can be -- indeed, as strong as it must be in an increasingly globalized market -- deregulation is not only desirable, it's essential. In short, history is on our side. A little patience is all that's needed.