<u>COMPETITION POLICY IN COMMUNICATIONS INDUSTRIES:</u>

<u>NEW ANTITRUST APPROACHES</u>

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Recent developments in the communications industries show a steady movement from direct regulation to increased reliance on free market incentives. As a believer in the efficiency of market incentives, I regard elimination or substantial reduction of regulation, assuming competition is a feasible alternative, as a good result. Of course, deregulation should be accompanied by a greater role for fundamental antitrust analysis and enforcement, lest the old shackles be replaced by new ones of private manufacture.

One theme of my remarks today is that antitrust, if it is to be effective in these newly deregulated areas, must take into account the special circumstances of each industry. Different sectors of the communications industry were regulated for different reasons, and the transition of various sectors to a free market may be complete or incomplete. As long as antitrust adheres to its tradition of paying careful attention to the facts of each industry, it can play a useful role.

Today I would like to offer some general observations about the transition from regulation to free market incentives and then address more specifically what is "new" about antitrust approaches in the communications industries. In examining what is new, I will in several instances draw examples from the Federal Trade Commission's recent action in requiring restructuring of the proposed deal involving Time Warner-Turner-TCI and then its approval of the transaction as restructured. As always, let me remind you that the views I express today are my own and do not represent the views of the Commission or any other Commissioner.

A. General Observations

Let me begin by outlining a few principles that apply across the board to newly deregulated industries.

First, participants in a deregulated industry, accustomed to coordinated action among themselves or the protection of regulators who guarantee a monopoly franchise, often seek to extend anticompetitive aspects to a newly deregulated regime. Cartel behavior in place of government price restrictions is a classic example. In my own limited experience, this has not been a problem with respect to networks, cable distribution and cable programming. But there can be strong incentives for incumbents to keep new entrants out of what used to be the incumbent's protected domain. Obviously, that can be a problem.

Second, transition out of regulation is almost never complete and immediate. Rather, a patchwork of state, federal and international rules on protection from competition continues to apply. Serious regulatory problems arise where some players in an industry are regulated and some are not, with the unregulated free to raise or cut prices in pursuit of various competitive strategies. It is difficult and often unfair to try to maintain a system for long where direct competitors are subject to radically different regulatory rules. For example, many believe that a principal reason truck transportation was regulated for a time in the United States is because railroads were regulated, trucks were not, and competition between the two was impossible to maintain on anything approaching a fair basis. In a deregulatory environment, we should always be looking for ways to equalize treatment by reducing regulatory burdens on incumbents rather than by increasing them on new entrants.

Third, some policy goals can be handled comfortably in a regulatory regime but are not congenial to antitrust enforcement. During a transition some continuing regulation may be necessary -- for example, caps on cable rates or mandated access to local markets -- to assist during the period before full competition emerges.

Fourth, as a result of the first three points, application of antitrust to newly deregulated industries often involves unconventional issues from the point of view of traditional antitrust. The very fact that an industrial sector was regulated suggests the possibility of some past market failure, or at least some competitive peculiarities (or perhaps what the legislature thought were peculiarities), and therefore calls for a special sensitivity in applying conventional antitrust rules.

B. What is "new" about antitrust approaches in communications industries?

While antitrust fundamentals can apply to the communications industries, those industries are not the same as steel mills and grocery stores and therefore call for adjusted approaches.

Let me list six points which if not entirely new are at least different.

First, the principal antitrust concerns in communications markets usually involve unilateral rather than coordinated effects.[1] In communications markets, products are highly differentiated, transactions between suppliers and distributors are often not observable, buyers are large and sophisticated -- all contributing to the fact that coordinated effects, i.e., price fixing or conscious parallelism, are not likely. For example, in the Time Warner-Turner merger, both companies were exceptionally large producers of cable programming. But, cable programming is highly

[1] There may be exceptions, particularly in markets providing alternative conduits rather than content (such as cellular telephone services or two cable companies serving the same area), and especially where products or services are sold to small businesses or individuals and prices are public.

differentiated: There are news offerings such as CNN, movie channels such as HBO, sports channels, family channels, cartoon channels, etc. Even if the merger significantly increased concentration in cable programming, demonstrating coordinated effects in the pricing of such programming may have been possible but certainly would have been difficult.

Second, because of the dynamic nature of markets and the impact of new technologies, the primary concern in communications arrangements is often access. That is because the entry of new technologies, and firms, is likely to dissipate market power over time, and so markets will tend to be self-correcting unless entry is impeded in some way. That in turn implicates vertical relationships between players in the market, because one method of exclusion is to deny access to critical inputs. Thus, one central aim of antitrust should be to protect the ability of markets to eliminate private restraints and reinvent themselves by precluding private restrictions on access to inputs that are critical to competition. Much of the order in Time Warner was designed to prevent the company's large cable subsidiary from discriminating against new programmers (who might compete with company-owned CNN and HBO), and preventing Time Warner's large programming business from discriminating against new methods of distributing programming to households in competition with its downstream cable companies.

One of the most difficult problems in antitrust analysis arises where a firm, or a group of firms through joint venture, obtains a bottleneck position in a marketplace. In some situations, customers and suppliers cannot survive in the marketplace without access to the bottleneck product or service, and rivals cannot effectively compete.

Antitrust sometimes requires that a monopolist or joint venture with enormous market power make its product or service available to all on fair and nondiscriminatory terms. An example is the Terminal Railroad case.[2] There, a group of 14 railroads owned the Terminal Railroad Association of St. Louis. The association controlled, through acquisitions, the two bridges and one ferry service that could be used to transport railcars across the Mississippi River at St. Louis. The river ran between St. Louis and East St. Louis, so railroads had to use bridges or ferries to get across the river, and terminal facilities were needed to connect individual railroads to the bridges and ferry facilities. One peculiarity of the situation was that none of the 24 railroads that served St. Louis had a line that passed all the way through. All of them had a terminus on one side of the river or the other, so interconnection facilities were essential to serve both St. Louis and East St. Louis, and points beyond. Thus, none of the railroads could transport railcars across the river without using the association's facilities.[3]

Since there was no other economically feasible way to get railcars across the river at St. Louis, the joint venture had market power. One remedy option was to undo the acquisitions, so there would again be two or three independent companies operating the facilities. The Supreme Court did not select that option as its remedy of choice, because it found that consolidation of the facilities provided substantial efficiency benefits and that the unified terminal system was of "great public advantage."[4] Instead, the Court ordered that the joint venture membership be open to any present or future railroad on "just and reasonable terms" that would place all railroads on a level playing field. In addition, any railroad that did not elect to become a member was to be given

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[2] United States v. Terminal Railroad Association, 224 U.S. 383 (1912).

[3] For a detailed presentation of the facts, see David Reiffen and Andrew N. Kleit, *Terminal Railroad Revisited: Foreclosure of an Essential Facility or Simple Horizontal Monopoly?*, 33 J. LAW & ECON. 419 (1990).

[4] 224 U.S. at 410-11.

access to the terminal facilities, again on "just and reasonable terms."[5] But the Court may have recognized the difficulty of reaching agreement on what constitutes "just and reasonable" terms, because its fall-back position was to order dissolution of the asset consolidation if the parties could not reach an agreement that was in substantial accord with the access order.[6]

A less intrusive form of antitrust solution would simply direct the monopolist not to exclude customers, suppliers and potential competitors for an anticompetitive reason. The Associated Press case provides an example of that.[7] There, approximately 65% of the newspapers in this country were members of AP, a joint venture news gathering association that prohibited its members from selling news to non-members. The Court found that newspapers that lacked access to AP news were competitively disadvantaged. Moreover, competitors of existing members had to go through special hoops to become members,[8] and the incumbents had effective veto power.[9] The case is often cited in support of an argument for mandated access to an "essential facility," but the remedial order in that case was actually quite limited. Basically, the Court held that

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[5] Id. at 411. The analysis by Reiffen and Kleit, supra, questions whether the association actually foreclosed access by non-members. The government's principal theory of the case seems to have been monopolization resulting in high prices, lower service and entry deterrence. See Reiffen and Kleit at 432-36.

[6] 224 U.S. at 412.

[7] Associated Press v. United States, 326 U.S. 1 (1945).

[8] In part, a new member, if it was fortunate enough to be admitted, was required to pay 10% of the total amount of the regular assessments paid to the association by the old members in the relevant market since October 1, 1900 -- approximately a 40-year period. Id. at 10-11. That requirement did not apply to applicants that would not compete with an existing member.

[9] What made the situation worse was that in many cities AP members also had contracts with UP and International News Service that required new newspapers to pay a large sum to enter the market. Id. at 13.

membership may not be withheld through discrimination based on competitive status. Specifically, a member of the joint venture was not to be given the power to exclude a competitor, and the by-laws were to provide that an applicant's competitive status was not to be considered in passing upon the application.[10] The reason for that more restrained remedial approach (compared to the one in Terminal Railroad) was not made clear in the Court's opinion, but it may have had something to do with the degree of need for access. There were two other sizable news gathering organizations (United Press International and International Press Service), as well as many smaller ones. Newspapers without AP service were found to be at a competitive disadvantage, but the Court did not say that membership in AP was essential for competition to exist.

But there may have been a more fundamental reason for the restrained hand in Associated Press. The kind of approach used in Terminal Railroad, so like conventional "regulation," is usually a stretch for antitrust. Antitrust rarely mandates access for several reasons: (1) if access is too easy, companies will be inclined to lie back and take no risks on the assumption they can free ride on the earlier investment and energy of their competitors; (2) permitting easy access for competitors can dampen the incentives for firms to undertake risky and costly investments in the first place, unless there are countervailing first-mover advantages; and (3) it achieves little to mandate access unless there is also provision to insure that price and other terms and conditions of sale are "reasonable;" otherwise the monopolist can agree to grant access but introduce terms that are so onerous that as a practical matter access is unavailable. But regulating price and other

[10] Id. at 21.

terms of sale on a continuing basis is exactly the thing that antitrust (as compared to a regulatory agency with ongoing oversight of firms in the industry) is ill-equipped to manage.[11]

Third, conglomerate effects are relevant in newly deregulated industries, but the scope of the doctrine is likely to emphasize actual or perceived potential competition. Indeed, since many deregulated firms will have been monopolists, the most important challenges for a time often will be from firms that are not present rivals in the market.

The Federal Trade Commission demonstrated its willingness to challenge a merger for its anticompetitive conglomerate effects in the Questar case,[12] which involved a situation not unlike that occurring in communications. The case involved the natural gas market in Salt Lake City, Utah. Questar was an integrated energy company, from natural gas production, interstate pipeline transmission, and local gas distribution. Questar was the only pipeline serving large industrial customers in the Salt Lake City area, who generally bypassed the local utility and purchased gas directly from other sources. Those customers used Questar's pipeline services to transport the gas either directly to their facilities or to the local utility, from which they purchased local transportation service.

Questar sought to acquire from Tenneco a 50% stake in Kern River Gas Transmission Company, which operated another interstate pipeline running through the area and was planning, not coincidentally, to build a lateral pipeline to serve industrial customers in competition with

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[11] It should be noted that in Terminal Railroad and Otter Tail Power Co. v. United States, 410 U.S. 366 (1973), another case involving mandated access, the courts could defer to regulatory bodies to determine the proper terms of access.

[12] FTC v. Questar Corp., No. 2:95CV 1137S (D.Utah 1995) (transaction abandoned); FTC Press Release, *FTC to Challenge Questar Acquisition of Kern River, Alleging Monopoly Over Natural Gas Transmission into Salt Lake City Area,* Dec. 27, 1995.

Questar.[13] That was one of the benefits of recent steps to deregulate the natural gas industry. Large customers could select their own suppliers, and contract separately for transportation of the gas. The evidence showed that Kern River was already having an effect on the market, before any lateral hookups were even built. It was actively soliciting customers, and Questar, in response, reduced prices to certain customers. Thus, potential entry was having precisely the kind of effect we would expect, and Questar's monopoly position was clearly threatened, if not already eroded. Questar's response was not surprising -- buy a major piece of the prospective competitor.

The potential competition theory in Questar involved primarily the actual potential entry theory, but there was also an element of perceived potential entry.[14] Kern River was an actual potential entrant in that it was actually planning to enter, and entry would have had a significant procompetitive effect on the market. There was also evidence that Kern River was perceived as a potential entrant at an earlier stage. Theory predicts that a perceived likelihood of entry can induce an incumbent firm to engage in limit pricing -- i.e., moderate prices -- to discourage entry. There was evidence of that here. Having strong evidence of both kinds of effects made this a particularly compelling case. Questar offered a settlement, but it would have been too regulatory and it did not address the adverse effect of the acquisition on Questar's incentives to compete aggressively against the new entrant. The Commission authorized its staff to file for a preliminary injunction, and the parties promptly abandoned the transaction. The 50% interest in Kern River

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[13] Kern River was a partnership owned in equal shares by a subsidiary of Tenneco and The Williams Companies, Inc.

[14] The district court complaint also pled the loss of actual competition.

that Questar tried to buy was later acquired by The Williams Companies, which already owned the other 50% and had wanted to maintain Kern River's competitive independence.

When the theory of anticompetitive effect turns on actual potential entry analysis -- i.e., but for the merger, the acquiring party would have entered the market independently -- a question arises as to the level of proof required to demonstrate that potential entry down the road would have occurred. In the Federal Trade Commission's 1984 decision in B.A.T. Industries, Ltd.,[15] a majority of the Commission concluded that a reasonable probability of entry was not enough and that "clear proof" that entry would occur was required. In this case, clear proof meant "concrete plans" such as a capital acquisition plan or a budget drawn up with entry in mind.

I believe the "clear proof" standard is inappropriate and in fact essentially guts the actual potential competition doctrine. Section 7 only requires that the effect of the transaction "may be" to lessen competition, and that has been interpreted in the majority of litigated cases as requiring only a reasonable probability.[16] At a more practical level, it is precisely in the most anticompetitive of conglomerate acquisitions that it is least likely that the government or a private party would discover documents assessing the prospects for entry other than by merger.[17] I would not impose a "clear proof" standard if a conglomerate merger were to come up today.

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[15] 104 F.T.C. 852, 916 (1984).

[16] See, e.g., Philip E. Areeda and Herbert Hovenkamp, ANTITRUST LAW ¶ 1121'e (1996 Supp.) at 821.

[17] To the extent a "clear proof" standard relies on subjective evidence, see B.A.T., 104 F.T.C. at 927-28, agency or court decisions may be based on evidence that is unreliable, because company statements may be motivated by a desire to influence agency review or merger litigation. See V Philip E. Areeda and Donald F. Turner, ANTITRUST LAW ¶ 1121b (1980) at 103; Philip E. Areeda and Herbert Hovenkamp, ANTITRUST LAW ¶ 1121'b (1996 Supp.) at 819 ("Few potential entrants will be found under [the B.A.T.] test").

Fourth, in the communications sector, markets tend to be dynamic and high-tech, and therefore rivalry frequently occurs primarily in the form of competitive innovation. That observation is consistent with the general conclusions of the Federal Trade Commission's staff report on competition policy in high-tech and global markets, that competition in particular market segments increasingly focuses on various dimensions of innovation.[18] Telecommunications is an example of that kind of industry.

The fact that a market is "dynamic," however, does not automatically lead to the conclusion that antitrust enforcement has no responsibilities. For example, let's assume it was certain that local cable companies, at present monopolists or near monopolists, would have their market position challenged effectively by direct broadcast satellite transmissions, phone companies moving into the cable market, and even computer screens becoming a medium to transmit the kind of news and entertainment presently on cable. In anticipation of that rivalry, the legislature may decide to eliminate prior regulatory restraints. But the question remains as to when this newly introduced rivalry will become effective. Otherwise anticompetitive mergers, long term contracts or distribution arrangements cannot be justified on grounds that eventually their anticompetitive effects will be dissipated by new entry. Even if "eventually" is only 2 or 3 years away, there remains the concern that consumers will be exploited while we wait for the future to arrive.

For example, in Time Warner, some believed that new distribution technologies, such as DBS and other digital delivery systems, would put competitive pressures on both cable

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[18] FTC Staff Report: ANTICIPATING THE 21ST CENTURY: COMPETITION POLICY IN THE NEW HIGH-TECH GLOBAL MARKETPLACE (May 1996) at 18-19.

distributors and programmers to offer quality programming at reasonable prices. But a majority of the Commission, myself included, did not see that in the evidence. Not yet. Alternative technologies such as DBS had only a small foothold in the market, with perhaps a 3% share of all subscribers. Moreover, DBS is more costly, including up-front equipment costs, and it lacks the carriage of local stations. We included DBS in the relevant market, but it did not appear likely that this emerging technology would be sufficient to prevent the competitive harm from the Time-Warner-Turner-TCI transaction.[19] More recently, an investigation of a proposed merger of two head-to-head competitors in cable distribution produced similar kinds of evidence. These two companies competed for the same group of customers in an "overbuild" situation, where more than one cable company is franchised by the local authority to serve the same geographic area. The evidence indicated that DBS may not have been in the relevant market, and was unlikely to constrain anticompetitive conduct in any event.

Another antitrust concern -- mentioned already but worth repeating -- is that it is precisely in a dynamic marketplace that it becomes particularly important to insure that private arrangements do not impede the ability of new technologies to enter the market. Indeed, that is one of the reasons the order in Time Warner prevents the company from disadvantaging competitors at the distribution level by discriminating in access to programming.

Fifth, antitrust enforcement efforts to preserve and protect access sometimes lead to rather regulatory decrees. Not always, of course. In my view, one of the most important aspects in requiring that the Time Warner-Turner-TCI deal be restructured was the requirement that TCI in

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[19] Time Warner, Inc., Dkt. No. C-3709, Separate Statement of Chairman Pitofsky, and Commissioners Steiger and Varney, Feb. 7, 1997.

effect give up its previous stock position in Turner and move to a stock position in which it had less influence on Time Warner. If TCI and Time Warner, two of the largest cable companies in the United States, had the incentive and ability through stock ownership to influence the behavior of the other or to moderate their own behavior to benefit the other, that could have had a serious effect on the incentive and ability of programming rivals of the two companies to innovate or achieve access to the market.

In other situations, decrees can minimize the degree of regulation and maximize the impact of market forces. The most widely noted aspect of the Time Warner decree was the requirement that Time Warner set aside at least one channel for a news service that would compete with Turner's CNN. Given CNN's dominant position as a 24-hour news service, and Time Warner's strong position as a cable outlet, the merger could have entrenched CNN against future competition. Because of the acquisition, Time Warner had an incentive not to carry a competing all-news service, and a news network seeking to enter the market would have had a difficult time reaching a sufficient number of subscribers to be viable without carriage on Time Warner cable. This was a situation we needed to address. But the remedy was designed to be as non-intrusive as possible -- specifically, making available at least one Time Warner cable channel for 3 or 5 years depending on how Time Warner chose to satisfy the requirement. The Commission recognized that this is an area with First Amendment overtones and therefore left Time Warner free to use its own judgment in choosing the acquirer of the assets and in negotiating the price that it would be paid. Some objective criteria were adopted to insure that the second news service would be a significant competitor to CNN, and for that we relied on CNN's own definition of itself in its contracts with cable companies. My own view is that if an applicant for the channel satisfied the essentials of serving as a rival to CNN -- for example, it was a 24-hour news service but happened not to carry sports -- the Commission should not object to Time Warner satisfying the decree by accepting that applicant.

By citing examples of modest "regulatory" decree provisions, I don't mean to slight the problem. If it is important to protect access, and surely that will be of paramount importance in many dynamic industries, fairly elaborate provisions that protect against barriers to access, by discrimination or otherwise, will often be necessary.

Sixth, because telecommunications markets are complex and dynamic, joint ventures and other strategic alliances will often be a preferred form of doing business. We recognize, partly because the witnesses in our global competition hearings told us so, that American antitrust law with respect to joint ventures and other forms of competitor collaboration is less than clear. It is for that reason that the Commission has authorized its Policy Planning Staff for its next project to develop proposed guidelines for joint ventures and other forms of competitor collaboration.

C. Institutional Differences

Perhaps the most important consequences of moving from regulation to antitrust result from institutional differences between the two regimes. Antitrust relies heavily on legal precedent based on a clearly-defined principle of protecting the competitive process and consumer welfare, and cases may be pursued in any of a large number of forums, in both private and federal agency actions. In a regulatory regime, decisions are made by a prescribed agency, and they often try to balance the interests of a wide range of considerations and constituencies.[20] Parenthetically, the

[20] It has been said that regulatory agencies are more flexible and less hesitant than courts in balancing competing factors in its analysis. See Stephen G. Breyer, *Antitrust, Deregulation*
(continued...)

Federal Trade Commission has perhaps the best of both worlds: a clear mission and a consistent forum that develops expertise in particular issues over time.

Another difference is that regulatory agencies (and here I am excluding the FTC) have an ongoing relationship with the industry they regulate. That can be good in the sense that they develop a fact base from which to operate and a sensitivity to particular types of problems; it may be bad in the sense that regulators sometimes adopt the viewpoint of the firms that they regulate. Antitrust reaches for rules of general applicability across all industries, although at its best it pays attention to the special facts of particular industries.

Perhaps the most troublesome difference is that if antitrust is to govern, competition policy can derive from decisions in scores of different courts, as federal and state agencies and private parties bring suits to advance their interests. Although the courts do rely on precedent, which should produce consistency in the result, it is not that easy. The facts and the laws are complex, the economics may be even more complex, and the interests of the litigants are diverse. And, frankly, some courts are better at the task than others. The resulting problem is that it may be difficult to discern a coherent, consistent policy. In fact, we have something approaching that situation in the many court cases dealing with long distance and local telephone service in the wake of deregulation. Some would say that is a temporary problem that will tend to disappear once the transition from regulation to competition is complete. But that transition can take a while and the disorder, inefficiency and general mess produced by scores of antitrust cases, often

[20](...continued)
and the Newly Liberated Marketplace, 75 CALIF. L. REV. l005, l043 (l987).

reaching inconsistent results, is not a good thing. Some creative thinking about how to handle those transitional problems in an orderly way would certainly help.

D. Conclusion

To sum up the answer to the central question -- what is new in antitrust approaches in communications industries -- the answer is not so much in the basic antitrust rules we apply -- they have been around for years -- but how we apply them. There is, I believe, an increased understanding and appreciation of the difficulty of making regulatory decisions in dynamic markets that will promote the competitive process and other statutory goals without having unintended adverse effects on incentives or the ability of firms to compete. That applies to both regulatory agency decisions and to antitrust. That does not mean that antitrust should be timid in dealing with such industries. On the contrary, antitrust has an important role to play in keeping markets open for competition. But antitrust rules and remedies must be applied with an understanding and consideration of the particular facts of each industry.