

Sector-Specific Competition Enforcement at the FCC

Jonathan B. Baker*

September 21, 2010

The Federal Communications Commission's (FCC's) charge to promote the public interest in the communications sector encompasses a mandate to foster competition.¹ The FCC is far from the only federal agency with an interest in competitive communications markets. The Antitrust Division of the Department of Justice (DOJ) and the Federal Trade Commission (FTC), the nation's generalist antitrust enforcers, also seek to ensure that communications markets (as well as all other industries) perform competitively. This Comment explains how and why sector-specific enforcement by the FCC complements generalist competition enforcement to the benefit of competition in the communications industry. The Comment also discusses the ways in which a sector-specific agency such as the FCC can foster competition and promote other public goals and compares merger reviews in the wake of the 1996 Telecommunications Act by the DOJ and the FCC.

* Chief Economist, Federal Communications Commission and Professor of Law, Washington College of Law, American University. The views expressed are not necessarily those of the Federal Communications Commission. The author has previously served in front office positions at the Federal Trade Commission (as Director of the Bureau of Economics) and the Antitrust Division of the Department of Justice (as Special Assistant to the Deputy Assistant Attorney General for Economics), but his views are not necessarily those of those agencies either. The author is indebted to Stuart Benjamin, Jim Bird, Joel Rabinovitz and Austin Schlick for helpful conversations and comments. A revised version of this comment will be published in the NYU Annual Survey of American Law.

¹ Recent FCC merger decisions, for example, routinely recite "Our public interest evaluation necessarily encompasses the 'broad aims of the Communications Act,' which include, among other things, a deeply rooted preference for preserving and enhancing competition in relevant markets" *E.g.*, Applications Filed for the Transfer of Certain Spectrum Licenses and Section 214 Authorizations in the States of Maine, New Hampshire, and Vermont from Verizon Communications Inc. and its Subsidiaries to FairPoint Communications, Inc., 23 FCC Rcd 514 ¶9 (2008).

One might expect to see little difference in how the competitive effects of mergers are analyzed at the FCC versus DOJ and FTC. After all, the economists at these agencies have similar training and think about industrial organization economics in the same way. Indeed, some FCC economists have previously worked at the antitrust enforcement agencies, and vice versa. Not surprisingly, moreover, the FCC often looks to the Horizontal Merger Guidelines promulgated by DOJ and FTC for guidance in analyzing horizontal mergers. For this reason, among others, some commentators claim that it is unnecessary and wasteful for multiple agencies to review communications industry mergers; these commentators typically recommend that the FCC defer to the antitrust enforcement agencies.² This view downplays the benefits of concurrent jurisdiction over competition questions.

The competition enforcers and the FCC do not necessarily see every proposed merger identically for a number of reasons unrelated to their similar approaches to analyzing the economic effects of a transaction. First, the agencies differ in the scope of their review. Both the FCC and the antitrust enforcers consider competition, but the FCC is also concerned with other public interest goals such as protecting service quality for consumers of interstate telecommunications services, accelerating the private sector

² See, e.g. Jonathan E. Nuechterlein & Philip J. Weiser, DIGITAL CROSSROADS: AMERICAN TELECOMMUNICATIONS POLICY IN THE INTERNET AGE 426 (2005) (“It is debatable whether the public interest demands these additional, largely unchecked layers of intervention [from the FCC’s independent merger review] beyond the basic inquiries already conducted by the Justice Department or FTC—inquiries that are considered more than adequate for other industries.”).

deployment of advanced telecommunications services, and ensuring that a diversity of information sources and viewpoints are available to the public.³

Second, the agencies differ in focus. The antitrust enforcers emphasize competitive analysis, though they learn in some depth about some industries in which investigations recur (including some aspects of communications markets). The FCC focuses on communications, though it also frequently analyzes competition questions.⁴

Third, the agencies differ in the statutory allocation of the burden of proof. The antitrust enforcers must ultimately prove harm to competition to a court (though nearly all transactions that raise concerns to DOJ or the FTC are remedied through settlement or abandoned by the parties).⁵ By contrast, merging firms must prove to the FCC that their proposed transaction is in the public interest, subject to the possibility of appellate review (though nearly all concerns about acquisitions at the FCC are resolved by imposing conditions on the merged firm).⁶

Fourth, the agencies differ in how they collect and test evidence.⁷ The antitrust enforcement agencies do so proactively in order to prepare for possible litigation, for

³ See, e.g., *Cf. Applications for Consent to the Transfer of Control of Licenses, XM Satellite Radio Holdings, Inc.*, 23 FCC Rcd 12348 ¶ 31 (2008) (XM-Sirius Order) (describing elements of the FCC's public interest evaluation of proposed mergers).

⁴ The difference in focus may be connected to a procedural difference among the agencies. The FCC must review every merger within the communications industries, as the parties cannot consummate their transaction without FCC approval. See 47 U.S.C. §310(d) (forbidding license transfers unless the Commission finds "that the public interest, convenience, and necessity will be served thereby"). By contrast, the antitrust enforcement agencies have discretion over which mergers to investigate, are notified only as to the largest transactions before consummation, and have prosecutorial discretion to focus their resources on the transactions raising the greatest competitive concern. See generally, Andrew I. Gavil, William E. Kovacic & Jonathan B. Baker, *ANTITRUST LAW IN PERSPECTIVE: CASES, CONCEPTS AND PROBLEMS IN COMPETITION POLICY* 474-78 (2d ed., 2008) (describing the U.S. merger enforcement process).

⁵ Gavil et. al, *supra* note 4, at 474-478.

⁶ ABA SECTION OF ANTITRUST LAW, *ANTITRUST LAW DEVELOPMENTS* 1333 (6th ed. 2007).

example by interviewing customers or deposing executives from the merging firms. The FCC reviews information obtained directly from the parties comparable to what the antitrust agencies receive through the use of compulsory process, but the FCC tends to rely more than the antitrust agencies on voluntary submissions by third parties and its own expertise to test the evidence proffered by the merging firms.⁸

Fifth, the agencies differ in their culture. The antitrust enforcers are wary of ongoing supervision of merged firms, so are more skeptical of conduct relief and more inclined toward structural relief than the FCC,⁹ which has an ongoing interaction with all sectors of the communications industry.

That ongoing interaction could in theory raise the risk that the sector-specific agency would be “captured” by the regulated industry, leading the agency to act to favor the interests of the industry rather than the public interest.¹⁰ But a sector-specific agency

⁷ This difference between the antitrust agencies and the FCC resembles a difference between U.S. enforcement agencies and the European Commission’s Directorate General for Competition. See Jonathan B. Baker, *My Summer Vacation at the European Commission*, ANTITRUST SOURCE (Sept. 2005), available at <http://www.abanet.org/antitrust/source/>.

⁸ Congress set up the FCC’s merger review process to ensure greater transparency and public participation than occurs with the process at the antitrust enforcement agencies, at the cost of leaving the FCC with greater difficulty obtaining confidential business information relevant to merger review.

⁹ E.g. Antitrust Division Policy Guide to Merger Remedies, U.S. Department of Justice (Oct. 2004), available at <http://www.justice.gov/atr/public/guidelines/205108.htm>.

¹⁰ In a strict sense, agency capture requires that regulators expect (perhaps only with probability) to be rewarded with political support or future employment at a regulated firm for decisions favoring the regulated industry relative to how the polity would like it to act. Michael E. Levine, *Regulatory Capture*, in THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 267, 269-70 (Peter Newman, ed. 1998). The term is also used more broadly to encompass all regulatory decisions that favor the interests of regulated firms relative to the public interest regardless of whether the decisions were adopted by regulators anticipating some reward, and that usage is adopted here. See, e.g., Theodore E. Keeler & Stephen E. Foreman, *Regulation and Deregulation*, in THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 213 (Peter Newman, ed. 1998). In a psychological sense, it may be natural for staff working only on matters involving one industry to see that industry as important, to identify with it, and to want the firms and their business experiments to succeed. Moreover, when it is costly for the sector-specific agency to learn about the regulated industry, the information on which agency decisions are based may become systematically biased toward what is provided by the regulated firms, leading staff to see issues the way the regulated firms do. In addition, if the political branches of government prefer the interests of regulated industries to what would be desired by the polity as a whole, those branches may use their supervisory

can counteract a possible tendency toward systematic bias in favor of relying on evidence provided by the regulated firms. For example, the sector-specific agency may take internal steps to test evidence that are analogous to the kind of discipline the adversarial process imposes on the antitrust agencies—as with FCC Chairman Genachowski’s emphasis on transparent, fact-based, and data-driven decision-making processes.¹¹

Moreover, there are benefits from placing competition review in a sector-specific agency such as the FCC. The FCC has an advantage over the generalist antitrust agencies in fostering competition in communication markets because of the FCC’s industry expertise and broad public interest mandate. These give the FCC the practical ability to take a longer view of the evolution of the industry than is possible for the antitrust agencies.¹² In addition, the FCC can address potential competition issues more easily than the competition enforcers can because of the hurdles the antitrust agencies face in proving a potential competition case in court.¹³

These FCC advantages were evident in the way the agencies addressed the possibility of telephone industry mergers in the immediate wake of the 1996

levers—appointments, budget, legislation, and oversight hearings—to encourage sector-specific regulators to share their viewpoint.

¹¹ *E.g.* Julius Genachowski, Chairman, Fed. Comm’n Comm’n, Preserving a Free and Open Internet: A Platform for Innovation, Opportunity, and Prosperity (Sept. 21, 2009), *available at* <http://www.openinternet.gov/read-speech.html> (“I will ensure that the rulemaking process will be fair, transparent, fact-based, and data-driven.”).

¹² *Cf. Applications for Consent to the Transfer of Control of Licenses, XM Satellite Radio Holdings, Inc.*, 23 FCC Rcd 12348 ¶ 32 (2008) (XM-Sirius Order) (“The Commission’s competitive analysis under the public interest standard is somewhat broader [than that undertaken by DOJ pursuant to the Clayton Act], ... and takes a more expansive view of potential and future competition and its impact on the relevant market.”).

¹³ *See* ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 371-79 (6th ed. 2007) (describing elements the government must prove to demonstrate harm to competition under the “perceived potential competition” theory and the “actual potential competition” theory); Herbert Hovenkamp, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE § 13.4 (3d ed. 2005) (same).

Telecommunications Act. At that time, the FCC took a longer view than DOJ and considered potential competition issues to the benefit of competition generally.

A year after the legislation, AT&T, which was then a long distance company, floated the idea of merging with SBC, a large, local telephone service provider and one of the regional Bell operating companies.¹⁴ From a purely competition perspective, even in 1997, this was a colorable possibility. Local and long distance telephone service are complements not substitutes, and in general the antitrust scrutiny of mergers among sellers of complements is more relaxed than when the merger is horizontal (among sellers of substitutes). Moreover, the 1996 Act had specified a path for local telephone service providers to enter long distance service,¹⁵ suggesting that Congress recognized the benefits of allowing providers to achieve scope economies in providing both services. The same legislative provisions also suggested that Congress believed that those benefits might outweigh the threat that a regulated local service provider, affiliated after merger with an unregulated long distance provider, could game the system to exercise market power.¹⁶ In consequence, it is possible to imagine that in 1997, an antitrust agency would have concluded on balance that competition would be enhanced by a merger between AT&T and SBC.

By contrast, the FCC, the expert communications agency, had a vision of how the communications industry should evolve. The FCC aimed in 1997 to effectuate the

¹⁴ See Mark Landler, *AT&T is Said to Break Off Merger Talks with SBC*, N.Y. TIMES, June 28, 1997, available at <http://www.nytimes.com/1997/06/28/business/at-t-is-said-to-break-off-merger-talks-with-sbc.html> (recounting history of merger talks).

¹⁵ 47 U.S.C. §271.

¹⁶ The merged firm might harm competition in the unregulated service by shifting common costs to the regulated service, or by impeding or raising costs of interconnection to rivals in the unregulated service; competition problems such as these had led to the Bell System breakup.

central thrust of the 1996 Act: developing markets that would become so competitive as to permit deregulation to the extent possible.¹⁷ In that vision there was no place for doing what the merger threatened in part to do: recreate the dangers presented by the old AT&T, which had been broken up more than a dozen years before.

The FCC at that time saw the long distance companies, particularly AT&T (the largest), as important potential rivals for providing local telephone service, and they saw the local telephone companies as important potential rivals for the long distance companies. The FCC's Chairman responded to the idea of an AT&T merger with SBC by declaring that the hypothetical AT&T merger was "unthinkable."¹⁸ As a result the merger did not happen for eight more years—until the industry had evolved to the point where the only concerns that the FCC and the Justice Department had in their merger reviews related to the effect of the transaction on certain lines and services provided mainly to local business customers in some locations.¹⁹

Bell Atlantic and NYNEX, two large local service providers (and former Bell system companies) had proposed a merger that was pending when AT&T suggested merging with SBC. In 1997, the FCC found that this merger would harm competition

¹⁷ Stuart Minor Benjamin, Douglas Gary Lichtman, Howard Shelanski & Phillip J. Weiser, *TELECOMMUNICATIONS LAW & POLICY* 772 (2d ed. 2006); Nuechterlein & Weiser at 69-74.

¹⁸ Reed E. Hundt, Chairman, Fed. Commc'n Comm'n, Thinking About Why Some Communications Mergers are Unthinkable (June 19, 1997), *available at* <http://www.fcc.gov/Speeches/Hundt/spreh735.html>.

¹⁹ *See* Competitive Impact Statement, *United States v. SBC Communications Inc.*, No.: 1:05CV02102 (D.D.C. Nov. 16, 2005), *available at* <http://www.justice.gov/atr/cases/f213000/213026.htm>; *In re SBC Communications Inc.*, *Memorandum Opinion and Order* (Fed. Commc'n Comm'n Nov. 17, 2005), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-05-183A1.pdf.

and secured relief.²⁰ Several months earlier, by contrast, the Justice Department had allowed it to proceed without challenge.²¹

The FCC was concerned that the Bell Atlantic/NYNEX merger would mean the loss of potential competition to NYNEX in providing local phone service, particularly in New York City.²² The Commission found that Bell Atlantic was one of four significant potential rivals to NYNEX in NYNEX's local service area, and that Bell Atlantic was actually planning to enter New York from its adjacent territory in New Jersey.²³ The other three significant potential rivals were the large long distance providers (AT&T, Sprint, and MCI), but the FCC found that among these four potential competitors, Bell Atlantic was particularly well positioned to succeed after entry.²⁴ The Commission concluded that the loss of Bell Atlantic as a potential rival would remove an important competitive restraint on NYNEX.²⁵

The FCC considered and rejected the efficiency arguments that the merging firms proffered in favor of the transaction, mainly on the ground that the efficiencies were not merger-specific.²⁶ It resolved its concerns about the loss of potential competition by imposing conditions that were intended to encourage entry by even more distant potential

²⁰ *In re* NYNEX Corp., 32 F.C.C.R. 19,985 (1997).

²¹ Press Release, Department of Justice, Antitrust Division Statement Regarding Bell Atlantic/NYNEX Merger (Apr. 24, 1997), available at http://www.justice.gov/atr/public/press_releases/1997/1113.htm. This transaction created the firm now known as Verizon.

²² *In re* NYNEX Corp., 32 F.C.C.R. 19,985 (1997) at ¶44.

²³ *Id.* at ¶¶44, 73.

²⁴ *Id.* at ¶¶105-108.

²⁵ *Id.* at ¶¶105.

²⁶ *Id.* at ¶¶168.

rivals, for example by requiring the merged firm to sell unbundled network elements at forward-looking cost.²⁷

The DOJ came out differently. The Justice Department declined to sue and declared that it did not believe the merger violated the antitrust laws.²⁸ The DOJ statement did not provide a detailed explanation of its reasoning, consistent with the usual practice when an antitrust agency declines to sue, but the Deputy Assistant Attorney General for Economics later suggested that the three long distance companies were roughly as good potential rivals as Bell Atlantic, and that three potential competitors were probably enough to protect competition.²⁹ Moreover, the Assistant Attorney General antitrust explained in a speech that he resolved this “difficult case” against challenging the merger on the basis that “on balance the merger was likely to benefit consumers in that the resulting efficiencies would lead to improved services.”³⁰

One interpretation of the different outcomes is that the two agencies simply disagreed about whether the remaining potential competitors provided a sufficient competitive constraint, and on how seriously to take the efficiency claims. But when disagreements between the DOJ or FTC and an industry regulator occur, it is unusual to

²⁷ *In re NYNEX Corp.*, 32 F.C.C.R. 19,985 (1997). Consistent with the sector-specific agency’s vision of developing more competitive communications markets, the FCC held that it in order to find the transaction in the public interest on competition grounds, the Commission needed to be convinced that the merger “will enhance competition.” *Id.* at ¶2.

²⁸ Press Release, Department of Justice, Antitrust Division Statement Regarding Bell Atlantic/NYNEX Merger (Apr. 24, 1997), available at http://www.justice.gov/atr/public/press_releases/1997/1113.htm.

²⁹ Andrew S. Joskow, *Potential Competition: The Bell Atlantic/NYNEX Merger*, 16 REV. INDUS. ORG. 185 (2000). For a discussion of “legitimate economic theories of potentially exclusionary effects of a merger between geographically non-overlapping incumbents” see Marius Schwartz, *Discussant Comments on Papers by Andrew Joskow, Daniel Rubinfeld, and Janusz Ordover and Margaret Guerin-Calvert*, 16 REV. INDUS. ORG. 219, 220-22 (2000).

³⁰ Joel I. Klein, Assistant Attorney General, The Importance of Antitrust Enforcement in the New Economy (Jan. 29, 1998), available at <http://www.justice.gov/atr/public/speeches/1338.htm>.

observe the sector-specific agency acting more aggressively to protect competition than the antitrust agency, so it may be that the DOJ's analysis of the facts was colored by the practical difficulty an antitrust enforcement agency would face in overcoming the legal hurdles involved in proving a potential competition case to a federal judge.³¹

This story illustrates the importance to competition policy of concurrent merger review by a competition enforcement agency alongside a sector-specific agency. In examining telephone industry mergers after the 1996 Act, concurrent review added to competition enforcement; its benefit was not simply from the ability of the expert agency to consider important non-competition public interest goals. The sector-specific agency has the expertise and ability to take a longer view of how the industry should evolve than the antitrust agency, allowing it to identify and address competitive issues that go beyond the practical ambit of antitrust enforcement. By drawing on the strengths of the sector-specific agency and the competition agency, concurrent review can thus enhance competition enforcement as a whole.

³¹ In discussing the Justice Department's review of the Bell Atlantic/NYNEX merger, the former Deputy Assistant Attorney General for Economics hints at such a concern. Joskow, 16 REV. INDUS. ORG. at 188-89. Cf. Nuechterlein & Weiser at 424 ("antitrust authorities may block mergers to protect 'potential' competition only in the narrowest of circumstances").