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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 17
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186

BY

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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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COMPETITION POLICY IN THE TELECOMMUNICATIONS INDUSTRY: A COMPREHENSIVE APPROACH (PART 1)

HEARING

BEFORE THE

SUBCOMMITTEE ON
ECONOMIC AND COMMERCIAL LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED SECOND CONGRESS

FIRST SESSION

AUGUST 1, 1991

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COMPETITION POLICY IN THE TELECOMMUNICATIONS INDUSTRY: A COMPREHENSIVE APPROACH (Part 1)

THURSDAY, AUGUST 1, 1991

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ECONOMIC AND COMMERCIAL LAW,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2141, Rayburn House Office Building, Hon. Jack Brooks (chairman of the subcommittee) presiding.

Present: Representatives Jack Brooks, Don Edwards, John Conyers, Jr., Romano L. Mazzoli, Mike Synar, Dan Glickman, Edward F. Feighan, Howard L. Berman, Harley O. Staggers, Jr., John Bryant, Hamilton Fish, Jr., D. French Slaughter, Jr., Lamar S. Smith, Craig T. James, Tom Campbell, and Carlos J. Moorhead.

Subcommittee staff present: Cynthia W. Meadow, counsel; George P. Slover, assistant counsel; Perry Apelbaum, assistant counsel; Mary V. Heuer, research assistant; Linda Jo Shelton, office manager; and Deloris Cole, secretary; full committee staff: Jonathan R. Yarowsky, general counsel; Robert H. Brink, deputy general counsel; James E. Lewin, chief investigator; Alan F. Coffey, minority chief counsel; and Charles E. Kern II, minority counsel, Committee on the Judiciary. Also present: Ned Friece, General Accounting Office detailee.

OPENING STATEMENT OF CHAIRMAN BROOKS

Mr. BROOKS. The subcommittee will come to order.

Two years to the day have passed since this subcommittee last convened to consider competition in the telecommunications industry. Vast changes have occurred in the courts, the Congress, and, certainly, in the positions of the various parties-in-interest to the modified final judgment.

When we last assembled, the subcommittee heard from an alliance of long distance carriers, information providers, and manufacturers professing a belief in the judicial process as the only way a delicate, competitive balance in telecommunications could be calibrated with any assurance of achieving fairness in the public interest.

They noted with wonderment—and not a little bitterness—the shift in the Department of Justice's position from first seeking the breakup of the AT&T monopoly in 1982 to the swift embrace just

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2 years later of allowing the regional Bell monopolies to enjoy almost unfettered access to all lines of business.

But now, one of the long distance carriers has actually joined with the Department in not objecting to the entry of regional Bell companies into informational services, all to the chagrin of their long-time allies, the information providers.

Some might even wonder whether this state of affairs was itself a reaction to an earlier decision by parts of the information industry to break ranks with the coalition in not opposing the piecemeal manufacturing bill that has now just emerged from the U.S. Senate.

Interestingly, just as the once-united front of "judicial solution" advocates began to develop individual positions, the regional Bell companies suddenly found religion in the virtues of judicial review when the D.C. Circuit Court of Appeals seemed to open up a major pathway to new lines of business.

Unfortunately, as a new horizon seemed to loom ahead, several of these regional companies were disciplined and enjoined from engaging in the very same illegal cross-subsidy activities that had spurred the Department of Justice to break up AT&T in the first place.

As I said, it has been an interesting 2 years. But what hasn't changed is what I believe to be the guiding principle of this subcommittee: That antitrust must remain at the heart of any solution to an industry that is born in monopoly, and now, some would say, "reborn in monopoly."

Without competition as the arbiter of telecommunications policy, the fate of this industry and consumers may rest with an endless series of temporary compromises to mollify shifting economic and political interests. That is not acceptable to me.

Two final points: The first is that there always has been a substantial reservoir of good will and respect on this committee for the care and public service of Judge Greene in handling the largest case in the history of American jurisprudence. I think it is not an overstatement to say that his recent judicial opinion allowing the regional Bell companies to enter information services was one of the most memorable decisions to be handed down in a long time.

The decision contained an unmistakable "voice within a voice." The outward voice was the dutiful tone of a jurist who felt compelled to apply an extraordinarily legal standard imposed upon him from the appellate court above—namely, that line-of-business restrictions in the consent decree should be lifted unless there could be shown an almost mathematical certainty that competition would be harmed. Nowhere in the application of the Sherman or Clayton Acts does such a standard to judge the competitive effect exist. Yet, as a district judge, Judge Greene had no alternative in these circumstances.

But the "voice within a voice" expressed grave concern about the ultimate effect of his ruling on the competitive vigor of a society where many contend that monopolies still exist to control the last mile of the road to the user's home or office. Nevertheless, Judge Greene did not abandon all hope that competition policy would ultimately succumb to a less vibrant and diverse set of competing forces.

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The second perhaps most important point is that we enter these hearings—just as we did 2 years ago—with an open mind and no presumptions as to final outcome. The only difference is that, increasingly, it appears that Congress will be drawn directly into establishing the competition policy to rule this unruly industry.

I want to welcome our distinguished witnesses. I look forward to your testimony.

I would like to say I am very disappointed that NYNEX Corp. could not testify today on panel one. I attempted to accommodate any problems they had in providing a witness. On learning that Mr. William Ferguson, chairman of the board and chief executive officer, was not available, I agreed on having one of NYNEX's vice presidents testify. I thought it was all arranged until Monday when the committee was informed that the vice president's schedule had changed and he was not available. I then informed NYNEX that anyone would be acceptable. But that didn't work either.

I figured surely they have three or four lawyers on the payroll who understand the problem a little. Anyhow, they didn't show.

I wanted to ask the NYNEX witness about the alleged $100 million in overcharges for New York ratepayers. Apparently, one of NYNEX's unregulated affiliates, NYNEX Material Enterprises, NMECO, was overcharging the local telephone companies for goods and services in order to boost NYNEX's corporate profits. They have no choice but to subscribe to monopoly services and monopoly prices of NYNEX. They can't go anywhere else. This is the classic case of cross-subsidization and self-dealing. I wanted to get the details of this kind of sweet little deal from NYNEX representatives themselves.

You can read the New York Times and get it pretty well, however. And we have been informed that Mr. Ferguson will be happy to testify in the future if we provide sufficient notice. They sound like the Justice Department. At any rate, I look forward to accepting his offer in the future.

I recognize Mr. Moorhead, the gentleman from California.

Mr. MOORHEAD. The chairman is a very tough act to follow. I wish to join him in welcoming our witnesses here this morning to testify to the AT&T consent decree.

I have already heard many of you testify before the Telecommunications Subcommittee of Energy and Commerce, of which I am also a member. I can also anticipate some of the testimony this morning with a fair degree of certainty. This is in part because the operation of the AT&T consent decree has been before us for some 9 years.

Almost immediately after the settlement of *U.S.* v. *AT&T* was announced in January 1982, this subcommittee and the Telecommunications Subcommittee held a series of joint hearings, in which we heard from Charles Brown, the chairman of AT&T, William Baxter, the Assistant Attorney General for Antitrust.

I would suspect that many of the concerns which were raised in that 1982 hearing will be raised again here today. This would include, of course, concerns about cross-subsidization, preferential treatment of affiliates, and the FCC's ability to effectively prevent abuses.

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The telecommunications world today is, however, not the same as it was in 1982. Instead of a single entity purchasing virtually all the telecommunications equipment from its own affiliates, we now have several different corporations making different choices. The fact that we now have many purchasers and many suppliers of telecommunications equipment is a relevant antitrust fact for us to consider.

At the same time, we still need to be concerned about the overall state of the competition in the telecommunications industry. This issue requires Congress to balance telecommunications policy requirements with the concerns about the potential for anticompetitive behavior. Those are choices that will affect the lives of ordinary Americans on a daily basis.

Although this debate has continued for years, I do not believe we have reached the end of the information-gathering process. Judge Greene's decision last week to lift the restrictions on information services, if upheld, can prove to be a watershed event in the evolution of this debate.

Mr. Chairman, I commend you for scheduling this timely hearing and also look forward to hearing the testimony of our witnesses. I want to conclude by emphasizing that I continue to have an open mind on this difficult and complex issue.

Mr. BROOKS. Mr. Glickman, the gentleman from Kansas.

Mr. GLICKMAN. I was very surprised by Judge Greene's decision last week to allow the regional Bell operating companies to get into the information services business. This area, it seems to me, creates the greatest opportunity for abuse for the holders of networks on which information service providers depend.

It would be hard, from a regulatory standpoint, to pinpoint the various ways the regional Bells could make it difficult for the person to plug into the network. This presents a real problem in terms of ensuring fair competition.

I do not, however, feel the same way with respect to manufacturing. There are some potential problems in this area, but I strongly believe they can be addressed in legislation and better enforcement by the FCC and Justice Department. That is why I support the efforts to allow the regional Bells to get into manufacturing.

I look on Judge Greene's decision as a call for Congress to step into the vacuum he has filled for almost a decade. He may have taken control over the industry because it seemed neither of the other two branches wanted to touch it.

I think it is time for Congress to step forward and take back its role of setting telecommunications policy. This is not simply a question of vertical integration, where the markets will take care of themselves. This is a very interesting, but curious, situation of regulated monopolies embarking on competitive markets and Congress should step in and take the active role in the regulatory process.

So I welcome this hearing and I thank my colleague.

Mr. BROOKS. Mr. Fish, the distinguished ranking minority member of the committee from New York.

Mr. FISH. Thank you, Mr. Chairman.

After working earlier this week on matters such as RICO reform and possible contempt citations, I am pleased that we now turn to a noncontroversial issue.

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Two years ago today, this subcommittee held 2 days of oversight hearings on the AT&T consent decree. Most of the organizations and many of the witnesses that we will hear from today were heard at that time.

Nevertheless, important developments have taken place in the intervening period, such as Senate passage of the Telecommunications Equipment Research and Manufacturing Competitive Act of 1991, S. 173, which would allow the regional Bell operating companies to design and manufacture telecommunications equipment.

In addition, just last week Judge Harold Greene ruled that the companies are not prohibited from entering into the information services business. Judge Greene's order has been stayed pending appeal, and it is my hope the appeal process will be allowed to proceed without legislative interference.

To say the least, then, this is a timely hearing. There are a number of questions that will again be raised here today. What is the likelihood of anticompetitive activities, should the regional Bell companies be permitted to get into manufacturing and/or information services? Assuming the local exchange monopoly still exists, how long is that local telephone monopoly likely to continue to exist? Does the FCC have the resources as well as the will to effectively oversee the regional Bell companies in the operations of such businesses?

Also, Mr. Chairman, lingering on nonantitrust questions, what will the entry of the regional companies into manufacturing mean in terms of the overall strength of our economy? Specifically, will regional Bell entry into manufacturing make a significant impact on our balance of trade and our ability to compete with foreign entities? Would the entry into information services provide important new benefits for consumers and businesses? These are important areas that need to be probed.

This is not a new issue. There are strongly held views on both sides, and I intend to listen carefully to the testimony this morning and continue to study this issue before making any decisions.

This is not a clear case of black versus white. We are in various stages of gray.

I thank you, Mr. Chairman.

Mr. BROOKS. Mr. Conyers.

Mr. CONYERS. Since Judge Greene's decision, the situation has changed. There are many more manufacturers to compete. The telecommunications industry has grown to international proportions.

The American industry is facing a serious threat from foreign competition. We are losing jobs to cheaper labor abroad. And so we are confronted with a changing reality with a more complicated domestic and international picture than we were when Judge Greene rendered his decision.

This doesn't make the court decision incorrect, but I think it certainly necessitates this oversight hearing and a new inquiry by the Judiciary Committee.

The relevant questions are: Has the telecommunications monopoly situation in this country changed significantly since divestiture? Does the telecommunications situation fit into our need to regain

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our competitive edge, and to provide for more jobs in the United States?

Will the bill recently reported from the Senate—which would allow the regional Bells to research, design, and manufacture in the telecommunications field, with a domestic content requirement—pass muster?

And finally, I am always concerned about the impact of anything that we do here in terms of improving the opportunity for small business, especially minority business, to get into this very complicated field.

I thank you very much.

Mr. BROOKS. Mr. Smith, the gentleman from Texas, is recognized.

Mr. SMITH. Mr. Chairman, thank you.

I, too, would like to add my thanks to you for conducting this hearing today. I certainly believe the effectiveness of the modified final judgment is a crucial subject for us to address. As the telecommunication issue continues to evolve, it brings new challenges for the common carriers. It also brings new opportunities for new players to enter the field and provide new services for consumers. We must ensure that these players are able to contribute their knowledge and resources to address this opportunity.

We now have two important items. We have legislation to allow the Bell companies to conduct, design, develop and manufacture equipment. We also have the recent district court decision to allow the Bell companies to provide information services, although he stayed his order until the conclusion of any appeals.

The Congress must carefully examine the possible effects of these measures on American businesses and individual consumers. In an increasingly competitive international market, it is important for Congress to create an environment that will enhance America's leadership in the telecommunications market, prompt research and development of new technologies, and stimulate the American economy.

Mr. Chairman, I look forward to working with you and the other members of the subcommittee in addressing the changes. Thank you, Mr. Chairman.

Mr. BROOKS. Thank you.

I would like to take this opportunity to, by unanimous consent, insert a statement by Congressman Mike Synar, Democrat from Oklahoma, in which he states, among other things, that "I believe strongly in innovation and the development of ideas, but I have a stronger belief that competition encourages innovation more than an anticompetitive marketplace."

He says further, "If the consent decree had prevented that competitive development to the detriment of the consumer, I would have been among the first to argue for modifications. I have not been convinced that consumers have been hurt by events as they have progressed. There may be room for some modifications, however, it will be necessary to guarantee that the business designs of the regional Bell companies do not override the interests of the consumer in a true competitive marketplace."

[Mr. Synar's prepared statement follows:]

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STATEMENT OF REPRESENTATIVE MIKE SYNAR (D-OK)

Two years ago to the day, this subcommittee held an oversight hearing on the operation of the At&T consent decree (MFJ). The hearing was important because it was one of the few hearings in which the primary focus was whether the consent decree was being monitored to ensure that the decree had served the public interest. Since that hearing there have been numerous hearings held by the Energy and Commerce Telecommunications and Fiance Subcommittee on which I sit. Just last week there was an opinion issued by Judge Greene reluctantly modifying some of the MFJ restrictions. These events have not convinced me that there should be complete freedom from restrictions.

Antitrust laws are for the benefit of the consumers. Often that is overlooked in the debate over the extent of services which should be provided by the regional Bell companies. Consumers need to have the assurance that the entrance of the Bell holding companies into certain areas of manufacturing and information services will not affect competition. I believe strongly in innovation and the development of ideas, but I have a stronger belief that competition encourages innovation more than an anti-competitive marketplace.

It is still unknown and somewhat questionable, even after two years, whether the Federal Communications Commission (FCC) will be capable of protecting the consumer when restrictions are lifted. In the two years since I expressed my doubts about the FCC's ability to provide consumer safeguards and prevent cross-subsidization, there has not been much to allay those fears.

In the years since the implementation of the MFJ, there is no question that there has been increased competition and more access to telecommunication services for consumers. The industry has been developing in a competitive fashion. If the consent decree had prevented that competitive development to the detriment of the consumer, I would have been among the first to argue for modifications. I have not been convinced that consumers have been hurt by events as they have progressed. There may be room for some modifications, however, it will be necessary to guarantee that the business desires of the regional Bell companies do not override the interests of the consumer in a true competitive marketplace.

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Mr. MAZZOLI. Mr. Chairman.

Mr. BROOKS. Mr. Mazzoli, the gentleman from Kentucky.

Mr. MAZZOLI. Thank you, Mr. Chairman.

I appreciate the chairman's having these hearings. I think they are very important. And I look forward to working with you in the months ahead.

I may be the only person on this committee to harbor these feelings, but I sometimes look back on the decision in 1982 as one of the worst decisions that could have ever been rendered.

I think in going back home, as I do every week, many of my people, many of my consumers and constituents look back on that 1982 decision as just being a moment in history when they became the befuddled people, not knowing whom to call for what services. And, while there may be some quantification of price reduction and of innovations that have occurred as a result of MFJ, there are an awful lot of people at home who wish for the good old days.

I, for one, Mr. Chairman, wonder why Congress cannot recapture control of this whole thing, subject to the laws of antitrust. We surely don't want monopolies; we don't want to have anybody create markets; and, we don't want anybody to dominate. We want to have lively competition, but I don't know why it has to be done by a Federal judge. I don't know why Congress can't do it as well, if not better. Keeping in mind the fact that we need to create jobs here in America, we need to be competitive in the world; somehow, we must have an opportunity for America to regain its purchase on the leadership role and technology.

Again, I say this with a great respect for Judge Greene, whom I have known for a number of years. I think we have the same genius that he has in trying to see the future and figure out where best the American technology ought to be. I think, subject to the fact we don't want to have monopolies, we could help craft a very bright next century for American technology. And so, therefore, I look forward to working with the chairman.

Mr. BROOKS. Thank you, Mr. Mazzoli.

Mr. James, the gentleman from Florida.

Mr. JAMES. Thank you, Mr. Chairman.

There are some issues that I am intently interested in from the standpoint of what happens in America and also what is fair and appropriate in relationship to the antitrust laws.

I am going to be looking in the testimony for an explanation of why the Baby Bells should be treated differently from GTE, which has the same characteristics to the extent they may be spread out all over the Nation as any one of the Bells. When you compare those under the antitrust laws, there seems to be little logic for the judge to retain control over seven companies that are almost identical in makeup as far as monopolistic characteristics are concerned. That is the antitrust side of it.

So it would seem that they should be treated perhaps in a similar way. That still leaves the question of how all eight should be treated. The judge's order only covers the seven.

The other question is that when you combine the eight together, what prevents cross-subsidization? Do we have the sophisticated rules that would keep the ratepayer from subsidizing the possible monopolistic characteristics of the Baby Bells selling their produc-

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tion to themselves, thereby doing substantial damage to a large corporation, AT&T, with $39 billion gross sales, $19 billion of which is involved in their productions division?

So it seems—and if you are looking at fairness in antitrust laws, it would seem that since they were under the original order and they did lose 60 or 70 percent of their assets, for Congress to change the rules of that judicial decision has to be dealt with.

So I don't find the matter simple at all, whether you are dealing in an economic sense or whether you are dealing in a sense of why treat corporations that are admittedly totally separate, the seven Bells, any differently than you would GTE, for example. So it is a very significant and complicated issue with significant consequences on how Congress decides to deal with the matter.

I look forward to the testimony.

Mr. BROOKS. Thank you very much.

In order to save time, I would hope that the witnesses will appear in panels. I would ask that each witness give a brief 5-minute summary of his or her prepared statement. All the prepared statements which you carefully put together will be submitted and made a part of the hearing record.

Our first panel consists of representatives from the major telecommunications corporations. We welcome back William G. McGowan, chairman and chief executive officer for MCI Communications Corp., who testified before this subcommittee 2 years ago.

The other panel members are Edward E. Whitacre, Jr. He is the chief executive officer of Southwestern Bell, from Calvert or Hearne, TX, somewhere out there. And Randall L. Tobias, who is a vice chairman for AT&T.

Delighted to have you, Mr. Tobias.

Gentlemen, we thank you.

Mr. McGowan, if you would open up.

STATEMENT OF WILLIAM G. McGOWAN, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, MCI COMMUNICATIONS CORP.

Mr. MCGOWAN. Thank you, Mr. Chairman.

My name is Bill McGowan. I am chairman and chief executive officer of MCI.

I would like to applaud the subcommittee for holding this hearing on the AT&T antitrust consent decree. I am pleased to be able to share MCI's viewpoint on this important antitrust issue.

This hearing is very timely given the recent Senate passage of legislation permitting the Bell companies to manufacture telecommunications equipment and last week's court ruling permitting their entry into information services.

As far as the court ruling is concerned, MCI will go to the mat. Judge Greene was reluctant to rule as he did. He made clear his feeling that the decision was contrary to the public interest—that removing the information services restriction poses a significant risk of anticompetitive activities on a substantial scale, with equally substantial injury to competition.

MCI strongly agrees with that viewpoint. I am hopeful that a higher court will reach the same conclusion.

If the question before the subcommittee is whether the Congress should legislatively eliminate or weaken the antitrust consent de-

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cree's line-of-business restrictions, I respond with an emphatic "no." MCI strongly opposes Bell company entry into manufacturing, long distance, and information services as long as the Bell companies maintain their monopoly control over the local exchange.

Competition is working for all of us—businesses and residential consumers alike—because of the consent decree and enforcement of our antitrust laws. The results of the antitrust decree have been what Americans expect from competition: Significantly lower prices for long distance and telecommunications equipment; greatly expanded customer choice; and U.S. global leadership in telecommunications and information products and services.

So why are we even discussing this issue? Because seven huge monopolies are mustering every ounce of political power they possess in the pursuit of special-interest legislation. Period.

The so-called Baby Bells are no poor orphans. They are thriving. Last year, their average return on equity was 13.4 percent and their profits were nearly $8.5 billion.

They would have you believe their entry into long distance manufacturing information services will stimulate competition and new product development. I submit the Bell companies are far less interested in the provision of new products and services to the public. They are really interested in owning and controlling any new products and services.

The Bell operating companies' entry into any of these lines of business would cripple competition. The consent decree's restrictions are still needed because the Bell local exchange networks continue to be bottleneck monopolies.

Wherever the BOC's are allowed to compete with others, they continue to abuse their position to discriminate and cross-subsidize, to the detriment of the public and their competitors.

In 1988, the Bell operating companies were granted permission to offer voice messaging services, a type of information service, in competition with many providers. Nondiscriminatory access to the network is essential for competitors. The BOC's have used their bottleneck position to destroy emerging competition.

The Georgia Public Service Commission just completed a thorough investigation and concluded that Southern Bell was guilty of "anticompetitive behavior with respect to discriminatory access to the local networks and marketing practices."

The commission also found "serious issues of actual cross-subsidy and predatory pricing." I could provide other examples.

Let me briefly provide MCI's perspective and why it is so important to maintain the consent decree safeguards against such BOC abuses. MCI provides long distance and information services. We do not manufacture, nor do we intend to. We depend on an unfettered multivendor environment which offers the highest quality equipment at the lowest possible cost. This is critical to our ability to compete.

To date, we have invested over $8 billion in our network. MCI continues to invest more than a billion dollars per year, selecting state-of-the-art equipment from the top manufacturers.

Before the breakup of AT&T, we were forced to buy most of our equipment overseas. Today most of the equipment we buy is made in the United States.

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If the BOC's were permitted to manufacture, many independent manufacturers that have sprung up in the 7 years since divestiture would very likely be bought up or forced out of business. BOC manufacturing would, as it did in the past, retard innovation and reduce choice. We'd see a kind of technological inbreeding. And no doubt equipment costs will climb.

As for Bell company entry into information service, I emphatically agree with the conclusion drawn by the district court in its recent decision, "The most probable consequences... will be elimination of competition from that market and the concentration of the sources of information of the American people in just a few dominant, collaborative conglomerates with the captive local telephone monopolies as their base. Such a development would be inimical to the objectives of a competitive market, the purposes of the antitrust laws, and the economic well-being of the American people."

My testimony would be different, Mr. Chairman, if we weren't talking about seven bottleneck monopolies. Until true competition comes to the local exchange, the Bell monopolies shouldn't be allowed into the competitive marketplace. We are a long way from true competition in the local loop. Indeed, the Bell companies do everything in their power to undermine potential competition.

By keeping the monopoly BOC's out of long distance, information services and manufacturing, those markets and consumer interests are safeguarded against anticompetitive monopoly abuse. That is the genius of the consent decree.

Which brings me to my final point, Mr. Chairman: The need to protect the integrity of the antitrust consent decree. Congress has the right and the duty to review these matters, to promote the public interest. To legislatively eliminate or weaken the consent decree's safeguards, however, would clearly be contrary to the common good.

Again, I quote from the district court information services decision, and note that the court's logic applies equally well to long distance and manufacturing:

"[I]t would hardly make sense or be in the public interest to cancel an important part of an antitrust decree forged after several decades of on-and-off litigation, and turn a key ingredient of the emerging information society over to corporations who not so long ago were involved in major violations of the antitrust laws, and who even now seem ready to engage in anticompetitive practices whenever the opportunity therefor presents itself. Indeed, it would be difficult to conceive of a step that would be less in the public interest."

It's been said that those who cannot remember the past are condemned to repeat it. Congress should not fail to remember the history of anticompetitive abuses committed by the Bell System. Don't turn back the clock on competition.

Mr. BROOKS. Thank you.

[Mr. McGowan's prepared statement follows:]

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STATEMENT OF
WILLIAM G. McGOWAN
CHAIRMAN AND CHIEF EXECUTIVE OFFIIICER
MCI COMMUNICATIONS CORPORATION

Thank you, Mr. Chairman. My name is Bill McGowan. I am the Chairman and Chief Executive Officer of MCI Communications Corporation.

I'd like to applaud the subcommittee for holding this hearing on the AT&T antitrust consent decree. I am pleased to be able to share MCI's viewpoint on this important antitrust issue.

This hearing is very timely given the recent Senate passage of legislation permitting the Bell companies to manufacture telecommunications equipment and last week's court ruling permitting their entry into information services.

As far as the court ruling is concerned, MCI will go to the mat. Judge Greene was reluctant to rule as he did. He made clear his feeling that the decision was contrary to the public interest -- that removing the information services restriction poses a significant risk of anticompetitive activities on a substantial scale, with equally substantial injury to competition.

MCI strongly agrees. I am hopeful that a higher court will reach the same conclusion.

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If the question before the Subcommittee is whether the Congress should legislatively eliminate or weaken the antitrust consent decree's line of business restrictions, I respond with an emphatic "No!" MCI strongly opposes Bell company entry into manufacturing, long distance, and information services as long as the Bell companies maintain their monopoly control over the local exchange.

Competition is working for all of us -- businesses and residential consumers alike -- because of the consent decree and enforcement of our antitrust laws. The results of the antitrust decree have been what Americans expect from competition:

- Significantly lower prices for long distance and telecommunications equipment;
- Greatly expanded customer choice; and
- U.S. global leadership in telecommunications and information products and services.

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The Bell Operating Companies would have you believe that their entry into long distance, manufacturing and information services will stimulate competition and new product development.

That is simply not true, Mr. Chairman. BOC entry into any of these lines of business would cripple competition. All available evidence strongly confirms that the line of business safeguards in the consent decree are still needed. BOC local exchange networks continue to be bottleneck monopolies. Wherever the BOCs are allowed to compete with others in the provision of services that require access to the local networks, they continue to abuse their position to discriminate and cross-subsidize to the detriment of the public and their competitors.

This is not just theory, this is fact. For example, in 1988, the BOCs were granted permission to offer voice messaging services -- a type of information service -- in competition with independent providers. Non-discriminatory access to the local network is essential for competition to develop. Throughout the country, however, the BOCs have used their bottleneck position to destroy emerging competition.

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The Georgia Public Service Commission just completed a thorough investigation and concluded that Southern Bell was guilty of "anticompetitive behavior with respect to discriminatory access to the local network and marketing practices." The Commission also found "serious issues of actual cross-subsidy and predatory pricing." I could provide many other examples of BOC abuses that continue today.

Mr. Chairman, let me briefly provide MCI's perspective on why it is so important to maintain the consent decree safeguards against such BOC abuses.

MCI provides long distance and information services. MCI does not manufacture. Nor do we intend to. Instead, we depend on an unfettered, multi-vendor environment which offers the highest quality equipment at the lowest possible cost.

This is critical to our ability to compete globally in the long distance and information services markets. MCI deploys a state-of-the-art network that uses the very latest in fiber optic and digital technologies.

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To date, MCI has invested over $8 billion in our network, and we continue to invest more than $1 billion per year, selecting the best equipment from the top manufacturers. Before the break-up of AT&T, MCI was forced to buy our equipment overseas. Today, the vast majority of the equipment we buy is made in the United States.

If the BOCs were permitted to manufacture, many independent manufacturers that have sprung up in the seven years since divestiture would very likely be bought up or forced out of business. BOC manufacturing would, as it did in the past, retard innovation and reduce choice. We'd see a kind of technological inbreeding. And no doubt equipment costs will climb.

As for Bell company entry into information services, I emphatically agree with the conclusion drawn by the District Court in its recent decision:

> ...[T]he most probable consequences ... will be the elimination of competition from that market and the concentration of the sources of information of the American people in just a few dominant, collaborative conglomerates, with the captive local

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telephone monopolies as their base. Such a development would be inimical to the objective of a competitive market, the purposes of the antitrust laws, and the economic well-being of the American people.

What may be good for the bottom line of seven large telephone monopolies would clearly be a disaster for consumers and our country.

My testimony would be different, Mr. Chairman, if we weren't talking about seven bottleneck monopolies. Until true competition comes to the local exchange, the Bell monopolies shouldn't be allowed into competitive markets. And we are a long way from true competition in the local loop. Indeed, the BOCs do everything in their power to undermine potential competition.

The consent decree's line of business restrictions is really a misnomer -- think of them instead as a line of consumer safeguards. By keeping the monopoly BOCs out of long distance, information services and manufacturing, those markets and consumer interests are safeguarded against anti-competitive monopoly abuses. That is the genius of the consent decree.

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Which brings me to my final point, Mr. Chairman: the need to protect the integrity of the antitrust consent decree. Congress has the right and the duty to review these matters, to promote the public interest. To legislatively eliminate or weaken the consent decree's safeguards, however, would clearly be contrary to the common good.

Again, I quote from the District Court information services decision, and note that the court's logic applies equally well to long distance and manufacturing:

> [I]t would hardly make sense or be in the public interest to cancel an important part of an antitrust decree forged after several decades of on-and-off litigation, and turn a key ingredient of the emerging information society over to corporations who not so long ago were involved in major violations of the antitrust laws, and who even now seem ready to engage in anticompetitive practices whenever the opportunity therefor presents itself. Indeed, it would be difficult to conceive of a step that would be less in the public interest.

It's been said that those who cannot remember the past are condemned to repeat it. Congress should not fail to remember the history of anticompetitive abuses committed by the Bell System. Don't turn back the clock on competition.

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Mr. BROOKS. Mr. Whitacre.

STATEMENT OF EDWARD E. WHITACRE, JR., CHIEF EXECUTIVE OFFICER, SOUTHWESTERN BELL CORP., ON BEHALF OF AMERITECH, BELL ATLANTIC, BELLSOUTH CORP., NYNEX, PACIFIC TELESIS GROUP, SOUTHWESTERN BELL CORP., AND U S WEST

Mr. WHITACRE. My name is Edward E. Whitacre, Jr., and I am the chairman and chief executive officer of Southwestern Bell Corp. I am here today on behalf of my company as well as the other six regional Bell companies.

Last Thursday you read about Judge Greene's order lifting the information services restriction. Let me put that matter into perspective for you.

Over 4 years ago, the Department of Justice concluded that competition by the Bell companies would be beneficial, not harmful to the U.S. consumer. It recommended the MFJ court lift this restriction. Four years later, we received an order only to have it stayed pending appeal.

After 4 years of wrangling, we still do not have relief on this issue. We cannot do anything today we couldn't do 1 week ago.

The information services restriction was imposed to provide a head start for potential entrants into what was then described as a new information services market. That certainly has happened. The information services market has become a multibillion-dollar industry and one that can benefit from the talents of the Bell companies.

Last week's court decision is a step in the right direction. Unfortunately, many more steps will be taken before consumers realize the benefits.

Having lost in the courts, our opponents want to restart the information services debate in Congress, and consume still more time and resources. They want to keep us bottled up in the halls of government rather than compete with us to bring new services to the American people.

A second newsworthy item this summer is the legislation pending before the House on the manufacturing restriction, H.R. 1527. In June, a companion measure to grant us that freedom passed the Senate by an overwhelming margin.

This legislation will be a significant step toward allowing the Bell companies to manufacture in this country. Today, we can only manufacture in other countries provided the products aren't sold to American customers. Ironically, foreign companies are free to acquire American manufacturers. They can make and sell products anywhere in the world with no restrictions.

Manufacturing relief would also put an end to the situation surrounding the recent service outage here in Washington and on the west coast in which an engineer has to find a lawyer to help him fix a service problem.

The cost of the MFJ restrictions over the past 10 years are impossible to measure. Costs from innovative services that were never pursued, efficiencies never realized, and investments in R&D never made.

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As a country, we can't afford this kind of waste. H.R. 1527 can put us back on the right track. Numerous consumer, medical, and education organizations, small domestic manufacturers, the Communications Workers of America, the administration and many others urge that you pass legislation removing the manufacturing restriction. They do so because it is good public policy. They understand that Americans will benefit from our entry into the market.

On a personal note, I resent the arguments of some that if we are permitted to enter new businesses, we will violate the law. This is an unjustified attack on the integrity of an industry that has served and continues to serve this country well by providing the best telephone service in the world.

Mr. Chairman and members of the subcommittee, thank you for the opportunity to present our views. We urge you to support H.R. 1527.

Mr. BROOKS. Thank you.

[Mr. Whitacre's prepared statement follows:]

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STATEMENT OF
EDWARD E. WHITACRE, JR.

on behalf of
Ameritech, Bell Atlantic, BellSouth Corporation, NYNEX,
Pacific Telesis Group, Southwestern Bell Corporation
and U S West

My name is Edward E. Whitacre, Jr., and I am the Chairman and Chief Executive Officer of Southwestern Bell Corporation. I am here today on behalf of my company as well as the other six regional Bell companies -- Ameritech, Bell Atlantic, BellSouth, NYNEX, Pacific Telesis Group, and U S WEST. It is my pleasure to testify before the Subcommittee on a matter of great concern to the telecommunications industry; an issue that, when resolved, will provide substantial benefits to American consumers, the American economy, and American workers.

I would like to thank you, Mr. Chairman, for giving me the opportunity to discuss the three domestic line of business restrictions imposed upon the Bell companies. In spite of last week's decree court order, all three line of business restrictions remain intact. The decree court has stayed the freedom to provide information services, pending resolution of an appeal. Clearly, prior experience has shown that this process will not be exhausted anytime soon.

I would specifically like to express our support for legislation to grant manufacturing relief for our companies. While the ban on equipment fabrication, design, and development is only one of the three restrictions inhibiting the telecommunications industry, I urge the Subcommittee to first consider legislation granting manufacturing relief for Bell companies. As a number of your colleagues stated at your last hearing on this issue in August of 1989, it makes good sense to allow Bell companies to put to full use their resources and knowledge of the network. Indeed, the Senate voiced its opinion on the matter when it approved the Telecommunications Equipment Research and

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Manufacturing Act of 1991, by an overwhelming vote of 71-24 on June 5. Similar legislation, H.R. 1527, was introduced in the House this past Spring and has been referred jointly to the Judiciary and the Energy and Commerce Committees. I would like to take this opportunity to ask for your support of H.R. 1527.

I. The Effects of the MFJ

Imagine that you operate an American pharmaceutical company that is prohibited by federal regulations from designing or developing a new form of medication to combat a life threatening disease. Imagine that you are an automobile manufacturer stymied by federal law from using its resources to produce more fuel efficient vehicles. You have now put yourselves in my shoes.

The Modification of Final Judgment has a similarly chilling effect on the telecommunications industry. Bell companies cannot translate detailed requests made by consumers into detailed specifications for new products. Likewise, if a customer requests a minor alteration which could improve his or her equipment, the MFJ prohibits Bell engineers from sharing the details of how this improvement could be made with the equipment manufacturer. Not only is this an ineffective way in which to address our customers' needs, it flies in the face of how the manufacturing process works.

The manufacturing process for high-tech telecommunications equipment -- like the process for most manufactured goods -- is not a series of independent linear activities strung together. Gone are the days when a scientist working in a lab developed a new idea, then passed that idea along to technicians to see if it would work, only to

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have them hand off a finished product to a marketing expert to sell it. Quite the contrary, today's manufacturing process is quite iterative. The various participants involved in the manufacturing chain must interact constantly in order to turn an idea into a workable product. Unfortunately, the MFJ ban on manufacturing cuts this interwoven process in half by creating a moat between the identification of consumer needs and the ability to effectively answer them. The restriction prevents Bell companies from crossing this moat in order to work directly with product designers and manufacturers.

The impact of this unnatural proscription is great and varied. Because of the MFJ, small and medium-sized equipment manufacturers have not had the ability to freely grow their companies or develop new products through interaction with many of this country's leading telecommunications experts. American workers have lost jobs as a significant number of the telecommunications equipment manufacturing jobs have moved overseas since 1982. American consumers do not have access to the same advanced products and services as many of their foreign counterparts. America is losing its place in the world as the leader in telecommunications services and technology standards.

H.R. 1527 represents a great opportunity to reverse these trends. The bill will create business opportunities for all equipment manufacturers by allowing them to enter into joint ventures with the Bell companies, or to seek an infusion of capital from us. American workers will benefit from H.R. 1527's provisions removing the ban on domestic manufacturing activities by new Bell affiliates. This provision will help stem the tide that has caused more than 60,000 American telecommunications jobs to vanish since the MFJ was entered. American competitiveness will also improve due to increased expenditures on research and development. Currently, the MFJ removes much

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of the incentive Bell companies would otherwise have to invest in R&D. This has resulted in an average Bell level of R&D expenditures of 1.3 percent of annual sales; about one-sixth of what most high-tech firms spend and well below the level by the emerging leaders in telecommunications from Japan and Europe.

II. A Decade of Uncertainty

In order to put this issue in a historical perspective, I'd like to spend a moment talking about how we got to where we are today. As you know, the MFJ was entered into in 1982 in settlement of antitrust litigation between AT&T and the Department of Justice. There never was a judicial finding of an antitrust violation by AT&T, much less by any one of the Bell companies. At that time, unlike today, it was the Department of Justice which favored restrictions on the Bell company lines of business, and AT&T who opposed those restrictions.[1] Now, the world has changed.

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[1]AT&T's principal attorney, Howard Trienens, advised the Court during the deliberations on the decree:

> "I'm against restrictions. I'll be happy if nobody is restricted in anything. After this divestiture occurs, let [the BOCs] do what they want." Tr. 25,210 (June 29, 1982).

Mr. Trienens similarly advised the FCC of the same thing:

> "We do not want restrictions on those BOCs. That wasn't our idea . . . The last thing in the world you want to do is impose some further restrictions on their efficiencies . . . [W]e should be getting rid of restrictions . . . we'd be happy to have them unrestricted . . . [T]he question was [asked], 'well, if Justice agreed to eliminate the restrictions would you agree?' and the answer was, 'of course.'" Comments of Howard Trienens at the En Banc Meeting of the Federal Communications Commission (March 24, 1982).

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The Department of Justice, along with the FCC, the Commerce Department, several consumer and industry organizations, and the United States Senate are all on the record supporting removal of some or all of the restrictions. Other oppose lifting the manufacturing, information services, and interexchange service restrictions because it is not perceived to be in its economic best interests to support such relief.

The line of business restrictions in the MFJ include a prohibition against the Bell companies providing interexchange services, which are usually referred to as long distance services; and a prohibition against the Bell companies either manufacturing or conducting design and development of telecommunications equipment or customer premises equipment; and, until last week's order, a prohibition against the Bell companies providing information services.[2]

Regardless of the Department of Justice's and AT&T's positions with respect to the imposition of them at divestiture, the MFJ's line of business restrictions were never intended to be permanent. Even Judge Greene himself, when imposing the restrictions, recognized that these entry barriers are "inherently anticompetitive."[3] Accordingly, the Department of Justice stated at the time the restrictions were imposed that it would "petition the Court for their removal at the earliest possible date consistent with technological and competitive conditions."[4] Specific provision was made in the

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[2]MFJ, Art. II; Order, July 25, 1991.

[3]United States v. Western Electric Co., 1982-2 Trade Cas. (CCH) ¶ 64,980 at 73,149 (D.D.C. 1982).

[4]Brief of the United States in Response to the Court's Memorandum of May 25, 1982, filed June 14, 1982 at 31.

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MFJ for removing a line of business restriction,[5] and the Department of Justice committed to review every three years whether or not the restrictions should be removed and report its findings to the decree court.[6]

Pursuant to this commitment, the Department of Justice submitted its First Triennial Review in 1987, three years after the MFJ was implemented. After considering the state of the economy and competitiveness in the telecommunications industry, the Department of Justice concluded that the information services and manufacturing restrictions should be removed in their entirety and strongly suggested that the interexchange restrictions should be removed for mobile services.[7] AT&T, contrary to the representations it had made to the FCC and others at the time the MFJ was under consideration in 1982, opposed manufacturing relief and any interexchange freedoms for the Bell companies.[8]

Despite the fact that the Department of Justice supported relief for the Bell companies in 1987, the decree court disagreed with the Department of Justice's recommendations. It refused to lift the three core restrictions, except for allowing the Bell companies to offer limited information services in the area of voice storage and

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[5]MFJ, Art. VIII(C).

[6]Response of the United States to Public Comments in Proposed Modification of Final Judgment, filed May 20, 1982 at 62.

[7]Reply of the United States in Support of Motion for Partial Removal of the Line of Business Restrictions, filed May 27, 1987 at 69-70.

[8]AT&T Comments on the Report and Recommendation to the United States, filed March 13, 1987 at p. 8.

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retrieval and gateway services.[9] The Court of Appeals reviewed that decision and determined that the wrong standard of review had been applied by the decree court with respect to relief from the information services restriction.[10] Accordingly, the matter was remanded to the decree court and a decision was issued last week.[11] Although the decree court lifted the information services restriction, on its own initiative it imposed a stay of the effectiveness of this relief, pending any appeal. Previous experience has demonstrated that the appeals process is a lengthy one. Clearly the issue is far from final. Thus here we are, four years later, and we still don't have a final decision on which we can base our business plans. Nor do we expect one shortly.

III. Day-to-Day Dilemmas

As a businessman, I can describe for you the profound impact the MFJ has had on our business. It is not an exaggeration to state that the MFJ permeates our daily operations. Every decision has to be made in light of the MFJ. It is not enough for us to make decisions based upon whether something may be beneficial to consumers. It is not enough for us to make decisions based upon whether the proposed activity is consistent with general antitrust principles. It is not enough for us to make decisions based upon whether or not the proposed conduct meets or exceeds the regulatory requirements of the FCC and our state commissions. Instead, before we make any of these decisions we must first consider whether the proposed activity rests within the gray

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[9]United States v. Western Electric Co., 673 F. Supp. 525 (D.D.C.) 1987.

[10]United States v. Western Electric Co., 900 F.2d 283 (D.C. Cir. 1990). The same wrong standard of review has apparently been applied by the decree court when considering other BOC requests since 1984.

[11]Order, July 25, 1991.

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boundaries of the MFJ. What makes this decision process even more disconcerting is that, it is not always clear what activities are permissible under the MFJ. Given the fact that the penalties for violations of the MFJ are extremely severe and can include criminal indictments, this interpretive uncertainty often precludes Bell companies from exploring innovative products and services.

IV. Examples of How the MFJ has Restricted Business

In an age when telecommunications services should be rapidly deployed, the MFJ's restrictions are not only unnecessary to protect competition, they are inherently anticompetitive and inhibit technological advances. The practical result of the MFJ's restrictions is that we are unable to offer many services we propose in a manner which our customers would find most desirable. Indeed, we are precluded from bringing some services to the marketplace at all.

For example, we had to go to court to get permission to provide hearing-impaired customers with a means of facilitating their communications.[12] A deaf individual may have a keyboard with his or her phone, but may need to call other individuals who do not have a keyboard. A waiver was needed before our operator could read aloud the message from the deaf caller so that it could be received by the called party.

Pending an appeal of last week's order, no Bell company can provide a service by which a contractor wishing to dig a hole in the ground can call just one

[12]United States v. Western Electric, No. 82-0192 (D.D.C. Sept. 11, 1989) [Order].

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number and be advised as to whether the planned excavation will cut the underground lines of area utilities, such as telephone, water, gas or electric lines.[13]

Because of the MFJ, we had to go to court to ask whether or not we could send people a signal indicating the time-of-day on their pagers. While an appeal of this issue is pending,[14] as of this moment, the answer is "no."[15]

Because of the MFJ's ban on information services, we had to go to the decree court to get permission for a telephone operator to be able to tell a caller what time it is. In fact, the Bell companies have had to go to Court twice on this issue. Once, in 1983, when the decree court granted a waiver for the Bell companies to give time-of-day information to callers if there was no other alternate provider.[16] And five years later, in 1988, when the Idaho State Commission ordered Mountain Bell to provide time-of-day information as a public service despite the fact that an alternate provider was willing to offer the information for a fee.[17]

Although none of the Bell companies is seeking relief from the interexchange restriction in order to provide traditional long distance service in direct competition with existing interexchange carriers, the outright ban does adversely affect other services we would like to offer. One example is the highly competitive cellular

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[13]See Civil Enforcement Consent Order, February 2, 1989.

[14]Notice of Appeal filed February 19, 1991.

[15]Memorandum and Order, February 14, 1991.

[16]United States v. Western Electric Co., 578 F. Supp. 658, 659 (D.D.C. 1983).

[17]Memorandum, February 8, 1988.

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industry in which Bell cellular affiliates go head to head with several carriers. The two largest cellular carriers -- McCaw and GTE/Contel -- surpass even the largest Bell cellular affiliate in terms of market share, markets served, and revenues earned. And yet the MFJ prohibits us from competing with them on equal terms. These two carriers, like their other non-Bell competitors, are able to string markets together without regard to artificial boundaries, effectively expanding their local area calling scope. The interexchange restriction prohibits us from doing likewise without first seeking a waiver from the decree court.

The manufacturing prohibition of the MFJ allows the Bell companies to provide a third party manufacturer with generic specifications for equipment, but it specifically prohibits the Bell companies from conducting product-specific design, development or fabrication work. The restriction is based on the faulty presumption that there is some clear line which distinguishes research which must be done to describe the functionality desired for a product from the design and development work. In actuality, the distinction between research and systems engineering and network planning, which the Bell companies can perform, and design and development work which the Bell companies cannot perform, is sometimes difficult to fathom.

Another example of the collateral effects of the interexchange restriction arose when Bell Atlantic was attempting to provide information gateways -- a service permitted under the decree -- to its customers in Pennsylvania. Gateway computer processing centers are not cheap, and Bell Atlantic petitioned the decree court in an effort to provide the service in a manner that would make it more affordable to the average residential user. Bell Atlantic asked the decree court for permission to locate a processing center in one central location, thus doing away with the need to duplicate this

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high expense in every local access transport area. The decree court rejected this request on the basis that a consumer's call to the center might cross an interexchange boundary and, in the decree court's eyes, Bell Atlantic would be transmitting a prohibited long distance telephone call.

The most frustrating ramification of the manufacturing restriction is the uncertainty as to what non-fabrication activities are permitted. A perfect example of this uncertainty was the dilemma faced by Bell Atlantic and Pacific Telesis in their efforts to find and fix the cause of recent service outages, which are believed to have been the result of a programming problem with their SS7 software. But for the MFJ, their immediate response would have been to assemble their technical experts to work closely with the manufacturer of that software to solve the problem. However, due to the uncertainties raised in the language of earlier decisions of the decree court interpreting what is prohibited conduct under the manufacturing restriction, Bell Atlantic was compelled to seek an interpretation from the Department of Justice as to whether their remedial activities were permitted under the MFJ. The Department of Justice indicated that there were no clear guidelines for this situation and it recommended that Bell Atlantic seek emergency relief from the court.[18] In this instance, the decree court ruled that the Bell companies could work with a manufacturer to repair a piece of

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[18]In entering its 1987 decision "defining" the term "manufacturing," even Judge Greene recognized that the BOCs would likely need further interpretations to know what type of activity they could and could not undertake:

> That is not to say that there may not be occasions when doubt may exist whether an activity represents network design and engineering or the design of products. Disputes in that regard, should they actually occur, will have to be resolved through the Department's normal enforcement activities under the decree, with resort, if necessary, to the Court.

U.S. v. Western Electric Co., 675 F.Supp. 655, 667 n.57 (D.D.C. 1987).

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equipment or product which had already been defectively manufactured. This was not clear from the decree court's earlier opinions.

As a result of this decision the Bell companies now are apparently free to work closely with manufacturers to repair defects and to ensure that products function according to their specifications. But, the Bell companies cannot work closely with manufacturers in the design and development of products and equipment to ensure that they do not contain defects before they are manufactured. I can tell you this, as one who has held just about every engineering job in the telephone company, the practice of having to first meet with lawyers is an inefficient way to have to approach a telephone service outage.

In addition, this decision is particularly confusing to me because my own company once sought permission to acquire a small business that repaired and refurbished telecommunications equipment. In denying our request for a declaratory ruling that the manufacturing restriction did not prohibit these repair activities, one of the court's opinions in 1989 stated, "it would seem that some repair and some testing functions are permitted under [the MFJ] and some are not."[19] With this lack of clear guidance, it is difficult to know what can and cannot be done.

Similarly, because of the uncertainties of the manufacturing prohibition, the Bell companies, again with the support of the Department of Justice, requested two

[19]Memorandum, p. 8, February 15, 1989 (denying request for declaratory judgment with respect to SBC's proposed acquisition of CTDI).

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years ago that the decree court rule on whether or not the MFJ allows the Bell companies to enter into certain funding/royalty agreements.[20]

Understandably, the demands of an industry as complex as ours are more than one person can effectively handle. Certainly, the decree court has addressed several important matters which affect our business. However, the telecommunications industry is one which is subject to rapid and complex technological change. I respectfully submit that its complexity is such that no single individual has sufficient wisdom or knowledge to keep pace with its proper evolution and deployment. We should not expect this from any one person, especially one of our federal judges who has numerous other responsibilities. The inevitable result is that progress is impeded, and consumers suffer.

And going to court is not always expedient. As noted above, the first Triennial Review which began in 1987, is still not over. Moreover, in 1986, the Department of Justice wrote an opinion letter in which it concluded that, consistent with the MFJ, the Bell companies could have their telephone operators set up conference calls so long as any transmission across an exchange boundary was provided by an interexchange carrier.[21] AT&T did not want the Bell companies to set up conference calls and compete with AT&T operators. AT&T went to the decree court to keep the

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[20]See Motion of the United States for a Declaratory Ruling Regarding the Receipt of Royalties on Third-Party Sales of Telecommunications Products and Reply Brief of the United States in Support of said Motion, filed January 4, 1989 and February 17, 1989, respectively.

[21]Letter of Mr. Ginsburg, Department of Justice, to Mr. Millard, Ameritech, dated July 18, 1986.

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Bell company operators from performing this call set-up function.[22] Thus, the question of whether or not the Bell company operators can provide this service has been pending for five years.

Our employees have ideas that are responsive to our customers' needs, but the MFJ prevents us from pursuing those ideas. In an age when latchkey children and aging parents are a common phenomenon, communication with absent parents and children is increasingly important and there are a number of needs we would like to address. In an age where rural communities have difficulty attracting physicians and educators, we would like the freedom to help alleviate these shortages through improved communications.

V. How the Telecommunications Industry has Changed Since 1982

The telecommunications industry has changed dramatically in the last decade. My company now faces competition from dozens of telecommunications companies. The FCC has paved the way for competition in the local exchange market -- a phenomenon currently taking place in major business sectors in cities such as New York and Dallas. Several hundred manufacturers of telecommunications equipment already compete with one another -- a trend that will be enhanced by allowing Bell companies to participate in the marketplace. And everyone is aware of the effective competition in the interexchange industry which exists in the form of MCI, Sprint, and others. Fair competition in any industry is beneficial, and that goal is clearly at the heart of our antitrust laws.

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[22] AT&T's Memorandum in Support of Its Motion for Declaratory Ruling on Operator Call Handling, filed August 20, 1986.

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The experience of the Bell companies in competitive markets since 1984, shows that they have not dominated any of the markets in which they have been allowed to compete. The Bell companies now provide cellular telephone services, paging, yellow pages, and many non-telecommunications services. In fact, not only do the Bell companies compete with all non-Bell telecommunications players, but each one of us competes directly against one another. Among the numerous examples, here in the Washington, D.C. area Southwestern Bell currently provides head-to-head competition to Bell Atlantic in the cellular and yellow pages markets.

One of our more successful competitors, GTE, provides proof that a local exchange carrier not bound by the MFJ can manufacture equipment and not impede competition. In its business as a local exchange carrier, GTE is larger than each of the seven regional Bell companies. GTE has the same incentives and abilities which our opponents allege will dictate the Bell companies' behavior if they receive relief from the manufacturing restrictions: alarmist notions that a local exchange carrier will have an unfair advantage over other manufacturers because of its knowledge of the infrastructure; that a local exchange carrier will cross-subsidize its manufacturing affiliate's operations; that a local exchange carrier will engage in self-dealing to the detriment of competitors and the network infrastructure; and that a local exchange carrier will manufacture abroad or in conjunction with a foreign manufacturer. Actual experience has shown that GTE has not dominated the telecommunications equipment marketplace. Similarly, United Telecommunications, the second largest non-Bell local exchange service provider, is subject to the same criticisms due to its ownership of the interexchange service provider Sprint. However it is clear that United

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Telecommunications/Sprint is able to provide effective long distance competition without dominating that market.

VI. Existing and Proposed Safeguards

Likewise, claims that MFJ relief will lead to abuses by Bell companies are unfounded. Such claims ignore the vast array of existing and proposed safeguards intended to promote competition. Federal and state regulatory safeguards, industry standard setting bodies, economic reality, practical business considerations, and the existing antitrust laws are more than adequate to assure fair competition in the marketplace.

Price cap regulation removes any presumed financial incentive for Bell companies to cross-subsidize an unregulated business. Price caps set maximum prices for a particular group of services and provide incentives for carriers to operate efficiently. Price caps alleviate the often cited ratepayer concern with shifting costs from unregulated businesses to the regulated accounts because even if such a cost transfer were made, the local exchange carrier would not be able to increase its rates to cover those costs.

Regulatory safeguards also prevent a Bell company from attempting to seek any unfair competitive advantage by failing to disclose network specifications or interconnection arrangements in an attempt to favor its own unregulated products or services. The FCC has extensive network disclosure requirements which require advance

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disclosure of new network services and interconnection offerings prior to their implementation.

Furthermore, industry standard setting bodies develop the requirements which describe how a customer interconnects his or her equipment to the network. These provide incentives for a Bell company to use standard interconnection arrangements, thereby alleviating speculation by some that unique interconnection arrangements would be devised for the sole benefit of the affiliated manufacturing affiliate.

Since divestiture, much work has been undertaken by the FCC to enable itself to more closely monitor the operations of the Bell companies. Cost allocation requirements have been adopted for every transaction between a local exchange carrier and its affiliates. In order to ensure compliance with these rules, the FCC requires each Bell company to conduct attestation audits which are performed by independent accounting firms. Once these audits are completed, the FCC reviews the findings, effectively adding another layer of audits.

The FCC and state regulatory agencies also have easy access to the Bell companies' books and regularly examine them. The FCC has recently developed a means to more easily identify whether a transaction or account needs further scrutiny. The FCC has created its ARMIS reporting system, pursuant to which all Bell companies submit financial and network information to the FCC in similar fashion on a regular basis. Since the Bell companies now consist of seven independent companies, it is relatively easy for the FCC to recognize when one company's accounting appears to be

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out of line. In short, the Bell companies operate in a glass house and there is no shortage of people willing to throw stones at us. There is no prospect that improper conduct would go undetected.

Furthermore, the expressed need for additional safeguards in any MFJ legislation has not gone unheeded. H.R. 1527 does nothing to relax existing antitrust laws, regulatory oversight, accounting and audit requirements, or other existing safeguards. To the contrary, H.R. 1527 contains these additional safeguards:

- the seven Bell companies and their affiliates may not enter into joint manufacturing ventures between or among themselves;

- all manufacturing activities must be performed in a subsidiary which is fully separated from the regulated telephone company;

- the separate manufacturing subsidiary must maintain its own accounting books;

- revenues earned by the regulated telephone company may not be used to subsidize the operations of the manufacturing affiliate;

- the manufacturing affiliate must sell its products to other telephone companies on non-discriminatory terms, without self preference;

- the regulated telephone company may purchase equipment from its manufacturing affiliate only at open market prices;

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- the regulated telephone company may not provide to its manufacturing affiliate preferential access to technical information necessary to interconnect equipment to the local exchange network;

- the regulated telephone company may not issue debt on behalf of the manufacturing affiliate, nor may a creditor of the affiliate have recourse to the assets of the telephone company; and

- Both affiliated and non-affiliated manufacturers must be afforded comparable opportunities to sell equipment to the regulated telephone company.

Furthermore, H.R. 1527 authorizes the FCC to prescribe any additional rules and regulations necessary to enforce the above principles.

VII. Conclusion

As long as the MFJ's line of business restrictions continue, we must view ourselves as having three options when presented with opportunities to advance the nation's telecommunications system. None of the options is desirable. One option will be to do nothing. That is far and away the least risky course of action. However, it goes against my nature to adopt such a defeatist attitude and it does nothing to advance the interests of this nation. A second option is to obtain advance permission from the Department of Justice and the decree court before we do anything. The time that is required for this process to reach a conclusion usually casts doubt on the viability of this option. Most business opportunities cannot await months, and sometimes years, of

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argument. The third option is to proceed without knowing for certain whether the MFJ will someday be interpreted as prohibiting the desired activity. Faced with the threat of civil fines and criminal penalties, no CEO can be enthused about this option. As Congressmen seeking to promote the advancement of the telecommunications industry of this nation, you must not tolerate the status quo and the absolute chilling effect it has on advancement.

What has been the cost of the MFJ restrictions? The costs of the restrictions over the last ten years are impossible to measure. The losses are in the form of innovative services that were never pursued, investments in R&D that were never made, efficiencies that were never realized either by the industry or its customers, and technology that was never developed. The MFJ is a cloud over not only the Bell companies, but also the nation's entire telecommunications industry.

What are the benefits that will be realized once the line of business restrictions are removed? On a very fundamental level, the Bell companies will be able to -- for the first time -- translate the needs identified by our customers into efficient products and services. Permitting the Bell companies to fully utilize their expertise and resources can only help America regain its service leadership in the telecommunications marketplace and strengthen America's position in world trade. We are all too familiar with what happened to the American consumer electronics industry. With relief from the MFJ, the telecommunications balance of trade will once again shift in America's favor. What was once a $200 million surplus has become a deficit of $1.8 million in less than a decade. Seven new competitors will enter the telecommunications equipment and information services markets, providing new products and services that directly address the needs of

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consumers. American competitiveness will be enhanced by unleashing technical and financial resources and increasing research and development expenditures. Allowing Bell companies to invest venture capital and improve the telecommunications infrastructure will benefit existing manufacturers and enhanced service providers. As a result, more domestic jobs will be created, the dichotomy between the information rich and the information poor will disappear, and consumers will benefit from a wide range of products and services.

Most people today regard the break up of the old Bell system to have been a net positive. My petition to you and to other forums does not, as some have implied, represent a desire to recreate some fondly recalled past. To the contrary, I want to see a healthy and vibrant U.S. industry which is capable of providing good jobs for good people, high quality services to the public, and opportunity for economic growth. We will not meet that future with the MFJ restrictions in place. They must be set aside in favor of fair competition if we are to realize the future we all seek.

Because that is the undeniable case, I am impatient. Within the past week we have seen one step in the Judicial branch that addresses one of the restrictions. Less than two months ago, the Legislative branch took a similar, positive step on one of the other restrictions. It is essential that this momentum not be slowed or lost. As those elected to represent us all, I ask you to see this job through.

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Organizations and Notable Individuals Who Support Lifting the MFJ Manufacturing Restrictions on the Bell Operating Companies

Absher, Woody, State of Wyoming, Vocational Rehabilitation*
Alaska Association of the Deaf
Alpha One - Center for Independent Living
American Association of State Colleges and Universities
American Council of the Blind
American Council on Education
American Legislative Exchange Council
Becker, Jody Anne, Marin County Mediation Services*
Black Citizens For a Fair Media
Center for Independence for the Disabled, Inc.
Center for Living & Working, Inc.
Citizens For A Sound Economy
Coalition for Citizens with Disabilities
Communications Workers of America
Connecticut Association of the Deaf
Council of Chief State School Officers
Council of Churches of the City of New York
Delgard, Ray, 4th District County Supervisor*
Donaldson, John, Educator
Foundation for Technology Access
Fox River Valley Center for Independent Living
Geller, Henry, Communications Fellow, Markle Foundation*
Granite State Independent Living
Greater Chicago Broadcast Ministry
Klass, Morris, Professor Memphis State University*
Maine Advocacy Services
Minnesota Association of Deaf Citizens
Minnesota Chapter of the American Deafness and Rehabilitation Association
National Association for Better Broadcasting
National Association for the Advancement of Colored People (National)
National Association of Arab Americans
National Association of Counties
National Association of Development Organizations
National Association of the Deaf
National Conference of Black Mayors, Inc.
National Council of Silver Haired Legislators
National Indian Youth Council
National Network of Learning Disabled Adults
National School Public Relations Association
National Silver Haired Congress

July 31, 1991

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Native American Public Broadcasting Association, Inc.
North Country Independent Living
Northeast Independent Living Program
O'Connor, Barbara, Professor, CSU - Sacramento*
Ohio Association of the Deaf
Ohio Developmental Disabilities Planning Council
Older Women's League
Options Center for Independent Living
PARAQUAD
Pepe, Donald, Gilmer County Industrial Development Association*
Phillips, Ken, Director of Information Systems*
Progress Center for Independent Living
Rehabilitation Engineering Society of North America
Sheehan, Larry, Santa Clara County Office of Consumer Affairs*
Shenandoah Valley Independent Living Center, Inc.
Symposium on Deafness and Hearing Impairment
Telecommunications for the Deaf
Texas Association of the Deaf
Town of Bloomsburg
United Cerebral Palsy Association of Texas
Van Deerlin, Lionel, Former Chairman House Subcom. on Telecommunications*
Vial, Donald, Former President California PUC*
Virginia Association of the Deaf
Western Kansas Association on Concerns of the Disabled
Widdows, Richard, Professor - Purdue University*
World Conference of Mayors
World Institute on Disablility
Zemechman, Edward, Consumer Activist

*Affiliation for identification purposes only

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SAMPLE LETTER TO MEMBERS OF THE U.S. HOUSE

July 24, 1991

Dear :

We are writing to express our support for H.R. 1527, the "Telecommunications Equipment Research and Manufacturing Competition Act of 1991," a bill to lift the ban that prohibits the regional Bell telephone companies from manufacturing telecommunications equipment.

- **H.R. 1527 is a pro-consumer bill.**

All consumers benefit from a robust public telephone network. The current court ban on manufacturing discourages the telephone companies from investing in their own domestic networks. H.R. 1527 will encourage investment in the public switched telephone network by granting the local telephone company authority to have a financial interest in the inventions and equipment that will drive the networks in the future.

Furthermore, allowing the regional Bell companies to manufacture will restore their incentive to invest in product-specific research and development, thereby bringing new products to the consumer.

- **H.R. 1527 is good for American workers.**

America's telecommunications workers know that H.R. 1527 will help create employment opportunities in the United States, which is why the Communications Workers of America has endorsed the bill.

Since 1984, when the prohibition against manufacturing by the regional Bell companies was imposed, manufacturing jobs in the telecommunications sector have been moving overseas at an alarming rate. In fact, over 60,000 domestic telecommunications manufacturing jobs have been eliminated.

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- **H.R. 1527 is good for ratepayers and competition.**

There are ample safeguards against any possible abuse by the Bell Companies, and the bill creates incentives for new investment in the network that may well lead to greater efficiency, broader availability of service, and continued affordable rates. H.R. 1527, therefore, poses no meaningful risk to either competition or local rates.

In short, consumers and the country benefit from the additional competition and innovation that is likely to result from lifting the manufacturing restriction.

Please lend your voice, vote, and co-sponsorship to H.R. 1527.

Communications Workers of America
Barbara J. Easterling
Washington, DC

National Association for the Advancement of Colored People (National)
Fred Rasheed
East Orange, NJ

American Council of the Blind
Oral Miller
Washington, DC

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

Alaska Association of the Deaf
Albert Berke
Anchorage, AK

American Association of State Colleges and Universities
Edward Elmendorf
Washington, DC

Center for Independence for the Disabled, Inc.
Marielayna Rossillo
Roanoke, VA

American Council on Education
Sheldon Steinbach
Washington, DC

National Association of the Deaf
Charles Estes
Silver Spring, MD

Henry Geller
Communications Fellow, Markle Foundation
Washington, DC

American Legislative Exchange Council
Sam Brunelli
Washington, DC

Alpha One - Center for Independent Living
Steven Tremblay
North Portland, ME

Black Citizens For a Fair Media
Emma Bowen
New York, NY

Council of Chief State School Officers
Gordon Ambach
Washington, DC

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Ray Delgard
4th District County Supervisor
Santa Cruz, CA

Fox River Valley Center for
Independent Living
Cathy Lutkin
Maine

Morris Klass
Professor Memphis State University
Memphis, TN

Marin County Mediation Services
Jody Becker
San Rafael, CA

Minnesota Association of Deaf Citizens
Ruby Vine
Blaine, MN

National Council of Silver
Haired Legislators
Reverend Edward E. Fields
Washington, DC

National Network of Learning
Disabled Adults
Jay Brill
MD

National Silver Haired Congress
Neel Buell
Fountain Valley, CA

Northeast Independent Living Program
Charles Carr
Lawrence, MA

PARAQUAD
Max J. Starkloff
St. Louis, MO

Foundation for Technology Access
Jacquelyn Brand
Albany, CA

Gilmer County Industrial Development
Association
Don Pepe
Glenville, WV

Maine Advocacy Services
Linda Dowell
Winthrop, ME

John Donaldson
Educator
Norwalk, CT

National Association of Arab Americans
Khalil E. Jahshan
Washington, DC

National Indian Youth Council
Joe Cordova
Albuquerque, NM

National School Public
Relations Association
Joe Scherer
Arlington, VA

North Country Independent Living
Brian Scott Bonitz
Superior, WI

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

Ken Phillips
Director of Information Systems
Santa Monica, CA

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Rehabilitation Engineering
Society of North America
Dennis Smeage
Washington, DC

Donald Vial
Former President California PUC
San Rafael, CA

Richard Widdows
Professor - Purdue University
West Lafayette, IN

Larry Sheehan
Santa Clara County Office
of Consumer Affairs
Santa Clara, CA

Virginia Association of the Deaf
Gary Viall
Falls Church, VA

Edward Zemechman
Consumer Activist
Canoga Park, CA

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Following is a list of 78 small telecommunications companies supporting H.R. 1527 as of July 30, 1991. In the aggregate, these companies employ 20,000 U.S. workers and produce annual revenues that total $3 billion.

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

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Company	Location	Business Engaged in By Company
The Tigon Corp.	Texas	voice messaging business
AmPro Corp.	Florida	miscellaneous
data Con, Inc.	Massachusetts	interconnect sub-systems
Lumisys	California	high definition scanners for converting x-rays into digital images
Broadband Technologies, Inc.	North Carolina	electronics for "fiber to the home" telephone systems
The Triangle Tool Group, Inc.	South Carolina	miscellaneous
Vicorp Interactive	Massachusetts	software for interactive telecommunications services
BI, Inc.	Colorado	RF identification management systems
Elcotel, Inc.	Florida	Intelligent products utilized in the public pay phone and hospitality industries.
L.M. Berry Co.	Ohio	yellow page directories
LHS, Inc.	Massachusetts	multilingual speech recognition software
Silent Call Corp.	Michigan	assistive communications devices for disabled people
Computer Consoles, Inc.	New York	miscellaneous products
Axes Technologies Inc.	Texas	miscellaneous
Teradyne, Inc.	Massachusetts Illinois	telephone line test equipment
XEL Communications, Inc.	Colorado	transmission equipment
TeleSensory Systems, Inc.	California	high tech products for visually impaired people
Aptek Technologies, Inc.	Florida	miscelaneous
Electronic Modules, Inc.	Texas	fax and voice messaging equipment

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WHY THE MANUFACTURING RESTRICTIONS SHOULD BE REMOVED

Restrictions placed on the seven regional Bell companies that prohibit or discourage them from manufacturing telecommunications equipment and from engaging in detailed design and product engineering development are damaging our domestic telecommunications industry. Lifting these restrictions will stimulate our economy and enhance America's leadership in the international telecommunications market.

Rep. Jim Slattery (D-KS) and Rep. Billy Tauzin (D-LA) have introduced the Telecommunications Equipment Research and Manufacturing Competition Act of 1991 (H.R. 1527) that will:

- **Allow the regional Bell companies to provide American consumers with state of the art equipment -- and the products and services such equipment makes possible.**

The restriction prohibits or discourages many forms of research and development, meaning that some of the best ideas for telecommunications innovation lie on the shelf. The regional Bell companies can neither develop these products, nor can they assist small and medium-sized domestic manufacturers at important steps in the development process.

The regional Bell companies are limited in their ability to share ideas and designs for other manufacturers to use.

An example is Eagle Telephonics Corp., one of the last American manufacturers of telephone handsets. Despite the fact that the regional Bell companies are among Eagle's largest distributors, they cannot provide normal commercial funding for the substantial R&D required to incorporate new features because of the restriction.

- **Provide the regional Bell companies the incentive to increase investment in telecommunications research and development.**

Because the regional Bell companies are prohibited from manufacturing and from important aspects of research and development there is a loss of creativity and innovation, and the incentive to engage in certain types of R&D is diminished significantly.

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Since divestiture in 1984, the regional Bell companies have devoted only 1.3 percent of annual sales to R&D, about one-sixth of what most high-tech firms routinely spend. In 1989, for example, software and services companies invested almost twenty times more on R&D than the regional Bell companies spent. And today, Japanese high-tech companies spend three and one-half times more than their U.S. counterparts on R&D.

Critics who point to the dollar figure spent by the regional Bell companies on the relatively small amount of R&D they currently conduct ignore the fact that the cost of developing new telecommunications technology is escalating much more rapidly than inflation or industry sales.

Further, according to BusinessWeek's annual "R&D Scoreboard," annual R&D spending by the U.S. telecommunications industry in general increased by 3.4 percent annually between 1984 and 1989. Comparable spending in the computer industry, for example, rose at annual rates of 11.5 percent.

- **Create more U.S. jobs.**

Americans are all too familiar with domestic industries, such as electronics (VCRs, televisions, etc.) and auto manufacturing, that have been eclipsed by foreign competition. The losses to the American economy have been substantial.

Since the 1984 divestiture, over 60,000 manufacturing jobs in the U.S. have been eliminated, and many U.S. telecommunications companies continue to reduce their manufacturing operations. Some entire domestic market segments have simply vanished.

Removing the restriction will produce more jobs in the telecommunications industry. It makes good business sense to target manufacturing activity to the market where it's needed -- in this case, in the U.S. This is why large foreign manufacturers such as Northern Telecom and Siemens have opened plants in America.

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Furthermore, a domestic content provision in H.R. 1527 will require the regional Bell companies to conduct all manufacturing activities in the U.S., using only American-made parts, unless a good faith effort to locate such components fails. This provision is a major reason that the Communications Workers of America and many small and medium-sized domestic manufacturers endorsed the legislation.

- **Keep domestic companies and American intellectual property in the U.S.**

Another unfortunate effect of the restrictions is that small and mid-sized manufacturers in America have become ripe targets for acquisition by foreign interests.

Accordingly, ownership of important industry assets has begun to shift abroad. Over 70 U.S. telecommunications and related high-tech companies, representing an investment of over $3 billion, have been gobbled up by Japanese and European conglomerates, who are buying U.S. technology that some in our own industry are not allowed to develop.

International Mobile Machines Corp., for example, entered into a venture agreement with the foreign conglomerate Siemens/Alcatel to make digital cellular equipment when one of the Bell companies withdrew from negotiations because of the manufacturing restriction.

Another disturbing trend is the steep decline in the number of patents for new telecommunications equipment held by American companies. In 1974, U.S. companies held 69 percent of the new telecommunications patents; 13 years later, that number has dropped to 48 percent.

- **Provide venture capital to small U.S. manufacturing firms.**

The manufacturing restriction on the regional Bell companies has reduced the capital that would have been available for small to mid-sized firms. For example, Centigram Corp., which develops equipment for providing audiotex services, recently sold a substantial portion of its stock to large foreign entities after two regional Bell companies failed to structure a financing deal that would pass muster under the manufacturing restrictions.

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Lifting the restrictions will allow the regional Bell companies to provide smaller firms and start-up companies resources to further invigorate the manufacturing industry.

- **Re-assert America's dominance in international telecommunication's trade.**

The U.S. telecommunications industry has been steadily losing ground to foreign interests. Where there once were 15 major telecommunications manufacturers worldwide (three from the U.S.), today there are eight -- only one is American.

American manufacturing jobs have been moving overseas; foreign interests have bought U.S. firms at a rapid pace; and our telecommunications balance of trade (SIC 3661 -- telephone and telegraph equipment), once a $200 million surplus, ran at an estimated $1.8 billion deficit in 1990. This rate is nearly four times faster than the the decline in the nation's overall trade balance. The estimated $1.8 billion deficit does reflect an improvement of some $500 million over 1989 -- but that improvement comes at a price.

The decrease in the deficit is not a result of increased U.S. exports. Indeed, exports grew by only 4.8 percent in 1990 despite extreme weakness in the U.S. dollar exchange rates that should have boosted foreign demand for U.S. products. Rather, the improvement in the telephone equipment trade balance that occurred in 1990 was largely attributable to a 10.1 percent decline in U.S. imports, due to the soft U.S. economy.

Furthermore, the U.S. is running a slight trade surplus in the so-called "high end" segments of the telephone equipment market, due to the fact that large foreign manufacturers are now manufacturing equipment in the U.S. and are beginning to export from their U.S. plants.

Relief from the manufacturing and R&D restrictions will not immediately reverse the nation's current telecommunications trade imbalance. Relaxing the restrictions, however, will enable the regional Bell companies to compete on a level playing field, where they can build the type of world class telecommunications infrastructure that will add to U.S. competitiveness in a wide variety of industries.

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- **Maintain competitiveness in the domestic market through legislative and regulatory safeguards.**

Competition in the U.S. telecommunications market is good for consumers and manufacturers alike.

The Department of Justice, Federal Communications Commission and state regulators already closely guard against anti-competitive threats. Together, they have enacted rules governing equal network access, Open Network Architecture, equipment interconnection and strict cost accounting, making telecommunications one of the country's most closely-watched and tightly regulated industries in America.

In fact, in testimony before the Senate Commerce Committee, Assistant Attorney General James F. Rill said that the current regulations have rendered the manufacturing restriction obsolete. "The manufacturing restrictions are no longer necessary to protect competition. Worse, these restrictions are themselves anticompetitive..." he said.

H.R. 1527 offers additional protections, including provisions that prevent the manufacturing affiliate from selling its products on a discriminatory basis.

At a time when the U.S. economy stands on shaky ground and foreign competitors are eager to divide the spoils of the U.S. telecommunications industry, it is imperative that the regional Bell companies be unshackled from restrictions that unfairly limit their participation in domestic and international markets.

Equally important, they will compete in an environment that includes appropriate regulatory safeguards to protect against anti-competitive harm to the market. The FCC and state regulators have put in place such restrictions, and the Slattery/Tauzin legislation provides additional protections.

The seven regional Bell companies represent over half of the national telecommunications resources. It simply makes no sense to keep that creativity and innovation watching from the sidelines as the industry, our economy and, worst of all, the American consumer, suffer.

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COMPETITIVE SAFEGUARDS FOUND IN H.R. 1527

H.R. 1527 is an important step in helping the telecommunications industry reassert its domestic and global leadership. Although industry safeguards are necessary to ensure full and fair competition, they can only achieve their full value in an open market. Congress, Federal regulators and the seven regional Bell companies understand that the freedom to participate in the equipment manufacturing market must protect the public interest. H.R. 1527 safeguards stipulate that:

- Any manufacturing affiliate established by a regional Bell company must be separated from its regulated telephone service activities, and manufacturing activities must be conducted within the separate subsidiary;
- the manufacturing affiliate must maintain books of account separate from those maintained for the regional Bell companies' telephone company operations;
- the regional Bell companies may not use revenues from their regulated telephone operations to subsidize the competitive ventures of their manufacturing affiliates;
- the manufacturing affiliates must sell their products on non-discriminatory terms to non-affiliated telephone companies;
- the regional Bell companies can only purchase equipment from their manufacturing affiliates at open market prices;
- the regional Bell companies cannot provide their manufacturing affiliates with discriminatory access to technical interconnection information;
- the telephone company may not issue debt on behalf of its manufacturing affiliate and a creditor of the manufacturing affiliate is prohibited from having recourse to the assets of the telephone company;
- each regional Bell company must afford both affiliated and unaffiliated manufacturers comparable opportunities to sell equipment to its local telephone companies; and
- the seven regional Bell companies may not enter into joint manufacturing ventures between or among themselves.

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H.R. 1527 authorizes the Federal Communications Commission (FCC) to establish other rules and regulations as may be necessary to enforce the above provisions. In addition, the regional Bell companies are, and will remain, subject to audits by state public service commissions and the FCC to prevent cross-subsidization between regulated and unregulated operations.

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Mr. BROOKS. Mr. Tobias, you are recognized.

STATEMENT OF RANDALL L. TOBIAS, VICE CHAIRMAN, AT&T

Mr. TOBIAS. Thank you.

My name is Randall Tobias and I am the vice chairman of the board of AT&T. It is a privilege to be here before the distinguished members of the subcommittee.

I commend you for calling this hearing and for your continuing interest in promoting a competitive business environment.

The paramount issue is, as you have said, whether the MFJ and the way it is being administered enhances or detracts from our ability to promote a healthy and dynamic telecommunications industry in this country.

By resolving decades of dispute, the decree has sparked unprecedented research and development, generated a vast array of new products, produced a sharp decline in prices and expanded the technological frontiers of our telecommunications infrastructure and preservation of these gains is an important public policy goal.

The advantages and the benefits of the decree have been enormous. 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 more than 42 percent. The same story is true of telecommunications equipment manufacturing. In the United States, this has been an enormous success story under the decree, and competition is vigorous, bringing with it all of the consumer benefits that the framers of our competitive laws envisioned.

This explosive competition has also produced great trade benefits, especially for products at the high end of the telecommunications market. Since the subcommittee hearing in 1989, there have been several dramatic trade developments.

In 1989 and 1990, we witnessed a drop of 70 percent in telecommunications equipment trade deficit for the United States. The U.S. exports jumped sharply, at an annual growth rate of 29 percent for the same period.

In one of the most critical product categories, the switching equipment that is used in telephone networks, we enjoyed a trade surplus which increased from $115 million in 1988 to $709 million in surplus in 1990.

There is certainly no legitimate basis for claims that the United States is falling behind or in any way becoming a second-class Nation with respect to our telecommunications infrastructure. There is no other economic community anywhere in the world that even approaches the United States in the availability, quality, reliability, and affordability of telecommunications services. This is not to say that the decree's injunction can never be eliminated. An injunction on the Bells' entry into the manufacturing of telecommunications products and equipment markets should remain as long as the local telephone service bottlenecks continue.

When the monopoly power ends, when the local service markets are as competitive as the long distance markets, we would have no objection to the Bell companies entering manufacturing, for we believe that America's great strength is the result of the existence of competitive markets. That is the thrust of our antitrust laws, and

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that is the basic thesis of the decree, and it should be preserved, and not dismembered.

It is precisely on this basis that AT&T strongly opposes the current attempts to undercut the framework of the modification of final judgment through piecemeal legislation.

The elimination of the full structural separation between the local exchange bottleneck and equipment manufacturing could mean the end of our existing 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, who would perform the important design and development functions abroad. It would therefore mean the end of important consumer benefits in the availability, innovation, and affordability of telecommunications equipment that have been brought about by the decree.

In short, the policy set in place by the decree is working well and reversing it at this time would bring back all of the problems that initially led to its adoption.

If this committee is to consider legislation, Mr. Chairman, such legislation should embody the fundamental procompetitive principles of the decree, the provisions of the decree mandating separate ownership of monopoly telephone exchanges on the one hand and competitive businesses on the other. Those are the only safeguards that have worked. They are simple, and they have been effective.

A comprehensive legislative approach which ratifies these safeguards for such time as the monopoly continues should be equally simple and effective. On the other hand, the piecemeal approach advocated by some would destroy the competitive equipment market by again combining the local exchange monopolies with in-house equipment suppliers.

The decree properly recognizes that the injunction must remain until the local exchanges are no longer monopoly operations and indeed the decree included provisions in it for its own modification when there is no substantial possibility that monopoly power would be used to impede competition in competitive markets.

In contrast, the legislative proposals with their clearly inadequate alternative safeguards ignore this very basic antitrust principle, and would recreate the problems that the decree resolved. This would surely detract from everyone's goal of promoting a healthy and dynamic competitive telecommunications industry.

Thank you, Mr. Chairman.

Mr. BROOKS. Thank you very much.

[Mr. Tobias' prepared statement follows:]

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STATEMENT OF RANDALL L. TOBIAS
VICE CHAIRMAN OF THE BOARD OF DIRECTORS
ON BEHALF OF THE
AMERICAN TELEPHONE AND TELEGRAPH COMPANY
BEFORE THE
SUBCOMMITTEE ON ECONOMIC AND COMMERCIAL LAW
UNITED STATES HOUSE OF REPRESENTATIVES

INTRODUCTION

My name is Randall L. Tobias. I am the Vice Chairman of the Board 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 recent developments surrounding the AT&T Consent Decree.

Mr. Chairman, I commend you for calling this hearing and for identifying the paramount issue in any appropriate debate on these issues -- whether the MFJ and the way it is being administered enhances or detracts from our ability to promote a healthy and dynamic telecommunications industry in this country. In this regard, ensuring that antitrust principles remain at the center of the telecommunications debate should be of fundamental importance.[1] It is precisely on these bases that AT&T strongly opposes attempts to alter the framework of the Modification of Final Judgment.

The Decree was the result of years of study and has been reviewed by a number of Committees of Congress, including

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[1]See Committee on the Judiciary, News Release, July 12, 1991.

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this one, as recently as two years ago. The Decree was the subject of an extensive Tunney Act review as required by statute, and was affirmed by the United States Supreme Court upon its approval by the District Court. It has been repeatedly ratified by the Court of Appeals in the intervening years. Since this Committee last reviewed this matter in 1989, the Court of Appeals has specifically reaffirmed the Decree's inter-exchange and manufacturing injunctions on grounds that nothing had changed to justify their 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.

What has not changed is the fact that the Decree has been one of the most significant pro-competitive actions ever taken under the Sherman Act. It resolved decades of dispute and created a genuinely competitive marketplace structure for the telecommunications industry. Any reintegration of the local exchange monopolies with in-house equipment suppliers would recreate the abuses and disputes the Decree resolved and could well destroy the competitive equipment market that has developed.

The advantages and benefits of the Decree have been and continue to be enormous. 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 more than 42 percent. The same story is true about telecommunications equipment manufacturing.

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Telecommunications equipment manufacturing in the United States has been a remarkable success story under the Decree, and competition is extremely vigorous, both domestically and in world markets. Among other evidence of this success:

-- 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. Rather, they purchase about half of their equipment needs from AT&T, Western Electric's successor, and the rest 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 exported over $1.2 billion of equipment. And AT&T's sales abroad are 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 percent -- 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 percent.

The creation of a competitive manufacturing market has produced great trade benefits, especially for products at the high end of the market. In the period since this Committee's 1989 hearing on the Decree, we have witnessed a drop of 70 percent in the telecommunications equipment trade deficit for the United States, from $2.6 billion in 1988 to only $.8 billion in 1990.[2] In one of the most critical product categories -- the

[2]When the deficit caused by "low end" equipment (telephones, answering machines, and like equipment) is excluded, the telecommunications trade balance for 1990 is actually a $1.7 billion surplus. This reflects the fact that the trade deficit in the telecommunications sector is caused by imports of "low end" equipment, a part of the market that depends heavily on overseas manufacturers and which the RBOCs are unlikely to enter,

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switching equipment used in telephone networks -- we now enjoy a trade surplus, which increased from $115 million in 1988 to $709 million in 1990. Both sides of the trade balance have contributed to these developments: U.S. exports have jumped sharply (growing at an annual rate of 29 percent between 1988 and 1990), and imports have leveled off (increasing at less than 2 percent in 1990).

With these accomplishments, there is certainly no legitimate basis to any claim that the Decree must be modified in order to avoid our "falling behind" other industrial countries with respect to our telecommunications infrastructure. There is no evidence that indicates that the U.S. is becoming a "second class" nation in this regard. No other economic community anywhere in the world even approaches the United States in the availability, quality, reliability, and affordability of telecommunications services. Our technology continues to be the most advanced in the world: for example, in 1988 (the latest year for which statistics are available) more than 76 percent of U.S. access lines were served by electronic switching systems; of our major trading partners, Japan, the U.K. and Germany cannot match the United States -- only France was even close at just under 70 percent. The same contrast is found when one considers digital switching capabilities or fiber optic facilities. Similarly, service innovation in the United States has been

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as John Clendenin, BellSouth's Chairman and CEO testified before the Senate Subcommittee on Communications on April 25, 1990.

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unrivaled -- witness the growth of facsimile services, cellular services, specialized value-added networks ("VANs"), packet switching and ISDN technology, to name just a few.[3]

The Decree has not curtailed this long history of innovation and dynamic change. To the contrary, it has accelerated it. R&D expenditures by the firms that comprised the Bell System more than doubled between 1981 (before divestiture) and 1989. R&D performed by non-Bell System participants in the industry -- investments made by the hundreds of firms now selling into Bell company markets -- has shown equally impressive growth. The net result is that company-funded R&D expenditures by domestic manufacturers of telecommunications equipment have increased as a percentage of overall shipments from some 6.6 percent in 1980 (before divestiture) to some 8.0 percent in the post-divestiture period, with astonishing breakthroughs in areas like photonics, chip design, and many others.[4]

Because the ownership separation of monopoly exchange operations from telecommunications equipment manufacturing so clearly promotes a competitive marketplace, with the associated benefits of product innovation, declining equipment prices, and international competitiveness, it is not surprising that our major trading partners are now pursuing similar structures or

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[3]The factual support for my conclusions can be found in the Comments of AT&T, submitted to the National Telecommunications and Information Administration, in Docket No. 91296-9296 (April 9, 1990).

[4]Id.

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industrial policies within their own telecommunications sectors. The United Kingdom, for example, has opened its telecommunications markets to those firms who are willing to invest in local manufacturing operations. Canada has followed suit and the Japanese and Germans have even begun some tentative steps towards opening their markets. The former has privatized its telecommunications system; the latter has announced, in recent weeks, the possibility of ending the relationship between the telecommunications ministry and its captive supplier, Siemens.

The proposed removal of the manufacturing ban is also unnecessary for addressing or eliminating equipment or service failures such as those recently experienced on the East Coast and in California. There is no basis whatsoever for the recent insinuations that the Decree's manufacturing safeguard contributed to these problems or delayed their resolution. The Decree does not prohibit the BOCs from talking with their suppliers, or from collaborating to fix a defective product, or from finding out why a product is not satisfying performance specifications. The District Court, in an emergency hearing on this matter last month, confirmed that the Decree did not stand in the way of prompt repair, and that neither a waiver nor "permission" from the Court was necessary in order to take whatever steps were necessary for the equipment vendor and its customers to correct the cause of the service interruptions.

Nor does the manufacturing restriction in general

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preclude the BOCs from specifying and demanding products from their suppliers that are innovative or that incorporate technological advances. The Decree expressly authorized the creation of Bellcore, a joint venture of the seven Bell Regional Holding Companies, to conduct research; to evaluate new technologies and products; and to coordinate innovative features and specifications throughout the network. The Regional Companies are free to apply their full expertise, creativity and resources to assure continued American technological superiority and leadership, and to make ongoing improvements to our telecommunications network. No change to the Decree is necessary for these purposes. What the Decree does -- and should continue to do -- is eliminate the real risk of stagnation that would result if bottleneck monopoly telephone companies were again permitted to affiliate with equipment manufacturers.

In sum, this is not an industry that demands major restructuring. Any careful analysis of our experience over the entire period following divestiture, as well as over the last two years, clearly supports the continuing validity of the Decree's clear-cut approach. Even proponents of the various bills acknowledge that some form of safeguards is necessary to ensure that the bottleneck local monopolies are not abused -- that they do not discriminate against competitors or cross-subsidize competitive ventures with monopoly operations. But as opposed to permitting the recombination of monopoly operations and competitive equipment manufacturing and relying on regulatory

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measures and enforcement, the Decree's manufacturing ban continues to offer the most effective and efficient safeguard possible.

I would next like briefly to review the relevant background of the Decree's manufacturing provisions, and explain why the removal of the manufacturing ban is premature at this time.

THE GENESIS OF THE DECREE INJUNCTIONS

The United States Government has brought four major antitrust actions against the Bell System during the course of this century. Each of these enforcement actions 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) resulted in divestiture of a nationwide radio programming network, removing the Bell System from that market. The third action (brought in 1949) produced an antitrust decree requiring the Bell System 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 Decree, the United States again contended that the integration of Bell telephone monopolies and competition businesses was fundamentally anticompetitive and

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harmed consumers and competitors alike. In particular, the self-dealing between the Bell Operating Companies and Western Electric's manufacturing operations was considered inherently abusive.

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 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 break the link between monopoly operations and competitive operations and to end the disputes and abuses that resulted from that combination.

The current industry structure and Decree provisions emerged as a response to these endless and costly challenges to the Bell System's integration. In order to resolve the Justice Department's Sherman Act enforcement proceeding, 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 adopt a structural separation of the monopoly local exchanges from competitive long distance and manufacturing functions. The Decree thus required a clean break between these operations. Other safeguards or injunctions were viewed as insufficient to eliminate the abuses -- and the debates concerning those abuses -- that would otherwise occur.

The Decree, however, is not immutable. It contains provisions for waiver and modification of its terms. As a result

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of the first Triennial Review required under the Decree, modifications proposed by the Regional Companies and the Department of Justice with respect to entry into unrelated businesses were thus adopted. Similarly, following remand and pending any further judicial review, the Decree has recently been modified to permit the Regions' entry into the information services market. And when the local exchanges no longer constitute bottleneck monopolies, the manufacturing injunction of the Decree will properly be removed as well.

THE CONSEQUENCES OF REMOVING THE MANUFACTURING INJUNCTION

Only a few years after all these issues were resolved and the country appeared to have recovered from the trauma of the Bell System's reorganization, the various bills under review 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, and discrimination. These bills would dismantle the very essence of what the United States Government insisted upon when the Decree was entered and would run directly counter to our national policy of promoting competition. 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

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widespread benefits for consumers, there is no sound basis for reversing course.

We should make no mistake in believing that the material circumstances of the industry have changed in the short period since divestiture -- or in the last two years -- to justify modifying the manufacturing ban. As the Court of Appeals concluded last year, the local exchanges still constitute a bottleneck of essential facilities which give the Regional Bell Companies tremendous market power. As just one example, since divestiture, regulatory oversight has required over $6 billion in reductions to the interstate access rates those companies otherwise wished to charge. Quite simply, the Bell Companies are still monopolies and they still have the incentives to exercise their power in predictable fashion.

If the manufacturing ban of the Decree were removed, the most immediate result would be a likely series of joint ventures between the BOCs and already-established major manufacturers, mostly foreign[5]. None of the proposed legislation on this subject would preclude joint ventures or other affiliations with foreign manufacturers who are eager to penetrate yet further into the American market. What the

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[5]At least one of the Regions has indicated that it would not intend to develop additional high-end equipment. In an interview published in Telephony (July 16, 1990), William Weiss, Ameritech's Chairman, said, "Do I want to be a switch manufacturer? Hell, no. ITT invested $1B trying to bring its European switch to this country and threw in the towel. I'm not a manufacturer. . . ." The alternative to the Regions' de novo entry is joint ventures with existing switch manufacturers, which would most likely be foreign.

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proposed legislation would thus do is open our domestic market far more widely to foreign manufacturers at the same time the market is being closed to unaffiliated domestic manufacturers. The legislation would effectively deny American firms the chance to earn in their home market the revenues which they need to compete successfully abroad -- a difficult enough task already, in light of the discriminatory practices that Japan and many of the European countries already employ to discourage competition from U.S. 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.

Foreclosing large segments of the market to unaffiliated domestic manufacturers, while permitting foreign manufacturers to affiliate with Bell companies (essentially to buy into a position of unfair advantage) would be particularly perverse and injurious to American competitiveness. This risk is not idle speculation. In the Triennial Review of the MFJ in 1987, for example, the District Court noted the intervention of one of the larger European firms, which predictably supported the removal of the restriction. The Court determined 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

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factors unrelated to efficiency or quality of performance."[6] And although the Administration now supports the lifting of the restriction, as recently as 1987, the Department of Commerce 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."[7]

The effect on the prosperity of American firms and opportunities for American workers would be dramatic. A 1989 Department of Labor staff study predicted that 18,000 - 27,000 American jobs could be lost if just two or three BOCs entered manufacturing by venturing with foreign producers. And, as the Deputy Secretary added, "possibly more" American jobs would be eliminated, "depending upon the RBOCs' behavior."[8]

In light of this record, some of which has been compiled after this Subcommittee's prior hearing, it is clear 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. And none of these bills, despite their promise, would

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6 U.S. v. Western Electric, 673 F. Supp. 524, 562 (D.D.C. 1987).

7 Assessing the Effects of Changing the AT&T Antitrust Consent Decree, 1987 NTIA Trade Report, page vi.

8 December 1989 Staff Study, Department of Labor.

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help to maintain American technological prominence. For example, even versions of bills with "domestic content" provisions would wholly exempt foreign "intellectual property" from applicable limits. That is, the Regional Companies would be free not only to affiliate with foreign manufacturers, but to rely entirely on the research, development, and design -- which together produce "intellectual property" -- that is performed outside of this Country. With or without domestic content provisions, continued American technological preeminence is assuredly not promoted by allowing the most crucial research and development tasks to be performed exclusively by foreign firms.

Even if the BOCs did not join with foreign manufacturers, or did not rely on foreign intellectual property, the results for domestic competition would still be substantial. If allowed into manufacturing, each BOC could be expected to look to its own affiliates to satisfy nearly all of its equipment needs, regardless of the relative merits of competitive equipment. This would have the effect of unfairly foreclosing substantial portions of the market -- exactly the state of affairs that existed before divestiture.

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 whether or not it will be able to compete on the merits. Prior to the Decree, firms

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were deterred even from entering the manufacturing market because they assumed that the Bell System would purchase exclusively from its own affiliate. Elimination of the manufacturing injunction would thus encourage companies to exit the manufacturing business and would deter others from entering. That was the result before the manufacturing and local exchange markets were separated, and the same result would quickly be recreated if the markets were 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 development only to the extent they believe that the products resulting from that investment will be able to compete on the merits. Few manufacturers believe that this 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.

Moreover, the Regions are particularly well-situated to provide unfair advantages to manufacturing affiliates. Consider Bellcore (the research and engineering entity jointly owned by the seven Regional BOCs) which was formed under the Decree on the express assumption that the BOCs would <u>not</u> be involved in

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manufacturing. Bellcore performs the research, the local exchange network engineering, and the product evaluation functions that Bell Laboratories performed for the former Bell System, all of which were repeatedly challenged by the United States, the FCC, and aggrieved manufacturers when these activities were performed within an integrated enterprise. If the manufacturing ban were removed, Bellcore's coordination of product standards and product evaluations would present the BOCs with a particularly effective vehicle for engaging in favoritism and discriminatory conduct. It appears, however, that each of the bills under consideration fails to address this issue.

For all of these reasons, the consequence of eliminating the manufacturing ban on jobs and on the competitive character of the equipment manufacturing segment of the domestic telecommunications industry would be profound. Yet there is an equally basic and important issue -- the effects on American 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 would be affiliated with local exchange monopolies) would substantially diminish competition with respect to products, innovation, service, and price -- both of telecommunications equipment and the telecommunications services offered by means of that equipment.

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The impact on consumers of telephone service would 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 affiliate would present 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 enterprises. This would give them an unfair advantage over their manufacturing competitors, who lack a similar captive source of financing. It also means that local ratepayers would be paying substantially more than they otherwise would 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 would inevitably face higher long-distance bills.

THE INADEQUACY OF REGULATORY SAFEGUARDS

Underlying all these bills is the belief that regulation can finally be written and enforced which could prevent discriminatory treatment, cross-subsidization, and other anticompetitive controversies. But what is different now about regulatory safeguards than was the case 2 years ago or even 9 years ago? If anything, this industry is more dynamic, complex, and technologically sophisticated than ever before. Accordingly,

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it is that much more difficult for regulators adequately to monitor all the transactions and accounting between the regulated and unregulated business affiliates. Until the local exchanges are truly competitive, no regulatory measure can even come close to structural separation as the only effective safeguard against abuse.

Indeed, before the Bell System management agreed to a divestiture, we considered every possible form of regulatory protection that might be imposed to guard against anti-competitive conduct, while still enabling our businesses to function in an integrated fashion. We tried our best to devise safeguards that would satisfy the critics and end the controversies over self-dealing, cross-subsidy, insider information, and all the rest. We found none.

In addition to our own efforts, the Federal Communications Commission, the Congress, 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. Similarly, almost every state had statutes and regulatory proceedings designed to prevent abusive procurement

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practices from affiliated suppliers. Although mountains of regulations and virtually endless numbers of proceedings were attempted, no adequate regulatory solution was found. And none curtailed the infinite controversies and lawsuits concerning the Bell System's procurement practices.

Not until divestiture did we solve the problem. Only then were we able to reduce regulation by orders of magnitude by bringing competition to the industry. I am therefore 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.

Experience under the Decree has shown that the clean separation of ownership between the monopoly operations and related competitive activities, such as manufacturing and interexchange carriage, has proved to be the most effective safeguard in preventing abuse and controversy. It curtails the incentive to discriminate or show favoritism to affiliated manufacturers. It eliminates a corporate structure where the risk of cross-subsidization is always present. It avoids the need for regulatory oversight of the vast and complicated dealings that occur between affiliates. It eliminates the ongoing disputes that would otherwise divert the industry and its regulators from tending to the continuous push toward innovation to keep pace with the ever-expanding technological possibilities.

It is not time to remove this crucial safeguard of the Decree. The whole array of problems connected with these issues

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would be resurrected if the Decree 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. We have learned that the anticompetitive controversies which these bills threaten to unleash can be prohibited by regulatory oversight only in theory -- never in practice.

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 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 that are beyond their

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capacity, or anyone's capacity, to address adequately.

Regulatory measures are not the answer to the potential for abuse that the affiliation of monopoly operations with competitive manufacturing creates, and they are not adequate substitutes for the clear safeguards provided by the Decree's manufacturing injunction. Such measures are not a substitute for a competitive marketplace. They are not the guarantor of competition. That is the role of antitrust enforcement. The Sherman Act, when enforced, works -- and works very well.

CONCLUSION

In conclusion, I would like to thank the Chairman and the other members of this Subcommittee for calling this hearing. 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 permission to perform important design and development functions abroad. It would therefore mean the end of the explosion of consumer benefits in telecommunications equipment 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

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that originally led to its adoption.

This is not to say that the manufacturing ban can never be eliminated. 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 the 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. It should be preserved, not dismantled.

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Mr. BROOKS. Gentlemen, I would like all of you to consider a response to the following statement: "The availability and technological sophistication of information services which are lagging behind those of other countries would vastly improve if the regional companies were permitted into the market." That is from a Department of Justice brief cited in Judge Greene's decision, page 48.

What do you think about that, Mr. McGowan?

Mr. MCGOWAN. Mr. Chairman, from the numbers I have seen and the experience I have, the United States is far and away the leader in information technology. Over one-half of all information services that exist are provided in the United States.

Mr. BROOKS. We might not have heard.

Mr. MCGOWAN. The United States has over 50 percent of all information services provided in the world—about 3 million customers for information services. One million alone are in one service by the name of Prodigy, I believe. So we are, by far, the leaders in providing information services.

Information services started about 10 years ago, and the Bell operating companies, a number of them, did receive permission to open up gateways, but I don't know if any of them are left. A lot of them closed down. They didn't seem to take advantage of that. They did not encourage it.

I am not sure of the current status of Southwestern Bell. But the BOC's have not done very well with the provision of information services. But where they have been provided by independent companies, they have done very well in the United States.

Mr. BROOKS. Thank you.

Mr. Whitacre.

Mr. WHITACRE. The answer to your question is, Mr. Brooks, yes, it will improve. The subcommittee needs to know that this industry now has a lot of very large companies in it, companies much larger than Southwestern Bell or the other regional companies. It is not like we want to get into a market with a lot of small companies. There are big players in this.

As Bell companies have the technology, we have the ability to provide this service to a lot of customers, and I think the answer to your question is undoubtedly it would improve.

Mr. TOBIAS. Mr. Chairman, I think the fundamental issue is the continued existence of the local exchange monopoly bottleneck, and as long as that exists, if we have a mixture of the ownership of the local exchange bottleneck with competitive services, then competitive services of all types and the incentives to create those kinds of competitive services will be stifled.

We have in this country, and I would be happy to submit for the record evidence of all kinds of measures of the leadership that we have in the United States in absolutely any conceivable aspect of innovative telecommunication services of all types. And that has come about in large part by the fundamental concept of competition that has been created under the decree.

[See appendix, Osceola F. Thomas' letter.]

Mr. TOBIAS. If anything happens to change that, then small companies, large companies, all kinds of companies who are incented to come up with a better idea with the knowledge that it will be

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entertained and purchased if it is a better idea in a fully competitive marketplace, those incentives will go away and be stifled.

Mr. BROOKS. We would observe that in the decision, on page 50, Judge Greene's reaction to the statement was, "The court considers the claim that regional companies' entry into information services would usher in an era of sophisticated information services available to all as so much hype."

Now, Mr. Tobias, why did AT&T recommend to Judge Greene that the Bell companies be allowed to enter into the information services market?

Mr. TOBIAS. Mr. Chairman, I think there is a major distinction between being neutral——

Mr. BROOKS. They did do that, didn't they?

Mr. TOBIAS. No, they did not.

Mr. Chairman, I think there is a major distinction between being neutral on an issue, not taking a position on an issue, and being for or against an issue. We are, have been, and continue to be fundamentally opposed to the mixture of competitive services with monopoly services and as long as the monopoly bottleneck exists, we have grave concerns about the implication of that bottleneck.

Our principal concerns have been focused on manufacturing and interexchange services because those are the businesses we are in and know best. There are many other people in this country, many of the witnesses that will appear before you today, who are far more knowledgeable than we are about whether or not the implications are the same as it relates to information services.

And so we have taken the position consistently of neutrality on the issue of seeking judicial relief as it related to that particular part of the decree. But on the decree itself, we have been and continue to be very adamant about our concern about the implications of the local exchange monopoly bottleneck.

Mr. BROOKS. Mr. Tobias, are you neutral on the question as to whether or not the regional Bells should be allowed to bid on contracts like FTS 2000? They would probably like to.

Mr. TOBIAS. That would clearly be a violation of the aspect of the decree that is in an area that we know a good deal about with respect to interexchange services. So we would not be neutral on that.

Mr. BROOKS. What do you think about that, Mr. McGowan?

Mr. MCGOWAN. I believe that—I wish I had a lot more of FTS 2000 than I have. But we have been trying hard to get at that.

Mr. BROOKS. I understand. I understand.

Mr. Whitacre, did you want to—it was not designed for you, but you may want to make a comment on it.

Mr. WHITACRE. I would like to speak to a couple points that were made. Mr. Tobias said the longstanding monopoly, and that is a pretty tired argument. There is no monopoly in a lot of our services any more.

I would be the first to say that there is a monopoly probably in residential service, but there is no monopoly in business service any more. This bottleneck theory that we continue to hear just doesn't exist any more in most of our business or in a great deal of it.

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As to the comment that it is so much hype that Judge Greene made on page 50 or whatever it was, I don't think it is hype for Southwestern Bell or any Bell company to be able to tell their customer what time of day it is when they call. That's not hype to me, or to be able to give a customer a ZIP Code for somebody they are looking up. I don't necessarily think that is hype. Or to tell them where the nearest plumber or the nearest doctor might be.

That is the only comment I have, Mr. Chairman.

Mr. BROOKS. Where do they tell them where the nearest plumber would be? I have a lot of emergency plumbing work at my house.

Mr. WHITACRE. I have had a lot of plumbing recently, too. That is why I use that example.

Mr. BROOKS. Can you call the telephone company and find out who the nearest plumbers are? I thought you had to look in the Yellow Pages.

Mr. WHITACRE. In today's world, if a customer called us and we could offer the service if they lived in a certain part of town, we could certainly offer to a customer the location of the nearest plumber for them to call. We could do that.

Mr. BROOKS. Do you do that now, really?

Mr. WHITACRE. No, we cannot do it now. We are prohibited by the MFJ.

Mr. BROOKS. Did you ever do it?

Mr. WHITACRE. No, we have never been able to do it. We do have that capability.

Mr. BROOKS. While we are on that subject, how about Yellow Pages? Now, could you give me a rundown on the Yellow Pages? I would like to know something about the ownership and the volume of business, and who owns it, and what the published net profits are.

Could you get that for me? I know you might not have that at your fingertips.

Mr. WHITACRE. Mr. Chairman, I can get anything for you that you want.

Mr. BROOKS. That would be helpful.

[See appendix, Martin E. Grambow's letter.]

Mr. BROOKS. If you can get the phone rates down, that would be the biggest help.

Mr. WHITACRE. We might have to talk about that.

Mr. BROOKS. Yes, I will bet.

Do you all remember when we used to have those arguments before the breakup of AT&T. Somebody who wanted a telephone would write and tell me, "They won't give me a telephone." I would then find out that the individual lived 8 miles from the nearest telephone, and AT&T would have to run a line and poles. I worked on AT&T and sometimes in the old days they would agree to amortize the cost over a period of 8 or 10 years.

AT&T didn't do bad on those deals most of the time. But now and then, they said, it would just be a little prohibitive. You know, AT&T would like to serve them, but they didn't want to build 8 miles of line for one telephone. You could understand their rationale.

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It is just like cable companies now. Cable companies like to work in the cities because the yield is higher per dollar of investment. It makes sense.

Now, Mr. Whitacre, it is my understanding some of the Baby Bells have had some problems with cross-subsidization between their regulated and unregulated affiliates. Can you describe what the problems are, what can be done to preclude these abuses from happening in the future?

Mr. WHITACRE. Mr. Chairman, I would be happy to address that. I would like to say first, though, that I don't suspect our industry or our businesses are any different than any others. And I can tell you knowingly we would not do that. Willfully we do not do that. But we do make mistakes. But the cross-subsidization issue, let me give you a list of some of the things that are in place to prevent that.

There are nondiscrimination rules by the FCC. There are equal access requirements. There are cost accounting manuals. There are CEI rules. There are ONA rules. There are State commissions. There are State rules. There are antitrust laws. There is a requirement that an outside auditor each year attest to the fact that all these procedures are being followed.

So I would say that plenty of mechanisms are in place to prevent cross-subsidization, and that list I just gave you is quite a list of rules.

Mr. BROOKS. Thank you.

Without objection, we will put the agreement with NYNEX and the Public Service Commission of New York in the record.

[See appendix.]

Mr. BROOKS. Gentlemen, I have one last question for you. Would you all support a bill that would codify the antitrust principles set forth in the MFJ, and how should this be done? Do we want Congress to take a look at it?

Mr. MCGOWAN. Mr. Chairman, if we could get by that very uneasy feeling I have about the travels that legislation takes on this distinguished Hill, I would like to see it all codified into legislation. But I am concerned about that.

For several years, we have been living under the consent decree. And when I see what is happening on some legislation, and I am concerned, but certainly why the legislation speaks to is one that I am fearful that we would probably be some day eventually asking you all to codify that into legislation.

Mr. WHITACRE. I can answer that real simply, Mr. Chairman. Yes, we would support that. Unquestionably we would support it. Certainly we would think it should apply equally to all players in the industry, though, or all players in the business, but certainly we would.

Mr. BROOKS. Mr. Tobias.

Mr. TOBIAS. Mr. Chairman, yes, we would support such legislation as long as it captured clearly the fundamental principle that is really at issue here, and that is the separation of the existence of the local exchange monopoly bottleneck from competitive services. And as long as that fundamental principle was captured, yes, we would certainly support such legislation.

Mr. MCGOWAN. Mr. Chairman, may I make a comment?

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Mr. Whitacre mentioned before about local bottleneck monopoly as if it was not there any more, as though it was not very important. Somehow or other we have not found anybody to provide us with local connections except the local Bell companies.

Mr. WHITACRE. I said it wasn't there in terms of business services.

Mr. MCGOWAN. In terms of business services, yes. We supply services to both residential and business customers and we have not found, except for a tiny little fraction, 99.5 percent of all the money we spend for local interconnections, all the physical connections we have depends on local Bell companies. There is nobody else out there.

Mr. TOBIAS. Mr. Chairman, if I could just add to that, I believe that what generally happens in a truly competitive marketplace is that those players who have a set of skills that—and experiences and capabilities that will give them an advantage, a competitive advantage in a truly competitive marketplace, flock to that competitive marketplace.

And if the market for the last mile of business services is truly competitive, then it is a mystery to me why the people in Bell Atlantic, for example, don't drive through the Lincoln Tunnel and begin to compete with NYNEX in Lower Manhattan and offer those kinds of services, because there is clearly no one in the United States who is better able to offer those kinds of services than the local companies. And I would suggest that that is evidence there is no significant competitive environment in those local markets.

Mr. BROOKS. Mr. Fish from New York.

Mr. FISH. Thank you, Mr. Chairman.

I will start off with a pretty straightforward, maybe even simple, question. Every time I seek an answer, I get a different one. I wonder if you three would like to comment. In your view, what does the term "information services" include? What does it mean? All three of you, please.

Mr. MCGOWAN. I would say information services embodies the use of a telecommunications network, together with an information base accessible to the user. If you want examples, I would think Prodigy, CompuServe, other data bases which are in place, or are being put in place, are a few. These services create the ability to access data bases with information embedded in that data base.

Some of the facsimile services and electronic mail services are, I think, information-based services.

Mr. WHITACRE. Congressman Fish, I don't know that I can give you an all-encompassing definition, but to me—and I think in this context—it means providing information or data to a customer that would be useful to them or perhaps not even useful but make information and data available to our customers.

Mr. TOBIAS. Mr. Fish, I am not sure I can add much to what has been said. I think the final definition in a competitive market is ultimately in the eyes of the customer.

Whatever the customer perceives to be an information service that they need or want, that is an information service.

Mr. FISH. Thank you.

Mr. Tobias, I am going to ask a simple question with respect to manufacturing.

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AT&T has testified if allowed into manufacturing, each RBOC could be expected to look to its own affiliates for nearly all its own equipment needs regardless of the merits of competitive equipment.

Is this very likely, that they could or would want to supply all or almost all their own equipment needs?

Mr. TOBIAS. Well, I think certainly they would have a predisposition to look there first, and I would simply offer this statistic, that prior to divestiture, AT&T's Western Electric organization provided about 95 percent of the equipment to the Bell companies. Today AT&T provides less than 50 percent. I think it would simply be natural and normal that if a company had a vested interest in a manufacturer, then it would want to take care of the interests of that manufacturer and it would be predisposed to deal with itself.

The danger follows from that because it would be dealing with itself with incentives other than the incentives of whether the product is really the best, the most innovative, the most cost effective, et cetera.

Mr. FISH. The reason the percentage is going down from 90 to 50, as you said, is at one point you were the sole supplier. Now, there is competition.

Mr. TOBIAS. I can tell you, because I spent my whole life in this industry, and worked in what was the Bell System and worked for AT&T since divestiture, I can tell you in my view the company was then and is now, all of the companies, made up of very honorable, well-intentioned people, people who are not intentionally doing anything wrong or inappropriate; but I think the world is driven by incentives.

I think what you would create here, if you have a circumstance where the owner of a monopoly also owns a manufacturer, and that manufacturer in turn is competing with other manufacturers who do not have the advantage of being owned by the monopoly, competition gets stifled because there is the incentive of the monopoly to engage in self-dealing.

Mr. FISH. Do you have any suggestions to this committee with respect to safeguards regarding the regionals as their own suppliers?

Mr. TOBIAS. Mr. Fish, I think the best safeguard is to leave things alone. I think we have a circumstance that has flourished since divestiture. I think other than the RBOC's, I do not hear a human cry about fixing a problem. In fact, I am not sure what the problem even is.

I think the best advice I could provide would be to simply leave it alone.

Mr. FISH. Mr. Whitacre, if the regional companies are allowed to get into manufacturing, what kinds of telecommunications products do you foresee the RBOC's manufacturing? PBX's, switches, residential telephone equipment, cables, circuits, chips? Do you anticipate joint ventures with foreign manufacturers?

Mr. WHITACRE. Mr. Fish, we are on record as saying we certainly would be interested in working with domestic manufacturers. Indeed, the Senate bill requires that. All the discussion that we seem to hear concerns switching machines; but there is a lot more equipment required than switching machines.

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We personally in Southwestern Bell are not interested in manufacturing switching machines. That does not appeal to us.

But there are many other types of things such as telephone sets to be used by customers, PBX's, other types of transmission equipment.

Today, there is no source in this country that we can buy that equipment from. We must go overseas to buy telephone sets. Southwestern Bell nor any other Bell company can have a proprietary product.

We would be interested in the areas you are talking about of a proprietary telephone set which we cannot buy from AT&T because they are in competition and that does not work out.

PBX's are the same way. We must go overseas or buy from a foreign manufacturer. We might be interested in a PBX that we could put Southwestern Bell's name on.

Certainly, we would be interested in software and the development of software which falls under the manufacturing description.

Back to the switching machines and software. Today most of our switching machines were manufactured by AT&T. They run on software. That software is updated periodically by AT&T. We cannot be in that business. That violates the MFJ.

Mr. FISH. Would you like to be in that position, that business, the equipment that goes along with the switches?

Mr. WHITACRE. We would certainly look at that.

Mr. FISH. Thank you.

Mr. Tobias, I understand in 1990 AT&T exported $1.2 billion in telecommunications equipment. Of course, AT&T also manufactures equipment overseas and imports some of that equipment to the United States.

Could you provide the committee with the comparative dollar figure on AT&T imports into the United States for 1990?

Mr. TOBIAS. Yes. I don't know if I have that with me. If I don't, I will certainly provide it.

Let me say in terms of what we sell to the Bell companies and to others in the United States, about 95 percent of the value of the manufacturing content, contrary to some information that I think has been circulated on the Hill, about 95 percent of the value added of that manufacturing is in the United States. Very limited amount of the value added comes from outside the United States.

AT&T has manufacturing capability outside the United States, but with the exception of consumer telephone sets, all of our manufacturing outside the United States is there to enhance what you are talking about which is the entry into markets around the world into which among other things we can feed technology that comes from jobs here in the United States.

I will be happy to supply for the record specific numbers for you.

Mr. FISH. If you would, please.

[See appendix, Osceola F. Thomas' letter.]

Mr. FISH. I have read that since divestiture in 1984 AT&T has eliminated over 60,000 manufacturing jobs in the United States. First of all, is that a correct figure?

Second, could you tell us how many U.S. manufacturing facilities have been closed?

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Mr. TOBIAS. Again, I will get you the precise numbers. We have in the United States today about 100,000 people who are engaged in manufacturing or manufacturing-related jobs. That number has been reduced since the time of divestiture.

There are fundamentally three factors.

The first is that we have gone from a monopoly market for our equipment sales to competitive markets. We have lost market share. In losing market share, that has caused us to lose jobs.

Second, in entering a competitive marketplace, we have had to take a very different mindset from the one we had when we were operating in a monopoly environment. We have learned a great deal. We have become much more efficient. Those productivity improvements have also resulted in the reduction of jobs.

The third reason is manufacturing-related technology. Our technology improvements in our factories go at the rate of about a 10-percent productivity improvement every year, which means that each and every year we are able to have the same amount of production with about 10 percent less labor content. That is a necessity in order to compete in today's world markets.

[See appendix, Osceola F. Thomas' letter.]

Mr. FISH. Thank you.

Mr. Whitacre, the Senate-passed bill, S. 173, prohibits joint manufacturing ventures between RBOC's. Could you address this? Why is that? Couldn't such joint ventures be procompetitive?

Mr. WHITACRE. Well, it does prevent manufacturing joint ventures between companies. I think that was a safeguard that was put in there. It is a safeguard that we are agreeable to.

I guess you could make any speculation, Congressman, but that is one of the provisions that is acceptable to us.

Mr. BROOKS. Speaking of safeguards, what if the regional Bells were allowed to manufacture telecommunications equipment through affiliates but could not sell the equipment to themselves? What if you could only market your products out of region?

Mr. WHITACRE. Well, I think essentially that is what has happened or at least the equivalent of that.

One of the provisions of the Senate bill is that the price to everyone, our own affiliates or anyone outside it, must be marketed at market price. So that everyone would have an option to buy at the same price.

There would not be any incentive to do, I don't think, what you are talking about.

Mr. FISH. Would you effectively be prohibited from being your own supplier?

Mr. WHITACRE. Prohibit us from being our own supplier?

Certainly, one of the reasons we would like to be our own supplier is to have some proprietary products for our customers. Today, we are allowed to manufacture overseas if we so chose. However, we cannot sell those products in this country. We can manufacture overseas and sell those products overseas. We do not do that.

Mr. FISH. Thank you, Mr. Chairman.

Mr. BROOKS. Mr. Conyers, the gentleman from Michigan.

Mr. CONYERS. Thank you very much, Mr. Chairman.

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I am not going to talk about the manufacturing relief part of this large issue today, but with regard to information services, there is a question about what is happening to American jobs, American industry.

I hear from time to time that we have a lead, and then it is slipping; and in other parts of our economy as well, one day we are leading, then the next time you turn around that lead has disappeared, evaporated.

What I want to find out is what would this legislation do for the job market in the United States of America? Where will we gain jobs through the modification of this judgment, or where might we be in danger of losing American work stations?

Could you gentlemen comment on that?

Mr. TOBIAS. Mr. Conyers, I would say that if changes are made in the application of the decree such that the RBOC's are permitted to engage in manufacturing, it will surely move jobs out of the United States, offshore, for the reasons that we have discussed.

Fundamentally, it will discourage what has occurred since the time the decree was entered in the creation of hundreds and hundreds of competitive businesses who are now incented to participate and compete in this very competitive environment.

I think it will also stifle our ability in this country to have the kind of competitive environment that permits us to do what we have been doing, that is, to improve the balance of trade as we are increasingly competitive, operating in world markets.

I can see absolutely no example of where it will create new jobs. So I think the net effect of a change would clearly be to reduce the number of jobs in the United States.

Mr. CONYERS. Mr. McGowan.

Mr. MCGOWAN. As far as information services is concerned, the United States, I think, is still clearly a leader in the world in providing the structure and information service itself.

The use of computers and information in electronic form is one that, especially in the business community, has become well established. Internal business systems use information technology to enhance productivity. For most corporations, it has become a norm.

It is starting, as you know, to make inroads into the educational field. They have had enough demonstrations and are putting in place enough systems to be very encouraging. Increased use of information service technology is going to be an excellent way to improve the educational system in the United States.

Mr. CONYERS. But what about job creation, job maintenance? Do you see the modified final judgment or a statutory re-creation of that as having a negative impact on U.S. jobs?

Mr. MCGOWAN. I do not.

I see the use of information in business and in most organizations enhancing efficiency productivity. Where you see a decrease in job positions in certain sectors, I think that is due to many other factors such as labor rates. They are significantly lower in many other countries versus the United States.

As far as the United States is concerned, I think, if anything, it has probably enhanced the number of positions available using information technology.

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Mr. CONYERS. This is a great hearing. If both of you will show me some backup information that explains why you are both going in different directions, I would be very grateful.

What about you, Mr. Whitacre? Where do you weigh in on this subject?

Mr. WHITACRE. Mr. Conyers, I think from our standpoint, it certainly would create jobs because we would have to have people to do research work if we were allowed to do that. We are not today. There would be development work of products. That would require—and I cannot quantify this as closely as I would like.

There certainly would be the design piece, the fabrication piece. It takes people to do all that. In the information services market, if you have new information services products that are available to the public, and if those products are successful—and some would be and some would not—it, obviously, takes people to put that together. It takes programmers, it takes people who can change software. There would be jobs created from Southwestern Bell's standpoint.

Mr. CONYERS. I am going to be looking for a resolution of this question.

I cannot imagine what could be more important to this country than creating a full employment economy that does not turn on a huge peacetime military machine.

It seems to me that, as we move along in this manner, the critical issue is—what is this going to do to for the job market in the United States?

We have people growing up with no employment prospects. We now have people graduating with no jobs in mind. We have a deindustrialization that it seems to me we have to overcome in this country.

So these questions in the backdrop of the question of antitrust are very, very, very important. They are the bread and butter decisions that millions of Americans will not have anything to do with resolving except for us here in the Congress who rely on the information that you bring to us.

So I think that this hearing is a very, very important part of the judgments that we will make with reference to modifying the final judgment.

Thank you, Mr. Chairman.

Mr. BROOKS. Thank you, Mr. Conyers.

Mr. Smith of Texas.

Mr. SMITH. Mr. Whitacre, let me go back to a couple of other issues and ask you a couple of direct questions.

First of all, Judge Greene apparently does not feel that the Bell operating companies can be trusted. How do you respond to the Judge's feelings?

Mr. WHITACRE. Well, as I said earlier in my opening statement, I think that is ridiculous. That is not true, you know. We make errors, but we certainly can be trusted. To say we are going to willfully go out and dominate a market or do something illegal is ludicrous.

Mr. SMITH. That was my next question.

What do you think about the judge's indirect suggestion you will drive everyone else out of the market?

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Mr. WHITACRE. We are not going to do that. If we are more intelligent, have a better product, it sells with the consumers, we will be successful. If not, we won't.

That market is already dominated by companies that are much larger than Southwestern Bell in terms of asset size or numbers of people. It is not like we are going against some small person providing it. These are huge companies in this business.

It is ridiculous to think we are going to dominate that.

Mr. SMITH. Thank you, Mr. Chairman.

Mr. BROOKS. Thank you.

Mr. Mazzoli.

Mr. MAZZOLI. Thank you, Mr. Chairman.

This has been very interesting, but I must honestly say my mind certainly has not been made up that we cannot do the job here as well as it is being done downtown. And, we—perhaps to address my friend from Michigan's question about jobs and job creation—would probably be more sensitive to some of those things than maybe the courts or outsiders.

Again, I want to listen. I want to learn. I guess if you go back to 1982, there probably were mischiefs being committed, overreachings, bad behavior. I, to this day, remain unpersuaded, unconvinced that it took a divestiture to show us the problems. In some sense, we have lost our world domination. In some sense, we have lost our sense of leadership.

Again, I go back to my friends back home. They may not be the most sophisticated people in the world, but I think many of them long for the good old days when they knew whom to call, when to call, where to call and the work would get done.

I don't know that we want anybody to come in, the RBOC's, the Bell Systems, to come in and take over and do something that is anticompetitive. I just see enough inhibitions on that, within the law, within the market, and within Congress, that would keep that from happening. I think we ought to get rid of the MFJ and start from scratch.

Mr. Chairman, thank you.

Mr. BROOKS. Mr. James.

Mr. JAMES. Thank you, Mr. Chairman.

The question I would have of all three of you is how can we—well, let me express my concerns first.

Here we have a very specific judge's order who is charged with the responsibility of dealing with the antitrust laws, the continuing order. Now, he finds himself in the position of making economic decisions and commenting as to the good or bad economic effect that it might have on the United States and the world and specific companies.

To me, that seems to go well beyond the responsibilities for antitrust decisions or at least to some extent it goes to facts beyond that.

It would seem to me that is a legislative responsibility to set public policy, especially when you deal with a significant percentage of the industry. This is not to say he should not on a case-by-case basis say whether or not specific acts violate our laws.

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On the other hand, this bill is more like a special bill that deals only with two companies, eight companies. It doesn't deal with the whole industry.

Where are the GTE's in this? They have the same position, monopolies, particularly speaking, as any one of the Baby Bells.

So it would seem if we are going to address it, perhaps we should address it as it involves the entire industry, though we are dealing with a significant percentage of the industry.

I find myself confused in that regard. Could any of you comment on that, why we should address the Baby Bells and not all of the issues? Could you all comment on that?

Mr. WHITACRE. Mr. James, I would certainly comment on that. I think it is inherently unfair; it makes no sense.

GTE is a larger company than any of the regional companies. They recently acquired Contel, which makes them larger than any of the Bell holding companies or BOC's. It is not fair.

I think that is common sense. It is not fair to deal with only seven companies in one way and players larger than we are in the other way. It doesn't make any sense.

Mr. TOBIAS. Mr. James, I think it may be constructive to look at what the circumstances were when GTE indeed was in the manufacturing business because much of what we are dealing with here when we mix competitive businesses and monopoly businesses is the ensuing controversy that comes out of the perceptions that people have with respect to self-dealing, cross-subsidy, that kind of thing.

Indeed, when GTE was in the manufacturing business, the record would show they were frequently in regulatory disputes with regulators about whether or not there was abuse. They purchased very, very heavily from Automatic Electric which was then their in-house supplier.

Mr. JAMES. Who are we talking about now?

Mr. TOBIAS. GTE, in fact, at one time it is my understanding the district judge in Hawaii, Judge Pence, actually ordered the divestiture of manufacturing from GTE which was subsequently overturned on what, as a nonlawyer, would seem to me a technicality.

GTE bought very heavily from their in-house supplier and subsequently made the decision they no longer wanted to be in the manufacturing business. I think as far as they are concerned, the issue is probably academic.

But the point is when GTE had the capability that we are discussing here that would happen if the manufacturing restrictions were removed, we had all of the same kinds of controversy and embroilments that I would predict——

Mr. JAMES. My time is rather limited. I would say I draw from what you have said, yes, there are problems within all the monopolies including GTE or could be but now they are not engaging in that kind of contact. Would you say that?

Mr. TOBIAS. I think it is academic at the moment.

Mr. JAMES. As legislators, we are required to anticipate the results of our antitrust legislation as it is applied to an entire industry or all companies, not normally to deal in specific instances between groups of companies. That is why I am interested.

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Mr. TOBIAS. I think the real solution at the moment, Congressman, is to do nothing. I think the consent decree as it applies is working fine. There is no problem with GTE. There is no need to address the issue.

Mr. JAMES. Having said that, it makes me suspicious when one company says it is working fine and you are dealing with a few companies and don't want to address the industry as a whole. It is working fine. You like it that way from the standpoint of antitrust legislation. It should apply across the board or not at all.

On the other hand, I can see the problem with, OK, you have the benefit of a judge's order in one aspect and perhaps other people are not too happy with the other aspect of it. As you would expect to take the benefits of it—you would say leave it alone as it relates to the Baby Bells? But don't worry about it in regard to GTE or others at this point as far as general legislation?

Mr. TOBIAS. I am simply saying I am unaware there is a problem with GTE and, therefore, I don't think there is a need to address the issue.

Mr. JAMES. Do you understand the concept of equity under the law?

Mr. TOBIAS. Certainly do.

Mr. JAMES. That is what I am talking about. That is what we are charged with.

The judge is charged with an entirely different responsibility. That is dealing with the antitrust violation as it relates to a company or groups of companies.

If I have time for another question—you decided my 5 minutes are up, Mr. Chairman?

Mr. BROOKS. Yes.

Mr. JAMES. Time passes fast.

I didn't see the light come on. I did notice—OK.

Thank you. What are the rules? Do I have 5 minutes or not on the next set of questions? This has happened to me before all too frequently. I am asking. I would like to have my time put on a clock so that that light comes on and warns me, if I could. I just request that, if I may.

Mr. BROOKS. We will do that next time.

Mr. JAMES. Would you please next time? This is not the first time.

Thank you, Mr. Chairman.

Mr. BROOKS. Mr. Glickman.

Mr. GLICKMAN. Thank you.

This is a complicated area. I think it was H.L. Mencken who said for every complicated problem there is a simple and a wrong solution. This is one that I am somewhat confused about.

I would say a couple of things. No. 1, as a conceptual matter, I hate to keep thriving, intelligent companies out of making things. The more the merrier when it comes to making things. That is why I cosponsored this bill to let the Bell operating companies get into the manufacturing business.

This is a concept. The Japanese are making things. The Germans are making things. We have—by statute—prohibited certain people from making things that could be extremely productive and could move the country along competitively.

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So that reflects my bias there.

That great civil libertarian Judge Robert Bork has written an interesting paper that I think is worthwhile discussing. That is what I want as my prime line of questioning.

Mr. Whitacre, he kind of takes you on. Therefore, my position probably is more consistent with Mr. McGowan and Mr. Tobias's position. I want to read you what Judge Bork said.

He basically believes that antitrust law should not interfere with conglomerate or vertical integrations whether accomplished by mergers or growth. The BOC's proposed to be vertically integrated by entering the manufacturing and provision of equipment, but when a vertically integrated firm is regulated at one level and unregulated at another level, an antitrust policy of nonintervention is no longer presumptively appropriate.

The situation would alter the company's opportunities and incentives. That would be the situation if the restrictions in question were removed.

He warns in his letter—this is a letter I assume that is in the record to AT&T. He may be on retainer to AT&T. I don't know what the relationship is there. Let us say what he warns.

He warns the Bell operating companies could engage in discriminatory design which locks competing equipment out of their systems; that you could cross subsidize in subtle ways like having the regulated side do all the R&D on equipment and handing that work over to your manufacturing subsidiary, thereby cutting its costs and giving it a price advantage over competitors; and you would only buy your own equipment declaring it superior regardless of price, something Mr. Fish referred to.

I would like you to answer this question. I think it goes to the heart of expanding the business. Part of you is protected. You are like a public utility; you get the governments of the States, the localities and the Federal Government to give you a certain rate of return, a certain protection.

Now, we are going into another area that is not protected. How do you protect the consumer in that context? I want to give you the opportunity to answer that question.

Mr. WHITACRE. Congressman Glickman, first of all, I would say we were not going to do that. We are not going to harm the consumer. We are not going to violate the law. We will not do any of that.

Beyond that, I gave a list and I could add to that list all day of rules by the people who regulate us that will prevent that from happening. If we think we need more rules, that is OK, too.

We will abide by those, as long as everyone else abides by them. We are certainly not against safeguards, rules, or regulations. If we want to put more on, that is OK with us. We are not going to do that.

Even beyond that, there are things now such as price caps which make—there is no incentive to do what you are talking about or Judge Bork is talking about. So we were not going to do it. We are honest people.

Second, if you do not buy that, there are many rules in place today; and, third, the incentive and the pricing systems will not permit that today.

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Mr. GLICKMAN. Mr. McGowan, any comments?

Mr. MCGOWAN. Yes, I believe the nub of the issue is that if the Bell operating companies did not have monopoly control over access to the local telephone network, then we would not object to whatever they are doing. As a matter of fact, if tomorrow they say, "We are going to start another commercial enterprise unrelated to our monopoly and spin off the monopoly to our stockholders," we would say more power to you. If they do not have that monopoly power to be able to control the services we get, the time we get it, the cost of it, the effectiveness of it.

Mr. GLICKMAN. You do not think the current rules are adequate?

Mr. MCGOWAN. They are not adequate at all. They have never been. State level, Federal level, any level.

Mr. GLICKMAN. Mr. Tobias, I assume you agree.

Mr. TOBIAS. I agree totally with my new friend, Mr. McGowan. I think he makes the point very well. The problem is the interrelationship between the monopoly bottleneck and the other businesses; and it is the fundamental heart of the issue.

Mr. GLICKMAN. I don't want to ask any more questions. Let me say that is one side of the public policy issue. The other side is why do we arbitrarily keep certain people out of the manufacturing of items, which we do, just allowing the European and Asian markets to begin to dominate that process.

Mr. TOBIAS. Congressman, you started by saying the more the merrier. I also want to endorse that.

I think if there is a disagreement, it is what is it that is going to create an environment where we will have more. And I believe what has happened since the decree was entered was that we have more. We have created a truly competitive environment which has invited lots and lots and lots of people to make investments knowing that the fruits of their labors would be evaluated and purchased or not purchased on their merits in a competitive environment.

If we allowed the mixture of the monopoly bottlenecks and manufacturing, then those same more people would be disincented to be in this market and the end result would be we would have fewer people engaged in this set of activities.

Mr. GLICKMAN. Obviously, there is a disagreement here. I find the discussion of this letter raises some of the issues that raise concern.

Mr. McGowan, are you doing OK? Is your health all right? I used to read about you a lot.

Mr. MCGOWAN. Thank you very much for asking. I am fine.

Mr. GLICKMAN. You are not stressed out because of being on the same panel with the other two fellows here?

OK. Thanks.

Mr. EDWARDS [presiding]. The gentleman from California, Mr. Campbell.

Mr. CAMPBELL. Thank you, Mr. Chairman.

A quick question to Mr. Tobias and Mr. Whitacre to conserve time for other questions before we break.

A tough question it seems to me, Mr. Tobias, is this: There may be synergies between the people who serve customers and the peo-

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ple who make the goods that help them serve the customer. That seems to me is the toughest problem for you to answer.

It seems to me hypothetically, right, there would be very useful information you gain from dealing with customers that help you in making the machines. Hence, you sought to allow the RBOC's in.

Quickly, why is that argument wrong?

Mr. TOBIAS. Congressman, there are no restrictions in the decree today at all, under the assumption they are constrained from manufacturing, there are no restrictions whatsoever that keep them from having the kind of meaningful discussion you are talking about with any and all of their manufacturers. Indeed, these kinds of discussions at all levels take place today.

If anyone can point to specific restrictions that keep that from happening under the decree, I would be happy to help get rid of them.

Mr. CAMPBELL. You are talking discussion. I am talking manufacturing.

Mr. TOBIAS. So am I.

Mr. CAMPBELL. I understand there are restrictions.

Mr. TOBIAS. There are not.

Mr. CAMPBELL. Let me state what I understand the case to be.

An RBOC may not manufacture equipment to be used by the person within that RBOC's territory; is that correct or not?

Mr. TOBIAS. That is correct.

Mr. CAMPBELL. Then I think we are operating under the same assumptions.

If there are synergies whereby it would be useful to talk to the customer, how do you like the equipment, how you are getting along, we change it, those synergies are lost when we prevent the RBOC's from getting into manufacturing for their own district.

What am I missing?

Mr. TOBIAS. Congressman, I think what I am saying is there are no restrictions that inhibit that kind of discussion. Indeed, many of us today are into the whole notion of quality principles and the integration of suppliers; whether they are owned or not in terms of this kind of discussion is not a very important concept.

The MFJ has nothing to do with it.

Mr. CAMPBELL. I think we are talking past each other. I am sorry. I wanted to hear your rebuttal. I am afraid I didn't get it very well.

Mr. Whitacre, why you? Why are there not a host of other companies that can come in and produce, provide information services? You have to admit, don't you, there is some risk? There is some risk, whether you have a perfect record or not. You know, I get all this stuff from everybody. The record is not good. The National Cable Television people, obviously have an interest. They provided me a study, The Never Ending Story: Telephone Company Anti-Competitive Behavior Since the Breakup of AT&T.

We have the NYNEX overcharges, the stories of U S West. The temptation is there. Occasionally, apparently, it has been used. Why give in to that temptation? Why give it to you if there are others more than able to supply information services, manufacturing? Why take the risk with the RBOC's?

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Mr. EDWARDS. Mr. Campbell, I am afraid we will have to let the answer to that be forthcoming when we return from a vote. You will be protected in your time.

The subcommittee will adjourn for just a few minutes and recess.

[Recess taken.]

Mr. BROOKS [presiding]. The subcommittee will come to order. And I believe that Mr. Campbell had addressed a question of some importance to the panel, and they are in the process of answering that.

We would welcome your answer, Mr. Whitacre. We still start in the middle and work each end.

Mr. WHITACRE. Mr. Campbell, as we said earlier this morning, there are a lot of big companies already in this business. But beyond that, we think we are in a position to provide the small consumer or small business—if they are going to participate in information services, we think we can make that available to them. We certainly have the network to do that.

We are in the business of telecommunications and broadening services in the market. We are not going to subsidize that service. There are safeguards. We think that we can deliver a service to broaden it.

Mr. CAMPBELL. I believe the question was really this, though. If there are many others capable of doing that, as well, then given the fact that there are some embarrassing things in the record of the RBOC's compliance with MFJ, why take the risk of giving them that opportunity? You could do well, but I wonder if you could address whether there is this host of others.

Mr. WHITACRE. There is a host of others. As I said earlier, our industry is no different than others, and unfortunately, we make errors; but I don't think that precludes us from being in the business and, you know——

Mr. CAMPBELL. I'll take your answer.

One last question to you, Mr. Whitacre. Has your company actually manufactured telephone equipment?

Mr. WHITACRE. No, we cannot, in this country, manufacture.

Mr. CAMPBELL. I understand. And I thought you might have had the opportunity overseas.

Mr. WHITACRE. No, we have not.

Mr. CAMPBELL. Mr. Tobias, as I explained, I am trying to give to each person the toughest argument, at least as I perceive it, and for me, the toughest argument is synergies.

You respond, OK, we can talk, but that is no reason to manufacture.

I would like to have an elaboration.

Mr. TOBIAS. Thank you. I think it is extremely important for the synergy that you are describing to take place so that information flows from the customer through the whole value-added chain, through design and development and fabrication. The point that I was trying to make is that there are no restrictions whatsoever in the decree today that inhibit that discussion from taking place.

In addition, in our case—and I am sure in the case of many other corporations who are embracing quality principles—we are developing relationships with thousands of suppliers that cause this kind of discussion to take place, and it is critically important.

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But if anyone could point out anything to me in the decree that gets in the way of stopping that——

Mr. CAMPBELL. Let me just bring it to a close, if I may, then.

I read you to say that the synergies can all be captured or can in preponderant part be captured by communication flow, and you don't see any significant value by the actual process of manufacturing and working with the customer that uses that product.

Mr. TOBIAS. That is correct. I think they can all be captured.

Mr. CAMPBELL. Mr. Tobias, should we ever have broken up the Bell System?

Mr. TOBIAS. I confess to having changed my mind on this issue.

Mr. CAMPBELL. Thank you, Mr. Chairman.

Mr. BROOKS. Thank you very much.

Mr. Berman, the gentleman from California.

Mr. BERMAN. Thank you, Mr. Chairman. We don't have too much time because of the panel, so I will just ask a few of the questions I wanted to ask.

Mr. Whitacre asserted there are a whole series of areas where there is no domestic manufacturing process, and I think he referred specifically to telephone sets, PBX systems. Where there is no domestic competition, what is the logic in keeping the regional Bell operating companies from manufacturing, assuming appropriate safeguards are established?

Mr. TOBIAS. Are you addressing the question to me?

Mr. BERMAN. You are the one who, I think, made the point—well, no; Mr. Whitacre made the point, but either one.

That is the point you made. I would like your response to it.

Mr. WHITACRE. You made the point very well that I made. Thank you.

Mr. TOBIAS. I think the fact is that the needs that—if there are needs there in the market, that they are indeed being met; and if they are not being met, I would welcome the opportunity to know exactly what they are, so we can see what we can do to meet them. And I am sure there are a lot of other competitive suppliers who would like to do the same thing.

I think the specific issue that was addressed was the issue of simple telephone sets; PBX's are made in this country, but in terms of simple telephone sets, we found in our case—and every other supplier has, too—that the economics of that industry on a worldwide basis means that if you are going to be in that business, at least to this point, it has been necessary for us to do the assembly outside the United States.

In doing that, that has permitted us to stay in that business and feed technology jobs, sales jobs, distribution jobs, service jobs; and the economics just don't permit doing that in the United States. And I am quite confident that if Mr. Whitacre were in that business, he would discover the same economic circumstances.

Mr. BERMAN. Do you want to respond, Mr. Whitacre?

Mr. WHITACRE. I want to make a point.

Mr. Tobias says if our needs are not being met, he would like to know about it. Certainly we have had many meetings with AT&T about this very subject, but they are not being met. We have asked them certain things and have talked; and in total, they are not being met, they have not been met.

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And I said earlier—Mr. Tobias says PBX's are made in this country, but they are made by his company. They will not sell those PBX's to us for resale. And the only other manufacturer in this country, to my knowledge, is a company that is not based in the United States.

Mr. BERMAN. Mr. Tobias, again, you keep making references to, we shouldn't open up this area when we are dealing with this bottleneck monopoly. Is this simply a statement of opposition to what the Senate did, or is there an underlying suggestion that there is something we could be doing that is realistic that could bust up this bottleneck monopoly you keep speaking about?

Mr. TOBIAS. Well, I think that a time will perhaps come at some point in the future when technology factors or other factors—and I don't know what they may be—will create a circumstance in the local exchange that is truly competitive. When that happens, then I think the problem goes away.

But until that problem goes away, the fundamental heart of the problem that I have described, that you referred to, that existed at the time the decree was written and entered, has not changed from then until now. And until such time as it changes, I think we are stuck with the issue.

Mr. BERMAN. Do I have any more time, Mr. Chairman, or do you want to keep moving?

Mr. BROOKS. We want to keep moving. Thank you.

Mr. EDWARDS. Mr. Chairman, I ask unanimous consent to insert in the record at this point a letter from Lester C. Thoreau of the Alfred P. Sloan School of Management at the Massachusetts Institute of Technology. It comes out very hard against manufacturing by the local companies.

Mr. BROOKS. Without objection, so ordered.

[The information follows:]

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Lester C. Thurow
Dean

June 19, 1991

Mr. John D. Zeglis
Sr. Vice President - Law and
Government Affairs
American Telephone & Telegraph Co.
295 North Maple Avenue
Basking Ridge, New Jersey 07920

Dear Mr. Zeglis:

At your request and without compensation, I am giving you my opinion on the congressional legislation that would allow the regional telephone companies to manufacture telephone equipment.

As structured, this proposal is a mistake. While it has been violated to some extent, there was a certain basic logic in the original court order dividing the Bell System into those activities that were intrinsically monopolistic activities (local telephone services) and those activities that were or could be competitive activities (long distance services, the manufacture of telephone equipment). To let the regional telephone companies manufacture telephone equipment makes a complete 'mockery' of the division of the old AT&T into competitive and monopolistic activities. It essentially recreates the problem that was supposedly solved by Judge Green.

If the regional companies are allowed into manufacturing, they should not be allowed to sell any equipment to themselves. They must also be disconnected suppliers.

There is, however, an even more important problem. Foreign producers now have access to the US market in a way that US manufacturers do not have access to their markets since the telephone companies in other major industrial countries are still either private monopolies or government owned companies. If we have learned anything from the history of world trade in the past 20 years, it is that those with protected home markets who can use the profits made in those markets to make themselves more competitive in foreign markets beat those that must be competitive in foreign markets and who do not have protected home markets. As a result any regional company going into the manufacturing business should not be allowed to do so with a foreign partner.

Foreign partners should only be allowed if foreign telephone systems have been restructured in the potential partners home country so that American manufacturers could form alliances with regional telephone providers into those countries to compete with the local manufacturer in those countries. Mirror image reciprocity has to be the name of the game if the American producers are not to be driven out of this business.

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Finally it is important to understand where the high income jobs are located in modern electronics. The real issue is not where is the manufacturing going to be done or what is the local content level in that manufacturing. The real issue is where are the products designed and developed. If the design and development is done abroad (as would happen if a regional telephone company in the United States entered into a joint venture with one of the major manufacturers from the rest of the world),the United States would lose most of the value added in this business regardless of how much of the manufacturing was or was not done in the United States. We would have what the Europeans call 'screwdriver' factories and be kept out of the high wage opportunities in design and development.

The rest of the world believes in industrial strategies designed to capture key industries. The telecommunications industry is on the lists of all of those who seek to implement industrial strategies. While America may not want to have an American strategy for capturing telecommunications, it had better worry about a defensive strategy for keeping part of the industry in the United States.

From that perspective this bill is in the long run essentially a bill to transfer this industry to the rest of the world. It increases their advantages in the American market without any attempt to increase American advantages in their home market. By entering into a joint venture with a regional telephone provider who can sell equipment to itself, foreign producers will be able to cheaply buy American market share. Meanwhile American manufacturers will be unable to sell to government telephone companies in their home markets. Design and development will be done abroad and Americans will be limited to the low wage parts of the business.

This is not a smart trade strategy. As a result I think that this proposal is a mistake.

Sincerely yours,

Lester C. Thurow mf

LCT:ml

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Mr. BROOKS. Mr. Moorhead, the gentleman from California.

Mr. MOORHEAD. Thank you, Mr. Chairman.

What kind of communication can you have with suppliers? Can you tell the suppliers exactly what you want or give them advice about your needs, so they can manufacture a product that will be beneficial to you?

Basically, Mr. Tobias said that you could do whatever you wanted in communications on R&D. I would like to hear your side of that particular point.

Mr. WHITACRE. What we can tell a manufacturer is almost nothing. We can't tell them what shape it should be, how loud it should ring, what the dial should look like. Essentially, to put it in the simplest terms, we can say we would like to have a telephone set, and if it meets our approval, we will buy it, and if it doesn't, we won't.

Not only that, but if we find one that is acceptable to us, and there is something wrong with it, we cannot tell the manufacturer what to fix. We can't tell him that the green wire goes where the red wire is. That is prohibited.

So only in the broadest definition can we describe what we want to have, and then the manufacturing company brings it back to us for acceptance or not; and beyond that, we essentially can do nothing in that area.

Mr. MOORHEAD. Do you have any further comment on that, Mr. Tobias?

Mr. TOBIAS. I simply disagree, and I think it would probably be useful to have Mr. Whitacre submit for the record the specifics that are in the decree that prohibit what he just described.

Mr. MOORHEAD. One question for you, Mr. Tobias. A gentleman from Centigram recently told a subcommittee that while R&D spending by high technology firms normally runs in the area of 7 to 9 percent, the manufacturing restriction in the AT&T consent decree has been responsible for holding RBOC's R&D to 1.3 percent of annual sales.

On its face, this seems like a good argument for lifting the manufacturing restrictions. What is your comment on that?

Mr. TOBIAS. Mr. Moorhead, I think that is an inappropriate comparison. I think that is like looking at the airline industry and looking at the amount of R&D that American Airlines spends when one really ought to be looking at the amount of R&D that Boeing spends.

The numbers are appropriate to high tech companies engaged in the development and manufacturing of high tech equipment, and these companies are not.

Mr. WHITACRE. In our case, Mr. Moorhead, we spent about $50 million last year in the so-called R&D area. But the question that I have, or the comment is, why would you spend money in that area or how can you spend money when you can't develop anything or bring it to the market, which we are prohibited from doing?

Mr. MOORHEAD. Mr. Tobias, why didn't AT&T oppose the regionals in their efforts to get into information services? Was it because the RBOC's are your largest customers, or because AT&T wanted to get into information services itself?

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Mr. TOBIAS. At the time we made our decision to be neutral, our fundamental thinking was that we know a great deal about the implications of the monopoly bottleneck on the businesses that we are in, manufacturing and interexchange services.

There are many others who are in the information services businesses who were addressing these issues and bringing the facts to the attention of the court. And therefore, it seemed appropriate to us to not engage in a debate where others were examining the issues, and we didn't think we had anything to bring to the argument.

Mr. MOORHEAD. Mr. Whitacre, Judge Greene——

Mr. BROOKS. Mr. Moorhead, will the gentleman yield just a moment?

Mr. MOORHEAD. Yes.

Mr. BROOKS. We have heard this neutrality statement before, and I want to say that the appellate decree—the appellate tribunal held, inasmuch as none of the original parties to the consent decree are opposing the Bell companies from providing information services, Judge Greene must rethink his decision. Mr. Tobias and his company were original parties. He says they are neutral, but actually they said they were not opposed to it. The result of all this is that none of the original parties opposed the situation.

So the judge says it gives the effect of support. If AT&T had opposed it, there would have been a controversy. AT&T did not oppose the RBOC's and therefore the decision was to let the RBOC's into information services.

Mr. TOBIAS. Can I respond to that?

I would simply——

Mr. BROOKS. I am sure you have read it and are familiar with it.

Mr. TOBIAS. I am familiar with it. I am not a lawyer, but my understanding is that the standard that the appellate court indicated that the district judge must apply here was a standard that at the time we made that decision, we were not aware of. So I think the circumstances changed a bit in terms of the rules that were applied when the appellate court came down with its decision.

Mr. BROOKS. Would you now oppose it, now that you know a little more about it, or the facts have changed?

Mr. TOBIAS. I would like to stay exactly where I am. And I know that this is a very uncomfortable position for everybody, including me. But the fact is that our focus is on the impact on manufacturing and on interexchange services.

But if it meant that the fundamental decree, as it applied to manufacturing and information services, was going to fall apart, we would have a very serious problem, because we are very concerned about the implications of the heart of the decree on manufacturing and on interexchange services.

Mr. BROOKS. But you know when you jumped the newspapers, the media, and let information services go by, not opposing it, maintaining a neutrality, but gave the RBOC's a shot at that—when you did that, the newspapers and other information service providers don't seem to love you as much any more. As a result, they might not support you on manufacturing. Then you are right back in the soup.

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It seems like you all would have thought about that, with all that money and brains, before you got into that little box.

Mr. TOBIAS. Mr. Chairman, I think we have a lot of friends in a lot of industries who have varying perspectives on all of this. And I think what your hearing, and others, provides the opportunity to take the input that comes from the knowledge we bring, the input that comes from the knowledge and perspective that is brought by those in the newspaper industry and others, and permits you to come to a judgment of the total picture.

Mr. BROOKS. Oh, we are going to hear them all. We understand that.

Congressman, you have one more question?

Mr. MOORHEAD. I have two more questions.

Mr. BROOKS. Two more, all right. I tried.

Mr. MOORHEAD. Mr. Whitacre, does Judge Green's decision last week alter the legislative strategy of the regional Bells? If you ultimately obtain information services, would that not be enough for now?

Mr. WHITACRE. Well, you ask me a direct question, does it alter our legislative strategy.

We think we should be in information services, and if we get it that way versus legislation, certainly that is good. But, I don't know that I can say that it alters our strategy. I don't know that we have a well-developed strategy related to information services at this point in time.

We have talked about a lot of things; and I don't want you to think we haven't done a lot of thinking about it, because we have.

Mr. MOORHEAD. I haven't forgotten you, Mr. McGowan. You come last but not least.

MCI is a long distance company, primarily. It also is in information services. How would the RBOC's entry into the manufacturing harm MCI? MCI is a large, substantial purchaser of all kinds of telecommunications equipment. Doesn't the law of supply and demand suggest that more manufacturing might be to the benefit of the purchaser?

Mr. MCGOWAN. Theoretically, it could be, but I don't believe it. I believe they have not changed all that much.

We purchase our interconnections from the Bell operating companies. About 43 percent of our gross revenue is paid to the Bell companies, which causes us to have great interest in them. And I believe that there would be inefficiencies in BOC manufacturing. And the use of a rate-based concept that they have had would cause us to pay more money for those services.

Look at the recent history of the Bell companies. Since the divestiture, there has been something like $20 billion written off by all of those companies collectively. I would not like to see that repeated and pay for it.

I think they are a lot more efficient the way they are today, which is purchasing their equipment from third parties, arm's-length suppliers. And that is the principal economic reason that we oppose their ability to be able to do their own manufacturing as they did it before.

Mr. MOORHEAD. Any comment by either of the other members of the panel?

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Mr. WHITACRE. Well, simply, the products we want to purchase are not available in this country. We have to go overseas. We have been unable to do anything in this country related to manufacturing, and we just think we should be allowed to.

Mr. MOORHEAD. Thank you, Mr. Chairman.

But, you know, it seems strange that we are basically able to buy almost all of what we need in this country, since the divestiture, and they have not been able to.

Mr. WHITACRE. He buys a lot of switching machines and not much else. We buy a lot of other things, too.

Mr. BROOKS. Mr. Staggers, the gentleman from West Virginia.

Mr. STAGGERS. Thank you, Mr. Chairman.

I noticed Mr. Moorhead asked Mr. Tobias a question, and Mr. Tobias answered that if Mr. Whitacre wanted to put something in writing—I ask unanimous consent that Mr. Whitacre be allowed to do that.

Mr. BROOKS. An answer on one subject?

Mr. STAGGERS. He said there is an interpretation of the decree that was in controversy, and Mr. Whitacre disagrees with Mr. Tobias. And I think he should be allowed to do that, to submit it for the record.

Mr. WHITACRE. We would like to do that, Mr. Chairman.

Mr. BROOKS. Without objection.

[See appendix, Martin E. Grambow's letter.]

Mr. BROOKS. Mr. Tobias can write another answer to that. We will keep those lawyers busy. You never know when they have to be out working for a living.

Mr. STAGGERS. Let me ask two quick questions, and then I would also ask unanimous consent—because I know you want to go on to the next panel—to be able to put some questions in writing.

Mr. BROOKS. Without objection.

Mr. STAGGERS. I have two questions directed to Mr. Whitacre.

If, in fact, we do allow you all into manufacturing and information, would you anticipate that you would allow the union, existing union, to organize in the separate subsidiaries for companies that would be created, or would you have opposition to union representation?

Mr. WHITACRE. We have several different subsidiaries now, companies other than the telephone company, and the union has organized some of those. We certainly have no objections under the laws today of the union organizing any of the companies.

Mr. STAGGERS. The second question concerns my district. I come from the second most rural district of the United States, it is very mountainous. In fact, our saying is, if you flatten West Virginia out, it would be larger than the chairman's State, Texas.

If, in fact, you are granted relief, what benefits to my constituents would you see or for any other rural district such as mine? What would be the benefit for that type of district?

Mr. WHITACRE. For one thing, we would be able to deliver to your customers information services, and I am not sure they are going to be delivered if we are not allowed to do that. We certainly can do that.

Mr. STAGGERS. Thank you, Mr. Chairman.

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[Messrs. Whitacre's and Tobias' responses to Mr. Staggers' questions for the record follow:]

MR. STAGGERS' QUESTIONS FOR THE RECORD
FOR MR. WHITACRE

Question 1. If a bill containing the domestic content provision gets to conference and the Administration indicates that it would veto the bill if domestic content is included, what would the RBOCs' position be? Would they remain committed to retaining the domestic content provision?

As has been stated several times in various forums, the seven Regional Bell Companies fully support H.R. 1527 and S. 173, including the provisions limiting relief to domestic manufacturing. The details of these provisions were developed in partnership with the Communications Workers of America (CWA) and have their unqualified support as well.

After several discussions among CWA officials, Regional Bell Company representatives, Senate personnel, and others, the language limiting relief to domestic manufacturing was drafted and incorporated by Senator Hollings into S. 173. Likewise, when Congressman Slattery introduced H.R. 1527, he also included this language and the Regional Bell Companies remain committed to it.

The Regional Bell Companies believe that it is unfortunate the Administration has had the view that the domestic manufacturing limitation is objectionable. It is our firm belief that greater harm lies in a continuation of the present situation, where seven of this industry's most capable players are denied the ability to enter the marketplace for manufactured telecommunications products and customer premises equipment (CPE). Legislative relief permitting the Regional Bell Companies to do so would allow us to develop new products and services for the benefit of the American consumer and the American worker. It also would give us the ability to work with independent manufacturers to develop new ideas, and to ensure that their products meet the requirements of a modern telephone network and the needs of its users.

The Regional Bell Companies are currently barred from manufacturing telecommunications products or CPE in the U. S. for the U. S. market. Pending legislation would remove that barrier, to the extent that we could manufacture telecommunications products or CPE in the U. S. for the U. S. market and for export. The Regional Bell Companies continue to believe that H.R. 1527 is a well-balanced bill, which should be passed by the U. S. House of Representatives. Should objections remain at the time of final passage, we will continue to work with all concerned parties, particularly the CWA, to ensure that an enrolled version emerges which continues to have the broad support which exists today.

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Question 2. I understand that H.R. 1527 contains several safeguards to prevent the kinds of alleged abuses that brought about the consent decree. Can you explain to me why these safeguards can be expected to be effective and how they would create an environment different than that prior to the divestiture?

Since divestiture, numerous safeguards have been implemented by both the Federal Communications Commission (FCC) and state regulatory authorities. The Regional Bell Companies believe that these safeguards are, and have been, more than sufficient to effect and to preserve a competitive environment in the telecommunications marketplace.

Taken together, the safeguards contained in H. R. 1527, as well as those safeguards implemented by the FCC and state regulatory authorities, create an environment totally different from that which existed prior to divestiture when AT&T controlled the Bell System. These safeguards promote competition by creating opportunities for independent manufacturers to make telecommunications equipment to meet the needs of the Bell telephone companies, and by minimizing the risk that the Bell telephone companies will purchase equipment only from their own manufacturing affiliate to the exclusion of other manufacturers. They further ensure that the Bell telephone companies cannot cross-subsidize their manufacturing affiliates by shifting costs to their regulated telephone operations, or by purchasing products from their manufacturing affiliates at above-market prices.

None of these safeguards existed prior to divestiture. At that time, the FCC was confronted with the task of monitoring and regulating the business operations of AT&T, a vertically integrated corporation which was the largest in existence, and which was the monopoly provider of telecommunications products and services to most of the United States. AT&T sought to preserve its monopoly position by convincing public policymakers that maintenance of the Bell System was in the public interest. Today, by contrast, the telecommunications products and services marketplace is a competitive one composed of a myriad of players providing a wide variety of combinations of products and services. Each Regional Bell Company plays an important role in this marketplace, but no one company dominates the telecommunications industry like the former AT&T Bell System.

The FCC is in a different position as well, in that it has achieved a degree of sophistication and expertise which it did not have prior to divestiture. Through the adoption and implementation of new regulatory safeguards, the FCC has demonstrated its ability to effectively monitor and regulate the activities of the seven Regional Bell Companies.

The safeguards contained in H.R. 1527 which create an environment different from that which existed prior to divestiture, include the following:

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- Separate Subsidiary Requirement - H. R. 1527 requires that any manufacturing be conducted by the Regional Bell Companies only through an affiliate structurally separate from any Bell telephone company. The manufacturing affiliate must maintain separate books, records, and accounts, and must prepare and file with the FCC financial statements which are in compliance with Federal reporting requirements. Any debt incurred by the manufacturing affiliate may not be issued by the Bell telephone company, nor may the manufacturing affiliate incur debt in a manner giving recourse to the assets of the Bell telephone company. Moreover, the FCC is required by H.R. 1527 to prescribe regulations ensuring that the Bell telephone companies not subsidize their manufacturing affiliates with revenues from their regulated telecommunications services. The bill further prohibits joint sales, advertising, installation, production, and maintenance operations between the manufacturing affiliate and the Bell telephone company.

- Prohibition Against Joint Manufacturing - H. R. 1527 prohibits the manufacturing affiliate of one Bell telephone company from engaging in manufacturing in conjunction with the manufacturing affiliate of another Bell telephone company.

- Disclosure of Protocols And Technical Requirements - H.R. 1527 requires that each Bell telephone company maintain and file with the FCC, full and complete information with respect to protocols and technical requirements for interconnection with and use of its facilities. In addition, any material or planned changes to such protocols and requirements, along with the schedule for their implementation, must be promptly reported to the FCC. H.R. 1527 also prohibits the Bell telephone company from disclosing any such information to its manufacturing affiliate before filing it with the FCC. When two or more carriers provide regulated telephone exchange service in the same area, each must provide to the others timely information on deployment of telecommunications equipment. Also the FCC may prescribe additional regulations to ensure that manufacturers in competition with a Bell telephone company's manufacturing affiliate have access to the same information.

This safeguard will promote competition by ensuring that independent manufacturers have an equal opportunity to develop and manufacture products which will meet the needs of the Bell telephone companies. This will have the effect of creating an environment where the Regional Bell Companies will have a choice of vendors to meet their telecommunications equipment needs, thereby preventing

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discrimination in favor of their own manufacturing affiliates.

- Equivalent Sales Opportunities - H.R. 1527 requires that the FCC prescribe regulations requiring the Bell telephone companies to provide other manufacturers with opportunities to sell their equipment to the Bell telephone companies which are comparable to the opportunities the Bell telephone companies provide to their own manufacturing affiliates. Additionally, the FCC must prescribe regulations requiring that the Bell telephone companies only acquire equipment from their manufacturing affiliates at the open market price.

  This safeguard also will promote competition and minimize the risk of cross-subsidization. Combined with the safeguard requiring disclosure of network information necessary to manufacture telecommunications products compatible with the Regional Bell Companies' facilities, this safeguard ensures that independent manufacturers will have an equal opportunity to market their products to the Bell telephone companies.

- Enforcement Authority - Finally, H.R. 1527 specifically provides that the FCC may prescribe additional rules and regulations which are necessary to administer, carry out and enforce the provisions of the Act.

Aside from the provisions of H.R. 1527, since divestiture, the FCC on its own has adopted and implemented safeguards to create a different environment, and to prevent the alleged cross-subsidization and discrimination which formed the basis for implementing the MFJ. The existing FCC safeguards include the following:

- Cost Allocation Manuals (CAM) - The FCC has permanent rules imposing accounting requirements governing Bell telephone company transactions with affiliates; allocating costs incurred when regulated and nonregulated activities are provided on an integrated basis; and requiring audit verification. The Bell telephone companies may not engage in any integrated regulated/nonregulated activities unless there is an approved CAM. Amendments to CAMs are issued for public comment, and Bell telephone companies must have independent outside auditors annually attest that they are conforming with their CAMs. This safeguard effectively precludes cost-shifting and cross-subsidization where a Bell telephone company provides basic and enhanced services on an integrated basis.

- Comparably Efficient Interconnection (CEI) - CEI is a requirement that a Bell telephone company submit for FCC

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approval any plan to offer an information service on an integrated basis. FCC-approved CEI plans require, among other safeguards, that "basic" facilities used by a Bell telephone company to provide such services be made available to other information service providers (ISPs) on like terms. CEI, which is a forerunner to ONA, has been readopted by the FCC's order in the Computer III Remand proceeding.

- Open Network Architecture (ONA) - Under ONA, the Bell telephone companies "unbundle" basic services into more elementary "building blocks." ISPs then pick and choose among those building blocks to construct unique or special basic network support for their particular information services. The FCC initially approved the Bell telephone company ONA plans in 1990, and in January 1992 approved their ONA tariffs. Initial ONA implementation for all Bell telephone companies is expected in the next few months.

- Nondiscrimination Reports - The Bell telephone companies are required to file quarterly reports showing that their competitors receive the same treatment as their own ISP operations in the provisioning of network services. These reports require annual affidavits by Bell telephone company officers responsible for installation and maintenance, attesting to the fact that the reports are accurate and that no discrimination has occurred.

- Price Cap Regulation - Price cap regulation, also used by many states for intrastate services, effectively removes the incentive to shift costs of competitive services onto monopoly ratepayers. A Bell telephone company cannot raise rates to cover the added costs of nonregulated services, so it must recover those costs from the users of those services.

- Customer Proprietary Network Information (CPNI) - This safeguard protects customer privacy and customer records by allowing customers to restrict access to their records by ISP providers affiliated with a Bell telephone company. Bell telephone companies must notify multiline business customers annually of their rights. The FCC reviews all changes to the notification forms.

- Network Disclosure Requirements - The Bell telephone companies are required to give a minimum of six months advance notification to third parties of any change in network design that might affect interconnection of telecommunications products and services. This safeguard prevents the Bell telephone companies from using their networks to gain any unfair advantage over others.

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- Automated Reporting and Management Information System (ARMIS) - The FCC has in place a sophisticated, computer-based reporting and monitoring system that contains detailed financial and operational data regarding regulated, nonregulated, and total company operations. This lets the FCC compare each Bell telephone company's performance with that of its peers and with its own historical trends. ARMIS reveals sufficient detail about the Bell telephone companies' financial and operating characteristics to enable ready detection of unusual trends and events.

- Affiliate Transaction Rules - The FCC has rules which require that when a Bell telephone company transfers assets to an affiliate, the price is recorded on the Bell telephone company's book of accounts at either the tariff rate or prevailing price. If neither exists, then revenues equal to the higher of fair market value or net value will be recorded. When a Bell telephone company provides a service to an affiliate, the Bell telephone company will charge the affiliate the applicable tariff rate, when a tariff exists. If the service is not tariffed, then the Bell telephone company will apply prevailing prices, if available, or, if not, fully distributed costs.

  Conversely, when an affiliate transfers assets to a Bell telephone company, the price will be recorded on the Bell telephone company's books of account at prevailing prices. Where no prevailing price has been established, the Bell telephone company will record the lower of fair market value or the affiliate's net book value. When an affiliate provides a service to a Bell telephone company, the Bell telephone company will record as an expense the prevailing price of such service, provided that it was established by the affiliate in a substantial number of actual transactions with non-affiliates. In those cases where an affiliate provides a service only to a Bell telephone company, the attributable costs method of fully distributed costs will be followed by the affiliate in providing the service.

  In either event, the Bell telephone company gets the benefit of the transaction. These rules eliminate the threat of the Bell telephone company being able to cross-subsidize the operations of the manufacturing affiliate, by either paying more than the cost of the equipment manufactured by the affiliate, or by having the Bell telephone company providing any asset to the manufacturing affiliate at less than its fully distributed cost.

- FCC Enforcement - The FCC has stepped up its enforcement activity and dramatically increased the fines and forfeitures which can be imposed for violations of FCC

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rules. The FCC can now impose fines of up to $1 million per offense. Even relatively minor violations of accounting rules have resulted in substantial fines.

- Public Scrutiny - Financial and operational records of the Bell telephone companies are open to public inspection in far more detail than in any past period. Large customers routinely use information to analyze Bell telephone company results and bring any anomalies to FCC's attention.

In addition to the FCC safeguards, most states have safeguards of their own. These differ from state to state. However, the most significant safeguards are detailed accounting requirements and price cap or other regulatory schemes that remove the incentive and the ability to recover the costs of nonregulated services from basic service ratepayers, without approval from the state public service commission.

Question 3. Is there a significant demand for new products which is not being satisfied by the current competitive marketplace?

There is no doubt that Americans want more than what is available to them today, in terms of telecommunications products, equipment, and services. Consumers are no longer satisfied with being able to reach a specific location when they dial a phone. They want a means of reaching an individual, without regard to that individual's location. They want to be able to transmit and to receive calls, data, facsimiles, E-mail, and other information of their choice; whether they are at their home, in their office, in their car, at play, or enroute to another country. Individuals with handicaps or other functional limitations want telecommunications devices and a networks that will allow them to communicate with the same level of independence and privacy that others have. Educational institutions want the advantages of distance learning, which will enable students to have access to knowledge and experts unlimited by distance, space, and time. Businesses want improved means of communications in order to reduce costs, to improve productivity, and to provide a competitive edge.

An excellent discussion of the information services market as it exists today, including the competitors, media alternatives, market segments, and competitive possibilities may be found in a report the Regional Bell Companies prepared for Judge Greene entitled "Competition In The Information Market, 1990", a copy of which is attached hereto. It provides strong evidence that there exists a competitive market where the Regional Bell Companies could provide new products and services.

However, this issue is more complex than the question of whether there is an unmet demand for innovative telecommunications products and services. That approach assumes

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that such demand is finite and measurable, which only serves to stifle innovation and creativity. The threshold issue should be whether or not the MFJ promotes or impedes the efforts of American companies to satisfy customer needs or to engage in design and development, thereby expanding the breadth of knowledge and scope of customer choice.

Specifically, with respect to manufacturing, it is beyond dispute that the MFJ has a chilling effect on innovation. For example, the MFJ prohibits a Bell telephone company, either directly or through an "affiliated enterprise", from manufacturing. However, the decree does not define this term. Many years ago, Ameritech sought permission to invest in a small U. S. manufacturer under a contract through which it would be able to share in the royalties resulting from any invention developed from its investment. The Department of Justice (DOJ), after an extremely thorough analysis of the issue, concluded that the funding and royalty arrangement proposed by Ameritech was permitted by the decree, and requested the court's concurrence. For three years, nothing happened. On January 31, 1992, the court ruled, and rejected the DOJ's position. As a result of this decision, the Regional Bell Companies may be reluctant, if willing at all, to provide "seed" money or venture capital to small manufacturers or entrepreneurs with ideas for new telecommunications products and services.

Question 4. Since divestiture in 1982, how many times have the RBOCs been found, by the courts or regulators, to have engaged in anticompetitive behavior?

Since divestiture on January 1, 1984, when the seven Regional Bell Companies became stand-alone entities independent from AT&T, there have been numerous allegations that they have engaged in anticompetitive behavior. However, there are no cases in which there has been a final order of any court that any of the Regional Bell Companies have violated either state or Federal antitrust laws.

There is one case in which a state public service commission concluded that a Regional Bell Company's operating telephone company affiliate acted "anticompetitively." In June of 1991, the Georgia Public Service Commission found that Southern Bell had impeded competition in the trial offering of its voice messaging service. The Commission ordered Southern Bell to suspend marketing of its service pending further hearings. Southern Bell strongly disagreed with the Commission's findings and petitioned the FCC to preempt the Georgia PSC's jurisdiction and allow Southern Bell to offer this jurisdictionally mixed service to new customers. The FCC, in a press release, has indicated that it will preempt the Commission's action and that Southern Bell will be able to resume marketing its voice messaging service.

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MR. STAGGERS' QUESTION FOR THE RECORD
FOR MR. TOBIAS

Question:

GTE is larger than any of the Bell companies by almost any measure. However, GTE is not bound by the kinds of restrictions contained in the consent decree. Moreover, I am not aware of any instances of abuse by GTE that you fear from the RBOCs. Why shouldn't the smaller Bell companies be allowed the same freedoms as GTE?

Response:

As I testified earlier, the GTE example does in fact raise concerns that are always present when a monopoly carrier enters adjacent competitive business. However, GTE is also very different from the RBOCs. Its regions are geographically more scattered than those of the Bell companies, touching only parts of two metropolitan areas. It does not own a joint research laboratory in concert with other monopoly local exchanges -- a body that has nationwide impact because it sets standards, evaluates products and could become an easy vehicle for discriminatory activities. In any event, the GTE case is somewhat academic, because GTE has decided to discontinue manufacturing equipment. This decision in fact underscores the point made by Mr. McGowan that carriers, including MCI, do not need to manufacture in order to provide the services their customers demand and need.

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Mr. BROOKS. Mr. Bryant.

Mr. BRYANT. I have raised this issue repeatedly, that to allow the BOC's to manufacture would simply result in competition with current domestic manufacturers and, therefore, you ought to be required to do your manufacturing here rather than joining up with some overseas company. I also would restrict your ability to put your very valuable trademark on overseas products, and then selling it to yourself—self-dealing.

Now, when I have raised that question, Mr. Whitacre has said back to me—he did yesterday, anyway—that that would not be fair because AT&T is allowed to manufacture overseas.

I would like to ask Mr. Tobias to respond to that. What is the response to Mr. Whitacre's response?

Mr. TOBIAS. I think the fundamental issue is the issue of manufacturing at all when you own a local monopoly bottleneck. In our own case, as I said earlier, about 95 percent of the content of what we sell in this country to Mr. Whitacre is manufactured in this country.

I think the risk of joint ventures with foreign partners would be that you could put those kinds of provisions in legislation, but the fact of the matter is that what we call assembly, wire, and test, the kind of simple things, would be done in this country, but the fundamental, high tech kinds of content that would go into the products would be done overseas.

And, therefore, I don't think the protections that are being discussed would be helpful.

Mr. BRYANT. Let me ask a question. I have heard that said before and tend to believe it. But why would they want to do research overseas when they are all over here? What do you say back to that?

Mr. TOBIAS. I simply think we have a disagreement.

Mr. BRYANT. What would be the research done overseas?

Mr. TOBIAS. What we are describing here is joint ventures that would take place with large companies that are based overseas, and the content of what would go into—what that joint venture might produce would not want to replicate in this country the research and development and high tech aspects that are being done overseas. So that kind of work would be done there.

Assembly would be done here. We would stand back and look at it and say, gee, isn't that nice. We are doing a lot here, but really the relevance of what we do here relative to the value of what is being done overseas would be different.

Mr. BRYANT. Ninety-five percent of what you buy now is made here. Why should American policymakers let you get into something where you could manufacture in competition with them overseas?

Mr. WHITACRE. Mr. Tobias is probably correct within a certain percentage, that 90 percent of the things we buy from them is made here. But there is a lot more we want to buy that they won't sell us or is not made here.

So to say that 90 percent of our purchases are made in this country is not right, because they will not sell us PBX's or telephones. There is a lot of equipment they will not sell us.

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Mr. BRYANT. Isn't it right that 90 percent of what you buy is made here? Is that correct or not correct?

Mr. WHITACRE. We do not buy any telephone sets in this country, because none are made here, to my knowledge.

Mr. BRYANT. You said 90 percent of what you buy from him is made here.

Mr. WHITACRE. Yes, that is right, 90 percent of what we buy from AT&T is probably made in this country. But there are a lot of things that we need to buy that either they will not sell us or is not manufactured in this country.

Mr. BRYANT. Of the remaining portion, what percentage of that is made here and what percentage is made abroad?

Mr. WHITACRE. I am not sure I can give you that, but I can tell you by category, that all the telephone sets are made abroad. Probably the PBX's are made in this country by a company that is not an American company.

I can get you some more information on that. But certainly none of the telephone sets are made in this country.

Mr. BRYANT. I would like to have that, Mr. Chairman.

Mr. WHITACRE. We would be happy to provide you the information.

[See appendix, Martin E. Grambow's letter.]

Mr. BRYANT. Do you want to get into this inquiry, Mr. McGowan?

Mr. MCGOWAN. I believe the manufacturing problem that they have had has been solved by time, except they won't let it solve itself. They won't leave it alone.

I think that the system itself has turned into a very productive one for the country. Certainly, there has been a lot more equipment manufactured domestically, at least for us. I think that is a reasonable balance to the users. Except they wish to upset that and go ahead and manufacture, which I strongly disagree with.

Mr. BRYANT. Mr. Whitacre, in 1988, you received permission to offer voice-messaging, electronic mail, electronic white pages, audiotext and video gateways, and electronic data storage for third-party information providers. But the BOC's didn't take advantage of those programs.

Why should you be granted more freedoms?

Mr. WHITACRE. We got in the voice-messaging business that year, and we are still in that business. So we did take advantage of it.

Audiotext and videotext, we had a trial in Houston—we said it was going to be a trial; we wanted to find out about the marketplace. Because of the restrictions of MFJ, we couldn't expand that trial to get data bases, so we were very confined.

We conducted that trial. We lost money. We also found out a lot about providing information services that we will certainly use if we are allowed to do so.

Mr. BRYANT. So you did try some of these things?

Mr. WHITACRE. Absolutely. We tried them all. And, we are still in some of them.

Mr. BRYANT. The court's decree ruling, giving the Bell companies information services relief, one might argue, demonstrates that the court review process works and that you should not look to Congress for relief. You went to court and got what you wanted, so why should Congress get involved in it?

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Mr. WHITACRE. Well, I think—I assume you are addressing that to me, Congressman?

Mr. BRYANT. Yes.

Mr. WHITACRE. I think the process does not work, or if it works, it doesn't work very well. Because it has been 4 years now, before anything has come out of the court, and now it has been stayed. So we have been waiting 4 years to get the answer to that one question.

There are many other questions pending before the court that have been there for years, many, many months, that we are still waiting to find out the answer to. I think the process doesn't work very well.

Mr. BRYANT. Thank you.

Mr. BROOKS. Did I understand you to say, they could not buy PBX equipment from AT&T?

Mr. TOBIAS. We have had, over time, discussions with various people in terms of our distribution strategy of PBX's. At the moment, we are not selling PBX's through Mr. Whitacre's company, but I am always willing to talk about anything.

Mr. BROOKS. All right.

Well, then, one other thing. I hope that Mr. Tobias and Mr. Whitacre will give us the general gross returns of the companies—publicly stated; we don't want any secrets—and the net returns as announced to the stockholders and so forth, so we have that for all of the Bell companies, all of the AT&T operations.

MCI, you are just trying to make a living, trying to make it through the winter.

Mr. MCGOWAN. We are a struggling, new company, Mr. Chairman.

Mr. BROOKS. Thank you very much, gentlemen.

[See appendix, Osceola F. Thomas' and Martin E. Grambow's letters.]

Mr. BROOKS. Mr. Fish.

Mr. FISH. I ask unanimous consent that three prepared statements by witnesses who were not present be included. These statements are by Henry Geller, communications fellow of the Markle Foundation; Deborah Kaplan, director of the World Institute on Disability; and Phillip Mink on behalf of the Citizens for a Sound Economy.

Mr. BROOKS. Without objection, so ordered.

[See appendix.]

Mr. BROOKS. The second panel is comprised of various representatives of trade and consumer organizations. We welcome Cathleen Black, a distinguished publisher and now president and chief executive officer for the American Newspaper Publishers Association.

The other three witnesses on the panel testified before the subcommittee 2 years ago and have kindly agreed to return and give us an update. Some have changed their positions a little bit since 1989. And we welcome back our long-time friend, Stephanie Biddle, executive vice president for the Computer & Communications Industry Association; Gene Kimmelman, legislative director for Consumer Federation of America; and Ed Spievack, president of the North American Telecommunications Association.

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Everybody wants to go to lunch around 1 o'clock, and we will be back for the third panel. So let's try to stay within the 5 minutes.

STATEMENT OF CATHLEEN BLACK, PRESIDENT AND CHIEF EXECUTIVE OFFICER, AMERICAN NEWSPAPER PUBLISHERS ASSOCIATION

Ms. BLACK. Thank you, Mr. Chairman. As you said, my name is Cathleen Black. I am the newly appointed president and CEO of the American Newspaper Publishers Association, a position I assumed just 6 weeks ago, having spent the last 8 years as publisher of USA Today. The American Newspaper Publishers Association represents 1,400 newspapers in this country, ranking from the very large to the very small.

Mr. Chairman, I offer this background only because this is my first appearance before Congress in any capacity. It is a particular honor to have this very special opportunity, so new in my position, to appear before your subcommittee.

This issue of the AT&T antitrust consent decree and the appropriate public policy Congress should adopt regarding the regional Bell operating companies' entry into electronic publishing is of vital and grave concern to the newspaper business.

To the newspaper industry, what happened last Thursday, July 25, could be referred to a 10-point earthquake or an atom bomb, when Judge Harold Greene felt compelled to lift the information services restriction, even though he personally found that such an action was not in the public interest under the antitrust laws.

Mr. Chairman, the newspaper business believes it is essential that Congress broaden the debate, as you are, on the MFJ, and legislate on the issue of the RBOC's entry into electronic publishing to achieve the following three goals:

No. 1, robust competition and continued diversity of information sources in this country;

No. 2, a fair playing field for information publishers; and

No. 3, prevention of consumer abuse by the telephone monopolies.

We ask you in your committee to enact legislation that will allow the regional companies to enter the electronic publishing business only when the competition exists in the local phone market. If Congress does not choose to act, it is not only newspaper publishers and other information providers who will be injured by the inevitable anticompetitive conduct of the regional companies; average citizens will also be harmed in two ways.

First, the RBOC's local monopolies will deprive Americans of a diversity of information sources.

Second, telephone consumers will ultimately pay from their own pockets to bankroll these monopolies.

We reject out of hand the notion that allowing RBOC's to provide information services somehow benefits the public. In fact, Mr. Chairman, the issue at stake here is a diversity of information sources for the American public.

Newspapers, in their key role as information providers, contributed—contribute and have historically contributed to that diversity. However, we are terribly concerned about the impact on our print and electronic products if we are forced to compete in the

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years ahead against the monopoly local telephone companies' information services, whose history of substantial anticompetitive behavior on a huge scale is well documented and already known by this committee and by the public at large.

The underlying reason for the public policy prohibiting phone company involvement in content exists today as it did in 1982, as the Department of Justice said then before its reversal of position, "If the BOC's were permitted to offer information services, they would have the power and the incentive to deter the development of competitive markets for these services."

Nothing has changed since then. The RBOC's still totally control local phone services and continue to engage in anticompetitive behavior. The RBOC's abuses over just the past year, including the NYNEX situation which you personally discussed this morning, Mr. Chairman, are true. They are lengthy and they are very frightening.

Our most recent example is the Georgia Public Service Commission, which found Bell South used its control of the telephone network to hinder competitors for nearly 10 years to benefit its memory call voice-messaging service.

My written testimony, which has already been supplied, lists eight pages' worth of current examples of RBOC's abuses. In fact, there is even more reason to be concerned today, since the regulatory requirements are far weaker than they were when the decree was implemented.

Contrary to public opinion, newspapers and other publishers are not afraid of competition, as long as the competition is fair. We face fierce competition every day in the marketplace, from an enormous array of media choices—television, video, radio, VCR's. You need only walk by a newsstand to see the plethora of media choices people have today.

To be forced to rely upon one's competitor for delivery of an electronic product is rather ludicrous. It would be like saying that the Washington Post could only deliver the Wall Street Journal in this town, or that Domino's Pizza had to be delivered by Pizza Hut.

Mr. Chairman, your committee is revered as the watchdog of competition. We urge you to legislate in those interests so that the RBOC's, the only electronic information highways, are not allowed to run everyone else off the road.

Thank you.

[Ms. Black's prepared statement follows:]

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STATEMENT OF CATHLEEN BLACK ON BEHALF OF THE AMERICAN NEWSPAPER PUBLISHERS ASSOCIATION

Mr. Chairman, my name is Cathleen Black and I am President and Chief Executive Officer of the American Newspaper Publishers Association ("ANPA").

ANPA is an international trade association representing nearly 1,400 newspapers throughout North America. Its membership comprises approximately 90 percent of the daily and Sunday circulation in the United States. Many non-daily newspapers also are members.

Mr. Chairman, I appreciate the opportunity to share the views of the newspaper business on the appropriate public policy Congress should adopt regarding entry by the Regional Bell Operating Companies into electronic publishing.

Mr. Chairman, the newspaper business believes it essential that Congress legislate on the issue of Regional Bell Operating Company entry into electronic publishing to achieve the following three goals:

- robust competition and continued diversity of information sources in this country,
- a level playing field for information publishers, and
- prevention of consumer abuse by telephone monopolies.

Specifically, Congress should enact legislation that would permit Regional Company entry into electronic publishing only when they do not have monopoly control of telephone exchange service. While the Regional Companies retain bottleneck control over local telephone transmission, they must be precluded from owning or controlling electronic information services.*

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* ANPA did not object to AT&T's entry into electronic publishing in 1989, after a seven-year ban, because competitive alternatives to AT&T's long distance transmission network had developed. With proper policies, similar competitive developments should take place in the local telephone exchange market.

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If Congress chooses not to act it is not only newspaper publishers and other information providers who will be injured by the inevitable anticompetitive conduct of the Regional Companies. Average citizens also will be harmed in two ways. First, the Regional Companies' creation of local telephone-based information monopolies will deprive Americans of a diversity of information sources. Second, telephone ratepayers will have money taken out of their pockets to bankroll these information monopolies.

We reject the notion that allowing the Regional Companies to provide information services will somehow benefit the public. Instead, their entry into a market that is now competitive could lead to the same terrible consequences for the public as did the monopolization of railroads in the last century.* The Regional Bell Operating Companies own the electronic highways for delivery of electronic publishing. As such, they are uniquely positioned to drive other electronic competitors off the road. As the electronic publishing industry continues to grow, given their immense resources, the Regional Companies could extend their monopolies into the entire information marketplace.

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* After the Civil War, Congress was persuaded to give exclusive franchises, massive subsidies, and enormous land grants to the great "Robber Barons" because these concessions were believed necessary to develop a railroad infrastructure. In fact, these Robber Barons quickly achieved dominant rail monopolies across the nation, drove out other competition such as ships and barges, and unscrupulously exploited the citizens who depended on the railroads for their very lives. They even extended their monopoly power into oil, mining, produce, and other industries that depended on their rails. True, some lines were built. But not as many as Congress hoped or the public needed. And quality and service were generally poor. The judgment of history is that through an eagerness to encourage the Robber Barons, a public policy was established that did not ensure competition, and grave harm was done to the country.

The modern-day telephone company Robber Barons have the same incentives as their 19th Century counterparts. If Congress does not act decisively, the Regional Companies will drive everyone else's information content off of their electronic "railroads."

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The Need for Congress To Act

Exactly two years ago, when Robert M. Johnson of *Newsday* testified on behalf of ANPA before this Subcommittee, we said that "Congress has a crucial role to play."

We urged you to "clearly endorse the line of business distinction" between content and transmission, which established the current market structure and has provided the American people with the world's best telephone system and the world's best electronic information services.

We asked Congress to "send a clear message to the BOCs that the information services content restriction will not be removed as long as the BOCs maintain their bottleneck monopoly over local exchange service."

Again in 1989, David E. Easterly of Cox Newspapers told the Telecommunications and Finance Subcommittee that "it is the job of Congress to establish policy for the nation's telecommunications industry" and called for "decisive legislation" "to assure that the provision of electronic publishing remains competitive and grows even more diverse over time." And last year, Mr. Johnson once again said, in testimony before that subcommittee, "whatever happens in Judge Greene's Court, we believe the appropriate place for this to be resolved is in the Congress."

Now, the need for legislation is even more urgent.

Judge Harold Greene felt compelled last week to lift the information services restriction (which was included in the 1984 Modification of Final Judgment and carried forward similar line of business restrictions from the 1956 Consent Decree). This decision is at odds with the court's finding that such an action was not in the public interest. It resulted from an April 1990 court of appeals decision that required Judge Greene—under the reviewing court's interpretation of the Tunney Act—to give virtually total deference to the Justice

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Department's views.* Since 1987 the Department has advocated lifting the restrictions—a complete about-face from the position it took in approving the decree in 1982, when it said:

> if the BOCs were permitted to offer information services they would have the power and incentive to deter the development of competitive markets for these services. The Department, therefore, continues to believe that the BOCs must be precluded from engaging in such activities to insure the development of competitive markets for information services.*

The Tunney Act was supposed to prevent the courts from rubberstamping Justice Department deals with the Regional Companies that were not in the public interest. But, under the court of appeals' decision, the Tunney Act is not working as intended. For this reason, prompt action by Congress is essential to prevent the monopolization of information services by the Regional Companies.

The District Court Record

In proceedings on remand from the court of appeals, Judge Greene assembled a comprehensive record of current market conditions for telephone and information services. This record included economic analyses by some of

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* According to the court of appeals, the fact that none of the parties to the case (AT&T, the Regional Companies, and the Department) opposed removal of the restriction meant that the Tunney Act required the district court to give extraordinary deference to the Justice Department's sudden reversal of position. Specifically, Judge Greene was required to defer almost completely to the opinion of the Department of Justice on the issue of whether removing the restriction is in the public interest. He was even directed to ignore the original antitrust trial record that was replete with examples of the anticompetitive potential of the Regional Companies' bottlenecks. Instead, he had to rely only on the Department's theoretical predictions about future market actions by the Regional Companies.

Moreover, the court of appeals did not allow Judge Greene to consider fairly and objectively the facts and arguments that questioned the Department's position. Regardless of how speculative and at odds with the facts the Department might be, Judge Greene had to defer to its supposed "expertise" unless he was convinced with absolute "certainty" that the Department was wrong. Judge Greene found that the "certainty" standard--a higher burden of proof even than that applied to criminal prosecutions--was simply "impossible" to satisfy.

* Response of the United States to Public Comments on Proposed Modification of Final Judgment, 47 F.R. 23320, 23338 (1982).

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the most distinguished professors in the field as well as affidavits by a wide spectrum of information service providers who must do business with the Regional Companies. (The affidavits of Professors Roger Noll and Glen Robinson, Robert Mercer, and newspaper and information service executives submitted by ANPA are appended as Attachment 2.) The Regional Companies themselves submitted a vast quantity of data and studies, presumably reflecting the best case they could make for removal of the restriction with their virtually limitless resources.

District Court Findings

Judge Greene held that all of the facts and antitrust policy considerations required a conclusion that "removal of the information services restriction is incompatible with the decree and the public interest" because:

- the Regional Companies possess market power in the information services market due to their indispensable and ubiquitous local wires and switches;
- neither the antitrust laws nor FCC or state regulations can prevent anticompetitive activities by the Regional Companies;
- current anticompetitive conduct by the Regional Companies shows that their entry into information services presents a significant risk of anticompetitive activities on a substantial scale; and
- the Regional Companies can use cross-subsidization to drive rivals from the market.

Nonetheless, because of the incredibly restrictive mandate by the court of appeals, Judge Greene felt he had no choice but to rubberstamp the Department of Justice recommendation that the restriction be removed.

Regional Company Market Power

The Regional Companies today have bottleneck control over delivery of most interactive electronic publishing or electronic information services. This is

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true whether the service is a relatively simple voice announcement service or whether it is a more sophisticated fax or database offering. To allow the Regional Companies to enter electronic publishing will permit local exchange monopolies to become information monopolies and stifle diversity. Without these telephone facilities electronic information service providers cannot reach their customers. This means the Regional Companies can raise the costs of their rivals, control prices in the market, and ultimately even drive out all competition.

Ineffective Regulation

ANPA does not believe that FCC or state regulation can be counted on to prevent this monopolization. The antitrust violations that led to the breakup of the Bell system took place under rules that were even stricter than those now in place. Keep in mind that the past decade has been one of deregulation in telecommunications.

As Professor Roger Noll of Stanford explains (see Attachment 2), the information services industry is just too complex and diverse for successful case-by-case government regulation.

The antitrust laws will not provide a significant deterrent to Regional Company anticompetitive conduct either. After all, the original reason for the restriction was a recognition that the threat of antitrust prosecution had not worked in the past to restrain the telephone monopolies.

Newspaper Concerns

Newspapers are concerned by the threat of Regional Company monopolization of information services and its impact on our print and electronic products. As pioneers in the 1970s, newspapers developed some of the first electronic database services directed at business and professional users. In the

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1980s, the newspaper industry moved aggressively to test the market by providing new electronic services to consumers. As a result, more than two hundred newspapers entered the market using every conceivable strategy and technology. In addition the *Los Angeles Times* and the *New York Times* are among the more than 140 newspapers offering electronic library or business information services aimed at the professional research/library user.

Today, newspapers are expanding their role as providers of critical business and news services and continue to invest in new electronic information services at a rapid pace. Dow Jones Information Services and Knight-Ridder's Business Information Services, for example, generate more than $1 billion in combined annual revenues.

Meanwhile, as a result of technology advances, the market for consumer services seems more promising. For more than fifteen years, newspapers have offered voice message services. In the late 1980s the combination of computer and telephone technology has made possible a whole new range of voice services. In 1987, the first interactive audiotex service was launched. Hundreds of newspapers are now involved with electronic services serving both consumer and business markets. For example:

- **Voice Services**—Voice services burst onto the media landscape in 1990. More than 75 newspapers now offer free-to-caller interactive audiotex services — a 150% increase over 1989. Most of these services are advertiser-supported.

  Voice mail box features offered to classified advertisers were introduced at a rapid pace in 1990, reflecting an increased emphasis on revenue-generating services. Dozens of newspapers offer this feature to classified advertisers, with many more newspapers developing plans for 1991.

  At least 300 newspapers are exploring the use of caller-paid services through a variety of options. Most subscribe to 900 number programs offered by newspapers in partnership with

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media syndicates. These services require no up-front investment from the newspaper and revenues are shared with the syndicate.

- **Online and Videotex Services**—Seven newspapers offer local consumer-oriented videotex services providing information through a home computer or terminal. Projects range from small bulletin board systems to full-fledged, graphic-based videotex services. Many newspapers have offered consumer videotex information services via regional Bell telephone company gateway services. However, several regional Bell telephone companies have suspended their videotex gateway programs. The Atlanta *Journal-Constitution* launched Access Atlanta, offering their services directly to consumers after participating for more than a year on the BellSouth gateway. Results have been positive. While still offering services on the gateway, the newspaper reports that most users prefer the direct access and flat-rate pricing offered by Access Atlanta. For each hour of usage via the gateway, Access Atlanta tallies more than 11 hours.

- **Facsimile Services**—1990 saw a number of new, experimental fax information services emerge while a few others were withdrawn from the market. Initial efforts focused on delivery of news and information digests to multiple subscriber locations simultaneously. Newspapers now are experimenting with new sales and product strategies. For example, four newspapers' fax products are available on a single copy basis at any time of day. The St. Paul *Pioneer Press* provides a customizing feature which allows NewsFax subscribers to select specific stock price information they want in their daily fax paper.

New ventures are being launched on a monthly basis and a changing mix of features are being offered to consumers, businesses and advertisers.

Some newspapers are specifically testing services aimed at groups with special needs. For example, to extend their reach to visually-impaired individuals, at least three newspapers have worked with local associations for the blind to produce a braille directory of the information available on the newspapers' interactive audiotex services. The *Miami Herald* produces Spanish programming for its TeleHerald voice service, which is promoted in *El Nuevo Herald*, a Spanish-language newspaper. Creative applications also have been developed to support Newspapers in Education and other educational projects. Teachers can call voice services at some newspapers to

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hear how to use that day's paper in planning their lessons. Newsday's GO SCHOOL program encourages students to become directly involved in using online services while reinforcing reading and writing skills. Several newspapers also have developed voice services to let callers identify the location of the closest recycling center by keying in their zip code.

The Regional Companies would discriminate against newspapers' electronic offerings through their control of essential network facilities. The Regional Companies' electronic services could displace newspaper news and features and reduce or eliminate substantial blocks of newspaper advertising. In short, newspapers and others would face grave difficulty in competing because the Regional Companies would have exclusive control of electronic access to all homes and businesses and would have enormous resources to fund their below-cost entry into content businesses.

Examples of Competitive Abuses

Even though the Regional Companies have had very little presence in information services and related markets, they have already shown by their behavior how they can discriminate and cross-subsidize anticompetitively. For example, they have designed network features so that competitors' standard equipment cannot use them. They have priced the features to raise rivals' costs. They have withheld important and necessary features from competitors or delayed them until the Regional Companies got a head start.

They have even used competitors' orders for network features as sales leads to steal those competitors' customers. Because the telephone companies have a huge reservoir of information about their competitors—how many calls customers make to their competitors, what special network features are used, their competitors plans for expansion, competitors' and customers' credit

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ratings—they have crucial advantages in product planning, roll out, and marketing.

In addition to the abuses considered by Judge Greene, more and more examples are coming to light of how little regard the Regional Companies have for the law.

This May, the Georgia PSC found that BellSouth had behaved anticompetitively in offering its voice messaging service, known as MemoryCall, resulting in inevitable and likely irreparable damage to the voice messaging services marketplace. BellSouth selectively introduced technology to favor its own activities at the expense of competitors. BellSouth designed MemoryCall to bypass certain technical barriers and then initially introduced the service in a location where most switches had not been upgraded, creating a technical barrier that disadvantaged competing voice messaging services. In addition, the Georgia PSC found "disturbing" evidence that BellSouth may have impeded the development of the voice messaging services market for almost a decade. Although the record in Georgia indicates that network features have existed since the early 1980s that would have permitted telephone answering bureaus to offer services comparable to MemoryCall, BellSouth chose not to unbundle and make these features separately available until BellSouth was ready to offer MemoryCall. The Georgia PSC also found evidence of unfair marketing practices and the possibility of predatory pricing.

Last February U S West admitted that it had violated the MFJ between 1985 and 1989 by providing prohibited information services, by designing and selling telecommunications equipment in violation of the manufacturing ban, and by discriminating against a competitor in providing services to GSA.

The $10 million fine imposed by the Justice Department is ten times larger than the largest fine imposed in any previous Antitrust Division contempt

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case. In fact, it is greater than any criminal fine or civil penalty the Antitrust Division has received in any case. As part of the settlement, Justice agreed to drop investigation and possible prosecution of nine other MFJ issues it had been investigating.

(More details on these abuses and other cases are set out in Attachment 1.)

Electronic Publishing Is Flourishing Under Current Market Conditions

While a pro-diversity policy separating the Regional Companies' transmission services from control of information content has been in place, the information services industry has flourished.

According to the U.S. Department of Commerce's 1991 report on the current status of this country's industrial and service sectors, "revenues of the electronic information services industry reached an estimated $9 billion" and the "demand for information services continues to expand." The Commerce report states that demand for electronic information services "is expected to increase at a high rate through 1995," with an average annual growth rate of 20 percent throughout the period.

As a result of this growth, the United States is clearly the preeminent information services provider in the world, producing 56 percent of the total databases available, and enjoying a positive international trade balance in information services.

Congress Should Set A Policy that Assures Diversity and Competition in Electronic Publishing

The market has been working well but the Department of Justice seems more interested in unleashing the Regional Companies than in keeping the market competitive. And the district court (under the court of appeals'

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interpretation of the Tunney Act) was powerless to make sure the public interest is protected, despite conclusive findings of market power, ineffective regulation, and patterns of abuse by the Regional Companies.

There is more at stake than the profits of the non-telephone company information service providers. If the Regional Companies drive out their rivals, the American people will be the real losers. Today we have thousands of independent information providers, both print and electronic. In the future we could have thousands more—or we could have only seven. The biggest loss if the Regional Companies monopolize information services will be that of the diversity of sources and opinions that is so vital to our economy and to our democracy.

As we have said in previous testimony before this and other committees, it is important for Congress to establish a strong policy in favor of diversity. As long as the powerful Regional Companies control the road over which information must be carried, the rules of the road should be fair and the owners of the road should not be able to drive competitors off.

We ask you first to investigate the role of the courts and the Justice Department under the Tunney Act in the AT&T case. Legislation may be needed to make sure that a single Assistant Attorney General cannot be the final arbiter of the public interest.

Second, we ask you to adopt a policy that would allow the Regional Companies to provide electronic publishing over their local exchange facilities only when they no longer have bottleneck monopolies and there are meaningful alternatives to the local exchange for delivery of information services. Legislation should provide for an *objective* measure of when the Regional Companies' market power is gone—one not susceptible to

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interpretation according to regulatory ideology. Competition is the best safeguard to assure fair rules of the road.

Finally, we believe Congress can do much to speed the time when the information services restriction should be lifted. To make sure the market *does* develop Congress should set a high priority on encouraging alternatives to the bottleneck. Regulatory measures cannot prevent the Regional Companies from acting anticompetitively if they are allowed into the electronic publishing market prematurely.

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In closing, I thank you again for this opportunity to present our views and I want to express our willingness to work closely with the Congress to resolve this important policy issue.

NOTE: Attachment 2, Affidavits Submitted by ANPA to the District Court, has been retained in Subcommittee files.

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Attachment 1

Examples of Regional Company Abuses in Markets Now Open to Them

AMERITECH

Wisconsin PSC

The Wisconsin Public Service Commission staff found that Ameritech lobbying costs had been improperly allocated to Wisconsin Bell's regulated activities. CommDaily, July 12, 1990, at 2. Other BOCs also have misallocated lobbying expenses, including MFJ lobbying.

Wisconsin Bell agreed to pay and refund millions of dollars to customers in deceptive sales practices to sell optional equipment. State Telephone Regulation Report, Aug. 10, 1989, at 12.

Cross-subsidization and Overcharges

According to the *Chicago Tribune* and *The Star* (Indianapolis) (July 10, 1990), Ameritech forced its phone customers to pay $33.6 million in illegitimate costs, making up 30 percent of their bill. Consumer groups charge that an Ameritech subsidiary, Illinois Bell, overcharges its customers $60 million a year for expenses including lobbying and advertising. In a separate case, the Michigan Public Service Commission charged that Ameritech paid $3.6 million for land worth $8.3 million, and billed its customers for the other $4.7 million. CQ, February 23, 1991.

BELL ATLANTIC

Pennsylvania

Bell of Pennsylvania agreed to pay more than $40 million to settle lawsuits which alleged that it had engaged in deceptive practices in the sale and marketing of deregulated optional services. State Telephone Regulation Report, Apr. 19, 1990, at 4. That is, Pennsylvania Bell used deceptive techniques to sell its customers expensive services they did not need.

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According to *The Wall Street Journal*, one investigator posed as a single mother on welfare; a customer sales representative used high-pressure tactics to sell her $28.55 in services like 38-number high speed dialing when all she needed was $6.55 in basic services.

BELLSOUTH

MemoryCall

In May 1991, the Georgia PSC found that BellSouth had "behaved anticompetitively with respect to its trial offer of MemoryCall service, with inevitable and likely irreparable damage to the VMS [voice messaging services] marketplace." *Georgia PSC Order* at 3. For example, BellSouth selectively introduced technology to favor its own activities at expense of competitors. BellSouth designed MemoryCall to bypass certain technical barriers and then initially introduced the service in a location where most switches had not been upgraded, creating a technical barrier that disadvantaged competing voice messaging services. In addition, the Georgia PSC found "disturbing" evidence that BellSouth "may have impeded development of the VMS market for almost a decade." Although the record in Georgia indicates that network features have existed since the early 1980s that would have permitted telephone answering bureaus to offer VMS services comparable to MemoryCall, BellSouth chose not to unbundle and make these features separately available until BellSouth was ready to offer MemoryCall. The Georgia PSC also found evidence of unfair marketing practices and the possibility of predatory pricing.

South Carolina Supreme Court

The South Carolina Supreme Court has ordered Southern Bell to refund between $10 and $12 million in Touch-Tone charges. BOC Week, July 1, 1991, at 12.

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Florida PSC Investigations

In April the Florida PSC initiated a formal investigation into allegations that Southern Bell had falsified maintenance and repair records. Three current and former employees of Southern Bell testified that they routinely falsified maintenance records at the direction of company management in order to meet PSC service quality standards. Southern Bell also is under investigation for improper sales practices and has had to refund about $5 million in improper pay telephone commissions and for improper sales of inside wiring [maintenance] and other services to customers who did not ask for the services. *See* BOC Week, May 27, 1991, at 12; CommDaily, Apr. 2, 1991, at 2.

Cross-subsidization and Overcharges

The *Atlanta Journal and Constitution* reported last July that BellSouth overcharged its customers by $180 million a year. And a few months ago, investigators caught its subsidiary, Southern Bell, falsifying customer repair records to avoid paying required rebates to customers. (BOC Week, April 8, 1991) Auditors also found that BellSouth charged phone customers $7.5 million to pay for club membership dues for Bell executives, charitable contributions and a PGA Atlanta Golf Classic tournament.

NYNEX

MECO

After reports in the press that NYNEX's purchasing subsidiary, Materiel Enterprises Co. ("MECO") systematically sold goods and services at inflated prices to NYNEX operating companies, which in turn passed on the inflated costs to their ratepayers, the FCC and the New York Public Service Commission ("NYPSC") initiated investigations. In February 1990 an FCC audit concluded that MECO had overcharged New York Telephone and New England Telephone by $118.5 million between 1984 and 1988. Under terms of

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an October 1990 consent decree that ends the FCC's investigation, NYNEX agreed to lower rates by $35.5 million, reduce capital accounts by $32.6 million and pay a $1.42 million fine. 5 FCC Rcd 5892 (1990). The FCC denied petitions to reconsider the consent decree filed by Allnet, the New York State Consumer Protection Board, and Scott Rafferty, a former NYNEX employee. BOC Week, June 10, 1991, at 9.

At the same time that the FCC was concluding its investigation, the general counsel of the New York Department of Public Service ("NYDPS") recommended that the state continue its investigation and suggested that the NYPSC consider a fundamental restructuring of NYNEX, including the possible divestiture of New York Telephone. NYNEX submitted an alternative plan of reorganization to the NYPSC on July 22, 1991 that would restrict contacts between the regulated and unregulated parts of NYNEX. Although the less radical restructuring plan is now endorsed by staff members who had previously recommended divestiture, Attorney General Robert Abrams is expected to oppose the plan. BOC Week, Oct. 8, 1990, at 1, CommDaily, July 22, 1991, at 1, July 24, 1991, at 2.

Grand Jury Indictment

A grand jury in June 1990 indicted NYNEX for violating the MFJ's information services ban, alleging that a subsidiary provided the prohibited services between April 1986 and February 1987. In February, NYNEX asked Judge Greene to dismiss the case arguing that there is a "disabling conflict" between Justice's role as NYNEX's prosecutor in a criminal case and its role as enforcer of a civil consent decree. BOC Week, Feb. 18, 1991.

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Construction Fraud

New York Telephone employees in its building and maintenance division are under investigation by the Manhattan district attorney. BOC Week, Nov. 5, 1990, at 12.

Interconnection

Following an extensive investigation and rulemaking proceeding, the NYPSC has propounded rules establishing the right of competitors and customers to collocate their facilities in LEC central offices, laying the groundwork for an unprecedented amount of competition for special access services within the state. The NYPSC released an order establishing in broad terms New York Telephone's obligation to permit central office collocation, and to rely on direct negotiations among interested parties to resolve the necessary technical and economic details. Subsequently, alternative carriers entered into an extensive series of meetings with New York Telephone. Due to New York Telephone's intransigence in this negotiation process, a tariff establishing basic terms and conditions for central office collocation was delayed for *two years* following the NYPSC'S Order. Moreover, to date, New York Telephone and the other carriers have been unable to negotiate some remaining essential terms and conditions—including key pricing elements—and may require further intercession by the NYPSC before these issues can be resolved. As a result of this negotiation process, competitive carriers have been denied an effective permanent collocation arrangement, despite an unequivocal order by the NYPSC that New York Telephone provide such interconnection.

U S WEST

MFJ Violations, $10 Million Fine

In February 1991, U S West admitted to four separate MFJ violations between 1985 and 1989:

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(1) discriminating in provision of exchange access and other services to GSA;

(2) providing an information service to Atlantic Richfield Co. in the form of computer facilities management;

(3) providing information services, in the form of six separate reverse directory services;

(4) designing and developing operator workstations and selling them to carriers, through its Knowledge Engineering, Inc. subsidiary.

The fine imposed—$10 million—"[i]n terms of severity is ten times larger than the largest fine imposed in any previous Antitrust Division contempt case. In fact, it is greater than any criminal fine or civil penalty the Antitrust Division has received in any case." Memorandum of the United States in Support of Motion and Stipulation for Entry of Enforcement Order at 17, *United States v. Western Elec. Co.* (Civ. Act. No. 82-0192)(Feb. 15, 1991). In requesting the court to accept the settlement, the Justice Department noted that "U S West tried to interfere with the Department's investigation." *Id.* at 3 n.2. As part of the settlement, Justice agreed to drop investigation and possible prosecution of nine other MFJ issues it had been investigating.

Oregon PUC

The Oregon Public Utility Commission found that U S West used an unregulated subsidiary to divert profits to its shareholders at the expense of ratepayers. Telephony, Jan. 8, 1990, at 4.

Inside Wiring Class Action Suits

A Denver state district court has approved an agreement to settle long-pending state and federal class action litigation in which Mountain Bell was accused of improperly marketing inside wiring maintenance plans in seven states. BOC Week, April 15, 1991.

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SOUTHWESTERN BELL

Jury Awards $15 Million Treble Damages

A 1990 federal district court jury found that Southwestern Bell had violated the antitrust laws by leveraging its monopoly power over telephone subscriber information and attempting to monopolize the directory publishing market. The judge upheld the jury award of more than $15 million in treble damages. *Great Western Directories, Inc. v. Southwestern Bell Tel. Co.*, No. CA-2-88-0218 (N.D. Tex. July 27, 1990)(partial judgment awarding damages).

Cross-subsidization

In a separate scandal, Southwestern Bell improperly allocated at least $19 million in lobbying costs to the regulated telephone company. When the regulators caught this abuse, the company claimed it had only misallocated $11 million. Scott Nicholls, Allnet Regulatory Affairs Manager, calls the $19 million "the tip of the iceberg."

PACIFIC TELESIS

Cross-subsidzation of Competitive Product Development

The ratepayer advocate staff of the California Public Service Commission in a report issued October 30, 1990 found that Pacific Telesis, the California RBOC, is currently subsidizing competitive product development with $18 million annually from captive ratepayer revenues, and has diverted $37 million in the past to such subsidies. The staff concluded that the Commission's cost allocation procedures were inadequate to detect and prevent such cross-subsidies, and that Pacific Bell's recordkeeping was so inadequate that it hindered the progress of the staff's audit.

NECA AUDIT

As a result of an audit of the National Exchange Carrier Association ("NECA"), the FCC notified Pacific Bell, Southwestern Bell Telephone

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Company, New England Telephone and Telegraph Company and New York Telephone Company that they are apparently liable for forfeitures totaling $1 million for "manipulative and erroneous reporting" of common line earnings in violation of the FCC's accounting rules. *See* BOC Week, Nov. 19, 1990, at 5,, Dec. 17, 1990, at 6; FCC 90-383, FCC 90-384, FCC 90-385, FCC 90-386 (Nov. 9, 1990).

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STATEMENT OF STEPHANIE BIDDLE, EXECUTIVE VICE PRESIDENT, COMPUTER & COMMUNICATIONS INDUSTRY ASSOCIATION

Ms. BIDDLE. Thank you, Mr. Chairman. It is a pleasure to be here again on behalf of the Computer & Communications Industry Association.

Our members range from large to medium to small and are drawn from every sector in the industry. Because our membership encompasses so many sectors, we are forced to approach issues such as the MFJ's line-of-business restrictions from a very broad perspective.

It is one simple question: Will any changes foster, or could it hinder, the long-term growth and profitability of the industry as a whole, rather than any single narrow sector?

In hearings before this subcommittee 2 years ago, we noted that we had great respect for Judge Greene as a jurist, and we thought his handling of the AT&T antitrust trial set a new benchmark. We also noted that many people at that time were making statements suggesting that his jurisdiction should not continue. We suggested to this committee that the sides might change as soon as decisions changed.

I think that has been borne out. We have always thought there are major differences between the information services restriction and the manufacturing restriction from an antitrust point of view.

The first is that information services were never an issue in the antitrust trial. Certainly there was a long history of manufacturing issues.

The second part, again from an antitrust point of view, is that the Bell operating companies represent a very significant portion of the buying marketplace for many types of telecommunications equipment, while they are an insignificant portion of the buying marketplace for information services. And we think that makes a significant difference. Just to be clear on the record, CCIA has advocated removal of the ban on Bell company participation in information services since 1987.

And before I go any farther here, I think it is important to note, as some members of this subcommittee well know, CCIA has a very long history as a serious supporter of antitrust law and its rigorous enforcement. It may also be relevant that CCIA was the only industry group in the country to support and work for passage of the Tunney Act. We continue to take the court's role under the Tunney Act very seriously.

But when we read Judge Greene's decision last week, although we agreed with him that the appeals court left him little option, we did not agree with his rationale. We do not believe that the court instructed Judge Greene to rubberstamp anything. Rather, as we read the record, the appeals court found that the Tunney public interest standard would have been met without the information services ban in it to begin with.

They then asked Judge Greene to look at present market conditions to see if anything had changed that would then make it necessary to have a restriction that was not necessary to have originally. It is obvious from Mr. Greene's decision that he tried very hard to find such legal evidence. There were miles of paper filed

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and 2 days of oral argument. We don't believe that the judge failing to find legal support for his feelings on the subject equate to an instruction to rubberstamp.

We believe, instead, that what is important in this marketplace is to look for incentive. Even if you believe, as we do not, that the Bell companies have a particular ability to impede competition in the information services market, what is their incentive to do so? The information services market, from the point of view of my member companies, has some elements that are different from other markets.

In order to create a mass market out of it, the largest possible number of offerings must be available. The only reason for a company of the size of one of the Bell companies to want to enter this market is because they believe that their entry could make the transition from a niche to a mass marketplace. We share that view and think it is a critical ingredient for the building of the infrastructure we need in this country.

Our views on manufacturing, as I noted before, are a little different because of the part of the buying marketplace the Bell companies represent. When we were before you 2 years ago, we noted we had been very strong supporters of the manufacturing ban. We continue to be supporters, but what we support is the ban that we believe was put in place in 1982, not the one that Judge Greene redefined, in our view, in 1987.

At that point, all of the questions that were being asked earlier about, can you talk to your customers, can you ask this, can you get involved in any of the process, started to evolve. And, yes, our members tell us that is a very serious problem.

We did not mean the Bell companies to be prohibited from research and development activities. And when we said that to the committee 2 years ago, we were asked for very specific solutions to that problem. At the time, we did not have them.

But since then, we have developed what we believe is a solution to that problem, one which allows the Bell companies a significantly enhanced role in research and development without raising the specter of cross subsidy or self-dealing or harm to competition or the ratepayers. We think it matches the economic realities of the business in which we operate.

The solution is quite detailed, carefully worded, and set out in full in the prepared statement. In brief, what we advocate is to allow the Bell companies to invest research and development funding of specific development projects of unaffiliated manufacturers under contract, and to receive royalties on the sale of those products only to unaffiliated parties.

We believe that this has very significant benefit and creates quite different incentives than would exist if the RBOC owned its own supplier, or even an equity interest in any other supplier.

Mr. BROOKS. Ms. Biddle, I want to thank you very much. We are going to put all these statements, every pristine word, in the record, in its entirety, the unedited, original, unabridged version.

[Ms. Biddle's prepared statement follows:]

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STATEMENT OF
STEPHANIE BIDDLE
Executive Vice President
Computer & Communications Industry Association

Good morning Mr. Chairman and Members of the Subcommittee. I am Stephanie Biddle, Executive Vice President of the Computer & Communications Industry Association (CCIA), and I am pleased to appear before you again this morning to present CCIA's views regarding the Regional Bell Operating Companies' provision of information services and the current interpretation of the Modified Final Judgment's ban on Bell Company participation in manufacturing.

CCIA is comprised of some 60 companies who are manufacturers and/or providers of computer, information processing, and telecommunications products and services. CCIA's member companies are drawn from virtually every sector of the computer and communications industry and range in size from small, entrepreneurial firms to many of the largest in the industry. Collectively, CCIA's members generate annual revenues in excess of $160 billion and employ well over a million people.

As this Subcommittee knows, in addition to our long history of active participation in national telecommunications policy debates before the Congress and the Federal Communications Commission, CCIA has a very strong record as a serious supporter of vigorous enforcement of antitrust law. In light of some of the comments contained in the Opinion on information services recently issued by Judge Greene, it may be particularly relevant to note that CCIA was the only industry group in the country to support and to work actively for passage of the Tunney Act. We were also, I believe, the first to suggest to Judge Greene the applicability of the Tunney Act to the proceedings to modify the 1956 AT&T Consent Decree which resulted in the Modified Final Judgment (MFJ).

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Because CCIA's membership encompasses so many sectors of the industry we must approach issues such as the MFJ's line-of-business restrictions from a very broad perspective: what will foster, or could hinder, the long-term growth and profitability of the computer and communications industry as a whole, rather than what would best serve the short-term interests of any single narrow sector. As a result CCIA's only "vested interest" is in achieving a business environment in which all industry participants:

- o have available to them a modern, efficient, cost-effective national telecommunications network which enables them to be competitive in both domestic and world markets;

- o have a reasonable opportunity to compete on equal terms in current and emerging product and service markets;

- o have the flexibility to innovate rather than being forced arbitrarily to limit their design efforts to specific technical solutions; and

- o have sufficient certainty in national policy in this critical area to allow logical planning and allocations of resources to be undertaken.

CCIA believes that it is of critical importance that public policy create an environment conducive to the creation of a public, switched-broadband telecommunications infrastructure in the United States. We believe that this country is lagging seriously behind other nations in recognition of this fact and that we are rapidly approaching the point where the absence of such an infrastructure will begin to harm the overall U.S. economy. While CCIA

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believes that all businesses would benefit from having a modern public telecommunications system in place, the largest benefit would be to small and medium-sized U.S. firms who run the risk of becoming non-competitive, not only against foreign competitors, but also vis-a-vis larger U.S. firms who can afford to build private networks of their own.

American consumers are equally disadvantaged by lack of access to the benefits that such public policy direction would achieve. The country has many problems which could be ameliorated by innovative use of information and information technology that only a ubiquitous, switched-broadband network can support. CCIA believes that broad participation in the information services market is an integral element in the creation of the policy environment necessary to achieve this goal. We believe that no firms should be needlessly barred from participating fully in this marketplace and strongly supports RBOC entry into the market.

The Information Services Restriction Was Unique

CCIA believes that several factors made the line-of-business restriction on RBOC provision of information services unique among the MFJ's restrictions. First, the information service business was never an issue in the antitrust litigation which preceded the MFJ. In fact, neither AT&T nor its operating telephone companies had ever engaged in that business.

Second, rather than providing a remedy for past abuses, it appears that the sole purpose of this restriction, which was placed on both AT&T and the seven

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new regional companies, was to allow the then-emerging information service industry a period of transition during which to become established in the marketplace before the entry of eight new competitors perceived to have "deep pockets."

Third, in his earlier "gateway" decision, Judge Greene himself found that the public's interest in the availability of a wide range of information services outweighed other concerns about RBOC participation in this market even though he then interpreted the "public interest" to stop short of full RBOC entry into this market.

The ban on AT&T's participation in the information services marketplace was, as Members of this Subcommittee know, lifted by the District Court several years ago. In the context of this debate, we think it is particularly interesting to note that at the time the MFJ was entered the major concerns of competitors regarding the ban on provision of information services tended to be directed at AT&T's national market position rather than at the local market position of the regional companies. CCIA had advocated the removal of the ban on Bell Company participation in information services at the same time.

As we understand the purpose of the nation's antitrust laws it is to protect competition not individual, or individual groups, of competitors. However, the competitors who were emerging in the information services market in 1982 have now been "protected" from RBOC entry into their business for nearly ten years. In our industry that is more than three full product life cycles.

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In his Opinion last week Judge Greene did finally lift the information services restriction, although his action was clearly reluctant. We concur that the Remand Decision of the Appeals Court left him little option but to lift the restriction but strongly disagree with his perception that the Appeals Court essentially directed him to "rubber stamp" the motion for removal because it was uncontested by the parties to the Decree.

I noted earlier that CCIA is a strong supporter of the Tunney Act, and I would like to emphasize that we continue to take seriously the role of the judiciary in consent decrees set out by the Tunney Act. It is often the case in judicial decision that the citations left out are as interesting as those included, and Judge Greene decision is no exception. We believe the most important statement made by the Court of Appeals on remand is:

> The parties agreed to the information services restriction as a precautionary measure in light of uncertainty about how divestiture of AT&T would affect the development of this embryonic market. Under these circumstances, it would not have been legal error for the district court to approve the decree had the parties not agreed on their own to include the restriction on information services. (Emphasis in original.)

The Appeals Court then went on to say:

> In reconsidering the BOCs' motion, the district court should determine whether removal of the information-services restriction as applied to the generation of information

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> would be anticompetitive under present market conditions. The court should also bear in mind the flexibility of the public interest inquiry... (Emphasis in original, footnote omitted.)

Rather than instructing Judge Greene to "rubber stamp" anything, the Appeals Court found that the Tunney Act public interest test would have been met without the inclusion of the information services bar in the first place. The Appeals Court went on to tell Judge Greene to examine "present market conditions" to determine if lifting the ban on the generation on information would now be anticompetitive. After lengthy briefing and two full days of oral argument Judge Greene was apparently unable to find a legal basis for retaining the restriction, although it is abundantly clear that he tried very hard to do so. We do not see how a judge's failure to find legal evidence, notwithstanding that his instincts somehow make him believe differently, can be equated with an order to "rubber stamp." Rather we believe that the process of weighing facts not feeling is the very basis of our legal system.

The Arguments Against RBOC Entry Do Not Stand Up Under Review

Leaving the Tunney Act arguments aside for the moment, CCIA does not believe that the substance of competitors arguments against RBOC entry into information services have ever been valid.

Arguments against RBOC entry into full-line provision of information services — including provision of content -- appear to fall into three categories: that the RBOCs control a "bottleneck" through which its competitors must pass;

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that they have both the incentive and ability to disadvantage competitors; and that their ratepayers would be harmed by their entry. I would like to take this opportunity to address each of these assertions briefly.

I would like to begin with the "bottleneck" question because so much of the current discussion regarding RBOC entry into the information services business seems to center on this concept. We find it curious that the proponents of this argument offer very little to support their assertion, and even more curious that there has been almost no question raised about its accuracy. Included within CCIA's membership are many of the most technically sophisticated companies in the world and we have been unable to locate the bottleneck.

Perhaps the confusion derives from focusing on the concept of the "gateway" which the RBOCs are now permitted to offer. In fact, it may be the choice of the term itself that raises the question. But as there is no mandatory requirement that information service providers avail themselves of an RBOC gateway, and certainly very few do, it can hardly be argued that the offering of a gateway capability is in itself the creation of a bottleneck.

On this point it might be useful to examine existing alternatives to an RBOC information gateway for the provision of information services. In CCIA's review of the options, which was by no means comprehensive, we immediately identified a number of alternative vehicles available for the distribution of information services. For example, information services can be provided through the following alternative technologies, most of which do not even require passage through the public switched telephone network.

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o **Satellite and VSAT technology**, that is through the direct broadcast of information services via satellite to stationary or mobile ground receiving stations — commonly known as satellite dishes and now as VSATs (Very Small Aperture Terminals) because of the decreasing size of the terminals required for reception.

Examples of information service applications for which this kind of technology is currently in use would include the in-transit re-routing of trucks hauling perishable goods, the assignment of repair calls to in-the-field maintenance personnel and their requests for checks on parts inventory, and the J.C. Penney application described in the Washington Post for testing of both consumers' and individual store buyers' reaction to particular merchandise.

o **Cable television systems**, which we understand now pass some 85% of U.S. residences.

Such systems can be used for a wide range of audiotext, videotext, including classified advertising, and full video information services.

o **Blanking intervals on broadcast television**, that is the portion of the video signal which is transmitted but not used to form the picture which is seen on your tv screen.

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An example of the use of this technology with which you are all probably familiar is providing the written text of words being spoken or broadcast along with the video and audio portions of the transmission to provide closed captioning for the hearing impaired.

o **Sideband transmission on broadcast radio,** which is the unused portion of a radio station's assigned spectrum which allows data to be transmitted concurrently with the audio to particular receivers.

Information applications currently offered via this technology include continual update on stock transactions for user-selected companies.

o **Wireless communications systems,** including cellular communications systems, which are increasingly all digital systems many of which are equally useful for data and voice applications and for transmission to stationary or mobile locations.

A good example of an information service employing this technology was reported in a Washington Post story on Dulles Airport's installation of remote terminals in their parking lots for credit card authorizations in under seven seconds.

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- o Fiber optic networks of alternative local transport (ALT) providers which are now proliferating in urban areas, these would include Teleport in New York and Metropolitan Fiber in Chicago.

  Using such systems integrated voice, data, and video information service applications are all eminently possible.

- o And, of course, an information service provider can bypass an RBOC gateway by providing service offerings in one of the two ways that most such services are delivered today: using any dial-up telephone line in conjunction with a personal computer and a modem, or through another "gateway" like those provided by Prodigy or Compuserve.

Given the variety of alternative delivery mechanisms which are available, one can hardly say that an RBOC bottleneck exists for information services.

Next, I would like to address the assertion of potential harm to competition resulting from RBOC entry into the information services business. Analysis of this question, we believe, is best undertaken by examining what business incentives, if any, exist to inflict such harm.

The RBOCs' primary business, and one about which there's little question they do quite well, is transmission of telephone calls. Every business call made from an RBOC's serving area generates revenue for that RBOC. And in an ever increasing number of states the same is true for every residential call over a limited number. Simple arithmetic dictates that the more calls that are made to information service providers -- that is the greater the success of

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information providers -- the greater the revenues received by the RBOC. It is my understanding that some RBOCs are currently using, or are contemplating, a time charge for gateway usage. Such an approach would seem to serve as a positive incentive to encourage the greatest possible use of information service offerings by consumers regardless of supplier.

The question which then arises is whether being able to produce their own content would change an RBOC's incentives. We don't believe so for two primary reasons. First, we think it is important to note that unlike the case of manufacture of equipment, no RBOC is itself a disproportionately large user of information services so no question of foreclosure of a significant portion of the marketplace arises.

Second, while it may be virtually a truism that suppliers in most markets would prefer to have few competitors, we would submit that in the information services marketplace the reverse is true. The evolution of the current market for information services from a small niche market to a mass market requires the creation of a critical mass of useful and innovative service offerings to attract a critical mass of consumers willing and able to use them.

The two sides of this equation are interdependent and mutually reinforcing. The availability of a wider and wider range of information service offerings provides the economic justification for more and more consumers to make the financial investment in the equipment necessary to access them. The larger the market for such equipment becomes, the lower the price for that equipment falls. The lower the price for the equipment, the larger the market for additional services, making the use of services ever more ubiquitous. Hence,

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the foreclosure of the marketplace to any competitor who has something to offer to the consumer is self-defeating.

Given no incentive -- and in our view a positive disincentive -- to disadvantage competitors, the question of an RBOC's ability to do so appears less relevant, but as the question does arise we would like to respond. As noted earlier, CCIA believes that the absence of an RBOC bottleneck for the delivery of information services is a critical consideration. We also believe that the "unbundling" of basic service elements required by the FCC in its Open Network Architecture proceeding, coupled with a requirement for RBOC-owned information service providers to purchase these same elements at tariffed prices and to access any RBOC gateway in the same manner its competitors do, resolves all but the theoretical concerns the Appeals Court recently spoke of regarding an RBOC's ability to disadvantage any information service competitor.

The final argument which is raised by opponents of RBOC provision of information services is harm to the telephone ratepayer. CCIA's members have a very good understanding of cross-subsidy and our preference would be for as rapid a transition as possible away from rate-of-return regulation and to a true price-cap regulatory regime at both the federal and state level. Price caps would provide not only a greater incentive toward modernization and efficiency, but would end any incentive to attempt to shift costs from unregulated to regulated businesses.

In the interim, we believe that the business of providing information content -- the collection of data and amassing of databases; the writing, editing, or

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manipulation of text; the presentation of retail merchandise available for sale -- is quite dissimilar to any of the businesses the RBOCs are now involved in and that provision of content is unlikely to prove an insurmountable allocation process for state public utility commissions to oversee.

The true irony is that current public policy is forcing the RBOCs to invest in the development of the telecommunications infrastructure of other nations rather than our own because only abroad can they hope to realize profits from their skills and investments.

MFJ Restrictions on Bell Company Manufacturing Are Overly Broad

Mr. Chairman, I would like to turn now to issues relating to Bell Company participation in the manufacturing process. Perhaps because of the diversity of our membership, CCIA has always made a serious effort not to approach issues as if they were either "black" or "white." Our preference instead is to attempt to separate the facts from the rhetoric and to examine proposals for change from a perspective formed by the realities of the marketplace.

One example of the results of this approach is the fact that during the same Tunney Act process in which CCIA, along with many others, advocated the establishment of the manufacturing ban, we were the only industry trade association to support a change in the originally-proposed MFJ to allow the RBOCs to market customer premises equipment (CPE) manufactured by others.

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CCIA shares many of the same concerns evidenced by sponsors of both House and Senate bills directed at allowing the Bell Companies a greater level of participation in the research and development process. Among these are CCIA's recognition of the critical importance of:

- o increasing the competitiveness of U.S-based industry both in domestic and international markets;
- o creating an economic environment conducive to greater investment in research and development;
- o accelerating the introduction of innovative new products into the public switched network;
- o encouraging the creation of U.S. jobs;
- o contributing to a positive U.S. balance of trade in high technology goods and services;
- o protecting telephone ratepayers from costs associated with unregulated ventures; and
- o avoiding the historic problems of unwarranted procurement preference and the foreclosure of significant portions of the telecommunications equipment market.

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As a result of our concerns, a special task force of CCIA members, reflecting all affected sectors of the industry, devoted several months to addressing these complex issues. CCIA's goal was to find a practical way to allow the Regional Bell Companies a significantly enhanced role in research and development and greater flexibility in their efforts to provide the consumer with a broader array of modern services efficiently and cost effectively without raising the spectre of cross-subsidy, self-dealing, or harm to competition or to telephone ratepayers.

Ideology was not a guiding principle in these debates. The only "litmus" test applied to each potential approach was consistency with the economic realities of the telecommunications business. The position CCIA endorses reflects the practical experience of businessmen who have designed and brought innovative products to market, faced competition, created jobs, and met the tests of the marketplace.

While no task force product can ever purport to mirror in every detail the precise views of 60 different companies, a single position statement was recommended by the task force, endorsed by CCIA's Executive Committee, and adopted unanimously by CCIA's Membership. I would like to devote the balance of my comments to explaining that position and why CCIA believes that its approach would contribute to the attainments of the goals outlined above.

It is CCIA's position that, contrary to Judge Greene's December 1987 "manufacturing decision," it is both possible and beneficial to define a practical line between RBOC fabrication of equipment, which we believe should be barred, and activities in the areas of research and development, close

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interaction with suppliers, and the funding of design of specific products which are highly beneficial and should not be prohibited.

In his decision, Judge Greene broadly interpreted the term "manufacture" to include research and development, design and, some would argue, even detailed product procurement specification. CCIA believes that the scope of the term "manufacture," as interpreted by the District Court, is at variance with the common acceptance and use of the term in our industry. In our view, in the two and a half years since the release of the "manufacturing decision," the ambiguities concerning just what the RBOCs can and cannot do has had a chilling effect on the rate of innovation in the telecommunications equipment market and the competitiveness of firms participating in that market.

To advance the development of high technology equipment, software and services, CCIA believes the following principles should apply to the Bell Companies' permitted activities in connection with basic and applied research and development and the design of specific products and would support any interpretation or clarification of, or modification to, the Modified Final Judgment which may be necessary to accomplish these goals:

1 R&D- The Bell Companies should be permitted to engage in their own basic and applied research and development activities. Bell Companies should be permitted to hold intellectual property rights on any advancements generated therefrom. Bell Companies should be permitted, as outlined below, to engage in such activity on their own, through Bellcore or in collaboration with a third-party vendor.

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The Bell Companies should further be permitted to enter into business arrangements with third parties for specific development projects, including contractual arrangements that would permit receipt of royalties, fees or other customary financial arrangements subject to the conditions set forth in Sections 2 and 4 below.

2 Intellectual Property Rights - In general Bell Companies should be permitted to make licensing decisions based solely on their business judgement, however, any patents, know how or other intellectual property right owned entirely or in part by the Bell Companies or Bellcore which is necessary for the purpose of achieving network transparency, interconnection, or interoperability should be licensed on a non-discriminatory basis, on reasonable terms and conditions and in a timely manner to any vendors of telecommunications equipment or software for those purposes. There should be no limits on the royalties that could be earned through such intellectual property licensing or sale.

3 Interactions with Manufacturers During Product Development - A Bell Company should be permitted, individually or through Bellcore, to engage in close collaboration with manufacturers during their design and development of hardware, software or combinations thereof. The relationship should permit frequent interaction, feedback, modification of designs, testing and evaluation of prototypes and/or production design units as the Bell Company or Bellcore determines whether the particular telecommunications products being designed and developed meets its needs. As an example, a Bell Company or Bellcore should be

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permitted to contract for the design and development of a specific prototype of a product and interact closely with the vendor during the creation, testing and documentation of that design.

4 Funding Specific Product Design and Development – A Bell Company should be permitted to fund design and development of specific hardware, software or combinations thereof for its own use and for sale to others. Business arrangements for such funding may not involve Bell Company ownership of, or an equity interest in, the vendor except in the case of vendors of applications software as provided for in Section 6 below.

To the extent that the product is used solely or essentially only by the funding Bell Company, such funding should be provided by a regulated entity and be subject to regulatory oversight and the funding arrangements should include only provisions to fully recover any funding and a reasonable return on capital.

If the product is for sale to others, such funding should be provided by an unregulated entity and there should be no limitations on the earnings from such sales.

For the funding of products that are both for use by a regulated entity and for sale to others, appropriate mechanisms should be in place to protect the interests of ratepayers.

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5 Technical Interfaces - The Bell Companies should comply with the requirements of current FCC rules to disclose new technical interfaces planned for the network so that all product vendors would have the opportunity to compete for the Bell Company's business and/or develop new services or products which connect to or could be used on the local networks.

6 Development of Applications Software - A Bell Company should be permitted to design and develop, on its own or in collaboration with a vendor, any applications software, i.e., any software other than that which is integral to the operation of telecommunications equipment. There should be no limitation on Bell Companies' equity interest in, or ownership of, any vendor which is exclusively engaged in the design, development and production of such applications software.

There are, we believe, a number of significant advantages to the approach detailed above. First, CCIA believes that it is important to distinguish realistically between areas where the RBOCs are likely to make significant contributions and those in which they simply have no experience to offer. Having never manufactured anything, the RBOCs clearly have no particular expertise to bring to the fabrication process. For the same reason, they would have equally little to contribute to the process of actually designing or engineering a manufacturable product.

What the RBOCs do have is a wealth of experience in network planning and systems engineering and, through Bellcore, expertise in conducting generic research. Such activities, whether basic or applied, are aimed largely at

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contributing to the body of scientific knowledge on which the evolution of network technology depends and we believe that they can make a substantial positive contribution in this area if there is a reasonable economic incentive for them to undertake such work. In addition, RBOCs have a very significant body of experience in understanding the needs of their customers.

This combination is a tremendous resource for consumers if the RBOCs apply it to the creation of the "applications" software which allows particular tasks to be performed more efficiently or makes information easier to access and use. It is the development of applications software that will drive the technology because it drives the use of technology. For this reason, RBOC endeavors in this area would provide enormous benefits to their customers, particularly small businesses and residential consumers.

Similarly, the RBOCs' network and customer knowledge is a beneficial resource to equipment manufacturers if they apply it to the equipment development process in cooperation with those manufacturers. Few telecommunications equipment manufacturers interact directly with end-users and those that do frequently have only limited expertise in networks. Permitting the RBOCs to bridge this knowledge gap would shorten the design cycle and bring more useful products to market sooner.

Second, it is the collective experience of CCIA's member companies that in a technically complex area like telecommunications customers simply must be able to talk freely and constantly with their suppliers. Such close collaboration between customers and suppliers is more than beneficial, it is a critical element in the innovative process of arriving at a meaningful product.

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Placing artificial limits on the extent of such interaction wastes scarce resources — human and financial--inevitably delays the introduction of new products and services, and makes telecommunications equipment manufacturers less competitive.

Third, allowing RBOCs to contribute research and development funding to the specific development projects of unaffiliated manufacturers and to receive royalties on the sale of such products to third parties solves what we believe is the central question: how to allow the RBOCs to play a significantly larger role in research, development, and product design without raising an endless controversy over potential procurement preference or market foreclosure.

Under CCIA's proposal quite different incentives would exist than would be created either by RBOC ownership of a captive manufacturer or an RBOC having a direct equity interest, no matter how small, in a particular supplier. One difference would be that the payment of royalties would only result from the sale of a successful product to others. Purchases of equipment for the regulated network could not create earnings for the unregulated side of the business.

Another significant advantage is that allowing an RBOC to contribute funding for specific product design and development by third parties would create a business relationship of only limited duration rather than an ongoing interest in the long-term success of any particular supplier at the expense of another. Future business relationships with other firms would not be prejudiced and

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further business relationship with any supplier would depend solely on the success of previous projects.

Fourth, CCIA's proposal would address the needs of the telecommunications market and provide much greater flexibility for the RBOCs without raising the troubling prospect of making U.S. manufacturing firms, for the first time in our history, subject to federal regulation.

Fifth, there would be no risk of foreign governments retaliating against U.S.-based telecommunications equipment manufacturers by the imposition of severe domestic content requirements in equipment procurements by their telecommunications service providers.

Finally, CCIA believes that its position would make a significant contribution to achieving each of the concerns underlying legislation passed by the Senate and under consideration in the House. For example:

Under CCIA's proposal competitiveness of U.S.-based telecommunications manufacturers would be increased because:

- o more capital would become available for R&D and product design by small and medium-sized firms. In many instances, the limited availability of such funds is now the primary obstacle to such firms bringing products to the marketplace in a timely fashion;

- o removing the current uncertainties surrounding the extent to which RBOCs may collaborate with their current or potential suppliers would

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eliminate much of the waste of scarce R&D resources now virtually built into the process and allow more R&D to be accomplished;

- o assuring that close interaction between customer and supplier is permitted would create more efficiency in the development process and shorten design cycles. This would bring more innovative products to the market sooner which would make the manufacturing firm more competitive both in domestic and international markets; and

- o RBOC R&D investments are likely to be channeled to smaller U.S.-based firms first because they are the ones which have an unmet funding requirement and second because the close interaction required in this process favors proximity.

Under CCIA's proposal an economic environment conducive to greater investment in research and development would be created because:

- o clarifying an RBOC's rights to own and license intellectual property would create a financial incentive to intensify generic basic research efforts;

- o permitting RBOCs to earn royalties on the sales of third parties' products in which they have invested would match the potential reward of such endeavors to their inherent risk; and

- o RBOC R&D funding channeled to small firms allows both the RBOC and the recipient company to leverage their available R&D funds because small

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firms have a much smaller overhead in managing R&D than do larger companies.

Under CCIA's proposal introduction of innovative products into the public switched network would be accelerated because:

- o close interaction of RBOCs with their suppliers would greatly reduce time wasted in the current "trial and error" approach of manufacturers trying to meet their RBOC customer's needs;
- o RBOC ability to invest in the R&D and design of smaller equipment competitors who have no installed base to protect will lead to more "generation skipping" product innovations; and
- o smaller firms ability to raise R&D funds from their RBOC customers will make them more competitive players in the equipment marketplace and bring increased pressure on larger firms to bring more innovative products to the marketplace more quickly.

Under CCIA's proposal the creation of U.S. jobs will be encouraged because:

- o smaller U.S. firms are the most likely beneficiary of RBOC R&D investment and historically it is small, just emerging companies who contribute most significantly to the creation of new jobs;

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- o smaller U.S. firms have a strong incentive to create more jobs where they are headquartered which entails no new costs associated with adding foreign-based managerial or administrative support; and

- o infusions of R&D capital helps smaller firms overcome a primary obstacle in "leapfrogging" technology. Once accomplished, such firms have a strong incentive to ramp up their manufacturing quickly which creates more U.S. manufacturing jobs.

Under CCIA's proposal there would be positive contribution to the U.S. balance of trade in telecommunications products because:

- o current U.S. exporters would not be at risk of facing mirror domestic content requirements in their foreign markets;

- o often the only thing which keeps small and medium-sized U.S. manufacturers from becoming exporters is the lack of capital to simultaneously fund R&D and the development of new foreign markets; and

- o as firms are able to become more competitive through the shortening of their development cycles their products are more attractive internationally as well as domestically.

Under CCIA's proposal telephone ratepayers would be protected because:

- o funds transfered to unaffiliated third parties for R&D and design projects are easily traceable one-time transactions;

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- o the distinction we suggest between treatment of funding for products intended for the regulated network and those intended for unregulated sale to third parties greatly simplifies the job of regulatory oversight;

- o not permitting royalties to be earned by unregulated RBOC entities on sales to their own regulated entities dramatically reduces economic incentives to buy overpriced equipment; and

- o the regulatory cost borne by ratepayers is significantly less if incentives are removed than it is in an endless effort to enact the "perfect" safeguard or to enforce such safeguards.

Under CCIA's proposal historic problems of unwarranted procurement preference and potential foreclosure of markets are avoided because:

- o the incentives created by limited duration, contractual agreements to fund a particular R&D or design project are vastly different from those associated with owning a captive supplier or even holding an equity interest in a supplier;

- o no artificial preferences for one potential supplier over another are created; and

- o RBOCs will continue to have the incentive the MFJ created to make their buying decisions based on the requirements of their networks and their customers and on price-performance of the product.

Mr. Chairman, this concludes my prepared remarks. I would be pleased to answer any questions you or other Members of the Subcommittee may have.

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Mr. BROOKS. Mr. Kimmelman.

STATEMENT OF GENE KIMMELMAN, LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA

Mr. KIMMELMAN. Thank you, Mr. Chairman.

On behalf of consumers, I appreciate the opportunity to present the views of the Consumer Federation on this important issue.

Mr. Chairman, I thought I had seen it all before this morning with the Justice Department flip-flopping on this issue, the courts all over the map. But I learned something this morning that was a new wrinkle in this matter. Two of the largest corporations in this country up here before you seemed confused. One of them, after one of the most important court rulings, couldn't seem to figure out what its legislative strategy would be in response to that ruling.

The other one couldn't seem to figure out what the legal ramifications of neutrality on this issue would be to its own business.

If that wasn't enough, they couldn't agree or even understand each other on whether one could sell what the other one wants to buy. Now, if that doesn't prove that they deserve each other, I don't know what does. But it seems to me what it proves more than anything else is they are not to be trusted in setting public policy on this issue.

This committee has a record before it of 7 years of procompetitive policy under the antitrust consent decree in the *AT&T* case, a policy that has promoted competition, a policy that has preserved universal service and makes it better each day for consumers to be able to afford telecommunications services. That is not a bad record. Any departure from these kinds of policies will have profoundly negative ramifications for consumers.

We believe specifically that Bell company entry into the business of manufacturing and into the information world would tend to expand their local monopolies into these businesses, reduce competition, and ultimately lead to much higher local telephone rates for consumers in this country.

The problem, Mr. Chairman, is that we are entering this new electronic information age, world, where we are looking at the telephone wires as a highway to provide even electronic newspapers in the home. The Bell companies are in a position to use ratepayer money to finance this kind of business and to favor any manufacturing affiliate they have a stake in. The ultimate effect is to undermine competition in both manufacturing and information services.

Now, would they do it? Mr. Chairman, the record in this case, the record before this committee, is replete with examples of abuse after abuse, discrimination, anticompetitive practices, and even a few direct violations of the consent decree.

It is kind of like, to make it visual, because the communications network is mostly invisible, the notion of a phone company buying up a major airline, like United Airlines, and then being able to buy up a National Airport like BWI or Dulles. Who do you think is going to get the best treatment in making airplanes? Who gets the best landing rights? Who is going to have the best takeoff performance? Who is going to get the best gates, advertising placement?

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Down the list, the problem with the Bell companies is that the telephone network is impossible for regulators to monitor.

Mr. Whitacre indicated he was offended on behalf of Southwestern Bell by the suggestion that his company would break the law. He seems like an honorable fellow, Mr. Chairman, but I just noted an article in the Wall Street Journal from July 22 that indicates that his company, Southwestern Bell, was found in an audit in the State of Oklahoma to have overcharged consumers $300 million.

And I will quote, "Jim Proctor, Director of the Oklahoma Public Utilities Division, called Southwestern Bell's 1990 proposal for incentive regulation a strategic ploy to maintain its excess monopoly profits and a fraud on the people of Oklahoma. The company return exceeds 30 percent, far above the authorized 11.41 percent rate of return."

Mr. BROOKS. I am glad Mr. Synar is not here right now. He would be very interested in that.

Mr. KIMMELMAN. It seems to me, Mr. Chairman, that someone else other than Mr. Whitacre ought to be offended by that, possibly the ratepayers who had to pay those bills.

I think the case is clear, Mr. Chairman, after watching the Justice Department and the courts flip-flop around this issue. We think it is time for Congress to reassert the antitrust principles that have been in place for the last 7 years to ensure that as long as the local telephone companies remain a monopoly, they not be allowed to enter into the competitive manufacturing or information businesses, that they not be allowed to expand their local monopoly to drive up telephone rates and to drive out competition in these two vibrant markets.

Thank you.

[Mr. Kimmelman's prepared statement follows:]

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Consumer Federation of America

Statement of Gene Kimmelman, Legislative Director
Consumer Federation of America
before the House Economic and Commercial
Law Subcommittee
on the AT&T Consent Decree
August 1, 1991

Introduction

Recent federal court rulings and pending legislation threaten to supplant competition in the information business and manufacturing market with the creeping dominance of local telephone monopolies. Congress must reassert antitrust and consumer protection policies that prevent the Bell telephone companies from inflating local telephone rates and extending their monolithic control over local phone service to the information and manufacturing world.

I. Background

The terms of the AT&T breakup (Modification of Final Judgement (MFJ)) are based on the theory that consumer benefits are maximized if telephone companies providing monopoly services are not allowed to enter adjacent, competitive markets. For the Bell breakup, this required prohibiting the Bell companies -- providers of monopoly, basic local phone service -- from entering

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more competitive businesses like interstate long distance, manufacturing and information services.

This consumer benefit theory is based on the historical anticompetitive practices of the unified Bell System, and the inherent incentives of a company that can maximize profits by overpricing monopoly services and underpricing competitive services. The government's antitrust lawsuit against AT&T included example after example of AT&T's taking advantage of its monopoly control of local phone business (i.e. the local "bottleneck") to discriminate against its potential long distance and manufacturing competitors. This anticompetitive behavior, though illegal, made perfect economic sense for a profit-maximizing AT&T: by thwarting entry into manufacturing and long distance, the Bell System could preserve a monopolistic revenue stream, spreading excessive costs to all AT&T services.

As policymakers opened the telephone equipment and long distance markets to competition, the Bell System's incentives to discriminate against potential competitors were reinforced by the profitability of shifting costs from competitive manufacturing, information services and long distance ventures to regulated monopoly local service. In a telephone network where the same equipment and resources are used to provide local, long distance and computer-based services, earnings rise when costs are loaded onto local phone service (where the public has no alternative provider and regulation guarantees adequate profit). Once costs are shifted to local service, the local phone company is better

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positioned to manipulate prices for all other services to benefit its unregulated or more competitive ventures. To prevent the "Baby Bell" local phone companies from repeating AT&T's anticompetitive behavior, and to reduce Bell company incentives to drive up the price of local phone service, the MFJ prohibited Bell entry into the potentially competitive businesses that rely on the local monopoly for their survival.

Under the consent decree's logic, if incentives to overprice local phone service are reduced and the ability to discriminate against potential competitors is eliminated, consumers should receive maximum benefit from the telecommunications market. In concrete terms, this means that competition in the long distance, manufacturing and information services markets should promote price reductions, higher quality service and the development of new services for consumers without exacerbating Bell company incentives to raise the price of monopoly, local phone service.

Our recent experience with the MFJ verifies that consumers are best protected by separating competitive businesses from monopoly ventures. This track record demonstrates both the consumer benefits of the Bell company restrictions and the dangers of Bell expansion into more competitive markets.

II. The Post-Divestiture Experience

Since the Bell breakup, long distance competition has grown significantly, more manufacturers are competing to provide

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network equipment and telephones, and new information services are being developed as more consumers become computer literate. Contrary to Bell company claims, the American telecommunications marketplace leads the world in infrastructure modernization, network development and cost-effective provision of telecommunications services.[1] In addition, with restrictions that reduce Bell company incentives to discriminate, the success or failure of businesses that connect to Bell lines has, for the first time in this century, not led to protracted litigation through the filing of new antitrust lawsuits against the Bell companies.

Unfortunately the Baby Bells, consistent with the economic incentives described above, have done everything imaginable to circumvent the anti-discrimination and ratepayer-protection goals underlying the MFJ restrictions. Bell company reorganization into a virtually unregulatable holding company structure, violations of the MFJ restrictions, discrimination against potential competitors, rate increase requests, marketing abuses, repricing proposals and deregulation efforts demonstrate a desire to raise the price of monopoly, local phone service and enter more competitive markets without adequate regulatory oversight. While the MFJ restrictions and occasional regulatory intervention have prevented substantial erosion of consumer protection,

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[1] See Comments of CFA and ICA to the National Telecommunication and Information Administration In the Matter of Comprehensive Study of the Domestic Telecommunications Infrastructure, Dkt.No. 91296-9296, April 9, 1990 at Appendix A and C.

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aggressive Bell company market strategies have led to the few consumer losses of the last seven years.

Following the stable 50-year pre-divestiture era, during which local residential rates declined 60 percent and overall residential bills fell 64 percent (factoring out inflation),[2] consumers were jolted by the new business practices of the divested Bell Operating Companies (BOCs). The Bell companies have aggressively taken advantage of their local monopoly business to enhance their options in the more competitive markets they seek to enter.

A. The Threat to Local Rates

Since divestiture, all the Bell companies have positioned themselves to use their monopoly local ratebase as a cash-cow to finance potentially more profitable, unregulated business ventures. First the Bells urged the FCC to transform $11 billion of long distance costs into local "access charges" which would have driven local rates up $6-8/month for all consumers.[3] Then, within two years of the announcement of the Bell breakup, the local Bell companies asked state regulators for approximately $20 billion in rate increases.[4]

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[2] Bureau of Labor Statistics, Consumer Price Index; see also Kimmelman and Cooper, Divestiture Plus Five, CFA, Dec. 1988.

[3] Comments of the Bell System Operating Companies before the FCC In the Matter of MTS and WATS Market Structure CC Dkt. No. 78-72 and before the Senate Commerce and House Energy and Commerce Committees on S.1660 and H.R. 4102, 98th Congress.

[4] Divestiture Plus Five, op. cit.

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These dramatic rate increase requests reflect the Bell companies' claim that local rates cover only about one-third the cost of providing local service.[5] Under this line of reasoning the Bell companies can argue that significant local rate increases do not involve subsidization of their unregulated business. In the context of H.R. 1527, the "Telecommunications Equipment Research and Manufacturing Competition Act of 1991," sponsored by Rep. Slattery, this means that Bell purchases of overpriced, customized equipment from their manufacturing affiliates, which cause local rates to rise, may not be viewed as inappropriate cross-subsidization.

The Bell companies have used a litany of other strategies to inflate the price of local, monopoly phone service. Besides direct efforts to have most if not all of their local phone operations deregulated (e.g., Nebraska and Idaho), the Bells have structured their business to make regulatory oversight as difficult as possible.

For example, regulators from nineteen states have complained to the federal courts that Yellow Pages advertising profits, which regulators traditionally used to keep local rates down, have been siphoned out of regulatory reach by the Bells' creation of out-of-state unregulated publishing affiliates, separate from their local phone operations.[6] Recently, the Oregon Public

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[5] In the Matter of MTS and WATS ... op. cit.

[6] Advice to the Court by Western Conference of Public Service Commissioners, Civil Action No. 82-0192 (HHG), U.S. District Court, D.C. October 23, 1989.

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Utility Commission ordered U S West to return $29 million in directory publishing revenue to the regulated ratebase because: "U S West formulated a corporate strategy in 1986 to divert directory profits from ratepayers to stockholders. The company acknowledged that the strategy would cause local rates to increase, but nevertheless concluded that it should pursue the goal of flowing as many dollars to the shareowners as possible."[7]

By establishing a complicated web of subsidiaries separate from their local phone companies, the Bells have demonstrated that they can elude regulatory cost allocation designed to protect consumers of regulated services. As an analysis of the National Association of Regulatory Utility Commissioners (NARUC) concluded:

> The operations and methods of Pacific Telesis bring to life the worst nightmares of regulators. There appears to be no advantage to the holding company structure except to the unregulated businesses of Pacific Telesis, which are cross-subsidized at every turn by Pacific Bell.[8]

Through the few audits and investigations regulators have the resources to undertake, the Bell companies have been found to allocate excessive costs to ratepayers for inappropriate network investments (Pacific Bell in California, $144 million),[9] wiring

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[7] See Oregon PUC press release, December 29, 1989

[8] NARUC Summary Report on the Regional Holding Company Investigations, September 18, 1986 at 17.

[9] California PUC, Division of RAtepayer Advocates, Staff Report on Pacific Bell's Capital Decision-Making Process, August 5, 1988 at xiii.

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costs (all Bell companies and GTE at FCC, $158 million),[10] and lobbying expenditures (NYNEX in Massachusetts, $12 million,[11] Ameritech in Wisconsin, $33 million),[12] while undercompensating ratepayers for directory earnings (BellSouth region, up to $400 million).[13] The Bells have also been caught deceiving consumers by forcing them to purchase extra services unwittingly (Pacific Telesis $35.6 million ratepayer refund for marketing abuse in California,[14] Bell of Pennsylvania $42 million refund for selling optional services, e.g., wire maintenance and call forwarding, as part of basic service).[15] If the Bell companies are allowed to enter other unregulated markets, like manufacturing, their incentives to shift further costs onto ratepayers of monopoly telephone service will only grow.

B. Discrimination Against Competitors

Similar to the old unified Bell System, the Baby Bells have been accused of discriminating against companies that rely on network facilities to compete with Bell service offerings. Since the MFJ prevents the BOCs from providing most network-reliant

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10 Telecommunications Reports, March 27, 1989 at 5.

11 Telephony, March 5, 1990 at 11.

12 Communications Daily, July 12, 1990 at 2

13 Southeast Association of Regulatory Utility Commissioners, Report on BellSouth Corporation and Affiliates, September 1990 at EX-10.

14 Wall Street Journal April 11, 1990 at A4.

15 Id.

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services (i.e., interstate long distance, information services and equipment manufacturing), the scope of such allegations are limited. However, they demonstrate that the Bell companies have inherited the predilections of their former parent, AT&T.

Businesses ranging from Dun and Bradstreet to cellular and cable companies to the Florida Telemessaging Coalition to Prodigy Services Company have accused the Bell companies of delaying and thwarting efficient network connections, discriminatory pricing and failure to provide customer information necessary to compete with Bell services.[16] With their complicated, ever-changing network designs, for which only they know the up-to-the-minute and likely future technical details, the Bell companies possess limitless untraceable methods of discriminating against network-dependent competitors.

Fortunately in the post-divestiture era, restrained by the MFJ restrictions, the Bells have had little incentive to harm the large majority of telecommunications equipment and service providers. However, even under these circumstances, U S West was found blatantly disregarding the rules of the consent decree in at least four business ventures and was charged the largest civil penalty, $10 million, ever assessed by the Justice Department's Antitrust Division.[17]

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[16] NCTA, The Never-Ending Story: Telephone Company Anticompetitive Behavior Since the Breakup of AT&T, April 1991.

[17] Peter Coy, "The Baby Bells Misbehave," Business Week March 4, 1991 at 23-24.

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III. Consumer Concerns About Lifting the Information Services Restriction

Federal District Court Judge Harold H. Greene's recent decision to lift the MFJ's information services restriction leaves consumers at considerable risk that the Bell companies will attempt to inflate local phone rates and expand their discriminatory practices to undercut competitors in the information business.[18] With their monopolies in the local telephone market, the Bells have an incentive to use revenue from captive local service ratepayers to finance new business ventures in the unregulated, competitive information market. As the AT&T case and recent pricing battles demonstrate (see section II. A. supra), regulation has never been able to prevent the Bells from misallocating network costs to benefit their unregulated business ventures (see section V infra).

A recent Georgia Public Service Commission decision concerning Southern Bell Telephone's (SBT) offering of an information service previously exempted from the MFJ ("MemoryCall," a voice messaging service (VMS)) demonstrates the consumer and competitive dangers of Bell entry into the information market. Although Southern Bell refused to provide the Georgia Commission adequate cost data to determine whether Bell's voice messaging service was being subsidized by local

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[18] U.S. v. Western Electric, Co. Inc. et al., (D.D.C.) Civil Action No. 82-0192 (HHG) July 25, 1991 (hereinafter "July 1991 Ruling")

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telephone rates,[19] the Commission found Southern Bell's "practices constitute marketing and other promotional activities that unfairly trade on SBT's monopoly position to the immediate and irreparable detriment of a competitive VMS market."[20] In addition, the Georgia Commission found considerable evidence that Southern Bell used discriminatory, anticompetitive tactics to give itself an artificial advantage in the voice messaging market:

> The record in this case demonstrates at least three significant issues of discriminatory, anticompetitive behavior by SBT in the VMS market regarding access to the local network. In the Commission's view, the evidence on each issue shows at a minimum that SBT has both the opportunity and incentive to use its monopoly control of the local network to defeat competition in the VMS market through its influence on whether, how and when competitors can access the local network. Further, the evidence shows that SBT has not hesitated to take advantage of this opportunity, has used its monopoly control over the local network to gain an anticompetitive advantage in its offering of MemoryCall service and will continue to do so if left unchecked by the Commission.
>
> First, SBT's trial offer of MemoryCall was undertaken in a manner that, due to technical barriers, meant that competitors to MemoryCall could not use the local network, except to provide a service significantly inferior to MemoryCall. Second, SBT refuses to allow MemoryCall competitors to co-locate their VMS equipment in SBT's central offices, thereby perpetuating a distinction in product quality and price that disadvantages competitors to MemoryCall. Third, the evidence suggests the possibility that SBT has manipulated development of the local network, especially the timing of unbundling certain network features necessary for MemoryCall to be offered at all, in order to maximize its competitive advantage with respect to its

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[19] In the Matter of the Commission's Investigation Into Southern BEll Telephone and Telegraph Company's Provision of Memory Call Service, Georgia Public Service Commission Dkt. No. 4000-U, May 21, 1991 at 42.

[20] Id. at 35

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> initial offering of MemoryCall. [transcript references omitted][21]

Judge Greene's reluctance in lifting the information services restriction reinforces consumer concern that the Bell companies will attempt to expand their local monopolies into the information market. As Judge Greene pointed out, the very same antitrust concerns exist today, as did in 1982 when the consent decree was entered, which require excluding the Bell companies from the information business:

> In fact, around ninety-nine percent of the traffic to the ultimate subscriber must still pass, in the end, through the Regional Companies' local loops.
>
> This basic circumstance gives these companies the ability to exercise market power with respect to the information services markets, that is, to raise price, to restrict output, or both. The Regional Companies would be able to raise price by increasing their competitors' costs, and they could raise such costs by virtue of the dependence of their rivals' information services on local network access. As Professor Hall states, "[w]hen all but one firm in a market have higher costs, the inevitable result is a higher price, lower output, and lower consumer welfare." Similarly, a Regional Company would be capable of discouraging entry by acquiring a reputation for strategic predatory pricing and denying its competitors post-entry profits, and it would be able to do so credibly because it could shift the costs of its information services to its regulated operations.
>
> The Court is further of the view that, if relieved of the restriction, the Regional Companies would carry out these strategies because (1) this was the pattern of their operations when they were a part of the Bell System, and (2) even after the break-up of that System, they have been engaging in these practices to the extent that they have been permitted into markets that offered opportunities therefor.

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[21] MemoryCall Service, op cit. at 27-8.

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