DEPARTMENT OF JUSTICE

PROMOTING COMPETITION IN TELECOMMUNICATIONS

Address by

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Today, I would like to discuss one of the most important economic issues facing the United States -- promoting free and open competition in the telecommunications industry. As you know, Congress has begun work on legislation to effect comprehensive reform in this area, an effort that we support. We look forward, as does this Administration, to legislation that promotes competition while protecting the competitive process and consumers. Real competition is the key to real deregulation. And I hope that legislation succeeds, because a good comprehensive policy is better than a good piecemeal approach.

But my focus today is not on legislation, although some of the ideas I will outline may be useful in that regard. Unless and until legislation is passed, the Department of Justice must fulfill its existing responsibilities under the antitrust laws and under the Modification of Final Judgment, or MFJ, which provided the framework for breaking up the AT&T telephone monopoly over a decade ago. Today, I will discuss our approach to these important issues and how we can support moving forward under the MFJ. This approach is based on our extensive experience for over 25 years now in assessing competition in the critically important local and long distance telephone markets.

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

Before outlining our views, however, it is worthwhile to review briefly the MFJ's role in promoting competition in the telecommunications industry. It is common these days to talk about the "telecommunications revolution" and how it is transforming our lives. Indeed, the changes in the past ten years have been breathtaking. Services that were novel a decade ago are taken for granted today. None of us thinks twice, for example, about faxing a document across the country -- or around the world. Cellular phones, cable television, a choice of long distance carrier -- all are a part of everyday life in the United States.

America is the world leader in this revolution in no small part because we were the first nation to commit to opening our telecommunications markets to competition, which we did when we dismantled AT&T's vertically integrated telephone monopoly. 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.

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. Some of you may recall, for instance, that 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. For example, the Federal

Communications Commission (FCC) attempted to increase competition in the equipment market with its 1968 Carterfone decision, which held that customers had a right to use their own terminal equipment -- in simplest terms, they should not have to buy their phones from AT&T. Nevertheless, AT&T succeeded in imposing such burdensome conditions on the interconnection of non-AT&T equipment that evidence of those conditions was an important part of the monopolization case that the Justice Department presented in 1981. 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 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 AT&T and its long distance competitors have equal, nondiscriminatory access to customers through the local networks.

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 local monopoly bottleneck to hurt competition in other markets.

These restrictions, though vital, are not inflexible. Section VIII(C) of the MFJ, for example, allows them to be removed upon a showing by the petitioning RBOC that there is no substantial possibility that it can use its monopoly power to impede competition in a market that it seeks to enter. The Department has an obligation to review requests for waiver or modification of the restrictions and provide its views to the court. The ultimate authority to grant waivers or other modifications resides with Judge Greene, to whom the nation owes an enormous debt of gratitude for the energy and wisdom with which he has administered the decree.

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 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. 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.

The dividends that competition has paid in these markets underscore the value of introducing competition to local telephone markets. The local telephone exchanges still appear to remain effectively the monopoly preserves of the RBOCs, each of which controls an enormous geographic expanse. For their part, the Bell Companies vigorously protest the competitiveness of some business telecommunications services and they are not entirely wrong -- for some services in some areas. Moreover, we will continue to investigate their claims.

But we believe thus far, simply stated, that the RBOCs protest too much. Competitive dial tone service is still unusual for business customers and nonexistent for residential customers. In fact, in many states it still is illegal to compete with the RBOC in the provision of dial tone service.

Some progressive States are moving to change this. We applaud these efforts and urge the other states to follow that lead. For example, the Rochester plan approved by New York regulators augurs real competition for local telephone dollars and real choices for Rochester residents. Partly in response to regulatory pressure and after extended negotiations facilitated by the regulatory staff, Nynex recently has agreed to reduce the charges it levies on MFS Communications for access to the local network in New York City; Nynex also will allow customers to keep their local telephone numbers if they switch carriers. Illinois is poised to move forward and has certified certain competitors, as have Washington State and Maryland. Michigan has both certified a competing carrier and issued a detailed order on terms of interconnection, prices for mutual compensation and unbundled network elements and other issues. California is taking steps to open its local markets to competition. Others are moving in that direction as well, although many are not.

It is an immensely difficult process, to be sure. These are complex markets with complex relationships between the monopolists and the competitors that seek to enter. But the States I have mentioned want competition in local markets and they are working to find ways to achieve it without threatening other reasonable policy goals.

I cannot overstate the importance of these State efforts to promote local competition. Local competition is the key to ending the Bell Companies' ability to impede competition in other markets. Meaningful local competition, combined with the safeguards which are necessary until competition flourishes on a large scale, is the surest way to erase the need to prolong the MFJ's line-of-business restrictions. It is the best way to protect consumers and promote better service. It is also the way to reduce the total costs of providing universal service.

Our 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. The government cannot and should not pick winners. Let the market decide. We would be naive, however, if we expected the transition from regulated monopolies to competitive markets to be flawless. To paraphrase Thomas Jefferson, we cannot expect to be transported from monopoly to competition in a featherbed.

The Transition to Competition Under the MFJ

In the absence of legislation, the MFJ has an important role in the achievement of that vision. The RBOCs have argued vociferously that the ability to offer one-stop shopping for local and long-distance telephone service is a major competitive advantage in the marketplace and that they do not want to be left out. By the same token, if the RBOCs are allowed into long-distance service before there is truly the opportunity for competition in local markets, they -- and they alone -- will have that advantage. Two intolerable results would follow. First, we likely would see a substantial loss of competition in the long-distance market, nullifying the hard-won benefits of the MFJ. Second, the RBOCs would gain an unwarranted advantage over potential local competitors, disabling the local competition that was supposed to serve as the predicate for removing the restrictions in the first place.

We therefore have devoted a great deal of thought to the relationship between the transition to competition and the relaxation of the MFJ restrictions in the absence of comprehensive, effective legislative reform. We have drawn on our more than 25 years of experience with competition in telecommunications markets, as well as intensive discussions over the past year or so with the Bell Companies and with other interested parties -- including competitive access providers, long distance carriers, cable companies, State regulators, the FCC, the National Telecommunications and Information Administration and consumer groups -- to find a way to increase local telephone competition as a basis for eventually considering the removal of the MFJ restrictions.

Until Congress enacts reform legislation, we are prepared to recommend to Judge Greene that the Court move forward under the MFJ when three basic principles are satisfied:

- First, steps to foster the emergence of local competition must be taken.
- Second, the effectiveness of these steps must be tested by actual marketplace facts -- by the state of competition.
- Third, RBOC participation in other markets initially must be accompanied by appropriate safeguards.

Let me elaborate on these broad principles.

Steps Appropriate for the Emergence of Competition

First, there are some steps that we believe from the outset are beneficial for the emergence of local competition:

- State removal of regulatory and legal barriers to competition;
- implementation of arrangements for mutual compensation and interconnection, including access to databases and signalling, 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 for those not in a position to duplicate the RBOCs' local networks;
- implementation of intra-LATA toll 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.

These steps stem from the fundamental economic characteristics of telecommunications markets and from our experience with competition, or the lack thereof, in these markets in the past.

Assessing the Development of Competition

Although these steps should foster the emergence of local competition, we cannot be certain that they will or how fast they will. On the one hand, they may not be sufficient. On the other hand, competition may flourish before some are fully accomplished, thus warranting the Department's earlier support before the Court of long distance entry. There simply are no guarantees as to whether and how fast local competition will develop. The Department of Justice will respond to real market facts and changes.

We recognize, however, that no set of conditions for promoting such competition could hope to address in advance the dozens and dozens of complicated implementation issues that will require resolution before meaningful competition is a practical reality, rather than merely a theoretical possibility. 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.

The underlying point is that we cannot simplistically 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? This is not and should not be a test based on market <u>share</u>, but a judgment based on market <u>facts</u>.

These implementation issues mean that the growth of local competition may take time, even under the best of circumstances. Thus, there remains the question of when in the process 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 blithely 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 a thorough assessment of actual developments in the market.

If market developments suggest that RBOC entry into other markets may be allowed without a substantial possibility of impeding competition, such entry initially must be accompanied by appropriate safeguards. At a minimum, those safeguards would include the creation of a separate subsidiary for interexchange operations to promote transparency in the operation of the Bell Companies as they enter long distance markets, as well as the continuation of equal access provisions to require nondiscriminatory treatment of competing interexchange carriers.

Let me emphasize explicitly what should be implicitly obvious from these ideas. The Department of Justice would not seek to supplant the State regulators or the FCC; they are the experts in telephone regulation. We depend upon and work closely with the States and with the FCC. In fact, this approach, if adopted, depends upon the States' acting first to encourage competition, because one of the most basic conditions for moving forward is for the States to remove legal and regulatory barriers to local competition. Where States do act (or where they already have begun to act), these carefully developed principles could establish a basis for approaching the Court for relief from the MFJ restrictions in a way that nurtures competition and allows it to flourish.

The success of this approach depends upon developing expertise about competition in telecommunications markets and applying that expertise in order to ensure that change is also progress. Our expertise in and understanding of these markets arise from our more than 25 years of experience since beginning the AT&T investigation. That understanding and expertise continue to grow through our recent discussions with the RBOCs, interexchange carriers and others.

Let me stress that forward movement within the framework of the MFJ does not mean that legislation is unnecessary. Following this approach is only a second-best alternative to comprehensive Congressional action that establishes a framework for open competition in all telecommunications markets. But it is an approach that may well yield progress until Congress supersedes the MFJ with comprehensive, competition-promoting telecommunications legislation.