UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Office of the Commissioner

July 21, 2006

The Honorable Arlen Specter
Chairman of the Judiciary
United States Senate
Washington, D.C. 20510

Dear Chairman Specter:

I am pleased to respond to the questions your colleagues on the Committee on the Judiciary have asked me to address regarding my testimony at the Committee's June 14, 2006 hearing on "Reconsidering Our Communications Laws: Ensuring Competition and Innovation."[1] Presented below are my answers to the questions transmitted in your letters dated June 26.

Questions from Senator Feingold

Question 1: It seems like there is a significant amount of overlap in the FCC and FTC's jurisdiction. Do you have formal means for collaborating when your actions may either be duplicative or at cross purposes? For example, was the FTC involved in advising the FCC regarding antitrust issues when it considered changing the media ownership rules.

Answer 1: As discussed in my testimony, the Federal Trade Commission (FTC) is the only federal agency with general jurisdiction over consumer protection and competition in most sectors of the economy.[2] As a result, only a small part of the FTC's work implicates areas of interest to the FCC. At the same time, as you are aware, the FTC Act includes an exemption for common

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[1] As with my responses to the Committee's questions at the hearing, these answers present my personal views and do not necessarily represent the views of the Federal Trade Commission or of any other Commissioner.

[2] The FTC has broad law enforcement responsibilities under the Federal Trade Commission Act, 15 U.S.C. §§ 41-58. With certain exceptions, the statute provides the agency with jurisdiction over nearly every sector of the economy. Certain entities, such as depository institutions and common carriers, as well as the business of insurance, are wholly or partly exempt from FTC jurisdiction. In addition to the general enforcement authority under the FTC Act, the agency has enforcement responsibilities under more than 40 other statutes and more than 30 rules governing specific industries and practices.

carriers subject to the Communications Act. The common carrier exemption further limits the concurrent authority in the two agencies' jurisdiction. The area of concurrent FCC and FTC activity, however, may well expand as Congress and the courts address the applicability of the existing legal framework to new and converging technologies.

Where the FTC's work overlaps with the FCC's work, the two agencies regularly share information and coordinate their activities. For example, the FTC and the FCC have some overlapping authority concerning telemarketing. To ensure that their actions are not duplicative, the two agencies have a Memorandum of Understanding regarding Telemarketing Enforcement. Under that established memorandum, the agencies share complaints, and their staffs meet quarterly to discuss each agency's enforcement work and issues of mutual concern relating to telemarketing. Most recently, for example, the staffs discussed the challenges presented by spoofing of caller identification information.

Other examples of how overlaps between the work of the FCC and the FTC implicate the FTC's consumer protection mission include:

- Coordination of FCC and FTC work on each agency's rulemaking pursuant to the Telephone Disclosure and Dispute Resolution Act;

- Participation by staff of both agencies in the National Association of Attorneys General monthly telecommunications working group conference calls; and

- Coordination of the FCC and FTC work in addressing the sale of consumers' cellular telephone records.

Cooperation between the FCC and the FTC on competition matters has been less extensive, given the smaller number of occasions on which the two agencies have addressed subjects of common concern. When such matters arise (for example, mergers which the FCC and FTC have reviewed concurrently), staff and managers of the two agencies have discussed the substance and timing of each agency's activities. I am not aware of an instance in which the FTC has consulted with the FCC on media ownership rules.

Question 2: I noticed in your prepared testimony that you mentioned that the FTC required AOL and Time Warner to open its cable network to competition on nondiscriminatory basis. Can you explain the potential competitive concerns the Commission had when it required this? It seems to me that this could give some insights as we consider the general preventative non-discrimination concept embodied by net neutrality.

Answer 2: Section 7 of the Clayton Act prohibits mergers whose effect "may be substantially to lessen competition, or to tend to create a monopoly."[3] When a merger is likely to have

[3] 15 U.S.C. § 18.

anticompetitive effects, the Commission typically sues to block the transaction unless it can agree with the merging parties on relief that would prevent such effects. The Commission's complaint in *AOL/Time Warner* alleged that the merger would harm competition and injure consumers in three antitrust markets: (1) the market for broadband Internet access; (2) the market for residential broadband Internet transport services (the "last mile" access); and (3) the market for interactive television (ITV) services.[4]

In the Internet access market, the merger would have combined AOL's Internet Service Provider (ISP) business with the service provided by Road Runner, Time Warner's partially-owned and wholly-controlled ISP. The Commission alleged that this combination would make broadband ISP markets highly concentrated and allow the merged entity to exercise market power unilaterally. The concern was that other ISPs would have been unable to compete effectively with the merged ISPs unless they had the same access to the Time Warner cable system as did AOL and Road Runner.

In the transport services market, the concern was that the merger would have reduced AOL's incentives to promote and market its broadband access through the telephone companies' DSL lines in areas where Time Warner owned cable systems. This would have adversely affected DSL rollout in those areas and allowed the merged firm to exercise unilateral market power over high-speed broadband access.

In the ITV market, AOL had launched one of the first products and was well positioned to become the leading ITV provider. The complaint stated that the cable lines had a distinct technological advantage over DSL lines in providing ITV services, the concern was that the merged company would have had an incentive to prevent or deter rival ITV providers by providing lesser quality access through the Time Warner cable systems.

To preserve competition that the merger allegedly would have diminished, the FTC required nondiscriminatory access to the components of the Time Warner system necessary for other firms to compete on an even basis. The Commission required Time Warner to grant access to other ISPs to its cable network on comparable terms to those given AOL. In the broadband transport market, AOL was required to market and offer its DSL services to subscribers in the same manner and at the same retail price in markets with and without Time Warner cable services. In the ITV market, the merged company was prohibited from interfering with content or the connections and interactive signals of non-affiliated ISPs.

Question 3: I wanted to explore the extent of the FTC's antitrust powers. Would any of the following scenarios violate these rules and, if so, how could a potential violation be reported to the FTC and what actions could the FTC take? As you probably know, high-speed Internet providers sometimes offer either their own or an affiliated VoIP service.

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4 *In re* America Online, Inc. and Time Warner, Inc., No. 3989 (Dec. 14, 2000) (complaint), *available at* http://www.ftc.gov/os/2000/12/aolcomplaint.pdf.

- **Could the Internet providers block a competing VoIP service that was not affiliated with them? Would it matter whether the access provider was also the local telephone or cable television provider?**

- **What about if the unaffiliated VoIP service wasn't completely blocked, but was provided at a lower priority causing a significantly lower quality connection or dropping of calls?**

- **Could the access provider carry their own or affiliated VoIP service for free while charging a fee of any other unaffiliated provider?**

Answer 3: This question poses a number of hypothetical situations and asks whether these situations would violate the antitrust laws. Any analysis of liability, however, always depends on the specific facts that exist at the time of an investigation. My answers, therefore, list a number of the factors that might be considered in light of the scenarios presented in the question.

My answers depend in part on how ISP services are characterized for regulatory purposes. Although the FTC has jurisdiction over most broadband Internet access services, the Commission may lack jurisdiction over a facilities-based service that is offered as a telecommunications service and therefore is regulated as a common carrier service under the Communications Act. In *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, Report and Order and Notice of Proposed Rulemaking*,[5] the FCC reclassified wireline broadband Internet access service by facilities-based carriers as an information service.[6] The same order, however, permits facilities-based wireline carriers to elect to provide transmission for wireline broadband service on a common carrier basis. The common carrier exemption in the FTC Act, therefore, may preclude FTC jurisdiction over transmission services that a facilities-based wireline carrier provides on a common carrier basis pursuant to the order. If a telephone company elects to offer transmission of internet access services on a common carrier basis, the FTC might have no jurisdiction over the provision of those services.

If ISP services are offered as an information service, the FTC certainly would have antitrust jurisdiction over the provision of those services. In that case, Internet service providers, acting collectively, could not block competing applications, including VoIP services, without violating the FTC Act's section 5 prohibition of "unfair methods of competition."[7] Internet service providers compete with each other in local markets. A horizontal conspiracy by Internet

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[5] *See Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, Report and Order and Notice of Proposed Rulemaking*, 20 F.C.C.R. 14853 (2005) *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-05-150A1.pdf; *and see* 47 U.S.C. § § 153(43) (44) & (46).

[6] A consolidated appeal of the order is pending in the Third Circuit. *Time Warner v. FCC*, No. 05-4769 (3d Cir., filed Oct. 26, 2005).

[7] 15 U.S.C. § 45.

service providers to block, or to otherwise disadvantage, potential competitors would violate the antitrust laws. If this concerted activity occurs, it would not matter that the Internet service providers were telephone or cable television providers.

The answer differs if a single Internet service provider, acting unilaterally, refuses to deal with a competitor VoIP provider or offers a higher price or a lesser quality service connection than it provides to its affiliated VoIP service provider.[8] The antitrust laws ordinarily impose no duty to deal. Except in extraordinary circumstance, the antitrust laws allow any company to decide which companies it will buy from or sell to. One of the most important attributes of a common carrier is the duty to deal with all who present themselves for business. In contrast, the antitrust laws allow a company wide leeway in deciding how to structure its distribution system, including by denying its business to actual or potential competitors.

United States antitrust jurisprudence gives a supplier broad discretion about how to buy its inputs or distribute its products. Generally, a refusal to sell to or deal with a particular customer is permissible as long as the supplier is not a monopolist and as long as the decision is made unilaterally. Therefore, if a company decides on its own that its interests are best served by not dealing with a particular customer, the company independently may decline to do business with that customer. The Supreme Court stated this principle in *United States v. Colgate and Co.*,[9]

> The purpose of the Sherman Act is to prohibit monopolies, contracts and combinations which probably would unduly interfere with the free exercise of their rights by those engaged, or who wish to engage, in trade and commerce – in a word to preserve the right of freedom to trade. In the absence of any purpose to create or maintain a monopoly, the act does not restrict the long recognized right of a trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal.

Two years ago, the Supreme Court reiterated this principle in *Verizon Communications v. Law Offices of Curtis v. Trinko, LLP,* which held that a telephone company that provided access to its network to a competing carrier on a discriminatory basis did not violate section 2 of the Sherman Act.[10] The Court noted the "uncertain virtue of forced sharing and the difficulty of identifying and remedying anticompetitive conduct by a single firm."[11] Lower courts likewise have refused to find refusals to interconnect by network service providers to be a violation of

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8 This analysis assumes that the service provider does not deceive a competitor VoIP service by claiming it is selling nondiscriminatory service while secretly compromising the quality of the service provided.

9 250 U.S. 300, 307 (1919).

10 124 S.Ct. 872 (2004).

11 *Id.* at 879.

Section 2.[12] By this line of precedents, an Internet service provider ordinarily would not be required to carry a competing VoIP service over its network.

Despite the approach outlined above, the courts have not entirely foreclosed the possibility that, in extraordinary circumstances, a unilateral refusal to deal with a competitor might violate the antitrust laws. *Trinko* and other cases generally take a skeptical view of such possibilities and appear to impose severe demands on plaintiffs. Important obstacles to a finding of liability include the availability of more than a single entity with whom the denied party might deal,[13] the existence of legitimate justifications for the refusal to deal in the interest of furthering the defendant's business and not solely to disadvantage the competitor,[14] and the existence of a robust collateral regulatory program to address access issues.[15]

At first glance, the nondiscriminatory interconnection requirement in the *AOL/Time Warner* remedy may seem inconsistent with the general antitrust principle that a network has no duty to deal on a nondiscriminatory basis (or on any basis), with its competitors. The merger-related posture of the *AOL/Time Warner* case dictated the remedy that was used. A finding that a merger is anticompetitive means that existing or potential competition will be diminished if the merger takes place. In *AOL/Time Warner*, the merger would have eliminated competition between AOL and Road Runner in ISP services between Time Warner broadband cable connections and telephone company DSL connections in last mile access, and between AOL's and other companies' ITV services. The mandatory nondiscriminatory connections were necessary to preserve the competition that existed before the merger. In the VoIP market as hypothesized in your questions, the FTC would not be analyzing a diminution of competition caused by a merging

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12 *Midwest Gas Services v. Indiana Gas Co.*, 317 F.3d 703 (7th Cir.), *cert. denied*, 124 S.Ct. 82 (2003); *Paladin Associates v. Montana Power Co.*, 328 F.3d 1145 (9th Cir. 2003); *Pittsburgh County Rural Water District No. 7 v. City of McAlester*, 346 F.3d 1260 (10th Cir. 2003).

13 The Court has never endorsed the "essential facilities" doctrine. *Trinko*, 124 S.Ct. at 881.

14 In *Trinko*, the Court called *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985), as being "at or near the outer boundary of § 2 liability." *Id.* 124 S.Ct. at 779. *Trinko* distinguished the refusal to deal in *Aspen* on the ground that the *Trinko* defendant did not abrogate a previously existing voluntary relationship, which in *Aspen* reflected a willingness to forsake short-term profits for potential monopoly profits – that is, an absence of legitimate business reasons in *Aspen* for the refusal. *Trinko*, 124 S.Ct. at 779-880. Citing *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973), the *Trinko* Court also noted that a defendant may be held liable where it is already providing to some customers the service it denied to plaintiff, which may indicate that the defendant had no business need to refuse to deal. *Trinko*, 124 S.Ct. at 880.

15 *Trinko*, 124 S.Ct. at 881, *citing* P. AREEDA & H. HOVENCAMP, ANTITRUST LAW 150, ¶ 773e (2003 Supp.).

of competitors. Instead, the Commission would be analyzing a unilateral refusal to deal with one supplier that, barring any evidence of "a purpose to create or maintain a monopoly,"[16] must be presumed to be benign or procompetitive, and undertaken for legitimate business reasons.

There are several ways to report apparent violations of the antitrust laws to the FTC. Any violation of a statute enforced by the FTC may be reported by telephone or in writing to the Commission's Consumer Response Center, or to the Bureau of Competition.

The FTC can take a number of steps to remedy violations of the FTC Act. One measure is to issue cease and desist orders which are enforced by court-imposed civil penalties for noncompliance. The Commission also may seek preliminary and permanent injunctive relief under Section 13(b) of the FTC Act.[17] In extraordinary cases, the Commission may seek disgorgement or similar remedies under Section 13(b).[18]

Questions from Senator Kohl

Question 1: **One important possible alternative to the dominant phone and cable companies are municipal wireless systems. Cities and municipalities such as Philadelphia have begun to build such wireless network and plan to offer these networks to their residents as a municipal service. Internet access for our citizens through these systems may well prove to be as vital as access to public libraries was to our citizens in earlier times. I understand that the FTC Office of Policy Planning has been conducting a inquiry for the past year on the benefits of municipal broadband. When can we expect to see the results of that study?**

Answer 1: FTC staff recently researched various technologies, operating models, and case studies of municipalities that have participated in the deployment of wireless Internet systems. Staff also have reviewed arguments that support efforts by municipalities to provide wireless Internet services, as well as arguments that such initiatives should be limited or prohibited. The Staff will summarize its learning regarding municipal wireless Internet and provide perspectives on the competition issues that policymakers may encounter when considering this issue. FTC staff expects that its review will be released this Fall.

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16 *Colgate,* 250 U.S. at 307.

17 15 U.S.C. § 53(b).

18 *FTC v. Mylan Labs., Inc.,* 62 F.Supp.2d 25 (D. D.C.), *modified on other grounds,* 99 F.Supp.2d 1 (D. D.C. 1999). *See also* Federal Trade Commission, *Policy Statement on Monetary Equitable Remedies in Competition Cases*, (July 25, 2003) *available at* http://www.ftc.gov/os/2003/07/disgorgementfrn.htm.

Question 2: What is your view of the importance of municipal broadband systems, Mr. Kovacic?

Answer 2: As I indicated in my June 14 testimony, encouraging more broadband competition for consumers is important. The importance of municipal broadband systems and their effect on competition may vary depending on the circumstances of each municipality. Individual municipalities have varied needs and face different Internet access issues. For example, the situation of a large metropolitan area served by multiple traditional wireline telecommunications providers and high-speed cellular Internet technology differs significantly from that of a small rural town with only one or no wireline telecommunications providers and low-speed cellular Internet or satellite Internet service.

Question 3: Do you believe that antitrust enforcement can safeguard against many of the problems that those concerned with net neutrality have identified? Do you believe the antitrust laws with respect to this subject need to be strengthened, and, if so, how?

Answer 3: I believe that antitrust enforcement can serve as a safeguard against many problems that those concerned with net neutrality expect to arise. The FTC is well-versed and experienced in consumer protection and competition issues involved in the provision of Internet access services, and it will continue to fulfill its responsibility to maintain competition in such services and to ensure that consumers are protected from unfair and deceptive acts and practices in this area.

I do not believe that the antitrust laws need to be strengthened to address these issues. However, as I mentioned in my testimony of June 14, as Congress considers legislation to amend the Communications Act, we believe that any new legislation should clearly preserve the FTC's existing authority over activities currently within its jurisdiction. The FTC is concerned that any explicit or implicit diminution of our existing jurisdiction would hamper our ability to continue to play the integral role we have in protecting consumers and maintaining competition in the rapidly evolving market for Internet access services.

Question 4: In your testimony at the hearing you advocated the repeal of the common carrier exemption from the FTC jurisdiction as it relates to telecommunications. What benefits to the FTC's enforcement of antitrust and consumer protection laws would arise from such repeal.

Answer 4: As you know, common carriers subject to the Communications Act of 1934 are exempt from the requirements of the Federal Trade Commission Act. 15 U.S.C. § 45(a)(2).[19]

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[19] 15 U.S.C. § 45(a)(2) exempts from the FTC Act "common carriers subject to the Acts to Regulate Commerce." 15 U.S.C. § 44 defines the "Acts to regulate commerce" as "Subtitle IV of Title 49 (interstate transportation) and the Communications Act of 1934" and all amendments thereto.

Because of this exemption, consumers dealing with an important segment of the economy – telecommunications – do not benefit from FTC enforcement of the FTC Act's prohibitions against deceptive and unfair practices and unfair methods of competition. We have found that the common carrier exemption frustrates effective consumer protection with respect to a wide array of activities in the telecommunications industry including advertising, marketing, and billing practices.

As the telecommunications and Internet industries converge, the benefits to consumers and competition of the FTC having clear and broad authority only increase. Neither the industry nor consumers are well served by uncertainty about the FTC's ability to stop deceptive and unfair practices and unfair methods of competition with respect to interconnected communications, information, entertainment and payment services. Repeal of the FTC Act exemption for common carriers subject to the Communications Act would ensure that the same consumer protection and competition rules apply to all entities regardless of whether the services at issue are common carrier services subject to the Communications Act.

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Mr. Chairman, thank you for the opportunity to participate in the hearing on June 14 and to respond to the Committee's questions.

Sincerely,

William E. Kovacic

William E. Kovacic
Commissioner