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WHAT HATH CONGRESS WROUGHT? REORIENTING ECONOMIC ANALYSIS OF TELECOMMUNICATIONS MARKETS AFTER THE 1996 ACT

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The Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996), is probably one of the most significant pieces of legislation in recent years. This law will cause sweeping changes in an industry that comprises over one-sixth of the American economy and directly touches over 250 million people. These changes will dramatically affect both the way telecommunications companies will do business and the way that they will be regulated. Local telephone companies will be able to provide long-distance service; long-distance companies will be able to compete with local telephone companies for local telephone service; cable companies will be able to compete with local telephone companies; electric utilities will be able to compete against cellular companies-and on and on.

As this competition develops and market performance improves, regulation by the Federal Communications Commission (FCC) will begin to change as well. In light of these sweeping changes, economic analysis of telecommunications markets will have to account for this evolving competitive landscape. Indeed, the changes set in motion by the 1996 Act will present far more complicated analytical problems of economic issues than before, when these issues seemed to

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be familiar and clearly delineated – i.e., “evil” monopolists or “dominant firms” with a “helpless” fringe. Now, with the potential convergence of technologies and bundling of products, the lines between customers and competitors will become increasingly blurred.

Further, as the world of telecommunications rapidly continues to change, it will become more and more difficult to determine exactly what is the market we are analyzing. As telecommunications markets become increasingly “multidimensional” (both horizontally and vertically), attempting to apply economic “first principles” (i.e., defining the relevant markets, evaluating the elasticities of supply and demand, identifying barriers to entry, etc.) to analyze the power in, and performance of, telecommunications markets initially may be frustrating to both neophytes and old hands alike.

The purpose of this article is to try to highlight some of the ways the 1996 Act may change the structural and behavioral characteristics of telecommunications markets. As explained below, correctly identifying the structural characteristics of telecommunications markets, post-1996 Act, is the key to determining accurately whether firms are-or can-engage in some kind of strategic, anticompetitive conduct (e.g., collusive behavior, raising rivals’ costs, price squeezes, erecting barriers to entry, etc.) that warrants intervention by the courts or regulators.

Importance of a Dynamic Perspective

As a start, it is very important to account for the real potential for change that characterizes telecommunications markets.¹ Indeed, because both demand and supply appear to be rapidly expanding,² simply focusing the analysis on current

¹ The particular time period used for such a forward-looking analysis is irrelevant to the broader issue of considering a dynamic approach. Depending on the purpose of the analysis, the two year time period specified in the 1992 Merger Guidelines may be sufficient (§ 3.2), or an even longer period may be necessary to adequately measure future market performance in an industry characterized by rapid change.

² For example, on the demand side, telecommunications and, in particular, interexchange services, is a growing industry. This is evident from the substantial increase in choices available to consumers. On the supply side, technological change is ongoing. Moreover, the cost of underlying
(Footnote Continued. . . .)

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market conditions may not reveal an accurate picture of what is (or may be) occurring. In the new telecommunications environment, we must now explicitly account for the potential for change in assessing the extent of competition in telecommunications markets.³

Why is a dynamic forward-looking approach so important? Failure to account for such change may not provide a paradigm that detects and promotes good market performance over the longer term.⁴ In an industry that manifests the potential for rapid technological change and innovation, such as telecommunications, an economic analysis should not focus too narrowly or exclusively on promoting the best use of society's resources from the standpoint of today's technology and resources availability-i.e., static economic efficiency. Rather, telecommunications, with its significant potential for rapid technological advance, should be viewed from a dynamic perspective.⁵ A static analysis, when used as a substitute for a comprehensive dynamic review, can actually impose significant economic costs on an industry characterized by rapid change, because any remedy imposed will not be able to adapt easily to future market conditions.⁶ [*33]

technology is becoming less significant (e.g., the cost of fiber optic continues to fall), while the costs of billing, advertising, and access continue to fluctuate.

³ See Burton H. Klein, *DYNAMIC ECONOMICS* 35 (1977) ("The essential difference between static and dynamic economic efficiency is that whereas the former is the result of making choices along a production-possibilities frontier, the latter is the result of extending the frontier by exploiting as fully as possible a technological potential").

⁴ See, e.g., *United States v. FCC*, 652 F.2d 72, 106 (D.C. Cir. 1980). There, the FCC, specifically rejecting arguments in opposition raised by the DOJ and FTC, approved a satellite joint venture between IBM and Comsat to offer integrated voice, data, and digital image transmission service. The FCC found that the potential competitive benefits would outweigh any alleged current anticompetitive effects created by the proposed joint venture. The FCC's forward-looking approach made a significant contribution to the performance of this market.

⁵ See Walter G. Bolter et al., *TELECOMMUNICATIONS POLICY FOR THE 1980'S: THE TRANSITION TO COMPETITION* 360 (1984).

⁶ See Friedrich A. Hayek, *THE FATAL CONCEIT: THE ERRORS OF SOCIALISM* 85 (1988) ("What cannot be known cannot be planned"); see also *In re Motion of AT&T Corp. to Be Reclassified as a Non-Dominant Carrier*, FCC 95-427, 11 FCC Rcd 3271 at ¶ 32 n.90 (rel. Oct. 23, 1995).

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Dynamic Change and the Need for the 1996 Act

The rapidly changing market conditions of telecommunication industries are one of the driving forces behind the 1996 Act's modification of the Modified Final Judgment (MFJ) regime. While the break up of the old AT&T monopoly was probably one of the most procompetitive achievements of the 20th century, the MFJ also created a scheme in which one segment of the telecommunications industry (i.e., the activities of the regional Bell Operating Companies or "BOCs") was effectively regulated by a static consent decree for the last fifteen years, which provided neither the court nor the DOJ with the ability or incentive to review the competitive effects of the MFJ beyond its narrow scope.⁷ With the increasing development of new telecommunications technologies, this static regulation was not able to effectively adapt to, and account for, long-term market performance in adjacent markets, such as wireless telecommunications.⁸

⁷ See generally A. Douglas Melamed, *Antitrust: The New Regulation*, ANTITRUST, Fall 1995, at 13, 14 ("The MFJ has become, in effect, a device for Antitrust Division regulation of both the wired and wireless industry"). In *SBC Communications, Inc. v. FCC*, 56 F.3d 1484, 1491 (D.C. Cir. 1995), the D.C. Circuit, in affirming the FCC's disposition of the AT&T/McCaw merger, rejected both BellSouth's argument that the FCC failed to consider the MFJ as a "special circumstance affecting competition" and BellSouth's notion that the Commission should impose MFJ restrictions on McCaw. Using the FCC's own words, the court reasoned that "assuming [with BellSouth] ... that the MFJ restricts competition in undesirable ways, expanding its application to the BOC's competitors would only compound the harm." (Emphasis supplied.)

⁸ As explained more fully below, when the MFJ was implemented, the various parties agreed to create "local access and transport areas" or "LATAs." LATAs are not uniform in shape or size and can be both interstate and intrastate. At the time, the LATAs were a convenient way to divide the assets of the old Bell system and to delineate the respective service areas of the BOCs. However, the MFJ, and the LATA boundaries in particular, were imposed on the BOC's cellular companies, even though the MFJ and LATA boundaries had been created without any thought of cellular service and the former bore no relation to the latter's. See generally *United States v. Western Elec. Co.*, 578 F. Supp. 643 (D.D.C. 1983). To fit the cellular square peg into the MFJ round hole, a waiver procedure involving both the court and the DOJ was created which, in one case, required nearly five years for the innocuous addition of one small county to an existing cellular system's coverage area. The net result of this procedure was the unnecessary denial of competition in cellular service for the residents of this county and the unnecessary delay of seamless cellular service between New York and Washington. See 141 CONG. REC. S7881-02, 7884 (June 7, 1995) (statement of Sen. Pressler).

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The 1996 Act is, at bottom, expressly designed to change this regime. Specifically, the DOJ is stripped of its “pseudo-regulator” status, while the FCC is required to establish the structural framework to accelerate competition. (See 47 U.S.C. § 152 note.) The FCC’s framework will attempt to achieve this goal by eliminating structural and regulatory barriers to entry by requiring, among other things, incumbent local exchange carriers to offer competitors interconnection, unbundled network elements, resale of exchange carrier services, and number portability. (See 47 U.S.C. § 251.) Once there is a sufficient level of rivalry, a substantial portion of current FCC regulation should presumably no longer be necessary.⁹ At that point, the FCC is supposed to use its new forbearance authority contained in the 1996 Act and eliminate the unnecessary regulation. (See 47 U.S.C. §§ 160, 161.)

Structural Market Conditions After the 1996 Act

Given the significant changes that may result from the 1996 Act, how should we think about applying economic “first principles” to assess market power in, or the market performance of, telecommunications industries? A good starting point is to try to identify some of the prominent structural characteristics of telecommunications markets.

Products and Producers. For example, many telecommunications firms-like most other firms-are not single-out-put providers. This observation is more significant than merely recognizing that many telecommunications firms sell multiple outputs using different technologies – e.g., wired and wireless telephone service, and cable and satellite video programming. Rather, a more sophisticated analysis of telecommunications providers often reveals that while many telephone companies appear to provide a homogeneous telephony service-either local or long-distance-the reality is that these carriers provide a number of discrete telephone services (at different prices) in the form of residential, business, toll, and wholesale services, such as local exchange access for use by

⁹ However, enforcement by the FCC to ensure that carriers continue to provide interconnection, unbundled network elements, resale, and number portability will probably continue for years to come.

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interexchange carriers. Moreover, products are further differentiated by the number and availability of various calling plans.

From the supply side, many of the facilities used to provide various services are identical; yet from a demand-side perspective, residential customers generally do not view business services as an acceptable substitute or vice-versa. In addition, the demand characteristics are often very different for each service, as business customers are often more sophisticated and, therefore, may have a higher own price elasticity of demand than residential customers. Finally, although the service may appear to be homogeneous, the presence of switching costs (i.e., searching out new providers, abandoning a traditional brand, and administering the switch) also demonstrates that there is substantial product differentiation among telecommunications services.¹⁰

Market Definitions. Given the above, it is extremely important to avoid the use of overly narrow or broad market definitions when analyzing the structure of telecommunications markets, because the convergence of technologies makes “traditional” telecommunications market definitions increasingly irrelevant. For example, it makes no sense to discuss a single “cable” or similar technology market, when cable actually competes with broadcast television, direct broadcast satellite systems, MMDS systems, and the like.¹¹

Similarly, it is becoming increasingly questionable to define distinct homogeneous “long-distance” or “local” telephone markets with the eventual re-integration of the long-distance and local business as permitted by the new 1996 Act. (See 47 U.S.C. § 271.) This distinction becomes even more blurred now that companies are beginning to bundle additional telecommunications or information products and services into a single package, such as wireless service, paging, Internet access, video, or even alarm monitoring.¹²

¹⁰ See W. Kip Viscusi Et Al., *ECONOMICS OF REGULATION AND ANTITRUST* 17-78 (2d ed. 1995).

¹¹ See Time Warner, Turner Seek Peace with FTC While Girding for War, *WALL ST. J.*, June 27, 1996, at A1 (reporting that parties object to narrow “cable” market definitions).

¹² See CNNFN, Apr. 29, 1996, MCI Launches All-in-One Communications Package.

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Accordingly, with this increasing convergence of telecommunications services and products into a variety of bundled offerings, the boundaries created by the MFJ increasingly reflect a dated economic picture of the market. When the MFJ was implemented, the various parties agreed to create “local access and transport areas” or “LATAs.” Although these lines were completely arbitrary, the LATAs were a convenient way to delineate the respective service areas of the BOCs. The creation of these boundaries under the MFJ therefore argued for three distinct economic markets: (1) local; (2) intra-LATA toll; and (3) inter-LATA or “long-distance” service. While these boundaries may have made sense at the actual time of divestiture, the LATA boundaries were never intended to be definitive (or permanent) economic boundaries for purposes of measuring market power. Accordingly, given the radical changes set in motion by the 1996 Act, the MFJ approach does not accurately reflect a market where firms offer “one-stop shopping” for a variety of telecommunications services.

For example, most consumers appear to take a more simplistic approach towards telephone service: there is the local (fixed-charge) call (near) and the more expensive (per minutes of usage) long-distance toll call (far). To consumers, there is no significant difference between an intra-LATA toll call and an inter-LATA toll call—they are both toll calls. Thus, the fact that consumers tend to view both toll calls as one product, rather than distinct services, argues against the automatic use of LATAs as appropriate market definitions for [*34] antitrust or regulatory purposes.

The increasing use of wireless service also argues against the use of LATAs as appropriate market definitions. Wireless service, by definition, can extend beyond artificial LATA boundaries. Accordingly, if wireless service eventually replaces, or at minimum is viewed as a close substitute for, wired local service, then LATAs again will not accurately reflect the economic boundaries of the market.¹³

Relevance of Market Share. In analyzing the structural characteristics of telecommunications markets, it is also important not to exaggerate the relevance of the Herfindahl-Hirschman Index (HHI). Given the technology of the

¹³ See *United States v. Western Elec. Co.*, 578 F. Supp. 643 (D.D.C. 1983).

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telecommunications industry, many markets will probably be characterized by the presence of one or more firms with a predominant market share. Under well accepted precedent, this basic condition alone does not indicate that a market is performing poorly.¹⁴ This is why, in the context of telecommunications, the analysis must always move beyond HHIs and toward the evaluation of the elasticities of supply and demand and, in particular, the presence (or lack) of barriers to entry.¹⁵

For example, consider the FCC's recent deregulation of AT&T for domestic long-distance service.¹⁶ In that proceeding, many parties argued that AT&T had market power simply by virtue of having a 60 percent market share. Upon review, however, the FCC found that while AT&T did have a very large market share, AT&T nonetheless faced a very elastic demand curve, in which consumers were very likely to switch carriers in the event of a price increase or unsatisfactory service. The FCC further found that AT&T no longer controlled any bottleneck facilities, and supply was highly elastic both in terms of excess capacity and the number of competing firms. The Commission also found strong evidence of nonprice competition in the form of frequent-flyer points or tie-ins with other products. Given such a market structure, the Commission found that

¹⁴ See, e.g., *United States v. Baker Hughes Inc.*, 908 F.2d 981, 986 (D.C. Cir. 1990) (Thomas, J.) (market share statistics "misleading" in a "volatile and shifting" market); *Southern Pac. Communications Co. v. AT&T*, 740 F.2d 980, 1000 (D.C. Cir. 1984), cert. denied, 470 U.S. 1005 (1985) (When a "predominant market share may merely be the result of regulation, and regulatory control may preclude the exercise of market power ... in such cases market share should be at most a point of departure in determining whether market power exists."); *Metro Mobile CTS, Inc. v. New Vector Communications Inc.*, 892 F.2d 62, 63 (9th Cir. 1989) ("Reliance on statistical market share in cases involving regulated industries is at best a tricky enterprise and is downright folly where ... the predominant market share is the result of regulation").

¹⁵ See generally Duncan Cameron & Mark Glick, *Market Share and Market Power in Merger and Monopolization Cases*, 17 *MANAGERIAL & DECISION ECON.* 193 (1996) (legal precedent requiring courts to draw inferences about market power based primarily or exclusively on market shares and/or market concentration can often be misleading; the only alternative to such bright-line rules is to utilize modern economic tools to undertake more extensive competitive analyses).

¹⁶ *In re Motion of AT&T Corp. to Be Reclassified as a Non-Dominant Carrier*, supra note 6.

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it would be difficult for AT&T to successfully engage in strategic anticompetitive conduct.¹⁷

Residual Regulation. There is one additional structural characteristic of telecommunications markets that simply cannot be ignored in any thorough economic analysis-i.e., the continuing presence of some sort of “public interest” regulation by the government. While regulation of telecommunications markets is supposed to decrease as more competition develops, residual regulation of telecommunications industries will nevertheless probably continue well into the future. It will, therefore, be crucial to account for such regulation and to examine the effects of such regulation on the various market participants.¹⁸

¹⁷ Similarly, take the situation where two contiguous cable systems want to merge (or “cluster”) in order to achieve the sufficient size and scope necessary to provide competitive telephone service to the incumbent local exchange carrier. Prior to the merger, each cable firm will probably have a respective HHI of around 10,000 for its respective service areas, as each enjoyed a lawful monopoly in the form of a franchise for many years. When the two companies merge, the merged entity will continue to be the dominant provider of cable service and, as such, the HHIs for cable service will probably remain at 10,000. However, if the merged firm now attempts to provide competition for local telephone service, its market share in the “local loop” market will be zero as a new entrant. Therefore, should a competitive inquiry be based upon a static analysis of a “cable” merger within arbitrary franchise territories, or rather upon the more dynamic possibilities that a new cable “cluster” may facilitate local phone competition in a regional area? Clearly, the answer should lie with the latter approach. See, e.g., *In re Cox Cable Communications, Inc. and Times Mirror Co., Transfer of Control and Petition for Special Relief*, DA No. 94-1570, 10 FCC Rcd 1559 at ¶¶ 16-19 (rel. Dec. 22, 1994).

¹⁸ See *Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 22 (1st Cir. 1990) (Breyer, J.), cert. denied, 111 S. Ct 1337 (1991). The court held that the differing “administrative considerations” between courts and regulatory agencies must be taken into account when adjudicating competitive issues in regulated industries. According to the court, although regulators and the antitrust laws “typically aim at similar goals ..., [e]conomic regulators seek to achieve them directly by controlling prices through rules and regulations; antitrust seeks to achieve them indirectly by promoting and preserving a process that tends to bring them about”

An antitrust rule that seeks to promote competition but nonetheless interferes with regulatory controls could undercut the very objectives the antitrust laws are designed to serve. Thus, where regulatory and antitrust regimes coexist, antitrust analysis must sensitively “recognize and reflect the distinctive economic and legal setting” of the regulated industry to which it applies.

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For example, the 1996 Act requires the FCC to impose residual regulations-unrelated to competition-designed to advance certain public policy objectives that will have a direct effect on market performance. Perhaps one of the most significant of these residual regulatory mandates is the Act's requirement that telecommunications firms provide "universal service" to, among other entities, rural health care providers, educational providers and libraries. (See 47 U.S.C. § 254.) Universal service is defined as those telecommunications products or services which: (a) are essential to education, public health, or public safety; (b) are subscribed to by a substantial majority of residential consumers; (c) are being deployed in telecommunications networks; and (d) are consistent with the public interest, convenience and necessity. (See 47 U.S.C. § 254(c)(1).) Unlike most other rate prescription statutes-where rates must only be "just and reasonable"-the rates for universal service must be "just, reasonable and affordable." (See 47 U.S.C. § 254(b)(1).) According to the statute, "affordable" appears to mean rates that are "less than the amounts charged for similar services to other parties ... that the [FCC] ... and the States ... determine is appropriate and necessary to ensure affordable access to and use of such services by such entities."¹⁹ (Emphasis added. See 47 U.S.C. § 254(h)(1)(B).) Thus, under this mandate, regulation will continue to be an important factor that can affect firms' conduct, because even if there is a "competitive" price, that competitive price has no meaning if it is not "affordable."²⁰

Potential Conduct After the 1996 Act

Once the relevant structural characteristics are defined, the question becomes whether this structure will permit firms to [*35] exercise market power to the

¹⁹ Moreover, the FCC has a substantial challenge ahead to ensure that "affordable" prices do not result in confiscatory rates.

²⁰ As one leading telecommunications antitrust lawyer recently wrote, "[u]niversal service, as defined in the new Act, and competitive markets cannot coexist, where the goods produced have many substitutes or where the technology is dynamic." Thomas G. Krattenmaker, *The Telecommunications Act of 1996*, 49 FED. COMM. L.J. 1, 41-43 (1996) (emphasis added). In Krattenmaker's judgment, "it is both bad competition policy and bad regulatory policy to think that one can achieve properly functioning telecommunications markets while a regulator sees to it that these same markets generate subsidized pro-societal benefits." *Id.*

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detriment of consumers.²¹ In the context of telecommunications, there are specific factors that can indicate whether competitors can engage successfully in anticompetitive conduct. On one hand, telecommunications industries are currently enjoying unparalleled investment in both capital infrastructure and research and development.²² Advertising revenues are currently up in many sectors,²³ and many telecommunications firms are also heavily competing in areas other than price, such as frequent-flyer miles, bar association discounts, credit cards, etc. These factors are consistent with the conclusions that there are high elasticities of supply and demand in these markets.

On the other hand, with the increasing trend of vertical and horizontal reintegration among telecommunications providers and/or services (e.g., MFS/WorldCom, AT&T/McCaw, BT/MCI, Sprint/DT-FT, NYNEX/BellAtlantic), firms may attempt to raise rivals' costs by, inter alia, foreclosing key inputs of production.²⁴ In addition, so long as the FCC remains in place, many firms may nonetheless continue to attempt to manipulate the regulatory system for their individual benefit and to the detriment of good market performance.²⁵

²¹ See, e.g., *Town of Concord*, 915 F.2d at 21-22; see also *Southern Communications*, 740 F.2d at 1000 ("Ultimately, a court should focus directly upon the ability of the regulated firm to control prices or exclude competition."); *In re Review of Commission's Regulations Governing Television Broadcasting*, Further Notice of Proposed Rulemaking, 10 FCC Rcd 3524, 3534 (rel. Jan. 17, 1995).

²² See, e.g., MCI Press Release, (Aug. 1, 1996) (MCI will invest close to \$1 billion by year-end 1996 to promote local service, and could spend additional \$1 billion in 1997); Stark Raving Rich, *FORBES*, Feb. 26, 1996, at 44-45 (Philip Anschutz to build a fifth nationwide fiber optic network at a cost of \$2 billion to compete head-to-head with AT&T, MCI, LDDS/WorldCom and Sprint).

²³ Indeed, one study indicates that AT&T's advertising revenue increased 85% between 1989 and 1992 to \$1.6 billion. See Michael E. Porter, *COMPETITION IN THE LONG-DISTANCE MARKET* 6-7 (1993).

²⁴ See generally James W. Olson & Lawrence J. Spiwak, *Can Short-Term Limits on Strategic Vertical Restraints Improve Long-Term Cable Industry Market Performance?*, 13 *CARDOZO ARTS & ENT. L.J.* 283, 294 (1995).

²⁵ See generally Bruce M. Owen & Ronald Braeutigam, *THE REGULATION GAME: STRATEGIC USE OF THE ADMINISTRATIVE PROCESS* (1978).

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For example, the interconnection provisions of the 1996 Act may provide fertile ground for a “price squeeze” claim. As mentioned above, the 1996 Act requires incumbent local exchange carriers to offer competitors interconnection, unbundled network elements, resale of exchange carrier services, and number portability to rivals. If they do not, then they may not provide long-distance (interexchange) service. (See 47 U.S.C. § 271.) In doing so, this framework sets up the classic supplier/competitor- customer/competitor friction that creates both incentives for (and perceptions of) strategic anticompetitive conduct.²⁶

Another significant challenge in evaluating firms’ conduct is determining whether the structure of telecommunications markets will permit firms to engage successfully in some sort of oligop-olistic pricing harmful to consumers. Clearly, if discovery reveals a “smoking gun” demonstrating overt collusion, then the inquiry is at its end. But what happens if no smoking gun is found, and there is a clear pattern of parallel pricing? Is it evidence of overt collusive attempts of joint-profit maximization (that should therefore properly be a violation of the antitrust laws) or is it simply Cournot pricing (and therefore probably not a violation)?²⁷

As a general matter, an industry, such as telecommunications, that is subject to rapid technological change and innovation is usually less susceptible to oligop-olistic coordination because technological change and innovation can introduce differences in product lines, production costs, and demand conditions-i.e., the pace and direction of innovation is difficult to predict. Indeed, the more rapidly producers’ cost functions are altered through technological change and the more unevenly those changes are diffused throughout the

²⁶ For a detailed explanation of the price squeeze doctrine, see Lawrence J. Spiwak, *Is the Price Squeeze Doctrine Still Viable in Fully Regulated Energy Markets?*, 14 ENERGY L.J. 75 (1993).

²⁷ See, e.g., *Market Force, Inc. v. Wauwatosa Realty Co.*, 906 F.2d 1167, 1172 & n.8 (7th Cir. 1990); *Clamp-All Corp v. Cast Iron Soil Pipe Inst.*, 851 F.2d 478, 484 (1st Cir. 1988), cert. denied, 488 U.S. 1007 (1989); *E.I. du Pont de Nemours Co. v. FTC*, 729 F.2d 128, 139 (2d Cir. 1984); *City of Tuscaloosa v. Harcros Chems., Inc.*, 877 F. Supp. 1504, 1524 (N.D. Ala. 1995); see also Louis Philips, *THE ECONOMICS OF IMPERFECT INFORMATION* ch. 6 (1988); Joseph Kattan, *Beyond Facilitating Practices: Price Signaling and Price Protection Clauses in the New Antitrust Enforcement Environment*, 63 ANTITRUST L.J. 133, 136 (1994).

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industry, the more likely it is that there will be conflict among competitors regarding pricing choices.²⁸ However, despite this generalization, there may be some telecommunications market structures that could facilitate successful joint profit maximization.

Accordingly, the ability to make an accurate determination of firms' conduct will depend directly on the accurate identification of the market's basic conditions and structure referenced above. Specifically, are there homogeneous products? Are supply and demand elastic? How sophisticated are consumers? And is there an adequate signalling mechanism? If the structure of the market indicates procompetitive conditions-i.e., high elasticities of supply and demand, sophisticated consumers, no asymmetrical or advanced tariffing requirements to act as price signals, etc.-then firms will probably not be able to succeed in strategic conduct, even if they try.²⁹

Again, examine the case of the domestic interexchange marketplace. Most customers avail themselves of a variety of discount plans, rather than "basic" service, which indicates that actual market prices are not homogeneous. Considering the complexities of a modern tariff, exact prices are extremely difficult to replicate. This pattern is further exacerbated by the fact that discount plans are often bundled with non-price incentives, such as reward programs, which are often hard to quantify in making a price comparison. Moreover, because supply continues to expand in terms of both the number of competitors and the amount of fiber transmission capacity that is available, firms are motivated to protect their sunk investments by competing for new customers. Similarly, there is a tremendous amount of consumer "churn" among carriers' various discount plans, which is consistent with a conclusion that firms face a high elasticity of demand. Finally, with the FCC's increasing trend towards the elimination of asymmetrical regulations and even total de-tariffing of

²⁸ See F.M. Scherer & David Ross, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 285 (3d. ed. 1990); Alexis Jacquemin & Margaret Slade, *Cartels, Collusion and Horizontal Merger*, in 1 *HANDBOOK OF INDUSTRIAL ORGANIZATION* 420 (Richard Schmalensee & Robert Willig eds., 1989).

²⁹ See generally *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993).

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telecommunications services, effective signalling mechanisms are rapidly disappearing.³⁰

Some observers, however, continue to maintain that the interexchange market will become “truly competitive” only when the BOCs can enter this market. As support for this position, proponents often cite the fact that “basic” rates for long-distance service appear to have increased in “lock-step” over the past several years.³¹ Focusing exclusively on basic rates, however, ignores the fact that most customers who spend more than the average amount for long-distance service (e.g., greater than \$20 a month) are on some kind of discount plan.

In contrast to the rise in basic rates, real prices for discount plans have fallen dramatically over the last several years. Thus, given the structural attributes of the interexchange market discussed above, this evidence supports the conclusion that strategic coordinated behavior is difficult to achieve, because firms must aggressively compete to retain (or possibly increase) market share and protect sunk investments.

Market Performance After the 1996 Act

In addition to looking at the structure of the relevant markets and the conduct of firms within these markets, we should also look at the current and potential performance of these markets to determine whether some sort of intervention-antitrust or regulatory-is warranted to ensure that consumers receive lower prices or new products and services.³² The inherent technological

³⁰ See Jerry Duvall et al., *Market Performance in the Long Distance Telecommunications Industry: The AT&T Non-Dominance Petition*, Paper Presented at 2nd Annual Conference of Consortium for Research on Telecommunications Policy, Evanston, Ill. (May 11, 1996).

³¹ See generally Paul M. Macavoy, *THE FAILURE OF ANTITRUST AND REGULATION TO ESTABLISH COMPETITION IN LONG-DISTANCE TELEPHONE SERVICES* (1996).

³² See, e.g., Jerry Duvall & Michael Pelcovits, *Reforming Regulatory Policy for Private Line Telecommunications Services: Implications for Market Performance* (OPP Working Paper No. 4, 1980) (analysis should focus on market performance, rather than on market participants’ residual market power); Thomas DiLorenzo & Jack High, *Antitrust and Competition, Historically Considered*, 25 *ECON. INQUIRY* 423, 433 (1988) (rivalry focuses on behavior associated with the
(Footnote Continued. . . .)

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characteristics (e.g., economies of scale and density) of many telecommunications markets make it unlikely that imposing remedial conditions in either a consent decree or an FCC order will achieve “perfect” competition.³³ [*36] As many economists have recognized, telecommunications markets typically are characterized by high fixed and sunk costs, making marginal cost pricing (the *raison d’etre* of perfect competition) impossible to achieve.³⁴ Also, the presence of network externalities – i.e., the value of the network increases with the number of users-makes “perfect” competition difficult to obtain. Finally, residual “public interest” regulation will continue to distort market performance by affecting both the structure of many markets and the conduct of firms within those markets.³⁵

verb “to compete,” whereas perfect competition focuses on properties of equilibrium; “[b]ut if [perfect competition model] conclusions are substantially different from conclusions based on rivalry, then the competitive model has very likely misdirected the profession, at least as far as ... policy is concerned”); see also *In re Implementation of Section 19 of the Cable Television Consumer Protection and Competition Act of 1992, Annual Assessment of the Status of Competition in the Market for Delivery of Video Programming*, 9 FCC Rcd 7442, App. H at ¶ 31 (1994) (focus should be on “policy-relevant” barriers to entry); Department of Justice & Federal Trade Commission *Antitrust Guidelines for the Licensing of Intellectual Property* (1995).

³³ For example, there are no federal regulatory commissions or comprehensive consent decrees in such industries as camera film (Kodak sells 70% of the film sold in the U.S.), pasta (4 firms comprise 77% of the market); commercial airplane manufacturing (3 firms control 97% of the market), soft drinks (2 firms control 71% of the market) or toothpaste (4 firms control 90% of the market). See Michael L. Katz & Harvey S. Rosen, *MICROECONOMICS* 508 (2d ed. 1994); John E. Kwoka, Jr., *Regularity and Diversity of Firm Size Distribution in U.S. Industries*, 34 *J. ECON. & BUS.* 391 (1982). Indeed, if there is sound economic evidence that indicates that a market is performing well in markets with low barriers to entry-e.g., static economic efficiencies in the form of declining prices and dynamic economic efficiencies in the form of increasing technological innovation and new services-it may be appropriate to let one firm earn high profits in the short term because, in the long term (a) new firms will have a greater incentive to enter and compete, and (b) the existing firm will have the incentive to innovate to retain its leadership position. However, if it is demonstrated that, over the long term, this same firm can erect barriers to entry by foreclosing key inputs of production, then some sort of intervention-antitrust or regulatory-may be appropriate.

³⁴ See generally William J. Baumol & David F. Bradford, *Optimal Departures From Marginal Cost Pricing*, 60 *AM. ECON. REV.* 265 (1970).

³⁵ See generally John Haring & Kathleen Levitz, *What Makes the Dominant Firm Dominant?* (OPP Working Paper No. 25, 1989).

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Rather than pursuing the ethereal goal of “perfect” competition by regulation or antitrust, however, the critical question should instead be whether competitive rivalry in telecommunications markets is generating either static economic efficiencies (are prices for telecommunications services going up or down) or dynamic economic efficiencies (is there innovation in new telecommunications technologies) or both. If technology is improving and costs are going down, will competition create sufficient incentives for firms to provide societal benefits to consumers, such as educational Internet service, in order to attract and maintain market share, or must government continue to mandate that these firms do so?

Conclusion

Because our actions today directly affect how we will live tomorrow, we should consider exactly how we want the market to look before we address the analytical issues presented by the 1996 Act. Given the complexities and dynamic nature of these markets, the possibilities for innovative ways to maximize – or, if we are not careful, to harm – consumer welfare, seem endless.

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