

ORIGINAL

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

BELLSOUTH COMMUNICATIONS, INC.
REBUTTAL TESTIMONY OF ROBERT PITOFSKY
BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
DOCKET NO. 020119-TP & 020578-TP
NOVEMBER 25, 2002

Q: PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.

A: My name is Robert Pitofsky and I am Professor of Law at Georgetown University Law Center, 600 New Jersey Ave., N.W., Washington, DC 20001, and Counsel to Arnold & Porter, 555 12th Street, N.W., Washington, DC 20004.

Q: PLEASE PROVIDE A BRIEF DESCRIPTION OF YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE.

A: I graduated from New York University in 1951 and from Columbia Law School in 1954. After military service and a year in an appellate section of the United States Department of Justice, I joined the New York Law Firm of Dewey, Ballentine, Bushby, Palmer and Wood as an associate. In 1964 I was appointed Professor of Law at New York University Law School and in 1974 was appointed Professor of Law at Georgetown University Law Center. Also in 1974 I initiated an Of Counsel relationship with the Washington, D.C. law firm of Arnold & Porter. From the period 1983 to 1989, I was Dean of the Law School at Georgetown. I have also taught as a Visiting Professor at Harvard Law School.

DOCUMENT NUMBER-DATE

12961 NOV 25 02

FPSC-COMMISSION CLERK

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

Q: PLEASE DISCUSS YOUR PROFESSIONAL EXPERIENCE IN THE ANTITRUST AND CONSUMER PROTECTION FIELDS.

A: I have served in the United States government four times, most recently as a Commissioner (1979-1982) and then as Chairman (1995-2001) of the Federal Trade Commission. In that capacity I was involved in and supervised a wide range of government antitrust and consumer protection enforcement efforts and policy decisions. I have also served as the Director of the Federal Trade Commission's Bureau of Consumer Protection.

During my years as a lawyer at Dewey Ballentine in New York and at Arnold & Porter in Washington, my practice has been devoted primarily to matters relating to antitrust enforcement. I have represented scores of clients in private litigation and before the United States regulatory agencies, and counseled companies on issues relating to telecommunications. I am coauthor of the leading set of antitrust teaching materials in American law schools (Handler, Pitofsky, Goldschmid and Wood, "Cases and Materials on Trade Regulation" (4th Ed. 1995)) and have authored over 50 articles and speeches on antitrust subjects, mostly published in American law journals. A copy of my most recent biography is attached as Exhibit A.

Q: WHAT MATERIALS DID YOU REVIEW IN ORDER TO PREPARE YOUR EXPERT OPINION?

1 A: I reviewed a range of written materials including the written direct testimony
2 submitted in this proceeding, the Florida Public Service Commission's Draft 2002
3 Report on Competition ("Draft 2002 Report") and the Recommendation of the
4 Antitrust Division of the Department of Justice concerning BellSouth's Request
5 for Section 271 authority in Florida ("DOJ 271 Recommendation"). I also have
6 spoken to various lawyers and business representatives of BellSouth.

7

8 Q: DID YOU HAVE ANY ASSOCIATION WITH BELLSOUTH PRIOR TO THE
9 TIME YOU WERE REQUESTED TO FURNISH AN EXPERT OPINION

10

11 A: No.

12

13 Q: WHAT IS THE PURPOSE OF YOUR TESTIMONY?

14

15 A: The purpose of my testimony is to rebut the direct testimony submitted on behalf
16 of various parties in this docket by addressing certain policy considerations the
17 Commission should take into account in reaching a decision in this docket. As an
18 overview, I believe that the discount programs made available to customers in
19 Florida by BellSouth are proconsumer and procompetitive. The various
20 challenges to that program that I have seen in materials submitted to the Florida
21 Public Service Commission, as I will discuss in subsequent portions of this
22 submission, are not valid. In my discussion of these issues, I will refer at times to
23 analogous questions that have arisen under the antitrust laws. I recognize of course
24 that the Florida Public Service Commission is not bound by the technical limits or

1 requirements of the antitrust laws. I offer these comparative views because I
2 believe the goals of sensible regulation and of antitrust are similar if not identical
3 – i.e., to preserve the free market from unjustified conduct by firms in the market
4 in order to preserve vigorous competition and to benefit consumers.

5

6 Q: DO YOU HAVE ANY GENERAL COMMENTS REGARDING THE
7 APPROPRIATENESS OF BELLSouth COMPETING THROUGH THE USE
8 OF PROMOTIONAL OFFERINGS?

9

10 A: As I understand the general nature of this proceeding, BellSouth has been
11 discounting to reduce its rates in some instances to levels closer to but generally
12 not equal to those of most of its competitors. Specifically, in January 2002 and in
13 June 2002 BellSouth implemented Key Customer programs that offered small
14 business customers that met the conditions for participation (purchases of \$75 to
15 \$3000 per month) in certain geographic areas (referred to as “hot wire centers”)
16 discounts ranging from 10% to 25% depending on the duration of the contract
17 chosen by the customer and on the specific program (January or June) in which
18 the customer participated. Similar discounts have been offered since the year
19 2000.

20

21 In offering these discounts, BellSouth is responding to significant marketplace
22 competition. In the Draft 2002 Report this Commission noted that “ALECs have
23 made impressive gains in the business market, increasing their share to 26%, up
24 from last year’s share of 16%.” (Draft 2002 Report at 3) The Draft 2002 Report
25 also notes that “ALECs show the heaviest presence in BellSouth’s territory,”

1 where they have 33.16% of business lines. (Id. at 20-21) These “impressive
2 gains” during the period when BellSouth was offering the Key Customer
3 programs are indicative of a vigorously, and increasingly, competitive market.
4 Indeed, it is my understanding that one of the ALECs participating in this hearing,
5 FDN, saw the number of access lines it was serving in hot wire centers increase
6 significantly from 2001 to 2002, despite the fact that it raised its tariffed rates
7 during that same time period. (Ruscilli Rebuttal at p. 6). Finally, the Draft Report
8 notes that there are 122 ALECs currently providing service in Florida. (Draft
9 2002 Report at 38).

10
11 The competitors that have submitted testimony in this proceeding have
12 complained that BellSouth’s conduct has been an “abus[e of] its monopoly status”
13 (Kennedy at p. 11, line 15; Gallagher at p. 4, line 12), “anticompetitive”
14 (Gallagher at p. 9, line 12, p. 13, line 13, p. 15, line 12) or “predatory” (Kennedy
15 at p. 11 line 15). These competitors have asked the Commission to impose
16 artificial limits on BellSouth’s ability to react to marketplace competitive
17 conditions by limiting the amount and duration of the discounts BellSouth can
18 offer until the competitors’ market shares reach a certain level. (Kennedy at p.
19 16, lines 6-12; Gillan at p. 8, lines 15-16; p. 9, lines 11-16; p. 10, lines 14-19;
20 Gallagher at p. 15, lines 3-13; p. 18, lines 13-18).

21
22 The requested limitation on BellSouth’s ability to compete vigorously would lead
23 to reduced competition and would not be in the interests of consumers in Florida.
24 Any regulatory agency that wants to be procompetitive and proconsumer should
25 be very cautious about adopting rules or enforcement interpretations that come

1 between a seller offering low prices and its customers. The immediate effect of
2 any such rules or interpretations is to deny customers low prices. Enforcement
3 along those lines also has the effect of creating a protective umbrella over rivals
4 that reduces their incentive to offer lower prices. Both consumers and the
5 competitive process lose out. Given competitors' ability to easily price below
6 BellSouth should such curbs be imposed, the competitors are actually doing
7 nothing more than asking the Commission to guarantee them higher prices and
8 higher profits. (Gallagher at p. 12; Kennedy at p. 7) Given the "impressive
9 growth" of ALECs' market share in the past year, such a protectionist step would
10 be a particularly inappropriate means of attempting to ensure continued vigorous
11 competition for small business customers in Florida.

12

13 Of course, it is theoretically possible that discounts could be too great, driving
14 BellSouth's prices below appropriate levels of cost. But as I shall explain in my
15 testimony, there is no reason to believe that BellSouth has offered discounts that
16 would reach that level. Further, because Florida statutes already set price floors
17 that adequately protect against below-cost prices, there is no need for additional
18 limits on BellSouth's ability to discount.

19

20 Q: IN YOUR OPINION, DOES BELLSOUTH ENJOY DOMINANT MARKET
21 POWER IN THE MARKETS WHERE IT HAS OFFERED THE KEY
22 CUSTOMER PROMOTIONS?

23

24 A: BellSouth is of course a powerful company but, as facts cited above indicate, it is
25 operating in a highly competitive market in which numerous rivals are increasing

1 their market share. BellSouth faces many aggressive competitors, and has
2 steadily lost market share among small business customers over the last three
3 years even while running promotional offers similar to those at issue in this
4 proceeding. These factors underlie the finding by the Antitrust Division of the
5 Department of Justice that the local telephone market in Florida is "fully and
6 irreversibly opened to competition." DOJ 271 Recommendation at 1.

7

8 Q: ASSUMING FOR THE SAKE OF ARGUMENT BELLSOUTH WERE
9 CHARACTERIZED AS A MONOPOLIST, WOULD IT FOLLOW THAT
10 SPECIAL RESTRICTIONS OUGHT TO BE PLACED ON ITS DISCOUNT
11 PROGRAMS?

12

13 A: No. I believe that the requests of Mr. Gallagher, Mr. Gillan and Ms. Kennedy for
14 special restrictions on BellSouth's ability to compete should be rejected, even if
15 we all agreed that BellSouth could be fairly characterized as a monopolist, which
16 of course, we do not. Antitrust law permits monopolists to aggressively compete
17 using any superior skill, foresight or industry at their disposal. Low prices and
18 discounts, rather than being examples of improper use of market power, are a
19 form of superior skill and industry. In addition, the rapid growth of the ALECs'
20 market shares during the period when BellSouth was offering the Key Customer
21 promotions demonstrates how easy it has been for competitors to enter and
22 expand their market shares, even when BellSouth was competing vigorously.
23 That rapid growth is inconsistent with the notion that BellSouth has been acting as
24 a monopolist that is impermissibly using its market power to expand its sales.
25 Based on the material I have reviewed, there is no basis for a conclusion that

1 BellSouth is using its size impermissibly to increase its share or exclude its
2 competitors.

3

4 Q: SHOULD BELLSOUTH BE REQUIRED TO MAKE ANY PROMOTIONAL
5 OFFER AVAILABLE TO ALL CUSTOMERS IN A PARTICULAR CLASS?

6

7 A: No. The suggestion of Mr. Gallagher that "because BellSouth has not made its
8 discounts available to all customers in the business class, the discounts are, if not
9 discriminatory, at least anticompetitive in the manner in which they are set up and
10 marketed" (p. 13) should be rejected. There is no legitimate policy reason to
11 adopt such a suggestion in a competitive market. BellSouth's rivals do not
12 operate under such restrictions. On the contrary, they can and do target specific
13 classes of customers in specific geographic areas where they believe BellSouth
14 may be vulnerable. It would be unwise to adopt a rule that if a provider (even if
15 that provider were a monopolist) discounts to some customers it must discount to
16 all. Under such a regulatory structure, it likely would be uneconomic for sellers
17 that face competition only for some customers to reduce prices to all customers.
18 Rivals would, of course, be aware of such a regulatory restriction, and would not
19 find it necessary to compete as vigorously to obtain customers. The result of such
20 a requirement would be that consumers would be deprived of the low prices and
21 enhanced service that results from competition on the merits.

22

23 A rejection of Mr. Gallagher's suggestion also is consistent with current antitrust
24 thinking. If one were to ignore the competitive nature of the Florida hot wire
25 markets and assume that BellSouth were a monopolist, some have concluded in

1 the past that such a party could not offer low prices in areas where it met
2 considerable competition and at the same time keep its prices high where
3 competition was weak or nonexistent, but that does not reflect current thinking.
4 Indeed, there have been many factual circumstances where exactly the opposite
5 result has now been obtained, as was the result when Telex Corporation
6 complained about IBM raising prices on part of its line, but lowering prices on other
7 items where competition was more intense. These are ordinary business practices
8 today, and are well accepted as ordinary business practices typical of those used
9 in a competitive market.

10

11 Q: SHOULD THE LEVEL OF THE PROMOTIONAL DISCOUNT OFFERED BY
12 BELLSOUTH BE LIMITED BY REGULATION?

13

14 A: No. Competition is supposed to lead to lower prices and enhanced service. It is
15 antithetical to the idea of competition policy to impose limits on the amount of
16 discount that can be offered. So long as BellSouth's prices are above a reasonable
17 measure of its costs, there is no reason to limit its ability to determine what level
18 of discount is necessary for it to compete to obtain or retain customers. Nothing
19 that I have seen in the record of this matter suggests that BellSouth's Key
20 Customer programs, as implemented, resulted in sales below costs, as costs are
21 defined by the state of Florida and the Commission. (Shell at p.3, lines 4-8; p.5,
22 lines 14-18).

23

24 There are limits under the antitrust laws on excessively low pricing. The most
25 widely adopted view is that competition is enhanced and consumers benefited by

1 low prices as long as they are not below average variable cost (i.e., essentially the
2 cost of ingredients) There is no policy reason to reach a different outcome here.

3
4 Q: DOES THE USE OF MULTI-YEAR CONTRACT LENGTHS AND OTHER
5 TERMINATION PROVISIONS "LOCK UP" CUSTOMERS AND IMPEDE
6 THE ABILITY OF BELLSOUTH'S RIVALS TO COMPETE EFFECTIVELY?

7
8 A: No. Mr. Gallagher and Ms. Kennedy have stated or at least implied that
9 BellSouth's 18-month and 36-month discount offers are comparable to exclusive
10 dealing arrangements, and that they inappropriately fence out BellSouth's
11 competitors for the duration of the contract. I believe any such challenge to these
12 contracts is exceptionally wide of the mark.

13
14 There are many reasons why complaints about "exclusivity" or "foreclosure of
15 rivals" are not persuasive here. Perhaps most important, the BellSouth discount
16 arrangements are not "exclusive." As I understand it, as long as the customer
17 satisfies the minimum-billing amount of \$75 per month, the customer is eligible
18 for the discounts. Even if a customer who met the \$75 minimum billing
19 requirement when it signed a Key Customer contract subsequently bills less than
20 \$75 per month, the customer does not pay any termination fee as long as it
21 continues to purchase some service from BellSouth. In all cases, the customer is
22 free to contract with BellSouth rivals for other services. Viewed in that light, the
23 challenge here is not so much to any alleged exclusivity of the Key Customer
24 programs as it is to the fact that BellSouth is offering discounts that are welcome
25 to consumers, but which put competitive pressure on rivals.

1 Even if these contracts could be viewed as exclusive, which I would dispute,
2 BellSouth's contracts should still be allowed. It is well established now that it is
3 necessary for a challenger to demonstrate the following in order to show that
4 partial or complete exclusive dealing contracts unreasonably restrain trade: a
5 person who complains about the arrangement must show that a substantial share
6 of the market is foreclosed, that the duration of the contract is unreasonably long,
7 that there are no other outlets that rivals of the exclusive dealing seller can turn to,
8 and that there are high barriers to entry. As I understand it, no more than 30% of
9 eligible customers in the state of Florida have participated in one of BellSouth's
10 promotional offerings at any one time. (Massey Rebuttal at pp. 11-12). Such a
11 low level of foreclosure would be *per se* legal. Even if more than 30% or 40%
12 were covered, the arrangements would still be examined under a rule of reason,
13 and any challenge would be defeated if the offers were of short duration or
14 entered into for good business reasons.

15

16 There also is no reason to regulate the duration of the promotional programs
17 offered by BellSouth in response to competition as Messrs. Gillan and Gallagher
18 have suggested. As I noted above, the Key Customer programs at issue here do
19 not require that a customer deal only with BellSouth. But even if they did, the
20 duration of those programs, eighteen months and thirty-six months, are not so
21 long as to inhibit competition. With respect to duration, there is no lack of
22 authority that exclusive dealing contracts terminable in less than a year are
23 presumptively lawful. Contracts of longer length might be reviewed under a rule
24 of reason but are not likely to be successfully challenged, especially in
25 circumstances like those that pertain here -- where competitors are offering

1 discount programs of even longer duration, up to five years in some instances.
2 (Ruscilli at Exhibit JAR-2, p.2). Finally, the recent history in the Florida markets
3 described by the 2002 Draft Report and the DOJ Recommendation indicates that
4 there has been significant new entry and thus no substantial barriers.

5 Q: IS IT UNFAIR OR ANTICOMPETITIVE FOR BELLSOUTH TO OFFER NEW
6 PROMOTIONS AS SOON AS ITS PREVIOUS PROMOTIONS EXPIRE?

7

8 A: Successive discount and other promotions are common business practices offered
9 in many sectors of the economy. As long as the promotions are not below cost or
10 require exclusivity, as I discussed above, they should be allowed regardless of
11 their duration. If the promotions require exclusivity, the issue should not be
12 whether discount arrangements are successive, but rather whether the contracts
13 inappropriately foreclose a large share of the potential customer base for an
14 unreasonable period of time. When, as is the case here, customers have the
15 opportunity to sign up with competitive providers at the end of the customer's
16 chosen 18 or 36-month contract period, challengers of the party offering the
17 discounts can then offer customers before or at the time of termination a better
18 deal and compete away attractive customers. Eighteen-month and 36-month
19 discount arrangements, especially when different contracts expire at different
20 dates, as is the case here, certainly offer those opportunities.

21

22 Q: DO YOU BELIEVE THAT BELLSOUTH IS PRICING SO AS TO DRIVE ITS
23 RIVALS OUT OF THE MARKET?

24

25

1 A: I have seen no indication that BellSouth is doing anything here except lower its
2 prices to a class of customers in order to retain or gain their business. I
3 understand that BellSouth's discounts do not bring its prices below those offered
4 by most rival ALECs. Even if BellSouth's prices in some instances would be
5 below a particular rival's prices, the point is that most rivals' prices for the vast
6 majority of services remain lower than BellSouth's discounted prices. A
7 restriction on BellSouth pricing might be welcomed by the ALECs but would be
8 antithetical to the most basic ideas of preserving competition. It is a fundamental
9 point of sound competition policy that even monopolists be allowed to compete
10 aggressively. Any other rule limits competition and harms consumers and
11 consumer welfare.

12

13 Q: DOES THIS CONCLUDE YOUR TESTIMONY?

14

15 A: Yes.

16

17

18

19

20

21

22

23

24

25