

**REMARKS OF FCC COMMISSIONER AJIT PAI  
AT TECHFREEDOM'S FORUM ON THE 100<sup>TH</sup> ANNIVERSARY  
OF THE KINGSBURY COMMITMENT**

**WASHINGTON, DC**

**DECEMBER 19, 2013**

One of the questions posed in the materials promoting today's event was: What should a new Kingsbury Commitment look like? At the risk of being an impolite guest, I'd like to dispute the premise of that question. To me, the Kingsbury Commitment is not a model to be emulated. Instead, it's a cautionary tale about the dangers of regulatory capture and the folly of attempting to manage competition.

A comforting mythology has long existed in many quarters about the development of our nation's telephone system. We are often told that the telephone industry was a natural monopoly. The rise of Ma Bell, or something like it, was inevitable. And it follows that the proper role for government was—and, by implication, still is—to regulate that monopoly and ensure that it served socially productive goals. As AT&T's slogan in the early part of the 20<sup>th</sup> century put it, "One System, One Policy, Universal Service."

But there's a tiny problem with this view of history. As Adam Thierer and others have explained, it doesn't comport with the facts. To be sure, in the earliest days of the telephone industry, there was little competition. But that's because of patents obtained by Alexander Graham Bell. Once those patents began to expire in 1893, things began to change—dramatically. By 1894, eighty competitors had entered local telephone markets. Less than ten years later, there were over 3,000. As a result, AT&T's market share fell from 95 percent in 1894 to 49 percent in 1907.

This competition was good for consumers. New entrants brought telephone service to many small and rural communities for the first time. More and more Americans were able to choose from multiple providers. Prices dropped, and the availability of service expanded. For example, between 1894 and 1907, the number of telephones rose from just 270,000 to about six million. And according to Professor Gerald Brock, "service [was] available practically anywhere in the country."

Of course, increased competition wasn't good for everyone. AT&T had enjoyed sky-high profit margins, with reported returns on investment of 46 percent during the patent-monopoly period. Those margins dropped to a more earthly 8 percent. So in order to restore its sagging fortunes, AT&T turned to its past. Perhaps inspired by the example of Grover Cleveland, AT&T picked one of its prior presidents to once again lead the company. In 1907, Theodore Vail was named president of AT&T after a twenty-year hiatus from the position. His turnaround strategy? Consolidation and regulation, all in the name of a noble goal: universal service.

Here's how the company executed that strategy. Wherever AT&T directly competed with an independent telephone company, acquisition and integration became the preferred path. AT&T also bought a controlling stake in Western Union, its primary telegraph rival.

Eventually, the U.S. Department of Justice took note of all these transactions and filed an antitrust suit against the company. In order to settle the case, Nathan Kingsbury, an AT&T vice president, penned a short letter to U.S. Attorney General James McReynolds. This letter, which came to be known as the Kingsbury Commitment, was written a century ago today. It represented an important milestone in the implementation of AT&T's strategy to dominate the market.

What was the Kingsbury Commitment? Nominally, it included three separate commitments supposedly designed to protect AT&T's competitors. First, AT&T agreed to divest all its Western Union stock. Second, AT&T agreed to stop acquiring independent telephone companies. And third, AT&T agreed to interconnect its long-distance network with those of the independents.

At the time, AT&T's competitors hailed the Kingsbury Commitment. Delivered six days before Christmas, they called it "a gift from Santa Claus Bell." After all, Western Union once again became an independent company, and Bell's competitors no longer faced the threat of extinction by acquisition. The government, too, was no less pleased. Attorney General McReynolds responded to Kingsbury by saying that "it seems to me clear that [the Commitment] will establish . . . full opportunity throughout the country for competition in the transmission of intelligence by wire."

In reality, however, the Kingsbury Commitment was a wolf in sheep's clothing. It was a triumph for AT&T because it paved the way for the company's monopolization of the telephone industry. Essentially, the company obtained government approval of AT&T's strategy of consolidation and regulation and shielded itself from real competition.

None of the three strategic concessions AT&T offered substantially advanced the public interest in the end. Indeed, they were far less important than they first appeared. Take AT&T's divestiture of Western Union. Western Union never successfully competed with AT&T's long-distance telephone service. Its network was simply not built to compete for that business. AT&T surely knew that before making the commitment, having controlled Western Union for 4 years already.

Additionally, AT&T kept its promise not to acquire independents, but that did not end the company's quest to end local competition in the 1,800 or so communities where it existed. Instead, AT&T and the independents divvied up territories. Through swaps, AT&T consolidated its control of one area and left other areas to the independents. All of this was blessed by federal regulators under the guidance of the Kingsbury Commitment. In other words, the Kingsbury Commitment did not preserve local competition, just local competitors. This ran contrary to the very purpose of competition laws, which the Supreme Court would later describe as "the protection of competition, not competitors." And unsurprisingly, this was bad for consumers. As the FCC stated in 1976, the Commitment's effect was "the end of significant head-to-head competition between AT&T and the Independents."

Finally, even AT&T's promise to interconnect its long-distance network was problematic. The ability to interconnect any regional network with the Bell system diminished the incentive for the independents to create a separate, competitive long-distance network. And the Kingsbury Commitment demanded exclusivity for the Bell system, so any independent connecting to AT&T had to use AT&T (and only AT&T) wherever it could. That arrangement essentially meant that no one could compete in the long-distance market unless they could replicate AT&T's entire network—quite a barrier to entry. This in a document intended to allay the government's antitrust concerns!

Of course, the Kingsbury Commitment was only the beginning of a cozy relationship between the Bell system and federal regulators. Over the course of the following decade, lawmakers began describing telephone service as a natural monopoly, apparently having forgotten the local competition that predated the Kingsbury Commitment. And by the 1930s, Congress officially sanctioned the Ma Bell monopoly in exchange for full-scale rate regulation along with the tariffing and cross-subsidization scheme that remains on the books today.

For those familiar with economic theory, this shouldn't be too surprising. Several regulated industries have captured the agencies that are supposed to oversee them. And the Kingsbury Commitment was regulatory-capture in action: AT&T was a savvy company. It understood the economics of the business well, much better than regulators did. So when it offered the federal government a "solution" for managing competition in the telecommunications industry and achieving the goal of universal service, alarm bells should have started going off that AT&T might be playing the regulatory game to its own advantage.

So to the question, "What should a new Kingsbury Commitment look like?", my answer is simple. There shouldn't be a new Kingsbury Commitment. We don't need a new Kingsbury Commitment for the wireless world, and we don't need one for an all-IP world either. Instead, the

Kingsbury Commitment should remind us of errors we should avoid as we set policies to govern a more mobile, all-IP marketplace. Here are three of the lessons we should draw.

*First*, the government should not try to manage competition. The Kingsbury Commitment is a prime example of regulators attempting to do so and failing miserably. No regulatory scheme, no theoretical formula for competition, no matter how finely crafted, can replace actual competition, with all its unmanageable imperfections.

Yet there are still those today that embrace the idea of managed competition, the idea that regulators know better than consumers what real choice looks like, that they can discern the optimal number of competitors or set optimal terms for competition. You can see it in the Telecommunications Act of 1996, which embraced concepts like the unbundled network element platform and mandatory wholesaling. But today only a small fraction of residential consumers subscribe to these forms of competition created by fiat.

In contrast, federal regulators could not and did not foresee the actual competition that has come about since the end of government-sanctioned local monopolies. Today, wireless substitution, over-the-top VoIP, and cable operators offering telephone service present serious competitive threats to the traditional carriers. 33.6 million Americans dropped their copper landlines over the past four years. 42 million Americans now subscribe to VoIP. And more than one third of households have cut the cord and gone wireless only. Each new competitor has reshaped consumer expectations and the marketplace in ways regulators never imagined.

*Second*, the government should not confuse the goal of protecting competitors with the objective of promoting competition. One could argue that the Kingsbury Commitment served the interests of both AT&T and its rivals. For AT&T, the compact ended an antitrust challenge to its domination of the long-distance market. For independents, the compact ensured their survival in some form. The real losers were the American public, who lost the benefits of actual competition.

Similarly, our goal today should not be to preserve the position of any particular company in the marketplace or to help one segment of the industry gain regulatory advantages over its rivals. In a competitive marketplace, we must understand that there will be winners and losers. It is not the government's job to tilt the playing field by punishing the winners or helping the losers.

*Third*, beware of businesses bearing commitments. Companies do not offer commitments out of the goodness of their hearts. Instead, as in the case of the Kingsbury Commitment, these commitments are generally designed to serve a company's self-interest. This is entirely understandable, of course. But we regulators must keep it in mind when companies come to our door. Is a company trying to use a voluntary commitment that sounds good on paper to obtain a regulatory leg up on a competitor? What is couched as an attempt to serve the public interest is often in reality an attempt to further private interests and raise rivals' costs of doing business.

Moreover, these days, many of these commitments are not voluntary in any meaningful sense. Instead, they are the product of government coercion. Just as commitments offered to settle antitrust litigation are not truly voluntary, neither do companies make commitments voluntarily when regulatory guns have been placed to their heads. Or when regulators suggest that certain commitments—perhaps worthy but extraneous to the deal—would improve the chances that the government will approve a pending transaction.

In closing, it is appropriate that we recognize today the 100<sup>th</sup> anniversary of the Kingsbury Commitment. But we should view that agreement not as an inspiration for the future but rather as a warning. It is a warning that regulatory capture is a real risk. It is a warning that some regulations preserve competitors at the expense of real competition. And it is a warning that when the government manages the scope and terms of competition, the creative destruction and innovation that the free market

bring are sure to be left behind. The dramatic changes we see in today's marketplace could herald a century of unprecedented breakthroughs—if the government's next great commitment is to consumers.