20 Years After Divestiture: Looking Back and Looking Forward

Association of the Bar of the City of New York
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Remarks by Commissioner Kathleen Q. Abernathy
(As prepared for delivery)

Thank you very much for including me in this excellent program on the breakup of Ma Bell. You have a first-rate roster of speakers lined up, and I am honored to be kicking off the discussion.

The AT&T divestiture was obviously a seminal event in the history of telecommunications in this country, and its legacy continues to be profoundly felt. Perhaps more than any other event, divestiture set us on a path from regulated monopolies toward unfettered competition. The long distance sector was the first to experience competition, and I believe it established a model that helped pave the way for the development of a robustly competitive wireless sector in the 1990s, and it set the precedent that regulators almost always get it wrong when they try to predict the future. The long distance experience also helped persuade government officials that *local* telephone service — once thought to be the last bastion of natural monopoly — could be opened up to competition from other platforms, such as cable, as well as from entities like AT&T, which lease network elements from the Bell operating companies. Indeed, as the RBOCs, the children of the divestiture, are now providing long distance service and AT&T is a local competitor, it may seem that we have come full circle since 1984. The challenge for regulators is to preserve and expand upon the competition that has developed in the intervening years. Not surprisingly, there are fierce debates underway about just how to promote that goal and how to establish appropriate incentives for

continued infrastructure investment — in particular, whether to maintain expansive unbundling obligations or to scale them back.

Tonight I will try to steer clear of those minefields. Instead, I want to focus on a question that is more closely related to divestiture, which is: What is the appropriate regulatory framework for the Bell companies' provision of long distance services? The Department of Justice filed its antitrust action against AT&T years ago based largely on concerns about the vertical integration of local networks and long-haul operations. Today, in light of the market-opening provisions of the Telecommunications Act of 1996 and the development of facilities-based alternatives, some argue that minimal government intervention is required. Others maintain that the Bell operating companies continue to possess the kind of market power that leads to the same threats of anticompetitive conduct that warranted antitrust intervention in the early 1980s. Especially in the wake of the Supreme Court's recent decision in *Trinko*, it seems clear that the FCC, rather than the antitrust authorities, will be responsible for resolving this debate.

But before I delve any further into this discussion of the appropriate regulatory framework for the Bell companies' provision of long distance services, I will try to put it in context by providing some background information on the state of competition.

The Impact of Divestiture on Competition

One of the central questions posed by tonight's symposium is whether the primary policy goals of divestiture have been achieved. The answer, in my view, is a resounding yes. When divestiture occurred in 1984, AT&T's share of the long distance market exceeded 90 percent. It has fallen to approximately 30 percent, according to the most

recent FCC statistics. MCI was a pioneer in introducing competition, and today it is the second largest long distance provider. Sprint has also developed a significant market presence, and literally *hundreds* of other long distance providers, including many resellers, provide service throughout the United States. And as I mentioned earlier, the Bell companies have finally entered the long distance business, after many years of exile under the MFJ and then under section 271 of the Communications Act. They have collectively achieved a market share of greater than 15 percent in only a few years.

It is also important to recognize that competition in long distance sector isn't restricted to wireline carriers. Wireless companies also have become major providers of long distance service, even though they offer it as part of a bundle, rather than on a stand-alone basis. And in the future, I expect VOIP services available via cable modems and other broadband platforms to be a major player in the market for any-distance telecom bundles.

The entry of hundreds of competitors into the long distance market in the wake of divestiture has had exactly the effect that economics textbooks would predict. Prices have fallen dramatically, and carriers have increasingly focused on improving service quality and offering innovative bundles. Since 1984, long distance prices have fallen more than 80 percent, adjusting for inflation. In terms of service quality, we all remember Sprint's advertising campaign based on hearing a pin drop, and other carriers also have attempted to distinguish themselves on this basis. The bundling of local and long distance minutes by wireless carriers, and now emulated by wireline carriers, would not have occurred without competition. Most of us probably can remember how competition noticeably improved customer service, as well. For example, I doubt that

people were thanked so often for using AT&T before divestiture changed the competitive landscape!

Developing an Appropriate Regulatory Framework for the Future

As this brief history demonstrates, divestiture succeeded in ushering in unprecedented competition in the provision of telecommunications services. And now that the Bell companies have entered into the long distance marketplace, regulators must address the important question of what type of regulatory safeguards are necessary to preserve the vibrant competition that has developed in the wake of divestiture.

As we all know, Congress enacted a variety of nondiscrimination and structural separation requirements, which the FCC has implemented. Most importantly, these provisions require the Bell companies to provide long distance through a separate affiliate, which must operate independently from the BOC. The BOC and the affiliate must have separate officers, directors, and employees; must transact business on an arm's length basis; and must comply with various other requirements. The FCC has some discretion in implementing these statutory provisions; for example, while the Commission initially prohibited BOCs and their affiliates from sharing operating, installation, and maintenance functions, we decided last week to eliminate that restriction. But for the most part, the concept of structural separation is enshrined in the statute — *that is, at least until the sunset provision in section 272(f) kicks in*.

Congress provided that the structural separation requirements imposed by section 272 expire three years after the Commission authorizes a Bell operating company to provide long distance in a particular state. In New York, for example, Verizon obtained section 271 authority in December 1999, and the section 272 separation requirements

sunset in December 2002. These requirements have since sunset in Texas, Kansas, and Oklahoma. The statute authorizes the FCC to extend the applicability of the separation requirements, but the Commission has yet to do so. Following the sunset of the separate affiliate requirements, Bell companies remain subject to certain nondiscrimination requirements under section 272(e). But the key point is that they are allowed to integrate the operation of the BOC and the long distance affiliate to a far greater extent than has been permitted since 1984.

Thus far, neither Verizon nor SBC has chosen to integrate its local and long distance operations in any of the states for which the separation requirements sunset pursuant to section 272(f). Part of the explanation may involve business strategy, but I suspect a bigger reason is that the Commission's rules treat the section 272 affiliate as nondominant but would subject an integrated company to dominant carrier regulation. In the competitive market for long distance services, the requirement to file tariffs with advance notice and detailed cost support, among other obligations, could lead to significant disadvantages.

Last May, the FCC issued a notice of proposed rulemaking seeking comment on the type of regime that should govern following the sunset of the section 272 separation requirements. First, the Commission sought comment on how to define the relevant markets. For example, we asked whether we should analyze wholesale and retail markets separately and whether we should distinguish among particular customer classes, such as large enterprises, small and medium enterprises, and the mass market. The Commission also asked about the relevance of bundled service plans and cross-platform competition with wireless services in particular. The Commission also sought comment on the extent

to which facilities deployment by CLECs, cable operators, and others has increased the substitutability of competitive access services.

After seeking comment on the relevant service and geographic markets, the Commission further asked whether the BOCs possess market power in any relevant market. In other words, do they have the ability to unilaterally raise prices by restricting output over a sustained period? And can the BOCs accomplish the same end by increasing their rivals' costs?

Depending on the analysis of market power, the Commission asked what kinds of safeguards remain necessary to deter and detect anticompetitive behavior. In particular, the Commission sought comment on the costs and benefits of each aspect of the existing dominant carrier rules. The Commission also asked whether other existing requirements — such as the safeguards embodied in section 272(e), price cap regulation, and the affiliate-transaction rules — obviate the need for dominant carrier rules or other forms of regulation. In other words, is it time for an overhaul of our rules?

I do not know when the Commission is likely to complete this rulemaking, but I encourage interested parties to participate actively. The regulatory structure we establish will be pivotal to the functioning of telecommunications markets for years to come.

Another issue I wanted to highlight is enforcement. Now that we have granted section 271 authority in every state, our challenge moves from assessing whether local markets have been opened to competition to ensuring that they *remain* open. The Enforcement Bureau has established new procedures and a special compliance review team to monitor audit data, complaints, and other information.

In addition, the Commission is considering the adoption of performance metrics for special access services. The idea is to improve our ability to protect competition and consumers. I have not received a recommendation from our staff, so I cannot say at this point whether I will ultimately support particular proposals that have been submitted in our pending rulemaking. But I am open to imposing regulations if the record demonstrates that market forces have not produced appropriate performance. It is difficult to have an effective enforcement policy when we cannot adequately measure whether discrimination has occurred, because we lack of concrete data. The recent D.C. Circuit decision in the Triennial Review proceeding seems to offer another reason to consider performance metrics. Since the court held for the first time that the availability of special access services can negate potential impairment, and that could reduce the availability of unbundled transport, it seems all the more important to ensure that special access services are provisioned in a nondiscriminatory manner.

Finally, as we look ahead, I will try to be mindful of just how fluid and fast-moving telecommunications markets have become. Developments including accelerating broadband deployment and the growth in IP-based voice services will continue to revolutionize how we communicate. It would be a serious mistake for regulators to become too fixated on the structure of markets as they existed in the past, with their relatively neat divisions between local, long distance, and data. Without question, it is extremely difficult to predict where markets are heading and to make judgments on that basis. For example, when the Department of Justice blocked the proposed merger of MCI and Sprint only a few years ago, it was concerned about excessive concentration in the stand-alone long distance market. Now, it is possible that *there won't be* a stand-

alone long distance market in a few years. MCI and Sprint were unsuccessful in arguing that the relevant market was the much broader market for bundled services, but today that argument would have far more credence. I am not suggesting that DOJ necessarily got it wrong, and the tasks of antitrust enforcers and policymakers are not exactly the same. My point is simply that it is extremely important for regulators to take heed of where markets are heading. We have to avoid crafting rules that become immediately outdated or that are premised on how the world used to look. So, as we decide how to regulate the BOCs when they integrate their local and long distance operations — and in other contexts — I will try to be cognizant of the ongoing digital migration and other transformative developments.

Thanks again for inviting me to join you this evening. I look forward to hearing your thoughts on these important subjects.