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-- Session I --

Creating Constructive Relationships Between Competition Policy and Sectoral Regulators

Submission of the United States

The relationships between sectoral regulators in the United States and the two federal antitrust authorities, the Antitrust Division of the Department of Justice ("DOJ") and the Federal Trade Commission ("FTC"), have evolved over the past 30 years. Prior to the 1970s, the regulators and the agencies interacted with each other relatively infrequently. At that time, the antitrust agencies began to engage in competition advocacy, through which they attempted to explain how various regulatory policies impacted competition and consumer welfare and the potential benefits of deregulation. As understanding of the economics of regulation has grown, federal sectoral regulators today increasingly embrace the goals of competition policy and tend to share a common set of policy objectives with the antitrust agencies. While differences remain in the case of some regulators, the competition agencies and sectoral regulators today increasingly coordinate and cooperate with each other, sharing industry and market expertise.

The various industry-specific regulators, such as the Federal Communications Commission ("FCC") and the Federal Energy Regulatory Commission ("FERC"), and the federal antitrust authorities, the DOJ and FTC, were created at different times with different authorizing statutes. Many regulatory statutes and agencies were established based on the assumption that certain industries were natural monopolies. Because consumers could not choose between competing providers, sectoral statutes typically provided for regulation of rates, terms of service, and entry (i.e., licensing) and established sectoral regulators in order to protect consumers from the possible exercise of monopoly power. In some cases, other regulatory objectives were also included in the statutes, such as promoting universal access and diversity of voices.

Historically, therefore, some industry regulators have been responsible for setting prices, terms of services, and regulating entry, whereas the antitrust agencies have focused solely on competition. However, as described more fully in the Secretariat paper,[1] the push toward deregulation of many industry segments in the United States over the past three decades has led the sectoral regulators increasingly to emphasize competition analysis and respect for free market forces.

Advocacy in Theory and in Practice

In many sectors, the competition agencies came to understand the potential for competition in historically regulated industries before the sectoral regulators did. Sectoral regulators, assuming the existence of natural monopolies, gave relatively little thought to competition issues. In some cases, they came to see their role of protecting the public interest as requiring the protection of industry members from what they saw as “injurious” competition.

This began to change in the 1970s. As better understanding of the costs and benefits of regulation developed, the FTC and DOJ worked with the regulators and the Congress to help increase understanding of the potential benefits of competition. An important early step came in 1974, when the Chairman of the FTC gave a speech that tied the country's macroeconomic problems (particularly inflation) to its competition policy. He argued that burdensome federal transportation regulations contributed to the problems, and focused in particular on how the Civil Aeronautics Board (“CAB”) raised prices by limiting the entry of new carriers and restricting the routes over which each airline could operate, and that the Interstate Commerce Commission (“ICC”) effectively sanctioned price fixing among trucking companies. New interest in deregulating the transportation sector followed, such as that in the airline industry by Dr. Alfred Kahn, Chairman of the CAB in the late 1970s. The FTC engaged in competition advocacy to promote deregulation of airlines, railroads, trucking, and inter-city buses. This advocacy took the form not only of speeches, but also of formal written submissions to regulatory agencies and testimony to legislative committees.[2] In the end, both the CAB and the ICC were abolished and markets were generally permitted to determine entry, exit, rates, and terms of service.

The agencies have continued to engage in advocacy for increased competition in regulated sectors through the present day. The FTC and DOJ have sought to inform sectoral regulators about the impact of regulation on efficiency and consumer welfare and potential benefits of deregulation in certain sectors of the economy, including electricity, natural gas, telecommunications, broadcasting, cable television, and electricity generation and distribution. As pointed out in the Secretariat paper, successful competition advocacy by FTC and DOJ depends not so much on any inherent or statutory power over the regulator by the competition authority, but on the cogency of the competition

1 See, J. Hilke, Improving Relationships Between Competition Policy and Sectoral Regulation ¶35 (airlines); ¶37 (trucking); ¶¶39-40 (electricity); ¶46 (postal services).

2 See T.J. Muris, Creating a Culture of Competition: The Essential Role of Competition Advocacy, Remarks before the International Competition Network (Sept. 2002), available at http://www.ftc.gov/speeches/muris/020928naples.htm. Transportation deregulation has been estimated to have improved consumer welfare in the United States by more than $50 billion annually. R. Crandall and J.Ellig, *Economic Deregulation and Customer Choice* (1997) at 2.

agency's arguments and its ability to build working relationships with sectoral regulators. The agency must develop expertise, a reputation for accuracy and objectivity, and a long-term relationship with the regulator. It must also continuously evaluate fresh evidence and analysis.

Since 1995, the FTC or its staff has submitted 22 competition advocacy comments to FERC on electricity issues, including unbundling of vertically integrated utility services; assessing and mitigating horizontal market power in generation; reforming transmission pricing; improving FERC merger review; promoting effective independent system operators; market power screens for authority to charge market-based wholesale rates; and standard market design for wholesale electricity markets. In addition, another 22 staff comments were submitted to state level public service/utility commissions on electricity issues on matters such as retail competition, regulatory treatment of electric utilities with unregulated affiliates; stranded cost recovery; and introducing demand-responsive pricing. The FTC's advocacy efforts in the electricity sector are further examined in the Secretariat paper. Other recent examples of advocacy relate to telecommunications, pharmaceuticals, and commodity futures exchanges.

The DOJ and FTC often advise industry-specific regulators on matters that impact competition. This advice may be voluntary or, in some circumstances, required by statute. For example, the U.S. antitrust agencies, like any private person, may *sua sponte* file comments offering their competition expertise in regulatory proceedings before independent agencies. In contrast, some statutes require the regulator to seek advice from the competition agencies in particular types of proceedings. One example of such a statute is the Telecommunications Act of 1996,[3] which seeks to open all telecommunications markets in the United States, including local services, to competition. Section 271 of the 1996 Act conditions Regional Bell Operating Company ("RBOC") entry into the long-distance market on a showing that the RBOC's local market is open to competition. In making this determination, the 1996 Act requires the FCC to consult with the DOJ and accord "substantial weight" to the DOJ's analysis; the FCC is not bound, however, to follow the DOJ's advice.

The Relationship Between Competition Authorities and Regulators Today

The shift in thinking on the part of regulatory agencies has resulted in a parallel shift in the relationship between the regulators and the antitrust agencies. As common goals have emerged, many regulators work cooperatively with the antitrust agencies to protect and promote competition, while respecting each others' roles and responsibilities. The trend towards shared goals and cooperation is unmistakable. In some sectors, however, competition principles have yet to be fully embraced. This is more pronounced in some (but by no means all) states for sectors that are regulated at that level of government, but is in a few cases still true at the federal level. In some cases this is attributable to the statutory mandate under which the regulator operates, but in others appears to result from the regulators' own policy choices. Therefore, the need for competition advocacy remains.

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[3] 47 U.S.C. § 151 *et seq.*

Responsibility for Competition Analysis

In general, U.S. federal antitrust law addresses the competitive effects of business conduct in regulated industries in one of three ways. First, in a few limited instances, conduct is statutorily exempt from the antitrust laws. An example is the business of insurance, which is exempt under the McCarran-Ferguson Act.[4] In addition, certain agreements among firms in the ocean shipping industry that are filed with the Federal Maritime Commission are exempt from the antitrust laws. In such cases, the regulated company is said to be expressly exempt or immune from the antitrust laws. Antitrust immunity may also be implied when there is a "clear repugnancy between the antitrust laws and the regulatory system."[5]

Second, the remedy to be sought determines which agency will evaluate certain types of conduct. Remedies designed to protect competition or punish anticompetitive conduct may be sought by the competition agencies, while policies designed to protect consumers of regulated monopolies may be implemented by sectoral regulators. For example, an industry-specific regulator may have jurisdiction to set prices or terms of service, but the competition agencies, depending on the industry involved, may have the ability to address anticompetitive behavior in markets outside of the regulated part of the industry.

Third, there are forms of conduct over which the antitrust agencies and the industry-specific regulator have concurrent or shared jurisdiction, most frequently in the area of mergers and acquisitions but also in some non-merger situations. Congress has decided, on an industry-by-industry basis, whether to grant an industry regulator exclusive jurisdiction over competition matters or to establish concurrent jurisdiction between the industry regulator and the antitrust agencies. For example, DOJ has jurisdiction in mergers between electricity transmission and generation utilities, and the FTC handles mergers within the natural gas industry and in some cases those between the natural gas and electric industries. The antitrust enforcement agencies have jurisdiction to challenge mergers in the natural gas and electric transmission industries even when the transactions require, and have received, FERC approval.

In the United States, cooperation and cooperative relationships between the competition agencies and the sectoral authorities are more likely when they share similar goals. This is true even when the goals of the sectoral authorities are broader than promoting competition. In the telecommunications sector, sectoral regulation and competition law enforcement work cohesively and complement one another. As mentioned above, one of the stated goals of the 1996 Act is to open the telecommunications sector to competition. Under the 1996 Act, the Federal Communications Commission ("FCC"), the industry-specific regulator for telecommunications, must determine whether transfers of telecommunications licenses and authorizations serve the public interest, convenience and necessity. The FCC's standard is broader than that employed by the DOJ,

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[4]*See* 15 U.S.C. §1012(b).

[5]*United States v. Nat'l Ass'n of Securities Dealers, Inc.*, 422 U.S. 694, 719 (1975).

which focuses purely on competition concerns. The two agencies also differ in their processes and timetables for reviewing mergers. Nevertheless, the two agencies' concurrent jurisdiction leads them to cooperate and coordinate their respective merger investigations.

Mergers in regulated industries

Industry-specific regulators and the competition agencies can and do cooperate on and coordinate merger investigations. There are no formal rules governing when or which agency may initiate the contact. Typically, such cooperation begins once the parties have filed with one of the agencies, although in large cases contact may occur even sooner.

In the case of telecommunications mergers, while FCC rules generally require it to disclose any communications directed to the merits or outcome of a proceeding (absent a protective order allowing such information to be placed under seal), the rules contain an exception for meetings with the antitrust authorities.[6] Although the FCC and the DOJ are thus free to meet and discuss theories of competitive harm, proposed remedies and timing, the DOJ may not disclose any information it has obtained via compulsory process from the parties or third-parties absent a waiver.

The 2004 acquisition by Cingular Wireless Corp. ("Cingular"), of AT&T Wireless Services, Inc. ("AT&T Wireless"), provides an instructive example. The proposed acquisition, the largest all-cash transaction in U.S. history, required approval from the FCC for the transfer of spectrum and was subject to antitrust review by the DOJ. From the time the proposed merger was announced by the parties, the FCC and DOJ began to cooperate informally. The two agencies met throughout the course of the summer to discuss theories of competitive harm and definition of appropriate markets, and to share industry information and ideas on how to conduct data studies. These meetings allowed the FCC to receive a competition perspective from the DOJ as well as allowing DOJ to take advantage of the FCC's technical expertise as it related to the wireless industry. This technical expertise was useful in evaluating the parties' efficiency claims. In addition, the FCC provided information regarding current spectrum holdings and the availability of additional spectrum in the future. The two agencies were able to communicate openly about information given to one or the other agency by the parties because the parties had granted a waiver allowing such information to be shared. This exchange resulted in more efficient use of the agencies' resources and reduced the burden to the parties of producing information.

In October 2004, both the DOJ and FCC approved the Cingular/AT&T Wireless merger, subject to divestitures by the parties of certain businesses, spectrum and partnership interests. The number of divestitures required by the DOJ and FCC were slightly different due to the differing standards of review. For example, the FCC required more divestitures in rural areas under its public interest standard. A common trustee was selected to oversee the assets required to be divested by both the FCC and DOJ until they could be sold. Cooperation between the agencies on the divestitures was useful to streamline the divestiture process and avoid having the agencies reach

[6] 47 C.F.R. § 1.1200 et seq.

inconsistent outcomes. In addition, the DOJ was able to share its expertise on ordering and effectuating divestitures of full businesses in the wireless sector. Prior to this investigation, the FCC had only required divestitures of spectrum.

In the area of antitrust enforcement in the natural gas industry, the FTC staff consults from time to time with FERC staff to seek technical advice on both industry structure and how FERC regulatory policies and procedures may affect pricing practices or entry conditions.

Pros and Cons of Concurrent Jurisdiction

There are advantages and disadvantages associated with concurrent or shared jurisdiction. One advantage is that it allows each agency to avail itself of the other=s expertise. The antitrust agencies are experts in competition policy generally whereas the regulatory agencies have broad knowledge of their respective industries. Interaction between the two agencies may be particularly helpful in defining markets, obtaining industry statistics, and articulating theories of competitive harm. Moreover, the antitrust agencies generally have greater investigative powers (*e.g.,* power to subpoena documents and depositions) than the regulatory agencies.

An additional advantage for competition may come from the different standards applied by the antitrust agency and regulatory agency. The antitrust laws are designed to protect against harm from certain coordinated and unilateral activities that threaten consumer welfare *(e.g.,* price fixing, monopolization). With that narrow focus, the antitrust agencies are limited to redressing only harm that flows or may flow from the proscribed conduct. By contrast, the regulatory agencies are not only authorized to redress anticompetitive harm in certain circumstances, but also, through their Apublic interest@ standard, they effectively can modify market structures.

Concurrent or shared jurisdiction imposes costs on the antitrust and regulatory agencies and the parties, especially in the merger context. In addition to increased transaction costs by the parties in dealing with multiple agencies, one of the disadvantages is that shared jurisdiction can lead to inconsistent outcomes. For example, the antitrust agency may decide not to challenge a merger, but the sector regulator may impose competition related conditions to its approval. When an antitrust agency and sector regulator both address the same conduct but have different competition goals under their respective statutory authority, differences in enforcement approaches may emerge and can increase the difficulty of achieving consistent competition policies. When goals are consistent, by contrast, consistent outcomes are more likely. Because regulatory outcomes can vary according to how individual regulators exercise their discretion, firms may expend additional resources to learn and monitor the preferences of both an antitrust agency and sector regulators. But these costs can be mitigated by early and regular contact between the agencies, which can reduce duplication of effort and limit the risk of inconsistent outcomes.

Conclusion: the Respective Roles of Antitrust Authorities and Sectoral Regulators

It is our experience that antitrust enforcement is most effective in dealing with problems created in markets that would, absent the targeted behavior, support competition. For example, antitrust enforcement is highly effective where its purpose is to:

- prevent mergers that are likely to lessen competition through injunction or structural remedies like divestitures;

- counter specific anticompetitive conduct that is likely to create or maintain a monopoly in a market that could otherwise support competition; and

- limit harm to otherwise competitive markets resulting from agreements among competitors.

What all these practices have in common is that a remedy usually can be developed to allow the market to return to the state of competition that existed prior to the targeted practice, such that market forces – not continued monitoring by the government – will again determine prices and output. The U.S. antitrust laws are enforced through the courts and, in the case of the FTC, a specialized independent agency. Such bodies are able to craft and enforce remedies that enjoin anticompetitive conduct or its recurrence through clear prohibitions or structural remedies. However, courts and competition agencies are not well suited to administer remedies that require long-term and intensive or frequent monitoring.

By contrast, it is our experience that regulation by an expert regulatory body can be more effective in dealing with persistent market failure, such as markets that, because of sustainable monopoly characteristics, cannot structurally support competition. Markets with persistent market failures tend to be infrastructure industries with natural monopoly characteristics like increasing returns to scale, such as electricity transmission. Where regulation is cost effective, monitoring and enforcing access conditions may be best handled by an expert regulatory agency with adequate knowledge and resources necessary to monitor and limit the exercise of market power on an ongoing basis. Furthermore, a regulatory authority may be able to promulgate narrow, industry-specific rules for access in a quasi-legislative procedure with public comments. The U.S. antitrust enforcement agencies do not have such tools; rather, they enforce a general competition law against individual market participants on a case-by-case basis. Of course, even where regulation is needed, care must be taken to accomplish its objectives without unintended consequences. Antitrust enforcement agencies have an important role to play in sharing their expertise in competition policy with sectoral regulators so that regulation to address a demonstrated market failure does not unduly restrict competition.

In sum, where natural monopoly conditions will not support competition, antitrust is likely to be ineffective and regulation may be needed to mimic competitive performance. However, antitrust rather than regulation is likely the better way to address market power issues in markets that can structurally support competition.