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FEDERAL TELECOMMUNICATIONS LAW:

A LEGISLATIVE HISTORY OF

THE TELECOMMUNICATIONS ACT OF 1996

PUB. L. NO. 104-104, 110 STAT. 56 (1996)

INCLUDING

THE COMMUNICATIONS DECENCY ACT

Volume 16
Document Number
185

BY

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Library of Congress Catalog Number 97-70098
ISBN 1-57588-279-5 (SET)

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INTRODUCTION

AN OVERVIEW OF THE TELECOMMUNICATIONS ACT OF 1996

The "Telecommunications Act of 1996," signed into law on February 8, 1996, opens up competition between local telephone companies, long-distance providers, and cable companies; expands the reach of advanced telecommunications services to schools, libraries, and hospitals; and requires the use of the new V-chip technology to enable families to exercise greater control over the television programming that comes into their homes. This Act lays the foundation for the investment and development that will ultimately create a national information superhighway to serve both the private sector and the public interest.

President Clinton noted that the Act will continue the efforts of his administration in ensuring that the American public has access to many different sources of news and information in their communities. The Act increases, from 25 to 35 percent, the cap on the national audience that television stations owned by one person or entity can reach. This cap will prevent a single broadcast group owner from dominating the national media market.

Rates for cable programming services and equipment used solely to receive such services will, in general, be deregulated in about three years. Cable rates will be deregulated more quickly in communities where a phone company offers programming to a comparable number of households, providing effective competition to the cable operator. In such circumstances, consumers will be protected from price hikes because the cable system faces real competition.

This Act also makes it possible for the regional Bell companies to offer long-distance service, provided that, in the judgment of the Federal Communications Commission (FCC), they have opened up their local networks to competitors such as long-distance companies, cable operators, and others. In order to protect the public, the FCC must evaluate any application for entry into the long-distance business in light of its public interest test, which gives the FCC discretion to consider a broad range of issues, such as the adequacy of interconnection arrangements to permit vigorous competition. Furthermore, in deciding whether to grant the application of a regional Bell company to offer long-distance service, the FCC must accord "substantial

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weight" to the views of the Attorney General. This special legal standard ensures that the FCC and the courts will accord full weight to the special competition expertise of the Justice Department's Antitrust Division--especially its expertise in making predictive judgments about the effect that entry by a bell company into long-distance may have on competition in local and long-distance markets.

Title V of the Act is entitled the "Communications Decency Act of 1996." This section is specifically aimed at curtailing the communication of violent and indecent material. The Act requires new televisions to be outfitted with the V-chip, a measure which President Clinton said, "will empower families to choose the kind of programming suitable for their children." The V-chip provision relies on the broadcast networks to produce a rating system and to implement the system in a manner compatible with V-chip technology. By relying on the television industry to establish and implement the ratings, the Act serves the interest of the families without infringing upon the First Amendment rights of the television programmers and producers.

President Clinton signed this Act into law in an effort to strengthen the economy, society, families, and democracy. It promotes competition as the key to opening new markets and new opportunities. This Act will enable us to ride safely into the twenty-first century on the information superhighway.

We wish to acknowledge the contribution of Loris Zeppieri, a third year law student, who helped in gathering these materials.

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April 1997

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MODIFIED FINAL JUDGMENT

HEARINGS

BEFORE THE

SUBCOMMITTEE ON
TELECOMMUNICATIONS AND FINANCE

OF THE

COMMITTEE ON
ENERGY AND COMMERCE
HOUSE OF REPRESENTATIVES

ONE HUNDRED SECOND CONGRESS

FIRST SESSION

ON

H.R. 1523, H.R. 1527, and H.R. 3515

BILLS TO PERMIT THE BELL TELEPHONE COMPANIES TO CONDUCT RESEARCH ON, DESIGN, AND MANUFACTURE TELECOMMUNICATIONS EQUIPMENT, TO ENCOURAGE COMPETITION IN THE PROVISION OF ELECTRONIC INFORMATION SERVICES, TO FOSTER THE CONTINUED DIVERSITY OF INFORMATION SOURCES AND SERVICES, AND TO PRESERVE THE UNIVERSAL AVAILABILITY OF BASIC TELECOMMUNICATIONS SERVICES

JULY 11, OCTOBER 23 AND 24, 1991

Serial No. 102-103

Printed for the use of the Committee on Energy and Commerce



U.S. GOVERNMENT PRINTING OFFICE
54-795 WASHINGTON : 1992

Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-038443-5

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MODIFIED FINAL JUDGMENT

THURSDAY, JULY 11, 1991

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON TELECOMMUNICATIONS AND FINANCE,
Washington, DC.

The subcommittee met, pursuant to notice, at 11:15 a.m., in room 2123, Rayburn House Office Building, Hon. Edward J. Markey (chairman) presiding.

Mr. MARKEY. Good morning. Ladies and gentlemen, we apologize. The vote for Democratic House Whip is being tallied right now, and so I think some of the members are still over there waiting to get the results. As soon as we get it called in over here, we will announce it publicly.

But in the interest of conducting a hearing that ends before early evening, I think it makes some sense for us to begin the opening statements of the members—and hopefully we will have that done before early afternoon.

Today, we will revisit the MFJ restrictions on the Bell operating companies. This subcommittee has held numerous hearings over the last 5 years on a multitude of consent decree-related issues, and although I was starting to feel a little like Sisyphus, forever pushing a huge stone up a hill only to have to roll it down again when nearing the summit, I believe that the time may very well have arrived when we can get something done.

For far too long, we have watched our Nation's telecommunications future volleyed back and forth from court to court. While the court is the appropriate body to interpret antitrust law, it is not the appropriate body to make policy decisions affecting American consumers, jobs, and both domestic and international competition. The appellate court itself emphasized this, and I quote, "We, the court, believe the text of the decree generally forecloses the goal of ratepayer protection." And, further stated that "the district judge may not, for example, deny the motion (of a BOC) because of the possible impact on the United States' balance of trade, or for any other reason not related to the antitrust laws."

It is clear to me that Congress, not the courts, must set coherent and comprehensive national telecommunications policy. The Senate-passed MFJ bill dealing with manufacturing contains some essential elements that should ultimately become a part of a final House product. I am committed to working with all of my colleagues on this subcommittee toward the goal of producing legislation, including Messrs. Slattery, Tauzin and Oxley, who have been leaders on this subcommittee in fashioning legislative recommenda-

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tions for the relief of the MFJ manufacturing restriction. I applaud them for their work and their effort.

I strongly believe that we must build on the momentum of Senator Hollings' work in the other body and work together to foster a competitive telecommunications marketplace, ensuring that MFJ manufacturing relief supplements the domestic manufacturing environment rather than merely supplanting it. We need legislation that will allow the country to harness the financial and technical resources of the Bell companies to rise to the challenge of competing in an increasingly competitive international marketplace.

Any legislation that this subcommittee considers, therefore, must not only be looked upon as a "relief" bill, but also as a piece of legislation that creates jobs, that stimulates economic growth, and that fosters American preeminence in telecommunications.

In light of the recent phone outages that have hit several areas of the country, it is clearly evident that our Nation's policy must include, as a top priority, strict and enforceable network quality, reliability and interconnection standards. These technological mandates must be considered preconditions to any legislation.

For this reason, the subcommittee's staff draft released last April included a section to ensure that such network quality, reliability and interconnection standards are met for the public switched network. The legislation must also include strong safeguards and sections addressing illegal cross-subsidies, self-dealing, joint ventures with foreign competitors, and predatory pricing. In short, we need a bill that protect ratepayers and competitors, and one that takes into account the ripple effect that relief in any one area will have on the American consumer, the state of competition, our Nation's telecommunications infrastructure, as well as the other MFJ restrictions.

This morning, we will hear from the administration's Commerce and Justice Departments and from industry witnesses. I look forward to hearing their testimony and to working with my colleagues on the task of writing telecommunications policy for this country. It has been a long time coming; now is the time to get to work and finally push this rock to the top of the hill.

That concludes the opening statement of the Chair. I would advise each member, they will be given 3 minutes for an opening statement. We will have to abide by that if we are to get through the day's testimony in a timely fashion.

So, let us then turn and recognize the gentleman from the State of Virginia, Mr. Bliley.

Mr. BLILEY. Mr. Chairman, I would like to say I have an open mind on this subject, but I have yet to be convinced that allowing the telephone companies into manufacturing will, in fact, produce jobs in this country.

I am concerned that if they are allowed, that we could regress to the same situation that we experienced prior to divestiture when virtually all of the equipment the telephone companies used was supplied by Western Electric. And I am concerned that if they are allowed back into manufacturing, that the switches they make will be used solely by their subsidiaries, and competitors' equipment, though it may be cheaper or better, will not be purchased.

And with that, I will yield back the balance of my time.

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[The prepared statement of Mr. Bliley follows:]

OPENING STATEMENT OF HON. THOMAS J. BLILEY, JR.

Mr. Chairman, I appreciate your efforts to address the Modified Final Judgment (MFJ) in a comprehensive manner, particularly the provisions relating to quality in the telephone network. I continue to have concerns about proposals to alter the MFJ restrictions—particularly in the manufacturing area. The incentive and ability of the RBOC's to act anticompetitively to the detriment of domestic manufacturers, information providers, electronic publishers, long distance carriers and consumers, particularly rural consumers, has not changed one iota since divestiture. These parties agree that the conditions that led to the consent decree are such that there is no need for a change at this time. I am largely satisfied with the way the courts are handling the manufacturing issue. The industry is "brutally" competitive. Currently, the courts are looking at the information services restriction, which is where Congress should be providing policy guidance right now. The Slattery and Oxley bills do not address these issues. Mr. Chairman, by all accounts, telecommunications is a deregulation success story on its current path. Anticompetitive predatory behavior still exists as defined by antitrust law. I question whether there's really a need to strip the built-in protection—the "safeguards" if you will—that the MFJ has provided. In fact, the MFJ contains the only "safeguards" that have ever worked.

If one examines the recent record of the past couple of years alone, there is ample proof that anticompetitive behavior can and will occur when monopoly phone companies are allowed to further consolidate into these businesses. We've all heard about the scandals involving the offering of reduced network quality voice storage service to competitors, the overcharging for equipment at consumer expense, the cross-subsidizing of competitive product development with captive ratepayer revenues and, yes, the creative lobbying budgets. Why no hearing on these egriegeous offenses?

What is needed here is a more comprehensive approach that addresses the real issue—simple competition. The MFJ is far too important to advance in a piecemeal fashion. Further, no public clamor exists. I submit that the proper approach is a competitive one with competitive solutions in the local loop and competitive entry tests for the RBOC's in other businesses. Just imagine blessing the elements of the local exchange with a new concept—competition. Wouldn't we liked to have had a choice when you couldn't make an outgoing call in the capital of the free world last week? Mr. Chairman, we have got to get at the real issue, that is, the removal of the what I call in southern slang the "Three B's"—The Biquitous Bell Bottleneck.

Mr. Chairman, in short, we appreciate your efforts in continuing to focus on these issues in a comprehensive manner. The "staff draft" is a good starting point, but we would prefer that the manufacturing restriction "safeguards" are maintained and that any bill addresses information service and a potentially competitive local loop. Additionally, I think that the subcommittee would benefit from a hearing on the RBOC's current behavior vis-a-vis their competitive businesses. We need this information on the record before we go forward with any legislation giving them more freedom to potentially allow foreign competitors with protected home markets into our own robust switching markets, effectively relegating U.S. manufacturers to be what has been described as "screwdriver" factories.

Mr. MARKEY. I thank the gentleman. I thank the gentleman for being brief, as well.

I will note that David Bonior has won the Whip's race, for any who are interested.

The Chair recognizes the gentleman from New York, Mr. Scheuer.

Mr. SCHEUER. Thank you, Mr. Chairman. I will be brief.

Mr. Chairman, today we gather here to evaluate a promise and a premise. The promise and the premise are that if Congress removes the antitrust decree restrictions on the Bell Telephone Service monopolies, and their participation in equipment manufacturing, these Bell companies will, as a result, erase our telecommunications trade deficit, create thousands of domestic jobs and provide the impetus for innovative new technology. These are worthy and lofty policy goals.

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Now, Mr. Chairman, there are clearly winners and losers in a policy change of this magnitude. I would hate to discover the winners are whoever and the losers are American workers and American consumers.

Consumers fear that this legislation will lead inevitably to cross-subsidies and local exchange bottlenecks such as the June outage we all suffered from. The outage demonstrated how dependent all of us continue to be on a single source of local exchange service.

Some manufacturers fear the extinction of their livelihoods. Outside studies suggest that there could be a negative impact of this legislation on the domestic labor force. Any legislation which the subcommittee reports must adequately address these fears with strong pro-competitiveness safeguards.

Judge Greene has granted over 160 waivers to the modified final judgment manufacturing ban. Let's reach some kind of consensus in this committee, Mr. Chairman, and transfer power from the appeals court to the Congress, where it really belongs.

I thank the chairman.

Mr. MARKEY. The gentleman's time has expired.

The Chair recognizes the gentleman from Pennsylvania, Mr. Ritter.

Mr. RITTER. Thank you, Mr. Chairman.

First of all, Mr. Chairman, let's take a look at the deal. There was a deal in 1984. That deal related to AT&T's future. It related to the future of a lot of companies that got into manufacturing, hundreds of companies.

Now, 7 years later, we are going to go back on the deal. There is an element of fairness here, Mr. Chairman, and it is not as if there isn't robust competition in these markets.

There are many more supplier choices, there are new companies, new investment dollars, and new jobs. In 1990, telecommunications exports jumped 29 percent, and in one of the most important product categories, major telephone switches jumped 500 percent in a 2-year period.

R&D dollars for the domestic telecommunications industry have been on the increase. Hundreds of firms have sprung up and are selling in these Bell company markets. Many of these companies didn't exist pre-divestiture.

Technology has advanced at a much faster rate due to the new players and the new robust competition in the market. Now we are going to change the deal. So, you know, there is something—an element of fairness here, and to the companies who have made commitments over this period of 7 years.

I would like to focus a little bit on this document, "Manufacturing Restrictions on Bell Companies is Good Policy for AT&T, Bad Policy for America." It has no name on it. It makes tremendous claims about AT&T, and I would like to clear a few of them up.

First of all, it makes claims about AT&T down-sizing and lost options, and investments in the foreign markets. The investments in the foreign markets are almost entirely designated to enter those markets. The down-sizing in this country is as a result of no longer

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having a pseudo-governmental monopoly on 100 percent of the BOC business.

This document attacks them because now, they only have 50 percent. When you are not a pseudo-governmental monopoly, you don't exactly have all of the business. I think somebody should take credit, or whatever, for this document, because it is quite injurious to AT&T's positions, and I think quite unfair.

You know, they criticize—the Bell companies criticize AT&T's decision to stay in the low end of the market and generate some sales for U.S. companies. It is cynical. No one is in that low end. The Bell company is going to enter the low end?

You know, there has been a tremendous amount of competition since divestiture, and that is one of the reasons why there has been down-sizing. You don't have all the business any more.

Mr. Chairman, I will close with this thought, lifting the MFJ manufacturing restrictions, it is not fair to people who entered into a whole set of corporate arrangements since 1984. It is not necessarily in that the field is full of dynamic, robust competitors.

I yield back. Thank you.

Mr. MARKEY. The gentleman from Oklahoma, Mr. Synar.

Mr. SYNAR. Mr. Chairman, I thank you for holding this hearing, and look forward to future hearings on this subject.

I continue to believe we should approach this issue cautiously, with much thought and careful deliberation. I agree with Chairman Markey that the subcommittee should view all current legislation on the MFJ broadly to ensure our Nation's competitive and consumer interests are served. I am anxious to bring the benefits of new technology to all of America. I am very open to hearing new evidence on how consumers will actually benefit by lifting MFJ restrictions.

That said, I am still very skeptical about the FCC's ability to conduct effective oversight to protect consumers from the dangers of cross-subsidization.

Just last month, I questioned Chairman Sikes about the FCC's ability to implement cost allocation procedures and its commitment to improve its existing auditing ability. Regrettably, Chairman Sikes' testimony did little to persuade me that the Commission had made substantial improvement in this area.

As a result, I am having a very difficult time believing it is prudent for the Congress to give the FCC more regulatory oversight responsibility. The legislation we are considering asks the subcommittee to make new policy in spite of the facts we know about the inadequacies of the FCC.

I look forward to the testimony of the panelists today, and hope today's hearing will provide an engaging discussion of the policy and regulatory issues associated with the MFJ.

Thank you.

Mr. MARKEY. The gentleman's time has expired.

I recognize the ranking minority member, the gentleman from New Jersey, Mr. Rinaldo.

Mr. RINALDO. Thank you, Mr. Chairman.

I want to commend you for holding this hearing. I also want to welcome our very distinguished panelists from both the administration and the telecommunications industry.

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This morning, we are examining issues that have been before us in the last two Congresses, but which have not been resolved. The dynamics have changed somewhat this year. The Senate has overwhelmingly passed the legislation, narrowly tailored to address the manufacturing restrictions.

I believe that manufacturing relief legislation will be ultimately approved, either by the courts or this body, and I would urge the interested parties to work with us to develop consensus legislation that they can live with.

The AT&T consent decree took effect in 1984, and a great deal has happened since then. Competition in the domestic telecommunications manufacturing marketplace has flourished. Hundreds of new companies have been created, innovation, efficiency and growth have led to better products at better prices.

We should not jeopardize that success. Proponents of H.R. 1527 contend that allowing the RBOC's into manufacturing would enhance U.S. competitiveness. In fact, the Bell companies maintain the MFJ restriction unnecessarily hinders their ability to work with small entrepreneurial companies. As a result, capital-rich foreign conglomerates have bought up over 70 U.S. companies since divestiture, leading to the growing and unabated export of U.S. technology, profits and know-how.

There clearly is merit to that argument, but it is not the whole story. If we adopt legislation to allow the Bell companies to pursue joint ventures with large, established foreign firms, and engage in self-dealing and possible other discriminatory practices, we will see a decline in competition that would drive smaller domestic manufacturers out of business, with the resultant loss in American jobs.

There is similar controversy on the trade impact of the manufacturing restrictions. Proponents have compared the telecommunications trade deficit of nearly $3 million annually, after divestiture, with the $1 billion surplus before it as evidence that our telecommunications trade strength has eroded. On the other hand, opponents counter that the high end sector of the telecommunications market, which happens to be the most important, we have a surplus that continues to grow.

These are important issues, dynamic issues, significant issues, issues that profoundly affect companies in this country and the consumers of this country. Consumers should know with certainty whether our competitiveness will be enhanced or harmed prior to moving forward on legislation. But there are other factors as well.

In considering manufacturing relief legislation, we must make sure we avoid RBOC breakups in the Nation and self-dealing of any type. We must take pains to ensure those do not and cannot occur. Manufacturing relief must not come at the increase of local exchange service rates and possible deterioration of local exchange customer service.

Additionally, we must see to it that the Bell companies, which comprise more than 70 percent of the market for much of the telecommunications equipment used at home, do not engage in any possible unfair self-dealing.

Mr. Chairman, I look forward to the testimony we will receive. I hope our witnesses are prepared to answer some of the questions that I have alluded to in my opening statement. I want to thank

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you once again for holding this hearing, and yield back the balance of my time.

Mr. MARKEY. I thank the gentleman. The gentleman's time has expired.

The Chair recognizes the gentleman from Maryland, Mr. McMillen.

Mr. MCMILLEN. I thank the chairman, and want to commend him for having these hearings and trying to deal with the MFJ comprehensively through the legislative process. Such legislation is sorely needed to try and come up with a plan as we move further into the information age.

I am interested in many of these areas, particularly the manufacturing area, and I have supported the entrance of the Bells into the manufacturing area for several reasons.

One is because I am concerned about our growing telecommunications deficit, our international competitiveness, but I am impressed by a lot of the small firms, manufacturing firms that have come to see me in support of the bill and have emphasized their need for capital and joint ventures and the like, that this legislation would provide.

But I must say, I do think we need to move cautiously and deliberately, as has been said here today; that any new freedom is to be coupled with safeguards. I have particular concern about the FCC, their ability to monitor these new freedoms and apply the appropriate regulatory structure and oversight preventing cross-subsidization and self-dealing.

I think it is very, very important we try to move forward and build the safeguards, and I know the chairman is trying to do, at the same time, legislatively moving on all fronts. And I hope we will be able to do that and accomplish the legislative objectives.

Mr. MARKEY. I thank the gentleman.

The gentleman from California, Mr. Lehman.

Mr. LEHMAN. Thank you very much, Mr. Chairman. I look forward to these hearings. I commend you for moving expeditiously to put this issue before us where it properly belongs.

Without denigrating the good judge, I think issues of this magnitude should be decided here in Congress, and our absence in this area needs to be rectified.

The legislation before us today would lift the court-imposed restrictions on the Bell operating companies as they relate to manufacturing, and I think the issue perhaps is not so much whether or not we should allow seven of this Nation's largest corporations to engage in what appears to be a very lucrative, yet competitive, business, but whether or not the FCC and State agencies can develop the policy guidelines to prevent the occurrence of monopolistic practices which the consent decree in MFJ sought to rectify in the first place.

The questions in my mind are as follows: Would lifting these restrictions increase competition or grant the RBOC's an unfair competitive advantage? Will it destroy domestic jobs? Will it enhance our ability to compete in the financial marketplace? Will it allow us to develop a nationwide and global telecommunications infrastructure and continue to provide consumers with an affordable, efficient and reliable communications network. What policy will best

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benefit small and medium-sized manufacturers. Can cross-subsidization really be prevented, and can we set up a regulatory mechanism to stop and prevent abuses that might arise from self-dealing?

I am convinced competition in the marketplace is healthy, provided we have safeguards against anticompetitiveness. On the one hand, that is what the breakup of AT&T was all about in the first place. On the other hand, I think it is encumbent upon this committee and Congress, and FCC, and other regulatory enforcement agencies to ensure appropriate safeguards are enacted.

Ultimately, I believe it is the consumer who has the most to gain or lose in this debate, and I strongly believe we should pursue our policy with that in mind. I know we have the best telecommunications system in the world at this time. That doesn't mean we shouldn't continue to examine our policies and practices, with an eye toward tomorrow.

Again, I commend you, Mr. Chairman, for holding these hearings and the good work your staff has done in preparing the members.

Mr. MARKEY. Thank you.

The Chair recognizes the gentleman from Tennessee, Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman, I appreciate you holding these hearings. From the start of the MFJ debate, I have said the burden of proof rests squarely on the shoulders of the RBOC's, seven of the richest, most powerful companies on earth, who have every power that is allows to any company on earth, but for three, and these three powers were denied them, for I think very appropriate reasons by the court decree.

I feel the RBOC's have failed to meet that heavy burden of proof on manufacturing, on long distance, and on all aspects of information services, except cable television. That is the information service the average American is demanding 7 hours a day today, and that the average America is being overcharged for, almost double, due to the complete lack of competition in most every community in the United States.

That is the information service where the Bells could be of help in allowing competition. Not so the Bells could just replace one monopoly with another, but so we could actually help lower cable prices for the average American.

The average person on the street has never heard of the letters, MFJ. They expect their Congressmen to help them lower prices. We have an opportunity today through bills like the chairman's comprehensive approach, looking at different aspects of this, and also through the Boucher-Oxley bill, to take effective action to help the folks back home.

I hope, despite the fullness of this room today, with both members and lobbyists, that we will not neglect this tremendous opportunity to provide the service that people want, that people deserve, and an opportunity to lower prices for folks back home.

Both the Consumer Federation of America and the Wall Street Journal seem to agree we might be able to cut prices in half for cable subscribers nationwide, saving as much as $6 billion a year. That is a magnificent opportunity for us. That should be the proper focus of our consideration.

I haven't had one constituent come to me and demand the right to buy a Bell-manufactured piece of hardware. People want lower

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cable prices. They don't want another piece of telephone equipment. Most of the folks I talked to feel there is plenty on the marketplace already.

Thank you, Mr. Chairman.

Mr. MARKEY. The gentleman's time has expired.

The Chair recognizes the gentleman from Colorado, Mr. Schaefer.

Mr. SCHAEFER. Thank you, Mr. Chairman.

I appreciate your concern in this matter in trying to come up with a solution on a very difficult problem that has been with us for sometime. Throughout the course of what has been a real lengthy debate, claims have been made as a result of lifting the line of business restriction in the modified final judgment.

Of those host of allegations, one seems to me beyond dispute, and that is, under the proper conditions, the Bell operating companies could greatly contribute to the development of a robust domestic telecommunications information marketplace, which we all certainly want to envision for the future.

Continuing to prevent the innovative ideas and the substantial resources of seven of the Nation's largest companies from reaching the American consumer is not now in their best interests.

Another element of debate is equally evident. Those seven companies maintain firm control of the local exchange. Their monopoly status raises concerns from competitors and consumers alike. Those dependent on local lines would be disadvantaged, and the captive ratepayer would foot the bill for new unregulated ventures.

Safeguards, we are told, would relieve these fears by carefully monitoring the natural and national symptoms of a monopoly. I would suggest too little time has been spent on the cure. For whether the issue is manufacturing information services, long distance, or even recent telephone outages, the ultimate protection to the consumer is not untested regulation, but competition.

Yet, as long as a central piece of our telecommunications network retains the inherent advantage of a monopoly, true competition can never exist.

Rather, we are presented with two options, neither of which are particularly appealing: A system fraught with regulation, or one burdened with protection barriers to entry.

As the Congress properly looks to the Nation's telecommunications future, we should strive to see the entire picture. We should rid ourselves of our blind spot to the notion that real competition could never come about in the local exchange arena, and we, not the courts, should determine our agenda.

I am interested in the thoughts of the witnesses in this particular regard and point out that if it is our responsibility to set telecommunications policy, which I believe it is, then we should do so in a thorough and a very comprehensive manner.

I yield back the remainder of my time, Mr. Chairman, and look forward to the witnesses.

Mr. MARKEY. The gentleman's time has expired.

The gentleman from Ohio, Mr. Oxley.

Mr. OXLEY. Thank you, Mr. Chairman.

Just briefly, I, too, want to commend you for this hearing, and welcome our witnesses today. The essential question is who shall

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make telecommunications policy in this country? To those of my colleagues who have urged caution and deliberation, I would say we have been, in fact, cautious and deliberate over the last several years as we wrestled with this issue.

It seems to me there is probably no one on this panel, or indeed in this audience, save a few, who would think the status quo is the way we should continue to make telecommunications policy in this country.

Anyone who would drop down from a planet and see that the telecommunications policy of the strongest telecommunications-producing country in the world is being run by an unelected Federal judge, who had no experience whatsoever in telecommunications policy, and is running that policy from an antitrust standpoint, would say that something is amiss, and indeed, something is amiss.

As we have gone from our telecommunications trade policy from a $1 billion surplus to a $3 billion deficit, we find that those who complain the most about foreign intervention and foreign sale in the loss of American jobs in many cases are the same ones who tend to support the status quo.

You can't have it both ways. This is the first opportunity, I would suggest, Mr. Chairman, that the Congress can take back, along with the FCC, our rightful role in writing telecommunications policy for this country.

The bill passed the Senate by over 70 votes under the great leadership of Senator Hollings. It is an idea whose time has come. It is an idea that is fraught with the potential for job creation, for trade opportunities, for American companies.

It is the future. It is going to happen. It is inevitable it is going to happen. I suggest we get on with it. I have my own bill, Mr. Slattery has his bill. We differ only in the domestic content area.

Our distinguished witnesses from the administration, I am sure, will draw the distinctions rather clearly from where the administration is coming from. Make no mistake, this effort to permit the RBOC's into manufacturing is the first opportunity we have had in several years to take back the rightful place in telecommunications policy that this Congress should, and in fact will, enjoy.

I yield back the balance of my time.

[The prepared statement of Mr. Oxley follows:]

OPENING STATEMENT OF HON. MICHAEL G. OXLEY

Thank you, Mr. Chairman. I commend you for holding this hearing, as I believe it is time to focus our attention on lifting the manufacturing restrictions imposed on the telecommunications industry under the auspices of the MFJ.

Two weeks ago, this subcommittee held a hearing addressing the issue of infrastructure modernization. We heard testimony on the importance of that modernization, and how the development of telecommunications infrastructure is crucial to our ability to compete in the global marketplace. To compete, we must modernize, and to make modernization both practical and possible, we must consider lifting the manufacturing restrictions imposed by MFJ.

Since the MFJ ruling and the divestiture of AT&T, U.S. trade in telecommunications has deteriorated at a rate of four times greater than our Nation's overall trade balance. Under the MFJ restrictions, the RBOC's are prevented from entering the manufacturing market. The result of this prohibition is that the U.S. risks falling hopelessly behind in a race which is just beginning.

By removing manufacturing restrictions imposed by the MFJ, Congress can reclaim the reigns of telecommunications regulation from the judiciary. Once in control of those reigns, the Congress can implement a national telecommunications

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policy and replace the MFJ restrictions with procompetitive regulatory safeguards. The United States needs a telecommunications policy. American industry needs incentives to undertake the immense task of infrastructure modernization. Eliminating the ban on manufacturing is an excellent place to start. Doing this will encourage economic development and allow American companies to be competitive in the global marketplace.

Also, removing the restriction on manufacturing will allow the RBOC's to design, develop and build new and better telecommunications equipment. This encourages the telcos to expand their research and development, not only to keep abreast of foreign competitors, but also to become the standardbearers of modern communications equipment in the next century.

Mr. MARKEY. The gentleman from Louisiana, Mr. Tauzin.

Mr. TAUZIN. Mr. Chairman, let me thank you for this hearing. And as a chief cosponsor with my colleague, Jim Slattery, of the MFJ bill to allow the Bell companies into manufacturing, let me say indeed, Mr. Oxley, it is time for us to move forward on an issue that is quite ripe.

In fact, it is riper than ripe. One of my colleagues just asked a question that I think deserves some answer. Is there some equipment out there that is not being manufactured that Americans are waiting for, and could use? Absolutely.

I would like to introduce in the record a nine-page list of community-based organizations who are in support of our legislation, a list that ranges from groups like Mt. Sinai Medical Center all the way to Pleasant Valley Animal Hospital; National Association of Retired Federal Employees, Black Citizens for Fair Media, Center for Independence for the Disabled, Communications Workers of America, who want jobs; National Conference of Black Mayors; many, many more.

You might notice disabled groups being mentioned a few times. I attended——

Mr. MARKEY. Without objection, we will include that.

Mr. TAUZIN. I attended a demonstration of some of that equipment. U S West now has available, if it could only manufacture and distribute to Americans who want it, equipment that would best be described as prescription audio; equipment when added to your phone, could actually modulate the audio sound coming through that phone so you can hear it if you are disabled; equipment that can scrub out all the airplane noise at an airport so you can speak clearly in a crowded, noisy environment.

Yet, U S West would have to go see Judge Greene for a very narrowly tailored waiver to begin considering engineering, designing, and marketing that equipment for the public. Deaf citizens would love to have that equipment, and are writing to us and wondering why half of our telecommunications industry is forbidden from designing that equipment because Judge Greene has issued such an order.

Ladies and gentlemen, it is time for us to start writing telecommunications legislation in this Congress. There is something silly about manufacturers and vital improvements in telecommunications having to go to Judge Greene to get permission.

It came to a head in this recent problem on June 26th, when telephone outages occurred in the District, Maryland, Virginia, West Virginia. The companies involved, Bell Atlantic and Bell

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Core, were told by the Justice Department, "We can't tell you whether you can fix the problem without talking to Judge Greene."

Judge Greene rules you can go ahead and correct the problem, but don't make any improvements in the software, because that would be design, and that is part of manufacturing, and that is forbidden by decree.

Here we are in an incredible situation where companies have a problem, and they have to ask a Federal judge to fix it. It is about time for us to deal with that, Mr. Chairman, and the bills we have offered, Mr. Oxley and one Jim Slattery and I offered to this committee, hopefully begin to deal with it in a sensible fashion.

It says we are going to let some of our best telecommunications companies begin to serve consumers, without having to check with a Federal judge. Mr. Chairman, I yield back.

Mr. MARKEY. The gentleman's time has expired.

[The information referred to follows:]

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THE FOLLOWING IS A PARTIAL LISTING OF
COMMUNITY-BASED ORGANIZATIONS AND LEADERS IN THE NORTHEAST
WHO HAVE TAKEN THE TIME TO WRITE TO CONGRESS
TO EXPRESS THEIR SUPPORT FOR LEGISLATIVE RELIEF
FROM THE MODIFIED FINAL JUDGEMENT (AS OF 6/90)

A.B. Davis Middle School
Adelphi University
Adult/Adolescent Counseling, Inc.
Albany-Colonie Regional Chamber of Commerce
Alice Peck Day Memorial Hospital
Alpha One (Maine)
American Gold Star Mothers, Inc. Chapter 31
American Heart Association - Nassau Region
American LegionAmerican Lung Association of Brooklyn
American Lung Association of Brooklyn (Brooklyn, NY)
Americas Society
Arlington Post No. 1302 - American Legion
Atlantic Avenue Association Local Development Corporation
Babylon Chamber of Commerce
Bakery, Confectionery and Tobacco Workers International Unio
Baldwin Union Free School District
Bayside Senior Center
Bayside Senior Services
Beth Shalom Oceanside Jewish Center
Bethel A.M.E. Church
Big Brothers/Big Sisters - Main Office
Big Brothers/Big Sisters of Monadnock Region, Inc.
BCFM-Black Citizens for a Fair Media
Blessed Virgin Mary Help of Christians Church
Board of Cooperative Educational Services
Bob Lysko - Carpets, Floor Covernings
Bowling Green Association
Boys' Club of Mount Kisco
Brewster Central School District
Briarcliff Manor Public Library
A Brooklyn Business Coalition
Brooklyn Chamber of Commerce
The Brooklyn Children's Museum
Brooklyn Navy Yard
The Bronx Jewish Community Council
Brother of Holy Cross
Buffalo Grange
Buffalo Hearing and Speech Center
Burlington Community Life Center
C.J. Patrick Real Estate, Inc.
Catholic Charities Diocese of Brooklyn
Center for Living and Working, Inc.
Central Astoria - Local Development Coalition
Central Westchester Senior Day Center, Inc.
Chamber of Commerce of The Borough of Queens
Chamber of Commerce of The Massapequas, Inc.
Chase - The Chase Manhattan Bank, N.A.
The Cheshire Medical Center (Keene, NH)

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Immaculate Conception Parish
International Union of Operating Engineers Local Union
Instructional Development Center
Jewish Child Care Association of New York/
Pleasantville Cottage School
Jewish Community Council of Pelham Parkway
Jewish Teachers Community Chest of NY
La Grange Fire District
Long Island Alzheimer's Foundation
Long Island Association
Long Island Forum Technology, Inc.
Long Island Hispanic Chamber of Commerce
Long Island University
Madison Square Boys & Girls Club Bronx Division
Malden Catholic High School
Malverne Teachers Association
Massachusetts Council of Human Service Providers, Inc
Middlesex Home Health Care, Inc. (Malden, MA)
Mid-Hudson Workshop for the Disabled, Inc.
Millbrook - Town of Washington Business Association, Inc.
Miller Place Mount Sinai Chamber of Commerce
Molloy College
Monadnock Community Hospital
Montgomery County Chamber of Commerce
Mount Sinai Medical Center
Mount Vernon Chamber of Commerce
Mount Vernon Public Library
Nashua Downtown Development Corporation
The Nassau Center for the Developmentally Disabled
Nassau-Suffolk Health Systems Agency, Inc.
National Association of Educational Buyers, Inc.
National Association of Retired Federal Employees
National Multiple Sclerosis Society
New Hampshire Association of Realtors, Inc.
New Hampshire Jaycees
New Hampshire State Grange
New York City Central Labor Council
New York State Association of Teachers of the Handicapped, Inc.
The Niagara Falls Chamber of Commerce
Niagara Frontier Industry Education Council, Inc. (Lancaster, NY)
The Northeast Independent Living Center
Oceanside Jewish Center
Orange County Rural Development
Orangeburg Volunteer Fire Association
Our Lady of Mt. Carmel Rectory
Outreach Project
The Parkway Hospital
Peekskille/Cortlandt Chamber of Commerce, Inc.
Pelham Chamber of Commerce
Pelham Fire Department
Pelham Memorial High School
PEOPLE
Pleasant Valley Animal Hospital

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Police Department-Town of Poughkeepsie
P.O.M.O.C-Polonians Organized to Minister to Our Community, Inc.
Poughkeepsie Area Ministerial Alliance
Pre-Trial Services Insititue of Westchester, Inc.
Queens Borough Lodge #878-Benevolent and Protective Order of Elks
Reading Public School
Red Hook Lions Club
The Retirees Association of District Council 37
R.K.R./Dial-A-Phone
Saint Ann's Episcopal Church
St. Brigid's Rectory
St. John's United Methodist Church
The Salvation Army (Jackson Heights, NY)
The Salvation Army (Freeport, NY)
The Salvation Army (New York, NY)
The Salvation Army (Long Island City, NY)
Sarah Lawrence Center
Scarsdale Community Baptist Church
School Administrative Unit No. 9
Security Systems by Hammond, Inc.
Sleepy Hollow Chamber of Commerce
SOBRO-The South Bronx Overall Economic Development Corporation
State Bank of Long Island (New Hyde Park, NY)
State University of New York/Educational Opportunity
Center in Brooklyn
SwissRe Services
Telemanagement Resources
Town of Amherst
Town of Fishkill
Town of Kent
Town of Pelham
Trinty Church
United Association fo Journeymen and Apprentices of
the Plumbing and Pipe Fitting Industry
United Brotherhood of Carpeters and Joiners
of America Local 163
United Brotherhood of Carpeters and Joiners of
America Local Union No. 149
United Refugee Council
United University Profession
United Way of Long Island
Utopia Improvement Association Inc.
Valhalla Public Schools
VFW Veterans of Foreign Wars of the US
Van Siclen Avenue Block Association, Inc.
Village of Freeport
Vocational Technical Education Center
Wappingers Central School District
Wayne Karns/Trustee Village of Brewster
West Astoria Community Development Corporation
West Maspeth Local Development Corporation

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Chinese-American Planning Council, Inc.
Christian Community Benevolent Association, Inc.
Church of the Good Shepherd
Church of Our Lady of Mercy
Church of St. Augustine
City of Everett Massachusetts-Council on Aging
City of Everett Recreation Department
City Historian
City of Mount Vernon, NY Fire Department
City of New York Community Board #1, Borough of Queens
City of New York Community Board Six
The City of New York Fire Department
Collin Allen Day Care Center
Colony - South Brooklyn Houses Senior Citizens Center
Community United Methodist Church
Concerned Citizens
Concordia College
Congregation of Holy Cross
Council of Supervisor & Administrators of the City of New York
Cultural Arts Council
Daemen College - Office of Public Affairs
Douglas Manor Association, Inc.
Dutchess Community College
Dutchess Community College Foundation
Dutchess County Community Action Agency, Inc.
Dutchess County Economic Development Corporation
Dutchess County Retired Teachers Association (Hyde Park, NY)
Easter Seal Society of New Hampshire, Inc.
Eastern Orange County Chamber of Commerce
The Equitable Financial Companies
Everett Arts Association
Farmingdale Public Schools
Federation of Italian-American Societies of Queens, Inc.
First Baptist Church (Everett, MA)
First Baptist Church (Malden, MA)
Forest Hills Montessori School
Franklin Park Improvement Association of North Revere, Inc.
Frontier Central School District (NY)
G.Guidi Corp - General Contractor
Gateway - Information Services, Inc.
Glen Cove Industrial Development Agency
Glendale United Methodist Church
Good Shepherd Services
Hamburg Chamber of Commerce
Heights Toastmasters - Club 4545
Hickey-Finn & Co., Inc.
Highland Falls-Fort Montgomery/Central School District
Hillside Church
Hitchcock Presbyterian Church
Home Builders Association of New Hampshire
Home Health Care of Mount Vernon, NY. Inc.
Human Development Services of Port Chester. Inc.
West Medford - Hillside Little League
Westchester 2000
Westchester Community Opportunity Program, Inc.
William M. Gouse, Jr. Post No. 3211
YM & YWHA of Northern Queens (Flushing, NY)
YMCA (Melrose, MA)
YMCA (Malden, MA)
Zanzarella Marketing Consultants (Ossinging, NY)

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THE FOLLOWING IS A SAMPLING OF NATIONAL THIRD PARTY ORGANIZATIONS AND NOTABLE INDIVIDUALS WHO HAVE EXPRESSED THEIR SUPPORT FOR THE FOLLOWING:

A. **S.173, the "Telecommunications Equipment Research and Manufacturing Competition Act of 1991"**
B. **H.R. 1527, the "Telecommunications Equipment Research and Manufacturing Competition Act of 1991."**

A. Example of Some of the Groups/Individuals Who Specifically Support S.173:

Absher, Woody, State of Wyoming, Division of Vocational Rehabilitation, Cheyenne, WY

Alaska Association of the Deaf, Anchorage, AK

Alpha One - Center for Independent Living, ME

American Council of the Blind, Washington, DC

American Legislative Exchange Council, Washington, DC

Black Citizens For A Fair Media, New York, NY

Center for Independence for the Disabled, Inc., VA

Center for Living & Working, Inc., Worcester, MA

Citizens for a Sound Economy, Washington, DC

Coalition for Citizens with Disabilities, Jackson, MS

Communication Workers of America, Washington, DC

Connecticut Association of the Deaf, CT

Council of Chief State School Officers, Washington, DC

Foundation for Technology Access, Albany, CA

Geller, Henry, Communication Fellow The Markle Foundation, Washington, DC

Gilmer County Industrial Development Association, Glenville, WV

7/10/91

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Granite State Independent Living, Concord, NH

Minnesota Association of the Deaf, MN

Minnesota Chapter of the American Deafness and Rehabilitation Association, St. Paul, MN

National Association of Arab Americans, Washington, DC

National Association of Development Organizations, Washington, DC

National Association of the Deaf, Silver Spring, MD

National Conference of Black Mayors, Inc., Cleveland, OH

National Council of Silver Haired Legislators, Washington, DC

National Indian Youth Council, Albuquerque, NM

National Network of Learning Disabled Adults, MD

National Silver Haired Congress, Fountain Valley, CA

North Country Independent Living, Superior, WI

Northeast Independent Living Program, Lawrence, MA

O'Connor, Barbara, Professor - California State University Sacramento, Sacramento, CA

Ohio Association of the Deaf, Inc., Willowick, OH

Ohio Developmental Disabilities Planning Council, Columbus, OH

Options Center for Independent Living, Kankakee, IL

PARAQUAD, St. Louis, MO

Phillips, Ken, Director of Information Systems, City of Santa Monica, Santa Monica, CA

Rehabilitation Engineering Society of North America, Washington, DC

Symposium on Deafness & Hearing Impairment, Austin, TX

Telecommunications for the Deaf, Inc., Silver Spring, MD

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Texas Association of the Deaf, Austin, TX

Town of Bloomsburg, Bloomsburg, PA

United Cerebral Palsy Association, Washington, DC

Lionel Van Deerlin, Former Chairman, House Subcommittee on Telecommunications, CA

Vial, Donald, Former President California PUC, San Rafael, CA

Virginia Association of the Deaf, VA

Widdows, Richard, Professor - Purdue University

World Conference of Mayors, Tuskegee, AL

World Institute on Disability, Berkeley, CA

B. Example of Some of the Groups/Individuals Who Specifically Support H.R. 1527:

Absher, Woody, State of Wyoming, Division of Vocational Rehabilitation, Cheyenne, WY

Alaska Association of the Deaf, Anchorage, AK

American Council of the Blind, Washington, DC

Jody Anne Becker, Marin County Mediation Services, CA

Black Citizens for a Fair Media, New York, NY

Center for Independence for the Disabled, Inc., VA

Center for Living & Working, Inc., Worcester, VA

Council of Chief State School Officers, Washington, DC

Fox River Valley Center for Independent Living, ME

Geller, Henry, Communications Fellow, Markle Foundation, Washington, DC

Gilmer County Industrial Development Association, Gilmer County, WV

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Klass, Morris, Professor, Memphis State University, TN

Lawrence Independent Living Resource Center, ME

Maine Advocacy Services, Winthrop, ME

Minnesota Association of Deaf Citizens, MN

National Association of the Deaf, Silver Spring, MD

National Council of Silver Haired Legislators, Washington, DC

National Indian Youth Council, Albuquerque, MN

North Country Independent Living, Superior, WI

Northeast Independent Living Program, Lawrence, MA

O'Connor, Barbara, Professor, CSU-Sacramento, CA

PARAQUAD, St. Louis, MO

Phillips, Ken, City of Santa Monica Information Systems, CA

Vial, Donald, Former President California PUC, CA

Virginia Association of the Deaf, VA

Western Kansas Association on Concerns of the Disabled, KS

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Mr. MARKEY. The gentleman from New Mexico, Mr. Richardson.

Mr. RICHARDSON. Mr. Chairman, I want to thank you for holding today's hearing. I know that many of my colleagues on the subcommittee are eager to begin our work on legislation to lift the manufacturing restrictions on the Bell operating companies.

Increased international competition and unmet product needs should challenge our assumptions about telecommunications regulation and force us to think about a new era of telecommunications policy.

As a cosponsor of the Slattery-Tauzin bill, H.R. 1527, I think it is time that our public policy prepare our telecommunications infrastructure for the 21st century and allow our largest telecommunications players to use their network knowledge and technical resources to develop new products and maintain our international clout. So I hope we can move forward with a bill in this year.

However, while I see substantial benefits in lifting the manufacturing restrictions on the Bell operating companies, my support for H.R. 1527 is not without some concerns. Members of this subcommittee often talk about the important linkage between a first-rate telecommunications industry and a first-rate economy. I agree with that assessment wholeheartedly.

America's productivity and economic strength is becoming increasingly tied to the quality of our telecommunications infrastructure. That economic truth is not lost on rural America. Economic development in rural areas will depend heavily on the ability of the small companies and cooperatives that serve rural areas to provide first-rate telecommunications equipment and software.

Without adequate rural safeguards, we run the risk of shutting off rural residents and rural economies from the benefits of MFJ legislation. I am pleased that H.R. 1527 contains language that addresses these concerns, and as the subcommittee moves forward, I hope to strengthen that part of the bill.

In addition to my concern about sharing the benefits of new technologies, I hope that Bell's entry into manufacturing will not come at the expense of making necessary improvements in the local network. Many of my constituents in New Mexico are most interested in affordable basic local service, and some New Mexicans in Ramah or Shiprock in the Navajo Territory have yet to get dial-tone.

Not only must Congress ensure that the benefits of MFJ legislation are shared, but that these benefits are not realized at the expense of local ratepayers or technological improvements in the local loop.

Finally, Mr. Chairman, two other areas that I would hope to strengthen as we move along. One would be in the area of international trade to ensure most of the manufacturing base be strengthened in the United States, and not overseas.

I am concerned, too, about giving reciprocal treatment to nations and companies that don't treat our own firms the same way we do. And lastly, Mr. Chairman, my long-standing concern with providing access to minority disadvantaged firms in this process, and a strong component for this legislation.

I thank the chairman.

Mr. MARKEY. The gentleman's time has expired.

The gentleman from Florida, Mr. Bilirakis.

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Mr. BILIRAKIS. Mr. Chairman, I first want to thank you for holding this hearing today. The question of modifying the modified final judgment has been with us for a number of years, but I believe this hearing will serve to focus the issue in a new light.

In specific, I believe our subcommittee will have the benefit of a longer view than that which surrounded past legislative initiatives. More time has passed and—while it certainly did not heal old wounds—our subcommittee should benefit from the experience of the marketplace and conditions which have surfaced subsequent to January 1, 1984.

Indeed, I think most subcommittee members would agree that the past 7 years have witnessed a substantial transformation of the domestic and international telecommunications market. While a certain percentage of this change has been technology-driven, it could be said that the MFJ has proven, at one time, to be a breakup, a breakdown and a breakthrough.

Regarding the breakup, the traditional marketplace for telecommunications services has been ripped asunder. Former colleagues are now competitors, the line of business restrictions have formed the foundation for major barriers in the provision of services and equipment, and relatively small companies have grown into major players in the market. Given the amount of change, it would appear impossible that Ma Bell, like Humpty Dumpty, will ever be put back together again, at least not on a national basis.

As to the breakdown, I am not specifically referring to recent Signalling System 7 problems, but rather a more generic public perception and confusion over service. It still appears that although the general public welcomes innovation and new services, it hates change.

Consumers have entered an often baffling world of access codes, new services and bills which resemble a cliff note version of "War and Peace." When I travel home to the Ninth District, I do not often hear plaudits for call forwarding, call waiting, call trace, repeat call or return call. Much more often, I hear a cry for help.

This, I expect, is part of the natural transition to the world of high technology, yet we must recognize it to be a real, bona fide sentiment. It clouds what many cite as the benefits of the MFJ, the breakthrough to a more decentralized market, benefiting from more competition and innovation.

Those who argue against changes to the MFJ cite a growing and diverse domestic manufacturing and services market, a veritable garden of home-grown talent and initiative. They have argued that small companies, upon being allowed to compete, have flourished in contrast to the former monopoly provision of equipment, dial tone, long distance and info services.

As a relatively new member of this subcommittee, I have several major concerns regarding this entire situation. While I have attempted to approach this issue and this hearing with an objective and open mind, there are several concerns I have with the status quo and the present functioning of the MFJ.

First, I think we must address both the domestic and international impact of regional Bell company entry into manufacturing. We cannot engage in unwarranted domestic protectionism between

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vendors and equipment purchasers any more than we can accept protectionist behavior from our international trading partners.

I find myself deeply troubled by statistics which indicate that European and Japanese equipment manufacturers are increasing their R&D efforts by a 3-to-1 ratio over U.S. manufacturers. I also question the rationale behind constraints which prevent the Bell companies from taking an equity position in support of other companies' export activities.

Are we that paranoid of the ghost of Ma Bell that we must limit the ability of U.S. companies to sell abroad? Do we need to protect other companies not only domestically but internationally?

Second, we must inevitably look to the future and to the development of our Nation's infrastructure. Legal bans which act to define a marketplace and which could act to inhibit legitimate business cooperation and development must be justified on the basis of strong policy concerns.

Specifically, I am interested in the degree of interaction which is presently allowed between regional Bell companies and equipment suppliers.

Third, precisely what protections are necessary to guard against monopolistic behavior or the twin evils of cross-subsidies and self-dealing? To what degree do we need an amalgam of sanctions and FCC oversight?

With current bill drafts, entry is conditioned on several fronts, including a mandate for competitive procurement. But how workable is a private sector procurement system given, for comparison's sake, the detail of the Government's own Federal acquisition regulations?

Can a few legislative paragraphs substitute for an entire Federal code and appeal process? Should it? Or can a similar purpose be served in another legislative fashion?

Mr. Chairman, we must observe the obvious. The MFJ did not appear out of the thin air, but the much-maligned and praised settlement is rooted in law and the decades-old actions of the Justice Department. To some extent, we created this monster.

In closing, Mr. Chairman, I believe that the last thing we can do is to forget the end user in this debate, the consumer who indeed may still be experiencing a minor case of future shock. All sides in this debate claim to be on the side of the truth, justice and the American way. I want to be on the side of the guy who pays the bills.

My lack of present cosponsorship, Mr. Chairman, does not mean I believe our subcommittee should ignore this issue or avoid questioning the rationale of a lawsuit settled some 9 years ago.

While the court has allowed some loosening of initial restrictions, it is well within our panel's prerogative and duty to delve deeper and to examine the policy rationale inherent in this debate to determine, in essence, whether times have changed and whether change makes sense with regard to broader, national goals.

Thank you, Mr. Chairman.

Mr. MARKEY. The gentleman's time has expired.

The gentleman from Texas, Mr. Barton.

Mr. BARTON. Thank you, Mr. Chairman. I have a written statement I will submit for the record.

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Mr. MARKEY. All written statements of subcommittee members will be included in the record.

Mr. BARTON. Let me briefly say now that Mr. Bonior is the Whip. I assume all the members in Energy and Commerce voted for him, and I wish you all the best getting some of the legislation from this committee moved.

I would like to say on this issue, the modified final judgment was really not meant to be, I think, the permanent answer to all of our telecommunications in this country. For that reason, I am a sponsor of the Oxley bill that would allow the Bell operating companies to participate in the manufacturing of some telecommunications equipment.

Having said that, I think that we should give both sides in this hearing a chance to air their views. If we are going to legislate—and I think it is entirely appropriate, we should do that from a position of knowledge and a position that every interested party has had an opportunity on the record to express their views.

I am supportive of the intent of this hearing. I know there will be an issue about the domestic content of it. I don't want to rush through this in 1 or 2 weeks. I think we ought to give the members of the subcommittee ample opportunity to hear views from each side.

[The prepared statement of Mr. Barton follows:]

OPENING STATEMENT OF HON. JOE BARTON

Thank you, Mr. Chairman. I, too, would like to thank you for conducting this hearing today. As a relative newcomer to this subcommittee I have seen many important issues come up for discussion. Mr. Chairman, I believe that the issue of Bell manufacturing freedom is certainly among the most important topics facing us this year.

I believe this for several reasons. Bell manufacturing freedom will bring new products and services to American consumers. Investments in telecommunications research and development will increase both among Bell companies and other equipment manufacturers. Non-Bell telecommunications equipment manufacturers will benefit from increased availability of capital and knowledge of the telephone network. And the continuing deficit in telecommunications equipment trade will narrow. Above all else, manufacturing freedom will allow seven of our most capable players—representing 70 percent of our Nation's telecommunications assets—to help America remain competitive in this industry.

I would like to take this opportunity to thank some of our colleagues for addressing this issue. Bills introduced this session by the distinguished gentleman from Ohio, Mr. Oxley—as well as similar legislation introduced by Mr. Slattery and Mr. Tauzin—recognize the importance of Bell research, design, and manufacturing. As a cosponsor of Mr. Oxley's version, I look forward to considering this issue today, and I urge you Mr. Chairman to bring it up for subcommittee action as soon as possible. Thank you.

Mr. MARKEY. Mr. Slattery?

Mr. SLATTERY. I appreciate the chairman holding this hearing today. I applaud your interest in this legislation, and I know you are committed to addressing a lot of concerns that have been addressed by other members of the subcommittee today.

I look forward to working with you in the days and weeks ahead. Frankly, my friend from Louisiana has given my speech. I did want to emphasize several points that have not yet been made. That is, from my perspective, it is fundamentally absurd we have laws in place in this country that in effect prohibit some of our major telecommunications firms in America from creating jobs right here in

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the United States when they currently can create these jobs in Mexico. These kinds of absurdities in the law need to be corrected.

I am also convinced this legislation is pro-competitive. The reason I say that is because with the passage of this legislation, we are going to open the doors of opportunity for a lot of new players in the manufacturing and telecommunications equipment industries in this country, and it won't be just the Bell operating companies.

I think we have already heard a lot of testimony from small entrepreneurial telecommunications, manufacturing concerns from all over the country that have made it clear to many of us that they, in fact, support this legislation and they do so because they recognize this legislation will enable them to enter into relationships with their largest customers that will enable them to acquire the financing they need to grow their companies right here in this country.

I think that is a compelling reason we should support this legislation and pass it. The final thing I feel strongly about is, I believe the task of writing telecommunications policy in this country should be with the Congress of the United States, and in particular this subcommittee. I don't like the idea that Judge Greene continues to exercise, in my view, far too much authority in the shaping of telecommunications policy.

So, Mr. Chairman, I hope that during the course of this hearing and in the course of the months ahead, we on this committee will be able to come together and pass this legislation and re-exert our prerogatives in the area of writing and shaping telecommunications policy for this country.

I happen to believe very strongly our competitiveness in an international economy in the 1990's is going to be in large part determined by how effective we are at maintaining and improving our telecommunications capability in this country. That is especially true, Mr. Chairman, for rural areas in America.

I thank you again, Mr. Chairman, for having this hearing today. I look forward to working with you in the days ahead as we try to shape a bill you and I agree on—and more importantly, we can find 218 votes for. Thank you, Mr. Chairman.

Mr. MARKEY. I thank the gentleman from Kansas very much.

The Chair recognizes the gentleman from Texas, Mr. Hall.

Mr. HALL. Thank you, Mr. Chairman.

I would ask unanimous consent to submit my statement.

[The prepared statement of Mr. Hall follows:]

OPENING STATEMENT OF HON. RALPH M. HALL

Mr. Chairman: Over the past 2 years, the members of this subcommittee have collected literally thousands of pages of testimony and opinion on changing the Modified Final Judgment. Few issues before the committee have received the attention and the scrutiny of MFJ reform—and with good reason—because the decisions we make on this issue will affect the telecommunications industry for decades to come.

I've heard a lot of excellent arguments from both sides, none more compelling than the one that states that the U.S. Congress ought to be formulating telecommunications policy—instead of a Federal judge. Almost everyone in this room will agree that this is an inappropriate and inefficient situation that must be reversed by Congress in the near future.

With that said, I think it's vital that we tread through this reform effort very carefully. it's been said that the most important rule for physicians when examining

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a patient is to "first do no harm." That's the way we have to approach this issue. The 1982 divestiture extended an opportunity for thousands of entrepreneurs to break into the telecommunications industry, and quite frankly, I'm concerned that this legislation will destroy many of the benefits of competition we have experienced over the last few years.

The regional Bell operating companies have argued that their expertise is needed in order to keep the U.S. competitive in the telecommunications industry. This argument seems to ignore the fact that there are already thousands of companies that manufacture communications equipment in the United States—and these companies continue to keep the U.S. competitive worldwide. Do we really want to place the current competitive environment in jeopardy by passing this legislation?

As we move towards final action on MFJ reform, I hope the members of this subcommittee will keep in mind that this is more than just "AT&T versus the Bells." An awful lot of small to medium size companies in the State of Texas and elsewhere have an equal stake in what we do, and I sincerely hope we won't structure a bill which does irreparable harm to their business.

Thank you Mr. Chairman, and I yield back the balance of my time.

Mr. MARKEY. Our last opening statement will come from the gentleman, Mr. Bryant, from Texas.

Mr. BRYANT. Mr. Chairman, I made my position on this legislation very clear. If we are going to pass legislation, it ought to be legislation designed to guarantee we have more jobs and more prosperity in America, not less.

The fact of the matter is the Hollings and Slattery proposals allows all the expensive, high-tech components of manufacturing—which was painstakingly introduced—defined in a bill H.R. 452—from the concept, to research and development, to be done in joint ventures overseas. That is not acceptable. It is not defensible and not necessary when we can pass legislation which would allow for a great increase for a number of jobs in this country, and perhaps achieve some of the stated goals of the Hollings and Slattery proposals.

Eighty percent of our switches are made by 100 percent American companies. Five thousand companies are doing R&D 7 short years after divestiture. Why in the name of common sense would we want to change the situation that would obviously allow the transfer of the manufacturing of these products overseas. There would be very little about these products that is American, except the fact they were assembled and had a label familiar to Americans. If we can achieve a bill that will do more than that, I am interested in looking it over and maybe sponsoring it.

I am not interested in sponsoring a bill which acts like it does one thing but very clearly does another thing, and that is transfer the real guts of our telecommunications manufacturing to another part of the world.

I am surprised we are even considering it. The members ought to look very carefully, not at the label, but what the bill says with regard to where we are going to manufacture in the country, where we are going to do research, because it is all of those things that add up to prosperity, not simply taking a screwdriver and putting two pieces of metal together.

Finally, Mr. Chairman, I would say it seems clear to me that if we are going to alter the terms of the modified final judgment, we ought to be prepared to offer and support proposals which are going to deal with a much broader range of these issues and not just the issue of manufacturing or not manufacturing.

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It seems clear from those who have been most acutely concerned about this area that the courts may very well drastically change the meaning of the modified final judgment in the near future. That is the case we ought to anticipate, we ought not simply say we are going to deal here with one narrow area, while at the same time the courts are going to deal with a much broader area, thereby opening up the entire information services to unknown potential result.

That is our business in this committee—if we are going to legislate, legislate across the board. I think that is the intention of the chairman. It is my intention. I look forward to working under his leadership to achieve that goal.

Mr. MARKEY. The gentleman's time has expired, and all time for opening statements by members has expired. I will note that in my 5 years of chairing this subcommittee, that we have just surpassed the record for most members who have come to make an opening statement on any subject, and that goes through the crash of 1987 and the cable bill, and a whole host of other issues that have commended a lot of attention in this committee.

[Testimony resumes on p. 56.]

[Opening statements of Hon. Jack Fields, Hon. Gus Yatron, and the text of H.R. 1523 and H.R. 1527 follow:]

OPENING STATEMENT OF HON. JACK FIELDS

Mr. Chairman, I want to join my colleagues in commending you for holding this hearing on legislation to remove the MFJ restriction to allow the regional Bell operating companies to manufacture telecommunications equipment. And, I look forward to hearing from the witnesses today.

As months of spirited debate have proven, this is surely an issue with as many answers as there are questions. It's a topic that draws strong feelings from all the players, including many members of our own subcommittee. As well it should, because how this Congress proceeds will determine America's future ability to compete in the international telecommunications market.

Up to this point, no one has been able to reach agreement on how to approach the issue of MFJ relief for the Bell operating companies. Perhaps the closest we've come to consensus thus far is on the need to transfer jurisdiction over telecommunications policy from Judge Greene to the Congress and to the FCC.

Quite frankly, I just don't think that we can continue to have a complete ban on competition by the Bell operating companies. Those who argue against allowing the Bell operating companies to design and manufacture equipment argue the Bell operating companies will use their monopoly position to engage in anticompetitive behavior. In theory, the Bell operating companies may have the incentive to overcharge customers for local service and use the inflated profits for entry into new businesses. In theory, the Bell operating companies may have the incentive to discriminate against their competitors. But incentive is one thing, ability quite another. If we proceed with legislation to relax the manufacturing restrictions on the Bell operating companies, our challenge will be to ensure that adequate safeguards are in place to lessen the Bells ability to abuse their monopoly power.

My priority in this debate is to do what best serves the consumer. If we can enact policy that improves the quality and diversity of telecommunications products and services to the American consumer, we should do so. However, this policy must also ensure a level playing field so that all manufacturers can compete on equal footing. Clearly, there will be some costs in loosening the prohibitions of the Modified Final Judgment. What I will continue to weigh is whether the benefits to the consumer exceed the costs.

Mr. Chairman this is a complex and controversial issue which we have been debating for sometime. If we are going to make legislative changes to the MFJ Consent Decree this year, and I think we should, then we must move forward in a very cautious and deliberate manner. I look forward to working with you to move the process forward. Thank you.

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STATEMENT OF HON. GUS YATRON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. Chairman and members of the subcommittee, thank you for providing me with the opportunity to appear before you today.

Lifting the restrictions of the Modified Final Judgment (MFJ) of the Bell System Consent Decree could severely affect the Sixth District of Pennsylvania.

I am here today to express to you some concerns that my constituents and I share. I hope the points I raise on behalf of my constituents are ones that this subcommittee will pose to those who testify here today.

AT&T Technologies, formerly Western Electric, has been one of the most significant employers in my home county of Berks for the past 35 years. Meanwhile, during these years, the industrial base in my district has been shrinking, slowly, but due to foreign competition. Thus, due to these losses and AT&T's steady employment, rate, AT&T has emerged as the largest employer in my district.

It has been said that lifting the MFJ manufacturing restrictions will create thousands of new jobs in the United States. My constituents and I would like to know where in this country these jobs will be created. Various scenarios have been discussed since this debate began. One of many possible outcomes suggested is that telephone companies would initiate joint ventures with other companies and not build new facilities.

Clearly, we need assurances about the specific future plans of the telecommunications industry and how these plans will impact the thousands already employed in this industry.

While we have been told that these Modified Final Judgment restrictions are the cause of the trade deficit in telecommunications equipment, we know that the trade deficit, when divided by equipment types, exists only at the lower end of equipment, specifically, residential telephones. My constituents would like to know if the telephone companies will commit to manufacturing residential telephones in America to end this deficit, or if they will instead duplicate central office switching equipment which is already being produced in the United States and, particularly, in Reading, Pa.

I have seen several legislative proposals: the Hollings bill, which passed the Senate, and the legislation sponsored by my distinguished colleague, Mr. Slattery. Both of these bills contain the domestic manufacturing language. Yet, my friend Mr. Oxley and the White House support legislation which does not contain any of the domestic requirements. My constituents and I are interested in learning which of these two opposing positions the telephone companies support.

Mr. Chairman, we look to you for leadership. While I do not pretend to have the depth and breadth of knowledge you and your fellow subcommittee members have on this vital issue, my sole request is that you attempt to obtain answers to the questions which my constituents and I have raised regarding the effects that pending legislation may have on the telecommunications industry and its employees. Indeed, the livelihood of the Sixth District of Pennsylvania depends on it.

Once again, I thank you, Mr. Chairman, for your consideration of these grave concerns.

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102D CONGRESS
1ST SESSION

H. R. 1523

To permit the Bell Telephone Companies to conduct research on, design, and manufacture telecommunications equipment, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

MARCH 20, 1991

Mr. OXLEY introduced the following bill; which was referred jointly to the Committees on Energy and Commerce and the Judiciary

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A BILL

To permit the Bell Telephone Companies to conduct research on, design, and manufacture telecommunications equipment, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Telecommunications Equipment Research and Manufacturing Competition Act of 1991".

SEC. 2. FINDINGS.

The Congress finds that the continued economic growth and the international competitiveness of American industry would be assisted by permitting the Bell Tele-

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phone Companies, through their affiliates, to manufacture (including design, development, and fabrication) telecommunications equipment and customer premises equipment, and to provide telecommunications equipment, and to engage in research with respect to such equipment.

SEC. 3. AMENDMENTS TO THE COMMUNICATIONS ACT OF 1934.

Title II of the Communications Act of 1934 (47 U.S.C. 201 et seq.) is amended by adding at the end the following new section:

"SEC. 227. REGULATION OF MANUFACTURING BY BELL TELEPHONE COMPANIES.

"(a) GENERAL AUTHORITY.—Subject to the requirements of this section and the regulations prescribed thereunder, a Bell Telephone Company, through an affiliate of that company, notwithstanding any restriction or obligation imposed before the date of enactment of this section pursuant to the Modification of Final Judgment on the lines of business in which a Bell Telephone Company may engage, may manufacture and provide telecommunications equipment and manufacture customer premises equipment, except that neither a Bell Telephone Company nor any of its affiliates may engage in such manufacturing in conjunction with a Bell Telephone Company not so affiliated or any of its affiliates.

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"(b) SEPARATE MANUFACTURING AFFILIATE REQUIRED.—Any manufacturing or provision authorized under subsection (a) shall be conducted only through an affiliate (hereafter in this section referred to as a 'manufacturing affiliate') that is separate from any Bell Telephone Company.

"(c) REGULATIONS.—The Commission shall prescribe regulations to ensure that—

"(1) such manufacturing affiliate shall maintain books, records, and accounts separate from its affiliated Bell Telephone Company which identify all financial transactions between the manufacturing affiliate and its affiliated Bell Telephone Company and, even if such manufacturing affiliate is not a publicly held corporation, prepare financial statements which are in compliance with Federal financial reporting requirements for publicly held corporations, file such statements with the Commission, and make such statements available for public inspection;

"(2) consistent with the provisions of this section, neither a Bell Telephone Company nor any of its nonmanufacturing affiliates shall perform sales, advertising, installation, production, or maintenance

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operations for a manufacturing affiliate; except that—

"(A) a Bell Telephone Company and its nonmanufacturing affiliates may sell, advertise, install, and maintain telecommunications equipment and customer premises equipment after acquiring such equipment from their manufacturing affiliate, and

"(B) institutional advertising, of a type not related to specific telecommunications equipment, carried out by the Bell Telephone Company or its affiliates, shall be permitted if each part pays its pro rata share;

"(3) any debt incurred by such manufacturing affiliate may not be issued by its affiliated Bell Telephone Company, and such manufacturing affiliate shall be prohibited from incurring debt in a manner that would permit a creditor, on default, to have recourse to the assets of its affiliated Bell Telephone Company's telecommunications services business;

"(4) such manufacturing affiliate shall not be required to operate separately from the other affiliates of its affiliated Bell Telephone Company;

"(5) if an affiliate of a Bell Telephone Company becomes affiliated with a manufacturing entity,

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such affiliate shall be treated as a manufacturing affiliate of that Bell Telephone Company within the meaning of subsection (b) and shall comply with the requirements of this section;

"(6) such manufacturing affiliate shall make available, without discrimination or self-preference as to price, delivery, terms, or conditions, to common carriers providing telephone exchange service, for use in the provision of such service, telecommunications equipment, including software integral to the functioning of telecommunications equipment, manufactured by such affiliate so long as each such purchasing carrier—

"(A) does not either manufacture telecommunications equipment, or have an affiliated telecommunications equipment manufacturing entity, or

"(B) agrees to make available, to the Bell Telephone Company affiliated with such manufacturing affiliate or any of the other local exchange telephone company affiliates of such company, any telecommunications equipment, including software integral to the functioning of telecommunications equipment, manufactured for use with the public telecommunications net-

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work by such purchasing carrier or by any entity or organization with which such carrier is affiliated; and

"(7) such manufacturing affiliate shall not discontinue or restrict sales to other local exchange telephone companies of any telecommunications equipment, including software integral to the functioning of telecommunications equipment, that the affiliate manufactures for sale until arrangements are made by the manufacturing affiliate, upon financial and other terms satisfactory to the manufacturing affiliate, to provide to such local exchange telephone companies the specifications, plans, and tooling to allow such local exchange telephone companies to arrange for the manufacture of such telecommunications equipment by another manufacturing entity.

"(d) INFORMATION REQUIREMENTS.—

"(1) FILING OF INFORMATION ON PROTOCOLS AND TECHNICAL REQUIREMENTS.—The Commission shall prescribe regulations to require that each Bell Telephone Company shall maintain and file with the Commission full and complete information with respect to the protocols and technical requirements for connection with and use of its telephone exchange

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service facilities. Such regulations shall require each such company to report promptly to the Commission any material changes or planned changes to such protocols and requirements, and the schedule for implementation of such changes or planned changes.

"(2) FILING AS PREREQUISITE TO DISCLOSURE TO AFFILIATE.—A Bell Telephone Company shall not disclose to any of its affiliates any information required to be filed under paragraph (1) unless that information is immediately so filed.

"(3) TIMELY DISCLOSURE REQUIRED.—When 2 or more carriers are providing regulated telephone exchange service in the same area of interest, each such carrier shall provide to other such carriers timely information on the deployment of telecommunications equipment.

"(4) ACCESS BY COMPETITORS TO PROTOCOL AND TECHNICAL REQUIREMENTS INFORMATION.—The Commission may prescribe such additional regulations under this subsection as may be necessary to ensure that manufacturers in competition with a Bell Telephone Company's manufacturing affiliate have access to the information with respect to the protocols and technical requirements for connection with and use of its telephone exchange service facili-

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ties required for such competition that such company makes available to its manufacturing affiliate.

"(e) ADDITIONAL COMPETITION REQUIREMENTS.—The Commission shall prescribe regulations requiring that any Bell Telephone Company which has an affiliate that engages in any manufacturing authorized by subsection (a) shall—

"(1) provide, to other manufacturers of telecommunications equipment and customer premises equipment that is functionally equivalent to equipment manufactured by the Bell Telephone Company manufacturing affiliate, opportunities to sell such equipment to such Bell Telephone Company which are comparable to the opportunities which such Company provides to its affiliates;

"(2) not subsidize its manufacturing affiliate with revenues from its regulated telecommunications services; and

"(3) only acquire equipment from its manufacturing affiliate at the open market price.

"(f) COLLABORATION PERMITTED.—A Bell Telephone Company and its affiliates may engage in close collaboration with any manufacturer of customer premises equipment or telecommunications equipment during the

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design and development of hardware, software, or combinations thereof related to such equipment.

"(g) ADDITIONAL RULES AND REGULATIONS.—The Commission may prescribe such additional rules and regulations as the Commission determines necessary to carry out the provisions of this section.

"(h) ADMINISTRATOR AND ENFORCEMENT AUTHORITY.—For the purposes of administering and enforcing the provisions of this section and the regulations prescribed thereunder, the Commission shall have the same authority, power, and functions with respect to any Bell Telephone Company as the Commission has in administering and enforcing the provisions of this title with respect to any common carrier subject to this Act.

"(i) EFFECTIVE DATE; RULEMAKING SCHEDULE.—The authority of the Commission to prescribe regulations to carry out this section is effective on the date of enactment of this section. The Commission shall prescribe such regulations within 180 days after such date of enactment, and the authority to engage in the manufacturing authorized in subsection (a) shall not take effect until regulations prescribed by the Commission under subsections (c), (d), and (e) are in effect.

"(j) EXISTING AUTHORITY.—Nothing in this section shall prohibit any Bell Telephone Company from engag-

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ing, directly or through any affiliate, in any manufacturing activity in which any Bell Telephone Company or affiliate was authorized to engage on the date of enactment of this section.

"(k) DEFINITIONS.—As used in this section:

"(1) The term 'affiliate' means any organization or entity that, directly or indirectly, owns or controls, is owned or controlled by, or is under common ownership with a Bell Telephone Company. The terms 'owns', 'owned', and 'ownership' mean an equity interest of more than 10 percent.

"(2) The term 'Bell Telephone Company' means those companies listed in appendix A of the Modification of Final Judgment, and includes any successor or assign of any such company, but does not include any affiliate of any such company.

"(3) The term 'customer premises equipment' means equipment employed on the premises of a person (other than a carrier) to originate, route, or terminate telecommunications.

"(4) The term 'manufacturing' has the same meaning as such term has in the Modification of Final Judgment as interpreted in United States v. Western Electric Civil Action No. 82–0192 (United

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States District Court, District of Columbia) (filed December 3, 1987).

"(5) The term 'Modification of Final Judgment' means the decree entered August 24, 1982, in United States v. Western Electric Civil Action No. 82–0192 (United States District Court, District of Columbia).

"(6) The term 'telecommunications' means the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received, by means of an electromagnetic transmission medium, including all instrumentalities, facilities, apparatus, and services (including the collection, storage, forwarding, switching, and delivery of such information) essential to such transmission.

"(7) The term 'telecommunications equipment' means equipment, other than customer premises equipment, used by a carrier to provide telecommunications services.

"(8) The term 'telecommunications service' means the offering for hire of telecommunications facilities, or of telecommunications by means of such facilities.".

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I

102D CONGRESS
1ST SESSION

H. R. 1527

To permit the Bell Telephone Companies to conduct research on, design, and manufacture telecommunications equipment, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

MARCH 20, 1991

Mr. SLATTERY (for himself, Mr. TAUZIN, Mr. BRUCE, Mr. GLICKMAN, Mr. MAZZOLI, Mr. BONIOR, and Mr. HALL of Ohio) introduced the following bill; which was referred jointly to the Committees on Energy and Commerce and the Judiciary

SEPTEMBER 4, 1991

Additional sponsors: Mr. RICHARDSON, Mr. SHARP, Mr. LIPINSKI, Mr. JOHNSON of South Dakota, Mr. LEWIS of Georgia, Mr. PARKER, Mr. BURTON of Indiana, Mr. RAVENEL, Mr. DARDEN, Mr. TALLON, Mr. PAYNE of Virginia, Mr. JACOBS, Ms. LONG, Mr. STALLINGS, Mr. SWETT, Mr. RAHALL, Mr. OLIN, Mr. CLAY, Mr. ALEXANDER, Mr. PICKETT, Mr. JONES of North Carolina, Mr. THOMAS of Georgia, Mr. HAMMERSCHMIDT, Mr. DERRICK, Mr. FALEOMAVAEGA, Mr. HUTTO, Mr. FORD of Tennessee, Mr. TAYLOR of Mississippi, Mr. DAVIS, Mr. NAGLE, Mr. ORTON, Mr. HATCHER, Mr. SMITH of Florida, Mr. WOLPE, Mr. OWENS of New York, Mr. MCMILLEN of Maryland, Mr. MCDERMOTT, Mr. TAYLOR of North Carolina, Ms. NORTON, Mr. OWENS of Utah, Mrs. UNSOELD, Mr. DICKS, Mr. SKEEN, Mr. SAWYER, Mr. REED, Mr. MCGRATH, Mr. HENRY, Mr. SLAUGHTER of Virginia, Mr. JEFFERSON, Mr. PENNY, Mr. HUBBARD, Mr. KOPETSKI, Mr. COYNE, Mr. DOOLEY, Mr. GAYDOS, Mr. DORNAN of California, Mr. ANTHONY, Mr. PETERSON of Florida, Mr. SOLOMON, Mr. ERDREICH, Mr. PEASE, Mr. TRAXLER, Mr. HOPKINS, Mr. WEBER, Mr. DYMALLY, Mr. SARPALIUS, Mr. PETERSON of Minnesota, Mr. MARLENEE, Mr. KLECZKA, Mr. WILSON, Mr. MFUME, Mr. CONDIT, Mrs. BENTLEY, Mr. DIXON, Mrs. BYRON, Ms. HORN, Mr. TRAFICANT, Mr. LEVIN of Michigan, Mr. ZELIFF, Mr. PURSELL, Mr. LAUGHLIN, Mr. DWYER of New Jersey, and Mr. MORAN

Deleted sponsor: Mr. RANGEL (added June 27, 1991; deleted July 31, 1991)

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A BILL

To permit the Bell Telephone Companies to conduct research on, design, and manufacture telecommunications equipment, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Telecommunications Equipment Research and Manufacturing Competition Act of 1991".

SEC. 2. FINDINGS.

The Congress finds that the continued economic growth and the international competitiveness of American industry would be assisted by permitting the Bell Telephone Companies, through their affiliates, to manufacture (including design, development, and fabrication) telecommunications equipment and customer premises equipment, and to provide telecommunications equipment, and to engage in research with respect to such equipment.

SEC. 3. AMENDMENTS TO THE COMMUNICATIONS ACT OF 1934.

Title II of the Communications Act of 1934 (47 U.S.C. 201 et seq.) is amended by adding at the end the following new section:

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"SEC. 227. REGULATION OF MANUFACTURING BY BELL TELEPHONE COMPANIES.

"(a) GENERAL AUTHORITY.—Subject to the requirements of this section and the regulations prescribed thereunder, but notwithstanding any restriction or obligation imposed before the date of enactment of this section pursuant to the Modification of Final Judgment on the lines of business in which a Bell Telephone Company may engage, a Bell Telephone Company, through an affiliate of that company, may manufacture and provide telecommunications equipment and manufacture customer premises equipment, except that neither a Bell Telephone Company nor any of its affiliates may engage in such manufacturing in conjunction with a Bell Telephone Company not so affiliated or any of its affiliates.

"(b) SEPARATE MANUFACTURING AFFILIATE.—Any manufacturing or provision authorized under subsection (a) shall be conducted only through an affiliate that is separate from any Bell Telephone Company.

"(c) COMMISSION REGULATIONS.—The Commission shall prescribe regulations to ensure that—

"(1) such manufacturing affiliate shall maintain books, records, and accounts separate from its affiliated Bell Telephone Company which identify all financial transactions between the manufacturing affiliate and its affiliated Bell Telephone Company

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and, even if such manufacturing affiliate is not a publicly held corporation, prepare financial statements which are in compliance with Federal financial reporting requirements for publicly held corporations, file such statements with the Commission, and make such statements available for public inspection;

"(2) consistent with the provisions of this section, neither a Bell Telephone Company nor any of its nonmanufacturing affiliates shall perform sales, advertising, installation, production, or maintenance operations for a manufacturing affiliate, except that—

"(A) a Bell Telephone Company and its nonmanufacturing affiliates may sell, advertise, install, and maintain telecommunications equipment and customer premises equipment after acquiring such equipment from their manufacturing affiliate; and

"(B) institutional advertising, of a type not related to specific telecommunications equipment, carried out by the Bell Telephone Company or its affiliates, shall be permitted if each part pays its pro rata share;

"(3)(A) such manufacturing affiliate shall conduct all of its manufacturing within the United

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States and, except as otherwise provided in this paragraph, all component parts of customer premises equipment manufactured by such affiliate, and all component parts of telecommunications equipment manufactured by such affiliate, shall have been manufactured within the United States;

"(B) such affiliate may use component parts manufactured outside the United States if—

"(i) such affiliate first makes a good faith effort to obtain equivalent component parts manufactured within the United States at reasonable prices, terms, and conditions; and

"(ii) for the aggregate of telecommunications equipment and customer premises equipment manufactured and sold in the United States by such affiliate in any calendar year, the cost of the components manufactured outside the United States contained in the equipment does not exceed 40 percent of the sales revenue derived from such equipment;

"(C) any such affiliate that uses component parts manufactured outside the United States in the manufacture of telecommunications equipment and customer premises equipment within the United States shall—

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"(i) certify to the Commission that a good faith effort was made to obtain equivalent parts manufactured within the United States at reasonable prices, terms, and conditions, which certification shall be filed on a quarterly basis with the Commission and list component parts, by type, manufactured outside the United States; and

"(ii) certify to the Commission on an annual basis that for the aggregate of telecommunications equipment and customer premises equipment manufactured and sold in the United States by such affiliate in the previous calendar year, the cost of the components manufactured outside the United States contained in such equipment did not exceed the percentage specified in subparagraph (B)(ii) as adjusted in accordance with subparagraph (G);

"(D)(i) if the Commission determines, after reviewing the certification required in subparagraph (C)(i), that such affiliate failed to make the good faith effort required in subparagraph (B)(i) or, after reviewing the certification required in subparagraph (C)(ii), that such affiliate has exceeded the percentage specified in subparagraph (B)(ii), the Commis-

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sion may impose penalties or forfeitures as provided for in title V of this Act;

"(ii) any supplier claiming to be damaged because a manufacturing affiliate failed to make the good faith effort required in subparagraph (B)(i) may make complaint to the Commission as provided for in section 208 of this Act, or may bring suit for the recovery of actual damages for which such supplier claims such affiliate may be liable under the provisions of this Act in any district court of the United States of competent jurisdiction;

"(E) the Commission, in consultation with the Secretary of Commerce, shall, on an annual basis, determine the cost of component parts manufactured outside the United States contained in all telecommunications equipment and customer premises equipment sold in the United States as a percentage of the revenues from sales of such equipment in the previous calendar year;

"(F) a manufacturing affiliate may use intellectual property created outside the United States in the manufacture of telecommunications equipment and customer premises equipment in the United States;

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"(G) the Commission may not waive or alter the requirements of this paragraph, except that the Commission, on an annual basis, shall adjust the percentage specified in subparagraph (B)(ii) to the percentage determined by the Commission, in consultation with the Secretary of Commerce, as directed in subparagraph (E);

"(4) any debt incurred by such manufacturing affiliate may not be issued by its affiliated Bell Telephone Company, and such manufacturing affiliate shall be prohibited from incurring debt in a manner that would permit a creditor, on default, to have recourse to the assets of its affiliated Bell Telephone Company's telecommunications services business;

"(5) such manufacturing affiliate shall not be required to operate separately from the other affiliates of its affiliated Bell Telephone Company;

"(6) if an affiliate of a Bell Telephone Company becomes affiliated with a manufacturing entity, such affiliate shall be treated as a manufacturing affiliate of that Bell Telephone Company and shall comply with the requirements of this section;

"(7) such manufacturing affiliate shall make available, without discrimination or self-preference as to price, delivery, terms, or conditions, to common

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carriers providing telephone exchange service, for use in the provision of such service, telecommunications equipment, including software integral to the functioning of telecommunications equipment, manufactured by such affiliate so long as each such purchasing carrier—

"(A) does not either manufacture telecommunications equipment, or have an affiliated telecommunications equipment manufacturing entity, or

"(B) agrees to make available, to the Bell Telephone Company affiliated with such manufacturing affiliate or any of the other local exchange telephone company affiliates of such company, any telecommunications equipment, including software integral to the functioning of telecommunications equipment, manufactured for use with the public telecommunications network by such purchasing carrier or by any entity or organization with which such carrier is affiliated; and

"(8) such manufacturing affiliate shall not discontinue or restrict sales to other local exchange telephone companies of any telecommunications equipment, including software integral to the func-

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tioning of telecommunications equipment, that the affiliate manufactures for sale until arrangements are made by the manufacturing affiliate, upon financial and other terms satisfactory to the manufacturing affiliate, to provide to such local exchange telephone companies the specifications, plans, and tooling to allow such local exchange telephone companies to arrange for the manufacture of such telecommunications equipment by another manufacturing entity.

"(d) INFORMATION REQUIREMENTS.—

"(1) FILING OF INFORMATION ON PROTOCOLS AND TECHNICAL REQUIREMENTS.—The Commission shall prescribe regulations to require that each Bell Telephone Company shall maintain and file with the Commission full and complete information with respect to the protocols and technical requirements for connection with and use of its telephone exchange service facilities. Such regulations shall require each such company to report promptly to the Commission any material changes or planned changes to such protocols and requirements, and the schedule for implementation of such changes or planned changes.

"(2) FILING AS PREREQUISITE TO DISCLOSURE TO AFFILIATE.—A Bell Telephone Company shall

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not disclose to any of its affiliates any information required to be filed under paragraph (1) unless that information is immediately so filed.

"(3) TIMELY DISCLOSURE REQUIRED.—When 2 or more carriers are providing regulated telephone exchange service in the same area of interest, each such carrier shall provide to other such carriers timely information on the deployment of telecommunications equipment.

"(4) ACCESS BY COMPETITORS TO INFORMATION.—The Commission may prescribe such additional regulations under this subsection as may be necessary to ensure that manufacturers in competition with a Bell Telephone Company's manufacturing affiliate have access to the information with respect to the protocols and technical requirements for connection with and use of its telephone exchange service facilities required for such competition that such company makes available to its manufacturing affiliate.

"(e) ADDITIONAL COMPETITION REQUIREMENTS.—The Commission shall prescribe regulations requiring that any Bell Telephone Company which has an affiliate that engages in any manufacturing authorized by subsection (a) shall—

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"(1) provide, to other manufacturers of telecommunications equipment and customer premises equipment that is functionally equivalent to equipment manufactured by the Bell Telephone Company manufacturing affiliate, opportunities to sell such equipment to such Bell Telephone Company which are comparable to the opportunities which such Company provides to its affiliates;

"(2) not subsidize its manufacturing affiliate with revenues from its regulated telecommunications services; and

"(3) only acquire equipment from its manufacturing affiliate at the open market price.

"(f) COLLABORATION PERMITTED.—A Bell Telephone Company and its affiliates may engage in close collaboration with any manufacturer of customer premises equipment or telecommunications equipment during the design and development of hardware, software, or combinations thereof related to such equipment.

"(g) ADDITIONAL RULES AUTHORIZED.—The Commission may prescribe such additional rules and regulations as the Commission determines necessary to carry out the provisions of this section.

"(h) ADMINISTRATION AND ENFORCEMENT AUTHORITY.—For the purposes of administering and enforcing the

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provisions of this section and the regulations prescribed thereunder, the Commission shall have the same authority, power, and functions with respect to any Bell Telephone Company as the Commission has in administering and enforcing the provisions of this title with respect to any common carrier subject to this Act.

"(i) EFFECTIVE DATE; RULEMAKING SCHEDULE.—The authority of the Commission to prescribe regulations to carry out this section is effective on the date of enactment of this section. The Commission shall prescribe such regulations within 180 days after such date of enactment, and the authority to engage in the manufacturing authorized in subsection (a) shall not take effect until regulations prescribed by the Commission under subsections (c), (d), and (e) are in effect.

"(j) EXISTING MANUFACTURING AUTHORITY.—Nothing in this section shall prohibit any Bell Telephone Company from engaging, directly or through any affiliate, in any manufacturing activity in which any Bell Telephone Company or affiliate was authorized to engage on the date of enactment of this section.

"(k) DEFINITIONS.—As used in this section:

"(1) The term 'affiliate' means any organization or entity that, directly or indirectly, owns or controls, is owned or controlled by, or is under com-

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mon ownership with a Bell Telephone Company. The terms 'owns', 'owned', and 'ownership' mean an equity interest of more than 10 percent.

"(2) The term 'Bell Telephone Company' means those companies listed in appendix A of the Modification of Final Judgment, and includes any successor or assign of any such company, but does not include any affiliate of any such company.

"(3) The term 'customer premises equipment' means equipment employed on the premises of a person (other than a carrier) to originate, route, or terminate telecommunications.

"(4) The term 'manufacturing' has the same meaning as such term has in the Modification of Final Judgment as interpreted in United States v. Western Electric Civil Action No. 82–0192 (United States District Court, District of Columbia) (filed December 3, 1987).

"(5) The term 'manufacturing affiliate' means an affiliate of a Bell Telephone Company established in accordance with subsection (b) of this section.

"(6) The term 'Modification of Final Judgment' means the decree entered August 24, 1982, in United States v. Western Electric Civil Action No.

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82–0192 (United States District Court, District of Columbia).

"(7) The term 'telecommunications' means the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received, by means of an electromagnetic transmission medium, including all instrumentalities, facilities, apparatus, and services (including the collection, storage, forwarding, switching, and delivery of such information) essential to such transmission.

"(8) The term 'telecommunications equipment' means equipment, other than customer premises equipment, used by a carrier to provide telecommunications services.

"(9) The term 'telecommunications service' means the offering for hire of telecommunications facilities, or of telecommunications by means of such facilities.".

SEC. 4. EFFECTIVE DATE.

(a) IN GENERAL.—Section 227 of the Communications Act of 1934 (as added by this Act) shall be effective 30 days after the Federal Communications Commission prescribes final regulations pursuant to such section.

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(b) RULEMAKING AUTHORITY EFFECTIVE ON ENACTMENT.—Notwithstanding subsection (a) of this section, the authority of the Federal Communications Commission to prescribe regulations pursuant to such section 227 is effective upon enactment of this Act.

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Mr. MARKEY. Today, we have about as distinguished a panel as we have had appear before us. We begin with witnesses representing the Department of Justice and Department of Commerce, so we can have a full expression of the administration's position on this subject.

Representing the Department of Commerce, the Honorable Janice Obuchowski, Assistant Secretary of Commerce, head of the National Telecommunications Information Administration.

For the Department of Justice, Honorable James Rill, Assistant Attorney General, representing the Antitrust Division, but more importantly, the Department of Justice itself.

Let us begin with you, once again, Secretary Obuchowski.

Ms. OBUCHOWSKI. Mr. Chairman, happy birthday.

Mr. MARKEY. Thank you very much. Can I make this note, although I appreciate very much the sentiments expressed, I would very much like not to celebrate next year's birthday with all of you. There, I think, Mr. Slattery and all members of the committee agree, 5 years on this subject has been enough. And I appreciate the fact that my 40th and 45th birthdays have been celebrated with this group. I would like that to be the conclusion——

Mr. RILL. Mr. Chairman, you can take the felicitations as a statement of the administration's position.

Mr. MARKEY. How close was the vote?

Mr. RILL. We do not disagree with your statement concerning next year, however.

Mr. SLATTERY. Mr. Chairman, I would like to wish my chairman a happy birthday and assure him, with his cooperation, I will do everything I can to assure he isn't here next year working on this project.

Mr. MARKEY. The spirit of compromise is very touching.

Again, the Secretary—Madam Secretary we recognize you. Please, 5 minutes, if you would, for your opening statement. As you can see, there is plenty of interest in the questions.

STATEMENTS OF JANICE OBUCHOWSKI, ASSISTANT SECRETARY OF COMMERCE, NATIONAL TELECOMMUNICATIONS INFORMATION ADMINISTRATION, DEPARTMENT OF COMMERCE; AND JAMES F. RILL, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

Ms. OBUCHOWSKI. Mr. Chairman, and members of the subcommittee, thank you for this opportunity to testify on behalf of the administration in support of legislation to modify the AT&T consent decree to permit Bell company entry into manufacturing.

I ask leave for my extended testimony to be admitted into the record.

Mr. MARKEY. All of the written opening statements of all the witnesses today will be put in the record in their entirety. This will be a blanket motion.

Ms. OBUCHOWSKI. We share your view, Mr. Chairman, that it is time to get something done. The time to lift this restriction, subject to appropriate safeguards, has come. The FCC and State Commissions have addressed many of the underlying premises of the original prohibition.

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The FCC has adopted much stronger and more clearly enforceable accounting rules and network disclosure requirements. It has built up a body of expertise that addresses dangers of cost and revenue-sharing.

The FCC has implemented rules that permit scrutiny of affiliate transactions. And the FCC is closely monitoring operating company service quality. In the meantime, the manufacturing ban is bottling up the sense of initiative and creative insights of thousands of Bell operating company employees.

Some of them have worked in the telephone industry for decades, continually acquiring knowledge and expertise. Yet many of them by now are probably afraid even to think about hardware or software improvements that could provide better service. For them under current law thinking about manufacturing is like lust in the heart, dangerous because it could lead to illicit action.

Mr. Chairman, it is time to end these restrictions. This step would help the United States compete more effectively in one of our most important high-tech industries. This important step would bring new, highly competent competitors into the manufacturing arena, and ensure American telecommunications research and development meets the test of daily operating experience.

And at a time when we are worried that many of our new domestic high-tech startup companies must turn to overseas sources for capital, it would free up some of the revenues of roughly 50 percent of our domestic telecommunications industry to invest.

Concerning the domestic content restrictions, this administration's position is known to you. Domestic content restrictions will invite protectionist responses from trading partners that have been opening their doors to American telecommunications sales.

The United States has always been strong in sales of network equipment. We are growing stronger in marketing this equipment overseas, a major concern of Secretary Mosbacher. And by lifting the ban, we could have even more to offer in world markets. This is not the time to shut doors.

Before closing, I would like to make one final point. Mr. Chairman, it is time to end one judge's control over the destiny of this industry. The proper function of courts is to decide cases. In this case, in its time, the court may have played its role well, but it is time for this one long-playing actor to move away from a starring role and for Congress, the FCC and the Executive Branch to take center stage. You can move this process forward by adopting Congressman Oxley's bill on manufacturing relief. It is a clean, straightforward bill on a single issue of bipartisan concern.

In the Senate, as you know, manufacturing relief legislation was adopted by an overwhelming margin. There are other very important issues such as information services and infrastructure development, but, you now have before you an opportunity to report out good legislation that can quickly be adopted into law.

Mr. Chairman, that concludes my prepared testimony, and I will be happy to respond to any questions the subcommittee may have.

[The prepared statement of Ms. Obuchowski follows:]

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Statement of

Janice Obuchowski
Assistant Secretary for
Communications and Information

Mr. Chairman and Members of the Subcommittee:

Introduction

Thank you for this opportunity to testify on behalf of the Administration on proposed legislation that would modify the AT&T consent decree to permit Bell company entry into manufacturing. We appreciate this opportunity to express our support for H.R. 1523, which mirrors S. 173 and H.R. 1527, but excludes the domestic content and domestic manufacturing restrictions found in those bills. During Senate consideration of S. 173, the Telecommunications Research and Manufacturing Competition Act of 1991, the Administration strongly opposed the bill's domestic content and domestic manufacturing requirements. If legislation were presented to the President with these requirements, the President's senior advisers would recommend a veto.

We are convinced that Bell company entry into manufacturing will produce significant public benefits. We can anticipate a variety of new services being made available to the public as more advanced capabilities are incorporated directly into our telecommunications networks. We also expect to see an increase in domestic competition, with the potential to enhance U.S. competitiveness in global markets as well. Accordingly, we urge the members of this subcommittee to join us in seeing that seven of our largest telecommunications companies are freed from restrictions impeding such important contributions to the nation's well-being.

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Bell Company Entry into Manufacturing will Benefit the Public Through the Offering of New Network Capabilities

The Bell companies represent very significant U.S. resources that are presently used to serve the public, and that could be further applied to the advancement of U.S. telecommunications and related high-technology endeavors. The Bell companies now provide local telephone service to approximately 80 percent of the U.S. population, and their assets, in the aggregate, represent a significant component of the country's telecommunications asset base. The manufacturing restriction in the AT&T Consent Decree, however, places severe restrictions on the Bell companies' ability to utilize these important resources to serve the American public.

The manufacturing restriction greatly circumscribes the extent to which the Bell companies may engage in any network-related research and development (R&D). Yet a primary output of the R&D process -- the introduction of new telecommunications products and services -- often serves an underlying impetus to technical advances in the telecommunications infrastructure. By prohibiting the Bell companies from manufacturing equipment and engaging more fully in R&D, the AT&T consent decree limits their ability to incorporate new or more advanced capabilities directly

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into their networks and thereby meet public's communications needs.

Some services would, in fact, become available more quickly and on a more widespread basis -- in rural as well as urban areas -- if certain capabilities could be provided through the Bell companies' networks, rather than requiring each individual desiring the service to buy the necessary terminal equipment. For example, I understand that initial developmental work is underway with respect to the provision of so-called "voice to text," or "text to voice," service through the network. In these cases, hardware and software installed in the network would allow a voice message to be translated into a written one and vice versa.

Such a capability would be particularly beneficial to those who are sight or hearing-impaired, by providing them an instant translator and thus facilitating their ability to communicate with others. Although final development of such a capability may be some years away, it is time to remove needless barriers that may impede or delay its realization, including the restriction on Bell company entry into manufacturing and R&D.

Moreover, while some new network features may initially be oriented to specialized needs such as those just described, the benefits can be expected to spread to other applications and

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produce additional benefits as well. New network capabilities facilitating ease of communications can enhance the quality of life for all segments of our society, individuals and businesses alike. The potential for increased worker productivity arises generally. Moreover, such new capabilities may also lead to additional U.S. jobs requiring highly skilled workers trained to use the various new means of communication that develop.

In urging that the Bell companies be permitted to engage in manufacturing activities and R&D, potentially leading to many new network capabilities, we are not suggesting that costs should be borne by all ratepayers, or that services ultimately provided through the use of such capabilities must be offered by the Bell companies. Rather, network capabilities could provide the general public with a ubiquitous means of access to desired services, at reasonable charges, regardless of the identity of the ultimate service provider.

The Manufacturing Restriction Impairs the Ability of Others to Manufacture Equipment for use in Bell Company Networks

In permitting the Bell companies to do "basic research," but not "research and development," the decree has become a potent force constraining the development of a significant portion of the nation's telecommunications assets. Not only are the Bell companies themselves prevented from investing in product-related innovative activities, but they are also impaired in efforts to

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work with independent manufacturers of telecommunications equipment. Pursuant to the decree, the Bell companies may participate only in certain limited phases of the manufacturing process. They may define generic product features, but not detailed design specifications; and they are barred from software design and development if it involves "software integral to equipment hardware, also known as firmware."

We are concerned because the manufacturing restriction greatly hampers the ability of other entities desiring to work with the Bell companies to manufacture telecommunications equipment. Such artificial definitional lines engender unwarranted difficulties for manufacturers attempting to design equipment specifically for use in Bell company networks, and may thereby deny or delay the offering of new network capabilities to the public. In short, the manufacturing restriction is impairing the pace at which innovations are being brought to the market, and increasing the overall cost due to restraints placed on Bell company participation.

Bell Company Entry into Manufacturing will Benefit the Public by Promoting Domestic Competition and U.S. Global Competitiveness

A strongly competitive domestic manufacturing market is the best means of ensuring that the public fully realizes the potential benefits of manufacturing advances. Competition is a significant spur to innovation, cost-cutting, and responsiveness

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to customers' needs. Entry of seven additional, large U.S. telecommunications companies into this already competitive field will further strengthen the level of competition presently characterizing the domestic market.

By permitting the Bell companies to contribute to the U.S. manufacturing base and thereby stimulate U.S. economic growth, we can also foster the international competitiveness of American industry. Today, the goal of maintaining and fostering U.S. global competitiveness is rightfully a high priority for U.S. policymakers, both in the Congress and in the Administration. It is time that we join together to promote this goal by eliminating barriers preventing the Bell companies from contributing to U.S. manufacturing efforts. In continuing to handicap seven of our largest telecommunications companies in this competitive environment, we are actually handicapping the ability of the United States to meet aggressively the competitive challenge presented by foreign commercial interests.

U.S. competitiveness would also be fostered by permitting the Bell companies to serve as a source of "seed" capital for smaller U.S. manufacturing companies, and also to enter joint manufacturing ventures themselves. In some cases, entrepreneurial U.S. companies have had to turn to foreign firms as a source of funding or expertise. We do not object to this investment in principle, but we recognize that this country would

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be the beneficiary if the Bell companies were permitted, along with other U.S. companies, to fulfill such capital needs.

The Administration Opposes Imposition of Domestic Content and Domestic Manufacturing Restrictions on the Bell Companies

Competition will best flourish in domestic and global markets if we continue to adhere to the U.S. policy of fostering free and open trade in telecommunications equipment markets both here and abroad. For this reason, the Administration is strongly opposed to imposition of any domestic content and domestic manufacturing restrictions as a condition of Bell company entry into manufacturing, including those specified in H.R. 1527; and, as we stated earlier, if legislation were presented to the President with these requirements, the President's senior advisers would recommend a veto.

The United States has met with some success in recent years in increasing exports of U.S. telecommunications equipment, with the result that the U.S. trade deficit in this area has fallen over the last two years, from approximately $2.6 billion in 1988 to approximately $790 million in 1990. Domestic content requirements would give our foreign trading partners a ready excuse to close the door on U.S.-manufactured goods at a time when U.S. firms have begun to turn the tide. Some of these same trading partners have begun to liberalize their own markets (e.g., United Kingdom, Japan). Local content restrictions could

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give such countries a pretext for reversing these liberalizing moves, further hampering U.S. export efforts.

Moreover, domestic content restrictions act, in effect, as a ban on imports. Such bans deny consumer choice, impose inflationary pressures on the economy, and may unfairly put the Bell companies at a competitive disadvantage vis-a-vis other manufacturers not forced to operate under the same restrictions. Private companies could be forced to procure and produce equipment on the basis of government fiat rather than sound economic and technical grounds.

Such requirements are also unacceptable because they would undercut U.S. trade negotiators who are trying to bring foreign government-owned telecommunication monopolies under the GATT Government Procurement Code. Absent a new GATT agreement, the EC's huge government procurement market for telecommunications equipment will remain closed to U.S. providers.

We may also be required to compensate our trading partners or face retaliation if the requirements are held to violate our international obligations. This result would be especially damaging in light of recent dramatic growth in U.S. telecommunications equipment exports. The United States had a $1.3 billion trade surplus in network and transmission equipment in 1990. Any retaliation due to U.S. local content requirements

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would cost us export-related jobs in telecommunications and other industries. We therefore have a lot to lose in any trade dispute in this area.

Safeguards can be Imposed to Prevent or Deter Potential Abuse

In evaluating the benefits to the public of Bell company entry into manufacturing, we also assessed arguments regarding anticompetitive conduct due to Bell company control over most local exchange facilities. To ameliorate such concerns, we support safeguards as a means to prevent or deter anticompetitive discrimination against competitors, as well as unlawful cross-subsidies between regulated and unregulated activities. However, we are also concerned that imposition of unnecessary or inflexible safeguards may also reduce the beneficial effects of Bell company entry into manufacturing.

H.R. 1523 and H.R. 1527, like S. 173, include a number of highly specific regulatory provisions, such as requirements that the Bell companies separate their regulated operations from their manufacturing ventures, that they not engage in self-dealing, and that they disclose information about Bell company networks needed by competitors. Regulatory safeguards contemplated in the legislation would be in addition to any already imposed, or imposed in the future, by the Federal Communications Commission (FCC).

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Including such highly specific regulatory provisions in the legislation (such as structural separation and conditions on sales to other local exchange carriers) creates unnecessary risks and implementation problems, as safeguards deemed desirable today may manifest a need for modification over time. Unnecessary or inflexible safeguards may thus undermine the benefits of permitting Bell entry into manufacturing. For this reason, the Administration believes that the FCC should be tasked with the responsibility of seeing that adequate safeguards are effectively implemented. We are confident that the FCC, which remains subject to Congressional oversight, can be relied upon to establish and enforce the necessary safeguards in the public interest.

Consistent with such an approach, we oppose the concept of specifically prohibiting joint manufacturing activities between or among the Bell companies. Such a prohibition is inconsistent with the Administration's goal of fostering competition in domestic and global markets. Should any antitrust issues arise from such joint ventures, the Department of Justice has the necessary authority and is the appropriate entity to ensure compliance with U.S. antitrust policies.

Conclusion

In conclusion, the Administration believes that modification of the AT&T Consent Decree to permit Bell company entry into

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manufacturing will have a significant, positive impact on the well-being of our nation's citizens. The Bell companies, as key participants in this industry, will be better able to serve and respond to the communications needs of the American public, to strengthen U.S. domestic competition, and to enhance the U.S. competitive position globally. It is time to resolve this controversy, which has lingered too long in the courts; it is time for the Congress and the Executive branch to set the direction of telecommunications policy for this country.

Action allowing Bell company manufacture of telecommunications equipment will provide certainty to industry participants. In so doing, it will permit U.S. manufacturing companies -- including the Bell companies in particular -- to concentrate on the contributions they can make to the public by enhancing efficiency, spurring competition, and introducing innovations in these important global markets.

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Mr. MARKEY. Thank you, Madam Secretary, very much.

I will note our concern is if there is lust in the heart, it doesn't result in the consumer getting screwed. I would say that is the bottom line of this committee.

The next witness, again, Mr. Rill, whenever you feel comfortable, please begin.

STATEMENT OF JAMES F. RILL

Mr. RILL. I am not sure, after this exchange, I am ever going to feel comfortable, but I am pleased to have the opportunity, together with the Department of Commerce, to present the administration's views on H.R. 1523 and H.R. 1527.

The administration strongly supports the objective of the legislation—that is, the removal of the line of business restriction of the AT&T consent decree, which prohibits the Bell operating companies from designing, developing or manufacturing telecommunications equipment.

However, the administration strongly opposes provisions—particularly the domestic content and manufacturing restrictions—of H.R. 1527 that would themselves be unduly restrictive and interfere with important policy objectives of furthering consumer welfare by increasing competition in the telecommunications equipment manufacturing markets.

As set forth in the June 3, 1991 Statement of Administration Policy on the Senate companion bill, if legislation were presented to the President with these requirements, the President's senior advisors would recommend a veto.

The administration supports legislation to remove the manufacturing restrictions for the same reasons that we at the Department of Justice have sought judicial removal of these restrictions. The manufacturing restrictions of the decree are no longer necessary to protect competition.

Worse, these restrictions are themselves anticompetitive, because they prohibit BOC entry into telecommunications markets and restrict BOC cooperation with independent suppliers in the design of equipment for use by the BOC's and others.

The telecommunications world of 1991 is very different from what it was in 1982 and 1984. First, there are seven companies making individual decisions as to their purchases of telecommunications equipment, rather than, as before the case, a single entity making the equipment purchasing decisions for the lion's share of all telecommunications equipment.

Second, other non-BOC carriers and private purchasers also buy new substantial quantities of such equipment. Thus, no single BOC's purchasing decisions are likely to have anticompetitive effects in the telecommunications equipment market as a whole.

Third, there are many competitive suppliers to the BOC's, and other carriers and users, and any BOC's entering would face vigorous competition in telecommunications equipment markets.

In addition, because of economies of scale, a Bell operating company would need to sell large equipment to outside purchasers and, therefore, would need to be an efficient producer.

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The need to satisfy the demands of unaffiliated customers would certainly act as a disincentive to supply lower-quality equipment to its telephone company affiliate and would also provide a yardstick by which that kind of conduct could be easily detected.

Finally, because of the economies of scale in manufacturing, and the wide variety of telecommunications products manufactured, and types of equipment needs, there are continuing opportunities for other manufacturing suppliers to serve those demands.

As Assistant Secretary Obuchowski has said, FCC regulations, as well as market conditions, have changed, making more effective the regulation of cross-subsidization and anticompetitive discrimination, making more effective the deterrence of conduct that would be within the ambit of those concerns.

The fact is that Chairman Sikes, in testimony in the Senate concerning the bill, said straight out, "Today, let me state, Mr. Chairman," speaking to the Senate, "current regulatory safeguards are effective."

We can go into detail in the question period, but it is my understanding that Chairman Sikes will be available to the subcommittee at a later date.

The administration endorses the bill's objective, to prevent cross-subsidization and anticompetitive discrimination by the BOC's. We believe, however, that the FCC currently has adequate authority and is implementing necessary rules to prevent and deter such conduct.

The Agency has taken important steps. We think that legislative prescription of those steps beyond a broad policy statement is unwise; rather, that we think that the FCC should have the maximum authority to implement regulations within their broad statutory mandate.

We also oppose a blanket prohibition on joint manufacturing ventures among the BOC's. The administration has emphasized, in connection with research and development joint ventures, that they often enable their participants to compete more effectively in global markets and provide significant benefits to consumers.

The administration has endorsed legislation to extend the fine-tuning and clarification of the antitrust laws beyond research and development joint ventures to manufacturing joint ventures, and we view a blanket prohibition in this case against such joint venture activity to be a step in the wrong direction.

Let me assure you, the Department of Justice will carefully scrutinize joint ventures involving the BOC's as it does other joint venture activity, and will take action to prevent the operation of joint ventures which threaten to injure competition.

Finally, as we have already noted, the administration strongly opposes the provisions of H.R. 1527 that would restrict the BOC's to manufacturing in the United States and to afford less favorable treatment to foreign component suppliers. We think these restrictions could impede competition within the United States, deprive the consumers as well as the BOC's of the benefit of shared technology and shared production efficiencies, contrary to U.S. trade policy.

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We think they are improper on competition policy grounds as well as trade policy grounds and therefore urge that they be stricken from the legislation.

I appreciate the opportunity to present the statement.

[Testimony resumes on p. 84.]

[The prepared statement of Mr. Rill follows:]

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STATEMENT OF

JAMES F. RILL
ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION
UNITED STATES DEPARTMENT OF JUSTICE

Mr. Chairman and Members of the Subcommittee:

I am pleased to have the opportunity to present views on behalf of the Administration on H.R. 1523 and H.R. 1527, bills "to permit the Bell Telephone Companies to conduct research on, design, and manufacture telecommunications equipment." The Administration strongly supports the objective of this legislation--the removal of the line-of-business restriction contained in the AT&T consent decree that prohibits the Bell Operating Companies ("BOCs") from designing, developing or manufacturing telecommunications equipment.

However, the Administration strongly opposes provisions--particularly the domestic content restrictions in H.R. 1527 and S. 173--that would themselves be unduly restrictive and interfere with the important policy objective of furthering consumer welfare by increasing competition in telecommunications equipment markets. During Senate consideration of S. 173, the Telecommunications Research and Manufacturing Competition Act of 1991, the Administration strongly opposed the bill's domestic content and domestic manufacturing requirements. As set forth in the June 3, 1991 Statement of Administration Policy on that bill, if legislation were presented to the President with these requirements, the President's senior advisers would recommend a veto. I hope that our views will assist the Subcommittee in its review of this important legislation.

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Divestiture under the decree of the BOCs' local exchange monopolies from AT&T, which retained its Western Electric manufacturing operations, was intended to remedy alleged AT&T antitrust violations that affected telecommunications equipment markets. The equipment manufacturing line-of-business restriction imposed on the BOCs reflected the Department's concern that if the BOCs had their own equipment affiliates they would have the incentive to favor them in disclosure of network changes or otherwise discriminate in interconnection, and to misallocate the costs of their competitive equipment businesses to their regulated monopoly telephone services. Now, 9 years later, marketplace changes and improved regulation have greatly reduced any risk that the BOCs would abuse their monopolies in local telephone service to the detriment of competition in equipment manufacturing. Thus, the principal effect of the manufacturing restriction today is to impede competition by excluding major U.S. telecommunications firms from participating in the development of products and services to serve present and future telecommunication needs. The time has come to remove the restriction on competition created by the decree.

Background

It may be helpful for me to summarize briefly the judicial proceedings that led to and have perpetuated the AT&T decree line-of-business restrictions. The AT&T consent decree was

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agreed to by the United States and AT&T and approved by the court in 1982 to settle a government antitrust case. In that case, the United States had alleged that AT&T illegally used its monopoly power in local exchange telephone service markets to injure competition in the telecommunications equipment and long-distance services markets. With respect to equipment, the Department alleged that AT&T had foreclosed other manufacturers from the market by requiring the BOCs to purchase almost exclusively from Western Electric and by seeking to prevent interconnection of competing customer premises equipment ("CPE") to its network.

To remedy and prevent recurrence of the anticompetitive conduct alleged in the Department's suit, the decree required AT&T to divest the BOCs with their monopolies on local telephone service. As a further prophylactic measure, the decree prohibited the divested BOCs from providing long distance services or information services, from manufacturing or providing telecommunications equipment, from manufacturing CPE and from providing any other product or service except exchange telephone services and directories. For convenience, I will refer to the restrictions on telecommunications equipment and CPE as the "manufacturing" or "equipment" restrictions.

In 1987, after conducting an extensive review of the decree restrictions, the Department of Justice concluded that in light

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of technical, market and regulatory developments since the 1982 entry of the decree, the restrictions on BOC participation in information services, manufacturing, and non-telecommunications businesses were unnecessary and unduly restrictive of competition and efficiency. Thus we asked the court to remove these restrictions as permitted under the decree. In asking the court to remove the manufacturing restriction, we relied in part on significant changes in market structure brought about by divestiture, technological change and other factors. Concentration on the buyer side of the market was reduced sharply by divestiture, and the equipment manufacturing markets are served by strong existing competitors. Regulatory changes, including interconnection standards, network information disclosure rules and cost allocation and affiliate transaction rules, also eliminated many of the reasons for maintaining the restriction. The Department provided competitive analyses of different equipment markets to support its recommendation.

Judge Greene removed the restriction on non-telecommunications activities and modified the information services restriction to allow the BOCs to provide certain transmission-related "gateway" and storage and retrieval services. But he denied the United States' motion for removal of the manufacturing restriction as well as the BOCs' motions for removal of the manufacturing and long distance restrictions.

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In April 1990, the United States Court of Appeals for the District of Columbia Circuit affirmed the district court's decision to retain the manufacturing and long distance restrictions. The Court of Appeals, however, remanded for further proceedings the question of removal of the information services restriction. The reason the Court of Appeals remanded was that AT&T had not opposed removal of the information services restriction. Since all parties to the decree consented to removal of that restriction, the Court concluded that the question of removal should be governed by a different and more lenient standard than the district court had used.

The information services motions have been briefed and argued and are again pending before the district court. In that proceeding, the Department strongly supports removal of the information services restriction. There are no pending court proceedings to remove the overall manufacturing restrictions, however, nor has AT&T altered its opposition to removal of those restrictions.

Removal of the Manufacturing Restriction

The Administration supports legislation to remove the manufacturing restrictions for the same reasons we have sought judicial removal of those restrictions. The manufacturing restrictions are no longer necessary to protect competition. Worse, these restrictions are themselves anticompetitive because they prohibit BOC entry into telecommunications

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equipment markets and restrict BOC collaboration with independent suppliers in the design and development of telecommunication products for use by the BOCs and others.

The telecommunications world of 1991 is very different from what it was in 1982, when the decree was entered. In 1982, a single entity made the equipment purchasing decisions for the lion's share of all telecommunications equipment. Today, the BOCs make individual decisions regarding their purchases of telecommunications equipment. Other purchasers in these markets, including private buyers and carriers not providing local exchange service, also buy substantial quantities of such equipment. Thus, no single BOC's purchasing decisions are likely to have anticompetitive effects in telecommunications equipment markets as a whole.

Further, there are many competitive suppliers of equipment to the BOCs and other carriers and users. A BOC that manufactures some types of equipment may well purchase its own products, but it is unlikely to supply all of its own equipment needs. Such partial vertical integration is common in many industries and is generally procompetitive. The concern that a BOC might purchase inferior equipment from or pay excessive prices to its manufacturing affiliate at ratepayer expense is alleviated by regulations governing affiliate transactions and by changes in the marketplace--particularly the divestiture and the ability of regulators to make benchmark comparisons of BOC

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purchasing activities. Under current regulation, federal and state regulators can scrutinize and disallow excessive equipment costs and, if necessary, could impose additional restrictions on BOC self-dealing. Moreover, strengthened Federal Communications Commission rules governing cost accounting and allocation alleviate the concern that the BOCs will engage in anticompetitive cross-subsidization of unregulated activities with ratepayer revenues.

Nor is there any significant risk that the BOCs would injure competition by denying independent manufacturers access to necessary information about local exchange networks. The FCC's rules provide for timely disclosure of network design information, and current equipment manufacturers--especially AT&T and other manufacturers that provide and continue to update BOC central office switches--already play such a large role in BOC network design that they would likely become aware of plans for major changes.

Moreover, any BOC entrant would face vigorous competition in equipment markets. A number of the current manufacturers occupy strong positions in various equipment markets, deriving in part from substantial economies of scale and scope. Other equipment manufacturers are sizeable firms that have strengthened their competitive positions in recent years through growth, consolidation and integration.

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Removal of the manufacturing restriction in all probability will have significant procompetitive benefits. It is critical that the nation's telephone companies be able to take advantage of and participate in the rapid technological changes that affect this industry. It is well-recognized that the BOCs would be formidable competitors in the telecommunications equipment market, and they would be expected to apply their considerable expertise and efficiency in the development of innovative products to the benefit of American consumers. Removal of the manufacturing restriction would permit the BOCs to design or work more closely with independent manufacturers to design equipment to best meet their own needs and those of other carriers and customers. This in turn would facilitate the efficient development and implementation of new services--especially exchange services to support the developing information service markets.

Removal of the manufacturing restriction also would permit elimination of the current waiver process under the AT&T decree for such activities. That process currently delays, deters or frustrates outright the provision by the BOCs of new products and imposes unnecessary burdens on the industry, the Department, the courts and the American public.

In light of the potential for significant competitive benefits if the BOCs are permitted to enter telecommunications equipment and CPE markets and the absence of significant risk

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of anticompetitive abuses, the Administration believes that the manufacturing restrictions should be eliminated as soon as possible.

Proposed Legislative Restrictions on BOC Manufacturing

In addition to lifting the manufacturing prohibition, H.R. 1523 and H.R. 1527 would impose new statutory restrictions on BOC manufacturing activities. They would provide that a BOC may engage in manufacturing only through an affiliate separate from the BOC's operating telephone company; they would require the FCC to prescribe regulations requiring that any Bell Telephone Company that has a manufacturing affiliate provide other equipment manufacturers opportunities to sell such equipment to such Bell Telephone Company which are comparable to the opportunities which such Company provides to its affiliates; and they would require any manufacturing affiliate to make any telecommunications equipment that it manufactures available "without discrimination" to any other local telephone carrier that does not have a manufacturing affiliate or that agrees to make available to the Bell Telephone Company any equipment that it manufactures. H.R. 1523 and H.R. 1527 also would prohibit a BOC or its manufacturing affiliate from engaging in any manufacturing joint venture with another BOC or its manufacturing affiliate, and H.R. 1527 would further require that all BOC manufacturing be conducted in the United

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States and, subject to certain exceptions, using only United States made component parts. We are seriously concerned with such statutory restrictions and conditions on BOC manufacturing.

The Administration endorses the bills' objective to prevent cross-subsidization and anticompetitive discrimination by the BOCs. We believe, however, that statutory provisions mandating structural separation requirements would not be necessary to achieve this objective and could foreclose many of the procompetitive benefits the bills seek to provide. The Federal Communications Commission has already developed and implemented information disclosure and cost accounting rules that directly address the issues of discrimination and cross-subsidization, and it could modify those regulations if necessary to address any future problems. We are also concerned with new FCC regulation of BOC purchasing decisions. Such regulation may be unnecessary to protect ratepayers or competition. As we have noted, purchases from affiliates are already regulated, and the BOCs have incentives to select appropriate products--whether from an affiliate or an independent manufacturer. The proposed statutory "comparable opportunities" requirement could invite complaints from disgruntled potential suppliers that could consume enormous FCC resources and serve no real competitive purpose.

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We are also concerned with the bills' provisions regarding the BOCs' sale of equipment to other local exchange carriers. BOC manufacturing affiliates usually will have incentives to make any equipment they manufacture available to as many customers as possible. Moreover, such equipment sales will take place in competitive markets comprised of non-BOC as well as BOC manufacturers; thus, there does not appear to be good reason for government regulation.

We understand that there may be residual concerns about joint manufacturing activities involving several BOCs. As the Administration has emphasized in connection with research and production joint ventures, however, joint ventures often enable their participants to compete more effectively in global markets and provide significant benefits to consumers. The Department will carefully scrutinize joint ventures involving the BOCs and will challenge any that are likely to injure competition, but a blanket prohibition on such ventures is unwarranted. Such a prohibition is also fundamentally inconsistent with the bills' objective of increasing competition in telecommunications equipment markets and with other Congressional efforts to reduce antitrust risks that may deter legitimate and procompetitive research and production joint ventures.

Finally, the Administration strongly opposes provisions of H.R. 1527 that would restrict the BOCs to manufacturing in the United States and require them to afford less favorable

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treatment to foreign component suppliers. These restrict
are unacceptable because they could impede the competitiv
of the Bell companies and result in substantial costs thr
retaliation by foreign governments. They would unfairly
the Bell companies at a competitive disadvantage vis-a-vi
other domestic and foreign manufacturers not forced to wc
under the same restrictions. Consumer choice will be
diminished and prices will be higher if private companies
forced to procure and produce equipment on the basis of
government fiat rather than sound economic and technical
grounds. Moreover, a dispute with our trading partners :
area could cut severely into U.S. exports of telecommunic
equipment.

To summarize, the Administration strongly supports re
of the unnecessary and anticompetitive restrictions on BC
manufacture and provision of telecommunications equipmen
manufacture of CPE. Now and in the foreseeable future,
regulatory, technical and market factors effectively const
any risk to competition; thus, there is no reason to perpe
an unusual prohibitory rule. Moreover, the manufacturin
restriction is contrary to our goal of a competitive and
productive future for these important global telecommuni
markets. It imposes an anticompetitive brake on competi
by seven major U.S. firms and thus impedes the efficient
development of new and improved products and services.
However, additional conditions the proposed legislation would
impose on BOC manufacturing raise serious concerns; they appear
to be unnecessary and inconsistent with the legislation's
fundamental procompetitive objectives and with U.S. trade and
competition policy.

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Mr. MARKEY. Let's now go to questions from the subcommittee members.

Let me ask you, Mr. Rill, on April 3, 1990, the Court of Appeals in remanding the case down to Judge Greene commented that he had used public policy considerations in his review. The appeals court stated "The district judge may not, for example, deny the motion of a Bell operating company because of the possible impact on the U.S. balance of trade or for any other reason not related to antitrust laws."

So, given the fact that the court, itself, has highlighted as a matter of antitrust law, the limitations on the court which "forecloses the goal of ratepayer intentions," can you comment on the limitations from your perspective, any court order or judicial modification of the consent decree has in its ability to protect ratepayers, insurance network interconnection, provide jobs, fair competition, international competitiveness and the other public policy objectives that the circuit court has ruled out.

Do you agree with the circuit court on that and do you recommend that we include those ratepayer protections and job protections into interconnection guarantees and the remainder of the list which I detailed?

Mr. RILL. Let me answer your fundamental question first, that is do I agree with the restrictions of the focus of the decree as being antitrust and focused on antitrust considerations. I quite agree with the Court of Appeals.

I think in some areas you referred to, interconnection, that there may well be antitrust issues at large that would fall not only within the decree but could well fall within the responsibility of the FCC to assure the safeguards are in place and, even absent the decree, could fall within the jurisdiction of the Department of Justice to assure the Sherman Act was not being violated.

The preponderance of the considerations that you referred to, the foreign trade position and the like, are, as identified by the Court of Appeals, clearly outside the ambit of antitrust concern. Whether Congress should act in that area is, of course, a question for Congress to determine.

It occurs to me, and this perhaps is a subject you might want to take up with Chairman Sikes, it occurs that in a number of those areas, the FCC has the power to act and perhaps the flexibility of administrative action is the better course.

I would hope that if Congress were to act in these areas, it would bear in mind competition policy as well as other national policies in an attempt to give a competitive thrust to whatever action Congress may take.

Mr. MARKEY. But you do concede, though, that Judge Greene is limited in terms of his ability to provide protection, to provide for those standards and that legislation which would pass which would strip many of his jurisdictions could quite rightly include all of those protections which the circuit court has instructed Judge Greene that he is not in power to exercise.

Mr. RILL. We think the bulk of the considerations referred to are outside the focus of the decree. I think it is a matter for congressional determination to deal with those other policies, hopefully balancing competition policies strongly.

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Mr. MARKEY. On behalf of the administration, you state in your testimony "divestiture under the decree was intended to remedy alleged AT&T antitrust violations that effected telecommunications equipment markets." You conclude that "Now, 9 years later, marketplace changes and improved regulations have greatly reduced any risk, that the BOC's would abuse their monopolies in local telephone service to the debt requirement of competition in equipment manufacturing."

In fact, the administration is so confident of its position that that is the case. It objects to statutory provisions mandating structural separation requirements stating that they would not be necessary to achieve the objective of preventing cross subsidization and anticompetitiveness.

You also state "there does not appear to be a good reason for Government regulation on BOC sale of equipment to other local exchange carriers and proposals for joint ventures involving the BOC's are unwarranted." Could you please explain to us what has changed in the last 9 years that has resulted in this 180 degree turn on the part of the Justice Department.

Mr. RILL. Let me respectfully not concur in your characterization of a 180 degree turn. The fact of the matter is that the decree itself, as fashioned under the supervision of Judge Greene, contemplated a review. And I think, as is truly implicit in your question, it is the conditions that have changed, not the antitrust enforcement.

Mr. MARKEY. Your position 9 years ago was "if the BOC's had their own equipment affiliates they would have the incentive to favor them in disclosure of network changes or misallocations of costs to their regular monopoly telephone services."

That is a pretty blunt statement as the Justice believed it exists in 1981 and 1982. Why has it changed? Why do you believe the protection against cross subsidies should not be built into any legislation even if we allowed BOC's into manufacturing.

Doesn't it seem that that would be a proper caution, a prophylactic protection that would be built in, given your own analysis of the situation just 9 years ago?

Mr. RILL. Let me agree with a basic premise of yours, Mr. Chairman, that is that we would concur strongly with the position that anticompetitive cross-subsidization and anticompetitive discrimination should be prohibited. That hasn't changed. We have had 9 years experience with seven BOC's, not one integrated Bell Systems.

Under this experience, we have had the opportunity to watch the competitive manufacturing industries develop. We have seen that no one BOC has the opportunity to dominate the purchasing market, the way the entire Bell System did prior to the entry of the decree. We have seen, in other words, that the process of divestiture is working and has worked to the point where the absolute prohibition is now unnecessary.

We have the yardsticks of BOC purchases. We have the analytical ability to look and have confidence that the possibility of cross subsidization that existed under the prior industry structure is not now one that gives us cause for concern that we had 9 years ago.

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In addition, we have seen the FCC take the position that due to its amended cost allocation rules, affiliate transaction rules, its continuation of its interconnection rules, its computerized information gathering system, it now asserts that it has the ability, contrary to its position before, to detect the kinds of offenses that you and I both agree would be anticompetitive and to deter them.

Further, the elimination of the absolute bar, the absolute prohibition, would not—and I strongly urge the subcommittee not to act otherwise—would not grant antitrust immunity to anticompetitive practices that might result in this industry. We will continue to be stringent.

Mr. MARKEY. I will note that you use, I think, accurate language in maintaining that the FCC asserts that it has the ability to monitor these activities but, in fact, the 9th Circuit has remanded FCC Computer 3 rules for non-structural safeguards maintaining that they cannot do the job and the assertions are not, in fact, borne out by the reality.

We have to deal with the real world. Although you might maintain that we did, in fact, build in some room for growth and change in this area, to go from 1982 with absolute prohibition to 1991, absolute freedom, it seems to me is too bipolar a world.

Somehow or other, we will have to work with the administration dealing with the monitoring capability given the reservations which I think exist in the minds of many members that we build in structural safeguards, that we test the new world that is asserted to exist for a period of time before we allow for the very realistic which you identified 8, 9 or 10 years ago to be visited on the marketplace.

My time has expired. I recognize the gentleman from New Jersey, Mr. Rinaldo.

Mr. RINALDO. Thank you, Mr. Chairman.

I think the chairman brought up a very important point.

The common thread that runs through the views of everyone on this committee, whether they are for or against it, is that the consumer has to be protected. I think everyone recognizes that one of the Government's concerns, as Chairman Markey accurately pointed out when he filed a suit against AT&T, was that the regulatory practice was uneffective in policing anticompetitive behavior.

Secretary Obuchowski, you were at the FCC. What can you tell us would lead you to conclude or assume that the FCC today is so much different from that other FCC two decades ago that it can effectively police the RBOC's in order to avoid cross subsidization and all the other problems the chairman mentioned.

How can the FCC do that? Do they have the manpower, the capability, to defend the tools? Do they have the know-how?

Ms. OBUCHOWSKI. I was at the FCC. Going back to my first year at the FCC in 1980, when this case was actually coming to trial, I can tell you, sir, that there was not even a uniform system of accounts in place at the FCC for what was then AT&T.

In the decade since that time, FCC has put in place cost accounting rules, cost allocation rules, network interconnection rules, CEP interconnection rules, equal access and separate subsidy ONA rules.

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I would just put a slightly different legal interpretation on the Ninth Circuit decision. The Ninth Circuit in ONA did two things. It questioned the FCC's ability to preempt and stated that the FCC did not state it clearly. I think they said the message was inadequate.

For all those reasons, there has been dramatic change in the FCC's ability to enforce in this field. I would also like to make the point that the over 6,000 manufacturing companies out there in the telecom industry are going to be extremely watchful. We not only have a FCC on guard, but we have 6,000 corporations that have been unleashed and who we're counting on to be very effective watchdogs.

Making the countervailing points, Justice Brandeis said, "The perfect should not be the enemy of the good." You are the balancing test. In 1980, the United States' share of telecommunications patents filed with the Commerce Department was 58 percent. That has declined to 48 percent this year.

In that same period, 1980, in this case to 1988, Japan has increased its share of telecom parts from 18 to 31 percent. You have a situation in the United States where the RBOC's are investing 1.3 percent of their revenues in R&D. So we should be worrying very much about protection. We should also be looking at what we are inhibiting when they take the absolute approach to protection.

Mr. RINALDO. Let me follow up.

That is very interesting. It doesn't explain what happened to our automobile manufacturers. But let's assume the bill is passed and the MFJ manufacturing restrictions are lifted.

With the safeguards in the Senate bills and the bills before this subcommittee, what red flag specifically would you and Mr. Rill over in the Justice Department be looking for to determine whether or not the RBOC's were engaging in the same kind of competitive practices that AT&T engaged in prior to divestiture?

Ms. OBUCHOWSKI. I will begin. I am sure Assistant Attorney General Rill will pick up on this. There are specific things I would look for. I would look to be sure there is absolutely no misallocation of costs and that plans are put before us to reflect that.

I would be certain that the FCC is looking at safeguards, that transactions in any form of sale dealing with equipment, I would be watching to see if transactions between the regulating company and others are apparent and see what that manufacturing company is being paid for equipment which might go over to the other side.

So those are the general kinds of concerns that I would want the FCC to be examining very carefully.

Mr. RINALDO. You said you want them to examine these signs carefully. How would they do that. We have meetings up here. Someone stated that the other day in a hearing we had, just determining what is on those books, how those costs get allocated versus exactly how would you determine these things?

Ms. OBUCHOWSKI. The FCC would be requiring the companies to put all of these allocations on the open record as they are now requiring in other cases of separation between regulated and unregulated activities. It would then be the job of the accounting staff of the FCC to examine those records but it would also be very open to

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all the 6,000 companies operating in this field, overseas competitors, AT&T, anybody who might be interested, to also take a look at those books and present any problems that might arise.

Mr. RINALDO. I believe my time has expired.

Thank you very much.

Mr. MARKEY. The gentleman's time has expired. The gentleman from New York, Mr. Scheuer.

Mr. SCHEUER. Let me continue on this tack because this is the heart and soul and the guts of these enormously important public policy decisions that we have to make. We are all torn. We have a Hobson's choice. We would love to have the RBOC's come in with their brilliant scientists and research people.

There could be some quantum jumps in the equipment and systems and we want that. But we are concerned about the demonstrated record the courts have identified that the RBOC's have violated the rules.

It is unfortunate that that should be so, but we have deep concern based on a number of court cases that we are all familiar with, we don't have to elaborate on them here, that we cannot be confident that the RBOC's will voluntarily adhere to the rules.

Maybe they will; maybe they won't. We hope the emerging sense of corporate statesmanship out there will have an effect on their behavior. We urge that, but we cannot be sure of that.

Now, General Rill, you told us that the FCC has the analytical capability of identifying cross subsidies so that that is no cause of concern. It is not like the situation 9 years ago.

Secretary Obuchowski, you said the same thing in different language. You have talked about the new systems they have put in. Frequently with the best of intentions, new systems and analytical content being there, it is a question of staff, for example, working the computers and analyzing these voluminous records and ferreting out the potential cross subsidy and other kinds of wrongdoing that is very sophisticated, that takes extremely talented accounting, talent of the highest level. My question is: does the FCC now have the staff to handle this challenge? Do they have the number of accountants who can do it?

Do they have the CPA's who can do it?

Frequently, the OMB, you know with a couple of slashes of that knife can make fools out of all of us who predicted, yes, we have the analytical ability, we put in the systems. All of that can be frustrated with a slash of the knife from OMB.

The question is: does the FCC have the accounting and bookkeeping and high level CPA skills to do that now or do you think they would need additional funding to bring the accounting talent up to the enormously challenging and demanding business of assuring that our standards of probity, that that recall that we are all familiar with is a reality. This is a question of dollars and cents and staff.

I would like a clear statement from both of you that you either think the present staff can do it or that there should be an increase in staff and that the administration would support such an increase in staff.

Ms. OBUCHOWSKI. Mr. Scheuer, I would say as somebody who worked for 7 years in the FCC and got my start there, not as a po-

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litical person, but as a staff person, that there is certainly a nucleus of a staff. There is all the expertise and dedication there that is needed.

I think this is a question only Chairman Sikes can answer, but you may well need to add numbers of people to that nucleus to do the kind of auditing that will be needed. In general, my answer is that you do have the expertise and the dedication. I would like to point out that when you look at what has happened to date——

Mr. SCHEUER. You are getting to the point I am trying to get at.

Expertise and dedication is not enough. If you don't have the people sitting at the computers and analyzing those reports, these pro-competitiveness protections that we wish to install to maintain that barrier to cross subsidy will be frustrated.

Ms. OBUCHOWSKI. Those will be in place.

Mr. SCHEUER. What is going to be in place?

Ms. OBUCHOWSKI. The people and resources to do the kind of protection we need. I think it is a commitment of this administration and of Chairman Sikes.

We recognize the entry to manufacturing is the carrot and there is also a stick that should come behind it.

Mr. SCHEUER. Yes.

Mr. RILL. I think the numbers and dollars are something you would take up more appropriately with Al Sikes. You mentioned the sophisticated analytical ability. I would refer you to his statement on the subject before the Senate committee in which he was also suggesting that the FCC had the capacity to make and implement the safeguards we all think are appropriate. He said "we have a sophisticated computer base reporting and monitoring system, systems such as our automated report and information systems; let us compare one firm's performance with their peers and compare that with historical friends."

This serves as an early warning system. So obviously, the Chairman of the FCC has confidence that the computer and information systems available at the Commission provides a strong support base for the safeguards. We are all interested in that.

The only question that may divide us is not when we oppose anticompetitive cross subsidization or discrimination, it is whether the FCC should have the administrative flexibility to impose those safeguards and assist us in the Justice Department in our monitoring anticompetitive practices better, under a broad mandate to the FCC, or whether Congress should prescribe particular standards itself.

I think Chairman Sikes and the Senate suggested that the FCC has the power, the will and resources to take that action.

Mr. SCHEUER. That is the resources to make all these systems of accountability a reality.

Mr. RILL. It is analytically sound to me. It is the testimony of Chairman Sikes as to numbers of people and dollars. I cannot answer that so well as Chairman Sikes may be able to.

I think that is an appropriate question to take up with him.

Mr. SCHEUER. Thank you.

Mr. BRYANT [presiding]. Mr. Lehman.

Mr. LEHMAN. Having been to yesterday's hearing on banking legislation, I cannot help but notice the similarities in the subject

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matter, seeking to deal with big heavily related industries seeking to move outside their normal activities.

The issues are the same. How do we protect the ratepayer in this instance and how to protect the taxpayers in the other. Can we erect firewalls and safeguards to insure that things like cross subsidization don't occur or that self-dealing is not going to happen. I am sure the committee will treat both of these with a great consistency as we go forward.

I guess what I hear from the testimony is, on the question of can we prevent the same kind of abuses that led to the court action in the first place from recurring if we begin to grab these powers that have been restricted, I hear you saying yes, but don't do it in the legislation. Leave that up to us in the regulatory agencies to go about doing that.

All I hear, and I get a little bit nervous about this obviously and all I hear you saying is we have more staff to deal with it, we are going to look at it from a different angle and we feel more responsible in this area.

Can you give me more assurance than that?

Ms. OBUCHOWSKI. First of all, in terms of the administration's position, the kinds of protections, for example, that are included in the Tauzin legislation.

Mr. TAUZIN. It is Slattery-Tauzin.

Ms. OBUCHOWSKI. While we would prefer to see that implemented in the FCC and the flexibility to meet changing demands, we think this is an internal, cohesiveness to them. It is not an ideal breaker. But our basic premise is that strong protection is needed, that it certainly would be wise for the Congress to direct the FCC that such strong protections be put into place. But given that this industry is changing and complicated, that it actually should be the FCC that does the rulemaking subject to your oversight, sir.

Mr. LEHMAN. Why can't we just assume that the BOC's, given this authority, will just go out and buy their own equipment for themselves. Wouldn't that be in their interest regardless of what was the price because they have a vested stake in keeping their company afloat?

Mr. RILL. I don't think it would make economic good sense for the BOC's to go out and buy junk equipment from themselves if there is better quality, competitively-priced equipment out there.

I think in any sense of vertical integration, vertical integration works if it is pro-efficiency. It doesn't work if it is anti-efficiency. They would be hurting themselves if they were doing that.

Second, if there is an antitrust offense in anticompetitive discrimination, we have better techniques now for identifying that.

We have yardsticks. We have a number of purchasers. We have competitive suppliers. We have affiliate transaction rules at the FCC in which Chairman Sikes puts confidence, and there is no reason to disagree with him. So the answer to your question is, I don't think it makes sense for one of seven BOC's to discriminate, if you will, in favor of a hypothetical second-rate manufacturing facility and to the extent that it would be illegal, taking into account the market circumstances under which it might occur, I think we have a way of detecting it and to go after it.

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Mr. LEHMAN. My concern is not that they make junk products. I don't expect that. Where things are of a marginal nature, I am sure they will make very good products.

You are telling me, and forget the economics here for a second, you are telling me that you have antitrust jurisdictions if they, in fact, buy something from themselves that they could have gotten something comparable to or cheaper somewhere else.

Mr. RILL. We would have the jurisdiction to look at it. In a situation of that sort, we take a look at the market power, whether that purchase creates or enhances the use of market power and look at the total context to determine whether there is an antitrust violation. In many circumstances, there may well be. I cannot generalize but yes, we have the jurisdiction to look at it and we would look at it.

Mr. BRYANT. The gentleman from Tennessee, Mr. Cooper.

Mr. COOPER. Earlier I think an injustice was done, not only to Judge Greene, but the judiciary branch. I think in a service outage situation, every American wants it fixed as quickly as possible.

I have not heard of anybody in our country who did not want it fixed as quickly as possible. Judge Greene said, "I see no basis for the court intervening except to say go ahead and fix it as quickly as you can."

To me the judiciary branch deserves credit for being commonsensical and in some cases for being wise. I resent the efforts of some—RBOC's apparently, does use a logical service outage as a PR opportunity to lobby the Congress on behalf of expanded powers.

To me a logical service outage is a logical service outage. It is a problem. We can get in to the details but to in any way slow the repair of or try to blame the judiciary is to me a little out of bounds.

Ms. OBUCHOWSKI. Mr. Cooper, we would agree with you. I think the only point we would make is that we would say that—I have seen the popular press, people trying to make hay out of a service outage in either direction on this case.

I think the point you made is the true point, that this is a standalone problem that should be fixed immediately because of its importance to the consumer.

Mr. RILL. I have an interest in this. It was my lawyers who went in to court on this issue.

It is our responsibility to enforce this. We did not then and do not now take the position that there is any reason to believe that this decree had anything to do with the service outage.

I join with you in opposing any implication that Judge Greene, the decree, or the Department of Justice caused the service outage. Judge Greene acted promptly in his best judgment to remove any concern that the decree might create that situation.

We went about it in a slightly different way but to the same end. The result was that it was effective.

We agree with everything you have said, Mr. Cooper.

Mr. COOPER. I should let you know I was lobbied privately by two RBOC's in my office in the last 2 days, who tried to use this with me to their PR advantage, blaming you and the Judge for problems that—to me that is just unfortunate.

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I would agree with Commissioner Obuchowski that neither side should use it, make the country work and put politics aside.

I only have 5 minutes.

My real point, the key issue is when we can trust RBOC's in the future to behave reasonably under the rules set down. The best way to predict that is to look at the past.

If you look at the past number, you will find this committee, despite its lengthy hearings, has never had a on RBOC's in the past. There are two areas we could look at.

One is the secret record of consent agreements entered into by RBOC's, in which they have stipulated that the aggrieved party would never talk about it, a gag order. Fourteen months ago I asked two of the RBOC's to discuss these issues with me. We have heard nothing from them; I asked in a public forum in this subcommittee. We have heard nothing.

I am wondering what are they citing. Perhaps their hands are completely clean, lily white. I hope so.

But it makes me wonder after 14 months on an issue this hot, we have heard nothing. The public record, it is hard to read the Wall Street Journal without ever 2 weeks or so an example of another fine or abuse or problem.

I wonder if you two distinguished folks can tell me which RBOC agreed to pay $42 million in penalties on deceptive marketing problems and which RBOC agreed to putting $19 million into the rate base? Which provided inaccurate information about its activities to the Justice Department and to the court?

Which one attempted to obstruct a Justice Department investigation of decree violations by restricting investigator's access to present and former employees. Which one established an unregulated subsidy apparently with the side effect of inflating prices for products and services purchased for and supplied to its affiliated telephone companies?

Bear in mind, these are things that happened while the RBOC's were on good behavior while Congress and the world were looking at them to see how they would behave.

Mr. BRYANT. The gentleman's time has expired, so if each of you would keep your answers brief, we can continue on schedule.

Ms. OBUCHOWSKI. The administration is here not to defend but certainly to condemn every single abuse that you have read.

We would also note, however, there is some comfort to be taken that each of these abuses came to light and I think were dealt with most effectively by the Department of Justice. That is our very firm commitment.

We are in the business of doing a balancing act. You see a great deal of concern about our manufacturing sector in the United States.

You see that 50 percent of that sector is tied up. You see forward investment in these high-tech companies and you ask yourself, is there a less restrictive alternative.

Our point of view is yes, we should carry a big stick, yes this should be a defense against these abuses. We see companies like AT&T who are not subject to such rigid rules who have been good actors.

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There have been many cases on the record where there has been affiliation between a service company and an affiliated company and we see the track record of success.

Mr. BRYANT. The gentleman from Ohio, Mr. Oxley.

Mr. OXLEY. Thank you, Mr. Chairman.

Let me just say on that exchange we had on the local outage, if my water goes out, the water department does not call the Federal Czar to ask if they fix it. If the cable goes out, the cable company does not call the Federal Czar to ask to fix it. If my electricity goes out, the electric company does not call to a Federal judge to see if they can fix it.

We really missed the point in the other exchange. That is what in the devil does a Federal court have to do with fixing that kind of outage problem. That essentially frames this problem and that is who is going to set policy in this country as it relates to telephone service.

It was interesting, Mrs. Obuchowski mentioned in her opening remarks about several U.S. companies having to go offshore for capital. Indeed, that does point out what I think is a very real problem with many of the small manufacturers and that is that because of a capital shortage in this country, brought about by low savings rates and a lot of other different things, in a macro-economic sense, they have, in fact, been forced to go offshore for raising that capital.

I think it raises a very, very important issue as it relates to freeing the RBOC's to allow them to provide in many cases the life savings capital to a newly-emerging manufacturer, or in the research and development area it could have a major breakthrough that would provide the kind of service to the disabled or the hearing impaired that my friend from Louisiana pointed out in his remarks.

Let me ask Mr. Rill, when the Justice Department brought the suit, and by the way that was the attorney general from the State of Ohio who brought that original suit, Bill Saxbe, and, of course, that suit was based on an AT&T bottleneck and the lack of anti-competitive behavior.

The world has changed in 20 years and I want to know how the Justice Department has worked on that. Obviously, the Justice Department was a different Justice Department. But it started that suit. Now it comes in and asks for that kind of regulatory relief.

Mr. RILL. The suit as brought initially was fundamentally correct. The conditions have changed, not the Justice Department's antitrust approach.

Mr. OXLEY. How have they changed?

Mr. RILL. We have experience since the end of the decree with the seven operating companies competing in the purchase of telecommunications equipment. We have a manufacturing industry that has grown up such that one company does not provide the overwhelming preponderance of manufacturing in the United States.

We have the opportunity with seven companies and, in fact, non-BOC purchasers operating to better assess competitive conditions and competitive conduct in the marketplace as well as a different structure to the marketplace.

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We have a base for comparison of purchasing and should the manufacturing restrictions be lifted, vertically integrated activities that would be engaged in by the BOC's.

To repeat both what Assistant Secretary Obuchowski and I have said before, we have, by their own estimates, improved FCC regulations that are better able to detect any anticompetitive conduct that would arise should the manufacturing restrictions be lifted. This is different from the position that was taken by the FCC at the time the case was brought.

We have improved technological standards that have made comparisons and made competition more effective across the United States, these would prevail even if the manufacturing restrictions were lifted. These are examples of changes that have taken place that give us confidence that an absolute prohibition is not necessary, indeed, it is anticompetitive.

We think our antitrust enforcement program together with the FCC safeguards and the information we get in cooperation with the FCC are satisfactory by a very large margin and that the absolute prohibition against entry into the manufacturing business is no longer justified.

Mr. OXLEY. Don't we have an example today of a company that has a local exchange, a monopoly on a local exchange and yet manufacturing at GTE, for example. Are you aware of any egregious, illegal or anticompetitive behaviors on the part of GTE which would essentially be a forerunner of what the BOC's could do if we pass this legislation?

Mr. RILL. I am not aware of any.

Mr. BRYANT. The Chair recognizes the gentlemen from Louisiana, Mr. Tauzin.

Mr. TAUZIN. Thank you, Mr. Chairman.

First let me, in fact, answer the allegations that the Bell companies have made a public relations ploy with Judge Greene. You might say the design and engineering might have caused the outage.

We said Judge Greene had to be called upon to decide whether he would go fix the thing. That is true because Justice could not decide whether or not it would be a violation of the decree for the Bell Atlantic and Belcare to go out and fix the problem; that is the truth.

When you are faced with the decision of a court and restrictions on the court that imposes criminal penalties on the CEO if he violates that, you better check before you move. To fault him for that, I think, is disingenuous.

Mr. RILL. I quite agree, the issue was not the outage, it was the correction of the outage. The nature of the correction was uncertain.

It was a rapidly developing situation. No one could answer, not Judge Greene, not us, when to fix it would come within the technical framework——

Mr. TAUZIN. Because you had to consider whether there would be designs in it. That question could send someone to jail.

You did not want to answer it for that reason. The judge had to answer and it is ridiculous.

Mr. RILL. Your point accurately states the situation.

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Mr. TAUZIN. Second, the argument that the bill does not protect against anti-pro-competitive repair, that is true. Let me cite to you where we proscribe that the FCC states it must only acquire equipment from its affiliate at open market prices and to prove they are buying them at open market prices. The bill adequately addresses this.

Third, this argument that we are going to be exporting jobs, let me cite to you for your reference Senator Breaux's comment to a witness, Mr. Kilpatrick, who was an associate counsel for AT&T.

Citing AT&T 10-C reports it shows that they closed five plants in Baltimore; Cicero, Illinois; Winston Salem, North Carolina and its open manufacturing in Ireland, Singapore and Hong Kong. Senator Breaux pointed out that AT&T has laid off all but 2,500 workers out of 7,500 in the Shreveport plants.

You wonder why Senator Johnson voted for the bill. The export of the bill is going on. Other entities desiring to manufacture in America, small entities who would like to get into the business and joint venture with the Bell companies cannot do it in America.

Let me make a further point. Is there reason why CWA supports our position? Is there a reason why the Communications Workers of America want jobs in America and would like to see the Bell companies an many other smaller entities in America who want to work here and create jobs here and are in support of this bill?

Is it a fact, Mrs. Obuchowski, that if we pass this bill, competitiveness would be fostered to serve as a source of seed capital for small U.S.-manufacturing companies that would have the joint ventures and could not do it by themselves. Isn't it correct? Say, amen?

Ms. OBUCHOWSKI. Amen.

Mr. TAUZIN. The bottom line is that this argument of exporting jobs applies in the fact of the facts. Since the decree separating the Bell companies jobs have been imported dramatically.

The testimony before Senator Breaux conceded those facts in the record.

I would also ask that part of the record in the Senate be made a part of the proceedings.

Mr. BRYANT. Without objection.

[The excerpt from the transcript of the Senate Subcommittee on Communications hearing on February 28, 1991, follows:]

Senator BREAUX. OK, let me ask a couple of other questions shortly, in a short time frame. Dealing with jobs and manufacturing, because that is the issue of the hearing, and ask you if the statement is correct, and if it is not correct, please correct it for me, because we are talking in a pamphlet that I have seen that says as the source for this information, AT&T Annual Report to Shareholders, and the AT&T Form 10-k reports. I am not too sure what that is, but that is what they cited as a source.

And they say in talking about the decline in At&T's domestic manufacturing since the divestiture, the statement is At&T has closed five production plants in Baltimore, Maryland, Cicero, Illinois, Indianapolis, Indiana, Kearney, New Jersey, and Winston-Salem, North Carolina. Now, is that correct, or if it is not correct, please straighten it out for me.

Mr. KILPATRICK. It is correct.

Senator BREAUX. Another question I have to ask, and the source for this is the same two sources that I read on the first line of the previous question. In the statement there is some elaboration here, now I am not asking about this, it says, rather than rebuild the domestic plant and equipment, AT&T chose instead to go foreign.

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But the question I want to ask is whether this is correct. Investing in major foreign joint production ventures based in Europe and Asia, and four wholly owned separate manufacturing operations located in Ireland, Hong Kong, Singapore and Thailand.

Which of that statement is not correct, if any of it is not correct?

Mr. KILPATRICK. The sites you mentioned are, so far as I am aware, places where AT&T has factories.

Senator BREAUX. OK, now make it more parochial from a Louisiana standpoint. One of the articles one of the papers dealing with your Shreveport installation in Shreveport, Louisiana. It was an announcement I am reading from a newspaper article. It said that it was an announcement, AT&T says it will lay off 330 workers at its plant here by March 30th. And the article continues. The layoffs are the result of AT&T's decision announced in 1988 to phase out the manufacture of pay telephones in Shreveport. The public phones will be manufactured for AT&T in Taiwan. The latest layoffs will leave the plant with about 2,500 workers from a peak of 7,500 workers in 1974.

The question I need you to comment on if you could, is the amount of workers that they say was approximately 2,500 from a peak of approximately 7,500 in 1974. Is that approximate correct or incorrect?

Mr. KILPATRICK. I cannot verify from my own knowledge. I would be happy to provide that.

Senator BREAUX. Well, from your own knowledge, well maybe you have no knowledge about it, it is not your area of personnel. But does that sound about the size of the reduction of the workers in the Shreveport, Louisiana plant?

Mr. KILPATRICK. I simply do not know, but I will find out.

Senator BREAUX. OK, because I said something in my opening statement that it was a reduction of about 60 percent in the Shreveport plant. This figures out about 66 percent, if it is correct. I am not sure it is, because I am only quoting from newspaper reports. Thank you.

Mr. KILPATRICK. Senator, could I make a comment about plant reductions and closings, and the reasons for them?

Senator BREAUX. I have heard the reasons. You are welcome to reinstate them. I am just trying to verify whether they in fact occurred or not.

Mr. KILPATRICK. A big reason is the increased competition. As I mentioned before, one of the purposes of the decree was to reduce AT&T's market share, which necessarily means sales are reduced, which means production is reduced.

Senator BREAUX. Well, let me ask you on that point, are you reducing production? Or are you just reducing production in the United States, if you are opening plants in Singapore, and in Taiwan and in Hong Kong and in Ireland. It sounds like you are not reducing production; you are just reducing U.S. production.

Mr. KILPATRICK. For the low-end equipment, I know of no manufacturers who are selling telephone sets in the United States who are manufacturing them here. That is one reason for going abroad.

Another is, as we try to sell to overseas telephone administrations, very often, one of the conditions of their considering our sales pitch is that we open facilities in their countries.

Senator BREAUX. Well, how much of your off-shore production is sent back to the United States in terms of imports?

Mr. KILPATRICK. I cannot give you the figure, but I will provide it.

Senator BREAUX. Do you have an approximate idea?

Mr. KILPATRICK. I do not.

Senator BREAUX. How much is the trade deficit in manufacturing?

Mr. KILPATRICK. The trade deficit?

Senator BREAUX. Yes, on telecommunications equipment?

Mr. KILPATRICK. For AT&T?

Senator BREAUX. Yes.

Mr. KILPATRICK. I could provide that figure as well.

Senator BREAUX. Ok.

Mr. TAUZIN. I yield back the balance of my time.

Mr. BRYANT. Mr. Ritter?

Mr. RITTER. Since divestiture we have witnessed the entry of hundreds if not thousands of new firms in the telecommunications business and the equipment market has flourished.

Can you respond to the thought that unleashing the massive dominant, potentially-dominant powers of the Bell companies, with

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their local exchange control into this mix, can you comment on the potential to perhaps create some real havoc amongst companies that got into businesses with the understanding that the Bell companies would not be players?

Mr. RILL. Let me address the second part of the question first, Mr. Ritter.

As you indicated in your opening statement, you are concerned about some kind of undertaking that a manufacturer going into the business might have believed he had, that the Bells would be——

Mr. RITTER. Logical entry.

Mr. RILL. At the time the decree was entered, Judge Greene made it very clear that he himself had great concerns about the absolute line of business prohibitions that were put into the decree.

He even went so far as to suggest that there were elements about these prohibitions that were anticompetitive but agreed to their entry at least for a time to correct the abuse in the marketplace that resulted in the complaint in the first place.

He built into the decree an automatic review provision, a triennial review provision and a special review provision for the lifting of the restrictions under appropriate circumstances where competitive concerns would be alleviated.

So anyone going into the business would have been aware that there was a review process and a potential for elimination of the restrictions. Now your basic question is, why will the entry not be anticompetitive. There are several reasons.

We think they will be pro-competitive with efficient entry. We think it will not be anticompetitive, although we will be vigilant; because we think there will be safeguards to protect against that.

Mr. RITTER. There were still tremendous numbers of investments and new firms formed based on an understanding that at least in the near term they would not see competition from Bell companies themselves. There is some confusion that concerns the impact that manufacturing relief for RBOC's would have on the trade balance.

As we understand this trade balance, it has gone from a deficit to $4 billion telecom in 1987. If this current restriction is detrimental, how come we are doing so much better incrementally over the last several years?

Ms. OBUCHOWSKI. We did a very comprehensive study.

Mr. RITTER. I would assume that anything NTIA does under your jurisdiction would be very thorough.

Ms. OBUCHOWSKI. Some would say encyclopedic or dry as dust. No, seriously, the study we did had very complete numbers on our trade position. The most recent numbers I have seen which were that last year the deficit was $790 million. That reflected an improvement of about $2 billion from the preceding 3 years.

Now two points should be made. First, of course, the deficit has improved versus, roughly, $2 billion, and $1 billion of that was an adjustment in the numbers. We were showing different classifications. The other $1 billion is an improvement. We are pleased with the improvement but not pleased enough. It is one of the sunset industries and we are not feeling good enough to say the deficit is improving. We should be in an overwhelming surplus.

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Mr. RITTER. Let's take the big stuff, switches. Are we doing quite well and maintaining a surplus? You have one major American power, 5 or 6 big foreign producers.

What happens to the possibility of reducing that surplus to a deficit as joint ventures come about replacing domestic American manufacturing?

Ms. OBUCHOWSKI. As you know Congressman Ritter, over the last several years RBOC's have been able to buy equipment anywhere they want. While there has been a prohibition on their manufacturing, they have been able to go to Alcatel, Seimens versus NEC, any of these companies.

We were pleased to see in the years 1984, to present AT&T market shares stabilized at 47 percent. We don't expect any, you cannot ever predict the future with 100 percent certainty, but there is no reason to expect that their behavior will result in a flood of oversees purchasing.

We are very strong in this area. The companies have been choosing U.S.-based producers for good and valid reasons and they will continue to. Even when it comes to oversees switching manufacturers we have seen in the switching sector most people, even if they are providing equipment for this market, locate their factories here.

The R&D tends to be close to the purchaser because it is that kind of iterative process in place when you are dealing with the most sophisticated equipment that is going into the network.

Mr. RITTER. Thank you, Mr. Chairman. I yield back the balance of my time.

Mr. MARKEY. The gentleman's time has expired.

The Chair recognizes the gentleman from Oklahoma, Mr. Synar.

Mr. SYNAR. Mr. Rill, could you estimate for us and the committee the number of complaints of BOC violations that have been investigated by the Department?

Mr. RILL. It is a large number. I can provide that for the record.

Mr. SYNAR. Can you give us a guess?

Mr. RILL. I would say, since divestiture, my staff indicates—I haven't been around that whole time, but around 100 to 150.

Mr. SYNAR. Is it the Department or administration's position we ought to let convicted felons out on parole?

Mr. RILL. Others obviously heard it. I didn't hear it.

Mr. SYNAR. Is it the position of the Department that there should be local telephone competition?

Mr. RILL. We think there should be competition in all markets.

Mr. SYNAR. Do you think there is local telephone competition?

Mr. RILL. We have not at this time, since 1987, taken a thorough look at the full status of competition in all the telephone markets. There is more competition than there was. When the first triennial review—court review process is over, we intend to take a look across the waterfront to continue the review process that we undertook to do under the decree. At this time, we have not made any proposal that the interexchange line of business restrictions be lifted across the board.

Mr. SYNAR. One final question.

Recently, Mr. Cooper was visited by a group of disabled people from his District who contended, unless we allow the BOC's to get

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into manufacturing, their rights would be impinged upon and basic services which they need and should have could not be provided.

How many times have the BOC's come and asked for waivers with respect to the disabled?

Mr. RILL. Again, I don't have that off the top of my head.

Mr. SYNAR. Anyone behind you that might have that information?

Mr. RILL. There have been several applications for waivers on that basis, and the court has granted those waivers.

Mr. SYNAR. There hasn't been this waive of requests for waivers?

Mr. RILL. Again, I would have to supply the exact number for the record. It has been an area where the court has granted waivers.

Mr. SYNAR. You will provide that for the record?

Mr. RILL. We will.

Mr. SYNAR. Thank you very much.

Thank you, Mr. Chairman.

[The following information was received:]

U.S. DEPARTMENT OF JUSTICE,
ANTITRUST DIVISION,
Washington, DC, August 2, 1991

Hon. EDWARD J. MARKEY,
Chairman, Subcommittee on Telecommunications and Finance, Committee on Energy and Commerce, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: I am writing to supplement the record of the hearing on H.R. 1523 and H.R. 1527 held by the subcommittee on July 11, 1991, regarding two questions I was asked by Congressman Synar.

First, Congressman Synar requested an estimate of the number of complaints of alleged violations of the Modified Final Judgment ("MFJ") by the Bell operating companies that have been investigated by the Department. Our records indicate that the Department has received approximately 140 such complaints. The great preponderance of those complaints involved conduct that was not a violation of the decree, and in many cases little investigation was required to make that determination. In other instances, the Department more fully investigated the allegations. Where appropriate, the Department has taken remedial action, including obtaining a cessation of prohibited activity or a change in business practices to conform with the decree's requirements and, in some cases, judicial orders, including a Civil Enforcement Consent Order and a $10 million civil settlement. The Department has also brought a criminal contempt case, currently pending, against a Bell operating company as part of its MFJ enforcement effort.

Congressman Synar also asked for information regarding the number of times the Bell operating companies have requested waivers of the MFJ's line-of-business restrictions to provide services for the disabled. To date, the Department has received six such requests, all involving telecommunications services for the hearing-impaired. Four of these requests have been granted by the court. The other two, both of which were approved by the Department, were filed with the court on July 15, 1991, and are currently pending.

I appreciate this opportunity to supplement the record.

Sincerely,

JAMES F. RILL, *Assistant Attorney General.*

Mr. MARKEY. The Chair recognizes the gentleman from Kansas, Mr. Slattery.

Mr. SLATTERY. Thank you, Mr. Chairman.

Most of the questions I have have already been focused on. I want to come back to the question of trade.

I think this is something we all on this committee need to focus on. That is, in 1981, the United States had a surplus of over $800 million in communications equipment and then, by 1988, that surplus in this area had shifted to a deficit of $2.6 billion.

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Now, since that time, because of some accounting errors or accounting changes, I should say; with the Department of Commerce, the numbers become a little difficult to compare. Is that your information, Commissioner?

Ms. OBUCHOWSKI. Yes, sir.

Mr. SLATTERY. I would just point out to my colleagues, when we talk about this issue, the bottom line is that we have seen literally thousands and thousands of U.S. jobs being exported overseas, in effect by AT&T and other so-called domestic manufacturers of telephone equipment, which can currently be involved in the manufacturing of this equipment.

And with the legislation we are talking about, we are in effect saying, allow the regional operating companies to get involved, and we further provide they can do this only if they do it in this country.

I know that you have some concerns about what has been called—and I think incorrectly—domestic content. I would hope that you will take the line that you used earlier today, Jan, and utter it over at the White House several times.

I think you said, don't let the perfect be the enemy of the good. When we get to the point where the President is looking at this legislation, and in my more optimistic moments, I hope that occurs, I hope you will be persuasive in telling the President this may not be exactly what he would like to see, but don't let the perfect be the enemy of the good, to use your words.

I don't know that I have any further questions, except I would want to focus a little bit on this question of high-end telecommunications equipment, and I am advised in recent years the United States has enjoyed a surplus in the area of high-end telecommunications equipment. Is that correct?

Ms. OBUCHOWSKI. Yes, sir, it is.

Mr. SLATTERY. But that is due, is it not, to the fact that some of the domestic manufacturers of this high-end equipment are companies like Seemans and Erickson and Northern Telecom; is that correct?

Ms. OBUCHOWSKI. In part, sir—but I think in part it is also attributed to the fact that AT&T, Northern and Digital, for example, all U.S.-based producers, have been exporting more high-end equipment.

Mr. SLATTERY. I would observe there have been some changes in the international monetary exchange rates that have made some of our exports more attractive in the international marketplace, so this could be an abnormality in the trend that we are looking at.

The bottom line, my friends, is that we are losing jobs to foreign companies, and it is to me just unbelievable we are in effect saying to some of our most logical competitors in this country that you can't compete.

The idea that we are saying that Southwestern Bell can manufacture equipment in Mexico, but can't manufacture it in Topeka, Kansas, just doesn't make any sense to this member at all. I would just observe that even with the domestic content provisions in it, that you are opposed to, I happen to support those, I think on balance this legislation will significantly improve the opportunity for us to create jobs in this country.

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I find it interesting my friend from Texas would try to argue this is going to result in the export of more jobs. This gentleman does not see it that way at all. I would be delighted to work with my friend from Texas in an effort to make it more difficult for there to be any further export of jobs, and in fact try to do everything we can to level this playing field to make sure our biggest and best players are on the field in this growing, tough, global competition.

Mr. MARKEY. The gentleman's time has expired.

The gentleman from Texas, Mr. Bryant, is recognized.

Mr. BRYANT. Thank you, Mr. Chairman.

Mr. Rill, you said the administration intends to veto a bill that contains domestic content; is that correct?

Mr. RILL. What I said in the remarks was the administration's position expressed in the Statement of Administration Position of June 3rd that referred to the Senate bill, which indicates that senior advisors would recommend a veto of legislation that contains provisions comparable to the domestic content, domestic manufacturing limitations of this bill and the Senate bill.

Mr. BRYANT. If a veto is inevitable, a member of this committee who would be in favor of a manufacturing provision for the RBOC's, only if it contained domestic content provision, has no reason for consideration of the bill if you are going to veto it anyway.

Mr. RILL. I am not going to veto it. You have to make——

Mr. BRYANT. If you are going to veto the bill anyway, what is the point?

Mr. RILL. That is a Statement of the Administration Position, senior advisors would recommend a veto. I think I would have to let that stand for itself.

Mr. BRYANT. We are trying to have the benefit of two positions. You are going to veto it because you do not like it, or not veto because you do like it. In the past, the President threatened to veto—do you intend to recommend a veto or not?

Mr. RILL. All I can say is what is set forth in the Statement of Administration Policy. Senior advisors would recommend a veto. I can't add or subtract from that statement.

Mr. BRYANT. I would yield to the gentleman from Kansas.

Mr. SLATTERY. The bill calls for the RBOC's to be able to enter into alliances with foreign companies to manufacture and market products; isn't that correct? Would you agree both bills do provide for that?

Ms. Obuchowski, would you agree with that?

Ms. OBUCHOWSKI. Yes, that would take place under the bills.

Mr. BRYANT. Many, if not most, foreign countries in the area of telecommunications block the entry of our products. If, after this bill is enacted, an America RBOC enters into a joint venture with a company from one of these foreign countries that blocks the sale of our products in their country, do you think we should let those products they are putting their label on come back in to the United States anyway?

Ms. OBUCHOWSKI. I think we can address that under the specific reciprocity provisions of the Telecommunications Trade Act.

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Mr. BRYANT. Explain how that would work. Would that prohibit the sale of those products coming in from countries with an American label, but were from a country that prohibits our products?

Ms. OBUCHOWSKI. I don't think it could come in with an American label with those trade provisions.

Mr. BRYANT. Explain what those provisions are.

Ms. OBUCHOWSKI. Basically, the telecommunications aspects of the comprehensive trade legislation sets up a set of steps by which the U.S. Government can look at markets, and if they are impeding trade, can then take a variety of sanctions.

Mr. BRYANT. But that is not happening now. They are selling telecommunications products in the United States now, even though they will not buy our products there, would you agree?

Ms. OBUCHOWSKI. To an extent, Germany has increased its purchase of America 101.5 percent. Taiwan, 81.2 percent.

Mr. BRYANT. Let's not talk about percentages; 151 percent could be almost nothing if you start off with nothing.

Ms. OBUCHOWSKI. I think you can see Europe has a net trade surplus with the United States. We are exporting more of telecommunications equipment to Europe than we are importing net.

Mr. BRYANT. Would you agree that my point stands if this bill passed under the present law, an RBOC could go into a joint venture located in a country that will not allow the sale of U.S. telecommunications products, and could manufacture a product there and send it back here and sell it?

Ms. OBUCHOWSKI. I won't state that unequivocally. I am not a trade expert. I do know under the telecommunications reciprocity provisions—and the Trade Act has only one industry that does have such similar provisions—under those provisions of the Trade Act, the U.S. Government can take action in certain circumstances.

Mr. BRYANT. Very well.

Mr. Rill, you answered Mr. Synar by saying the 100 to 150—I will acknowledge it was only a guess—complaints have been filed with your Department against the RBOC's with regard to alleged telecommunications violations with regards to the Modified Final Judgment.

Is that what you said?

Mr. RILL. That is the estimate.

Mr. BRYANT. How many suits has your office filed against RBOC's?

Mr. RILL. Two in the last year.

Mr. BRYANT. Two out of 150.

Mr. RILL. The district rules prevent me from discussing one of them, which is a criminal proceeding.

Mr. BRYANT. What caused you all to get so anxious in the last year?

Mr. RILL. I don't know that anxious is the right word. I can speak only for myself. As long as this decree is in force, we will enforce it. This position was recognized by Judge Greene in approving our $10 million settlement with U S West. He said the Department has taken a position which shows strong enforcement.

Mr. BRYANT. Two out of 150, would that indicate a lot of false allegations are being made?

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Mr. RILL. I can't deal with each individual allegation. We deal with these at the present time as strongly as we can with the staffing that we have got. I think our record during the current tenure is a good record, and so does Judge Greene.

Mr. MARKEY. The gentleman's time has expired.

The gentleman from Alabama, Mr. Harris.

Mr. HARRIS. Thank you, Mr. Chairman.

Mr. Rill, were you in the Justice Department when this case was settled?

Mr. RILL. I was not in the Justice Department when it was settled. I was not in the Justice Department when it was brought. However, I will say that from my study of the case as an antitrust lawyer, I endorse the case that was brought, and I think the settlement that was entered is basically a sound settlement.

Mr. HARRIS. Actually, shortly after the divestiture, the Justice Department was back in court under President Reagan urging the elimination of the restrictions, were they not?

Mr. RILL. The decree provided for a triennial review. The Justice Department undertook a major review; brought in an outside consultant who made the Huber report. Based on the triennial review, the Department did move the court to modify the manufacturing and information services restrictions; that is correct, in 1987.

Mr. HARRIS. Of course, any time you have a consent decree, you know people give and people take, and I guess one of the problems I have had all along with this issue—and I have got pulls and tugs on all sides, I have had everybody to reach out and touch me on it. But basically, this was an agreement that all parties were involved in, was it not?

Mr. RILL. It was an agreement entered into between the government and AT&T and approved by Judge Greene after some agreed-upon modification by Judge Greene. And unlike many decrees, it contained within itself a mechanism for review and a particularized provision contemplating petitions for lifting of the line of business restrictions.

Mr. HARRIS. Of course, at the time, it was a massive undertaking on the Department of Justice in bringing this suit. It is a complicated area. I am a new kid on the block on this committee, and trying to learn all the ins and outs of what is going on. And having had a judicial background, I guess I feel like I need to defend Judge Greene some, because I think in a lot of ways, he has received criticism, maybe unfairly, that this was a very complicated case for anyone to handle.

Mr. RILL. It certainly was, and is a complicated matter. And you are not going to hear any personalized criticism from me of Judge Greene.

Mr. HARRIS. The problem of trade, of course, is one that is very much of concern to me. I know, having come from an area or coming from an area that we have lost a lot of jobs in a lot of different fields, that a lot of our folks have come to the conclusion our number one export in the last 10 years has been our jobs.

I just—I certainly want—would oppose, whether it be the Bells or AT&T or anyone else, moving jobs out of the country. I am concerned in this legislation that what we have here is we are going to be opening up ourselves more to the rest of the world, and on the

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other hand, we are not doing the things we should to open up the markets to our people that are in the business now.

Ms. OBUCHOWSKI. I will certainly speak for Secretary Mosbacher on that later issue. We are very, very committed—and I believe that the Secretary is working extremely hard to promote exports of U.S. goods and also to try to open overseas markets to the export of U.S. goods.

We are really talking, I think, about a somewhat different issue here. We are talking about a circumstance where the United States is tremendously capable in a field, and yet 50 percent of our companies can't try to export.

Now, I recognize that there was a judgment that went into place, but that judgment is now 9 years old, and this industry has changed radically, and the U.S. trade position and our concerns about our competitiveness and our manufacturing abilities have really changed dramatically over that period.

And as we do cost-benefit analysis, we do agree with you very strongly that we should be trying very hard to export, but we also think we should unleash as much power as we can out of U.S.-based companies.

Mr. HARRIS. I understand that. I don't want to unleash what few jobs we have got left overseas. I know my people are very concerned about that.

Ms. OBUCHOWSKI. Certainly, that is something we are all very concerned about. What you are dealing with in telecommunications is a globalized marketplace. We have to worry about jobs going overseas. At the same time, no one in this administration is trying to second-guess, for example, what AT&T has done. AT&T has to compete in foreign markets against people with all sorts of different cost structures.

And so, they have to look at their bottom line. All companies are looking at their bottom lines. And you really—we would propose—be heading in a wrong direction if a different set of standards were applied to these companies than any companies operating in the U.S. market.

Mr. HARRIS. I will close with this: A lot of these countries we are talking about have industrial strategies, and that is a complaint I have had, and I know with this administration, but certainly with the prior administration, that we had as a Government no industrial strategy. That is one reason we have lost a lot of our hold on some of these industries.

Thank you, Mr. Chairman.

Mr. MARKEY. The gentleman's time has expired.

And all time for questions by subcommittee members has expired for this panel. We thank you very much. I think it is quite clear to you that the administration is going to have to accommodate the genuine concerns for the protection of workers and ratepayers in proper safeguards which are constructed legislatively, if anything is to move out of this committee.

And we invite you to work with us. And I would note that while there is an admirable set of lists of objectives to which the administration is willing to say amen. We will have to note that we don't quite believe that the second miracle of Lourdes has occurred with

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regard to the Bell operating companies, and certainly interim safeguards must be built in.

If the administration objects to that, I think we will have reached an impasse. We invite you to work with us, and hopefully something constructive——

Mr. TAUZIN. Mr. Chairman, I only want to point out, before a miracle can happen, you have to believe.

Mr. MARKEY. God knows this is an administration of true believers. We have the right people to work with. And hopefully, over the course of the next several months, we will be able to work——

Ms. OBUCHOWSKI. We pray you will see it our way.

Mr. MARKEY. Our second distinguished panel consists of Mr. Robert Allen, chairman, American Telegraph and Telephone Company, Basking Ridge, NJ.; Mr. William C. Ferguson, chairman of the board and CEO, NYNEX, White Plains, NY.; Mr. George Sollman, president, Centigram Corporation, San Jose, Calif.; and Mr. Michael J. Birck, Chairman, Telecommunications Industry Association, Washington, D.C.

Thank you, gentlemen, very much. We apologize again for the delay in hearing your very important testimony. We are putting in another round of calls to the members so they can be informed that your testimony is commencing, so that they can come back and hear it at this time.

So, if we could again ask each of the witnesses to keep their opening statements to 5 minutes or less, I think it is quite apparent that the questions of the subcommittee members will give you plenty of opportunity to expound upon the initial outline which you lay out for us.

Let's begin with you, Mr. Ferguson. Why don't you make the case for relieving the Bell company of these restrictions.

STATEMENTS OF WILLIAM C. FERGUSON, CHAIRMAN, NYNEX CORP.; ROBERT E. ALLEN, CHAIRMAN, AMERICAN TELEPHONE AND TELEGRAPH CO.; GEORGE SOLLMAN, PRESIDENT, CENTIGRAM COMMUNICATIONS CORP.; AND MICHAEL J. BIRCK, CHAIRMAN, TELECOMMUNICATIONS INDUSTRY ASSOCIATION

Mr. FERGUSON. Mr. Chairman, thank you.

Thank you for your leadership on this issue, and thank you to the committee members for asserting the rightful position of Congress on this issue.

I am here not only representing NYNEX, but also representing the other six regional Bell telephone companies. We are here to strongly support H.R. 1527.

There are three main reasons: No. 1, this is legislation that is good for America. It is good for economic and social reasons. It is good for jobs. It will increase research and development in the United States, and it will help American competitiveness.

No. 2, the time is now. We should not wait any longer. We have already lost some 60,000 jobs in telecommunications. I don't know why we need to lose 100,000 or 120,000 before action is taken.

No. 3, I am here to commit that the regional companies are prepared to deliver on the promise of this legislation. We are prepared to increase our research and development. We will aggressively

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pursue business opportunities with American businesses. We will abide very scrupulously by the safeguards that are built into H.R. 1527. After all, we are common carriers. We are under the microscope of regulation on many fronts.

Mr. Chairman, I have a concern that sometimes when we talk about manufacturing, all we think about is fabrication. If I could, I would like to take 2 minutes and use a diagram to explain the manufacturing process.

If we think about the manufacturing process, it starts with the customer; it should end with a product that satisfies the customer. It goes through many stages, but with information flowing in both directions, from the customer down through the various stages and from these stages back up, it is an interactive kind of process.

It isn't simply a hand-off with no information flowing back. It starts with research, research of customers' needs. Basically, research on the technologies that are available and how to apply that research to satisfying customer needs.

That then results in prototyping, a crude model that would be developed as to how might that satisfy customer needs. When that crude modeling is done, work takes place in the normal process with designers, with fabricators, with researchers—again, this iterative process.

What we have with a modified final judgment restriction is we have a gulf in here, a gulf that we cannot go across. All we are allowed to do is develop a crude model and then take our scientists into a room with a group of lawyers and say, now let's write generic requirements. We cannot hand the crude model over.

Let's write the generic requirements, then we will throw those over the gulf and we will see what designers, what fabricators, what manufacturers can pick that up and try to satisfy these customers' needs without the free flow of information going back.

If we know how to satisfy the needs, we cannot say that. That was part of the problem that Mr. Tauzin was referring to when he responded to the problem of the network failure. We cannot say this is the right way to do it. We can only generically state what the customer's requirements are.

All kinds of design is done from ergonomics to chips, to software, to whatever, and finally this process results in fabrication.

Again, my point is, manufacturing is all of this, it isn't simply the bending of metal, the screwing it together, the assembly, it is all of this. We are into some research, development of generic requirements. We are not into this. We think this is not in the best interest of the citizens of this country, because you really have separated customers from the design, the fabrication, from the people who can really help to do the job.

Mr. Chairman, I think I have used up my allotted time. Thank you. We strongly support this legislation.

[Testimony resumes on p. 128.]

[The prepared statement of Mr. Ferguson follows:]

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Testimony of

WILLIAM FERGUSON
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
NYNEX CORPORATION

Mr. Chairman and Members of the Subcommittee:

My name is William Ferguson, and I am the Chairman and Chief Executive Officer of NYNEX. I am here on behalf of NYNEX as well as Bell Atlantic, BellSouth, Ameritech, U S West, Southwestern Bell, and Pacific Telesis. I want to thank you for the opportunity to discuss an issue which is critical to American consumers, the American economy, and the telecommunications industry. I also want to commend you for your leadership in again bringing the issue of MFJ relief before this Subcommittee. Let me also applaud you and Chairman Dingell for your leadership in asserting Congress' rightful role in setting national telecommunications policy.

Mr. Chairman, I am here to express our strong support for legislation which removes the manufacturing restriction imposed upon the Bell Companies by the AT&T Consent Decree. We specifically support H.R. 1527, which is a significant first step toward regaining America's leadership position on competitiveness and stimulating innovation in the telecommunications industry. The Senate, by a vote of 71-24, recently took this step by overwhelmingly passing a bill that is almost identical to H.R. 1527. The choice is now up to this body. The issue is simple: we can encourage new opportunities for American workers, businesses, and consumers, or we can hand these opportunities to foreign conglomerates, which are, even as we speak, rapidly taking over this industry. Failure to enact this legislation means lost opportunities for small and medium-sized companies,

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who cannot compete with the foreign conglomerates without our help. It means lost opportunities for American consumers, who are denied the timely introduction of new products and technology. And finally, it means lost opportunities for American families who, during these troubled times, desperately need jobs. Mr. Chairman, let's not allow these opportunities to be lost forever.

Lifting the Manufacturing Restrictions Will Create New Opportunities For American Businesses and Will Stimulate U.S. Competitiveness

Mr. Chairman, we are all tired of watching American industries and jobs get displaced by foreign competition. First there was steel, and then consumer electronics, micro-electronics, and automobiles. Now there is the potential of losing telecommunications. Between 1981 and 1988, the U.S. fell from a telecommunications trade surplus of $800 million to a deficit of $2.6 billion.1/ Since 1982, over 70 American computer and telecommunications equipment companies were taken over by, or merged with, foreign-based firms, with over $10 billion in capital assets entering foreign hands.

1/ Although the deficit decreased to $772 million in 1990, this change was due partly to accounting changes at the Department of Commerce, such as the inclusion of communications satellites and various types of radio equipment, and partly to the setback in the American economy, which has caused businesses to reduce imports. AT&T continues, however, to contribute to the trade deficit, because much of its offshore production is shipped back to the U.S. as imports. All of AT&T's 50-model consumer telephone product line sold in the U.S. is imported from Asia and Mexico.

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Perhaps more alarming for the future of our industry, however, is that the MFJ inhibits U.S. expenditures in R&D, the lifeblood of competitive telecommunications manufacturing. A recent Business Week article stated that between 1989 and 1990, the telecommunications industry suffered the largest fall in R&D expenditures of any U.S. industry -- 5 percent. In 1990, the Bell Companies spent over $1 billion in R&D, which includes research conducted at Bell Communications Research and other Bell Company facilities. These expenditures, however, represent only 1.3 percent of Bell Company revenues in 1990. This figure is less than half of the national average for R&D spending -- 3.4 percent -- and is much less than the average for telecommunications and computer firms. For example, Germany's Siemens recently spent 11.2 percent of its sales revenue on R&D, Japan's Fujitsu spent 10.3 percent, and Sweden's Ericsson spent 11.3 percent.

The Bell Companies want and need to increase R&D expenditures to remain competitive. The intricacies and vagueness of the manufacturing restrictions, however, have a dramatic chilling effect on Bell Company R&D efforts. Each decision to conduct R&D is preceded by intensive analysis by a battery of lawyers and technical experts to determine whether the activity would violate the MFJ. Hairline distinctions must be drawn between, for example, research for the issuance of generic product specifications, which is not prohibited, and the specific design and development of products, which is prohibited.

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Moreover, even though the Bell Companies can legally write product specifications and provide those specifications to manufacturers, the Bell Companies cannot participate in the design process with those manufacturers -- a vital step in bringing a product to market efficiently.

The problem is that the research and development workers all have multiple paths to pursue in finding a technological solution to a customer request. They can pursue hardware designs; they can pursue firmware designs; they can pursue software designs; or they can pursue some combination of these three. In fact, in most instances a combination is optimal.

Bell Company R&D workers are at a distinct disadvantage in pursuing optimal solutions. If they pursue hardware/firmware prototypes (e.g. voice recognition models) and optimize them in prototypes, they must then ignore the details of that optimization and send out requests for proposals for others to do the same optimization they have just completed. The responses may not achieve the same optimization, the delay may cause the market window to close or there may be no vendor willing to respond. The R&D effort is thus frustrated.

On the other hand, if they pursue software solutions on standard, off-the-shelf hardware, the software may be unnecessarily complex, slow in operation or otherwise limited. What is needed for the Bell Company R&D workers is the same

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options available to their competitors - optimization without limitation as to combinations of hardware/firmware/software.

The diminished R&D spending caused by the manufacturing restriction has serious implications for the domestic economy, and is, in itself, the cause of many lost opportunities for American businesses. These implications are perhaps nowhere better illustrated than in the testimony of William Hilsman, the President of a small telecommunications company in California, before the Senate Communications Subcommittee on May 9, 1990. Mr. Hilsman's company was the leader in a certain digital cellular technology, and BellSouth was interested in working with the company to develop the technology. A draft agreement was reached whereby BellSouth would invest up to $50 million in an R&D contract for the development of a digital cellular system. At about the same time that the draft agreement was completed, the court announced that the manufacturing restriction includes design and development work, and the whole project had to be scrubbed. As a consequence, the U.S. lost its nearly two year advantage in bringing digital cellular technology to the market, and America missed a golden opportunity to develop and market a promising new technology. Mr. Hilsman's company wound up going overseas for financing.

Experiences like Mr. Hilsman's are indicative of the difficulties small and medium-sized companies have in raising capital in the U.S. Telecommunications research and development

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is very cash-intensive. Small and medium-sized companies are unable to muster sufficient capital on their own, and generally must turn to outside sources, such as corporate grants and joint ventures. This well of funding, however, has been drying up in recent years. The recession, the banking crisis, and the unpredictable stock market all have contributed to the decline in available capital. The Bell Companies, however, are limited by the MFJ in the types of funding they can provide. As a result, many businesses seek investment capital outside the United States. Why should the U.S. depend upon foreign financing for joint ventures with the innovative small and medium-sized American companies, when the U.S. has the resources and skills of seven of our nation's leading companies available and ready to be used? Reliance upon foreign funding and expertise allows foreign firms to dictate the type of products and technology that American companies will be producing, and this is bad policy for America. Lifting the manufacturing restriction will allow companies like Mr. Hilsman's to participate in product development joint ventures with the Bell Companies so that new and innovative products and technologies will be developed.

In addition to depriving U.S. firms of R&D funds, the MFJ restrictions inhibit the normal free exchange of technical ideas and knowledge. Small and medium-sized manufacturers are unable to work with us to design new products, or to make engineering or other modifications to meet our specific needs. The implications of this restriction are clearly demonstrated by the experience of

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a small, Santa Barbara based equipment manufacturing company -- Protocol Engines. Protocol Engines develops products for increasing the speed at which data is transmitted over telecommunications networks, and was working to design and develop products for the public telephone network. Before this technology could be used in the public network, however, specific input was required from the Bell Companies. The manufacturing restriction prevented the Bell Companies having meaningful discussions with Protocol Engines and, as a result, Protocol Engines was forced to abandon its plans for the mass market. Protocol Engines now focuses its development work entirely on the private corporate networks.

In an industry as technically complex and intricate as telecommunications, it is essential that ideas and knowledge be freely exchanged. Without such free exchanges, American companies will be unable to compete with their foreign counterparts who are not constrained artificially, and who, in many cases, receive the full support of their governments. A more detailed description of the iterative, interrelated and overlapping steps involved in the manufacturing process is provided in the testimony of Casimir Skrzypczak which is attached to my testimony. His testimony was provided to this Subcommittee during the last Congress in 1989.

Mr. Chairman, the roadblocks to Bell Company investment in U.S. manufacturing have hurt small and medium-sized

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manufacturers. It is no surprise, therefore that in Business Week magazine's recent list of the 100 fastest growing American small companies, only one was a telecommunications firm. Why should the future of these small and innovative firms, and the future of American competitiveness, continue to be jeopardized when the solution is standing at our doorstep?

Lifting the Manufacturing Restrictions Will Benefit Consumers

Consumers are also missing opportunities for new and beneficial products because of the MFJ restrictions. Bell Companies have been delayed by the MFJ restrictions in bringing technological advances to the market. As discussed in greater detail later in my testimony, NYNEX's participation in a project to develop an inexpensive database retrieval terminal was abandoned, in part, because of the MFJ restrictions. NYNEX would like to help develop recognition technology, both speech and image, that would be helpful in areas including education, health services, personal services and with the disabled community.

Numerous projects have been put on the back burner or canceled. For example, U S West has developed a "Prescription Phone Service" that uses an audiologist's report to fine tune a customer's telephone line to compensate for any frequencies that the customer has difficulty hearing. One way of deploying the service is to customize a computer chip that replaces the missing frequencies. The manufacturing restriction, however, prohibits

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us from manufacturing the hardware to accomplish this, or from providing an outside company with the detailed design information necessary to develop it.

U S West has also developed "Clean Sound" technology, which eliminates annoying background noise, such as from busy streets, airports, and shopping malls, that often make telephone conversations nearly impossible to hear. Clean Sound, like the Prescription Phone Service, also called for chip technology and other developmental work prohibited by the manufacturing restrictions. It is clear to me, Mr. Chairman, that consumers have been harmed by the manufacturing restrictions.

Lifting the Manufacturing Restrictions Means New Jobs for America

Mr. Chairman, this bill does more than let us manufacture telephone equipment; it creates American jobs. The Communications Workers of America fully support this legislation because they know the employment problems in the domestic telecommunications equipment manufacturing industry. The Consent Decree left AT&T with overwhelming dominance in the domestic production of telecommunications equipment. Rather than use this dominant position to invest in and secure America's future, AT&T has exported U.S. jobs to a host of foreign countries. Since 1982, AT&T has eliminated over 60,000 domestic manufacturing jobs and closed six domestic production plants in Baltimore, MD, Cicero, IL, Indianapolis, IN, Kearny, NJ, Winston-Salem, NC, and

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Fairlawn, VA. Similarly, AT&T has substantially reduced its workforce in at least 24 other domestic manufacturing plants, including an 83 percent reduction in its Shreveport, LA plant and a 70 percent reduction in its Kansas City, MO facility. Although AT&T claims that all of the equipment it sells in the United States is manufactured in the United States, what it really means is that all of this equipment is assembled in the United States. Many of the component parts are, in fact, manufactured overseas. In 1985, AT&T built a $200 million computer chip factory in Madrid, Spain, and recently built a second plant on the outskirts of Madrid to build large switches. In Singapore, AT&T owns a telephone and semiconductor manufacturing plant that employs 7,000 people. AT&T also owns a similar plant in Bangkok, Thailand that employs 300 people. In Matamoros, Mexico, AT&T just recently opened a plant that also employs 7,000 people, and a second plant is under construction in Guadalajara, Mexico. AT&T has signed 18 joint venture agreements with foreign firms, and is an equity owner of the principal telecommunications equipment manufacturing companies of several countries, including the Netherlands, Italy, Denmark, Taiwan, Thailand, Hong Kong, South Korea, Japan, and China. Mr. Chairman, these jobs should be in the U.S. for American workers.

The Bell Companies are prepared to manufacture in the United States. We know that American firms, and the American workforce, are second to none, and that they are eager to work with us to develop new opportunities, technologies, and jobs. For example,

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NYNEX formed a partnership with RCA and Citicorp in 1986 to engage in research into an inexpensive terminal that would have combined the ordinary household telephone with video access to information databases and other services. This technology, which is now widely accepted in France, would have provided substantial employment for highly skilled American workers, such as engineers, scientists, technicians, and marketers. The District Court's 1987 manufacturing order, however, severely hampered our participation in the project. We now ask you to give us the opportunity to revitalize these and other projects, and to bring American jobs back home where they belong.

The Importance of Regulatory Safeguards

Whenever MFJ relief is discussed, questions always are raised about the adequacy of regulatory safeguards against improper cross-subsidies. The combination of safeguards contained in H.R. 1527 and those already in place are more than sufficient to protect the public interest.

Since divestiture, there have been several occasions at both the state and federal levels where regulators have dealt with the cross-subsidy issue. One includes the FCC's audit of NYNEX's procurement company activities.

At divestiture, NYNEX organized to meet the materials management needs of its two telephone companies in a very cost effective way. By centralizing procurement, we were able to

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achieve significant savings compared to what each of our telephone companies could have accomplished on its own. Those savings benefitted ratepayers. We had hoped to achieve even greater economies of scale, and thus further savings, by also selling telecommunications products to third parties. Because of the MFJ restrictions, and in spite of the Justice Department's endorsement, we were not able to obtain the authority to develop this outside market.

NYNEX always conducted its procurement business in a manner that we believed fully complied with both the letter and the spirit of our regulatory obligations. Last year, however, we learned that the FCC's interpretation of its rules was different from our own interpretation. In spite of the significant savings we had realized for ratepayers, the FCC objected when its calculations showed that our procurement company earned profits in excess of the allowed rate of return set for telephone companies.

As the issue was fully examined, and we came to understand the FCC's position, we decided to enter into a Consent Decree. We made a payment to the U.S. Treasury as well as a refund to our interstate customers. The Decree was entered without any finding of violation or liability against the NYNEX telephone companies, and the experience established a strong foundation for communication between NYNEX and the FCC for the future.

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Since then, we have also reorganized the corporation so that there is a distinct, bright line separating the regulated and unregulated sides of the business. We will continue to maintain clear distinctions between the two sectors, and observe the rules governing interaction between them. Specific to the cross-subsidy concern, we have placed the purchasing function for our telephone companies directly under their ownership and supervision.

In the context of the bill before the Subcommittee, the NYNEX experience demonstrates that the Commission is fully capable of asserting itself in cases where it believes its rules are being violated, or, as in our case, interpreted differently than the Commission might.

There also are general allegations that lifting the manufacturing restriction will lead to anticompetitive behavior by the Bell Companies. These arguments, primarily touted by AT&T, simply are not true. The communications market has changed radically in the past nine years. Since divestiture, there have been a number of large, foreign-based companies that have moved quickly into the market. These companies present formidable competition to the Bell Companies. In addition, there are seven Bell Companies competing against each other, and not, as before, merely one major domestic manufacturer, or one dominant domestic buyer. In the words of the Assistant Attorney General James Rill, who recently testified before the Senate Communications

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Subcommittee regarding the manufacturing restriction, "the manufacturing restrictions are no longer necessary to protect competition. Worse, these restrictions are themselves anticompetitive...".

In addition, the Bell Companies are facing growing competition in the local exchange service market. The March 18, 1991 issue of Forbes magazine noted that "[a]n onslaught of new technologies, hungry entrepreneurs and pro-competition regulators are all teaming up" to compete against the Bell Companies for local exchange and other services. The competitive climate has clearly changed since 1982, and the law should reflect these changes.

H.R. 1527 contains safeguards that will protect against any cross-subsidization and other anticompetitive practices that could harm telephone service consumers and competition. These safeguards also will aid regulators in detecting and preventing such conduct.

First, the bill prohibits any Bell Company from engaging in manufacturing with another unaffiliated Bell Company or that company's affiliates.

Second, the bill requires the manufacturing affiliate to maintain separate books of account that identify any transactions between the manufacturing affiliate and the telephone company.

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The Commission may review any such transactions to detect cross-subsidization. Moreover, the bill requires that the manufacturing affiliate prepare and file financial reports just as if it were a publicly held corporation. This will further open up the manufacturing affiliate to public scrutiny. This would be enough, but the bill goes beyond this and requires separate subsidiaries, as well.

Third, the bill prohibits a Bell Company from performing sales, specific advertising, installation, and similar functions for its manufacturing affiliate. This provision removes opportunities for cross-subsidization by precluding the two companies from sharing certain costs.

In addition, the bill precludes the manufacturing affiliate from incurring debt in a manner that would allow a creditor, on default, to have recourse to the telephone company's assets. This protects telephone company customers from the possible loss of assets, and protects the manufacturing affiliate's competitors from the possibility of cross-subsidization.

Fifth, the bill requires that any affiliate of the Bell Telephone Company that becomes affiliated with a manufacturing entity must comply with the separate affiliate provisions of the bill. This precludes the Bell Companies from acquiring or otherwise obtaining an interest in a manufacturing entity without complying with all of the provisions of the bill.

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Sixth, each manufacturing affiliate must sell, without discrimination as to price, delivery, terms, and conditions, the equipment it manufactures to other telephone companies for use in the local telecommunications network. This provision will assist other local exchange telephone companies and ensure that the network is benefitted by the equipment that the Bell Company manufacturing affiliates produce.

Seventh, the bill requires the Commission to promulgate regulations requiring the Bell Companies to maintain, at the Commission, complete information regarding the protocols and technical requirements for connection with the telephone exchange network. This precludes the Bell Companies from discriminating against other manufacturers by refusing to provide them with information about the technical aspects of the network. The regulations also must require that a Bell Company not inform its affiliates of this type of information unless the information is immediately filed with the Commission. The Commission is authorized by the bill to promulgate further regulations to ensure that competitors have "ready and equal access" to this type of information.

To preclude procurement discrimination, the Bell Companies must provide to other manufacturers of telecommunications equipment, and customer premises equipment, opportunities to sell such equipment that are comparable to those that the Bell Companies provide to their manufacturing affiliates. Further,

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the Bell Companies cannot subsidize the manufacturing affiliate with revenues from their regulated telecommunications service, and must purchase from their manufacturing affiliate at the open market price.

Finally, in administering and enforcing the provisions of the bill, the Commission is given the same authority, power, and functions with respect to a Bell Telephone Company that it has with respect to all common carriers subject to the Act.

In addition to all of the safeguards in the bill, the FCC and the states are better equipped today to protect against anticompetitive activity than they were before divestiture. There now are seven independent Regional Holding Companies plus AT&T, instead of a monolithic Bell System controlled by AT&T. The size of each of those companies is much less than the old Bell System, and thus the complexity of the review of their operations is greatly diminished. The FCC can now compare the actions and operating results of one of the Bell Companies against those of the other Bell Companies, and can require conformance of all to the conduct which best serves the public.

The FCC also has implemented new and stronger measures to protect against cross-subsidization and discrimination. The Commission has adopted sophisticated rules governing cost allocations (the "Part 64 Rules") to prevent the Bell Companies from shifting costs from unregulated enterprises such as

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manufacturing activities to their regulated telephone operations.[2/] Each Bell Company is required to prepare and have approved by the FCC a cost allocation manual that describes how costs are to be allocated between its regulated and unregulated activities. In addition, the Commission requires an annual attestation audit by independent auditors to verify that each Bell Company follows its cost allocation manual. As a final check, the Commission reviews the audit findings and the auditors' work papers.

The FCC has boosted its auditing programs in the past few years, partly in response to Congressional concerns. For instance, the FCC now makes extensive use of its automated reporting and management information system (ARMIS), which allows the FCC to compare one Bell Company's performance to that of its peers, and to compare historical trends. Because ARMIS requires all of Bell Companies to report their responses in the same format, and because it is a computerized report, the FCC is better able to compare the reports provided by the Bell Companies to determine if any one of them deviates substantially from established benchmarks.

The FCC has worked hard to develop strong relationships with the State regulatory commissions that have oversight authority over the Bell Companies' intrastate communications services. The

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2/ See Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, CC Docket No. 86-111, Report and Order, FCC 86-564, released February 6, 1987.

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FCC frequently confers with State public utility commissions to coordinate and compare regulatory activity by the various Bell Companies.

The State public utility commissions, through the National Association of Regulatory Utility Commissioners (NARUC) and similar regional associations, share information about actions taken within their territories so that improper conduct by the Bell Companies can be precluded. They assist each other with information provided by the Bell Companies to better regulate the intrastate operations of the Bell Companies.

Finally, the Commission is not a toothless watchdog. Expanded authority for fines and forfeitures of up to $1 million has been implemented, and will help deter discrimination and cross-subsidization. The FCC is committed to developing and enforcing sound rules to protect competition.[3/] We have confidence in the FCC's ability and responsibility to enforce the law and regulations.

The Commission has established other regulations to protect competition in the equipment marketplace against potential anticompetitive activity. The risk of interconnection discrimination has been limited by widespread acceptance of FCC regulations such as those that spell out the requirements for

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3/ Testimony of Alfred C. Sikes, Chairman, Federal Communications Commission, before the Communications Subcommittee, on S.173, February 28, 1991.

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interconnection of terminal equipment.[4/] Interconnection standards also have been developed by working groups of the International Telecommunication Union and other standards-setting bodies that are equally available to all manufacturers.

Moreover, the FCC has minimized opportunities for discrimination in installation, repair, and maintenance by requiring the Bell Companies to file quarterly reports that quantitatively compare the services they give themselves in these areas to the service they give to non-affiliated customers. They file annual affidavits, signed by officers, attesting that the services are qualitatively equal. Perhaps one of the most important safeguards are rules that require the disclosure of information about network interface changes.[5/] Finally, the FCC and some state public service commissions have implemented "price cap" regulations, which further minimize the incentive of the Bell Companies to engage in improper cost-shifting.

Mr. Chairman, all of these safeguards and protections are more than adequate to prevent any potential anticompetitive behavior. These safeguards will allow the Bell Companies to manufacture without impeding competition in the telecommunications equipment and customer premises equipment markets. This competition will lead to benefits to consumers,

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4/ 47 C.F.R. 64.702(d)(2) (1985). These rules were clarified in Computer and Business Equipment Mfrs.' Assn., 93 FCC 2d 1226 (1983).

5/ See 47 C.F.R. Part 68 (1985).

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increasing economic growth, and international competitiveness of American industry.

Conclusion

Mr. Chairman, H.R. 1527 is opportunity, and it is knocking at our door. We can open the door and embrace its promise for increased jobs, competitiveness, and consumers, or we can bolt the door, and watch through the window as foreign countries reap the rewards of a healthy and robust telecommunications industry. While other nations nurture and support their telecommunications industry, we shackle and bind seven of our nation's leading companies.

Mr. Chairman and members of the Subcommittee, please pledge your support for H.R. 1527. Thank you for the opportunity to present our views.

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Mr. MARKEY. Thank you very much, Mr. Ferguson.
Mr. Allen, when you feel comfortable, please begin.

STATEMENT OF ROBERT E. ALLEN

Mr. ALLEN. I appreciate the opportunity to state my position on behalf of AT&T today. I can summarize my views very simply.

Legislative proposals to permit the regional Bell operating companies to manufacture is bad public policy. They are bad for consumers, for business, for the telecommunications industry, and I believe for the Nation. These bills are being painted as pro-competitive, but I believe they are just the reverse.

They would cripple today's competitive industry, as opposed to helping it to flourish as they suggest. Proposals would not—would recreate the very structural relationship that stagnated the industry in controversy for nearly three decades, a relationship where local monopolies own their own manufacturing supplier.

The Justice Department, under three administrations, Republican and Democratic, contended this relationship was anticompetitive. In 1984, under the modification of the final judgment, the relationship was severed.

Severing the bond was seen as the only way of protecting consumers from problems inherent in having local telephone monopolies, owning captive manufacturing suppliers. Since the breakup of the Bell System, one thing has remained unchanged, another was dramatically transformed, as you have heard here this morning.

What has not changed? The telephone companies are still monopolies. What has changed dramatically, competition in the telecommunications manufacturing industry. Competition in the manufacturing of telecommunications equipment is booming domestically and in the world markets.

In 1990, as you have heard here this morning, the trade deficit for telecommunications equipment dropped 70 percent, and U.S. exports jumped 29 percent. In one of the most critical categories, switching equipment, the United States soared 500 percent in a 2-year period.

The real success is found in research and development now underway. This investment is being fueled by hundreds of firms now selling to the Bell operating companies, many of the companies did not even exist prior to the breakup. And today, AT&T's share of the Bell operating company purchases is only about half of what it was before the breakup.

There has been an explosion of new products. Competitors abound, prices are down. R&D is up, and the RBOC's are getting the benefits of what is a very highly competitive marketplace, the best, most innovative equipment in the world at the lowest prices.

That, in turn, ensures the American public of the best technology, equipment, services and prices. Competition is alive and well, and it is working. So, what is the urgency to put Humpty-Dumpty together again? What is driving this return to yesteryear?

This subcommittee has the rare advantage of answering these questions, because you have the benefit of 20-20 hindsight. You have the benefit of the experience of two areas, before and after the breakup.

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Prior to the breakup, speaking about anticompetitive behavior, unfair pricing and exclusive in-house purchasing dominated the telecommunications equipment market. This created a thicket of regulatory proceedings, dozens of antitrust suits, and the attention of Congress, including this subcommittee.

The industry's energy and attention shifted from the marketplace to the hearing room, and into the courtroom and into the halls of Congress. The industry stagnated, and the process was costly, dilatory and a drag on progress.

It took the historic decision in 1982 to eliminate the rankling and incentives for anticompetitive behavior. I would remind this committee, as it reviews proposed legislation that offers to put limits, rules and restrictions in place, that this ground was already worked over for nearly a decade.

Yet, despite concerted efforts and piles of regulation, no administrative remedy, no rules, no structural safeguard, no regulatory oversight was sufficient to overcome the problem of local monopolies versus self-dealing arrangements with captive suppliers.

Only severing the bond could open the market, and it did. The MFJ now stands as one of the great deregulatory competitive acts of the 20th century; legislating a return to yesteryear with all the possibilities for abuse will wash out these gains.

Worse, it will take American jobs and American high-tech leadership with it as the RBOC, in every partner with foreign competitors, many of which, of course, operated in protected home markets.

Clearly, the RBOC's have an intense desire to enter manufacturing, but in my opinion, desire is not enough, however intense, not when the fundamental condition of the local monopoly has not changed, and it is not enough when the consent decree has yielded consumers and the benefits and protections of a competitive marketplace that is working and is working well.

Thank you very much, Mr. Chairman.

[Testimony resumes on p. 151.]

[The prepared statement of Mr. Allen follows:]

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STATEMENT OF ROBERT E. ALLEN
CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER
ON BEHALF OF
AMERICAN TELEPHONE AND TELEGRAPH COMPANY
BEFORE THE
SUBCOMMITTEE ON TELECOMMUNICATIONS AND FINANCE
COMMITTEE ON ENERGY AND COMMERCE
UNITED STATES HOUSE OF REPRESENTATIVES

INTRODUCTION

My name is Robert Allen. I am the Chairman and Chief Executive Officer of the American Telephone and Telegraph Company ("AT&T"). It is a privilege to be here today before the distinguished members of this Subcommittee. I am pleased to have the opportunity to testify about the various bills under consideration which are designed to modify the 1982 AT&T antitrust decree, particularly with respect to its manufacturing injunction.

Mr. Chairman, AT&T strongly opposes these attempts to alter the framework of the Modification of Final Judgment or "Decree." The Decree resolved decades of dispute that had afflicted the industry, and it created a competitive marketplace structure for telecommunications. The Decree was the result of years of study and was reviewed by four Committees of Congress, including this one. It was subjected to an extensive Tunney Act review as required by statute, and was affirmed by the United States Supreme Court in 1982. It has been repeatedly ratified by the Court of Appeals in the intervening years. Indeed, just last year, the Court of Appeals specifically reaffirmed the Decree's

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manufacturing injunction, after seven years' experience, on the grounds that nothing has changed to justify its removal and that the local monopoly is still a "bottleneck" of essential facilities that gives the Bell Companies both the incentive and the ability to frustrate free and open competition.

The principal common feature of the proposed bills is the removal of the Decree's ban on the divested Bell Operating Companies' engaging in the "manufacture" of telecommunications equipment. Such a removal could well doom the competitive equipment market that has developed as a result of divestiture by again joining together the local exchange monopolies with in-house equipment suppliers. Perhaps such legislation would be understandable if the divestiture decisions had proved to be ill-conceived, or detrimental to the public interest or the health of the American economy. But nothing could be further from the truth. The decree proved that our national policy of competition works -- and delivers better products and services at lower prices to the people of this country.

Every American knows that the long distance marketplace has flourished. Today we have choices, new technologies, and ever decreasing prices. Since divestiture, long distance rates have dropped, on average, by over 42 percent. Although not as obvious to the average citizen, the same story can be told about telecommunications equipment manufacturing. Telecommunications equipment manufacturing in the United States is a dazzling success

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story, and competition is booming both domestically and in world markets. The record is clear:

- Before divestiture, the Bell Operating Companies satisfied some 95 percent of their equipment needs from their in-house supplier, Western Electric. Today the Bell Operating Companies have no affiliated suppliers as to which they would undoubtedly show preference. Rather, approximately one-half of their equipment needs are satisfied by AT&T, Western Electric's successor, and the rest comes from a variety of both domestic and foreign firms.

- In 1984 the Western Electric Company sold virtually all of its output domestically -- to the Bell Companies. In 1990 AT&T, the successor corporation to Western Electric's manufacturing activities, exported over $1.2 billion of equipment. And that number is growing.

- Since divestiture, American firms have entered the market or expanded their investment in equipment manufacturing, such that the domestic telecommunication equipment industry has a compound annual growth rate of 9.6%, double the rate for manufactured goods as a whole. Moreover, that rate has been rising. In 1990, even with the beginning of the recession, that growth rate was 11.6%.

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- This explosive competition has also produced great trade benefits, especially for products at the high end of the market. In 1989 and 1990 we witnessed a drop of 70% in the telecommunications equipment trade deficit for the United States, from $2.6 billion in 1988 to only $.8 billion in 1990. U.S. exports jumped sharply -- an annual growth rate of 29% for the same period. And, foreign imports leveled off, increasing less than 2% in 1990.

- In one of the most critical product categories -- the switching equipment used in telephone networks -- we enjoyed a trade surplus, which itself increased from $115 million in 1988 to $709 million in 1990.

But the real success story of competition is found in the accelerated rate of investments in research and development -- investments made by the hundreds of firms now selling into Bell Company markets -- and astonishing breakthroughs in areas like photonics, chip design, and many others. It is marked by new technologies the Bell companies are employing. It is characterized by new services they and other local telephone companies are bringing to their customers. It is shown in the dramatic price reductions for telecommunications equipment while new features are being added, with the per-line price for central office switches falling dramatically in the years following divestiture. It is marked by the struggle of manufacturers to win customers in a marketplace freed from allegations of captive

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supply, insider dealing, cross-subsidy and information delay -- allegations which dominated the marketplace before 1984. In short, it is a marketplace where dozens of private and government antitrust suits and long-reaching regulatory investigations have been replaced by vigorous competition.

This is not a tale of an industry which demands major legislative restructuring. To the contrary, any careful analysis of the experience in the industry over the past seven years clearly supports the wisdom of the decisions that were made at divestiture. The policy adopted at that time was right for Americans and for U.S. industry.

I would briefly like to review with you the bases for our national competitive policy decisions, and why, in the face of those decisions, the bills under consideration are unwise.

HISTORY OF ANTI-COMPETITIVE ISSUES

The United States Government has brought four major antitrust actions against the Bell System during the course of this century. Each of these lawsuits resulted in injunctions prohibiting certain actions and forbidding business activities in certain markets. The first antitrust case (brought in 1913) resulted in an agreement by the Bell System to sell its holdings in Western Union and to refrain from purchasing any more local telephone companies. The second action (brought in the 1920s)

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resulted in AT&T divesting its ownership of a nationwide radio programming network, removing AT&T from that market. The third action (brought in 1949) yielded an antitrust decree ordering AT&T to divest non-telecommunications business and to confine its manufacturing business to the production of telecommunications products. In the fourth action, begun in 1974 and lasting until the 1982 consent decree, the United States again contended that the integration of Bell telephone monopolies and competition businesses--this time--long distance telephone service and Western Electric's equipment manufacturing--was inherently anticompetitive and harmed consumers and competitors alike.

In most industries, self-dealing presents no threat to competition. That is because, in most industries, the "buyer" of in-house equipment is not a monopoly. The government contended, however, that the local bottleneck monopolies in telecommunications presented special opportunities for the Bell companies to engage in anticompetitive conduct in at least three different forms -- through granting preferential access to their generic equipment requirements and specifications, through misallocating manufacturing costs to the local telephone service activities funded by local ratepayers, and through conducting discriminatory evaluations of competing products.

Congress itself helped give the message to the Bell System that it should separate its competitive and monopoly operations. For example, in S. 1167 (introduced by Senator Hart

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in 1973), S. 898 (passed by the Senate in 1981), and H.R. 6121 (passed by the House Energy and Commerce Committee in 1980), the principal point was to address the combination of monopoly operations with competitive operations and the abuses likely to result from that combination.

The current industry structure emerged as a response to these endless and costly challenges to the Bell System's integration. The parties agreed that the best way to prevent actual and suspected abuse, as well as to eliminate the enormous social costs imposed by the constant litigation, was to impose a structural separation of the monopoly local exchanges from competitive long distance and manufacturing functions. The Decree required a clean break between the monopoly local exchanges and the competitive manufacturing operations; other forms of safeguards or injunctions were viewed as in sufficient to eliminate the abuses -- and the debates concerning those abuses -- that would otherwise occur.

Now here we are in 1991, only a few years later, with various bills that would reverse all the principles and gains upon which our new competitive telecommunications industry is based. These bills would again combine monopoly and competitive markets. They would recreate the structure of the past, and would therefore recreate all the controversy of the past, including claims of self-dealing, cross-subsidy, reciprocity, and discrimination. These bills reverse the very essence of what the United States

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Government formerly insisted upon, and they run directly counter to our national policy of promoting competition.

THE CONSEQUENCES OF REMOVING THE RESTRICTION

In light of the success that the divestiture of local exchanges from manufacturing has achieved, and continues to achieve, in promoting competition, innovation, growth, and widespread benefits for consumers, there is no sound basis in law or policy for reversing course. It is, however, not simply -- or even principally -- a question of whether these bills are needed, although the progress brought about by divestiture is itself compelling evidence that they are not. More fundamentally, it is a question of whether we are going to recreate precisely the conditions that led to claims of abuses prior to divestiture, and thereby undo all the competitive advances of the past decade. Permitting the local exchange monopolies to engage in equipment manufacturing would have devastating effects on our international competitiveness, on the state of domestic competition, and on the prices and services available to consumers.

The most immediate result of permitting the BOCs to engage in manufacturing would be a likely series of joint ventures between the BOCs and already-established foreign manufacturers. If the BOCs purchase the bulk of their equipment from these foreign-owned affiliates -- as almost everyone expects -- the American market will be opened to foreign manufacturers at the

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same time, and to the same extent, as it is being closed to domestic manufacturers. This will in turn deny American firms the chance to earn the revenues in their home market which they need to compete successfully abroad -- a difficult enough task in light of the discriminatory practices that Japan and many of the European countries already employ to discourage competition from our companies. And difficult, too, because the American market is not "protected" for American manufacturers. We have the only wide open, truly competitive market in the world, and all revenues here must be earned in the face of vigorous competition.

The foreclosing of large segments of the market to domestic manufacturers, while permitting foreign manufacturers to buy into a position of unfair advantage, would be particularly perverse and injurious to American competitiveness. A wide range of commentators, including leading antitrust and business scholars, agree.

The District Court, for example, noted the intervention in its Triennial Review of the MFJ of one of the larger European firms, which predictably supported the removal of the restriction. The Court concluded in the Triennial Review that the likely effect of such a removal would be "the displacement of small, efficient American firms by a few huge syndicates composed of foreign company and Regional Company components whose survival and domination in this environment will have been achieved by factors

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unrelated to efficiency or quality of performance."[1] And although the Administration now supports the lifting of the restriction, the Department of Commerce, as recently as 1987, expressed its concern that partnerships between BOCs and foreign manufacturers "would likely cause significant harm to American competitive technology and trade positions, and could pose the threat of destroying this country's indigenous central office equipment manufacturing capacity."[2]

The effect on the prosperity of American firms, and the opportunities for American workers, would be dramatic. A 1989 Department of Labor staff study flatly predicted that 18,000 - 27,000 American jobs could be lost if just 2 or 3 BOCs entered manufacturing, and, as the Deputy Secretary added, "possibly more" American jobs would be eliminated, "depending upon the RBOCs' behavior."[3] In light of this record, it is plain that the effects of these bills would be profound and far-reaching. Far from promoting American international competitiveness in manufacturing, these bills would advantage foreign firms at the expense of domestic manufacturers and U.S. workers.

Even if the BOCs did not join with foreign manufacturers, however, the results for domestic competition would

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1 U.S. v. Western Electric, 673 F. Supp. 524, 562 (D.D.C. 1987).

2 Assessing the Effects of Changing the AT&T Antitrust Consent Decree, 1987 NTIA Trade Report, page vi.

3 December 1989 Staff Study, Department of Labor.

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still be ruinous. If allowed into manufacturing, each BOC could be expected to look to its own affiliates for nearly all of its equipment needs, regardless of the relevant merits of competitive equipment. This would have the effect of unfairly foreclosing from competition substantial portions of the market.

It is no coincidence that it was only after divestiture that the number of American manufacturing firms, and their level of activity, grew at such an extraordinary rate. Before a business enters a particular industry, and certainly before it can attract investment, it needs to know that it will face a level playing field. Until divestiture, firms were deterred from even entering the manufacturing market because they assumed that the Bell System would purchase exclusively from its own affiliate. Firms that doubt they will be given a chance to compete on the merits will choose different lines of business. Exit from the manufacture of telecommunications equipment will be encouraged while entry is deterred. That was the result before the manufacturing and local exchange markets were separated, and the same result will quickly be recreated if the markets are reintegrated.

The threat these bills pose to domestic competition applies not only to opportunities for American workers and prosperity for American firms, but also to the research and development that has given the United States its leading technological edge. American firms will invest in research and

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development only to the extent they believe that the fruits of that investment will be marketable on its merits, and they do not believe that will happen if the BOCs are free to meet their needs simply by buying from their own affiliates. If the market is substantially foreclosed to competition, unaffiliated manufacturers will no longer have the incentive or revenue stream to support investment in research and development.

Thus far, I have been discussing the effects these bills would have on jobs and on the competitive character of the equipment manufacturing segment of the telecommunications industry. There is a much more basic and important issue -- their effect on consumers. The touchstone of our national telecommunications policy has been, and should remain, the provision of top-quality service accessible to all consumers at reasonable prices. The likely reduction in the number and strength of American manufacturing firms, and the consolidation of the market into a small number of major players (most of whom will have the luxury of selling to themselves) will substantially retard competition with respect to products, innovation, service, and price--both of telecommunications equipment and the telecommunications services offered by means of that equipment.

The effect on consumers of telephone service will be direct and immediate -- lower quality service and higher prices. In addition, permitting the BOCs to combine their regulated monopoly local telephone service with an unregulated manufacturing

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affiliate presents the BOCs with powerful incentives to engage in cross-subsidization. By purchasing products from their own affiliates at inflated prices, or by misallocating manufacturing costs as local telephone service costs, the BOCs could force their local monopoly customers to fund their manufacturing enterprise. This gives them an unfair advantage over their manufacturing competitors, who lack a similar captive source of financing. More significantly, however, it means that local ratepayers will be paying substantially more than they should for local service. Further, to the extent the inflated equipment costs are passed on to long-distance companies in the form of higher access costs for long-distance service, consumers will inevitably find their long-distance bills to be higher than they should be.

Finally, the entry of the BOCs into manufacturing will delay the possibility of genuine competition in local exchange service. Right now, we are possibly seeing the early stirrings of competition in certain limited areas. The BOCs still have the bottleneck monopoly, and still control necessary access to and from all telephone users. The nascent efforts by alternative access providers to crack that bottleneck depends on their ability to purchase innovative equipment in a competitive market at competitive prices. If the BOCs are permitted to foreclose large segments of the markets, they will then be able to eliminate or otherwise constrain the activities of the equipment manufacturers on whom the alternative providers depend. It would be unfortunate if we were to adopt a policy that had the effect of discouraging

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local exchange competition -- precisely the precondition which would enable the BOCs to enter manufacturing in the future without the anticompetitive effects that such entry would currently generate.

THE PROPOSED LEGISLATION

Let me turn to the various bills under consideration and review by the Subcommittee. Two of the proposed bills, H.R. 1523 and H.R. 1527, are patterned after S.173, the bill recently passed by the United States Senate. That bill, however, does not attempt in any meaningful way to address the significant concerns identified above. Indeed, far from protecting against the anticompetitive risks inherent in integration, S.173 and its companion House bills expressly permit the BOCs to engage in "close collaboration" with their affiliated manufacturer in the design and development of the equipment -- a virtual prescription for encouraging both discrimination against non-BOC-affiliates and the generation of numerous joint and common costs with the accompanying misallocations. Moreover, the two House bills do not even include the mild improvements to S.173 provided by floor amendments. In short, each of these bills represents a fundamentally simplistic and misguided approach to what is a very complex problem and would throw the doors wide open to abuse.

With regard to the Subcommittee staff's discussion draft, the final version of which we have not yet received, our initial review finds it to be an improvement over these other

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bills. You have recognized throughout these proceedings, Mr. Chairman, the very real dangers to American industry, American jobs, and American consumers posed by the lifting of these restrictions, and the draft bill at least acknowledges and attempts to address those dangers in a broader fashion by providing monopoly and infrastructure safeguards beyond manufacturing alone. This is commendable. Unfortunately, the problem here is the local monopoly, not the manufacturing industry, so the means chosen in the draft bill are not fully up to the task.

For example, Section 228(b)(4) of the draft bill would attempt to deal with the problem of self-dealing -- and the resultant abuse of cross-subsidy from local ratepayers -- by prohibiting the BOCs, during the first three years following enactment, from purchasing more than 70% of any type of equipment from their own manufacturing affiliates. This provision would generate a slight improvement over the other bills, but only to the extent that 30% of BOC purchases were protected against self-dealing abuses. The ultimate result would be the same -- the foreclosure of the most substantial market segments from competition -- and even the slight limitation on that foreclosure reflected in this bill would only last three years, after which each BOC would be free to become its own sole supplier.

Nor does the bill address the problem of Bellcore, a research and engineering entity jointly owned by the seven

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Regional BOCs. Bellcore was formed under the Decree with the express assumption that the BOCs would not be involved in manufacturing. It performs the research, the local exchange network engineering, and the product evaluation functions that Bell Laboratories performed for the former Bell System. The coordination of product standards and product evaluations presents the BOCs with a particularly effective vehicle for engaging in favoritism and discriminatory conduct. It appears that each of the House bills fails to address the Bellcore problem: notwithstanding the fact that the manufacturing injunction was one of the important predicates for permitting Bellcore to engage in collective activity.

With respect to the export of jobs and businesses overseas, the discussion draft has provisions that attempt to encourage domestic production of component parts. Much has been said and debated about the domestic content provisions of these bills, and I will confine myself to making one further point. The issue is not only whether the fabrication or assembly of components is done in the United States. It is also a question of where the design and development takes place. If, as is likely, the design and development takes place abroad in the laboratories of the RBOCs' joint-venture partners, then the United States will lose the high-tech jobs, and be reduced to maintaining "screwdriver factories" for products that are determined by our international competitors. This is a problem the bill does not address, and the issue of equipment design and development is at

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least as serious an issue as that of equipment fabrication and assembly.

THE INADEQUACY OF REGULATORY SAFEGUARDS

Underlying all these bills, Mr. Chairman, is the faith that regulations can be written and enforced which will prevent the discriminatory treatment, cross-subsidization, and other anticompetitive controversies about which you have so properly expressed concern. We have, however, been down that road before. This industry is so dynamic, complex, and technologically sophisticated that there is no way to monitor all the transactions and accounting so as to avoid such controversies once the regulated and unregulated businesses are reintegrated. Until the local exchanges are truly competitive, there is no basis to reverse the clean break reflected in the manufacturing injunction of the Decree, which years of litigation showed was the only truly effective safeguard possible.

Indeed, prior to divestiture, we studied possible regulatory safeguards that might be imposed to guard against anticompetitive conduct, while still enabling our businesses to function in an integrated fashion. Capable and well-intentioned people in government, industry, and academia sought to design safeguards that would address the problems -- safeguards that would satisfy the critics and end the controversies over self-dealing, cross-subsidy, insider information, and all the

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rest. None were found, although mountains of regulations and regulatory proceedings were attempted. And none curtailed the endless controversies and lawsuits concerning the Bell System's procurement activities from its manufacturing affiliate. I am convinced that stopgap safeguards which sidestep the inherent risks of integration are no more adequate to the task now than they were a decade ago.

The Federal Communications Commission, the Congress, the Bell System, and the Justice Department made massive efforts to develop ratepayer protections that would prevent abuses while allowing the integration of monopoly and competitive businesses to continue. For example, the FCC instituted proceedings to assure that BOC procurement practices were fair, that costs were properly allocated between competitive and monopoly telecommunications services, that monopoly revenues did not cross-subsidize equipment manufacturing, and that technical information was disclosed in a timely fashion. In addition, almost every state had statutes and regulatory proceedings designed to prevent abusive procurement practices from affiliated suppliers. These issues were so complex that several of these proceedings spanned decades; yet none could conclusively resolve the issue.

The Decree was designed and agreed to for the precise purpose of ending the contentious debate over self-dealing, cross-subsidies, and discrimination. The whole array of problems connected with these issues would be resurrected if the Decree

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restriction on BOC manufacturing were removed. The familiar allegation that the Bell Companies are subsidizing the prices of their equipment with revenues from monopoly ratepayers would reappear with the same force, because reintegration would restore the incentives and abilities to do exactly that. The Bell Companies would again be in a position to charge product design and development expenses to local telephone affiliates, and thereby to misallocate engineering and research costs by including them in the rate base for local telephone services. Existing concerns about the use of Bellcore as a conduit for early disclosure of essential network information would escalate.

It is not time to remove this feature of the Decree. The anticompetitive controversies which these bills threaten to unleash can be prohibited by regulatory oversight only in theory --but never in practice. Cost allocation rules are inherently arbitrary, and the only way for the FCC to determine whether they are being evaded would be to conduct virtually continuous audits of every transaction in every BOC -- a task for which the regulators are plainly not equipped.

The problem is not simply one of resources. There is simply no way for any regulator, federal or state, to second guess the decision by a BOC to purchase one piece of equipment --its own -- over a rival's offering, or to determine what the true market price really is of a specially-tailored product that is sold principally to one customer. It will always be a matter of

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subjective business judgment that is impossible effectively to review or oversee. The same is true with respect to cost identification and allocation in the rate-making process. The elimination of the manufacturing injunction would impose upon regulators a whole new set of problems which are beyond their capacity, or anyone's capacity, to address adequately. It creates incentives and opportunities for misallocation of costs, but removes the only proven consumer protection: the level playing field of a fully competitive market where the local monopolies would not have incentives to favor their own manufacturing affiliate.

Regulation is not the answer to the potential for abuse under these bills, and it is not an adequate substitute for the clear safeguards provided by the Decree's manufacturing injunction. It is not a substitute for a competitive marketplace. It is not the guarantor of competition. That is the role of antitrust enforcement. And the Sherman Act, when enforced, works.

CONCLUSION

In conclusion, I would like to thank the Chairman and the other members of this Subcommittee for insisting that views on these bills be heard, that important questions be asked, and that necessary facts be gathered. For in the end, what would passage of such a bill mean for America?

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Elimination of the full structural separation between the local exchange bottleneck and equipment manufacturing could mean the end of our competitive marketplace. It would certainly mean the end of a number of domestic suppliers who are providing new ideas, new products, new technologies, new services, and lower prices across our society. It would clearly mean further inroads into our domestic market by foreign suppliers, with the important design and development functions performed abroad. It would therefore mean the end of the explosion of consumer benefits in availability, innovation, and affordability brought about by the Decree. In short, the policy set in place by the Decree is working well, and reversing course at this time would bring back all the problems that originally led to its adoption.

An injunction on Bell entry into the manufacturing of telecommunications products and equipment markets should remain as long as the local telephone service bottleneck continues. When the monopoly power ends, when the local service markets are as competitive as the long distance markets, we will have no objection to Bell Companies entering manufacturing. For we believe that America's great strength is the result of its competitive markets. That is the thrust of our antitrust laws and that is the basic thesis of our Decree.

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Mr. MARKEY. Thank you, Mr. Allen.
Mr. Sollman, can we hear from you?

STATEMENT OF GEORGE SOLLMAN

Mr. SOLLMAN. Thank you, Mr. Chairman, Mr. Rinaldo, members of the committee. I would like to ask permission to enter my written testimony into the record.

Thank you for this opportunity to present to this committee the views of a small telecommunications equipment manufacturer regarding this bill, legislation that is critical to our corporation, our industry, and our national interests.

I am George Sollman, and I am President and Chief Executive Officer of Centigram Communications Corporation. We are a profitable, privately-held company, located in San Jose, Calif., with over 200 employees and revenues of about $40 million in this calendar year. We develop, manufacture, and market voice processing equipment that provides voice messaging capability, as well as integration with electronic mail and FAX messaging.

Centigram Communications is one of a rapidly growing number of small and mid-sized telecommunications manufacturers who support the legislation under consideration, H.R. 1527. As of today, the ad hoc coalition of companies totals at least 58 manufacturing companies, employing some 12,000 U.S. workers in 20 States, producing some $2 billion in revenues each year.

Recently, Montgomery Securities, one of this country's leading and highly respected investment bankers for high-technology companies, reached the conclusion that H.R. 1527 will lead to the more rapid development of small high-technology firms in this country.

The Montgomery Securities report, just released by their top communications industry analysts, confirms that the 58 manufacturers who have announced their support for H.R. 1527 are certainly correct when they conclude that this legislation will benefit small businesses. I have attached a copy of this Montgomery Securities report.

In summary, Montgomery Securities concludes that H.R. 1527, upon passage, would: (1) encourage close cooperation of small and mid-sized manufacturers with the regional Bell companies that would expand the U.S. telecommunications market; (2) increase the flow of capital to small and mid-sized manufacturers, reversing the current highly restricted state of capital availability; (3) provide for the cross-exchange of knowledge between the regional Bell companies and independent manufacturers, allowing small and mid-sized telecommunications manufacturers to become more competitive in today's global economy; and, (4) heighten the world competitiveness of the U.S. telecommunications industry, helping to reverse the $1.8 billion negative balance of trade in telecommunications equipment today.

I would like to make several key points regarding the modified final judgment and its impact on our business sector, as well as the relief possible under H.R. 1527.

First, the MFJ severely restricts the sources of knowledgeable capital to small and mid-sized telecommunications manufacturers.

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Increasingly, these companies cannot find capital for growth in this country.

As members of this committee, I think you are very much aware telecommunications manufacturing is incredibly cash-intensive. And small manufacturers tend to have limited resources. When a firm needs capital to turn a great idea into a commercial product, or wants to expand into new markets, there are rapidly declining alternatives. The recession, the unpredictable stock market, the banking crisis have combined to create a very challenging and limited investment and lending picture.

Bank financing is restricted and restrictive. The public equities market is constrained, and venture capital is on a general decline.

A prime example that just occurred last Friday was an article in the San Francisco Chronicle that provided the results of the recent yearend venture capital, where the venture capital investments declined by 56 percent, dropping from 1.2 billion to 518 million this last year.

We expect them to drop even further in this next year. In addition to that, the money flow into the venture funds themselves has dropped off even more precipitously.

Second, because of the MFJ, the bulk of the telecommunications R&D conducted in the United States cannot be influenced by timely, knowledgeable investments by the major purchasers and users of this technology; the regional Bell companies.

Consequently, many American telecommunications manufacturing firms seek investment capital outside the United States for growth of their businesses. This is in spite of the fact that the Bell companies are seven of the country's 35 largest companies, representing more than half the Nation's telecommunications resources and combined assets in excess of $150 billion, yet the small telecommunications manufacturers cannot avail themselves of this resource in any fashion.

Third, as a direct consequence of the MFJ manufacturing ban as described above, U.S. telecommunications R&D policy is de facto set outside our borders by the investment decisions taken outside of our borders as described above. This, it must be believed, is highly contrary to our national interests. I take this position on the basis that telecommunications is strategically critical for this country to compete in a global economy.

Four, the small and mid-sized telecommunications manufacturers of this country need the help of the regional Bell companies to hold their competitive edge. This can come in the form of both technical exchanges as well as capital investment.

Five, the legislation under consideration would establish a free market economy for many small and mid-sized manufacturers to actively meet the needs of their largest customers, the regional Bell companies.

An example that we have spent very little time on this morning so far is the prime example that GTE is larger than any of the Bell companies. It is not under the MFJ, and has exhibited highly procompetitive environment.

In my own market segment, I have seven competitors, plus ourselves, all selling to GTE. It is aggressive, highly competitive. It is

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not easy, but it is where I think we need to be at the end of the day.

Mr. MARKEY. I am afraid, Mr. Sollman, your time has expired.

Mr. SOLLMAN. Thank you.

[Testimony resumes on p. 172.]

[The prepared statement and attachments of Mr. Sollman follow:]

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Testimony of George Sollman
President and Chief Executive Officer
Centigram Communications Corporation
San Jose, California

Mr. Chairman and Members of the Committee:

Thank you for this opportunity to present to this Committee the views of a small telecommunications equipment manufacturer regarding this bill--legislation that is critical to our corporation, our industry, and our national interests.

Centigram Communications is a profitable, privately-held company, located in San Jose, California, with over two hundred employees and revenues of about $40 million in this calendar year. We develop, manufacture and market voice processing equipment that provides voice messaging capability, as well as integration with electronic mail and FAX messaging. This equipment is used by many the regional Bell companies, including BellSouth and NYNEX, and is a standard with the independent telephone companies. All seven of the regional Bell companies have purchased our equipment for various applications; however, more than 75 percent of our revenues originate from non-Bell company sources. We provide this same voice and information processing equipment to major corporations using the distribution channels of regional Bell companies such as Ameritech, BellSouth, and PacTel Meridian Systems as well as many independent distributors.

Centigram Communications is one of a rapidly growing number of small and mid-sized telecommunications manufacturers who support the legislation under consideration, H.R. 1527. As of today, this ad hoc coalition of companies totals at least 58 manufacturing companies, employing some 12,000 U.S. workers in 20 states, producing some $2.0 billion

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in revenues each year. I have attached a list of these companies as Exhibit 1. This list shows the location by state and manufactured product of each of the companies in this coalition of small and mid-sized manufacturers.

Recently, Montgomery Securities, one of this country's leading and highly respected investment bankers for high technology companies, reached the conclusion that H.R. 1527 will lead to the more rapid development of small high technology firms in this country. The Montgomery Securities report, just released by their top communications industry analysts, confirms that the 58 manufacturers who have announced their support for H.R. 1527 are certainly correct when they conclude that this legislation will benefit small businesses. I have attached a copy of this Montgomery Securities report as Exhibit 2. In summary, Montgomery Securities concludes that H.R. 1527, upon passage, would:

1. Encourage close cooperation of small and mid-sized manufacturers with the regional Bell companies that would expand the U.S. telecommunications market,
2. Increase the flow of capital to small and mid-sized manufacturers, reversing the current highly restricted state of capital availability,
3. Provide for the cross-exchange of knowledge between the regional Bell companies and independent manufacturers, allowing small and mid-sized telecommunications manufacturers to become more competitive in today's global economy, and

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4. Heighten the world competitiveness of the U.S. telecommunications industry, helping to reverse the $1.8 billion negative balance of trade in telecommunications equipment today.

I would like to make several key points regarding the Modified Final Judgement (MFJ) and its impact on our business sector, as well as the relief possible under H.R. 1527.

First, the MFJ severely restricts the sources of knowledgeable capital to small and mid-sized telecommunications manufacturers. Increasingly, these companies cannot find capital for growth in this country. Telecommunications manufacturing is incredibly cash-intensive, and small manufacturers have limited resources. When a firm needs capital to turn a great idea into a commercial product or wants to expand into new markets, it faces rapidly declining financing alternatives. The recession, an unpredictable stock market and the banking crisis have combined to create a very challenging and limited investment and lending picture. Bank financing is both restricted and restrictive, the public equities market is constrained, and venture capital is in a general decline, especially for start-up firms.

A prime example of the current situation in Silicon Valley is the recent article entitled "Venture Capital Is Drying Up," from the San Francisco Chronicle, July 5, 1991, attached as Exhibit 3. In summary, this article states that the amount of venture capital invested in new startups plunged 56 per cent, from $1.2 billion in 1989 to $518 million in 1990, based upon recent studies released by Venture Economics. The amount of new venture capital

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raised by the funds themselves this year has shown an even more precipitous fall as reported by Dick Shaeffer in Computer Letter.

Second, because of the MFJ, the bulk of the telecommunications R&D conducted in the U.S. cannot be influenced by timely, knowledgeable investments by the major purchasers and users of this technology--the regional Bell companies. Consequently, many American telecommunications manufacturing firms seek investment capital outside the United States for growth of their businesses. This is in spite of the fact that the Bell companies are seven of the country's thirty-five largest companies, representing more than half the nation's telecommunications resources and combined assets in excess of $150 billion.

Third, as a direct consequence of the MFJ manufacturing ban as described above, United States telecommunications R&D policy is de facto set outside our borders by the investment decisions taken outside of our borders as described above. This, it must be believed, is highly contrary to our national interests. I take this position on the basis that telecommunications is a strategically critical for this country to compete in a global economy.

Fourth, the small and mid-sized telecommunications manufacturers of this country need the help of the regional Bell companies to hold their competitive edge. This can come in the form of both technical exchanges as well as capital investment. Otherwise, the restrictions of the MFJ will leave the regional Bell companies standing by helplessly as foreign

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competition moves unrestrained to dominate the telecommunication marketplace, costing U.S. jobs and business opportunities.

Fifth, the legislation under consideration would establish a free market economy for many small and mid-sized manufacturers to actively meet the needs of their largest customers--- the regional Bell companies. The experience that our industry has had with GTE is highly favorable in terms of generating substantial business opportunities for our business sector. This is especially interesting because of fact that GTE is not subject to the limitations of the MFJ and is larger than any regional Bell company today. Of special note to members of this Subcommittee, GTE has exhibited pro-competitive behavior without anti-trust consequences. It would be expected that H.R. 1527 would establish an even more competitive environment and an increased equipment market based upon this experience. Furthermore, this would justifiably lead to a rich array of new product offerings for consumers that a fully-funded entrepreneurial community would make available to the regional Bell customers.

Finally, in the event in H.R. 1527 is enacted, small manufacturers would be free to negotiate a large variety of forms of financing that are appropriate in and normal for other industries. These financing forms would include such options as:

1. Equity investment in a manufacturing company through the sale of stock to a regional Bell company, or
2. Joint ventures between a manufacturer and a regional Bell company, or

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3. Loans to a manufacturer by a regional Bell company, over a prescribed period, jointly agreed to, or
4. Investments by a regional Bell company that are returned via royalties of products developed under an agreement between the regional Bell company and the manufacturer receiving the investment, or
5. Combinations of the above.

Several years ago, Centigram Communications needed major investments to take advantage of significant growth opportunities in the voice processing business. We turned--logically, we thought--to regional Bell companies Ameritech and BellSouth. It made perfect business sense to approach two of the largest and most successful telecommunications companies in the country as potential users of our product and as knowledgeable investors. So much for logic.

Our venture investment proposals were blocked by the MFJ on the basis of our manufacturing status. Left no alternative, we sought and received capital from highly knowledgeable investors in Canada and Singapore who allowed Centigram Communications to grow into the profitable company we are today. We could have grown faster and better-addressed the product needs of the regional Bells (and their customers) if the MFJ had allowed them to invest in us as well. Additionally, that investment would have used U.S. dollars to create more American jobs and opportunities.

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A similar story can be told of Speech Plus, formerly of Sunnyvale, California. This company pioneered a number of technological advances and key patents in text-to-speech technology. Speech Plus was funded initially by Ameritech as a software company. Subsequently, the product lines of Speech Plus evolved into hardware products (based upon later technology developments and market needs) that made follow-on financing impossible by Ameritech under the MFJ. Without this critical financing, the company nearly failed financially due to the cash requirements for its growth, leading it to be sold to Centigram Communications in March, 1990. If Speech Plus had disappeared it would have taken with it a very socially significant product- a product that is inserted into any personal computer today to allow blind workers to use a standard PC workstation effectively for word processing and financial spreadsheet tasks. This product, marketed by Telesensory Systems Incorporated, Sunnyvale, California, is a standard with the Social Security Administration and the Internal Revenue Service. An extension of this product is used by the famous author of A Brief History of Time, Stephen W. Hawking, to be able to speak in spite of the terrible toll that amyotrophic lateral sclerosis (Lou Gehrig's disease) has taken.

Centigram Communications and Speech Plus are but two examples. There are many more companies that can share experiences similar to those above. Small and mid-sized manufacturing firms across the country can sell to the regional Bells but cannot receive critically needed investment capital from them. It just doesn't make sense.

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This country is in serious danger of watching yet another industry go the way of consumer electronics, textiles, steel and automobiles. Our leadership position has eroded badly in the semiconductor industry, and the telecommunications industry faces the same threat today. We require the active financial and joint venture support of the regional Bell companies to retain U.S. telecommunications leadership. It is now time to take action.

This bill would help the U.S. telecommunications industry shore up a weakened and much-neglected area--R&D. The regional Bell companies collectively spend only 1.3 percent of annual sales on R&D. Other U.S. high-tech firms spend about 7 to 9 percent--Centigram Communications spends more than 14 percent. There is little reason for the regional Bell companies to spend more on R&D--they cannot participate in manufacturing or product-specific research, design and development. Moreover, under the MFJ, they cannot invest in any company engaged in such a venture.

You might expect AT&T to take up the slack, but it has spent an average of only 2 percent of annual sales on R&D since divestiture in 1984, and its R&D investment actually dropped in 1990. AT&T has closed six U.S. manufacturing plants and reduced production jobs to less than 30 percent in two others, while investing in or establishing manufacturing operations in 16 foreign countries. Clearly, AT&T shows little ability to keep American dollars and jobs in the U.S. Instead of investments in U.S. telecommunications, AT&T has been more interested in pursuing the recently completed $7.5 billion dollar unfriendly takeover of NCR.

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Before I close, I would like to make one final point. You may have heard representations by the Telecommunications Industry Association (TIA) that its members strongly and almost unanimously oppose this legislation; however, I believe the reality is quite different. I am personally aware of some 20 TIA members who manufacture telecommunications equipment who have announced that they support this legislation, and I am aware of many more who have stated privately that they support this legislation. The industry is not united, it is split. In fact, I believe that a substantial majority of all small manufacturers are in favor of this legislation for all of the benefits that they believe accrue to their long term growth interests. Therefore, I believe that the TIA should refrain from making public comments that the telecommunications manufacturing industry is overwhelmingly opposed to the passage of H.R. 1527.

To conclude, this is not a plea for protection. Quite the opposite. This bill would allow the regional Bell companies to fund research and development as well as provide venture capital and joint venture opportunities to American manufacturers. Small and mid-sized telecommunications manufacturers simply want our largest customers freed to form strategic and financial partnerships that will enable us to compete effectively in a tough international market while keeping American jobs and dollars at home.

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AD-HOC COALITION
OF SMALL TELECOMMUNICATIONS COMPANIES
PUBLICLY ENDORSING H.R. 1527

Company	Location	Business Engaged in By Company
Protocol Engines, Inc.	California	software for facilitating high speed data transmission
Eagle Telephonics, Inc.	New York Pennsylvania	telephones
Voice Control Systems	Texas	voice processing technology (including voice processing and voice recognition)
ICOM America	Washington	miscellaneous
Cobotyx	Connecticut New York	robot reception and voice mail equipment
Advanced Electronic Applications, Inc.	Washington	miscellaneous
PairGain Technologies, Inc.	California	equipment to increase use and quality of transmissions on telephone copper wire
International Mobile Machines Corp.	Pennsylvania	digital radio transmission equipment
Eldec Corporation	Washington	miscellaneous
URIX Corp.	Pennsylvania	equipment necessary to provide "900" services
Summa Four, Inc.	New Hampshire	call accounting and programmable network interface equipment for enhanced services
Applied Voice Technology, Inc.	Washington	voice and call processing equipment

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Company	Location	Business Engaged in By Company
Centigram Communications Corp.	California	voice messaging equipment
Superior Teletec	California Georgia	telephone cable and test equipment
Utlix	Washington	miscellaneous
TeleSciences, Inc.	California Illinois New Jersey	manufacturer and distributor of various equipment, including Centrex SMDR systems, network management and analysis systems, pay telephone retrofit kits, and digital microwave and lightwave transmission systems
Crest Industries, Inc.	Washington	miscellaneous
Integrated Network Corp.	New Jersey	multiplexing equipment, data switching equipment, and T1-Mux equipment
Everett Sound Machine Works, Inc.	Washington	miscellaneous
Meteor Communications Corp.	Washington	meteor burst communications technology
Adtran	Alabama	transmission equipment
Biddle Instruments	Pennsylvania	cable locating equipment and misc. test equipment
Racon, Inc.	Washington	microwave transmission equipment
Solid State Systems Inc.	Georgia Mississippi	automated call distribution equipment
International Teleservices, Inc.	Mississippi Pennsylvania Virginia	pay telephones
Silicon General, Inc.	California	transmission equipment
Nicollet Technologies, Inc.	Minnesota	voice recognition technology

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Company	Location	Business Engaged in By Company
Cortelco	Mississippi Tennessee	telephones
Frontier Communications Corp.	New York	miscellaneous
Teltrend	Illinois	transmission equipment
Multipoint Networks, Inc.	California	digital radio transmission equipment
Verilink Corp.	California	muliplexers, diagnostic monitoring systems
Phone - TTY	New Jersey	software necessary to provide telecommunications services for hearing impaired people
American Pipe & Plastics	New York South Carolina	PVC telephone conduit
Avtec, Inc.	South Carolina	specialized PBX
Communications Test Design	Pennsylvania	refurbishment and repair of various types of telecommunications equipment
Able Telecommunications, Inc.	California	digital loop carrier systems
Applied Digital Access, Inc.	California	test equipment
Keptel, Inc.	New Jersey	power supplies, network interface systems, and test equipment
Advance Concrete Products, Inc.	Michigan Illinois	miscellaneous
Applied Innovations, Inc.	Ohio	data communications equipment, data multiplexing equipment, protocol conversion units, and fiber optic mediation devices
EMAR, Inc.	Indiana	housings for telephone switching equipment

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Company	Location	Business Engaged in By Company
SLT Communications, Inc.	Texas	distributor of telephone systems
Trimm, Inc.	Illinois	jack panels and jack fields, DSX panels, patch cords, and terminal blocks
XY Resources Inc.	Oklahoma	miscellaneous equipment for telephone central offices
HealthTech	Illinois	equipment allowing for monitoring health conditions of elderly and chronically ill people
LC Technologies, Inc.	Virginia	computer device enabling people with physical disabilities to communicate more easily than otherwise is possible
Kurzweil Applied Intelligence, Inc.	Massachusetts	speech recognition products
Microwave Networks Inc.	Texas	microwave systems and components
Indiana Electronic Manufacturers Assoc.	Indiana	Indiana trade association representing electronic manufacturers in Indiana
X-10, Inc.	New Jersey	products for physically disabled people
Trident Technologies Corp.	Connecticut	technology to improve communications for the hearing impaired
Telect	Washington	miscellaneous
Seiscor Technologies	Oklahoma	miscellaneous
Ambox, Inc.	Texas	miscellaneous
Restor Industries, Inc.	Florida	miscellaneous
Bejed, Inc.	Oregon	miscellaneous
Accurate Electronics, Inc.	Oregon	miscellaneous
Oval Window Audio	Maine	audio assistive devices for hearing impaired people
The Tigon Corp.	Texas	voice messaging business
AmPro Corp.	Florida	miscellaneous

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MONTGOMERY SECURITIES

INDUSTRY OVERVIEW
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July 2, 1991
DJIA: 2973
S&P 500: 378

RHC Deregulation Movement: Benefit to Small Telecom Manufacturers

The movement to release the restrictions imposed by the Modification of Final Judgment ("MFJ") on the Regional Holding Companies ("RHCs") has gained important momentum with the passage of Senate Bill 173 ("S.173"). This bill seeks to free the RHCs from the telecommunications manufacturing restrictions imposed by the 1984 MFJ ruling. Companion bills have also been submitted to the House. While the political outcome of the legislation is far from certain, it is our opinion that the passage of legislation granting the RHCs some form of manufacturing relief (outright ownership, minority interests, joint ventures) is a question of when and not if. The issue is politically complex but is likely to be resolved during this session of Congress (1991-1992). When it does occur, we would expect the following impact on the telecommunications companies in our universe:

- **Losers:** AT&T would be a clear loser. AT&T is too large to be an acquisition target and is unlikely to be a R&D joint venture partner. AT&T is currently leading the opposition to S.173.
- **Uncertain:** The effects on Northern Telecom and other foreign headquarterd manufacturers (Siemens, Ericsson) are less certain. Like AT&T, it is likely that the foreign headquartered manufacturers would face increased competition in certain product areas. However, like the small telecom manufacturers, the foreign headquartered companies could form R&D partnerships between their U.S.-based manufacturing operations and the RHCs.
- **Winners:** Each manufacturing company in our coverage area could benefit at one level or another. Should some form of relief come, we believe the RHCs would look to joint venture/acquire manufacturers rather than ramp manufacturing from a standing start. We note the RHCs have already exhibited an acquisitive streak in allowed, non-regulated lines of business (cellular, financial services). The most obvious examples of potential winners are those companies that have a high degree of customer concentration within the RHCs including:
  - DSC Communications (DIGI)*
  - Digital Sound Corp. (DGSD)*
  - Laser Precision (LASR)
  - Octel Communications (OCTL)*
  - Telco Systems (TELC)*
  - Tellabs (TLAB)*

The next obvious candidate would be Network Equipment Technologies (NWK) which sells a telephone network-oriented product although predominantly sold to date into private corporate networks. While less

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likely, we would not rule out the possibility of the RHCs using MFJ relief as a means for becoming aggressive in the LAN/data networking sector as well (SynOptics Communications*, Cabletron Systems, Cisco Systems*).

At minimum, we believe the legislative outcome of the discussions provide a stock price floor for the stocks in our universe.

Background

On June 5, 1991, the U.S. Senate passed S.173, the Telecommunications Equipment Research and Manufacturing Competition Act of 1991, by a floor vote of 71-24. A companion bill, HR 1527 sponsored by Representative Slattery (D.-Kansas), has been introduced into the House of Representatives. S.173, sponsored by Senator Hollings (D.-S.C.), seeks to relieve the RHCs from the ban on manufacturing imposed by the 1984 MFJ. The MFJ set the conditions and guidelines for the break-up of AT&T. The MFJ specifically prohibits the RHCs from three main areas of business: long distance services, information services and manufacturing. The intent of the manufacturing limit on the RHCs was to prevent non-competitive business practices by captive, RHC manufacturing subsidiaries. Under the MFJ, manufacturing is defined to include product design and development (hardware and certain kinds of software) as well as the actual production of equipment. S.173 and HR 1527 seek only to provide relief from the manufacturing restrictions. S.173 contains domestic content provisions and anti-competitive behavior safeguards.

Opponents of S.173 warn that freeing the RHCs to manufacture would lead to the return of the anti-competitive behavior common before the divestiture including cross-subsidization and discrimination in purchasing, interconnection and information disclosure. Opponents assert that deregulation will stifle R&D investment, lead to RHC/foreign manufacturer joint ventures and increase competition for smaller manufacturers.

RHC Deregulation: A Benefit to Small Telecom Manufacturers

While there are points well taken on both sides of the issue, we believe allowing the RHCs to develop and manufacture telecommunications equipment would benefit small telecommunications manufacturers. In our view, manufacturing deregulation would:

- **Expand the RHC Market:** Close cooperation with the RHCs in product design and development could expand the $20 billion U.S. telecommunications equipment market for small to mid-size manufacturers.
- **Increase Capital Flow:** The flow of capital to small and mid-size companies is currently severely restricted. Telecommunications equipment manufacturing is cash intensive and small companies face the limited and restrictive financing alternatives of bank credit, public equities markets, and venture capital. Many companies have turned to foreign capital sources, while others have been acquired by foreign companies Over 70 telecommunications companies, representing an investment of over $3 billion, have been acquired by foreign companies since 1984.
- **Transfer RHC Knowledge to R&D Efforts:** Currently, the majority of telecommunications R&D cannot be directly influenced by the vast knowledge base of the largest purchasers of this technology, the RHCs The RHCs cannot work closely with independent manufacturers in the design and development of hardware and certain software products Smaller companies do not have the capital or knowledge necessary to compete and often lose contracts to

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larger foreign manufacturers. As a result, the percentage of new telecommunications patents held by U.S. companies has dropped from 69% to 48% during 1974-1987. We believe the extensive knowledge base of the RHCs would assist smaller companies in the development of new and innovative products.

- **Heighten Worldwide Competitiveness:** We believe the inability of the RHCs to fund and cooperate on R&D activities with manufacturers has contributed to the current negative U.S. balance of trade in telecommunications equipment. The telecommunications balance of trade has moved from a surplus of $200 million in 1982 to a $1.8 billion deficit in 1990.

  Having access to capital and the latest technological expertise would enable smaller manufacturers to strengthen their competitive position relative to foreign manufacturers through strategic partnerships/joint ventures with the RHCs.

Sam Ginn, Chairman and CEO of Pacific Telesis shares our belief that relief from the manufacturing restrictions would strongly benefit small manufacturers. "I believe that small companies which develop telecommunications equipment would be among the biggest winners if the ban were lifted. The ban was supposed to help them, but in many cases it has hurt them by preventing them from working closely with companies, such as ours, that could be their very best customers. If there were no ban, I anticipate we would seriously consider providing more capital funding than we can today to small manufacturers in whom we have confidence. I also expect we would try to work closely with companies—in Silicon Valley, for instance—that develop software-based services."

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* Company in which Montgomery Securities currently maintains a market. Montgomery Securities was co-manger of common stock offerings for Digital Sound in February 1990. Montgomery Securities was co-manager of convertible subordinated debenture offerings for Network Equipment in May 1989, and DSC Communications in August 1989.

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San Francisco Chronicle
BUSINESS

Venture Capital Drying Up

Startups having a tougher time as funds become more cautious

By John Eckhouse
Chronicle Staff Writer

Although best-known for making risky investments — and big profits — in new high-tech companies, many venture capitalists suddenly seem afraid to take chances with their money.

The amount of venture money invested in the first-round financings of startup companies plunged 56.3 percent to $518 million last year from $1.2 billion in 1989, according to Venture Economics Publishing Co.

Instead, venture capitalists put their money into the more stable, growing companies they had started previously. First-round financings accounted for only 27 percent of all venture capital invested last year, down from 35 percent in 1989, 42 percent in 1988 and 56 percent in 1981.

It's as startling a change as the Oakland A's Jose Canseco deciding to quit swinging for the fences and stick to hitting singles in order to raise his batting average.

"The venture capitalists are becoming more risk averse — they're looking to invest in more mature later-stage companies, which can give them a more certain, albeit smaller, return on their money," said John Bonnanzio, editor of the Needham, Mass.-based Venture Capital Journal owned by Venture Economics Publishing.

The change in financing practices has caused consternation among many Silicon Valley entrepreneurs, unable to obtain the money to turn their dreams into reality. Only 259 startups, down from 538 the previous year, received venture money last year.

Richard Shaffer, editor and publisher of the Computer Letter, calls 1990 "the year the Great American Venture Capital Machine began to slow down." Industry pundits used to say there was too much money chasing too few good deals, but today there seem to be too many deals chasing too little money.

A sharp decline in the amount of available venture capital coupled with pressure from investors to improve the funds' performance have caused major alterations in the industry.

The amount of venture dollars raised from investors has fallen off in each of the past three years. After rising spectacularly from $170 million in 1979 to a peak of $4.2 billion in 1987, the amount of new capital committed to private venture capital funds dropped to just $1.8 billion last year.

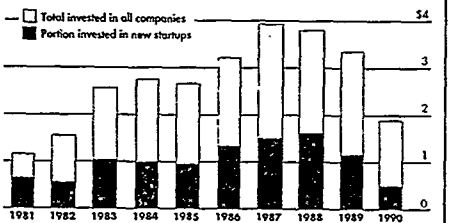
Part of the reason had nothing to do with the venture business — problems in the real-estate industry meant many investors had less money to

See Page B10, Col. 1

U.S. VENTURE CAPITAL PICTURE

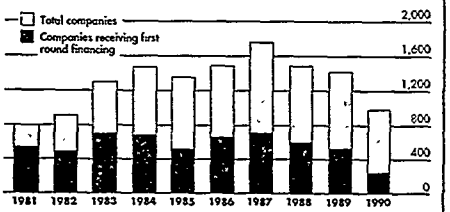
Less Venture Capital Available ...

Venture capital disbursements, 1981-1990, in billions



... Means Fewer Companies, Especially Startups, Get Financing

Number of companies



Source: Venture Economics Publishing Co

CHRONICLE GRAPHIC

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VENTURE

From Page B1

risk. But the funds' falling profits in the second half of the 1980s also took a toll. After posting 25 percent compound annual rates of return during the 1970s, single-digit profits now are commonplace. That sent many investors running for the sidelines.

"We've been told we're one of the top-performing funds launched in 1985 and yet we find it difficult to raise money for a new fund in the 1991 environment," said David Gold of Indosuez Technology Group in Menlo Park. El Dorado Ventures took twice as long as it expected, 14 months, to raise the $27 million for its third fund that closed on May 9th — the first of the country's 300 or so venture capital firms to close a fund this year.

With less money coming in the front door, it's no wonder the funds have less to hand out. Venture Economics Publishing reported last week that total disbursements dropped 43 percent to $1.9 billion last year from the year before.

That's the lowest level of investments since 1982. Based on preliminary figures for the first quarter of 1991, Bonnanzio warns that venture capital disbursements could fall another 50 percent to the $1 billion level this year.

"With less money in circulation, venture capital partnerships recognize they must put aside larger reserves for the companies they help launch," said Robert Momsen of InterWest Partners in Menlo Park. "You can't count on getting a lot of other venture capital investors interested in participating in second- and third-round financings."

Having to husband scarce resources for later-round financings cuts the amount of money available for new startups. AVI Management Partners normally puts 75 percent of its money into early stage financings, but that has dropped to 50 percent lately.

"We're being very conservative as far as allocating resources to our new companies," said partner Chuck Chan.

The sudden rash of conservatism at many funds also comes from the behind-the-scenes pressure exerted by the limited partners (the pension funds, foundations and insurance companies) that contribute the bulk of the venture capital. Stung by the poor performance of many funds — some are showing compounded annual returns no better than a passbook savings account and a few may not return a profit at all — normally passive investors are becoming restive. "The venture capitalists would probably be happy to continue to stand at home plate and try to belt out home runs, but they are feeling incredible pressure from the limited investors to win more ball games," said Bonnanzio. "The limited partners are saying they want more certain returns and they want them earlier."

Venture funds normally do not provide limited partners with a return on their investment until the end of the seven- to 10-year life of the fund. But to pacify investors, many funds now are considering distributing some profits earlier.

To do that, they are investing less in early-stage companies and more in less risky second- and third-round financings. The latter companies also offer a chance to cash out earlier, since they are closer to selling their stock to the public.

In order to raise money for new funds, some venture capitalists have had to agree to lower fees or to defer distributing profits to the general partners until the limited parters receive a prescribed return on investment.

"The limited partners are trying to exert more and more control on the venture capital community and the terms are not appealing," said Ann Winblad of Hummer Winblad Venture Partners in Emeryville.

The pressures of fund raising, satisfying limited partners and managing to nurture successful companies are taking a toll on the industry. Shaffer's newsletter counts at least 10 venture capital firms that left the business last year and several more that have become inactive in what clearly is becoming an industry consolidation.

"This is a diet for the industry, not a shakeout because that implies it's going to happen quickly," said Brook Byers, partner at Kleiner Perkins Caufield & Byers. He insists the industry slim-down will affect only the younger, weaker participants.

"The people who have not produced good returns or devised a strategy for competing in the '90s, who have not hired good talent and who have not found ways to manage that talent are not going to get funded," he said.

To cope with the industry's new realities, KPCB has abandoned its old policy of making all partners generalists. Whereas they used to spend the morning working on a desktop software deal, the afternoon on a biotechnology venture and the next day on a networking company, the partners now specialize. To keep up with the fast-paced technology, KPCB venture capitalists now spend as much time going to conferences, reading obscure scientific journals and being tutored in technology as on the details of financing. Neither Byers nor Gib Myers of the Mayfield Fund anticipate problems raising upwards of $100 million for their next venture funds. That confidence has made both old-line venture funds extremely aggressive in the current environment, with both pouring just as much money into seed- and first-round financings in the past 12 months as in any other 12-month period.

"I don't see any of the dozen or so major firms out here being more risk averse," Myers said.

For the average firm, however, the numbers compiled by Venture Economics Publishing say otherwise. Fewer startups received money last year and the amounts they obtained from venture capitalists fell sharply from previous years. Only 38 companies received seed financing — generally a few hundred thousand dollars to see if an idea has enough promise for further development — down from 105 in 1989. Seed financing dropped 57 percent to $60 million, while what Venture Economics calls startup capital dropped 50 percent to $142 million.

California remained the dominant recipient of venture investments, although the $714 million provided to venture-backed companies in the state represented a 41 percent decline from 1989. Venture dollars disbursed in Massachusetts, the second-ranked state, dropped 35 percent to $215 million.

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Mr. MARKEY. So, Mr. Sollman speaks for one group of small companies that would support generally the lifting of the restrictions.

Mr. Birck, you are our last witness. You represent the Telecommunications Industry Association, and they generally represent the smaller high-tech companies out there in the American high-tech world. Why don't we hear from you, and then we will go to questions.

STATEMENT OF MICHAEL J. BIRCK

Mr. BIRCK. Thank you, Mr. Chairman, and members of the subcommittee.

Let me first state that Telecommunications Industry Association [TIA] represents both large and small manufacturers of telecommunications equipment in this country. We have 550 or so members, and they range in size from AT&T to some of the very small companies.

This is a complex issue, and that has been noted many times here. TIA's position on this issue, I think, is quite simple. And what I would like to do is basically leave two messages or two aspects of the same message with you, and a few supporting comments for those messages.

The first is the MFJ and divestiture have had dramatic positive impact on the domestic telecommunications industry, on consumers and on the U.S. economy.

The second is lifting MFJ manufacturing restrictions at this time would pose serious and unnecessary risks to competition, to consumer welfare, and to competitiveness of the U.S. telecommunications manufacturing industry in general.

With regard to the first point under MFJ equipment, prices have declined. Industry R&D expenditures and quality of products have risen. The proliferation of new and improved products speaks for itself, and equipment is available from a very, very wide range of suppliers, substantially larger range of suppliers than ever has before existed.

I can't help but introduce personal experience in these discussions. I am also President and CEO of one of those relatively small telecommunications manufacturing companies that started in business just before the divestiture took place, and has survived for 17 years, and through this period. That company is named Tellabs.

We are a little over $200 million in sales. Since 1982, our sales have tripled, despite price reduction in every single product we manufacture. Our R&D budget has increased from $3.7 million in 1982, which amounted to 6.5 percent of our sales at that time, to over 31 million, and about 15 percent of our sales, in 1990.

And our international sales more than doubled in just this last year. But we are not alone in having experienced some of these sorts of things. By severing the ties between the Bell operating companies and their affiliated manufacturer at the time, Western Electric, and the prohibition on their reentry into manufacturing, the MFJ has spurred competition, innovation, efficiency and growth throughout the domestic telecommunications industry.

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The increasing strength of U.S. manufacturers is reflected in the Commerce Department's most recent trade figures, which show 1990 U.S. trade surplus increased by over $1 billion.

Now, with regard to point two: The dangers we see in lifting the MFJ restrictions are really related to what we think is the inevitability of a return to practices which limit competition, which limit innovation, and which have a negative effect on efficiency and growth within our own domestic industry.

Biased procurement practices, which really was the reason for—one of the reasons for the MFJ in the first place, would tend to exclude independent manufacturers from a substantial portion of the market for many types of equipment, and we as a trade association believe that is a danger we don't need to face at this time.

The adverse effects are likely to be most pronounced for the smallest manufacturers. While a few of these small companies might possibly prove attractive to RBOC acquisition, those firms that are not so acquired will probably find it increasingly difficult to survive.

The Bell operating companies have worked hard to enlist the manufacturers to support their position, generally with very little success. Support for removal of MFJ restrictions among domestic manufacturers is very limited. A handful of U.S. companies have expressed limited support for RBOC's, and work with RBOC's in developing new products.

TIA believes MFJ is not as restrictive as RBOC's and some of their allies——

Mr. MARKEY. Mr. Birck, if I may, your time has expired as well.

[Testimony resumes on p. 259.]

[The prepared statement of Mr. Birck follows:]

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STATEMENT OF MICHAEL J. BIRCK

Mr. Chairman and Members of the Subcommittee:

My name is Michael Birck. I am the Chairman of the Telecommunications Industry Association, a national trade association whose membership includes over 500 manufacturers and suppliers of all types of telecommunications equipment and related products. TIA's members are located throughout the United States, and collectively provide the bulk of the physical plant and associated products and services used to support and improve the U.S. telecommunications network. In addition, TIA members are involved on an ever-increasing basis in providing telecommunications equipment and services in other developed and developing nations around the world.

I am also President and Chief Executive Officer of Tellabs, Inc. of Lisle, Illinois, a manufacturer of high-technology telecommunications equipment for sale to local telephone companies, interexchange carriers and other telecommunications providers, as well as private users. Tellabs was founded in 1975. Today it is a public company with over 2,200 employees and annual sales for 1990 of approximately $211 million.

I appreciate the opportunity to appear before the Subcommittee to convey to you TIA's position on the important public policy issues raised by legislative proposals which would in effect remove the manufacturing "line of business" restriction imposed on the divested Bell Operating Companies (BOCs) under the terms of the Modification of Final Judgment (MFJ), the consent decree entered in 1982 in settlement of the government's antitrust suit against the Bell System.

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TIA supports Congressional efforts to ensure that the line of business constraints contained in the MFJ remain consistent with our national interest. However, while Congress has both the right and the responsibility to review and alter the current legal and regulatory framework to further the national interest, TIA continues to believe that removal or substantial modification of the MFJ manufacturing restriction would have a significant adverse impact on competition, innovation, consumer welfare, and the competitiveness of the U.S. equipment industry in domestic and foreign telecommunications markets.

BOC Participation in Technology Development Under the MFJ

The Bell Operating Companies contend that the MFJ manufacturing restriction precludes them from making a significant contribution to the evolution of more efficient and innovative telecommunications products designed to meet the increasingly complex needs of the BOCs, other carriers, and end users. Nothing could be further from the truth.

Under the MFJ, the BOCs are permitted, and indeed encouraged, to play a major role in the evolution of new telecommunications technologies, services, and equipment. Appended to my testimony is a chart (Attachment A) which depicts the broad range of technology and equipment-related activities which the BOCs may engage in under the MFJ. As the chart indicates, the manufacturing restriction in fact encompasses a relatively narrow range of activities i.e., in general terms, the design and/or fabrication of telecommunications equipment or CPE. Moreover, contrary to the BOCs assertions, the

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MFJ does not bar them from engaging in an interactive dialogue with manufacturers who are engaged in those facets of the equipment business which the BOCs are precluded from entering. See Minority Views of Senator Inouye, Commerce Committee Report on S. 173, S. Rpt No. 102-41 (April 19, 1991) at 63-64.

The MFJ permits the RBOCs themselves to engage in basic and applied research into new technologies which may ultimately lead to improvements in telecommunications. Individually and through Bellcore, the BOCs are actively engaged in such research. In addition, consistent with the terms of the MFJ, the BOCs are extensively involved in network and systems engineering and a broad range of software development activities. Through their procurement-related activities (e.g., establishment of generic requirements, dissemination of network-related information critical to the design of equipment for use in or connection to the BOCs' networks, product testing, quality assurance) and through their involvement in industry standard-setting initiatives, the BOCs have an enormous impact on the evolution of new telecommunications equipment and CPE.

The significant contribution which the BOCs and Bellcore have made, and continue to make, in the area of research and development under the MFJ is frequently overlooked or given short shift by the BOCs, in their effort to build a case for removal of the MFJ manufacturing restriction. The BOCs collectively spend well over a billion dollars each year to support their own R&D activities. As the largest domestic purchasers of telecommunications equipment,

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each of the RBOCs also provides substantial support for the R&D programs of an increasingly diverse group of small, medium and large businesses engaged in manufacturing an ever-expanding array of products designed to meet the diverse needs of the BOCs and their customers. Moreover, because they are precluded from telecommunications equipment manufacturing, the BOCs have a strong incentive when making purchasing decisions to base those decisions on the basis of cost and the quality of the product, rather than the corporate affiliation of the supplier.

The RBOCs and their supporters have further suggested that the MFJ manufacturing restriction prevents the RBOCs from communicating with manufacturers during the product design and development process to ensure that the products which emerge correspond to the BOCs' needs. TIA does not believe that the BOCs are precluded from engaging in an ongoing constructive dialogue with their suppliers. In point of fact, the level of cooperation and interaction between the BOCs and equipment manufacturers -- in the establishment of network standards, in the development of generic specifications, in the technical analysis of products which have been or may be purchased by the BOCs, and in addressing equipment compatibility problems as they arise -- has increased substantially under the MFJ.

Indeed, one of the principal benefits of the MFJ has been to create an atmosphere in which the Bell Operating Companies have established a more open, cooperative relationship with the entire equipment manufacturing community. As the Vice-President of

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Technology Systems for Bellcore has observed, in describing the progress achieved by the industry since divestiture:

> Not only have we solved the immediate problems of divestiture, but we have, as an industry, moved well beyond our immediate post-divestiture circumstances. In particular, we have seen major progress towards the opening of the telecommunications marketplace through a free flow of information on architectures, requirements, and interfaces. The response has been an outpouring of products that Bellcore's clients are using to grow and evolve their networks, to provide existing services more economically than heretofore and to provide new services. . .
>
> In January 1984, our supplier database contained 2000 companies; by January 1986, that number had grown to 4850, and now [in 1989] we have 9000 suppliers in our database and 500 shelf feet of supplier information in our library. . . .
>
> The two-way communications that has been established between Bellcore and the telecommunications supplier community is one of the successes of divestiture.

This new relationship has grown broader and deeper over time, as the BOCs have become attuned to the benefits of working with a number of vendors to better define their needs and to facilitate the development of products which meet those needs. For example, a February 19, 1990 article in Communications Week described Bellcore's active participation in the removal of "one of the biggest stumbling blocks in deploying intelligence in the public network" -- i.e., the development of a viable means of connecting two vendors' central office switches to facilitate the transmission of ISDN calls using the new Signalling System 7 functionality -- through the cooperative efforts of Bellcore and the two vendors, AT&T Network Systems and Northern Telecom Inc.

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Clearly, continued enhancement of the relationship between Bellcore, the BOCs, and the vendor community at large works to the benefit of all parties. Without question, the ability of Bellcore and the BOCs to serve as "honest brokers" among competing manufacturers has made the transition to a multi-vendor environment far easier and more productive. To the extent that the relationship between the BOCs and their suppliers can be improved or strengthened, without creating renewed incentives for discrimination among vendors and other anticompetitive behavior, TIA is supportive of such efforts.

Beneficial Impact of MFJ on Telecommunications Equipment Industry and Consumers

TIA takes strong exception to the flawed premise which underlies proposals to lift the MFJ manufacturing restriction, i.e., the notion that the telecommunications equipment industry in the U.S. is "on the brink of disaster" and that removal of the MFJ restriction is needed in order to "rescue" the industry and make it globally competitive. In point of fact, the more competitive, dynamic industry structure which has emerged under the MFJ has greatly strengthened the domestic telecom manufacturing sector, which today includes literally thousands of firms, many of them among the world leaders in the development of advanced telecommunications products.

As the attached statistical study of the post-divestiture U.S. telecom manufacturing industry (Attachment B) vividly demonstrates, the MFJ has had an extremely beneficial impact on the domestic

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manufacturing sector, on consumers of telecommunications equipment and services, and on the U.S. economy as a whole. Since divestiture, equipment prices have declined -- in many instances dramatically -- from pre-divestiture levels, the quality of products in all areas has been greatly enhanced, industry research and development expenditures have risen, many new competitors have entered the market, the efficiency and competitiveness of U.S. manufacturers has increased, and there has been a proliferation of new and improved telecommunications products and services.

My own company's experience since the divestiture provides a good illustration of the beneficial impact of the MFJ within the domestic telecom equipment industry. Since 1982, the year the MFJ was approved and entered by the District Court, cur business has more than tripled, with annual sales revenue increasing from $57,217,000 in 1982 to $211,046,00 in 1990. Building on the progress it has achieved in developing and marketing state-of-the-art telecommunications products in the U.S., Tellabs' is now in the process of expanding its efforts to penetrate telecommunications markets outside the U.S. In 1990, Tellabs international sales were over $25 million, an increase of more than 125 percent over 1989 sales.

A number of companies which did not even exist prior to divestiture have since emerged as viable competitors in U.S. equipment markets. As the attached industry study indicates, the total number of domestic telecom manufacturers increased substantially between 1985 and 1988, with the industry's 7.1%

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compound rate of growth far exceeding the economy-wide average of 1.6%.

The interests of American business and residential consumers of telecom equipment and related services have also been well-served under the MFJ. Price and non-price competition (with respect to items such as warranty protection, delivery schedules, and after-sales service) has been very intense. During the immediate post-divestiture period, prices for products purchased by the BOCs from Western Electric (now AT&T Technologies) declined dramatically as the BOCs began to develop alternative sources of supply. For example, prior to divestiture, one of my company's products routinely used by local telephone companies sold for just under $1300 per circuit. By 1986, the price for this product, which had been significantly improved in the interim, was approximately $650 per circuit. The more competitive marketplace which has emerged under the MFJ continues to exert enormous downward pressure on prices, forcing manufacturers to make maximum effort to control costs for existing and newly-introduced products. Digital cross-connect equipment which Tellabs introduced in 1985, at a list price of $1,800, is currently marketed at a discounted price of just under $700; a similar product which originally sold for $2,175 is now priced at just under $900. Moreover, each of these products has been significantly upgraded to provide increased functionality.

In summary, the more open, dynamic environment created by the MFJ has yielded significant growth, reduced prices, and increased

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innovation throughout the domestic equipment industry, producing substantial benefits to American businesses, consumers, and the U.S. economy.

Positive Impact of MFJ on Industry R&D Investment

To succeed in the highly competitive post-divestiture environment, U.S. manufacturers have had to become increasingly efficient, innovative, and quality-conscious. The MFJ has provided tremendous opportunities for growth, by creating a new industry structure in which all manufacturers are able to compete on the merits of their products for sales to the BOCs and other potential customers. These opportunities, and challenges, arising from the new, more competitive industry structure bolstered by the MFJ have provided Tellabs and other U.S. manufacturers with strong incentives to improve and expand their research and development programs.

Since the MFJ was adopted, Tellabs has increased its annual R&D commitment from $3,697,000 (or 6.45% of total sales) in 1982 to $31,565,000 (approximately 15% of total sales) in 1990. Reports show that the industry's overall expenditures on R&D have also grown substantially under the MFJ, with communications company-funded R&D rising from $1.6 billion in 1977 to $5.5 billion in 1987. The efficiency of the industry's aggregate R&D investment has also been enhanced in the more competitive environment fostered by the MFJ.

This increased commitment to the development of new and improved telecommunications technology clearly has paid significant

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dividends. From 1980 to 1988, U.S. factory shipments of telecommunications equipment increased dramatically from $36.0 billion, to $74.2 billion in 1988, despite price reductions in all major product areas.

Impact of the MFJ on U.S. Trade and Competitiveness

The strong (and rapidly improving) performance of the domestic telecom manufacturing industry in overseas markets provides strong corroboration for the proposition advanced most recently (and eloquently) by Michael Porter in his book The Competitive Advantage of Nations, i.e., that vigorous domestic rivalry serves to facilitate the creation and maintenance of "competitive advantage" in an industry. The emergence of a more open, intensely competitive equipment marketplace in the U.S. has forced American manufacturers to become increasingly creative and efficient in meeting the needs of their customers. As a result, U.S. manufacturers are now better able to compete both domestically and in overseas markets.

The American position in international trade in telecommunications equipment is stronger than it has been since before divestiture and continues to improve. As the attached summary of data compiled by the Commerce Department (Attachment C) demonstrates, the trade deficit for all types of communications equipment fell dramatically from a $1.9 billion deficit for 1989 to $792 million in 1990, i.e., an improvement of over $1.1 billion in one year! The 1990 figures reflect a substantial (24.7%) increase in exports as compared with a much smaller (1.6%) increase in

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imports. At this rate, the United States may well enjoy an overall trade surplus in telecommunications equipment by mid-1991.

Government trade figures reveal that the bulk of the remaining telecommunication trade deficit relates to "lower end" customer premises equipment, (e.g., telephone handsets, facsimile machines, cordless phones). The rapid growth of imports in this area began well before the divestiture, following implementation by the FCC of its Part 68 equipment registration program. Significantly, while the more open, competitive marketplace fostered by the MFJ has provided opportunities to foreign, as well as domestic equipment suppliers, the U.S. continues to maintain a trade surplus in network switching and other high-technology telecommunications products.

Moreover, the trade surplus in high-technology telecom products -- i.e., switches, mobile communications equipment, transmission equipment, communications satellites, fiber optics, and other sophisticated equipment -- has increased substantially over the past several years. For high-end products, the U.S. achieved a trade surplus in 1990 of $2.3 billion, up from $1.1 billion in 1989.

Of particular interest, U.S. producers are becoming increasingly successful at exporting even to countries with strong indigenous industries and markets historically closed to U.S. producers. These include Germany, where U.S. exports increased 157 percent comparing 1989 and 1990; France, where U.S. exports increased 25 percent; Taiwan, where U.S. exports increased 82

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percent; Japan, where U.S. exports increased 10 percent; and Canada, where U.S. exports also increased 43 percent. The growing strength of domestic manufacturers in high-tech telecom equipment markets is reflected in the Commerce Department's continually improving trade figures, which show a reduction in the overall U.S. balance of trade in telecommunications equipment from $2.6 billion in 1988 to less than $.8 billion in 1990, despite continued declines in consumer and mass market product categories.

Need to Retain the MFJ Manufacturing Restriction

In assessing the wisdom of proposals which would eliminate the MFJ manufacturing prohibition, it is important to recall the long history of antitrust litigation which led to imposition of the restriction in the first instance. Entry of the MFJ ended more than 30 years of controversy focusing on the competitive problems associated with AT&T integration into adjacent, potentially competitive equipment markets. The Justice Department's 1949 antitrust complaint focused almost exclusively on the Bell System's efforts to impede competition in the manufacture and sale of telecommunications equipment. In the 1949 litigation, the Justice Department advocated a structural remedy involving the divestiture of the Bell Operating Companies' manufacturing affiliate, Western Electric. However, the Department later bowed to political pressure and agreed to a settlement which allowed the Bell System to retain its manufacturing operation. Following extensive investigative hearings exploring the circumstances surrounding

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