# DEPARTMENT OF JUSTICE

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Subcommittee on Telecommunications
on S.652

The Telecommunications Competition and Deregulation Act

It is a great honor to testify before this subcommittee, along with Assistant Secretary Irving, on behalf of the Administration concerning one of the most important pieces of legislation this Congress will consider -- S.652, the Telecommunications Competition and Deregulation Act. I congratulate Senators Pressler and Hollings, and their colleagues on the Commerce Committee, for their hard work and constructive efforts in drafting S.652. And I am grateful to you, Mr. Chairman, Senator Leahy and this subcommittee for holding these hearings, exercising leadership in this vital area of our economy and competition policy and proceeding in a bipartisan fashion.

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, because, increased competition in telecommunications will benefit consumers, spur economic growth and innovation, promote private sector investment in an advanced telecommunications infrastructure and create jobs. 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.

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 key test for any telecommunications reform measure is whether it helps the American people. To meet this test, it must be effective in opening all telecommunications markets to competition, including -- first and foremost -- currently monopolized markets. And it must ensure that monopolists cannot harm consumers and competition in the transition to competitive -- and then deregulated -- markets.

Important portions of S.652 are consistent with these goals and with the need to encourage real competition. In many states, today, local telephone competition is still illegal. Thus, the bill's preemption of state entry barriers to local telephone markets is an absolutely essential element of opening those markets to competition. Likewise, the unbundling of local telephone networks that the bill envisions could facilitate the development of meaningful local telephone competition by making it easier for potential competitors to enter the market.

In several critical respects, however, the bill does not do enough to promote competition and protect consumers. The Administration supports changes to S.652 that would strengthen the bill's promotion of real competition and protection against monopolistic behavior. These changes will help ensure that American consumers actually receive competitive telephone prices, competitive cable prices and more and better quality telecommunications services. They will help consolidate America's position of international leadership in telecommunications and further sharpen the important competitive edge that such leadership gives American businesses.

Three changes in particular are vital to ensure that telecommunications reform achieves deregulation through real competition rather than unleashing monopolies:

- First, cable rates should not be deregulated unless and until they are subject to the discipline of competition.

- Second, subject to limited exceptions, telephone companies should not be able to merge with cable companies in their local service areas and deprive consumers of the benefits of competition between these two wires.

- Third, Bell Company entry into the long distance market should be conditioned on a Department of Justice assessment of actual marketplace facts to ensure that such entry will not unravel a decade of progress in opening that market to competition.

Of these three issues, I will focus my testimony on the importance of a Department of Justice role in approving Bell Company entry into long distance. I also will discuss why the antitrust laws alone cannot protect adequately against anticompetitive mergers by telephone and cable companies who share service areas. Both of these are matters that this subcommittee is especially equipped to address, implicating as they do important issues of competition and the Department of Justice's enforcement of the antitrust laws. Finally, I will highlight several other aspects of S.652 that raise competitive concerns. My colleague, Assistant Secretary Irving, will focus on cable and broadcasting issues.

The History of the Bell System Decree

The seven Regional Bell Operating Companies (Bell Companies), each of which has a monopoly over local telephone service in its respective region, are restricted from entering the long distance market by the Modification of Final Judgment or MFJ, the 1982 consent decree that settled the Department's landmark antitrust case against the Bell System. The danger of the local monopoly was the basis of that case. Before it was broken up, the Bell System was a vertically integrated monopoly. In addition to having a monopoly over the local telephone bottleneck, the Bell System

monopolized communications equipment manufacturing, through its Western Electric subsidiary, and monopolized long distance telephone service, through its AT&T Long Lines Department. But the key to maintaining the equipment and long distance monopolies was the Bell System's control over local telephone service for most Americans. See United States v. AT&T, 552 F. Supp. 131, 162 (D.D.C. 1982), aff'd sub nom., Maryland v. United States, 486 U.S. 1001 (1983). Long after competition in long distance service and communications equipment became technologically and economically feasible, the Bell System abused its control of the local bottleneck to frustrate consumer choice and actual competition.

As Judge Harold Greene, who presided over the eleven month trial of the case and who continues to administer the terms of the MFJ, has explained, it was control of local exchange service

> that gave the Bell System its power over the competition. That control enabled the System to foreclose or impede interconnection to its network of lines of its long distance competitors and of equipment produced by its manufacturing rivals. It also made possible the subsidization of one activity with the profits achieved in another.

United States v. Western Elec. Co., 673 F. Supp. 525, 536 (D.D.C. 1987), aff'd in relevant part, 900 F.2d 283 (1990).

Until the success of the Department's suit, regulation and litigation had not been effective in breaking through that local bottleneck. The Bell System proved itself adept at devising new ways to use the bottleneck to hurt competition in other markets more quickly than the courts and regulatory agencies could order solutions. Among other things, the Bell System used its monopoly profits to hire legions of lawyers to make sure that any proceeding that challenged any aspect of the monopoly was bogged down in endless proceedings. For example, the struggle to allow telephone customers the right to use their own equipment on their own premises, rather than being forced to

purchase that equipment from the Bell System, spanned decades -- from the beginning of the Hush-a-Phone litigation in the 1940s to the break-up of the Bell System in 1984, which finally resulted in open competition in customer premises equipment. See, e.g., United States v. AT&T, 552 F. Supp. at 162-63 (discussing a portion of this struggle -- the Bell System's use of "protective connecting arrangements" to discourage the use of competitors' equipment).

The Benefits of Competition After the MFJ

The MFJ addressed the problem of the local monopoly bottleneck and promoted competition in the long distance and equipment manufacturing markets by strictly separating the local monopoly from those markets. Competition in those two markets subsequently exploded. The result has been dramatically lower prices, better quality and more choice for American businesses and consumers.

MCI, Sprint and hundreds of smaller carriers 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 of the Bell System. 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.

Because of lower prices and better quality, 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.

Allowing the Bell Companies into Long Distance

Section VIII(C) of the MFJ provides that any Bell Company may obtain a waiver of the line-of-business restriction as soon as it can show that there is no substantial possibility that it could use its monopoly power to impede competition in the market it seeks to enter. Judge Greene has granted over 250 such waivers. In fact, just last week, Judge Greene approved a waiver request made by all the Bell Companies and supported by the Department that will allow the Bell Companies to provide long distance services to their wireless customers. The core restrictions on the Bell Companies' entry into long distance for landline customers and into equipment manufacturing remain, however.

Ideally, we would like to remove these restrictions and allow the Bell Companies to be able to enter those markets, in keeping with our goal of a future in which every company is free to compete in every market for every customer. The trick, of course, is to ensure that removing the restrictions does not result in the re-creation of the old Bell System, this time on a regional rather than a national basis, complete with the incentive and the ability to impede competition in the long distance and manufacturing markets. Seven separate monopolies, each controlling one large region of the United States, would be scant improvement for the cause of competition over a single national monopoly.

As the Congressional leaders who crafted S.652 apparently agree, the best legislative

approach for removing the restraints that keep the Bell Companies out of long distance would be the development of competition in local telephone markets. In drafting S.652, Senators Pressler and Hollings and the other members of the Commerce Committee embraced this approach by requiring the Bell Companies to take specified steps to open the local markets to competition as a condition to entering long distance.

The problem with S.652, however, is that it does not include provisions for testing the effectiveness of those steps in actually enabling local competition. The ultimate effectiveness of any set of steps -- including the steps prescribed in S.652 -- depends on the resolution of dozens and dozens of complicated implementation issues. To say, for example, that a Bell Company must unbundle the elements of its local network begs the questions of the price of the unbundled 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. Yet, it is the answers to these questions that will determine the marketplace effectiveness of the unbundling.

The history of the Bell System before entry of the MFJ proves that the mind of man cannot anticipate all the ways that a local telephone monopolist can thwart competition. What is needed to ensure that we fulfill the bill's vision of enabling competition in the local telephone market prior to Bell Company entry into long distance is to measure the effectiveness of the steps taken against actual marketplace facts by asking such questions as: Have competitors been able to enter? Are they able to serve a variety of customers in the geographic area that the Bell Company seeks to serve? Is the availability of such competing service expanding? Are competitors encountering significant barriers to such expansion? How effective are the safeguards? The goal should be a judgment -- based on market facts -- whether Bell Company entry presents a substantial possibility of impeding

competition in other markets.

The Need for a Department of Justice Role

The responsibility for making that judgment should be assigned to the Department of Justice. DOJ is the agency with deep competition expertise, the agency whose unwavering focus is on the protection and promotion of competition. It has effectively enforced the antitrust laws in the telecommunications industry on a completely nonpartisan basis throughout this century, including, of course, bringing the suit that dismantled the old Bell System.

It has assisted Judge Greene in administering the MFJ through Republican and Democratic Administrations alike, by reviewing over 350 requests for waivers under Section VIII(C) -- an average of about one every two weeks. Many of the most recent waiver requests have involved complex issues related to the competitive impact of the Bell Companies' provision of long distance services or equipment manufacturing.

Last month, the Department asked Judge Greene to modify the MFJ to 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 there are substantial opportunities for additional local exchange competition in those cities. The proposal builds on the idea that one possible basis for lifting the line-of-business restriction is the existence of local competition. The Department's motion was filed along with a stipulation by Ameritech and AT&T that the modification is in the public interest. The proposed modification represents an unprecedented consensus of industry participants, originating from a proposal by a Bell Company and now supported by major long distance competitors, local competitors, state regulators and

consumer groups.

The proposed modification is the product of thousands 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. During that process, the Department deepened its already extensive expertise in telecommunications competition and its understanding of the competitive implications of Bell Company entry into long distance. Earlier this week, we filed our brief in support of the motion, and hope that Judge Greene will agree with us that the modification is in the public interest.

In short, the Department's experience working with the MFJ uniquely positions it to assess what is actually happening in the market and whether there is a danger that entry by the Bell Companies could impede competition in other markets.

Thus, the Administration strongly believes that S.652 should be amended to provide for a DOJ role in reviewing proposed Bell Company entry into long distance. In conducting that review, the Department should apply the test found in Section VIII(C) of the MFJ: whether Bell Company entry into long distance presents no substantial possibility of impeding competition in that market. The VIII(C) test focuses on market realities, not theoretical presumption. Moreover, it is well-understood, having been considered and applied by the Department and by the courts numerous times since the entry of the MFJ.

Assigning to DOJ the responsibility of applying the VIII(C) test will not slow the process of Bell Company entry into long distance -- except to the extent that such entry would be harmful to competition and thus undesirable in the first instance. We support legislation that would provide that

DOJ apply the test by a date certain -- within a specified period after filing of a Bell Company application -- completing its analysis during the same time frame and on the same schedule as the FCC applies its public interest test.

Perhaps more important, adoption of the VIII(C) test will result in a long term savings of resources. Bell Company entry that occurs without assurances that the entry presents no substantial possibility of impeding competition in long distance likely will result in the proliferation of complex, expensive antitrust and other suits under federal and state law, suits that will consume resources better spent on competing to offer American businesses and consumers better service and higher quality. Applying a marketplace test as a condition to entry will avoid this waste.

Assigning DOJ the role of applying VIII(C) also would save resources by bringing DOJ's expertise directly to bear on the question of Bell Company entry. Requiring the FCC to filter the Department's antitrust analysis on such a critical issue would be grossly inefficient because it would cause the FCC to duplicate expertise that DOJ already possesses and analysis already done by DOJ.

Finally, DOJ responsibility for applying the VIII(C) test has enjoyed widespread support. The Senate Commerce Committee last year approved it by a vote of 18-2. Likewise, more than 420 members of the House of Representatives voted in favor of it just one year ago. It is an intelligent, effective approach to putting consideration of competitive facts and analysis at the center of our telecommunications reform efforts.

Extending the Competitive Checklist

The Administration believes that S.652 places too much faith in the competitive checklist.

Although the checklist certainly will be helpful, there is no basis for believing that any checklist drawn up in advance can anticipate the myriad implementation issues that effective unbundling and interconnection will entail. The reality is that, to date, virtually no one in this country or the world has any actual experience with what can only be described as an exceedingly complicated undertaking. It is a myth that a simple formula can guarantee competition and replace the need for an expert analysis of real marketplace competitive developments. Recognition of the need for experience in this vitally important new undertaking is one of the principal reasons that the Department is recommending to Judge Greene that the Court adopt the proposed modification on a trial basis in Chicago, Illinois, and Grand Rapids, Michigan.

The bill prevents the FCC from extending the terms of the competitive checklist. The uncertainty that pervades the entire effort to open the local market to competition counsels against carving a checklist in stone in advance without allowing ourselves the opportunity to learn from experience and expand the checklist as the important but as yet almost wholly untested transition to competition proceeds.

Competition Between Cable and Telephone Companies

My colleague, Assistant Secretary Irving, will discuss the Administration's views on the cable and broadcasting provisions of S.652, but I did want to address briefly the provisions of the bill that would allow mergers and joint ventures between telephone companies and cable systems in the telephone companies' local service area. Permitting such mergers could undermine potential competition between the "two wires" before it begins, potentially raising telephone and cable prices paid by consumers and leaving antitrust litigation as virtually the only potential barrier to anti-

competitive behavior.

Expensive, complex litigation is not the way to promote competition. It would invite a host of judicially determined outcomes in districts around the country. The result may well be that some Americans will enjoy the benefits of a competitive, "two-wire" world, while others will be saddled with one monopolist providing both cable and telephone service.

The absence of a prohibition of buyouts within the same service area also could result in the antitrust enforcement agencies being inundated with cable-telephone company merger filings. Litigation of contested mergers is extremely resource intensive; the antitrust authorities may be hard pressed to protect the public from an onslaught of anticompetitive mergers if more than a small fraction of the 12,000 cable systems in the U.S. choose to merge with their local telephone company. The cost to consumers of anticompetitive mergers could be huge, and we will have lost an historic opportunity to promote competition in the delivery of both telephony and cable programming.

For these reasons, the Administration continues to support a strong ban on acquisitions and joint ventures between a telephone company and cable systems in the telephone company's local service area, subject to an exception for case-by-case review in rural areas and authority for the FCC to review the ban after a certain number of years and modify it if competitive conditions change.

Additional Important Issues Concerning Competition

I am attaching to my testimony a white paper that discusses in some detail other Administration concerns regarding S.652. Let me highlight several of those concerns:

- The Administration believes that the bill should not allow a Bell Company to obtain relief from the MFJ restrictions by showing that it has entered into merely "an" interconnection agreement that satisfies the "competitive checklist" in the bill; this

provision could render the competitive checklist largely irrelevant, because a Bell Company may not need to enter into interconnection arrangements with all, or even several, of its competitors, and may not need to reach agreement with any significant competitor before seeking and securing long distance entry.

- The Administration believes that the bill should not dictate to the States which form of rate regulation best protects State consumers under the different circumstances and levels of competition that develop in each State.

- The Administration believes that legislation should not preempt state efforts to open the multibillion dollar, currently monopolized intraLATA toll market to competition.

- The Administration believes that legislation should not condition the joint marketing of long distance and resold local services by competitors on Bell Company entry into long distance service; such a provision unnecessarily extends regulation to currently unregulated companies that have no power to impede competition.

Conclusion

I am proud that our country and this Congress have the courage to take on the tough issue of telecommunications reform. It took a lot of courage to break up the Bell System's vertical monopoly and allow competition into the markets for long distance and equipment manufacturing. But we did and as a result we now lead the world in telecommunications.

The easy thing, of course, would be for us stay where we are today. That, however, is not the American way. We welcome the challenge of striving toward a future of open telecommunications markets. But let us confront that challenge in the wisest way possible, and that is by making real competition our guide. The changes supported by the Administration add the focus of competition to the broad vision of S.652. If amended and strengthened in the ways outlined here, we believe the bill can and will lead the Nation to prosperity in the 21st Century.