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Image: Tim Webb

Will Anyone Stop Big Phone?

Two major court losses, added to the FCC's failure to enforce, could destroy telecom competition

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As a result of two recent judicial decisions, the entire legal foundation of the modern telecommunications industry is now in question. Absent fixes by both the Supreme Court and Congress (with a little help from the Federal Communications Commission), the nascent competition that more than 19 million U.S. consumers and small businesses currently enjoy will be destroyed, and the return of a vertically integrated "Ma Bell" monopolist (albeit on a regional basis) is inevitable.

The fundamental bargain of the Telecommunications Act of 1996 was that the Bell companies (now known as Verizon, BellSouth Corp., Qwest Communications International Inc., and SBC Communications Inc.) had to make unbundled elements of their telephone networks available to rivals at just, reasonable, and nondiscriminatory wholesale rates as a precondition to re-entering the long-distance market. The economics of this mandatory access are simple: Incredibly high costs are required to build the "last mile" of service — a fact that discourages new entrants. Unbundled access shortcuts this problem by allowing competitors to build their customer base first.

Eight years after passage of the 1996 act, however, it is clear that the Bells got the long end of the stick: They have captured huge portions of the long-distance market. (Verizon is now the third-largest long-distance carrier in the country and controls at least 50 percent of long-distance traffic in many of its core states.) At the same time, they have successfully sabotaged new entrants' efforts to compete with them.

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Unfortunately, the FCC has done little to constrain the Bells' discriminatory conduct. Not only are the fines levied ridiculously low in relation to the overall harm (a $3 million fine is chump change to a company with gross revenue in the billions), but the FCC has so far refused to make an actual finding of improper conduct against any Bell company. Instead, the FCC enters into consent agreements with the Bells, requiring them only to make "voluntary contributions to the U.S. Treasury" (as if they felt bad about the lack of funding for the National Endowment for the Arts). Meanwhile, the FCC has permitted the Bells to re-enter the long-distance sector in all 50 states, so whatever small incentive the Bells originally had to comply with the 1996 act is now removed.

With the FCC willing only to slap the Bells on the wrists for anti-competitive behavior, frustrated entrants have looked to the courts for another remedy. After all, Section 601 of the 1996 act specifically provides that nothing in the act "shall be construed to modify, impair or supercede the applicability of any of the antitrust laws."

But the Supreme Court in *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko* didn't quite see it that way.

LEAVE IT TO REGULATORS

This January, the Court in *Trinko* held that the failure of Verizon (and the other Bell companies) to comply with the unbundling provisions of the 1996 act does not constitute a separate cause of action under Section 2 of the Sherman Act. In so doing, the Court essentially said that whenever Congress has set forth a specific regulatory scheme governing incumbent monopolists' obligations to deal with their competitors, all parties (private and public) are precluded from filing a separate monopolization claim under Section 2. That preclusion stands even when there is a clear regulatory failure to constrain the incumbent monopolists' ability to exercise their market power.

The *Trinko* Court did acknowledge that the Bells continue to hold a monopoly over the "last mile" of the phone network. (In fact, every time the Court has reviewed a case relating to the 1996 act — *AT&T Corp. v. Iowa Utilities Board* (1999), *Verizon v. FCC* (2002), and *Trinko* — the Court has never deviated from that factual finding.) But then the *Trinko* Court gave three primary reasons for rejecting an antitrust remedy.

First, the Court reasoned that because the 1996 act is much more "ambitious" than Section 2 — in that it seeks "to eliminate the monopolies enjoyed by the inheritors of AT&T's local franchises" altogether, rather than merely to prevent unlawful monopolization — the 1996 act's "extensive provision for access makes it unnecessary to impose a judicial doctrine of forced access" under Section 2.

Second, the Court recognized that, in light of the complexities of the telecom business, Congress had directed the FCC — as the expert agency — to develop a "regulatory structure designed to deter and remedy anticompetitive harm." Because the ongoing implementation of the 1996 act requires "highly detailed" supervision, the Court concluded that a court applying antitrust law is "unlikely to be an effective day-to-day enforcer."

Finally, the Court reasoned that because Congress' desire to create a wholesale market for leasing network elements via the 1996 act's unbundling obligations produced "something brand new," the Bells' alleged "insufficient assistance" in providing unbundled services to new entrants is not a recognized antitrust claim under the Court's existing precedents.

NO MORE HAROLD GREENES?

The effects of *Trinko* are significant. To begin with, remember that the landmark AT&T divestiture was based upon a Section 2 claim against the old Ma Bell for failing to provide rivals access to its network in accordance with the Communications Act of 1934. It is highly unlikely, therefore, that the Modified Final Judgment, with Judge Harold Greene riding herd over the Bells for 15 years, would survive *Trinko* scrutiny today.

Similarly, *Trinko* may undercut the interconnection and forced-access provisions found in, for example, the Federal Power Act and the Natural Gas Act. What makes the Telecom Act so different from all these other laws where Congress also set forth a detailed regulatory scheme to govern incumbent monopolists' conduct in dealing with rivals?

However, given the Court's opinion in *Verizon v. FCC* two years ago, where it upheld the FCC's wholesale pricing methodology for unbundled network elements, one could perhaps understand the motivation behind its reasoning in *Trinko.* After all, the Court found in *Verizon* that the FCC's wholesale rates were not below

cost, that unbundling did not produce "parasitic" competition, and that the Bells' argument that the market-opening provisions of the 1996 act stymied investment simply "founders on fact." Thus, the Court in *Trinko* apparently believed that, the two key issues of unbundling (price and access) having previously been resolved, the matter was now closed.

Unfortunately, the decision by the U.S. Court of Appeals for the D.C. Circuit this month in *United States Telecom Association v. FCC* to eviscerate the FCC's unbundling access rules has removed the purported backstop of regulatory protection on which the high court relied in *Trinko.*

As I wrote in this space just over a year ago ("Getting Their Wires Crossed," Jan. 27, 2003, Page 54), the D.C. Circuit is extremely hostile to the basic principle of unbundling and has persisted in reading the 1996 act so narrowly as to make it impossible to implement — including by deliberately disregarding Supreme Court precedent in the 2002 *Verizon* decision. *USTA v. FCC* is no exception: Not only did the court both eliminate the lawful, proper role of the states in ensuring that any federal regulation has sufficient "granularity" to respond to individual markets *and* ignore the fundamental economics of the telecom industry, but the D.C. Circuit inserted itself so heavily into the statutory implementation process as to render the *Chevron* doctrine of deference to agency decision making meaningless.

COMPETITION AT RISK

So what to do? As the courts, Congress, and the FCC fiddle, the prospects for telecom competition are rapidly burning out.

As an immediate step to stop the combustion, the Supreme Court must grant certiorari in *USTA v. FCC* to bring some sanity back to the process in accord with its own precedents. If the justices do not, then the FCC's unbundling rules go away as of May 1, potentially leading to ripped-out wires and service interruptions for 19 million people and businesses.

Equally as important, the FCC must be reminded of its core statutory responsibilities. Unfortunately, while FCC Chairman Michael Powell diverts public attention by acting as an über-censor to block purported indecency on the airwaves, he continues to allow the Bell companies to re-monopolize the industry with relative impunity. Indeed, because he is ideologically opposed to the market-opening provisions of the 1996 act, Powell has even publicly opposed the FCC majority's decision to seek certiorari in the *USTA* case.

As a longer-term measure, if the Court refuses to grant certiorari and the FCC continues its shenanigans, then Congress must act to clean up this mess. New legislation does not mean a complete rewrite of the law deregulating everything — as many Bell supporters would like — but rather implementation of a cohesive and clear paradigm that honestly accounts for the fundamental economics of the business.

While Justice Antonin Scalia may have correctly observed that the Telecom Act is a "model of ambiguity," that does not relieve any branch of our federal government of its responsibilities to the American consumer. Perhaps the root of the problem is that policy-makers do not have the time to learn the complex economics underlying the telecom industry. While understandable, this is no excuse. Despite all the hype of technological progress, the basic facts don't change: Absent meaningful mitigation of the Bell incumbents' ability and incentive to exercise their significant market power, the telecom industry simply will not move from *de facto* monopoly to true competition. And that failure will hurt us all.

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