

The AT&T Consent Decree: In Praise of Interconnection Only

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I. THE BELL DECREE AND THE CORPORATIST MINDSET

In this short Article, I shall return to some of the issues that I addressed in my short book, *Antitrust Consent Decrees in Theory and Practice: Why Less is More*.¹ The basic theme of that book is that the success of consent decrees, and indeed the resolution of all large antitrust cases, follows a clear pattern. The more ambitious the decree, the worse matters are likely to turn out. The reasonable response therefore is to cut back on ambition in order to execute modest plans well. Perhaps the most vivid illustration of a consent decree process gone wrong is the breakup of AT&T.² Therefore, holding a conference that addresses the strengths and

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1. RICHARD A. EPSTEIN, *ANTITRUST CONSENT DECREES IN THEORY AND PRACTICE: WHY LESS IS MORE* (2007).

2. *United States v. AT&T*, 552 F. Supp. 131 (D.D.C.1982).

weaknesses of that decree twenty-five years later offers a propitious occasion on which to examine this fundamental restructuring of the telecommunications industry.

At the time of its adoption, the 1982 decree was generally lauded as a rebuke to the old corporatist way of doing business.³ That system of self-conscious industrial policy dominated New Deal thinking. Its operation rested on three legs. The first was a strong government willing to create and preserve monopoly profits. The second was a system of strong labor unions, bolstered by the protections of the Norris-LaGuardia Act⁴ and National Labor Relations Act,⁵ that shared in those gains. The third was a corporate and antitrust culture that blessed these accommodations. The corporate law did not see shareholder maximization as an exclusive goal, and thus fostered accommodations with labor and other political constituencies. In addition, the antitrust law often punished competitive behavior or insulated anticompetitive behavior from judicial scrutiny. This system offered a cozy comfort to all the participants, and it promised stability in institutional arrangements that could not have been achieved in a competitive market where new entry and exit would quickly erase the monopoly profits for both the firm and its union.⁶ But the defenders of the system thought that they had created the vaunted stability long prized by regulators of all stripes, who seek to insulate their own preferred constituents from the vicissitudes that plague the rest of the world.

That so-called stability is in fact an illusion by any system-wide measure.⁷ Of course, the regulated industry and its constituents are

3. See Michael Wachter, *Labor Unions: A Corporatist Institution in a Competitive World*, 155 U. PA. L. REV. 581 (2007).

4. Federal Anti-Injunction Act, Pub. L. No. 72-65, 47 Stat. 70 (1932) (codified as amended at 29 U.S.C. §§ 101-115 (2000)).

5. Pub. L. No. 74-198, 49 Stat. 449 (1935) (codified as amended at 29 U.S.C. §§ 151-169 (2000)).

6. The stabilization theme is highly evident in the National Labor Relations Act, which reads:

The inequality of bargaining power between employees who do not possess full freedom of association or actual liberty of contract, and employers who are organized in the corporate or other forms of ownership association substantially burdens and affects the flow of commerce, and tends to aggravate recurrent business depressions, by depressing wage rates and the purchasing power of wage earners in industry and by preventing the stabilization of competitive wage rates and working conditions within and between industries.

29 U.S.C. § 151. For an attack on the coherence of these propositions, see RICHARD A. EPSTEIN, *HOW PROGRESSIVES REWROTE THE CONSTITUTION* 95-99 (2006).

7. For an early statement of the point, see FRIEDRICH HAYEK, *THE ROAD TO SERFDOM* (50th Anniversary ed. 1994). There, the author observes,

What is constantly being done is to grant this kind of security [of a given income] piecemeal, to this group and to that, with the result that for those who are left out in the cold the insecurity constantly increases.

protected against both price fluctuations and new entry. But the model is not sustainable in the long run for three reasons. First, its ostensible certainties cannot be replicated system-wide. Uncertainty is an inescapable feature of all complex social systems. The only question is who will be forced to bear its consequences. The effort to insulate one group from the uncertainty increases the level of uncertainty borne by everyone else in the system, for all the initial variation is now forced on that fraction of the economy that is denied the protection afforded selectively to the regulated industry. Thus, if economic circumstances move sharply, these parties will be forced to bear the price declines in their own industries and to subsidize the price rigidities in telecommunications. If voluntary markets will tend to equalize uncertainty at the margin for all sectors, regulation tends to force greater risks on certain groups to benefit others. The likely consequence is to prevent the outside groups from making their needed adjustments. They will be on the steep portion of their uncertainty cost curves. Yet, the regulated parties will be spared the initial amounts of uncertainty, which they could probably bear at far lower cost. The result is more uncertainty system-wide, all in the name of price and income stabilization.

The second risk with these accommodations is that while they insulate the protected groups from a multitude of small shocks, they do not protect them from the few large ones that really matter. Constant levels of protection look good until a large event makes the position of the preferred players untenable. New entry from some unanticipated corner can topple the financial base on which these long-term accommodations rest. In telecommunications, that transformation started with the rise of MCI, founded in 1963, which offered a way around the Bell monopoly, chiefly by exploiting the then new technology of transistors, coaxial cable, and microwave technology.⁸

Third, the members of any industry—steel, automobiles, tires, agriculture—can try to play the same corporatist strategy. Access to that combined strategy became easier once labor unions received statutory monopolies under the National Labor Relations Act, justified, of course, as a way to “stabilize” the wages and purchasing power of their members.⁹

...

[W]ith every grant of complete security to one group the insecurity of the rest necessarily increases. If you guarantee to some a fixed part of a variable cake, the share left to the rest is bound to fluctuate proportionately more than the size of the whole.

Id. at 137-41. In effect, the preferred recipients enjoy the priority of debt in downturns and participate equally as holders of equity in good times. By definition, someone else has to get a smaller share of what turns out, given the inefficiencies involved, a smaller pie.

8. For discussion, see MICHAEL K. KELLOGG, JOHN THORNE & PETER W. HUBER, *FEDERAL COMMUNICATIONS LAW* 24-28 (1992).

9. See discussion *supra* note 6.

The agricultural price support systems similarly stabilized prices for farmers but forced the public at large to take the full risk of the price fluctuations by buying back excess production at inflated prices. It is no accident that labor and agriculture won exemptions from the antitrust law under section 6 of the Clayton Act of 1914.¹⁰ Nor is it an accident that the broad expansion of the reach of the federal commerce power took place first in labor and then in agriculture.¹¹ State-wide regulation was subject to too much competitive pressure from other states to succeed. With each additional maneuver of this sort, system-wide uncertainty increases, representing yet another distortion of a system of state monopolies. What is good for the coddled industry is systematically bad for the public at large. Indeed, there is a grand prisoner's dilemma at work here. It would be better for all of these cartel-like structures to disband simultaneously, for the gains that any group got from its own protection were more than offset over time when firms in other industries successfully imitated their strategy. In the long run, no one wins as the social pie shrinks. And on the few occasions where that point was grasped, large moves toward deregulation were possible. Airline transportation was deregulated in 1978¹² and surface transportation was largely deregulated in 1982.¹³ It is not, therefore, entirely coincidental that the Bell consent decree dates to 1982, at the outset of the Reagan years.

The conventional accounts of that decree treat it as yet another nail in the coffin of the corporatist strategy. In one sense, this proposition must be regarded as true, given that the architect of the system was the late Assistant Attorney General William Baxter, whose anti-corporatist sentiments are beyond dispute. But there is good reason in this instance to think that in some sense he did not quite shed the corporatist heritage. In part, this is perfectly understandable. The great "achievement" of the New Deal corporatist state was its uncanny ability to take competitive industries like agriculture and convert them into grotesque monopolies and cartels organized and propped up by the government. The most evident move in that direction was the decision of the U.S. Supreme Court in *Parker v.*

10. Pub. L. No. 63-212, § 6, 38 Stat. 730, 731 (1914) (codified as amended at 15 U.S.C. § 17 (2000)). The Act states "[t]hat the labor of a human being is not a commodity or article of commerce. Nothing contained in the antitrust laws shall be construed to forbid the existence and operation of labor, agricultural, or horticultural organizations, instituted for the purposes of mutual help. . . ." *Id.*

11. See *NLRB v. Jones & Laughlin Steel Corp.*, 301 U.S. 1 (1937) (upholding the constitutionality of the National Labor Relations Act); see also *Wickard v. Fillburn*, 317 U.S. 111 (1942) (upholding nationwide restrictions on agricultural production).

12. Airline Deregulation Act of 1978, Pub. L. No. 95-504, 92 Stat. 1705 (1978).

13. Surface Transportation Assistance Act of 1982 (Highway Improvement Act), Pub. L. No. 97-424, 96 Stat. 2097 (1983).

Brown,¹⁴ which exempted a state-run raisin cartel from the reach of the federal antitrust law on the ground that states were entitled to enact their own industrial policies unless the federal government had intervened to block their decisions. To be sure, the New Deal marked a huge expansion in federal power. Yet, at the same time, it must never be forgotten that it also led to an expansion of state power as well, so long as there was no clash between the two systems. And to reduce the likelihood of that clash, the Supreme Court created its “presumption against preemption,” which to this day still increases the risk of dual systems of regulation.¹⁵

II. “DEREGULATION” IN A NETWORK INDUSTRY: DO GREENE AND BAXTER MIX?

Start with this proposition: the provision of telecommunications services is not like the production and sale of raisins. Even if pure competitive markets are possible in agriculture, they are not possible in telecommunications, notwithstanding the hype in support of this assertion. Judge Greene, for example, lamented that AT&T was in the worst of both worlds because “the Bell System has been neither effectively regulated nor fully subjected to true competition.”¹⁶ This simple observation has powerful implications for the counterattack against the corporatist mentality. If there is no good competitive solution for networks, the strong pro-market intuition may be enough to make the consent decree feasible. It need not be strong enough to make it work, however, because the only choice is a different—and hopefully better—form of regulation, not a pure competitive market.

Optimism, therefore, has to be tempered in light of the restricted set of feasible alternatives. The minimum requirement for a sound network is that each person situated at any point on the network be in a position to communicate with any other person situated on the network. That problem—universal access—is easily solved under the corporatist model that animated the old AT&T. If every system user is situated under one roof, there is no need to decide who should pay what fees to gain access to

14. 317 U.S. 341 (1943).

15. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947) (“So we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.”). For a defense of that preemption in the name of federalism, see Ernest A. Young, *Federal Preemption and State Autonomy*, in *FEDERAL PREEMPTION: STATES’ POWERS, NATIONAL INTERESTS* 249 (Richard A. Epstein & Michael S. Greve eds., 2007). For the author’s critique of these dual systems of regulation, see Richard A. Epstein & Michael S. Greve, *Introduction: Preemption in Context*, in *FEDERAL PREEMPTION*, *supra*, at 1; Richard A. Epstein & Michael S. Greve, *Conclusion: Preemption Doctrine and Its Limits*, in *FEDERAL PREEMPTION*, *supra*, at 309.

16. *United States v. AT&T*, 552 F. Supp. 131, 170 (D.D.C. 1982).

networks populated by independent firms and their independent customer bases. All the cross-subsidies are kept internal to a single umbrella firm so that ratemaking can be separated from the problem of establishing interconnections. So shielded, these hidden subsidies can be quite large because the parties who are subject to regulatory taxes usually have no place to go and, given the monopoly nature of the industry, no sure knowledge of the magnitude of the subsidies created.

Removing this unified monopoly makes it hard to keep the cost subsidies alive because they must now become more explicit and therefore more vulnerable to attack. If and when an exit option becomes credible, the source of the subsidy can be eroded, which is one of the reasons why AT&T lost out in the long-distance market: it was burdened by consent decree obligations that its rivals did not have to bear. More importantly, even after the initial monopoly was broken up, we do not leave the world of second-best. We still have to make some judgments as to which of the many possible deviations from the competitive model will produce the fewest distortions, both in the short term and the long run. In this permanent second-best world, the question of system design becomes critical precisely because the competitive solution—the more independent firms, the merrier—does not apply. Rather, the increase in firm number creates a more fragmented network. The costs of keeping the various players together increases in ways that offset, at least in part, the benefits of price competition by independent service providers. How the network is configured therefore really matters, and it is here that it seems that the long-term (permanent is too strong for this industry) result of the 1982 consent decree, and of the 1996 Telecommunications Act¹⁷ it spawned, was that it made the wrong bets on the structure of the future telecommunications market, in large part because it underestimated the transformative effect of improved technology on industry structure.¹⁸

17. Pub. L. No. 104-104, 110 Stat. 56 (codified as amended in scattered sections of 47 U.S.C.).

18. The court noted:

Under [its customer service] provision, a competitor could interconnect with the AT&T network only if the interconnection occurred in switching equipment located on the customer's premises where the telecommunication originated or terminated. The effect of this restriction was to prevent competitors from entering the intercity market gradually, and thus effectively from entering the market at all. For example, because of this restriction, a customer whose sole office was in St. Louis could not choose to use the services of an AT&T competitor for part of a route (*e.g.*, from St. Louis to Chicago), and then AT&T's services for the remainder of the route (*e.g.*, from Chicago to Bethesda, Md.) because the St. Louis customer did not have the "premises" in Chicago that AT&T required for interconnection. Thus, to receive service for Bethesda as well as for Chicago, the customer was required to purchase both services from AT&T.

AT&T, 552 F. Supp. at 161 n.123.

In a sense, I think that this result was inevitable because of the improbable alliance between Assistant Attorney General Baxter and Judge Greene. On this occasion, at least, the Chicago school economist (who taught at Stanford) and the progressive democrat were able to work out a common solution on the thinnest of records. For the enormity of this decree, its basis in antitrust law was feeble at best. The single specific instance that provoked the separation was the unwillingness of AT&T to provide forward transmission service that would allow MCI to communicate with customers through Chicago if they did not have a Chicago office. Hence, a phone call that started in St. Louis and was routed to Bethesda, Maryland through Chicago could not use MCI or any other provider for the first leg of the trip and AT&T for the second, unless it also had a Chicago office. Dumb, to be sure, but the kind of issue that could be resolved by having the FCC issue a simple interconnection order, without restructuring the entire system, which, of course, the FCC could never do without some specific congressional authorization.

Judge Greene did not look with favor on that modest alternative, with consequences that soon became clear in unintended ways. This should not come as a surprise, though, since, as a general matter, Judge Greene was temperamentally skeptical of market solutions because he thought that bigness and badness went hand in hand. His distrust of markets led him to shy away from any minimalist approach to antitrust law. Rather, his grander vision of the field was concerned more with large concentrations of wealth than it was with market power—the ability to alter price and retain sales. His heroes were not Robert Bork and Philip Areeda, but Arthur Schlesinger and Ralph Nader.¹⁹ His sins may perhaps be forgiven since he was a self-conscious dissenter to the Chicago School of antitrust. Less forgivable, in a sense, was the failure of Assistant Attorney General Baxter, excellent economist though he was, to be sufficiently skeptical about *his* ability to understand the full range of structural imperfections that permeated the telecommunications industry no matter how well configured. He was too confident that he understood all that there was to know about network industries, so he too did not seek to focus his remedies on the hold up problems that were suggested by the two-legged telephone call.

Assistant Attorney General Baxter's major structural gambit was to separate the long-lines operation from the local exchange carriers (LECs) because of the risks of cross-subsidies that could otherwise take place in order to block new entrants in the long-lines market. But he failed to see that the elaborate structure that would be created would lead to other tensions, including difficult issues over the relationships between the various LECs and the inability to create effective parity between AT&T—

19. *See id.* at 164 n.139, 165 n.141.

which was subject to regulation under the consent decree—and other long-lines carriers—which were not. Alas, he (and he was not alone) had no conception of how complex the ratemaking issues could turn out to be. Finally, neither Assistant Attorney General Baxter nor anyone else knew how advances in technology would play into the various strictures of the consent decree. Technical advances have a way of shortening the useful life of institutional structures. The years after the 1982 decree saw the rise first of the cell phone, and then of the Internet, both of which have wholly transformed the nature of telecommunications by removing the last vestiges of monopoly power that the LECs had over their respective territories. Yet the entire structure of the 1982 decree and the 1996 telecommunications statute were predicated on the assumption of the permanence of LEC dominance.

Here is one story that helps make the point. As late as 1995 and 1996, I consulted for (then) Bell Atlantic on issues like the application of the “bill and keep” formula to interconnections between land lines and cell phones. Even at that late date, most industry experts regarded cell phones as an expensive luxury that they thought would not displace land lines, at least in the foreseeable future. That is why the 1996 Telecommunications Act treated the LECs as if they had a permanent chokehold over all land lines. After all, the price for cell phone minutes was sufficiently high that most people kept their cell phones turned off unless they wanted to make a call. Most of the traffic between land lines and cell phones originated on cell phones, which created an odd asymmetry in the market such that “bill and keep” would have resulted in a substantial wealth transfer from LECs to cell phone carriers. Yet, ten years later there were more cell phone lines than land lines and the disparity has continued to widen since that time.²⁰ The land lines in the Epstein household, for example, have declined by fifty percent, from two to one.

The subsequent mergers have shown just how wrong Assistant Attorney General Baxter’s original guess was. We have in place vertically integrated networks that both compete and connect with each other. The original structure under the decree has been undone by mergers and technical advances. It is more than symbolic that Southwestern Bell, one of the original Regional Bell Operating Companies (RBOCs), quickly renamed itself SBC in order to shed its local image when it entered the cellular and global markets. As one of the survivors of the massive

20. For example, by 2007, households with only cell phones outnumbered those with only landlines. *See* Press Release, Mediamark Research Inc., Telecom Milestone: More Cellphone-Only Than Landline-Only Households (Sept. 12, 2007), available at <http://www.mediamark.com> (follow “Newsroom” hyperlink; then follow “2007 Press Releases” hyperlink).

consolidation within the industry—which neither Assistant Attorney General Baxter nor Judge Greene could have foreseen or tolerated—it acquired the struggling AT&T company, crippled as it was under the 1982 decree, only to change its name from SBC to AT&T. The value of the brand transcended the value of the firm that owned it.

III. STRUCTURAL VERSUS CONDUCT REMEDIES

The unexpected twists and turns in the Bell consent decree raise a theoretical question whose importance is undiminished today. What should guide the choice between the use of structural or conduct remedies in fashioning consent decrees more generally? To set the framework, it is useful to recall the message that this distinction is intended to convey. A structural remedy is most commonly sought in a monopolization case brought under section 2 of the Sherman Act.²¹ It seeks to change the form in which the regulated entities do business, by requiring, for example, the breakup of a firm or spin off of a particular subsidiary. Once the structural move is made, regulators may then put in place additional measures to prevent the reformation of the original entity by subsequent corporate maneuvers. These monopolization claims typically involve suits against single firms charging them with a pattern of conduct that has allowed them to acquire improperly a position of monopoly power within a certain industry. The breakup of the Bell System was the outgrowth of a section 2 case, as was the major litigation in the *Alcoa* case,²² where the planned breakup was averted by the creation of two new aluminum companies—Reynolds and Kaiser—at the end of the Second World War. The structural remedy was also employed in the endless pursuit which the United States made of the hapless United Shoe Machinery Company. The effort took place over a period that spanned close to seventy years, from the completion of the merger in 1899 to its final dissolution in 1968 as a result of the breakup which cast it into bankruptcy.²³

The difficulty in dealing with these cases is that it is widely understood that the acquisition of monopoly power, without more, is no more a violation of the antitrust laws than it is a common law tort. Firms that start from nothing and achieve their ends through excellence, acumen,

21. 26 Stat. 209, ch. 647 (1890) (current version at 15 U.S.C. §§ 1-7 (2000)).

22. *United States v. Aluminum Co. of America (Alcoa)*, 148 F.2d 416 (2d Cir. 1945).

23. For an account of the case, see EPSTEIN, *ANTITRUST CONSENT DECREES IN THEORY AND PRACTICE: WHY LESS IS MORE*, 40-53 (2007). Some of the landmark cases were *United States v. Winslow*, 227 U.S. 202 (1913); *United States v. United Shoe Mach. Co.*, 247 U.S. 32 (1918); *United Shoe Mach. Corp. v. United States*, 258 U.S. 451 (1922); *United States v. United Shoe Mach. Corp.*, 110 F. Supp. 295 (D. Mass. 1953); *United States v. United Shoe Mach. Corp.*, 391 U.S. 244 (1968).

and foresight are entitled to keep the fruits of their labor.²⁴ That holds true even if the integrated nature of their businesses makes it very difficult for the new entrant to find a chink in the firm's armor that allows them to acquire a foothold in the relevant line of business. One illustration of this system was the conscious effort of United Shoe Machinery Company to merge seven different companies in order to overcome the holdout problems that arose when each firm held patents to equipment used at different stages in the shoe production process. Putting all the companies together in sequence was, in effect, an early version of a patent-pooling device that effectively counteracted the extensive social waste from the standard double marginalization problem.

To each such advance there is a hitch. The moment that one party is able to smooth over the joints in a production sequence, it necessarily disadvantages any competitor that sells equipment only in a single niche. It has no particular comparative disadvantage when it faces no integrated competition: mixing and matching is then inevitable. But it is hard to say that this form of exclusion counts as an antitrust violation of any sort given the net benefits to consumers from having this integrated option available. The United States' strategy in these cases was to start with a conduct remedy, by insisting that United Shoe Machinery Company not use any sale or lease practice that prohibited outsiders from entering at one stage of the production process.²⁵ But owing to the convenience of the integrated process, the preservation of these options did little to overcome the natural efficiency advantage of United Shoe Machinery Company when it, and it alone, could offer end-to-end service to consumers who were willing to pay a premium for reliable service. United Shoe Machinery Company continued to dominate the market, which led the Supreme Court to call for its dissolution, the ultimate structural remedy.

Both remedies make no sense in the *United Shoe Machinery Company* cases, and for the same reason: there should have been no antitrust violation at all, so that the choice between bad conduct and a bad structural remedy disappears. But if one remedy was worse than the other, it was clearly the breakup decree. In fact, one of the risks associated with the insistence of keeping certain contractual practices is that they loom far larger in theory than they are valuable in practice, which is one reason why I advocate a litigation strategy of unilateral surrender whenever contract

24. See *Alcoa*, 148 F.2d at 429-30. Unfortunately, the *Alcoa* decision found ample exception to this basic rule.

25. For a catalogue of forbidden clauses struck down, see, *United Shoe Mach. Corp.*, 258 U.S. at 456-57. For the earlier defense of this case see, *United Shoe Mach. Co.*, 247 U.S. at 45; *Winslow*, 227 U.S. at 215-17.

terms are challenged.²⁶ But that surrender was not feasible in an age that resolved all doubts about the scope of the antitrust laws in favor of their application. All too often the Supreme Court would condemn practices that it did not understand, or whose efficiency properties were apparent from the record below.²⁷ The 1968 Supreme Court could not fathom how United Shoe Machinery Company's ability to hold market share could be evidence of its efficiency. Since the Court thought that United Shoe Machinery Company's continued dominance had to be the result of a restrictive practice, it ordered the firm to be broken up, given that lesser remedies had repeatedly "failed." The Court did not then see that inability of a competitor to break in at one stage is a private loss that does not positively correlate with any systematic measure of the competitive misallocations of concern to the antitrust laws. It is just this ultimate awareness of the frequent misalignment of private and social losses that eventually led the Supreme Court to hold that a patent does not supply conclusive evidence of a legal monopoly in a tie-in case, given the competition from other patent systems that require the same tie-in arrangements.²⁸

IV. CONDUCT AND STRUCTURAL REMEDIES FOR NETWORK INDUSTRIES

United Shoe Machinery Company was only an integrated company. At no point did it sell its products to downstream competitors. A telecommunications company, however, could be in the position of competing with its customers. Indeed, that situation could arise if the original and integrated AT&T were ordered to sell services to competitors in the long-distance markets. In that case, the pricing is no longer an internal accounting device within one giant AT&T firm. Rather, it represents a transfer of real dollars between unrelated entities. The firm that overcharges the outsider could easily cover its tracks by charging identical prices to its own downstream units. The upstream firm has its own costs, which, when added to the costs of its inputs, result in a higher cost than the single firm with the integrated product.²⁹ This form of a "price squeeze" is notoriously difficult to prove on the facts, even in unregulated industries,

26. EPSTEIN, ANTITRUST CONSENT DECREES, *supra* note 23, at 113 (noting the problem for both United Shoe Machinery Company and Microsoft Corp.).

27. For the ultimate in *per se* violations see *Topco Assoc., Inc. v. United States*, 405 U.S. 596 (1972) (finding a *per se* violation from efficient buying cooperatives).

28. See *Ill. Tool Works Inc. v. Indep. Ink, Inc.*, 547 U.S. 28 (2006) (rejecting automatic inference from valid patent to monopoly position in tie-in cases).

29. For the classic exposition of the permutation, see *Town of Concord v. Boston Edison Co.*, 915 F.2d 17 (1st Cir. 1990). In that case, Chief Judge Breyer, as he then was, refused to accept the possibility of a price squeeze by a monopolist in a regulated industry, given its inability to raise prices at will. *Id.*

because the costs needed to produce complex goods and services are not easily calculated given the prevalence of joint costs and the inevitable difficulties in calculating marginal costs. But in the competitive context, there is a respectable theoretical concern that the “equally efficient competitor” will be unable to compete at the second stage of the business because of the overcharge it faces from the monopolist that supplies it with their initial input.

The 1982 Bell decree was fashioned in large measure to avoid these serious problems, for which neither Judge Greene nor Assistant Attorney General Baxter saw any conduct remedy. But the alternative substituted one serious problem for another. Under the decree scheme, many phone calls were routed through three separate companies: one LEC, one long-line company, and a second LEC (some calls in an extended local region—the so-called LATAs, or local access transfer area—were kept within a single company). Given the strong restraints on entry, no telephone company at the time could put together an alternative end-to-end package of its own to take on the established firms. Now the pricing issues are real. Assistant Attorney General Baxter’s fatal miscalculation was to assume that the risk of cross-subsidy when AT&T remained an integrated firm with long-distance competitors was greater than the risk of mispricing access charges when all long-distance carriers were independent of the LECs. His choice of the structural remedy could not function like its ideal twin in a competitive market in which the regulator is able to cut the new firm loose and let it rip.³⁰

Most critically, this structural remedy required someone to regulate all the various interconnections. Yet, as everyone immediately knew, the judicial application of the antitrust law could not mount sufficient expertise and firepower to deal with the pricing and access issues that Judge Greene’s structural decree forced to the fore. The ratemaking and access chores had to be tackled by the FCC, which operated in tag-team style in conjunction with Judge Greene’s nonstop judicial oversight of its output, backed by a team of experts from the Department of Justice. The complex multi-stage process led to clear delays on innovation. But the bad structure of the Bell consent decree put greater pressure on the conduct remedies.

30. Even that point was not always clear. In the famous consent decree in the *Packers Case*, *United States v. Swift & Co.*, 286 U.S. 106 (1932), the original settlement not only broke up the cartel within the meatpacking industry, but also prevented each of the companies from competing separately in other markets, including agricultural processes. The last restrictions were profoundly anticompetitive. In the 1932 litigation, Swift sought to break the decree, but on that point was stoutly opposed by the grocery industry, which profited from the consent decree bar. The modification was denied and, once again, the antitrust law was pressed into service for anticompetitive ends. *Id.* For discussion, see EPSTEIN, ANTITRUST CONSENT DECREES, *supra* note 23, at 22-29.

The conduct remedy in this context says that the regulated party should offer correct prices to its downstream rivals, and refrain from certain practices that shore up its monopoly position. It is often unclear, though, what that correct price should be, or which practices should be regarded as anticompetitive. The antitrust law has a shot at controlling some of these issues if there are certain contractual practices that it can sensibly ban, but it is hopeless on dealing with rate issues and technological innovation, as Assistant Attorney General Baxter and Judge Greene both understood.

At this point, the question is what other course of action could have been taken in these cases which did not require the conduct remedy. In this context, the first lesson that should have been learned from the previous history of litigation under section 2 of the Sherman Act is that there is something deeply incongruous in invoking the most potent remedy—structural change—in circumstances where it is often difficult to get a clear fix on the underlying liability. Stopping cartels from colluding gives the best of both worlds, high social gain at low administrative cost, but these cases are the low-hanging fruit.

The question is what should be done with more difficult cases, such as telecommunications, where no competitive solution is possible, no matter what the terms of the consent decree or settlement. The first point to recognize here is that once we leave the AT&T monopoly model, some form of regulation will prove necessary to deal with the question of interconnections between the parties. In this regard, some of the administrative turmoil associated with the 1982 breakup of the Bell System was unavoidable. But there is still a question of how this should best be done, to which there are two potential answers. The one chosen in 1982 created seven LECs and thus committed the system to a strong separation between local and long-distance carriers. The alternative approach would not have broken up AT&T, but would have required it to interconnect on just and nondiscriminatory terms with any and all telecommunications companies.

Here are two arguments in favor of the second option. First, this very approach was slowly gaining traction in the FCC at the time of the breakup. Indeed, Judge Greene acknowledged that FCC policy was tending in that welcome direction by allowing both interconnection and resale, and sharing of AT&T services.³¹ The question, therefore, was why not continue with

31. In his opinion, Judge Greene noted:

It must be remembered that the regulatory decisions which introduced competition into the interexchange market are themselves relatively recent. It was not until 1978 that the provision of regular long distance telephone service (i.e., MTS/WATS type service) became subject to competition. . . . The FCC decisions allowing interexchange carriers to expand their service offerings by reselling and sharing AT&T services have likewise been in force only for the last several years.

the efforts to open up this network by taking one of these routes, preferably through interconnection. Second, this approach was ultimately embedded in the 1996 Telecommunications Act, in section 251, which creates a general duty of telecommunications carriers “(1) to interconnect directly or indirectly with the facilities and equipment of other telecommunications carriers; and (2) not to install network features, functions, or capabilities that do not comply with the [applicable FCC guidelines and standards].”³² In order to make this system go, it is also necessary to impose a duty to negotiate in good faith over the terms of the interconnections, which the Act did,³³ subject to a set of provisions that dealt with the negotiation, arbitration, and approval of agreements, here done by state communications commissions, subject to rules and regulations promulgated by the FCC.³⁴ These provisions have provided the least controversy under the 1996 Act. Indeed, virtually all the confusion under that Act came from the same mode of aggressive intervention that undermined the effectiveness of the 1982 consent decree. The chief villain of the piece was section 251(c)(3), which created an “additional” obligation that swamped the stated obligation by forcing each of the carriers to sell off in bits and pieces the unbundled network elements, which created endless disputes over pricing.³⁵ There is no point to restate the pathology here. Suffice it to say that the statute gave a free option to the new entrant that a set of regulations were allowed to be exercised in such a manner that if the entire network were sold off piecemeal, the incumbent carrier could not recover the cost of its investment.³⁶ The ostensible benefit of this provision was that it prevented needless duplication of network elements. Its far greater vice was its utter inability to control the key pricing decisions. Sale at a forced valuation is dangerous even in the simplest eminent domain context; it is far more dangerous with tiny components of key switches.

United States v. AT&T, 552 F. Supp. 131, 172 n.172 (D.D.C.1982).

32. 47 U.S.C. § 251(a) (2000).

33. § 251(c)(1).

34. § 252.

35. The statute reads:

Unbundled access. The duty to provide, to any requesting telecommunications carrier for the provision of a telecommunications service, nondiscriminatory access to network elements on an unbundled basis at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory in accordance with the terms and conditions of the agreement and the requirements of this section and section 252 of this title. An incumbent local exchange carrier shall provide such unbundled network elements in a manner that allows requesting carriers to combine such elements in order to provide such telecommunications service.

§ 251(c)(3).

36. For a fuller account, see Richard A. Epstein, *Takings, Commons, and Associations: Why the Telecommunications Act of 1996 Misfired*, 22 YALE J. ON REG. 315 (2005).

The subsequent history shows the superiority of interconnection. Had Judge Greene decided to stress that theme, the entire path of the telecommunications industry would have been altered, and for much the better. The key decisions on how to expand the network would be made by market players with guaranteed entry and not through an administrative process filled with major uncertainties and lengthy delays. One key consequence of this new pattern would have been the more rapid rise of cell phone use in the United States, which market actors could have developed in connection with the existing network. This free entry approach would, in principle, have allowed entry at both the local and the long-distance level, or a combination of the two, at the discretion of the applicant, not the judge. Unfortunately, the proper treatment of mobile phones was nowhere mentioned in the backward-looking 1982 decree.³⁷ It therefore fell to the fine art of legal interpretation to see whether, in the end, they would be allocated to the LECs or treated as new competitive elements in the long-distance side of the equation. At the time the decision was made, the range of mobile telephony was limited so that all this business was allocated to the RBOCs, just as if it had all the characteristics of the last mile monopoly of the land phones.

Naturally, the high stakes led to extensive litigation. Judge Greene held in 1986, four years into the decree, that the LATA boundaries were applicable to cell phones and pager services, even though their technology bore no relationship to the then-dominant land lines: there is no last mile control for cell phones.³⁸ That decision was, not surprisingly, overturned in the court of appeals, which found no evidence in the decree or the circumstances of its negotiation of an intention to so limit cellular services.³⁹ But even with that appellate assist, the entire administrative path was filled with potholes, for Judge Greene still remained at the helm, a veritable one-man regulatory monopoly. Even though he routinely approved requests for waivers from the LATA provisions, all this took time (eight months for pager waivers and nineteen months for cellular waivers).⁴⁰ These numbers are very large in a world in which the useful life of some technical innovations is measured in months, not years.

It is important, therefore, to think about this entire episode from a more structural perspective. If the 1982 decree had never undertaken divestiture, but had made facilitation of new entry from any and all

37. See KELLOGG, THORNE & HUBER, *supra* note 8, at 46-47, for a terse account that concluded thus: "The drafters of the decree simply blew it." But of course it is not so simple. There are endemic limitations to the consent decree process.

38. *United States v. W. Elec. Co.*, 627 F. Supp. 1090 (D.D.C. 1986).

39. *United States v. W. Elec. Co.*, 797 F.2d 1082 (D.C. Cir. 1986).

40. KELLOGG, THORNE & HUBER, *supra* note 8, at 677-686 (offering a detailed and incisive account of these events).

directions its sole objective, mobile phone technology could have skipped over extensive obstacles to its widespread deployment. All the applicant need do is show up for an interconnection hearing in order to be added to the network. What it puts on its side of that interconnection is strictly its own business. The phone company has no more control over that end use than the electrical company has over the appliances that are attached to its outlets. At a guess, earlier arrival of cellular could have hastened the demise of the local exchange monopoly by perhaps a generation by providing on a secure and rapid basis an alternative entry path into the home. The entire episode shows that, notwithstanding the commendable desire to break the old Bell monopoly, the 1982 decree contained many structural limitations on innovation that could only warm the hearts of the die-hard supporters of corporatism.

In a similar vein, the adoption of the interconnection approach would have let the existing Bell System and any of its competitors provide "information services,"⁴¹ including data processing, electronic publishing, voice answering services, and electronic mail to their customers.⁴² Yet the 1982 decree gave the government and Judge Greene the opportunity to put restrictions on the RBOCs, which they did based on the inchoate belief that the RBOCs were capable of using their monopoly power to distort the operation of this emerging market. How was never stated. In retrospect, the entire episode starts from exactly the wrong premise. New and emerging markets benefit from new entry, not from institutional prohibitions. The most costly restrictions on entry come from those companies with the greatest potential expertise on the relevant issue. The restriction here thus harkens back to the unwise provisions in the *Packers* case that kept the various meatpacking companies out of key segments of the grocery business. In 1991, this restriction was removed, but not until it had generated endless rounds of pointless litigation.⁴³ Once again, the corporatist approach to new entry found a welcome home in the 1982 breakup decree.

V. A SUMMING UP

Any complete discussion of the Bell consent decree could take volumes to complete. But it takes far less time to summarize the lesson. The principle that should inform all exercises of government regulation is that regulation is an evil until it can be shown to be a good. In this particular instance, the rather hefty costs of implementing the 1982 decree

41. *United States v. AT&T*, 552 F. Supp. 131, 229 (1982) (Decree § IV(J)).

42. For an exhaustive account, see KELLOGG, THORNE & HUBER, *supra* note 8, at 315-27.

43. *Id.*

should count as a substantial thumb on the scale. Robert Crandall estimates that these direct costs ran to a tidy sum, but that the overall decline in telephone costs per minute occurred more rapidly in the United States than in Canada and the EU. This decline now hovers at about the same rate of five to seven cents per minute, at least as of 2006.⁴⁴ This one number suggests that it would be hard to identify any systematic savings that came out of a process that has been rich in litigation, but little else. More to the point, none of these numbers deal with the interim delays in innovation that are fairly attributable to the decree. The broad lesson here is that the choice of remedial instruments really matters, often times more than the perception that some degree of regulation is in fact needed. The 1982 decree introduced an unwieldy alliance between Judge Greene and the FCC which helped set the course of regulation under the 1996 Telecommunications Act. None of these movements were wise, and all of them could have been anticipated by regulators who started with the right frame of mind, which favors modest steps over grand coups. A simple interconnection approach is not the hallmark of a competitive market. But it would surely have functioned far better than the complex schemes of regulation that have controlled telecommunications in the United States since the adoption of the 1982 Bell consent decree, now some twenty-six long years ago.

44. Robert W. Crandall, The Brookings Inst., Presentation at the University of Pennsylvania Law School, Center for Technology, Innovation, & Competition Symposium: The Enduring Lessons of the Breakup of AT&T: A Twenty-Five Year Retrospective (Apr. 18-19, 2008) (powerpoint slides on file with The Federal Communications Law Journal).

