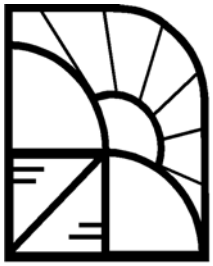


PHOENIX FOR ADVANCED LEGAL & ECONOMIC PUBLIC POLICY STUDIES

CENTER

www.phoenix-center.org

PHOENIX CENTER POLICY PAPER SERIES

Phoenix Center Policy Paper Number 49:

Eroding the Rule of Law: Regulation as Cooperative Bargaining at the FCC

T. Randolph Beard, PhD
George S. Ford, PhD
Lawrence J. Spiwak, Esq.
Michael Stern, PhD

(October 2015)

Phoenix Center Policy Paper No. 49
Eroding the Rule of Law: Regulation as Cooperative Bargaining at the FCC

T. Randolph Beard, PhD[*]
George S. Ford, PhD[†]
Lawrence J. Spiwak, Esq.[‡]
Michael Stern, PhD[♦]

Abstract: Over the past twenty years we have seen the emergence of an important phenomenon in the practice of modern regulation—cooperative bargaining between the regulator and the regulated over a "bundle" of seemingly unrelated issues. Because of the multiplicity of issues being adjudicated "simultaneously" materially affects the nature of the resulting bargains, the rise in cooperative bargaining reduces the likelihood that past regulatory action will produce useful legal precedents for regulated firms. Also, regulation "as practiced" now may allow an administrative agency to expand greatly its power beyond its statutory mandate via "voluntary" concessions by regulated firms that are only a part of a larger bargain across multiple issues (e.g., mergers and acquisitions, waiver requests, declaratory rulings). To examine this important phenomenon, we use the Federal Communications Commission ("FCC") as a case study (although we expect issue bundling occurs at other regulatory agencies as well). We begin by presenting evidence on issue bundling by the FCC in the form of consent decrees to settle outstanding enforcement actions that were entered into either during or immediately following merger approval windows. Next, we provide a series of case studies in which the Commission has engaged in "issue bundling" in the form of "voluntary" commitments in exchange for obtaining regulatory relief from the Commission. As we show, the concessions have little to do with the merits but were instead used by the Commission to achieve political outcomes that could not otherwise be legitimately achieved through generic, industry-wide rulemakings. We then turn to the game-theoretic analysis of issue bundling and discuss the basic theoretical results, as well as some caveats and possible extensions. Conclusions and policy considerations are at the end.

---

[*] Senior Fellow, Phoenix Center for Advanced Legal & Economic Public Policy Studies; Professor of Economics, Auburn University. The authors would like to thank the participants—and especially Mark Burton—at the *Pricing and Resource Allocation in Telecommunications* session at the American Economic Association's Annual Meeting in Boston, MA (January 4, 2015) for helpful comments and suggestions. All remaining errors and omissions are the responsibility of the authors.

[†] Chief Economist, Phoenix Center for Advanced Legal & Economic Public Policy Studies.

[‡] President, Phoenix Center for Advanced Legal & Economic Public Policy Studies. The views expressed in this paper are the authors' alone and do not represent the views of the Phoenix Center or its staff.

[♦] Senior Fellow, Phoenix Center for Advanced Legal & Economic Public Policy Studies; Professor of Economics, Auburn University.

TABLE OF CONTENTS:

I. Introduction

There is a possibly apocryphal account of a conversation between an old, grizzled professional poker player and a young, inexperienced colleague that can be paraphrased as follows:

> "So, young man, how many poker games do you think you will play in your life?"
>
> "Thousands I would think."
>
> "No, actually you will only play in one game—it just lasts a lifetime."

The simple insight underlying this exchange has profound similarities to the nature of economic regulation: that is, given the pervasive nature of regulation over the U.S. economy, for the majority of important regulatory proceedings, a regulatory agency's decision-making regarding one particular issue inevitably takes place against a complex backdrop of other regulatory issues yet to be adjudicated. As a result, we see the emergence of an important phenomenon in the practice of modern regulation—i.e., the cooperative bargaining between the regulator and the regulated over a "bundle" of seemingly unrelated issues.

As we demonstrate below, because a regulated firm and its regulator are always engaged with each other, the multifaceted nature of the negotiation and litigation occurring between the two increases the complexity of their interactions while simultaneously providing additional avenues for agreement, compromise, and horse-trading. Intuition suggests that the multiplicity of issues being adjudicated "simultaneously" will materially affect the nature of the resulting bargains in particular cases. This conclusion, in turn, reduces the likelihood that past regulatory action will produce useful legal precedents for regulated firms because each regulatory action is a unique cooperative bargain under the particular facts and circumstances of that case. Also, regulation "as practiced" now may allow an administrative agency to expand greatly its power beyond its statutory mandate via "voluntary" concessions by regulated firms that are only a part of a larger bargain across multiple issues (e.g., mergers and acquisitions, waiver requests and the like). These "voluntary" concessions are fully enforceable by the agency, but not practically appealable for court review by the regulated firm, thereby having the potential to unshackle the regulatory agency from its statutory chains.

In the regulatory sphere, in which negotiation is ubiquitous and legal precedents are important inputs to regulated firm decision-making, the

cooperative bargaining between the regulator and the regulated over a bundle of issues—especially when it is unofficial and informal—is a practice of great significance. What, though, are the consequences of such bundling of issues? It seems inevitable that this issue bundling will occur, since both the regulatory authority and the firms it regulates will always look to the totality of their circumstances, regardless of the theoretical legal isolation of the issues involved. Is "issue bundling" likely to improve regulatory performance, or should one expect the results to be more nuanced and unpredictable? Such questions are the focus of this PAPER.

To examine this important question, we use the Federal Communications Commission ("FCC") as a case study, although we expect issue bundling occurs at other regulatory agencies as well.[1] The FCC's authority over the companies under its jurisdiction encompasses price and quality regulation, merger review, license transfers, enforcement, subsidization programs, spectrum auction design, investment decisions, among a wide range of other subjects. While issue bundling at the FCC generally takes place whenever a regulated firm seeks favor from the regulator (e.g., waiver requests, petitions for declaratory orders, etc.), perhaps nowhere are the consequences of this mixing of matters more manifest today than in the FCC's merger review process.

Under the plain terms of the Communications Act, the agency is obligated to review industry mergers and acquisitions to determine whether such transactions serve the public interest. If the agency finds a specific merger-related harm, then it has the authority to impose a narrowly-tailored set of requirements before allowing the transaction. Given that the FCC is "entrusted with the responsibility to determine when and to what extent the public interest

[1] *C.f.* R. Knutson, *FCC Could Use Merger Concessions to Advance Policy Goals,* WALL STREET JOURNAL (May 27, 2014) (reporting that "Regulators have used mergers as a way to push policy goals in the past. Electricity regulators used conditions on deals to help reshape the power market last decade, and national security officials have used merger approval to gain access to telecom networks and block use of Chinese network equipment.") (available at: http://www.wsj.com/news/articles/SB10001424052702303903304579587110962186316?mod=_newsreel_2); L. Downes, *Will California Regulators Overstep on the Comcast-Time Warner Cable Merger?,* CNET (April 13, 2015) (available at: http://www.cnet.com/news/will-california-regulators-overstep-on-the-comcast-time-warner-cable-merger).

would be served by competition in the industry"[2] the Commission's merger review serves a useful and important function.[3]

However, over the past two decades, the Commission's merger review process, being far more active since the Telecommunications Act of 1996, has come under increasing scrutiny due to the agency's frequent use of "voluntary commitments" and merger conditions to achieve concessions from the merging parties that the agency might have (or have not) otherwise achieved through industry-wide rulemakings. Much of this criticism stems from the opinion that many of the concessions extracted by the agency had little or no nexus to any merger-related harm, with many appearing to be clearly aimed at placating various political interests. These politically-motivated merger commitments are not the end of the story, however. A review of recent, large-scale transactions reveals a striking coincidence between consent decree settlements of pending enforcement investigations and complaints during and around mergers. Such settlements during and around the merger review window suggest that these consent decrees are cooperative bargains to "clear the decks" of outstanding dockets or, in some cases, to foreclose effective judicial appeal of others in exchange for regulatory relief. In either case, by bundling "voluntary" agreements with the agency's merger authority, the merging parties have no legal recourse (i.e., they have "voluntarily" agreed to the terms) thereby permitting the agency to operate outside the authority granted by Congress.

To provide some context, we present a number of instances of "issue bundling" by the FCC over the past two decades. Our examples are not selected randomly and are, admittedly, designed to be both informative and provocative. We also focus on recent examples, but make no claim that cases of issue bundling are not to be found deep in the agency's history. Next, we offer a preliminary theoretical analysis of the implications of the bundling of "unrelated" regulatory matters into a single "process." In this context, we wish to compare the outcomes and welfare results that arise when these issues are resolved in isolation, versus when they are bundled into a single bargaining problem. We consider the case of two agents—a public regulatory authority and a private regulated firm—who reach bargaining agreements on two otherwise unrelated

---

2 *See United States v. FCC*, 652 F.2d 72, 88 (D.C. Cir. 1980).

3 For a thorough examination of the bounds of the FCC's merger review authority, *see* T.M. Koutsky and L.J. Spiwak, *Separating Politics from Policy in FCC Merger Reviews: A Basic Legal Primer of The "Public Interest" Standard*, 18 COMMLAW CONSPECTUS 329 (2010) (available at: http://phoenix-center.org/papers/CommLawConspectusMergerStandard.pdf).

issues. As we will show, even in a very stylized version of this model, interesting conclusions regarding the consequences of issue bundling, and the desire for or opposition to issue bundling by the parties, are available. Importantly, our approach is very different than the standard, non-cooperative methods for analyzing regulation in which regulators "command and control" the regulated firms.[4] We believe the modern regulatory record, at least at the FCC, shows the importance of cooperative scenarios in the regulatory process. In fact, bargaining in the regulatory sphere is increasing in importance and this development may be among the most important innovations in regulation in many years.

Despite the preliminary nature of our analysis, the following conclusions are clear and are quite likely to survive considerable generalization of the underlying model structure. First, it does indeed matter, for both agent welfare and resolution of the underlying conflicts, whether the bargain is over an individual issue or over a bundle of issues. Under plausible conditions, we find that the regulated firm is likely to want issues adjudicated separately, while the regulator is likely to want them to be bundled together.[5] By bundling issues, the regulator's interest in a politically-relevant outcome in one area is allowed to "spill over" into other regulated areas where politics are less relevant. Depending on the nature of the agreements, issue bundling may expand the agency's effective authority beyond that intended by Congress.[6] We believe a number of our case studies point to such instances.

---

[4] In most cases, economic analyses of regulation have been modeled either as decision problems (*e.g.,* peak-load pricing) or as non-cooperative games. Thus, outside of the cooperative analysis of cost-sharing games (*e.g.,* cost-game cores, natural monopoly, and cross-subsidy), application of a cooperative scenario (bargaining) is non-standard.

[5] We note, however, that one can easily reverse this conclusion through manipulation of the payoff functions. Further, because we impose the Nash bargaining axioms on our solutions, all outcomes are necessarily Pareto optimal, and no problem of naked inefficiency arises. We provide a summary description of cases where efficiency is implicated by bundling.

[6] Certainly, the literature on rent seeking and political interest groups in relevant here. *See, e.g.*, S. Peltzman, *Toward a More General Theory of Regulation*, 19 JOURNAL OF LAW AND ECONOMICS 211-240 (1976); G. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 QUARTERLY JOURNAL OF ECONOMICS 371-400 (1983); G. Becker, *Public Policies, Pressure Groups, and Dead-weight Costs*, 28 JOURNAL OF PUBLIC ECONOMICS 329–347 (1985); S. Peltzman, *The Economic Theory of Regulation After a Decade of Deregulation*, BROOKINGS PAPERS ON ECONOMIC ACTIVITY: MICROECONOMICS 1-41 (1989) (available at: http://www.brookings.edu/~/media/Projects/BPEA/1989%20micro/1989_bpeamicro_peltzman.pdf).

Second, from the policy point-of-view, our analysis provides a warning: In general, legislatures express their will as to regulatory outcomes in somewhat non-specific ways. However, practical implementation of regulation requires a far more specific expression of what is regarded as compliant, and what is not. For example, the issue of forbearance from price regulation is intimately connected to a notion of sufficient competition: price regulation will be relaxed when market competition is suitably robust so the resulting prices will remain "just and reasonable."[7] For a particular firm considering a merger or the like, an intelligible definition of what constitutes "sufficient competition" is quite important.[8] Since the law is often vague, firms look to the regulatory history: what levels of competition have been seen as sufficient in the past? However, if the record reflects a sequence of bundled agreements, of which forbearance in one market is but a component, then the record will be no good guide to the likely regulatory reaction when the issue is presented in isolation. Thus, the bundling of issues makes the agency's issue-specific precedent much less informative. In fact, bundling issues may largely obliterate the relevance of precedent in regulatory rulemakings, a consequence that will lead to great uncertainty for regulated firms about the likely regulatory responses to petitions and other matters and, in turn, alter the nature and flow of mergers and transactions and increase the risk of investments in infrastructure.[9]

Third, issue bundling allows an administrative agency to achieve outcomes that the agency lacks a direct statutory mandate to carry out. We present a

---

[7] For an examination of the FCC's forbearance authority, *see* G.S. Ford and L.J. Spiwak, *Section 10 Forbearance: Asking the Right Questions to Get the Right Answers,* 23 COMMLAW CONSPECTUS 126 (2014) (available at: http://scholarship.law.edu/cgi/viewcontent.cgi?article=1551&context=commlaw).

[8] *See* T.R. Beard, G.S. Ford, L.J. Spiwak & M. Stern, *Wireless Competition Under Spectrum Exhaust*, 65 FEDERAL COMMUNICATIONS LAW JOURNAL 79 (2012).

[9] For an examination of the effect of regulatory uncertainty on the investment decision of firms, *see, e.g.,* G.S. Ford and L.J. Spiwak, *The Unpredictable FCC: Politicizing Communications Policy and its Threat to Broadband Investment,* PHOENIX CENTER POLICY PERSPECTIVE NO. 14-05 (October 14, 2014) (available at: http://www.phoenix-center.org/perspectives/Perspective14-05Final.pdf); G.S. Ford and L.J. Spiwak, *What is the Effect of Regulation on Broadband Investment? Regulatory Certainty and the Expectation of Returns,* PHOENIX CENTER POLICY PERSPECTIVE NO. 12-05 (September 19, 2012) (available at: http://www.phoenix-center.org/perspectives/Perspective12-05Final.pdf); *see also* N. Levy and P.T. Spiller, *The International Formulation of Regulatory Commitment: A Comparative Analysis of Telecommunications Regulation*, 10 JOURNAL OF LAW, ECONOMICS AND ORGANIZATION 201, 208 (1994); F. Gilardi, *The Institutional Foundations of Regulatory Capitalism: The Diffusion of Independent Regulatory Agencies in Western Europe,* ANNALS OF THE AMERICAN ACADEMY OF POLITICAL AND SOCIAL SCIENCE 84, 87-88 (March 2005).

number of examples showing how the bundling of issues by the FCC has permitted it to control the conduct of firms in ways that push at (and sometimes go beyond) the boundaries of its delineated authority as set forth in the Communications Act.[10]

Fourth, our paper sketches out a new approach to the economic analysis of regulation suitable for modern times (and perhaps historical times as well). Traditionally, the economic study of regulation assumes a powerful public authority polices misconduct by passive private agents (the "command and control" or "Principal-Agent" approach) or that the regulator is merely a passive agent of the powerful regulated firm ("Capture Theory"). Recent U.S. regulatory practice reveals the growing incidence of negotiated resolutions of multiple regulatory issues, clearly demonstrating, in contrast to these earlier approaches to modeling regulation, that neither the regulator nor the regulated are powerless or passive, but that both have power (even if unequal). Thus, we model the regulatory process as one of *cooperative bargaining* between the regulated firm and the public authority.

This paper is organized as follows. Section II provides context by presenting evidence on issue bundling by the FCC, including the rising role played by voluntary merger commitments, enforcement actions in the form of consent decrees, and other ancillary agreements. In Section III, we provide a series of case studies in which the Commission has engaged in "issue bundling." In Section IV, we turn to the theoretical analysis of issue bundling and discuss the basic theoretical results, as well as some caveats and possible extensions. Section V provides conclusions and policy considerations.

II. Background: Regulation and Issue Bundling

As noted above, given the repeated engagement between the regulated firm and its regulator, issue bundling is almost always a potential mode of regulation. Issue bundling has no doubt been around since the FCC's inception, but we believe it has increased dramatically in recent years due to the expansion of competition in the communications industry and the 1996 Telecommunications

---

[10] The Commission's actions in this regard have not gone unnoticed. Indeed, some Members of Congress have attempted to introduce legislation that would refocus and limit the FCC's ability to impose conditions only upon a specific finding of a "merger related" harm. For a full discussion, *see* L.J. Spiwak, *Curbing the FCC's Ability to Impose "Voluntary" Merger Commitments,* @LAWANDECONOMICS BLOG (March 6, 2012) (available at: http://phoenix-center.org/blog/archives/490).

Act's more permissive stance on industry consolidation. Indeed, nowhere are the consequences of this mixing of matters more conspicuous than in the FCC's merger review process. As part of its statutory mandate under the Communications Act, the Commission has the authority—and the obligation—to review industry mergers. For example, under Section 214(a), "No carrier . . . shall acquire or operate any line" without first obtaining from the Commission a certificate of public convenience and necessity.[11] Similarly, pursuant to Section 310(d), the Commission must find that any transfer of a license serves the public interest, convenience, and necessity.[12]

Significantly, the Communications Act gives the FCC the authority to impose conditions on transactions so long as those conditions are designed to remedy a specific, merger-related harm. Section 214(c) of the Communications Act states that the Commission "may attach to the issuance of [a 214] certificate such terms and conditions as in its judgment the public convenience and necessity may require."[13] Section 303(r), governing radio communications, provides that "[e]xcept as otherwise provided in this Act, the Commission . . . shall . . . prescribe such . . . conditions, *not inconsistent with law*, as may be necessary to carry out *the provisions of this Act*."[14] While these sections arguably render broad authority to the FCC, there are limits; when imposing such conditions, the courts have long made it clear that the *"Commission is not at liberty . . . to subordinate the public interest to the interest of 'equalizing competition among competitors.'"*[15]

Despite this established case law, beginning with the merger of Bell Atlantic and NYNEX in 1997, the FCC requires applicants to demonstrate that their merger will "*enhance* competition"—a vague standard that no one has challenged in court to date.[16] As a result, as part of its merger review process, the FCC now

---

11 47 U.S.C. § 214(a) (2006).

12 *Id*. § 310(d).

13 *Id*. § 214(c).

14 *Id*. at § 303(r) (emphasis added).

15 *See, e.g., SBC Communications v. FCC*, 56 F.3d 1484, 1491 (D.C. Cir. 1995) (emphasis supplied) (citing *Hawaiian Telephone*, 498 F.2d 771 (D.C. Cir. 1974)); *W.U. Telephone Co. v. FCC*, 665 F.2d 1112, 1122 (D.C. Cir. 1981) ("equalization of competition is not itself a sufficient basis for Commission action").

16 Firms do not challenge the approval of their own mergers. *In re NYNEX Corporation, Transferor, and Bell Atlantic Corporation, Transferee, for Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries,* FCC 97-286, MEMORANDUM OPINION AND ORDER, 32 FCC Rcd 19,985 (August 14, 1997) at ¶ 2 (emphasis added).

routinely expects the merging firms to proffer various "voluntary commitments" as part of the transaction—many of them wholly-unrelated to the competitive issues at hand—to sweeten the deal for regulators and public-interest groups. In fact, it appears that such "voluntary" commitments are now boilerplate in any major transaction at the FCC, as evidenced by such concessions being included many public interest statements for mergers even before the pleading cycle is established.

As Koutsky and Spiwak (2010) observed, there are many problems with this growing trend. First, the agency is arguably using "voluntary commitments" to achieve concessions from the merging parties that the agency should have otherwise achieved through industry-wide rulemakings. In so doing, such commitments fail to provide industry-wide solutions to industry-wide problems. Second, "voluntary commitments" may impose, even if informally, regulations on the entire industry, thus raising significant due process concerns because the drafting and adoption of "voluntary commitments" often occurs in backroom negotiations between the FCC and the merging entities with very little opportunity for public input and review.[17] Third, because "voluntary commitments" are essentially a "contract" between the merged entity and the government, not only does the merged entity waive any right of legal appeal to challenge the Commissions disposition of the merger in court, but any subsequent "breach" of this contract subjects the merged entity to enforcement action (along with potential penalties) by the FCC.[18] In effect, merger conditions may easily permit the FCC to operate outside its legal authority without challenge and, by bundling such regulatory actions to high-valued mergers, the agency does so with consent of the regulated firm.

The agency's apparently opportunistic use of its power to extract concessions during high-value mergers appears not limited to the more explicit "voluntary commitments." There is, for example, a striking coincidence of settlements of on-going enforcement actions by consent decree in and around the FCC's merger review process. Settlement of open issues is not uncommon, as sometimes it just doesn't pay to fight City Hall. As the Supreme Court recognized in *U.S. v. ITT Continental Bakery Co.*, administrative consent decrees "are arrived at by negotiation between the parties and often admit no violation of law, they are

---

[17] *See, e.g.*, Koutsky and Spiwak, *supra* n. 3; *accord,* S. Crawford, CAPTIVE AUDIENCE (Yale University Press 2013) at p. 209.

[18] *See, e.g., In re Comcast Corporation*, DA 12-953, 27 FCC Rcd 6983, ORDER (rel. June 27, 2012).

motivated by threatened or pending litigation…."[19] The danger, however, is that by bundling enforcement matters with mergers, the agency again uses its enhanced bargaining power to curtail a regulated entity's due process right to fight what they may genuinely believe to be a baseless charge.

Table 1. Mergers and Consent Decrees

Merging Parties	Value (Billions)	Begin	End	Consent Decree
AT&T , Leap Wireless	$1.2	August-13	March-14	Yes
AT&T , Atlantic Tele Network	$0.78	February-13	September-13	Yes
SoftBank , Sprint , Clearwire	$20.1	November-12	June-13	No
T-Mobile , MetroPCS	$1.5	October-12	March-13	No
Verizon , SpectrumCo	$3.9	November-11	August-12	Yes
AT&T , Qualcomm	$1.93	January-11	December-11	Yes
Level 3 , Global Crossing	$1.9	March-11	September-11	No
CenturyLink , Qwest	$24	May-10	March-11	Yes
Comcast , NBCU	$45	January-10	January-11	Yes
Frontier , Verizon	$5.3	May-09	May-10	Yes*
AT&T , Centennial	$0.94	November-08	November-09	Yes
CenturyTel , Embarq	$11.6	November-08	May-09	No
Verizon , AllTel	$0.78	June-08	November-08	Yes
AllTel, TPG Partners	$27.5	June-07	October-07	Yes*
XM , Sirius	$13	March-07	August-08	Yes
Liberty Media , DirecTV	$6.6	January-07	March-08	No
Fairpoint , Verizon	$2.5	January-07	January-08	Yes
AT&T , BellSouth	$67	March-06	March-07	Yes
AllTel , Midwest Wireless	$1	December-05	October-06	Yes
Time Warner , Comcast, Adelphia	$17.6	May-05	July-06	Yes*
Verizon , MCI	$7.65	March-05	November-05	Yes*
SBC , AT&T	$22	February-05	November-05	Yes*
Sprint , Nextel	$36	February-05	August-05	Yes
Alltel , Western Wireless	$6	January-05	July-05	No
Cingular , AT&T Wireless	$41	March-04	October-04	Yes*
NextWave , Cingular	$1.4	May-03	February-04	Yes

* Within two months of the review window.

In Table 1, we list twenty-six of the largest telecommunications mergers and acquisitions reviewed by the FCC over the past ten years.[20] For all but six, one or more of the merging firms was party to a settlement with the Commission on an enforcement issue during (or within two months of) the merger review window.

[19] *U.S. v. ITT Continental Bakery Co.*, 420 U.S. 223, 237 fn. 10 (1975).

[20] Data are from the FCC's Electronic Document Management System ("EDOCs"; https://apps.fcc.gov/edocs_public/edocsLink.do?mode=basic&type=n) and its merger webpage (http://www.fcc.gov/mergers).

As shown in the table, the six transactions without a consent decree typically involve firms like Sprint and T-Mobile with smaller market shares in their respective sectors. These data show that in *three-fourths* of the largest telecommunications mergers we find a consent decree. While these data do not have a causal interpretation, they are consistent with the practice, using industry lingo, of "clearing the decks" of unresolved matters before the Commission by firms engaged in a merger or acquisition.[21] (The presence of the "clearing the decks" lingo in the industry does seem to infer some causal nexus.) Also, in some cases (e.g., the XM/Sirius and Univision mergers discussed below), consent decrees are explicitly appended to merger approvals.

Table 2. FCC's Use of 'Consent Decrees' and 'Notices of Apparent Liability' in Enforcement Actions (1996-2014)

Year	CD	NAL	CD Share	Year	CD	NAL	CD Share
1996	8	81	9.0%	2006	23	287	7.4%
1997	6	113	5.0%	2007	48	742	6.1%
1998	0	107	0.0%	2008	75	453	14.2%
1999	3	148	2.0%	2009	89	383	18.9%
2000	26	229	10.2%	2010	282	262	51.8%
2001	15	204	6.8%	2011	105	280	27.3%
2002	15	398	3.6%	2012	47	235	16.7%
2003	18	304	5.6%	2013	54	236	18.6%
2004	40	371	9.7%	2014	50	214	18.9%
2005	21	242	8.0%				

Source: FCC Electronic Document Management System.

Table 2 shows that the Consent Decree is a somewhat modern development in FCC enforcement. Prior to 2000, the number of Consent Decrees was in the single digits per year with Notices of Apparent Liabilities ("NALs") around 100 per year. Consent Decrees as a share of enforcement actions would remain at or below 10% for a decade after the 1996 Telecommunications Act. In 2008 pattern of enforcement actions at the agency changed with the numbers and share of Consent Decrees rising quickly. In 2010, the FCC issued 282 Consent Decrees, a number which exceeded the 272 NALs that same year. After the spike of

[21] As detailed in the following case studies, the appearance of consent decrees in and around mergers and acquisitions also affects broadcasters.

Consent Decree activity in 2008-2011, Consent Decree use has fallen off to about 50 per year but still constitutes nearly 20% of enforcement activity per year.

Consequently, the Commission's increasing use of merger proceedings either to extract "voluntary commitments" or to "clear the decks" of pending enforcement actions grants the Commission vast power for which there is no check or balance.[22] As Judge Frank Easterbrook observed over thirty years ago:

> Often an agency with the power to deny an application (say, a request to commence service) or to delay the grant of the application will grant approval only if the regulated firm agrees to conditions. The agency may use this power to obtain adherence to rules that it could not require by invoking statutory authority. The conditioning power is limited, of course, by private responses to the ultimatums—firms will not agree to conditions more onerous than the losses they would suffer from the agency's pursuit of the options expressly granted by the statute. *The firm will accept the conditions only when they make both it and the agency (representing the public or some other constituency) better off. Still, though, the agency's options often are potent, and the grant of an application on condition may greatly increase the span of the agency's control.*[23]

Easterbrook's comment was prescient and may be said to underlie much of our analysis. Our theory will treat modern regulation as a cooperative bargaining game ("make both it and the agency better off") across a bundle of issues ("will grant approval only if the regulated firm agrees to conditions"), demonstrating the potential for such bundling to "increase the span of the agency's control."

In the following section, we present nine case studies of issue bundling by the Commission. Such bundling is generally manifested in the form of voluntary commitments, merger commitments and consent decrees. In most cases, the "voluntary commitments" involve promised activities by the merging parties that the Commission probably would have no authority to mandate if the issue were treated alone. Many of the commitments are likewise blatantly political in

---

[22] *See, e.g.*, Frank Easterbrook, *The Supreme Court, 1983 Term—Foreword: The Court and the Economic System*, 98 HARVARD LAW REVIEW 4, 39 (1984).

[23] *Id.* (emphasis added).

nature.[24] While most of these examples are from cases involving mergers and acquisitions, we provide examples outside of merger activity—e.g., the first in our list— to illustrate the breadth of the issue. It appears from these examples that the bundling of issues has greatly expanded the authority of the agency and contributed to the expanded politicization of the Commission's actions.

III. Case Studies

In the following case studies we discuss some, but certainly not all, of the voluntary conditions and consent decrees arising during regulatory proceedings and recent merger and acquisition activity at the FCC. Our chosen examples are intended to be neither exhaustive nor randomly selected, but rather illustrative of a pattern of behavior which indicates that in order to obtain the regulatory relief sought, the regulated entity was willing to enter into a cooperative bargain with the regulator. In many of these examples, a reasonable argument could be made that the agency has pushed the bounds of its authority, if not exceeded its authority. We note, however, that we have no formal insight into the backroom negotiations that produced these outcomes, though perhaps this caveat says as much about the process as the outcomes themselves. Inside knowledge about the consent decrees might indicate that some of these examples merely reflect a coincidence, though we have been careful to focus on what appears to be clear examples of issue bundling. Furthermore, we do not pass judgment on these particular outcomes or programs other than perhaps in noting that in some cases the activity seems well outside the statutory authority of the agency, a judgment mostly impossible to support with judicial decisions since merger commitments, voluntary or otherwise, cannot be litigated.

A. *AT&T Non-Dominant Petition "Low Income" And "Low Volume" Voluntary Commitments*

Our legal research indicates that one of the Commission's first uses of "voluntary" commitments in a regulatory proceeding did not come in the context of a merger review, but rather when AT&T petitioned the Commission to be reclassified as a "non-dominant" carrier for retail long-distance service in the mid-1990s.[25] Other long distance carriers were already classified as non-

[24] *C.f.* Becker, *supra* n. 6.

[25] *In re Motion of AT& T Corp. to be Reclassified as a Non–Dominant Carrier*, FCC 95-427, 11 FCC Rcd 3271, Order (rel. October 23, 1995). For a complete overview of the FCC's *Competitive Carrier* paradigm, *see* M. Naftel and L.J. Spiwak, THE TELECOMS TRADE WAR, THE UNITED STATES, THE EUROPEAN UNION AND THE WORLD TRADE ORGANISATION (Hart Publishing 2000) at Appendix.

dominant, and competition in the industry was certainly workable. AT&T's dominant status subjected the company to more intense regulation than that faced by its rivals; its petition for non-dominance aimed to level the playing field and eliminate regulatory asymmetry.

By the Commission's own admission, asymmetrical dominant carrier regulation made absolutely no sense in a competitive environment:

> The cost of dominant carrier regulation of AT&T in this context includes inhibiting AT&T from quickly introducing new services and from quickly responding to new offerings by its rivals. This occurs because of the longer tariff notice requirements imposed on AT&T, which allow AT&T's competitors to respond to AT&T tariff filings covering new services and promotions even before AT&T's tariffs become effective. The longer notice requirements imposed on AT&T thus also reduce the incentive for AT&T to initiate price reductions. In addition, to the extent AT&T were to initiate such strategies, AT&T's competitors could use the regulatory process to delay, and consequently, ultimately thwart AT&T's strategies. Furthermore, such regulation imposes compliance costs on AT&T and administrative costs on the Commission.[26]

Notwithstanding this concession of the merits, it appears the Commission encouraged (though the next quote, *infra,* suggests *demanded* may be more appropriate), and AT&T agreed to provide, certain "voluntary" commitments designed to protect both "low income" and "low volume" consumers in the event of a rate hike: in effect, rate regulation by contract.[27]

The use of voluntary commitments was novel twenty years ago, so it is interesting to note how both the regulatory agency and the regulated entity described the bargain. On the one hand, the Commission in the *Order* notes that:

> AT&T filed an ex parte letter in which AT&T specifies certain actions that it voluntarily commits to undertake to address concerns raised in the record regarding the effects of reclassifying AT&T. AT&T maintains in its letter that these concerns are

---

[26] *AT&T Non-Dom Order, id.* at ¶ 27.

[27] *Id.* at Appendix C.

> "misplaced" because "for the most part" they "have no logical connection to AT&T's regulatory classification," and, insofar as they implicate important policy issues, "they apply with equal force to all interexchange carriers and have nothing to do with market power." Nevertheless, AT&T sets forth in the letter various voluntary commitments, which it describes as "transitional provisions," that are intended to allay these concerns, pending the Commission's review of its current scheme for regulating interexchange carriers. In that regard, AT&T renews its request that the Commission commence an examination of the interexchange industry "to consider whether appropriate rules for all carriers should be adopted."[28]

And on the other hand, while the Commission went out of its way to note specifically that its "determination [with respect to dominance] *is not based upon the voluntary commitments* offered by AT&T … but on the economic information in this record regarding AT&T's position in the overall relevant market," the Commission then went on to hold that it was nonetheless accepting "all of AT&T's commitments, and order[ing] AT&T's compliance with those commitments."[29] Adding to the gravity of the moment, the Commission also specifically noted that "AT&T's failure to comply with its commitments may result in the imposition of fines or forfeitures upon AT&T (pursuant to Section 503(b) of the Act) or a revocation of its radio licenses (pursuant to Sections 312(a) of the Act)" and that the agency would "reject as unreasonable on its face any tariff filing that contravenes AT&T's commitments."[30]

This example is a very clear case of the Commission bundling independent issues. By the agency's own admission, the voluntary commitments were not probative to the question of dominance but they were nevertheless part of the grand bargain. Also, the commitments were plainly aimed at placating particular interest groups. Finally, it is not clear that the agency had the authority to impose such requirements directly, but given AT&T's "voluntary" commitment the company was in no position to test the legality of the content of the commitments.

---

28 *Id.* at ¶ 17.

29 *Id.* at ¶ 37 (emphasis supplied and citations omitted).

30 *Id.*

B. *Madison River Consent Decree*

In 2005, the FCC entered into a consent decree with Madison River Telephone Company to settle a pending investigation in which Madison River was found to have blocked ports for Voice over Internet Protocol ("VoIP") applications. While admitting no wrongdoing, Madison River agreed both to stop blocking VoIP ports going forward and to make a "voluntary payment to the United States Treasury" in the amount of $15,000.[31] The Madison River settlement was widely applauded because it marked the first time the Commission took an affirmative enforcement action to ensure an "Open Internet."[32]

As is often the case, there appears to be more to this story. For the Commission, settling this case was a prudent legal strategy because it postponed having a reviewing court rule on the bounds of the FCC's authority over Title I information services—a question which was very much unsettled at the time.[33] For Madison River, entering into this settlement was not very costly (only $15,000) and could have generated goodwill with the Commission for its pending acquisition of two local exchanges from BellSouth as well as its petition for waiver of the study area boundary freeze contained in Part 36 of the Commission's rules. Indeed, the Commission approved Madison River's

---

[31] *In the Matter of Madison River Communications, LLC and Affiliated Companies,* DA 05-543, 20 FCC Rcd 4295, ORDER (rel. March 3, 2005) (available at: http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-05-543A1.pdf); CONSENT DECREE (available at: http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-05-543A2.pdf).

[32] *See, e.g.,* D. McCullagh, TELCO AGREES TO STOP BLOCKING VOIP CALLS, CNET (March 3, 2005) (available at: http://news.cnet.com/Telco-agrees-to-stop-blocking-VoIP-calls/2100-7352_3-5598633.html).

[33] Ten years later, there is far more guidance from the courts. *See* L.J. Spiwak, *What Are the Bounds of the FCC's Authority Over Broadband Service Providers? A Review of the Recent Case Law,* PHOENIX CENTER POLICY BULLETIN NO. 35 (June 2014) (available at: http://www.phoenix-center.org/PolicyBulletin/PCPB35Final.pdf); and republished as *What Are the Bounds of the FCC's Authority over Broadband Service Providers? – A Review of the Recent Case Law,* 18 JOURNAL OF INTERNET LAW 1 (2015).

acquisition just one month after entering into the Consent Decree,[34] and approved Madison River's waiver request the following November.[35]

The Commission has articulated no formal linkage between the acquisitions and the consent decree. Still, this evidence is strongly consistent with the concepts of "issue bundling" and "clearing the decks." While the timing is certainly impeccable, the evidence is nevertheless circumstantial and must be combined with other facts to draw any conclusion.

C. *AT&T/BellSouth "Voluntary" Merger Commitments to Provide an Introductory Low Cost Broadband Product, to Repatriate Jobs, and to Waive Forbearance Rights*

In 2007, the FCC approved the merger of AT&T (formally SBC) and BellSouth.[36] While the *Order* contained a large number and wide variety of "voluntary commitments," three in particular for purposes of our discussion stand out.

1. *Low Cost Broadband Offering*

Within six months of closing the merger, AT&T committed to sell a retail DSL service at a speed of up to 768 kps to new customers in their service territory for $10 a month for at least thirty (30) months.[37] Putting aside the low connection speed for the moment (it was 2007 after all), there are two points which we should observe about this "voluntary" commitment. First, offering a product ostensibly designed to increase broadband adoption, while certainly a worthy social goal, does nothing to remedy a merger-related harm. Indeed, the merged entity could have easily offered such a product but-for the merger, and $10 was well below the market price for broadband. Second, the FCC has, to date, never formally regulated the retail price of broadband. However, by accepting a

---

[34] *Nonstreamlined Domestic Section 214 Application Granted,* DA 05-1086, 20 FCC Rcd. 8042 (rel. April 14, 2005).

[35] *In the Matter of Madison River Telephone Company, LLC Mebtel, Inc. D/B/A Mebtel Communications and Bellsouth Telecommunications, Inc., Joint Petition for Waiver of the Definition of "Study Area" Contained in Part 36 of the Commission's Rules; Petition for Waiver of Section 69.3(e)(11) of the Commission's Rules,* DA 05-3104, 20 FCC Rcd. 19173, ORDER (rel. November 29, 2005).

[36] *In the Matter of AT&T Inc. and BellSouth Corporation, Application for Transfer of Control,* FCC 06-189, 22 FCC Rcd 5662, MEMORANDUM OPINION AND ORDER (rel. March 26, 2007).

[37] *Id.* at Appendix F.

"voluntary" commitment which establishes the specific price for a specific product offering, the FCC used a merger proceeding to impose a form of *de facto* retail price regulation.

2. *Job Repatriation*

In another "voluntary" commitment, AT&T agreed to repatriate 3,000 jobs that had been outsourced by BellSouth within one year of closing the merger. As an additional "feel good" measure, AT&T agreed to repatriate at least 200 of these jobs to New Orleans, which had just been battered by Hurricane Katrina.[38]

While increasing employment is a perennial bi-partisan political priority, it seems clear that job repatriation does not address a merger-related harm. Moreover, there is a serious legal problem with the commitment: under the United States Supreme Court's ruling in *NAACP v. Federal Power Commission*, because neither Section 214 nor Section 310 specifically mentions employee job concerns, the FCC is *prohibited* from considering employment effects of telecommunications mergers under the "public interest" standard.[39] As the Court observed, "the use of the words 'public interest' in a regulatory statute is not a broad license to promote the general public welfare."[40] Job concerns are therefore well outside the agency's merger-review authority, but AT&T was not in a position to challenge the legality of the action. As such, this case provides a good example of a potential abuse of such authority—engaging in activity well beyond that authorized by Congress—that may arise when a regulator bundles issues.

3. *Waiver of Right to Seek Forbearance of Residual Unbundling Obligations*

In the last "voluntary" commitment of note, AT&T agreed not to file a petition for forbearance under Section 10 of any residual unbundling obligations provided under section 251(c)(3) of the Telecommunications Act. As an added measure, AT&T also agreed not to give effect to any forbearance ruling obtained by a third party for the forty-two months the merger commitments remained in effect.[41] Again, while it is unclear how this particular "voluntary" commitment is

---

38 *Id.*

39 425 U.S. 662, 670 (1976).

40 *Id.* at 669–70.

41 *AT&T/BellSouth Merger Order,* Appendix F, *supra* n. 36.

designed to remedy a specific merger-related harm, it is readily apparent that the FCC has successfully used a "voluntary" merger commitment to force a regulated firm to waive an important legal option (i.e., the right to petition for forbearance) available to it under the Communications Act.

D. *Comcast/NBCUniversal "Voluntary" Merger Commitment to Implement "Internet Essentials" Broadband Adoption Program*

Over the past decade, great effort and resources have been dedicated towards increasing broadband adoption in the United States. One of the most successful programs has been Comcast's "Internet Essentials" initiative. Under this program, Comcast provides both a $9.95 a month Internet service along with a low-cost computer to those families with at least one child eligible for the National School Lunch Program.[42] There can be no doubt that this program has been very successful. Comcast has invested over $200 million into Internet Essentials and, to date, the program has connected more than 1.4 million low-income Americans, or more than 350,000 families, to home Internet and digital literacy training (about $570 per connection).[43] In contrast, the roughly $3 billion allocated to broadband expansion by the American Recovery and Reinvestment Act ("ARRA") has connected a claimed 730,000 subscribers (about $4,000 per connection), a subscriber figure that is likely exaggerated and, according to the Government Accountability Office, is based on questionable accounting.[44]

However, as reported by the WASHINGTON POST, Comcast had originally planned to launch this program in 2009, but Comcast Senior Vice President David Cohen told his staff to wait because he believed that such a program would be a useful for bargaining with the FCC over its proposed takeover of NBCUniversal. Indeed, according to a quote attributed to Mr. Cohen, "I held back because I knew it may be the type of voluntary commitment that would be

---

[42] *Third Annual Compliance Report On Internet Essentials, The Comcast Broadband Opportunity Program* (July 31, 2014) (available at: http://www.internetessentials.com/sites/internetessentials.com/files/reports/comcast_internet_essentials_annual_report_2014-07-31_-_fcc_low_res.pdf).

[43] Internet Essentials 2014 Executive Summary (available at: http://www.internetessentials.com/sites/internetessentials.com/files/reports/fcc_executive_summary_bifold_080114.pdf.)

[44] *Recovery Act: USDA Should Include Broadband Program's Impact in Annual Performance Reports,* General Accountability Office (2014) at p. 19 ("BIP status reports have previously contained information that was determined unreliable by GAO and USDA's OIG) (available at: http://www.gao.gov/assets/670/664129.pdf).

attractive to [FCC Chairman Julius Genachowski]."[45] This holding back was likely influenced by the inclusion of a similar low-priced broadband offer included in the AT&T-Bellsouth merger discussed above.[46]

Mr. Cohen was proven correct. While a commitment to increase broadband adoption clearly had no nexus to any merger-related harm involving the acquisition of a content company by a broadband service provider, not only was Comcast's voluntary commitment to initiate its "Interest Essentials" program a cited factor in the Commission's ultimate positive disposition of the merger application,[47] but one year later then-Chairman Julius Genachowski publicly praised this program as "the best in public-private partnerships to address pressing national issues. In this case, the digital divide."[48] The depiction of the relationship between the regulator and the regulated as a "public-private partnership" does much to support our treatment of modern regulation as a cooperative bargaining game.

E. *Comcast/NBCUniversal "Voluntary" Merger Commitment to Adhere to the 2010 Open Internet Order – Even If that Order is Overtuned on Appeal*

After the D.C. Circuit rebuked the FCC's first efforts to enforce its Open Internet principles in *Comcast v. FCC*,[49] the Commission responded by promulgating more formal Open Internet rules in December 2010.[50] While the vast majority of firms who would be subject to such rules (with the exception of

---

45 C. Kang, *David Cohen May Be Comcast's Secret Weapon, But In D.C. He's A Wonk Rock Star,* WASHINGTON POST (October 29, 2012) (available at: http://www.washingtonpost.com/business/technology/david-cohen-chief-dealmaker-in-washington-is-comcasts-secret-weapon/2012/10/29/151e055e-080a-11e2-858a-5311df86ab04_story.html).

46 *See supra* Section III.C.1.

47 *In the Matter of Applications of Comcast Corporation, General Electric Company and NBC Universal, Inc. For Consent to Assign Licenses and Transfer Control of Licensees,* FCC 11-4, 26 FCC Rcd 4238, MEMORANDUM OPINION AND ORDER (rel. January 20, 2011) at ¶¶ 232-33.

48 Remarks of FCC Chairman Julius Genachowski, Comcast Internet Essentials Event, Joint Center for Political and Economic Studies, Washington, DC (September 24, 2012) (available at: https://apps.fcc.gov/edocs_public/attachmatch/DOC-316430A1.pdf).

49 *Comcast v. FCC,* 600 F.3d 642 (D.C. Cir. 2010).

50 *See In re Preserving The Open Internet,* FCC 10-201, 25 FCC Rcd 17905, REPORT AND ORDER (rel. December 23, 2010) (hereinafter "*2010 Open Internet Order*").

Verizon) signed off on the end result and effectively agreed not to challenge the rules in court,[51] Comcast—which was in the final stages of getting the FCC to approve its acquisition of NBCUniversal—went one step further: As a "voluntary" merger commitment, not only did Comcast redundantly agree to "comply with all relevant FCC rules," but Comcast also affirmatively agreed that "in the event of any judicial challenge affecting [the just-promulgated *2010 Open Internet Rules*], Comcast-NBCU's voluntary commitments concerning adherence to those rules will be in effect."[52] So, even if a reviewing court determines the FCC has acted outside its authority, Comcast remains bound by the agency's over-reach.

The Commission was pleased with its handiwork. As it noted in an accompanying footnote:

> We will rely upon Comcast-NBCU's agreement to adhere to the terms of the Open Internet rules, including submission to enforcement by the Commission. This agreement contains voluntary, enforceable commitments but is not a general statement of Commission policy and does not alter Commission precedent or bind future Commission policy or rules.[53]

Without going into the merits of the *2010 Open Internet Order*, Comcast's "voluntary" merger commitment in this instance represents a unique precedent in the FCC's ability to extract concessions from firms seeking a favorable disposition from the Commission. Indeed, the Commission did not merely require Comcast to promise to support (and subsequently not appeal) an FCC order with significant political implications (a common tactic inherent to FCC advocacy); rather, the Commission required a regulated entity to agree to be bound by rules even if a reviewing court subsequently overturns those regulations. In so doing, the Commission used "voluntary" merger commitments as a way to insulate itself from potentially adverse appellate review. (The FCC's *2010 Open Internet Order* was subsequently reversed and remanded by the D.C. Circuit.[54]) Since larger telecommunications providers are

---

[51] *See, e.g.,* S. Gustin, *Telecom Giants Cheer FCC Plan, Net Neutrality Advocates Aren't Amused, Wired* (December 1, 2010) and citation therein (available at: http://www.wired.com/2010/12/net-neutrality-reaction/#seealso0c607a9171f17331e5f96c6406550657).

[52] *Comcast/NBCU Merger Order, supra* n. 47 at ¶ 94.

[53] *Id.* at fn. 213.

[54] *Verizon v. FCC*, 740 F.3d 623 (D.C. Cir. 2014).

frequently involved in mergers and acquisitions—e.g., AT&T has been formally engaged in such activity for 75% of months over the last 10 years—regulation by "voluntary commitment" may be the primary and most potent form of regulatory control used by the Commission.

F. *Lightsquared "Voluntary" Merger Commitment to Impose de facto Spectrum Caps*

Another interesting (but less well-known) case study can be found in the FCC's disposition on Delegated Authority of the license combinations required to create the firm that is now known as "Lightsquared." There, Harbinger Capital Partners sought to acquire Mobile Satellite Service ("MSS") provider SkyTerra.[55] Although the respective Chiefs of the International Bureau, the Wireless Bureau, and the Office of Engineering and Technology raised serious concerns about the merged entity's potential dominance of the MSS market (including a finding that Harbinger had ownership positions in MSS competitor TerreStar, along with a variety of other wireless competitors), what apparently tipped the Bureau Chiefs' hands was their acceptance of the merged entity's promise to build a "4G" terrestrial (as opposed to satellite) wireless network that will provide coverage in the United States to at least 100 million people by December 31, 2012, at least 145 million people by December 31, 2013, and at least 260 million people by December 31, 2015.[56]

While one can certainly see the appeal of Harbinger's offer, this was not the end of the story. As an additional "voluntary commitment," the merged entity agreed to adopt a *de facto* spectrum cap on two other wireless carriers uninvolved in the transaction without an opportunity for public notice and comment.[57] In particular, Harbinger first promised that, should it seek to make spectrum available "to either of the two largest terrestrial providers of CMRS and

---

[55] *In the Matter of SkyTerra Communications, Inc. and Harbinger Capital Partners Funds, Applications for Consent to Transfer of Control,* DA 10-535, 24 FCC Rcd 3059, MEMORANDUM OPINION AND ORDER AND DECLARATORY RULING (Rel. March 26, 2010) (hereinafter the *Harbinger Order*).

[56] *Id.* at ¶ 46.

[57] Indeed, although the *ex parte* presentations containing voluntary commitments were made on March 26, 2010, the Commission did not post these *ex parties* on EDOCs until March 29th—*three days after the order was released on delegated authority. See* March 26, 2010 letter to Marlene Dortch from Henry Goldberg, *et al.* (available at http://fjallfoss.fcc.gov/ecfs/document/view?id=7020397552). Thus, it was impossible by administrative fiat to for the public to have an opportunity to comment on Harbinger's "voluntary commitment" of a *de facto* spectrum cap.

broadband services," the merged entity would need to obtain Commission approval. Second, the merged entity would be required to live up to the buildout schedule proposed in the order. Finally, the merged entity would first obtain Commission approval before allowing traffic to the two largest terrestrial providers' accounts to amount to more than twenty five percent (25%) of SkyTerra's total traffic on its terrestrial network in any Economic Area.[58] Not only did these "voluntary commitments" have no apparent connection to any specific anticompetitive harm revealed by the Bureau Chiefs' competitive analysis, but in light of the fact that LightSquared's stated business plan is to provide wholesale capacity to retail carriers, this *de facto* spectrum cap seemed odd indeed. And, as noted just above, most troubling is the fact that this "voluntary" commitment was negotiated and adopted behind closed doors on the day the order was released, so that the public had no ability for notice and comment.[59] Thus, this *de facto* "spectrum cap"[60] illustrates that the Commission may not hesitate to use "voluntary" commitments instead of rules of general applicability to modify market structure in mobile communications by limiting access to spectrum resources by some or all incumbent firms. Also, the administrative manner in which these conditions were imposed may raise questions about the integrity of the agency's administrative process.

G. *Univision Children's Television Consent Decree*

In 2007, Broadcasting Media Partners sought to acquire Spanish-language broadcaster Univision Communications. Standing in the way of the transaction were petitions from both the United Church of Christ and the National Hispanic Media Coalition to deny the license renewal of two of the stations involved in the deal for allegedly failing to provide adequate children's television programming. In particular, the petitioners claimed that Univision tried to pass off various "telenovelas" as educational television.[61] To resolve this matter and allow the

---

[58] *Harbinger Order, supra* n. 55 at ¶ 72.

[59] *Id.* at ¶ 72.

[60] The Harbinger Decision is plainly a backdoor attempt to regulate indirectly by adjudication rather than by industry-wide rulemakings. On such matters, *see, e.g.*, Koutsky and Spiwak, *supra* n. 3, and *FCC Commissioner Meredith Attwell Baker, Towards a More Targeted and Predictable Merger Review Process (March 3, 2011) (available at:* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-304946A1.pdf*) citing id.*

[61] *In re Univision and Broadcasting Media Partners,* FCC 07-24, 22 FCC Rcd 5842, MEMORANDUM OPINION AND ORDER (rel. March 27, 2007). FCC Chairman Kevin Martin described

(Footnote Continued. . . .)

deal to close, Univision entered into a consent decree with Commission under which Univision agreed both to make a "voluntary contribution to the United States Treasury" in the amount of $24 million and to set forth a detailed plan to ensure further compliance with Commission rules going forward. While not the only case, this transaction was one of few where a consent decree was formally part of the Commission's merger decision.[62]

H. *XM/Sirius "Voluntary" Commitment to Lease Channel Capacity to Qualified Entities*

In 2007, Sirius Satellite Radio and XM Satellite Radio filed a petition to merge into a single entity which would ultimately control all of the SDARS licenses in the United States. Taking advantage of the pressure to close the deal, two public interest groups pressed the FCC to mandate some sort of leased access regime patterned after the system used in cable television. While the applicants originally opposed such proposals, they eventually capitulated and submitted a "voluntary" commitment which, among other things, committed them to enter into long-term leases or other agreements to provide, among other things, "Qualified Entity" rights to four percent (4%) of the full-time audio channels on the Sirius platform and on the XM platform, respectively (which then represented six channels on the Sirius platform and six channels on the XM platform), and to enter into such leases within four months of the consummation of the merger.[63] The Commission went on to define a "Qualified Entity" as "any entity that is majority-owned by persons who are African American, not of Hispanic origin; Asian or Pacific Islanders; American Indians or Alaskan Natives; or Hispanics."[64] According to the Commission, it was its hope that this "voluntary" commitment "addresses the concerns voiced by Media Access Project, Public Knowledge, and others [including several powerful politicians who filed letters with the Commission] who contend that the consolidation of the

---

these "telenovelas" as something "similar to teen soap operas and not educational in nature." Chairman Martin Separate Statement, *id.*

62 *See* discussion of XM/Sirius Merger, *infra* Section III.H.

63 *In the Matter of Applications for Consent to the Transfer of Control of Licenses XM Satellite Radio Holdings Inc., Transferor To Sirius Satellite Radio Inc., Transferee,* FCC 08-178, 23 FCC Rcd 12,348, MEMORANDUM OPINION AND ORDER AND REPORT AND ORDER (rel. August 5, 2008) at ¶¶ 133-134.

64 *Id.* at ¶135, n. 437.

SDARS service to a single provider will harm programming diversity."[65] The condition appears nakedly aimed at placating political interest groups.[66]

Yet, implementation of these "voluntary" commitments would prove harder than the Commission expected. After two years of intense wrangling, the Commission in 2010 finally issued an order to address the implementation details of XM/Sirius' "voluntary commitments" to lease channel capacity to Qualified Entities as a condition of the Commission's approval of the merger. Facing sound arguments about Constitutional concerns regarding the Equal Protection Clause, the Commission backed away from its use of a "race-conscious" standard fearing it would inevitably lead to litigation and "delay implementation of this important public interest benefit."[67] As such, The Commission reversed itself and adopted a definition of Qualified Entity that was unambiguously "race-neutral."[68]

I. *AT&T/Direct TV Merger and the 2015 Open Internet Rules*

With the D.C. Circuit's remand of the FCC's first attempt to write legally defensible net neutrality rules in *Verizon FCC*,[69] the Commission in May 2014 launched a proceeding to take a second bite at the apple[70]—ultimately culminating in the agency's reclassification of both wireline and wireless Internet access service as a common carrier "telecommunications" service under Title II in March 2015. Given the extreme politicization of this fight (including direct and

---

65 *Id.* at ¶ 135 and n. 442.

66 It should be noted that in order to close this deal, both XM and Sirius also respectively entered into consent decrees—included as part of the Commission's merger approval order—to terminate the agency's investigations into Applicants' compliance with the Commission's regulations governing FM modulators and the terms of their authorizations for their terrestrial repeaters. As with many other consent decrees, the applicants each agreed to make a substantial "voluntary contribution" to the U.S. Treasury. *Id.* at Section VII.

67 *Id.* at ¶ 9 (citing comments of Progress and Freedom Foundation and comments of Free State Foundation President Randolph May).

68 *In the Matter of Applications for Consent to the Transfer of Control of Licenses XM Satellite Radio Holdings Inc., Transferor To Sirius Satellite Radio Inc., Transferee*, FCC 10-184, 25 FCC Rcd 14-779, MEMORANDUM OPINION AND ORDER (rel. October 19, 2010) at ¶¶ 9-10.

69 *Verizon v. FCC*, 740 F.3d 623 (D.C. Cir. 2014).

70 *Protecting and Promoting the Open Internet*, REPORT AND ORDER ON REMAND, DECLARATORY RULING, AND ORDER, FCC 15-24, 30 FCC Rcd 5601, 80 Fed. Reg. 19738 (rel. Mar. 12, 2015) (hereinafter "*2015 Open Internet Order*").

intensive political pressure from the White House[71]), anyone opposed to such reclassification yet at the same time requiring the Commission's favor during this time period inevitably opened themselves up to a significant risk of issue bundling from the Commission. Such was the case of the AT&T/DirecTV merger.[72]

On June 1, 2014, AT&T sought Commission approval for its merger with DirecTV. However, while it was trying to convince the Commission of the merits of the transaction, at the same time AT&T vigorously fought against the Commission's efforts to reclassify broadband Internet access as a Title II common carrier. Although the Commission ultimately found no competitive problems and approved the merger of AT&T and DirecTV in July 2015 (two months after the adoption of the *2015 Open Internet Rules*), the FCC nonetheless imposed a series of "conditions" that can be traced directly back to the bitter Open Internet fight.[73]

Significantly, while issue bundling again occurred in this merger, it did not take its traditional form—i.e., the "*voluntary*" merger commitment, even though the merged entities went by the "playbook" and proposed a variety of "voluntary" conditions to curry the regulator's favor.[74] Instead, in a radical departure from past mergers (and perhaps reflecting a sensitivity to years of

---

71 *See, e.g.*, L.J. Spiwak, *The "Clicktivist" In Chief*, The Hill (November 12, 2014) (available at: http://thehill.com/blogs/pundits-blog/technology/223744-the-clicktivist-in-chief).

72 *In re Application of AT&T and DirecTV for Consent to Assign or Transfer Control of Licenses and Authorizations*, MEMORANDUM OPINION AND ORDER, FCC 15-94, __ FCC Rcd __ (rel. July 28, 2015) (hereinafter "*AT&T/DirecTV Order*").

73 In addition to the net neutrality-related merger conditions, the Commission again took the opportunity to force a merger applicant to "make available an affordable, low-price standalone broadband service to low-income consumers in the combined entity's wireline footprint." *AT&T/DirecTV Merger Order, id* at ¶ 397. Unlike accepting a similar $10/month program as a "voluntary" commitment (as it did in the Comcast/NBCUniversal and AT&T/Bell South deals), however, the agency in this case reasoned that it was necessary to impose this condition on the merger in order to "ensure that a bundle of video and broadband services is not the only competitive choice for low-income subscribers who may not be able to afford bundled services" even though the Commission specifically found that "the availability of better and lower priced bundles of video and broadband service" would result from the merger. *Id.* As a result, just as in the AT&T/Bell South and NBC/Universal deals, the Commission used a merger proceeding to impose *de facto* rate regulation on retail broadband service in order to serve a favored political constituency.

74 *See* AT&T/DirecTV Public Interest Statement (June 11, 2014) (available at: http://licensing.fcc.gov/myibfs/download.do?attachment_key=1050160).

criticism for abusing the "voluntary" commitment mechanism), the Commission engaged in analytical gymnastics to characterize the cooperative bargaining as conditions necessary to remedy a specific merger-related harm. Still, as the acquisition was a key building block for AT&T's business plan of the future, AT&T was willing to accept these conditions rather than walk away from the deal.

1. *Buildout Requirements to Show that Title II Does not Deter Investment*

Two years prior to the transaction's announcement, AT&T indicated that it had aggressive plans to expand its fiber network across its service area dubbed "Project Velocity IP ("Project VIP").[75] Among other plans, AT&T intended to deploy its U-Verse service using Fiber to the Premises ("FTTP") offering speeds up to 1 Gbps in up to 25 metropolitan areas. When the merger was announced, AT&T stated to the Commission that merger-related efficiencies would allow it to deploy FTTP to at least 2 million more customer locations than could be economically justified without the transaction's synergies.[76] However, while the merger review was pending, the Commission was coming under direct pressure from the White House to reverse nearly two-decades of applying a light touch to the Internet by reclassifying broadband as a Title II common carrier telecommunications service.[77] In a speech on November 12, 2014, Randall Stephenson, AT&T's CEO, announced that AT&T would pause its investments to bring fiber connections to 100 cities until the Commission resolved issues related to the Open Internet proceeding. Mr. Stephenson was quoted as saying, "We can't go out and invest that kind of money deploying fiber to 100 cities not knowing under what rules those investments will be governed."[78] Mr. Stephenson's message to the Commission was clear: if the Commission proceeds with reclassification, then investment will decline.

---

[75] Press Release: *AT&T to Invest $14 Billion to Significantly Expand Wireless and Wireline Broadband Networks, Support Future IP Data Growth and New Services* (November 7, 2012) (available at: http://www.att.com/gen/press-room?pid=23506&cdvn=news&newsarticleid=35661&mapcode=).

[76] *AT&T/DirecTV Order, supra* n. 72 at ¶¶ 316-318.

[77] Spiwak, *supra* n. 71.

[78] M. Lopes, *AT&T to Pause Fiber Spending On Net Neutrality Uncertainty*, REUTERS (November 12, 2014) (available at: http://www.reuters.com/article/2014/11/13/us-at-t-regulations-internet-idUSKCN0IW1JC20141113).

Immediately after Mr. Stephenson's speech, on November 14, 2014, the Commission sent a letter to AT&T requesting an explanation of AT&T's statement. Given that it still needed to have the Commission approve its merger, AT&T walked itself back from the cliff, noting that it was not limiting its FTTP deployment to 2 million homes and that, in fact, it plans to complete its previously announced FTTP expansion in 25 major metropolitan areas nationwide. AT&T stated, however, that the uncertainty regarding regulatory treatment of broadband "makes it prudent to pause consideration of any further investments—beyond those discussed … AT&T simply cannot evaluate additional investment beyond its *existing commitments* until the regulatory treatment of broadband service is clarified."[79]

In an apparent retaliation to Mr. Stephenson's shot across the bow regarding Title II reclassification, the Commission imposed a rather unique condition upon the merger. Finding that AT&T would have a disincentive to deploy FTTP after the merger for fear that it would "cannibalize" its revenues from DirecTV, the Commission imposed a stringent FTTP buildout requirement as a condition of the merger. However, this buildout requirement was not limited to the additional 2 million customers that the merger's synergies would allow AT&T to pay for such additional construction, but to AT&T's previously announced 2012 plans to add a total of 12.5 million customer locations.[80] Significantly, the Commission required AT&T to meet this buildout requirement within four years.[81] In so doing, assuming the Commission's *2015 Open Internet Order* withstands judicial scrutiny, the agency now has a guaranteed political talking point four years hence that Title II does not deter infrastructure investment.

2. *A "Second Bite" at the 2015 Open Internet Rules*

As noted above, on March 12, 2015 the Commission released its controversial *2015 Open Internet Rules*, and three months later it approved the merger of AT&T and DirecTV. Although the Commission did not require a Comcast/NBCUniversal-type requirement that the merged entity adhere to the *2015 Open Internet Rules* even if they are eventually thrown out in court, the agency nonetheless used the opportunity to impose on the merged entity a variety of regulatory requirements that the Commission could have imposed in

---

79 *AT&T/DirecTV Order, supra* n. 72 at ¶ 343.

80 *Id.* at ¶ 326; ¶ 343.

81 *See id.*, Appendix B, Section III.2.

the generic *Open Internet* rulemaking proceeding but for whatever reason chose not to.

For example, in its *2015 Open Internet Order*, the Commission could have, but specifically chose not to, ban data caps. However, to prevent AT&T post-merger from using such practices "to hinder the development of third-party [over-the-top video providers] as a competitive option to its own offerings", the Commission imposed as a condition of the merger a requirement that the "combined entity … refrain from discriminatory usage-based allowance practices for its fixed broadband Internet access service."[82] If data caps are really so bad, however, then the Commission should have applied this prohibition industry-wide.

Similarly, interconnection was also off the table in the Commission's *2015 Open Internet Order*.[83] However, finding that the transaction "increases the risk that the combined entity will use interconnection agreements to limit competing online video content and OVDs", the Commission concluded that the "future disclosure of such agreements to the Commission are necessary to address the increased risk of anticompetitive practices by the combined entity." As such, as a condition of the merger, the Commission took the unprecedented step of requiring the merged entity to disclose all of its interconnection agreements to the Commission for four years after closing."[84]

But the Commission did not stop there. In addition to forcing the merged entity to file all of its interconnection agreements with the Commission for four years after closing, the Commission also required as a condition of the merger that AT&T retain—at its own expense—both an internal company compliance

---

[82] *Id.* at ¶ 396.

[83] *See 2015 Open Internet Order, supra* n. 70 at ¶ 30 ("[T]his Order does not apply the open Internet rules to interconnection.")

[84] *AT&T/DirecTV Order*, *supra* n. 72 at ¶ 396. Commissioner Pai was quite critical of this requirement, arguing that

> This government-mandated surveillance is entirely unnecessary and is just another step towards putting the FCC at the core of the Internet. It has been said that the Commission's Title II order makes the FCC the referee on the field, ready to throw the flag whenever a broadband service provider does something that it doesn't like. This condition goes beyond that and injects the FCC into the huddle, monitoring a team's play calling.

Id., Statement of Commissioner Ajit Pai, Approving In Part And Dissenting In Part.

officer and an independent, external compliance officer that will report and monitor the combined entity's compliance with the various conditions imposed by this order.[85] As Commissioner Pai argued in his dissent, such an "extraordinary" condition

> establishes a dangerous precedent. I have little doubt that when we consider future transactions, there will be calls for future applicants to accept Independent Compliance Officers as a condition of approval. Virtually any transaction involving companies we regulate could result in the injection of a Commission-selected solon with vast powers. Government-approved monitors placed throughout the communications industry would represent a pernicious intrusion into the affairs of private businesses and a dramatic expansion of the Commission's authority.[86]

IV. An Economic Analysis of Issue Bundling

While representing only a tiny part of the regulatory activity at the FCC, the examples above reveal that regulation today often does not fit the non-cooperative or principal-agent type models typically found in the economic analysis of regulation. Instead, regulation involves bargaining between the regulator and the regulated firms across multiple issues.[87] In some cases, this bundling of issues binds firms to actions that could be beyond the Commission's authority (or its patience) to implement in the normal way. Given the widespread practice of issue bundling and the bargaining nature of modern regulation, it seems natural to investigate the practice in the context of a bargaining game. Of course, not all regulatory decisions involve issue bundling,

---

85 *AT&T/DirecTV Order*, *supra* n. 72 at ¶ 149.

86 *Id.*, Dissent of Commissioner Pai.

87 A more complex model could involve Congress, or even the Executive Branch (*see, e.g.*, L.J. Spiwak, *The "Clicktivist" In Chief,* THE HILL (November 12, 2014) (available at: http://thehill.com/blogs/pundits-blog/technology/223744-the-clicktivist-in-chief) (observing that rather than provide a detailed proposal on how a Title II "Lite" regime might work, the White House instead opted to foment a "clicktivist" campaign to politically pressure an independent administrative agency); G.S. Ford and L.J. Spiwak, *Lessons Learned from the U.S. Unbundling Experience,* PHOENIX CENTER POLICY PAPER NO. 45 (June 2013) (noting how the George. H.W. Bush Administration refused to seek *certiorari* at the Supreme Court of the D.C. Circuit's ruling in *USTA II*, thus effectively ending the unbundling paradigm contained in the Telecommunications Act of 1996) (available at: http://www.phoenix-center.org/pcpp/PCPP45Final.pdf).

and not all instances of issue bundling are intended to test or surpass the authority of the regulator. Nevertheless, issue bundling occurs frequently enough, and occurs regularly when the stakes are high, to warrant further attention.

Bargaining when multiple issues are relevant to the welfare of the involved parties has been analyzed in the economics literature in several ways. Most analysis to date adopts the non-cooperative, alternating-offer set-up.[88] Particular interest focuses on the roles of time preference and the nature of informational imperfection on the resulting equilibria. Often, the construction of the "agenda"—i.e., the order in which issues are addressed—is a significant component of agent strategy. Although the variation in approaches adopted to date make generalizations hazardous, it is safe to say that, in general, combining multiple issues into a single contracting procedure affects the outcomes when compared to atomistic negotiation. In the literature there are at least two distinct senses in which one can speak of multiple issues affecting the results of bargaining: issues can be formally tied (so, for example, the outcome of one bargain affects the payoffs from a subsequent bargain), or agent behavior in one bargaining session might be informative, causing other agents to update their beliefs in later rounds.[89]

---

[88] A. Rubinstein, *Perfect Equilibrium in a Bargaining Model*, 50 ECONOMETRICA 97–109 (1982); C. Avery & T. Hendershott, *Bundling and Optimal Auctions of Multiple Products*, 67 REVIEW OF ECONOMIC STUDIES 483-97 (2000); M. Bac & H. Raff, *Issue-by-Issue Negotiations: The Role of Information and Time Preference*, 13 GAMES AND ECONOMIC BEHAVIOR 125-34 (1996); R. Eilat & A. Pauzner, *Optimal Bilateral Trade of Multiple Objects*, 71 GAMES AND ECONOMIC BEHAVIOR 503-12 (2011); C. Fershtman, *The Importance of the Agenda in Bargaining*, 2 GAMES AND ECONOMIC BEHAVIOR 224-38 (1990); G. Gayer & D. Persitz, *Negotiation across Multiple Issues*, Working Paper, Tel Aviv University (2014).

[89] Coconi and Perroni (2002) consider multilateral negotiations in an international economic context, and examine the incentives for actors to introduce "linkages" between different issues of mutual concern. They envision a two-stage game in which nations can make binding commitments of certain sorts in the first stage, and then behave non-cooperatively in stage 2. They find that issue tie-ins sometimes, but not always, affect outcomes. P. Conconi and C. Perroni, *Issue Linkage and Issue Tie-in in Multilateral Negotiations*, 57 JOURNAL OF INTERNATIONAL ECONOMICS 423-447 (2002). The incentives of agents to act so that bundling of issues arises endogenously is examined by Inderst (2000), and it is found that, given the incentive structure of his non-cooperative bargaining protocol, bundling of issues is an expected result. R. Inderst, *Multi-Issue Bargaining with Endogenous Agenda*, 30 GAMES AND ECONOMIC BEHAVIOR 64-82 (2000). *See also* L.A. Busch & I. Horstman, *The Game of Negotiations: Ordering Issues and Implementing Agreements*, 41 GAMES AND ECONOMIC BEHAVIOR 169-91 (2002) and S. Fatima, M. Wooldridge, & N. Jennings, *An Agenda-based Framework for Multi-issue Negotiations*, 152 ARTIFICIAL INTELLIGENCE 1-45 (2004).

In this PAPER, we adopt the *cooperative bargaining approach* to analyzing regulation. This is a conscious and consequential choice. In the traditional economic modeling of regulation, regulators either act as principals (who have goals and view firm recalcitrance as a form of constraint on their ability to pursue them), or, more generally, regulation is viewed as a non-cooperative game between regulator and regulated. However, the current understanding in game theory stresses the underlying unity of the cooperative and non-cooperative scenarios: associated with any non-cooperative game is an extension that incorporates the ability of coalitions of players to coordinate their strategies. In the "real world" of regulation, the conflicting interests of the regulator and the regulated exists within a legal environment in which binding contracts are available. Although previously quite rare, legal agreements in the form of "voluntary commitments" between the regulator and the firm are now extremely common, though we suspect more informal agreements have been around for some time. We believe this evolution in regulation toward more formal contractual bargains is among the most important developments in the last two decades, and bargaining over such binding agreements is naturally modeled as a cooperative bargaining game. We believe the cooperative bargaining game is also useful for analyzing regulation more generally, even in cases where issues are bundled in a less formal and less explicit way (including the use of Consent Decrees, which are a somewhat modern approach to regulatory enforcement).

Perhaps the papers of most immediate technical relevance to the present article are those of Ponsati and Watson (1997) and Peters (1985).[90] Ponsati and Watson, in particular, provide a detailed description of the geometry underlying two-issue cooperative bargaining games and provide a strong justification for our use of the Nash bargaining solution for our analysis.[91] In particular, the Nash solution is the only one that satisfies a form of agenda independence (so the order in which individual issues is resolved is irrelevant under sequential schemes) for games in which the bargaining sets for multiple issue bargaining are obtained through addition of the individual issue bargaining sets, a procedure examined by Peters (1985).

---

[90] C. Ponsati & J. Watson, *Multi-issue Bargaining and Axiomatic Solutions*, 26 INTERNATIONAL JOURNAL OF GAME THEORY 501-24 (1997); H. Peters, *A Note of Additive Utility and Bargaining*, 17 ECONOMICS LETTERS 219-22 (1985).

[91] J. Nash, *Non-Cooperative Games*, 54 THE ANNALS OF MATHEMATICS: SECOND SERIES 286-295 (1951).

A. *A Simple Model*

As our primary goal is to illustrate the regulatory consequences of the growing practice of multi-issue negotiation, particularly as practiced recently at the FCC, we will specify the most parsimonious model which captures the contemplated effects. We intend only to lay the groundwork for research on this complex issue. Thus, we make the following simplifying assumptions:

A1. There are two agents, a profit-maximizing firm F and a politically-controlled regulator R;

A2. There are two structurally unrelated issues, X and Y, over which bargaining will occur;

A3. Payoffs for a joint bargaining outcome are identified as the sum of the payoffs from the individual issues resolved in the joint bargain; and

A4. The outcome of bargaining is described by the Nash axioms. Thus, all bargaining solutions will be Pareto optimal, invariant to affine transformations of utility, and so on.

We go further with some additional simplifications motivated by the particular nature of the relationship being analyzed. In particular, we will interpret the firm's payoffs as profits. In contrast, the regulator R will have somewhat more complex preferences, reflecting the political nature of regulation.

There are two structurally-unrelated bargains, X and Y. Let x denote the relevant variable in bargain X. In keeping with the traditional approach of analyzing economic regulation, we interpret x as an index measuring how close the outcome is to the perfectly competitive outcome (e.g., zero economic profit). Thus, $x = 1$ denotes a completely competitive outcome, while $x = 0$ denotes the most preferred outcome of the for-profit firm (e.g., the monopoly profit). We can therefore take the payoffs of the players in bargain X to be given by:

$$U_F = 1 - x, \quad U_R = x, \quad 0 \le x \le 1 \tag{1}$$

where U_F is the firm's and U_R the regulator's payoff (or utility). Hence, the firm's most favored outcome is x equal to zero (indicating a monopoly profit of 1), and the regulator most favored outcome in X is x equal to 1 (indicating the competitive profit of 0).

We do not envision our problem, however, as solely one involving an argument over the level of profits (and, along the Pareto frontier, consumer

surplus). Rather, the regulator, being a political actor with a mandate from the legislature and leadership appointed by the executive, has preferences over one issue which cannot be described quite so easily. We will assume, in fact, that for bargain Y the outcome variable y produces utility for the regulator R according to the function y^{θ}, where $0 < \theta < 1$. The regulator's payoffs are non-linear and concave. Thus, payoffs for issue Y with resolution y are:

$$U_F = 1 - y, \quad U_R = y^{\theta}, \quad 0 \le y \le 1 \tag{2}$$

This particular formulation of the regulator's payoff in bargain Y creates a different marginal rate of substitution for the regulator and the firm. The firm is concerned only with profit, a condition that justifies the simple linear payoff. In contrast, the regulator's interest in issue Y is not simply about profit (as it is for X), but is more nuanced. Bargain Y represents a more politically-sensitive issue. The curvature of the regulator's payoff function indicates that the regulator gains value very rapidly for relatively small sacrifices of the firm's profit level.[92] The marginal value for the regulator diminishes rapidly as the value of y becomes larger. We can potentially think about Y as involving issues like the geographic ubiquity of service or low-income support. Settlements of politically-sensitive enforcement issues may also fall under such a structure. Consequently, the marginal rates of substitution across values of y will differ between the regulator and the firm in that the firm cares only about profit but the regulator may have other concerns. Our chosen specification is a simple one that permits that difference.[93]

From the firm's point-of-view, payoffs are most naturally seen as profits. Profits, of course, are simply additive so the firm, in principle, would trade a dollar of profit from one market or activity for a dollar of profit from another. This one-to-one substitution, however, clearly cannot apply to the regulator: a change in the profit the firm earns in one market cannot be offset by an opposite change in another. This is because the regulator has concerns above and beyond firm profit, such as consumers' surplus or the like, and such surplus is not linear in profits. The present formulation, which introduces this nonlinearity only in one market, is merely the simplest example possible of this general fact.

---

92 For example, in the Madison River case (*infra* Section III.B), the FCC reaped the sizeable benefit of an unchallengeable action on "network neutrality" while the company incurred a fine of only $15,000.

93 There are other specifications that would do the same.

1. *Separate Bargains*

We begin by noting that the Nash bargaining outcomes for the individual issues *X* and *Y* are easily obtained as those values x_S^* and y_S^* that maximize the Nash products which, with zero disagreement payoffs, are just:

$$x_S^* = \frac{1}{2}, \quad y_S^* = \frac{\theta}{1+\theta} \tag{3}$$

The resulting utilities from *X* and *Y* are given by:

$$\sum U_F = \frac{1}{2} + \frac{1}{1+\theta}, \tag{4}$$

$$\sum U_R = \frac{1}{2} + \left(\frac{\theta}{1+\theta}\right)^{\theta}. \tag{5}$$

Notice that the solution to the *Y* issue bargain depends on the parameter θ for both the regulator and the regulated. We note that this formulation has two simple consequences. First, the fractional exponent enters a degree of curvature to the regulator's payoff in regards to issue *Y*. Second, except at the extreme values of 0 or 1, y^{θ} exceeds *y* for any value of θ. These two factors allow the firm to extract more than a half-unit of payoff from the bargain over issue *Y*. Further, the firm extracts a larger payoff than the regulator. The curvature in the regulator's payoff for issue *Y* places him at a disadvantage in the bargain over this isolated issue. Although a very simple formulation of payoffs, this specification introduces the variation in payoff evaluation that produces significantly different results when the issues *X* and *Y* are bundled.

2. *The Joint Bargain*

We turn next to the joint bargaining problem. Our normalization of firm profits across the two issues implies here that each issue is of equal potential importance to the firm. For example, if *X* and *Y* reflect different markets subject to price regulation or forbearance, then these markets are of identical potential profitability. However, the regulator, by design, does not regard these two issues are essentially identical. Bargain *Y*, as we have discussed, might represent regulation in regards to a politically sensitive issue.

In the joint bargaining problem (indicated by subscript *J*), the players have payoffs given by:

$$F_J = (1-x) + (1-y), \quad R_J = x + y^{\theta}. \tag{6}$$

The solution to the corresponding Nash bargaining problem leads to the following outcomes:

$$x_J = 1 - \tfrac{1}{2}(1+\theta)\theta^{\frac{\theta}{1-\theta}}, \quad y_J = \theta^{\frac{1}{1-\theta}}. \tag{7}$$

We note immediately that the joint solutions in Expression (7) do not correspond in general to the individual bargaining outcomes in Expression (3), a result in keeping with most previous models of joint bargaining. However, consistent with intuition and of some importance for what follows, we see that the joint bargain in issue X, x_J, depends on θ unlike in the individual case. Thus, even though the issues X and Y are logically independent, bargaining over both together causes the nature of the Y bargaining problem to "spill over" into the X bargaining problem. Given the discussion in the prior section, we may say that the concern over low-income Internet adoption has spilled over into a media merger, for example.

3. *Welfare Effects*

We turn finally to the welfare consequences of the joint bargain. Because we envision a regulator who may entertain politically-driven evaluations of outcomes (i.e., R may care about issues that are not identically identified with surplus or profit calculations), we cannot really speak of "social welfare" in this context. The utilities of the firm and the regulator cannot be simply added together to obtain an aggregate utility. However, we may certainly evaluate the welfare of the individual actors from their own points-of-view.

Denoting the welfare of the parties under the joint bargain as R_J^* and F_J^* for the regulator and firm, respectively, we obtain the result:

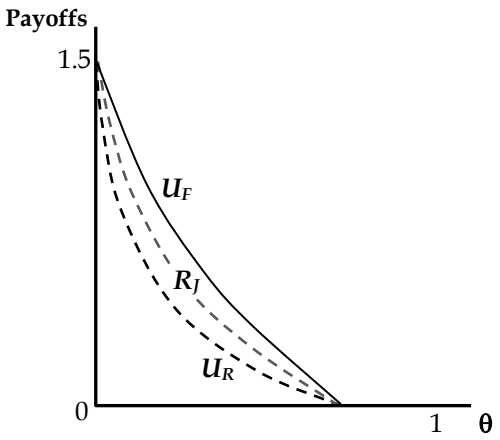
$$R_J^* = F_J^* = 1 + \tfrac{1}{2}(1-\theta)\theta^{\frac{\theta}{1-\theta}} \tag{8}$$

Note that the welfare of both parties is driven to "equality" in the joint bargain. Importantly, Expression (8) reveals that the distinct disadvantage of the regulator caused by the curvature in the Y issue payoff is neutralized by combining the X issue into the bargain. The equal footing that the firm and the regulator have on the X issue forces the payoffs to be equal in the joint bargain. The first-order condition on x for the joint Nash product generates the necessary condition of equal payoffs: $R_J^* = F_J^*$.

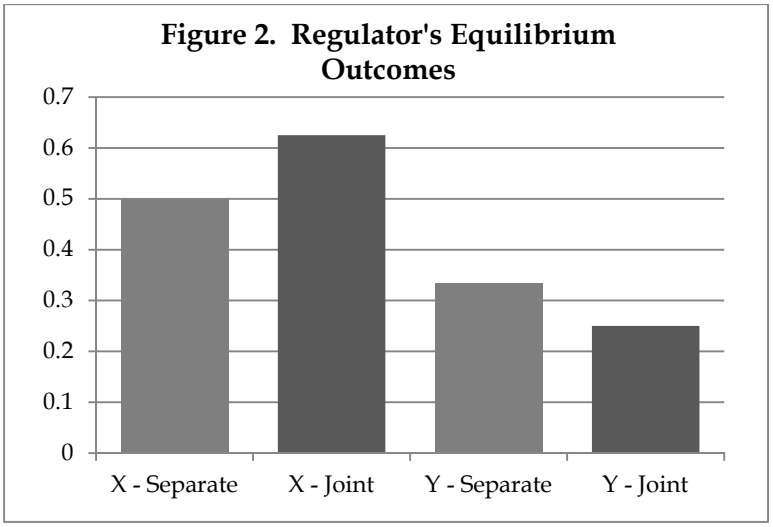
In this model, the firm enjoys greater welfare overall when the issues are bargained separately, i.e., it suffers in the relative welfare sense from bundling of the negotiations into a single agreement. For example, when $\theta = 1/2$, we have

$\sum U_F = {}^{7}/_{6}$ from Expression (4) while from Expression (8) we have $F_J^* = {}^{9}/_{8} \leq {}^{7}/_{6}$. The firm prefers separate bargains. The opposite conclusion is reached in the case of the regulator since from Expressions (5) and (8) we have $R_J^* > \sum U_R$. Hence, the regulator unambiguously prefers that the separate issues be bundled together and that a single "grand bargain" be struck. The joint bargain eliminates the disadvantage that the regulator has due to the curvature in his issue *Y* payoff, and creates an averaging effect in terms of the payoff of the firm and the regulator.

Figure 1. Payoffs



This averaging effect is illustrated in Figure 1, where the payoffs of the firm and regulator are measured on the vertical and θ on the horizontal axes. As our analysis revealed at Expressions (4) and (5), when the two issues are resolved independently, the utility of the regulator, U_R, and the utility of the firm U_F, are different and the firm has a higher payoff (over all but the boundary values of θ). With issue bundling, in contrast, Expression (8) shows that the payoffs are the same for the firm and the regulator at R_J. For the firm, bundling reduces its payoff from U_F to R_J while for the regulator the payoff rises from U_R to R_J. Plainly, in this scenario, the regulator is better off and the firm worse off under issue bundling.



The impact of issue bundling can also be seen by examining the equilibrium outcomes for the two issues. Figure 2 illustrates the change in the issue outcomes due to joint bargaining. Consider once again the computationally simple example of θ equal to one-half. When the two issues are bargained over separately, issue *X* reaches the balanced outcome of $x_s^* = \frac{1}{2}$. However, issue *Y* results in an equilibrium outcome skewed against the regulator with $y_s^* = \frac{1}{3}$. The combining of the two issues into a joint bargain generates a further sacrifice of issue *Y* by the regulator, but with a substantial gain in terms of issue *X*. Indeed, the equilibrium issue outcomes under joint bargaining are $x_J = \frac{5}{8}$ and $y_J = \frac{1}{4}$. Most of the regulator's payoff surrounding the politically sensitive issue *Y* is achieved at relatively small levels of sacrifice for the firm, thus making the regulator willing to make further sacrifices on issue *Y* in order to achieve larger gains on issue *X*.

An analogy may help clarify the theoretical analysis. Imagine a professional baker and his brother engaged in two bargains. In the first bargain, the two brothers will split a stack of money and both value money the same. In the second, the two will split a blueberry pie. For the baker, each piece of pie can be sold for, say, $5 each, so his preference for pie is linear: the value of *n* pieces of pie retained by him is $5*n*. His brother, however, values pie only in its eating, and is easily satiated with just a few pieces. The brother's preferences are thus non-linear. (Here, the brother plays the role of the regulator since his preferences are non-linear.) If the bargains are separate, then the money is split evenly (in a Nash Bargain) and the brother only asks for, say, three pieces of pie which is more than he'll likely finish. When the two bargains are bundled, however, the brother will take only two pieces of pie in exchange for a greater share of the

money, since the third slice provided only a small benefit. The baker-brother is willing to take the deal, since the pie has market value unrelated to his personal consumption of pie.

B. *Generalizations*

The specification of the model used to demonstrate the consequences of issue bundling can be generalized in several ways without affecting our basic conclusions. Perhaps the most important generalization involves altering the payoff to the regulator to introduce nonlinearity in *both* issues. For example, we might take the regulator's payoffs to be x^{α} and y^{θ} for example, where, with no loss of generality, we may take $1 > \alpha > \theta > 0$. Thus, the regulator's preferences are more complex than those of the firm (which cares, by assumption, only about profits) in both issues.

In this case, closed-form solutions for the joint bargain are not available, and the problem must instead be solved for numerically using a computer. However, such analysis shows that this sort of complication has no qualitative effect on the results: so long as $\alpha > \theta$, then the bargain over the outcome indexed by "x" plays much the same role as under linearity, and the relatively higher marginal value of y at low levels for the regulator again results in "horse trading" so that the regulator benefits by bundling issues, and we again observe lower y values and greater x values when comparing the joint to the separate bargaining outcomes. For example, if $\alpha = 0.75$, $\theta = 0.50$, the single bargain solutions are $x = 0.429$ and $y = 0.33$. Moving to the joint bargain, $x = 0.467$ and $y = 0.304$, repeating the pattern observed previously. Thus, the nature of this analysis does not in any way depend on linearity of one of the regulator's two payoffs.

C. *Caveats and Possible Extensions*

The simple model analyzed here has the virtue of making clear that issue bundling can benefit one party, while reducing the welfare of the other. It is plausible that the regulator will often be the beneficiary, but this is by no means certain. However, it is likely that the regulator will perhaps have more influence on whether issues are bundled than would be the firm. If that is so, then one would expect multilateral agreements to arise primarily in those cases in which the regulator benefits from the bundle vis-à-vis several atomistic bargains. This implies, in turn, that a complex but potentially large change in the relative levels of influence of the main players in the regulation game has occurred, and it has occurred not by statute, but almost by accident.

We need to stress that the particular findings regarding the differential desirability of bundling negotiation examined here are quite parochial.

Certainly, we can alter the result easily enough by judicious re-specification of the utilities. Further, for simplicity we have ignored the role of differing conflict payoffs in the underlying bargains, and that too is an easy modification which can qualitatively affect the conclusions. However, the specification used here was selected with a purpose: both intuition and casual empiricism suggest that, by and large, it is regulators who seem to prefer the fruits of bundling issues together, and firms who often resist this course. This state of affairs may partially be explained through the simpler argument that, under bundling, the regulatory history provides only very diluted guidance to firms in their business planning. Thus, firms prefer simple, intelligible standards focused on the specific issues.

Additionally, our simple analysis shows that it is sufficient to introduce differences in the marginal gains from the bargain payoffs to obtain our results, and thus we do not need to consider any systematic differences in conflict payoffs (i.e., the payoffs to the parties if no bargain is reached). In other words, our findings do not arise because one party (say, the firm) has a very good conflict payoff in one case but not the other. However, it is also clear and easily shown that such differences, which correspond fairly directly to intuitive speculations as to the consequences of bundling issues together, can also affect the resulting equilibrium bargains. Such complications offer additional avenues for analysis.

Also, we have ignored any strategic interaction between the firm and regulator regarding which issues will or will not be bundled together in the sense envisioned by this model. Considering the temporal nature of the relationship between the regulator and the regulated, the strategy of what issues to bundle and whether or not to do so is actually a very difficult question. From the standpoint of economic theory, two parties competing in a game consider *all* ramifications of every action they might take until the end of time (or the end of the game). For example, "economic man" solves a dynamic consumption problem to plan his entire lifetime's purchases, evidently doing this at the moment of birth (if not before). Non-economic man, on the other hand, is somewhat more slapdash in his actions and less precise in his calculations. Thus, it is unlikely as a practical matter that current relations between the FCC and AT&T, for example, are considered by both parties to simultaneously encompass every aspect of their potential future interactions forever. That said, it is equally naïve to suppose that important issues occurring together in time are separated by Chinese Walls which are impermeable to strategic breaching. The challenge will be to determine when bundling of issues is the correct assumption, and when it might be superfluous.

V. Conclusions and Policy Considerations

Regulation is one of the basic mechanisms whereby society seeks efficient and equitable outcomes in areas of great public importance. Traditionally, though, the economic study of regulation in the United States has developed under either from a "command and control" orientation, in which the public authority polices misconduct by private agents, or a "Capture Theory" approach, in which the regulator is an agent of the regulated.[94] Yet, among the most important evolutions in some U.S. regulatory practice is the growing incidence of negotiated resolutions of multiple regulatory issues, clearly demonstrating, in contrast to these earlier approaches to modeling regulation, that both the regulator and the regulated have power (though perhaps unequal). Regulation involves a bargain. Indeed, the regulatory record, at least at the FCC, illustrates the importance of cooperative scenarios in the regulatory process. In fact, all regulatory outcomes that are not litigated can, in some sense, be regarded as bargains.

Empirical evidence and casual observation suggests that bargaining is increasing in importance, and nothing suggests this trend will reverse itself soon. This development may be among the most important innovations in regulation in many years. As a general matter, this trend is perhaps one that should be applauded though, as usual, the "devil is in the details." Because of the complexity of regulation and the numerous proceedings large firms might engage in nearly simultaneously, there is a profound risk that negotiations, which are far less public than ordinary contested proceedings or rulemaking, will swell to encompass numerous matters surrounding the most critical current issue. As such, this phenomenon also makes it more difficult for the legislature to achieve its aims.

Although we did not look closely at other regulatory agencies where firms are heavily engaged (e.g., the Federal Energy Regulatory Commission, the Consumer Financial Protection Bureau, the Securities and Exchange Commission, the Environmental Protection Agency, etc.), we suspect the

---

[94] Capture theory is a form of a principal-agent model, except the regulated firm is considered the principal and the regulator the agent. *See, e.g.,* E. Dal Bó, *Regulatory Capture: A Review*, 22 OXFORD REVIEW OF ECONOMIC POLICY 203-225 (2006); W. J. Novak, *A Revisionist History of Regulatory Capture*, in PREVENTING REGULATORY CAPTURE: SPECIAL INTEREST INFLUENCE AND HOW TO LIMIT IT (D. Carpenter and D. Moss, eds) (2013).

phenomena of issue bundling is not limited to FCC.[95] An important policy question then is what, if anything, can or should Congress do about it?

One option is to draft legislation specifically designed to curtail such behavior. For example, House Energy and Commerce Sub-Committee Chairman Greg Walden attempted to introduce legislation to amend the Communications Act to codify current case law which requires the FCC to limit its conditioning authority to remedying only merger-related harms, but the bill also included measures that would likely exacerbate the problem (e.g., a softening of Sunshine rules).[96] Significant strengthening of the Commission's now loose *ex parte* rules would probably help, perhaps shedding light on what are now mostly backroom dealings. Making the bargaining process more pubic—like the FCC-supervised ENFIA negotiations between AT&T and MCI during the late 1970's—may also constrain the FCC from acting on its political temptations.[97] As U.S. Supreme Court Justice Louis Brandeis pointedly observed, "If the broad light of day could be let in upon men's actions, it would purify them as the sun disinfects."[98] However, as demonstrated in the AT&T/DirecTV case study *supra*, the FCC may bundle issues through formal conditions ostensibly designed to remedy merger-specific harms.

Along the same vein, to restore the crucial role of precedent and increase regulatory certainty, Congress could take steps to amend the Administrative Procedure Act to constrict the current broad legal standard under which agencies may easily change policy direction.[99] Indeed, discussed in more detail in a moment, long-term private investment will likely suffer unless there are

---

[95] *See supra* n. 1.

[96] *See* Spiwak, *supra* n. 10. For a full copy of the final reported bill, see https://www.congress.gov/113/crpt/hrpt338/CRPT-113hrpt338.pdf.

[97] G. Brock, TELECOMMUNICATIONS POLICY FOR THE INFORMATION AGE: FROM MONOPOLY TO COMPETITION (1998), at Ch. 8.

[98] M.I. Urofsky and D.W. Levy, LETTERS OF LOUIS D. BRANDEIS: VOLUME 1 (1978) at p. 100.

[99] *See, e.g., FCC v. Fox Television Stations*, 556 U.S. 502, 515-16 (2009) (To change policy, an administrative agency need only provide a "reasoned explanation … for disregarding facts and circumstances that underlay or were engendered by the prior policy." An administrative agency "need not demonstrate to a court's satisfaction that the reasons for the new policy are *better* than the reasons for the old one; it suffices that the new policy is permissible under the statute, that there are good reasons for it, and that the agency *believes* it to be better, which the conscious change of course adequately indicates. This means that the agency need not always provide a more detailed justification than what would suffice for a new policy created on a blank slate.")

substantive restraints on the discretion of the regulator and the regulatory system as a whole.

Another option is for Congress to use its oversight authority more aggressively to expose improper issue bundling. If, after investigation, Congress finds that an agency has inappropriately engaged in issue bundling, then Congress may use its appropriation power to reign in the agency.

Finally, Congress could reduce the overall regulatory burden on the American economy, thereby reducing the scope of issues that could be bundled and the opportunities to do so.[100] Still, the evidence from the FCC reveals that the breadth of issues that may be bundled—sometimes "voluntarily" by the regulated firm—are not limited by the statutory boundaries on the agency's authority. Regulation, in some respects, may be slipping out of the control of Congress, and we should expect a response. As the Commission continues to push the envelope of issue bundling, the agency provides its critics continued ammunition that it remains unfit to regulate an industry of immense economic and social significance.

In all, it appears that the growing practice of negotiated resolutions of multiple regulatory matters has brought us into a new and largely uncharted phase in public policy, at least in telecommunications. We should not let these developments go unexamined, and, in particular, we should consider the wisdom and probable practical effects of the current practice. Any such investigation will be difficult, though, because bargaining takes place outside of the eyes of Congress and the public. But difficulty is no excuse for complacency.

From the legal point-of-view, the bundling of issues is very problematic because of its effect on the value of precedent. Firms require some sense of what to expect in particular proceedings, and precedent of prior Commission decision-making provides exactly such a guide. However, as the use of "issue bundling" continues to rise at the FCC, the value of past precedent may be sharply attenuated because every outcome is a result of a cooperative bargain under the facts of each case. And, by extension, if the Commission increasingly believes that it is not bound by its prior precedent in cases involving cooperative bargaining with the regulated entity, then the Commission will inevitably (and

---

[100] *C.f.*, T.R. Beard, G.S. Ford, H. Kim, and L.J. Spiwak, *Regulatory Expenditures, Economic Growth and Jobs: An Empirical Study*, PHOENIX CENTER POLICY BULLETIN NO. 28 (April 2011) (available at: http://www.phoenix-center.org/PolicyBulletin/PCPB28Final.pdf).

we submit already has) become increasingly comfortable with abandoning precedent (and, by extension, become less inclined to be constrained by caselaw and statutory language) even in cases which do not involve any bundling of issues.[101]

From the economic and financial perspective, of all the myriad ways that regulation can fail, the lack of credibility of the regulator—its inability to keep its word and follow its own precedent—is perhaps the most important. Indeed, regulatory credibility is key to a firm's investment decisions. Participating in the provision of communications services requires large fixed and sunk investments whose returns are realized only sporadically over long periods. If firms and investors fear expropriation of returns by a regulator unable to commit to its policies, however, then investment will be severely curtailed.[102] Given the Commission's mandate in Section 706 to "encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans," the FCC must guard what credibility it has left to maintain investor confidence.[103]

---

[101] *See, e.g.*, G.S. Ford and M. Stern, PHOENIX CENTER POLICY PERSPECTIVE NO. 15-04, *Ugly is Only Skin Deep: An Analysis of the DE Program in Auction 97* (July 20, 2015) (available at: http://www.phoenix-center.org/perspectives/Perspective15-04Final.pdf); L.J. Spiwak, *How the AWS Auction Provides a Teachable Moment on the Nature of Regulation,* BLOOMBERG BNA (April 28, 2015) (available at: http://www.phoenix-center.org/BloombergBNADesignatedEntities28April2015.pdf).

[102] B. Levy and P. Spiller, *The Institutional Foundations of Regulatory Commitment: A Comparative Analysis of Telecommunications Regulation*, 10 JOURNAL OF LAW, ECONOMICS, & ORGANIZATION, 201-246 (1994) ("The combination of significant investments in durable, specific assets with the high level of politicization of utilities has the following result: utilities are highly vulnerable to administrative expropriation of their vast quasi-rents. Administrative expropriation may take several forms. Although the easiest form of administrative expropriation is the setting of prices below long-run average costs, it may also take the form of specific requirements concerning investment, equipment purchases, or labor contract conditions that extract the company's quasi-rents. Where the threat of administrative expropriation is great, private investors will limit their exposure.").

[103] *See* 47 U.S.C. § 1302. The agency's credibility is already is doubt. *See, e.g.*, G.S. Ford,. L.J. Spiwak and M. Stern, *The Broadband Credibility Gap*, 19 COMMLAW Conspectus 75 (2010) (available at: http://www.phoenix-center.org/papers/CommlawConspectusBroadbandCredibilityGap.pdf); L.J. Spiwak, *The FCC's New Municipal Broadband Preemption Order Is Too Clever By Half*, BLOOMBERG BNA (April 10, 2015) (available at: http://www.phoenix-center.org/oped/BloombergBNATennesseePreemptionOrder10April2015.pdf); G.S. Ford and L.J. Spiwak, *The Unpredictable FCC: Politicizing Communications Policy and its Threat to Broadband Investment*, Bloomberg BNA (October 30, 2014) (available at: http://www.phoenix-

(Footnote Continued. . . .)

Yet, perhaps most importantly, the public must have confidence in the integrity of its government's institutions. Without regulatory credibility, the "rule of law" and "due process" have no meaning. For that reason alone, the increased use of "issue bundling" in the modern regulatory state merits greater attention and study.

center.org/oped/BloombergBNARegulatoryCertainty30October2014.pdf); G.S. Ford and L.J. Spiwak, PHOENIX CENTER POLICY PERSPECTIVE NO. 14-05: *The Unpredictable FCC: Politicizing Communications Policy and its Threat to Broadband Investment* (October 14, 2014) (available at: http://www.phoenix-center.org/perspectives/Perspective14-05Final.pdf).