DEPARTMENT OF JUSTICE

INJECTING COMPETITION
INTO REGULATED INDUSTRIES AND UTILITIES

Address by

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One of the most important developments in the American economy (and in other developed economies) over the past twenty years has been the movement in industries such as utilities and transportation toward competitive markets policed by vigorous antitrust enforcement as an alternative to highly regulated monopolies or cartels. The more segments of any industry that can be subjected to meaningful competition, the better for American businesses and consumers, because competitive markets almost always surpass government regulation in providing lower prices, higher quality and more rapid innovation. But the key to meaningful competition -- especially in markets that have been regulated monopolies or may still be adjacent to regulated monopolies -- is alert antitrust enforcement.

Some observers try to pin the label of "pervasive government regulation" on antitrust enforcement, and create a presumption that if one supports doing away with the former one should support doing away with the latter. That suggestion is preposterous and fundamentally ignores the success of the antitrust laws in protecting and promoting free and open markets for over a hundred years. In fact, as our experience with deregulation in a variety of industries over the past two decades shows, it is precisely when we seek to end pervasive government regulation that we must make sure that we have a sound antitrust enforcement policy that emphasizes innovative, creative approaches to the transition to competition.

Antitrust Enforcement and Competition in the Airline Industry

The deregulation of the airline industry illustrates both the dividends that freeing regulated markets can have for American businesses and consumers and the role of sound antitrust enforcement. The deregulation of the nation's airlines in 1978 resulted in vigorous price competition and an

astounding expansion of capacity. Today, more people are flying to more places than ever before.

An important source of these benefits has been structural changes in the industry as firms have responded to the freedoms and pressures of the marketplace. To be sure, some companies did not respond as well as others to the need for change, and we have seen the disappearance of airlines that played distinguished roles in the development of the industry. But this is a natural -- indeed, an inevitable -- product of introducing competition into what previously was a government-sponsored cartel. When you have free and open markets, you will have winners and losers. In the long run, however, the ultimate winners are American consumers, American businesses and the American economy.

As you know, deregulation encouraged and enabled airlines to adopt more efficient route structures -- the hub and spoke systems that are so prevalent today. The overriding efficiency of these networks made possible more service to more origins and destinations and generally lower fares.

But the hub and spoke systems presented new challenges to the competitive process. Hub airports tend to be very concentrated, with one or, at most, two airlines having dominant shares of the traffic and providing most of the nonstop service between the hub and spoke cities. Entry by other airlines into these city pairs is difficult, in part because new entrants cannot easily duplicate the hub airline's network without incurring large sunk costs. This difficulty of entry is cause for concern -- studies have shown that at concentrated airports, air fares are higher for passengers traveling between the hub and spoke cities.

Airline deregulation also has resulted in structural changes affecting international aviation. Domestic airlines are entering market alliances with foreign airlines for international service to and from the United States. These alliances offer the promise of more frequent service to more

points, as well as other benefits. There is, however, also the possibility that such agreements -- depending on the participants -- could eliminate actual or potential competition for service between particular cities. We have been scrutinizing and will continue to scrutinize each agreement to ensure that it does not lessen competition and hurt U.S. consumers.

The Need for a DOJ Role in the Transition from Regulation to Competition

The hub consolidation that occurred in the early years of deregulation demonstrates the need to have the Department of Justice -- the agency with expertise in competition -- apply the antitrust laws to newly deregulated industries and industries in transition from pervasive regulation to more open competition.

From the demise of the Civil Aeronautics Board on January 1, 1985, through January 1, 1989, the authority to review and approve mergers among airlines was vested in the Department of Transportation. Although DOT sought to apply competitive principles in reviewing proposed consolidations, its analysis did not reflect the broad expertise in competition analysis that the Department of Justice brings to merger review. Thus, DOT approved mergers over the opposition of the Department of Justice -- mergers that unfortunately resulted in anticompetitive concentration at specific hubs and higher prices to consumers.

As we move forward with deregulating more industries -- such as telecommunications and railroads -- we should keep in mind that the goal of deregulation is to promote and protect competition, not to replace regulated monopolies or cartels with unregulated ones.

The best way to achieve that goal is to provide a decisionmaking role in the deregulatory process to the agency that is the competition expert -- the Department of Justice.

The Administration's proposal to sunset the ICC reflects this approach. It would remove all antitrust immunity for both motor carriers and railroads. Whatever economic regulation is still needed in order to protect captive rail shippers from an exercise of market power by dominant railroads would be transferred to DOT, while responsibility for labor issues would be transferred to the Department of Labor. But all rail mergers and acquisitions would be reviewed under the antitrust laws, as are mergers in virtually every other industry. Merger review in this important industry could then appropriately focus on one issue -- how the transaction likely will affect the prices and service quality of rail service to consumers.

Injecting Competition into Regulated Energy Markets

Two prominent examples of industries that are moving toward more market competition are interstate natural gas pipelines and wholesale electric power, industries that have been subject to pervasive federal regulation since the 1930's, with local aspects of their businesses regulated by the States. At least at the federal level, that pervasive regulation is giving way to free market forces.

The fundamental reworking of the natural gas industry -- which began when President Carter signed the Natural Gas Policy Act of 1978 and has continued with passage of the Wellhead Decontrol Act of 1989 and a series of broad-based initiatives by the Federal Energy Regulatory Commission (FERC) -- will be complete within the next two years. By then, the industry will be functionally de-integrated into its component functions, with price control remaining over only the core transportation function. The benefits of this change from regulated to competitive markets have been dramatic -- ample supplies at low cost. American businesses and consumers have saved billions of dollars.

Interstate electric power markets have been moving in the same direction, although at a more halting pace. The industry originated and developed in the form of vertically integrated utility companies that combined bulk power production at large central generating stations, long distance transportation to load centers and local distribution to end users. Deregulatory steps begun during the Carter Administration prompted the emergence of independent, non-utility power wholesalers by requiring utilities to interconnect with, and purchase energy from, cogenerators and small power producers. FERC also obtained limited authority to compel interconnection and transmission services. That authority was greatly expanded with passage of the Energy Policy Act of 1992, which repealed a requirement that the Commission preserve existing competitive relationships. In addition, the 1992 Act made it easier for independent generators, brokers and marketers to enter wholesale power supply markets.

FERC also has taken steps to facilitate effective competition in wholesale power markets by conditioning its approval of mergers and market-based pricing upon an applicant's agreement to provide open access to its transmission network. More recently, FERC issued a notice of proposed rule-making to require the utilities subject to its jurisdiction to file tariffs offering comparable transmission service to outsiders and to apply the tariff to its own sales for resale, effectively unbundling all transmission of wholesale power.

In short, the industry has moved, and continues to move, in the direction of competition in wholesale power supply markets. Independent power producers, marketers and brokers are assuming a larger role in the market, while regulated utilities are increasingly pursuing unregulated markets and businesses. As State regulators, who have jurisdiction over retail transactions representing four-fifths or more of the sales volume, tackle these issues, consumers can expect lower

costs and wider choices among available services and suppliers.

DOJ's Active Role in the Transition to Competition

The Department of Justice has played an active role in supporting and encouraging these administrative and legislative initiatives to open regulated industries to competitive forces. In broad terms, we seek to share with regulatory agencies our expertise in competition and to assure that emerging market forces are protected from private restraints. To that end, the Division will continue its competitive advocacy efforts in major agency proceedings and its enforcement activities in deregulating industries.

Two recent initiatives illustrate our efforts to protect and promote emerging competition in energy markets: (1) our comments in FERC's inquiry into alternative power pooling institutions (the "PoolCo" inquiry) and (2) our civil antitrust case to enjoin El Paso Natural Gas Company's practice of tying the sale of meter installation services to the provision of gathering services in the San Juan Basin.

PoolCo Comments

A "PoolCo" is a market-maker for wholesale electricity that dispatches generating units according to the prices they bid for supply, regardless of unit ownership, and that arranges for the energy produced to be marketed in voluntary sales transactions. A PoolCo is one of several promising concepts that could assist the transition of the electric power generation industry from regulated monopolies to more efficient, openly competitive and effectively unregulated markets. We see a PoolCo, with proper safeguards in place and under appropriate market conditions, as a potentially efficient allocator of electric energy, in effect de-integrating the industry by economically separating production from transmission and distribution.

Let me emphasize, however, that our assessment of the PoolCo concept must not be confused with support of any particular implementation. A pool has been established in the United Kingdom, for example, but it lacks some of the characteristics and safeguards that we believe are necessary. Furthermore, other institutions may be preferable, depending on the circumstances.

A competitively structured bulk power market is central to any market-based pricing mechanism that relies on competition among buyers and sellers to yield efficiently-priced and allocated resources. Where there is sufficient competition, market forces are clearly preferable to traditional rate regulation. PoolCos cannot, however, create competition in oligopolistic or other structurally uncompetitive markets. We have thus urged the Commission to withhold PoolCo approval unless the relevant bulk power markets are sufficiently competitive to assure that the benefits of dispensing with rate regulation will outweigh the costs. The converse also may be true, if the efficiency potential is to be realized. Where a PoolCo is created and operates in an efficiently competitive market, the FERC should consider removing price controls from PoolCo-traded bulk power.

Our comments emphasize the importance of open transmission access and appropriate transmission pricing. By effectively divesting transmission owners from control over the generating resources traded by the PoolCo, a properly structured PoolCo could facilitate equal transmission access without resort to complex, cumbersome and costly regulations or industry restructuring. Although such decoupling does not directly eliminate the need to regulate, it reduces the economic incentive to manipulate transmission access and pricing in order to favor certain generating transactions.

Transmission pricing must still be regulated, since over-priced or unreasonably-conditioned transmission is accessible

in name only. Inefficient transmission pricing leads to inefficient trading. Accordingly, we urged FERC to reject add-ons to PoolCo transactions designed to recover so-called stranded investment or other costs not associated with the energy transactions implemented through the PoolCo.

To achieve the maximum benefits of market competition, PoolCos must be open, equally available to all interested parties and voluntary. Buyers and sellers should neither be forced by the regulator to participate, nor unreasonably excluded, nor subjected to unequal treatment. Any approved Poolco should explicitly preserve freedom to trade bilaterally or through competing multilateral arrangements, should not have unreasonable membership criteria or operational rules and should expressly assure all participants equal access to transmission. In addition, approved PoolCos should confer no special regulatory privileges, especially preferential transmission access rights, which could dissuade buyers and sellers from trading outside the institution. Beyond these essential safeguards, the specifics of a particular PoolCo proposal are best left to negotiation among buyers and sellers.

El Paso Natural Gas

Our PoolCo comments demonstrate our use of competition advocacy to assist in the transition to more competitive markets. We also place a high priority on enforcement actions to stop anticompetitive practices in markets that are making that transition, as illustrated by a recent case involving El Paso Natural Gas Company, which operates the largest gas pipeline system in the San Juan Basin of New Mexico and Colorado. We alleged it had used its regulated monopoly to restrain competition in the unregulated market for meter installation services -- the construction and installation of the metering equipment that connects wells to gathering systems in the field.

Many producers in the San Juan Basin have no access to alternative gathering systems, and hence have no other means to move their gas to end-users. El Paso's gathering system is under the jurisdiction of the FERC, which regulates the prices El Paso is authorized to charge for gathering services. The installation of meters and associated equipment needed to connect wells to the gathering system, however, is an unregulated business. We were concerned that El Paso was extracting supra-competitive profits from metering installations, allowing it effectively to evade the full regulatory scrutiny designed to assure that it was not recovering more than its cost of service.

Our complaint alleged that El Paso denied or delayed gathering system interconnections to producers wishing to hire independent contractors to install meters. Tying arrangements have long been regarded as *per se* unlawful, and we concluded that the effect of such an arrangement in this case was to raise prices for meter installation and, in many instances, to slow the pace of installation completion. The practice cost well owners thousands of dollars on each installation and weeks of time in bringing their natural gas to market.

El Paso consented to entry of final judgment under which the company will cease engaging in these practices. Competition to provide meter installation services will lower the cost of producing natural gas in the area by millions of dollars over the term of the final judgment.

DOJ's Role in Promoting Telecommunications Competition

Finally, I would like to discuss briefly one of the most exciting transformations from regulated monopoly to competition -- the opening of telecommunications markets. As you know, one of the most important steps in the promotion of U.S. telecommunications competition was the success of the Department of Justice in breaking up the Bell System's

vertically integrated telephone monopoly. The Department's case against the Bell System, built up during the course of an investigation and litigation that spanned four Administrations of both parties, alleged that the Bell System used its monopoly control over most local telephone service in the United States to thwart competition in the markets for long distance telephone and equipment manufacturing. Judge Harold Greene in 1982 approved the entry of the Modification of Final Judgment, which required the complete separation of the local telephone monopoly from those competitive markets.

Once this divestiture was complete in 1984, competition in the long distance and equipment manufacturing markets exploded, bringing American businesses and consumers lower prices, better service and more products than ever before. MCI, Sprint and hundreds of smaller carriers now 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 some 50 percent since the break-up. Lower prices, greater choice and better quality also have come to the equipment market.

Because of this competition, 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.

Local telephone service, however, largely remains the monopoly preserve of the Regional Bell Operating Companies. The line of business restrictions of the MFJ keep these Bell Companies out of the long distance and equipment manufacturing markets, removing any incentive for them to impede competition

in those markets. The MFJ thus provides important protections for those competitive markets.

But the Department has long believed that the restrictions on the Bell Companies should last only as long and only to the extent necessary to protect competition in other markets. Thus, the Department has supported numerous waiver requests by the Bell Companies for relief from the MFJ's restrictions.

One basis -- and I emphasize that this does not exclude other possible bases -- for removing the restraints that keep the Bell Companies out of long distance would be the development of competition in local telephone markets. Earlier this month, the Department took a major step toward achieving the kind of local competition that would justify such removal when it filed a motion with Judge Greene asking him to approve a modification of the MFJ that would permit a limited trial of interexchange service by Ameritech, one of the Bell Companies, in two cities in Ameritech's service area, once Ameritech faces actual local exchange competition and the threat of substantial additional local exchange competition in those cities. The Department's motion was filed along with a stipulation by Ameritech and AT&T that the modification is in the public interest, and enjoys broad support among industry participants and consumer groups.

The proposed modification is the product of many hundreds of hours of staff work by the Department over the course of more than a year, including several rounds of public comment, as well as intensive discussions with Ameritech, state regulators, potential competitive local exchange carriers, long distance carriers and consumer groups. It represents major, affirmative progress toward realizing our fundamental vision of a telecommunications future in which every company will be free to compete in every market for every customer.

The proposal makes progress in two very important ways. First, it both builds upon and encourages the efforts of some

state legislatures and regulatory commissions to introduce competition in local exchange services -- competition that is the best possible safeguard against anticompetitive behavior in other markets. Second, it provides the opportunity to gain practical experience and develop real marketplace facts about the effects of Bell Company entry into the long distance market, without threatening substantial harm to competition in the long distance market.

We are now in the process of drafting our brief in support of the motion, and hope that Judge Greene -- who has been instrumental in promoting telecommunications competition in the United States -- will agree with us that the modification is in the public interest.

The proposed MFJ modification is just the latest in our efforts to seek innovative means of promoting telecommunications competition. Last year, for example, we worked with AT&T and McCaw Cellular to resolves competitive concerns arising from that transaction in a way that would allow the merger to go forward without threatening to lessen competition. Similarly, we supported a proposed waiver of the MFJ's line-of-business restrictions that, if approved by Judge Greene, will authorize the Bell Companies to provide long distance service for calls that originate in their cellular telephone systems. We determined that, with appropriate conditions, this waiver presented no substantial possibility of impeding competition in the long distance market.

Conclusion

America has prospered over the years because of our fundamental commitment to free and open markets characterized by competition on the merits. In the past twenty years, we have extended that commitment to markets that previously were the subject of pervasive government regulation, an extension that is ongoing in many vital industries. The experience of

these past two decades demonstrates that effective deregulation -- deregulation that results in meaningful competition and brings to American businesses and consumers all the benefits of free enterprise -- requires alert antitrust enforcement to ensure that we do not replace regulated monopolies and cartels with unregulated ones.