

# Winning By Losing: The AT&T Settlement and Its Impact on Telecommunications\*

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On January 8, 1982, Assistant Attorney General William F. Baxter and Charles L. Brown, chairman of the American Telephone and Telegraph Company (AT&T or Bell), jointly announced settlement of the government's 1974 antitrust suit against AT&T and its affiliates.<sup>1</sup> The settlement, as approved by Judge Harold Greene,<sup>2</sup> required AT&T to divest its local Bell operating companies and satisfied virtually all of the demands for structural relief made at trial by the Department of Justice (DOJ or Department). The Department has thus achieved its litigation objectives without a judicial decision on the merits of its case.

Why did AT&T suddenly agree to the draconian structural reorganization it had spent almost a decade and millions of dollars in legal fees resisting? Our analysis suggests that Bell's legal position was strong, but that changes in technology and in the regulation of telecommunications had made advantageous for Bell the divestiture it had previously found so objectionable. AT&T's profits from long-distance service, required by regulators for local service subsidies, were being deeply eroded by the entry of independent long-distance carriers upon whom regulators had imposed far lower subsidization requirements. Consequently, AT&T let the Department of Justice do what the regulators would never have let the company do on its own: divest its low-profit local exchange operations, leaving

\* This article is a project of the Research Program in Government-Business Relations, Yale School of Organization and Management. Funding has been generously provided by the General Electric and Olin Foundations. Comments and criticism have been offered by Professors Louis B. Schwartz and M. J. Peck, and Olin Fellow Denise McMillan. The authors are grateful for this program and the valuable assistance, including that of the very creative editors of this journal.

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1. N.Y. Times, Jan. 9, 1982, at A1, col. 1.

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

it free to focus on competing in the long-distance and equipment markets. AT&T, by capitulating to DOJ and thus "losing" the antitrust suit, won a reprieve from local service obligations it could not otherwise have achieved.

Section I of this paper describes the regulatory dilemma facing AT&T, which required AT&T to subsidize local service yet tolerate encroachment on its long-distance profits by new competitors. Section II discusses the allegations at issue in DOJ's suit against AT&T and delineates the terms of the settlement. In Section III, we analyze the legal merits of the suit and conclude that had the case proceeded to judgment, AT&T probably would have avoided liability and, even in the event of liability, divestiture. Section IV examines the economic effects of the settlement and highlights what must have been AT&T's primary consideration in acceding to divestiture: Freed from the requirement that it pay a disproportionate share of the costs of local service, AT&T will be able to compete much more vigorously in the lucrative long-distance and equipment markets—so vigorously, in fact, that it may drive its competitors out of those markets. On the other hand, the divested local exchange companies will have to raise substantially local service rates to cover costs, or else AT&T's competitors will be charged significantly higher fees to pay for local service subsidies. Section V, the concluding section of the article, assesses the implications of the settlement for antitrust enforcement and regulatory policy.

## I. AT&T's Dilemma: Inconsistent Regulation

### A. *The Subsidization of Local Services Out of Long-distance Revenues*

For the past century, the American telecommunications industry has been an intensely regulated sector of the economy. Companies in the industry face regulation in virtually all of their activities, through requirements that a myriad of service tariffs<sup>3</sup> be certified and approved by the Federal Communications Commission (FCC) and by state regulatory agencies, and through controls on entry into all fields of service. In establishing "just and reasonable"<sup>4</sup> prices, the FCC and most state regulatory agencies have as a central goal the assurance of universal service; the language of the Communications Act of 1934,<sup>5</sup> the basic statutory framework within which the FCC operates, expresses this objective in the following

3. A "tariff" must be filed with the FCC for every service offering. The tariff not only establishes the rates for the service, but also specifically defines the offering and its limits, as well as the general obligations of the company for provision of the service. BELL TELEPHONE LABORATORIES, INC., ENGINEERING AND OPERATIONS IN THE BELL SYSTEM 70-71 (1977).

4. See, e.g., 47 U.S.C. § 205 (1976); 1913 Mo. Laws 621; 1911 N.J. Laws 380; 1915 Wyo. Sess. Laws 221.

5. Pub. L. No. 73-416, 48 Stat. 1046 (1934) (codified at 47 U.S.C. §§ 151-609 (1976)).

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terms: "to make available, so far as possible, to all the people of the United States a rapid, efficient, nationwide, and world-wide wire and radio communication service with adequate facilities at reasonable charges."<sup>6</sup> The pursuit of this objective has meant that the prices for different services do not bear any consistent relationship to the costs of providing those services. In this rate structure disoriented by regulation, long-distance rates far exceed the costs of providing service; the profit opportunities created by this disparity have attracted new entrants into the long-distance market.

The U.S. telecommunications industry is composed of three tiers of companies. At the top stands—and will continue to stand—the nation's largest corporation, AT&T, which has supplied, through some twenty-three fully or partly owned "operating companies," approximately eighty-five percent of local phone service and, through its Long Lines department, approximately ninety percent of all domestic and international long-distance service.<sup>7</sup> An AT&T subsidiary, Western Electric, is the largest producer of telephone equipment and supplies the material needs of virtually the entire Bell System, by manufacturing components itself and by serving as a centralized procurement agency.<sup>8</sup> Western Electric and AT&T jointly own Bell Laboratories, one of the country's foremost basic and applied research facilities, which provides virtually all of the new technology in the domestic telecommunications industry.<sup>9</sup>

The second tier of companies in telecommunications centers around a cluster of large, somewhat vertically integrated telephone holding companies—e.g., General Telephone and Electronics (GTE) and United Telecommunications—which provide service largely to the less populated areas of the country. In addition, many firms have recently entered the intercity and equipment fields; the antitrust suit focused on Bell's competition with these firms. The third tier of the telephone industry consists of 1,500 or so rural telephone companies, which serve about twenty-five percent of the

6. 47 U.S.C. § 151 (1976).

7. Market share statistics vary across a broad range. A recent Congressional staff report estimated that AT&T's effective share of the intercity services market exceeds 90 percent. STAFF OF HOUSE SUBCOMM. ON TELECOM., CONSUMER PROTECTION, AND FINANCE, 97TH CONG., 1ST SESS., TELECOMMUNICATIONS IN TRANSITION: THE STATUS OF COMPETITION IN THE TELECOMMUNICATIONS INDUSTRY 124 (Comm. Print 1981) [hereinafter cited as HOUSE STAFF REPORT]. The decree uses a lower estimate:

There can be no doubt that AT&T's market share in the interexchange market is high. Although it is not possible to focus on a precise figure inasmuch as the number of market share estimates is almost as varied as the number of persons submitting comments, even AT&T concedes that as late as 1981 its share of interexchange revenue was around 77 percent.

United States v. AT&T Co., 552 F. Supp. at 171.

8. See HOUSE STAFF REPORT, *supra* note 7, at 159.

9. Testimony of William D. Nordhaus at 73-83, United States v. AT&T Co., 552 F. Supp. at 131.

country's geographical area but less than four percent of total households.

The flow of funds from long-distance services to the three classes of local phone companies—AT&T's local operating companies, the other majors, and the rurals—is determined by both federal and state regulation. The FCC approves tariffs for only the interstate portion of long-distance services, while the state agencies approve tariffs covering local and intrastate long-distance services. Since the 1950's, the costs of local service have been increasing, while the costs of long-distance service have declined, the latter due largely to technological innovation. Repeated requests for increases in local service charges resulted. State regulatory officials were hesitant to grant such requests, in light of the substantial political costs involved: Ratepayers vote. Moreover, local rate increases disserved the goal of universal service shared by all regulators.

As a result of the federal/state division of regulatory authority and of the universal service mandate, rates were divorced from costs. Regulators turned to "value of service" pricing, under which those users who are less price-sensitive pay more, and those who are more price-sensitive pay less.<sup>10</sup> As a result, commercial rates were kept higher than residential rates, and urban and rural users were charged similar rates even though costs of serving them differed. Long-distance rates were set substantially above costs in order to generate excess revenues with which to subsidize local service, thereby avoiding inflation-induced local rate increases. In the 1960's and 1970's, this was accomplished by using long-distance revenues to cover a substantial and increasing portion of the costs ostensibly common to both local and long-distance operations.

The arcane process that produces these revenue transfers is called the Jurisdictional Separations Procedure (separations) and has been developed through agreements among state regulatory agencies and the FCC.<sup>11</sup> Initially, the costs directly allocable to intrastate and interstate services are assigned for ratemaking purposes to the state agencies or the FCC. The joint and common costs of providing these services are then arbitrarily divided between the interstate and intrastate categories. It is the arbitrary division of joint and common costs that constitutes, in the words of Judge Greene, a "subsidy from interexchange revenues to local rates."<sup>12</sup> Average price levels for each class of service are then set to satisfy a "revenue requirement" that covers the assigned portion of these joint and common costs. The revenues generated under the requirement are then paid to lo-

10. For a theoretical discussion of this principle, see Baumol & Bradford, *Optimal Departures from Marginal Cost Pricing*, 60 AM. ECON. REV. 265 (1970).

11. See, e.g., Separation Procedures, 26 F.C.C.2d 248 (1970) (Ozark Plan).

12. 552 F. Supp. at 169 n.161.

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cal companies as “divisions of revenues” if the company is a Bell affiliate, or as “settlements” if the company is an independent firm.

The current separations agreement, the Ozark Plan,<sup>13</sup> deserves specific discussion. In December, 1969, Bell proposed a large reduction in interstate rates, which the FCC allowed to go into effect in January, 1970.<sup>14</sup> State regulators, besieged with requests for local service rate increases, sought help from Congress. Legislation was quickly introduced to remove from the FCC jurisdiction over separations.<sup>15</sup> In April, the FCC reacted with the creation of a “Joint Board,” composed of representatives from the FCC and the National Association of Regulatory Utility Commissioners (NARUC), to reassess the separations process.<sup>16</sup> The Ozark Plan was the whirlwind result. The plan was first seen by staff of the Joint Board on June 30, filed with the board on August 6, referred to the FCC on August 13, proposed as a rule on August 26, and adopted on October 27.<sup>17</sup>

The Ozark Plan caused a substantial increase in the amount of joint and common costs borne by long-distance services.<sup>18</sup> Commissioner Johnson, dissenting from the FCC’s refusal to consider explicitly the public interest implications of its decision, bluntly explained the result:

One could advance arguments about what is being done here. But that would require that we be open, candid, straightforward and honest in stating what it is we are doing. Basically, what we are doing is *subsidizing* the costs of local service with Bell’s excess profits from long-distance service. [Emphasis added.]<sup>19</sup>

The effect of changes in separations plans is shown in Table One. These plans have imposed progressively larger shares of joint costs on

13. 26 F.C.C.2d at 248.

14. AT&T, Revisions to AT&T Tariff F.C.C. No. 263, Long Distance Message Telecom. Serv., 20 F.C.C.2d 886 (1969).

15. 26 F.C.C.2d at 261.

16. Separation Procedures, 23 F.C.C.2d 465 (1970) (order convening Joint Board). Congress subsequently enacted legislation officially conferring separation jurisdiction on a joint FCC/NARUC board. Pub. L. No. 92-131, § 2, 85 Stat. 363 (1971) (codified as amended at 47 U.S.C. § 401(c) (1976)).

17. By contrast, over ten years have elapsed without the FCC determining the procedures by which AT&T’s competitors will be charged their share of joint and common costs. See *infra* text accompanying notes 45-48.

18. Under the Ozark formula, subscriber line usage (SLU)—the percentage of time that joint and common equipment is used by interstate calls—is multiplied by 3.3 to arrive at the subscriber plant factor (SPF)—the percent of joint and common costs to be allocated to interstate jurisdictions. Thus, if such equipment is used for interstate calling 7 percent of the time, then 23 percent of the joint and common costs are allocated to interstate jurisdictions. See Testimony of Charles R. Jones at 11-12, *United States v. AT&T Co.*, 552 F. Supp. at 131.

19. Separation Procedures, 26 F.C.C.2d at 262.

long-distance operations, causing a substantial increase in the difference between the price and direct costs for long-distance service. By 1978, one-third of interstate toll revenues were being directed to the operating companies to cover joint and common costs. This shift of revenues allowed state regulatory agencies to reject or otherwise moderate requests from local exchanges for rate increases to compensate for increased costs.

Under the Ozark Plan, as Table Two indicates, price increases in the 1970's for both local and long-distance services were kept well below increases in the Consumer Price Index. Table Three depicts shifts in service prices and direct operating costs between 1964 and 1977. During this period, the average charge for local service in current year dollars increased by two-thirds, while the direct costs associated with that service tripled. For interstate long-distance service, on the other hand, prices remained constant in current dollar terms, while direct costs fell by more than two-thirds. The difference between prices and direct costs for long-distance service, as a percentage of price, jumped from eight percent in 1964 to seventy-four percent in 1977; this vastly increased margin was available to help cover rising local service costs.

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**TABLE ONE**  
**PORTION OF JOINT AND COMMON COSTS COVERED BY INTERSTATE REVENUES**  
**BELL SYSTEM, 1955-78**

Year	Separations Plan	Requirements Covered by Interstate Revenues (A)	Total Interstate Revenues* (B)	Requirements as a Percentage of Interstate Revenues (A/B)
		(\$ millions)	(\$ millions)	(%)
1955	Charleston	55	985	5.6
1960	Charleston	90	1520	5.9
1965	Charleston/Denver	205	2435	8.4
1970	FCC Plan	740	3750	19.7
1972	Ozark	1100	4490	24.5
1973	Ozark	1280	5210	24.6
1974	Ozark	1510	5610	26.9
1975	Ozark	1790	6210	28.8
1976	Ozark	1990	7150	27.8
1977	Ozark	2380	7870	30.2
1978	Ozark	2870	8880	32.3

\*Revenues from message toll service (MTS) and wide area telephone service (WATS) only.

SOURCE: Based on Industry Message Interstate Costs, Testimony of Charles R. Jones, Attachment 9, United States v. AT&T Co., 552 F. Supp. 131 (D.D.C. 1982).

**TABLE TWO**  
**PRICE INDEXES FOR BELL SYSTEM SERVICE CATEGORIES**

Year	Interstate Toll	Intrastate Toll (1967=100)	Local Service	Consumer Price Index
1965	102.9	102.6	100.4	94.5
1970	97.7	105.6	106.5	116.3
1975	106.9	136.4	141.1	161.2
1978	110.1	150.4	155.1	194.0

SOURCE: Based on AT&T ANNUAL REPORTS, various years; *Telecommunications, Competition & Deregulation Act of 1981: Hearings on S. 898 Before the Subcomm. on Communications of the Senate Comm. on Commerce, Science & Transportation*, 97th Cong., 1st Sess. 458 (1981) (Statement of NARUC); CPI from BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, PRODUCER PRICES AND PRICE INDEXES (1980).

TABLE THREE  
PRICE-COST MARGINS FOR CATEGORIES OF BELL SYSTEM SERVICE

Year	Price of a Long Distance Call	Incremental Direct Cost of a Long Distance Call	Price-Cost Margin for a Long Distance Call as a Percentage	Annual Price of Local Service	Incremental Direct Cost of Local Service	Price-Cost Margin for Local Service as a Percentage
	(1)	(2)	(3) = $\frac{(1) - (2)}{(1)} \times 100\%$	(4)	(5)	(6) = $\frac{(4) - (5)}{(4)} \times 100\%$
1964	85¢	78¢	8.2%	\$ 80	\$ 35	56.3%
1965	83	64	22.9	77	35	54.6
1966	84	55	29.8	75	38	49.3
1967	83	49	41.0	80	45	43.8
1968	82	44	46.3	85	50	41.2
1969	81	40	50.6	90	53	41.1
1970	80	36	55.0	93	57	38.7
1971	85	31	63.5	95	60	36.8
1972	90	25	72.2	105	64	39.1
1973	94	23	75.5	110	70	36.4
1974	97	18	81.4	120	77	35.8
1975	84	21	75.0	125	83	33.6
1976	88	22	75.0	130	95	26.9
1977	87	23	73.6	135	100	25.9

Note: All numbers are based on averaging, using current year dollars.

SOURCE: The Historical Cost Study, Defendants' Exhibit D-T-427, United States v. AT&T Co., 552 F. Supp. 131 (D.D.C. 1982).



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These dramatic changes in the price-cost margins for long-distance and local services would not have occurred in the absence of regulation. An unregulated firm would have reduced long-distance prices as direct costs dropped, thereby stimulating demand and expanding profits. Most experts agree that demand is more elastic for long-distance calls than for local service and thus more susceptible to such stimulation.<sup>20</sup> An unregulated telephone company would also have at least doubled local exchange prices to compensate for increases in direct operating costs.<sup>21</sup> Instead, acting under regulatory constraints and contrary to its profit-maximizing interests, the Bell System kept its interstate rates more or less constant and failed to increase local exchange rates sufficiently.

Forcing long-distance services to bear a larger proportion of joint and common costs furthered the FCC's goal of universal service and appealed to state regulators as well, because by keeping local service charges low relative to costs, they were able to reduce both consumer pressure and the number of rate proceedings. However, the resulting rate structure made entry into the long-distance market attractive. When that entry occurred, it upset the entire subsidization process.

### B. FCC Policies Fostering Limited Entry

Probably no service industry has experienced, in the recent past, as many simultaneous changes in competitive conditions as has the telecommunications industry. New entry by competitors was encouraged by a combination of technological advances, which reduced costs, and FCC and state regulatory policies, which kept up long-distance prices. The FCC began in the 1950's and 1960's to open up telecommunications to competitive entry—in equipment sales, long-distance services, and even, to some degree, local services.<sup>22</sup> However, wary of the impact that “creamskim-

20. See, e.g., Davis, Caccappolo & Chaudry, *An Econometric Planning Model for American Telephone and Telegraph Company*, 4 BELL J. ECON. & MGMT. SCI. 29 (1973); Dobel, Taylor, Waverman, Liu & Copeland, *Telephone Telecommunications in Canada: Demand, Production and Investment Decision*, 3 BELL J. ECON. & MGMT. SCI. 175 (1972).

21. See, e.g., Littlechild & Rousseau, *Pricing Policy of a U.S. Telephone Company*, 4 J. PUB. ECON. 35 (1975).

22. For the history of entry in the long-distance and equipment fields, see Note, *Resale and Sharing of Private Line Communications Services: AT&T Restrictions and FCC Regulations*, 51 VA. L. REV. 679 (1975); Note, *Competition in the Telephone Equipment Industry: Beyond Telerent*, 86 YALE L.J. 538 (1977); Comment, *Intercity Telecommunications Competition After Execunet*, 31 FED. COM. L.J. 117 (1978). Mobile radio services have become competitive with some of the services traditionally provided by local carriers. Judicial and FCC rulings have fostered this development. Allocation of Frequencies in the 150.8-162 Mc/s Band (*Guardband*), 12 F.C.C.2d 841, 14 F.C.C.2d 269 (1968), *aff'd sub nom.* Radio Relay Corp. v. FCC, 409 F.2d 322 (2d Cir. 1969); Mobile Radio Communications, Inc., 29 F.C.C.2d 62 (1971) (“head-start” policy); Land Mobile Serv. (*Cellular Mobile Radio*), 51 F.C.C.2d 945 (1974). Revenue growth in this field has also been spectacular: In 1976, land mobile radio equipment and services generated about \$731 million in revenues; in 1980,

ming" by new entrants might have on the separations process and on the pursuit of its regulatory goals, the Commission limited entry to private line services not using the Bell switched exchange network.<sup>23</sup> This restriction on entry was upended in 1977, when a Court of Appeals reversed the FCC in the critical *Execunet* decisions,<sup>24</sup> thereby opening the floodgates to new competitors and leaving both the FCC and AT&T in a state of confusion.

The first court decision upholding the right of telephone customers to use equipment supplied by firms other than Bell was the 1956 *Hush-a-Phone* decision.<sup>25</sup> Previous FCC policy had flatly prevented customer use of any non-AT&T equipment if connected to the AT&T switched telephone network. The Hush-a-Phone device was not directly connected to the network, but was a simple attachment that snapped onto a telephone receiver and provided for privacy of conversation. Judge Bazelon reversed the FCC's refusal to sanction this new device, writing that, "The intervenors' [AT&T's] tariffs under the Commission's decision are in [sic] unwarranted interference with the telephone subscriber's right reasonably to use his telephone in ways which are privately beneficial without being publicly detrimental."<sup>26</sup> Following this decision, the FCC, in its *Carterfone* ruling, relaxed its regulations on the use of non-Bell telephone equipment.<sup>27</sup>

As a practical matter, however, the conditions necessary for sustained competition in the customer-premises telephone equipment market were not fully established until the FCC's "Registration Program" was implemented in 1977.<sup>28</sup> Until then, Bell had required the use of a protective

revenues exceeded \$2.4 billion, and it is predicted that they will rise to \$4.7 billion by 1985. Miles, *An Overview of the Land Mobile Industry*, COMMUNICATIONS, Sept. 1980, at 57.

23. The switched exchange network refers to the portion of the Bell network that connects local users to other local users or to long-distance trunk lines. Most calls are switched, but some are not (e.g., when calls are made within a business complex using an internal switching system). If denied access to the Bell switched exchange network, a competitive carrier would be forced to find alternative switching facilities or construct its own.

24. *MCI Telecom. Corp. v. FCC (Execunet I)*, 561 F.2d 365 (D.C.Cir. 1977), *cert. denied*, 434 U.S. 1040 (1978); *MCI Telecom. Corp. v. FCC (Execunet II)*, 580 F.2d 590 (D.C. Cir.), *cert. denied*, 439 U.S. 980 (1978).

25. *Hush-a-Phone Corp. v. United States*, 238 F. 2d 266 (D.C. Cir. 1956). *See also Use of Recording Devices*, 11 F.C.C. 1033 (1947).

26. 238 F.2d at 269.

27. *Carterfone Device*, 13 F.C.C.2d 420, 14 F.C.C.2d 571 (1968). *See also AT&T Foreign Attachment Tariff Revisions*, 15 F.C.C.2d 605 (1968), 18 F.C.C.2d 871 (1969). The *Carterfone* ruling initially applied only to equipment already in place; it did not afford customers a right to replace equipment already supplied by the local phone company. The FCC broadened the scope of *Carterfone* in 1975 to include such displacement actions. *See AT&T Proposed Tariff Revisions (Mebane Home Tel. Co.)*, 53 F.C.C.2d 473, 476 (1975).

28. *Interstate Foreign Message Toll Tel. Serv. (Registration Program)*, 56 F.C.C.2d 593 (1975), 58 F.C.C.2d 736 (1976); *see North Carolina Util. Comm'n v. FCC*, 537 F.2d 787 (4th Cir.), *cert. denied*, 429 U.S. 1027 (1976).

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connection attachment (PCA) with any non-Bell equipment being hooked into the system. Under the registration program, virtually any equipment satisfying minimal performance standards could be “registered” with the FCC, “type-accepted,” and then used by telephone subscribers without a PCA—but only for non-network functions. Sales of customer-premises phone equipment supplied by firms other than AT&T and other carriers have since expanded rapidly.<sup>29</sup> Carrier-affiliated companies—in particular Western Electric—continue to receive most of the revenues in the equipment field.<sup>30</sup> However, new entry has reduced AT&T’s profit margins on equipment, particularly commercial equipment.<sup>31</sup>

Competitive entry in the long-distance telecommunications field has also had a long and erratic history. The Communications Act of 1934 provided:

It shall be the duty of every common carrier engaged in interstate or foreign communication by wire or radio . . . in accordance with the orders of the Commission, in cases where the Commission, after opportunity for hearing, finds such actions necessary or desirable in the public interest, to establish physical connections with other carriers . . .<sup>32</sup>

Thus, the FCC did not have to grant all requests for interconnection, but only those it deemed to be in the public interest. For many years, long-distance service was left in the hands of regulated monopolies.

Technological advances, however, changed the competitive landscape. In particular, microwave relay facilities—based on technology developed by Bell Labs during World War II—offered long-distance service at costs substantially below those of existing wire facilities. In its 1959 *Above 890*<sup>33</sup> decision, the FCC authorized certain private companies to provide

29. NORTH AMERICAN TEL. ASS’N, *INDUSTRY STATISTICAL REVIEW 1980*; U.S. DEPT OF COMMERCE, 1982 U.S. INDUSTRIAL OUTLOOK 228. Different sources have developed slightly different sales figures; all agree that between 1977 and the present, “interconnect” sales have at least doubled. The North American Telephone Association, the “interconnect” industry’s principal trade association, estimated 1974 total sales of \$320 million, 1979 sales of \$729 million, and 1981 sales of over \$1.4 billion.

30. HOUSE STAFF REPORT *supra* note 7, at 184; U.S. DEPT OF COMMERCE, *supra* note 29, at 228; NORTH AMERICAN TEL. ASS’N, *supra* note 29. In 1981, for example, total equipment industry revenues amounted to about \$12.2 billion, of which Western Electric received approximately 75 percent. In the critical submarket for network switching equipment used in providing most toll and local services, Western Electric continued to be almost the sole source of supply.

31. HOUSE STAFF REPORT, *supra* note 7, at 184; *Hearings on H.R. 5158 Before the Subcomm. on Telecom., Consumer Protection, and Finance of the House Comm. on Energy and Commerce*, 97th Cong., 2d Sess., pt. 2, at 106 (1982) (Testimony of Charles Marshall, Executive Vice President, AT&T).

32. 47 U.S.C. § 201(a) (1976).

33. *Allocation of Frequencies in the Bands Above 890 Mc.*, 27 F.C.C. 359 (1959); *modified* 29 F.C.C. 825 (1960).

microwave services for their own internal use. That decision, though limited in scope, indirectly created pressure for entry into other fields.

In 1963, MCI applied to the FCC to supply private line communications between St. Louis and Chicago. MCI's application was for non-switched service; that is, it did not request any connection with the Bell switched network. The application generated substantial controversy. A 1967 Presidential Task Force on Communications Policy, headed by Eugene V. Rostow, recommended that, to retain efficiencies of scale and to prevent creamskimming, the public network should remain a regulated monopoly, with entry limited to private non-switched services.<sup>34</sup> In fact, the FCC granted MCI's application in 1969 on just such a limited basis.<sup>35</sup>

In 1971, the FCC adopted rules sanctioning a policy of entry into the narrowly defined private line field.<sup>36</sup> Its *Specialized Common Carrier* decision stated:

[C]ompetition in the specialized communications field is reasonably feasible, there are grounds for a reasonable expectation that new entry will have some beneficial effects, and there is no reason to anticipate that new entry would have any adverse impact on service to the public by existing carriers such as to outweigh the considerations supporting new entry.<sup>37</sup>

This statement, the FCC later said,<sup>38</sup> was intended to be limited to entry into service markets not on the Bell system, i.e., non-switched communications between customer facilities. No specific mention of interconnection was made, in part because none of the entering carriers requested it. The decision was so confusing on this and other issues that one judge has referred to it as "not a model of clarity,"<sup>39</sup> while another has called it an "abomination" and "one of the worst examples of legal draftsmanship I have ever seen."<sup>40</sup>

The incentives for further encroachment by independent "Specialized Common Carriers" (SCC's) were very strong. FCC policies did not require SCC's to contribute to separations payments; therefore, the access charges for attachment to the local exchanges were lower for these firms

34. *Southern Pac. Com. Co. v. AT&T Co.*, 556 F. Supp. 825, 862 (D.D.C. 1983).

35. *Microwave Communications, Inc.*, 18 F.C.C.2d 953 (1967), *reconsid. denied*, 21 F.C.C.2d 190 (1970), *modifs. granted*, 27 F.C.C.2d 380 (1971).

36. *Specialized Common Carrier Servs.*, 29 F.C.C.2d 870 (1971), *aff'd sub nom.* *Washington Util. & Transp. Comm'n v. FCC*, 513 F.2d 1142 (9th Cir.), *cert. denied*, 423 U.S. 836 (1975).

37. 29 F.C.C.2d at 920.

38. *MCI Telecom. Corp.*, 60 F.C.C.2d 25 (1977).

39. *Southern Pac. Com. Co. v. AT&T Co.*, 556 F. Supp. at 865.

40. *MCI Communications Corp v. AT&T*, 44 ANTITRUST & TRADE REG. REP. (BNA) 112, 114 n.13 (7th Cir. Jan. 12, 1983) (quoting Grady, J., Trial Tr. 3785).

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than for Bell's own Long Lines department.<sup>41</sup> This disparity opened up to the SCC's greater profit margins in toll services than those enjoyed by Bell Long Lines, which continued to subsidize local services. Following MCI's lead, affiliates of Southern Pacific Railroad, ITT, and others of the largest companies in the country entered the field.

When MCI proposed new switched service in direct competition with Bell's Long Lines, the FCC refused approval.<sup>42</sup> In its decision, the Commission explained that *Specialized Common Carriers* was meant to allow entry only into private line service, and not into direct competition with the public network. As noted above, the Court of Appeals, in *Execunet*,<sup>43</sup> reversed the FCC and opened virtually all intercity markets to competitors. After *Execunet*, the FCC attempted to adapt to the new judicially imposed reality by further lowering entry barriers. For example, in 1980 it eliminated rules that had prohibited the sharing of heavy use, bulk rate circuits, and it directed AT&T to permit the resale and sharing of these circuits by its competitors.<sup>44</sup>

However, the Commission has been slow to modify separations procedures to reflect competitive entry. SCC's are now charged a portion of joint and common costs,<sup>45</sup> but charges are still not on a par with Bell separations contributions.<sup>46</sup> The FCC has been developing for years a "Cost Allocation Manual," meant to establish an economically justified method of determining separations payments.<sup>47</sup> As part of this process, the FCC in 1976 directed AT&T to price all interstate services on a fully distributed cost basis;<sup>48</sup> these higher floors for Bell's prices were above the marginal costs, and perhaps even the average total costs, of new entrants, since they included an arbitrary percentage share of AT&T's fixed costs.

Yet the cost allocation process is still incomplete.<sup>49</sup> In the meantime, Bell Long Lines continues to pay twenty-two percent of joint and common costs, even though long-distance calls take up only seven percent of the time used on common facilities.<sup>50</sup> The SCC's, on the other hand, continue

41. Exchange Network Facils. for Interstate Access (*ENFIA*), 71 F.C.C.2d 440, 440-41 (1979).

42. 60 F.C.C.2d at 25.

43. *Execunet I*, 561 F.2d at 365; *Execunet II*, 580 F.2d at 590.

44. Resale and Shared Use of Common Carrier Servs. & Facils., 60 F.C.C.2d 261 (1976), *aff'd sub nom.* AT&T Co. v. FCC, 572 F.2d 17 (2d Cir.), *cert. denied*, 439 U.S. 875 (1978); Resale & Shared Use of Common Carrier Pub. Switched Network Servs., 83 F.C.C.2d 167 (1981).

45. *ENFIA*, 71 F.C.C.2d at 440.

46. Exchange Network Facils. for Interstate Access (*ENFIA*), 51 RAD. REG. 2D (P & F) 677, 677 (1982).

47. AT&T, Manual & Procedures for the Allocation of Costs, 84 F.C.C.2d 384, 412-31 (1981).

48. See Aeronautical Radio, Inc. v. FCC, 642 F.2d 1221 (D.C. Cir. 1980), *cert. denied*, 451 U.S. 920 (1981); MCI Telecom., Inc. v. FCC, 627 F.2d 322 (D.C. Cir. 1980); AT&T, Revisions of Tariff FCC No. 260 Private Line Servs., 61 F.C.C.2d 587 (1976).

49. 84 F.C.C.2d at 384-85.

50. Defendants' Third Statement of Contentions & Proof 250, United States v. AT&T Co., 552

to pay access charges at reduced rates that do not cover their portion of joint and common costs. In these circumstances, it should not be surprising that AT&T's share of the long-distance services market continues to fall by about two percent a year,<sup>51</sup>—or that new entrants, subsidized by current separations procedures, continue to flourish.<sup>52</sup>

## II. The Litigation: Allegations and Settlement

### A. *Allegations*

The Department of Justice filed its antitrust case against AT&T on November 20, 1974, following an intensive three-year investigation of Bell System activities. The suit was brought under Section Two of the Sherman Act<sup>53</sup> and relied initially on a novel "triple-bottleneck" theory.<sup>54</sup> The Department alleged, in essence, that AT&T had illegally manipulated its dominant position in three sets of telecommunications markets—equipment, local exchange, and long-distance—in order to monopolize the entire domestic telecommunications industry. The Department accused AT&T of illegally refusing to provide competitors with local interconnection service and of setting entry-inhibiting prices in potentially competitive parts of its business.

Pretrial discovery and stipulations produced some eighty-two discrete "episodes" of allegedly monopolizing behavior.<sup>55</sup> By the close of the government's case, sixty-odd of these episodes were still at issue.<sup>56</sup> These can be divided into two categories: those related to long-distance markets and those related to equipment markets.

In the first category, a number of episodes involved allegations of refusal to provide interconnection of long-distance competitors. For example, DOJ cited a Bell "customer premises" requirement that allowed the hook-up of a long-distance competitor only if hook-up occurred within the

F. Supp. at 131.

51. *Southern Pac. Com. Co. v. AT&T Co.*, 556 F. Supp. at 884.

52. See *Competitors Chip Away at Market*, N.Y. Times, Oct. 13, 1982, at F8; *MCI Earnings, Competition Continue Rise*, Wash. Post, Oct. 15, 1982, at D1. The leading competitor in the intercity business, MCI increased its revenues from about \$37 million in 1977 to more than \$560 million in 1982. In 1978, total SCC revenues were about \$120 million, the revenues of the domestic satellite carriers about \$70 million, and those of the resale carriers about \$30 million. U.S. DEPT OF COMMERCE, *supra* note 29, at 373. The estimated 1981 revenues of these firms were, respectively, approximately \$700 million, \$130 million and \$135 million. *Id.* at 371-72. See also HOUSE STAFF REPORT, *supra* note 7, at 120.

53. 15 U.S.C. § 2 (1973).

54. See *Hearings on H.R. 13015 Before the Subcomm. on Communications of the House Comm. on Interstate & Foreign Commerce*, 95th Cong., 2d Sess. 748 (1978) (testimony of Assistant Attorney General for Antitrust John H. Shenefield).

55. For a complete description of the 82 episodes, see Defendants' Third Statement of Contentions and Proof, *United States v. AT&T Co.*, 552 F. Supp. at 131.

56. *United States v. AT&T Co.*, 524 F. Supp. 1336, 1343 (D.D.C. 1981).

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confines of the customer's premises, thereby preventing the use by competitors of local networks in the operation of their competing systems. Similarly, the government endeavored to show that AT&T had calculatedly refused to provide General Electric—itsself a major company presumably capable of safeguarding its commercial interests—with services necessary to enable it to construct and operate its own private communications network.<sup>57</sup> In addition, allegations were made that intercity competitors, in obtaining interconnection from local operating companies, experienced delays, poor maintenance, inferior and erratic service, discrimination between competitors, and bad faith negotiations by AT&T.<sup>58</sup>

The Justice Department also alleged antitrust violations by AT&T in its use of the regulatory process. For instance, one episode involved Bell's opposition in FCC hearings to the offering of metered long-distance service by MCI.<sup>59</sup>

The Department contended further that AT&T had engaged in predatory pricing in the long-distance market. DOJ argued not that Bell priced its services below cost, but rather that its prices had been set *without regard to cost*. One such allegation was that Bell's Hi/Low private line rates—initially allowed by the FCC in 1974<sup>60</sup>—were deliberately set at noncompensatory levels as an anticompetitive response to independent private line services.<sup>61</sup> AT&T had argued that markets generating high volumes of traffic were in fact experiencing lower per-unit costs of service, which justified lower prices than those charged in lower density markets. The Hi/Low tariff schedule allowed lower long-distance rates in these high-density areas. But these were also the markets in which SCC's sought authorization to provide new service precisely because of lower per-unit costs. The FCC ultimately reversed itself, concluding that AT&T had not submitted enough information to justify the Hi/Low rates—but not finding, as DOJ later contended, that they were predatory.<sup>62</sup>

The filing of similar tariffs to supplant Hi/Lo rates was alleged by DOJ to reflect exclusionary and predatory behavior.<sup>63</sup> These tariffs, again

57. 524 F. Supp. at 1354. The Department further alleged that defendants' refusal to provide FX (foreign exchange) and CCSA (common control switching arrangement) services to competitors until so ordered by the FCC was proof of monopolization. *Id.* at 1335. FX services allows a customer to make and receive calls from a distant location as if they were local calls. CCSA allows a customer to create its own long-distance network for intra-office communications.

58. *Id.* at 1355-57.

59. *Id.* at 1356, 1363.

60. AT&T, Voice Grade/Private Line Serv. (High Density-Low Density), 45 F.C.C.2d 88 (1974).

61. 524 F. Supp. at 1365 n.118.

62. AT&T, Voice Grade/Private Line Serv. (High Density-Low Density), 55 F.C.C.2d 224, 244 (1975) (Interim Decision), 58 F.C.C.2d 362, 370 (1976).

63. 524 F. Supp. at 1365 n.118.

proposing lower rates on high-density routes, were called Multischedule-Private-Line (MPL) rates and were in turn suspended as a result of FCC proceedings in 1976.<sup>64</sup> The Justice Department later argued that these successively rejected tariff filings (Hi/Lo and MPL) were part of a pattern of low rates designed to intimidate potential entrants.

The Justice Department also alleged that predatory pricing directed against one new entrant, Datran, reflected a policy on the part of AT&T to exclude others illegally.<sup>65</sup> When AT&T introduced its "Dataphone Digital Service" (DDS) in March, 1974—only one month before Datran initiated its own digital service—it filed a tariff proposing rates substantially below those planned by Datran. In fact, two administrative law judges in 1976 ruled that Bell had understated its costs and overstated demand, and concluded that the DDS rates were "anticompetitive" and "predatory."<sup>66</sup> This finding of anticompetitive behavior was affirmed by the full Commission in 1977,<sup>67</sup> but a judicial review of the matter was declined on jurisdictional grounds.<sup>68</sup> New rates based on fully-distributed cost methods were proposed and later approved.<sup>69</sup> However, the question of whether the rates were "predatory" in an antitrust sense is not one that can be resolved by the FCC proceedings.

As to equipment markets, a series of DOJ allegations involved AT&T's responses to the attachment of competitors' customer-premises equipment to the Bell switched network. When non-Western Electric equipment producers sought to market telephone hardware, AT&T required that the purchaser obtain a shielding device (PCA) before attaching the hardware to the switched network. The Justice Department alleged that this PCA requirement was deliberately anticompetitive.<sup>70</sup>

Further allegations involved the monopolization of Bell's own demand for telephone and switching equipment. DOJ contended, in some seventeen additional episodes, that AT&T created a buy-Western bias in its local operating companies, that AT&T refused to purchase competitors' goods even if equivalent Bell equipment did not exist, and that crash development programs were undertaken when Western Electric did not produce competing equipment.<sup>71</sup> Finally, the Department alleged that in the equipment market, too, AT&T was engaging in predatory pricing—again

64. AT&T, Private Line Services (MPL), 59 F.C.C.2d 428 (1976).

65. 425 F. Supp. at 1356, 1364.

66. AT&T, Dataphone Digital Serv., 62 F.C.C.2d 815, 841-43 (1976).

67. AT&T, Dataphone Digital Serv., 62 F.C.C.2d 774 (1976).

68. AT&T Co. v. FCC, 602 F.2d 401 (D.C. Cir. 1979).

69. *Id.* at 404.

70. 524 F. Supp. at 1348-49.

71. *Id.* at 1370-72.



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by pricing its equipment without regard to cost.<sup>72</sup>

### B. *The Settlement and Decree*

On August 11, 1982, Judge Harold Greene issued an opinion essentially approving the Baxter-Brown settlement and, on August 24, 1982, entered a modified final judgment.<sup>73</sup> Under its terms, AT&T will divest itself within eighteen months of its local telephone exchange operations. The new AT&T will provide long-distance telephone services in markets that eventually will be deregulated, and it will be allowed for the first time to diversify into data processing activities.

Current plans under this decree call for the former Bell local operating companies to be separated into seven regional telephone companies, each with projected assets of \$17 billion to \$21 billion. The regional companies are precluded from entering long-distance communications, or any other competitive market, with two exceptions: publishing the Yellow Pages and marketing, though not manufacturing, telephone equipment.<sup>74</sup> AT&T will retain ownership of its Long Lines department and will obtain the long-distance telephone facilities of the divested local exchange companies to form an integrated national long-distance network. AT&T also will retain Western Electric and Bell Laboratories and will be allowed to compete for the equipment business of the new regional operating companies. The currently installed base of Bell-owned customer premises equipment will be transferred from the operating companies to AT&T.

Many of the specifics of the divestiture remain to be fleshed out. AT&T and the Justice Department have filed with the trial court an elaborate plan calling for subdivision of local Bell System operations into some 161 "local exchange and transport areas" (LATA's).<sup>75</sup> Some LATA's seem hardly local at all. California, for example, will apparently be divided into only four LATA's. Nearly the entire eastern coast of Florida is to be contained in another, as will the entire lower portion of Michigan. As much as \$5 billion of AT&T's existing intrastate toll traffic may ulti-

72. *Id.* at 1380.

73. Under the Antitrust Procedures and Penalties Act, 15 U.S.C. § 16(b)-(h) (1976) (Tunney Act), the Court is required to make an affirmative "public interest" determination prior to entering any negotiated antitrust settlement. Judge Greene so determined in the decree. *United States v. AT&T Co.*, 552 F. Supp. at 143-47. Ironically, it would have been in the public interest to complete the case and obtain relief through normal judicial decisionmaking rather than entering into the negotiated settlement.

74. 552 F. Supp. at 193-94. The local companies were not permitted under the settlement to market equipment or to publish Yellow Pages, but this was modified by Judge Greene. *Id.* at 143, 225.

75. Application for Approval of Exchange Areas or Local Access & Transport Areas (LATA's) Established Pursuant to the Modification of Final Judgment (Filed Oct. 4, 1982), *United States v. AT&T Co.*, No. 82-0192 (filed Nov. 20, 1974).

mately be deemed "local" through this redistricting process.

At the same time, the settlement will lift the constraints imposed by the 1956 *Western Electric*<sup>76</sup> consent decree on AT&T's retailing of data processing services. The development of markets for integrated transmission and processing of data has attracted data processing and computer companies that approach the size of AT&T, and the 1956 decree unjustifiably forestalled the entry of AT&T as an effective competitor. Under the 1982 settlement, AT&T is now free to enter and compete in these emerging markets, with the exception of a seven-year ban imposed by Judge Green on entry into electronic publishing.<sup>77</sup>

These structural changes in AT&T are illustrated in Figure One and Tables Four and Five. Figure One outlines the present structure of AT&T. The current Bell operating companies will be divested, in order to set up seven separate companies with the operating statistics as shown in Table Four. The remainder makes up the new AT&T Company as shown in Table Five. At first impression, it seems that the eight emerging companies will be roughly equal in size, particularly in current sales. But prospects for earnings, growth, and service are not at all equal.

76. *United States v. Western Elec. Co.*, 1956 Trade Cas (CCH) ¶ 68,246 (D.N.J. 1956).

77. 552 F. Supp. at 185-86, 225.

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**FIGURE ONE  
AT&T ORGANIZATIONAL CHART**

AT&T COMPANY		Other Subsidiaries
Bell Telephone Laboratories, Inc.*	1.7%	
Western Electric Company, Inc.	15.6%	
General Departments	.6%	
Long Lines Department	3.8%	
Bell Operating Companies	77.5%	
Other Subsidiaries	.8%	
<p>Teletype Corp. Nassau Recycle Corp. Sandia Corp.</p> <p>195 Broadway Corp. American Bell International, Inc. Transoceanic Cable Ship Co. TransPacific Communications, Inc. Cuban American Tel. &amp; Tel. American Bell, Inc. Eastern Tel. &amp; Tel. (Nova Scotia)</p> <p>Bell of Pennsylvania C&amp;P Tel. Cos. (4 Cos.) Cincinnati Illinois Indiana Michigan Mountain New England New Jersey New York Northwest Ohio Pacific NW Pacific South Central Southern Southern New England Southwestern Wisconsin Diamond State</p>		

\* Jointly and equally owned by AT&T and Western Electric.

Percentage figures represent portion of total AT&T employment now accounted for by each subsidiary.

SOURCE: Arthur D. Little Co., Analysis of Telecommunications Industry Restructuring 3 (Sept. 1977).

**TABLE FOUR**  
**REGIONAL HOLDING COMPANIES RESULTING FROM THE SETTLEMENT**

Regional Company	Total Assets	Employees
	(\$ millions)	
Northeast	17,778.6	121,600
Midatlantic	17,267.3	108,103
Southeast	21,800.4	137,500
Midwest	17,038.4	112,978
Southwest	15,949.3	97,600
Mountains & Great Plains	16,109.1	104,900
Far West	16,573.4	114,700

SOURCE: 2 COMMUNICATIONS DAILY, no. 243, at 2 (Dec. 17, 1982).

**TABLE FIVE**  
**REVENUES FOR SERVICES TO BE ASSIGNED TO THE AT&T COMPANY AFTER DIVESTITURE**

	Operating Revenues <sup>a</sup>	Total Assets <sup>b</sup>	Long-Term Debt <sup>b</sup>	Number of Employees <sup>c</sup>
	(\$ billions)	(\$ billions)	(\$ billions)	
Reorganized AT&T*	31.2	24.6	7.8	264,000

\* Includes Western Electric, Bell Laboratories, the Long Lines Department, other subsidiaries besides basic operating companies, all interstate toll revenues, roughly half of intrastate toll revenues, and all customer premises equipment.

**SOURCES:**

<sup>a</sup>Figure includes total 1981 Bell System interstate and international toll revenues (\$25.7 billion) and an AT&T-estimated \$5.5 billion in intrastate toll revenues, as reported in the Baltimore Sun, Oct. 5, 1982, at B-10, col. 5.

<sup>b</sup>Lehman Brothers Kuhn Loeb Research, Divestiture Topics No. 2: The AT&T Divestiture Plan, 14 (Dec. 17, 1982).

<sup>c</sup>Estimate from AT&T, 1981 STATISTICAL REPORT.

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Under the settlement, AT&T retains virtually all the higher-profit, expanding portions of the telecommunications business (those shown as long-distance services in Table Three) and, moreover, is now allowed to diversify into rapidly expanding markets for data processing and related services. From Tables Four and Five, it is apparent that AT&T, while retaining assets of only \$25 billion—one-sixth of current Bell System assets—will receive annual revenues of over \$30 billion or over one-half of current revenues.<sup>78</sup> The newly independent exchange companies, however, will be limited to providing local telephone services—which are in the lower-profit, lower-growth portion of the current industry.<sup>79</sup> Permitting the local firms to market the Yellow Pages and customer-premises telephone equipment offers them somewhat greater promise of profits and growth than monthly local telephone service.<sup>80</sup> The local operating companies, however, are barred from engaging in any part of the long-distance communications business. Thus, the practical effect of the decree is to restrict the new local Bell companies to markets in which past profits and growth rates were so low that the old AT&T found it necessary to subsidize them.<sup>81</sup>

From the perspective of the Justice Department, then, the settlement ostensibly removes the local exchange “bottleneck” that provided AT&T monopoly control over the long-distance and equipment markets. From the perspective of AT&T, the settlement removes the local exchange losers, leaving it free to compete in the long-distance winners and, as well, to compete for the first time in data processing. Who is winning and who is losing?

### III. The Merits of the Case

If the AT&T suit had proceeded to judgment, what would have been the outcome? It is not clear from Judge Greene’s opinions whether he would have found AT&T guilty. In denying AT&T’s motion to dismiss, submitted after the government’s presentation of its case in chief but before AT&T’s presentation of its own evidence, Greene stated that the applicable standard of proof for denial of such motion was very low, and that the choice was largely discretionary.

[I]t [the Court] is empowered . . . to grant the motion if it is convinced that, on the merits, the [plaintiff’s] evidence preponderates

78. For current revenues, see AT&T, 1981 ANNUAL REPORT. The actual division of assets and revenues between Bell Long Lines and the new operating companies is not yet fully determined.

79. See *supra* Table Three.

80. 552 F. Supp. at 191-93.

81. See *supra* text accompanying notes 11-20.

against the plaintiff. . . .

Yet a court is not required to grant a defendant's motion at this stage of the proceedings even if under the law that motion might have been granted.<sup>82</sup>

Judge Greene further explained the denial by pointing to the already lengthy proceedings, and noting that appellate reversal would require a new trial.<sup>83</sup> In the settlement decree, Greene explicitly avoided any "definitive conclusions with regard to either the sufficiency of the evidence to sustain a finding of liability or to the validity of AT&T's various legal and factual defenses."<sup>84</sup>

To support a finding that AT&T was guilty of monopolization under Section Two of the Sherman Act, the government had to establish, by a preponderance of the evidence, two elements: (1) that AT&T possessed monopoly power in the U.S. telecommunications markets, and (2) that AT&T willfully acquired or maintained that power other than through a superior product, business acumen, or historic accident.<sup>85</sup> The government's burden of proof is becoming heavier under contemporary antitrust law, as *Berkey-Kodak* attests.<sup>86</sup> And, as the Second Circuit has more recently noted:

While it is a fundamental tenet of antitrust law that customers will benefit from the salubrious effects of competition, a monopolist's right to compete is not limited to actions undertaken with an altruistic purpose. Even monopolists must be allowed to do as well as they can with their business.<sup>87</sup>

The fact that AT&T is regulated, both by the FCC and state regulatory bodies, affects the Sherman Act analysis in several ways. First, regulation sometimes creates an implied, complete immunity from the antitrust laws.<sup>88</sup> Early in the proceedings, AT&T attempted to invoke this immunity, but was rebuffed by Judge Greene.<sup>89</sup> AT&T could have appealed

82. *United States v. AT&T Co.*, 524 F. Supp. at 1343.

83. *Id.*

84. 552 F. Supp. at 161.

85. *United States v. Grinnell Corp.*, 384 U.S. 563 (1966); *United States v. Aluminum Co. of Am.*, 148 F.2d 416 (2d Cir. 1945).

86. *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 273 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980). See Comment, *Antitrust Scrutiny of Monopolists' Innovations: Berkey Photo, Inc. v. Eastman Kodak Co.*, 93 HARV. L. REV. 408 (1979); Note, *Standards for an Integrated Monopolist's Liability Under Section Two of the Sherman Act*, 48 GEO. WASH. L. REV. 620 (1980).

87. *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76, 93 (2d Cir. 1981).

88. *Gordon v. New York Stock Exchange*, 422 U.S. 695 (1975); *Otter Tail Power Co. v. United States*, 410 U.S. 366, 373-78 (1973).

89. *United States v. AT&T Co.*, 461 F. Supp. 1314 (D.D.C. 1978).

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this ruling after a final judgment.<sup>90</sup> Second, because AT&T was regulated by the FCC, Judge Greene had the option, under the “primary jurisdiction” doctrine, of referring to the FCC those issues that involved a conflict between antitrust principles and regulatory goals.<sup>91</sup> Arguably, the entire case presented this conflict. Judge Greene, and Judge Waddy before him, expressed an intention to refer appropriate issues to the Commission, but no such referral was ever made.<sup>92</sup> Lastly, as discussed below, the regulation of AT&T by the FCC is relevant in determining whether the government proved each of the two elements of Section Two of the Sherman Act: monopoly power and purposeful acts.

### A. Monopoly Power

According to the Supreme Court, “[m]onopoly power is the power to control prices and to exclude competitors.”<sup>93</sup> Since these indicia are difficult to establish directly, courts often look to market share as the principal sign of monopoly power. In *Alcoa*, Judge Hand noted that, even though ninety percent of a relevant market is enough to constitute a monopoly, “it is doubtful whether sixty or sixty-four percent would be enough.”<sup>94</sup>

At the time of trial, AT&T’s share in virtually all of its important markets except local exchange had been falling for some time. It was thus difficult to establish that Bell even had a monopoly to maintain. Its percentages in equipment markets do not satisfy the standards set forth in *Alcoa*. Despite Bell’s allegedly exclusionary activities, competitive entry into the long-distance market in the 1970’s was persistent and sustained; such entry continued and even accelerated during the trial period.<sup>95</sup> In fact, as Judge Greene noted in the decree,

[b]oth the Department of Justice and AT&T contend that competition in the interexchange market is growing and that this increase in competition demonstrates an absence of monopoly power.<sup>96</sup>

Moreover, the FCC had recently taken administrative steps to reduce

90. See Note, *AT&T and the Antitrust Laws: A Strict Test for Implied Immunity*, 85 YALE L.J. 254 (1975).

91. *Ricci v. Chicago Mercantile Exchange*, 409 U.S. 289 (1973); *United States v. AT&T Co.*, 461 F. Supp. at 1329.

92. 461 F. Supp. at 1329 n.45. Judge Waddy retired due to illness and was replaced by Judge Greene.

93. *United States v. E.I. DuPont & Co.*, 351 U.S. 377, 391 (1956); *American Tobacco Co. v. United States*, 328 U.S. 781, 811 (1946).

94. *Alcoa*, 148 F.2d at 424.

95. See *supra* text Section I.B.

96. *United States v. AT&T Co.*, 552 F. Supp. at 171. Interestingly, DOJ took a contrary position at trial.

some of the impediments it had placed in the way of fuller entry. For example, the Commission adopted an equipment registration program<sup>97</sup> that afforded users the option of using competitive equipment on the Bell local exchange system without having to purchase a Bell protective device. Complaints by SCC's regarding access to local exchange facilities were also largely resolved by judicial and FCC rulings directing AT&T to grant competitors more rapid and unimpeded access.<sup>98</sup> Against this background of eased competitive entry, the Justice Department's focus on allegations of long past abuses, while orderly and methodical, seems abstract and irrelevant.

But AT&T's strongest argument against the government's contention that it had the monopoly power to control price and exclude competitors was the fact that it was comprehensively regulated by the FCC and state regulatory bodies. AT&T merely proposed tariffs to the regulators; the regulators, not AT&T, had final authority to determine what prices would be. Moreover, the FCC had authority to approve or deny new entry into almost all markets, authority that was designed primarily to prevent market power.<sup>99</sup> Hence, AT&T could not possibly have had monopoly power in any regulated market.<sup>100</sup> This argument was recently adopted in the *Southern Pacific* case.<sup>101</sup>

## B. Purposeful Acts

Monopoly power alone is not sufficient to establish a violation of Section Two of the Sherman Act; some act or conduct, the purpose of which is to obtain or maintain a monopoly position, must be found. Examples of such purposeful, anticompetitive conduct are (1) exclusionary conduct that unnecessarily impairs or restricts the ability of other firms to compete,<sup>102</sup> (2) predatory pricing, and (3) refusal of a company possessing a natural monopoly to supply an essential product or facility on a reasonable, non-

97. See *supra* note 28 and accompanying text.

98. *Execunet I*, 561 F.2d at 365; *Execunet II*, 580 F.2d at 590.

99. Policies & Rules Concerning Rates for Competitive Common Carrier Servs. & Facils., 84 F.C.C.2d 445, 457, 459 (1981).

100. *Mid-Texas Communications, Inc. v. AT&T Co.*, 615 F.2d 1372, 1386-87 (5th Cir.), cert. denied, 449 U.S. 912 (1980); *Travelers Ins. Co. v. Blue Cross of W. Pa.*, 361 F. Supp. 774, 780 (W.D. Pa. 1972), aff'd, 481 F.2d 80 (3d Cir.), cert. denied, 414 U.S. 1093 (1973); *Redwing Carriers, Inc. v. McKenzie Tank Lines*, 443 F. Supp. 639 (N.D. Fla. 1977), aff'd, 594 F.2d 114 (5th Cir. 1979); *Nankin Hosp. v. Michigan Hosp. Serv.*, 361 F. Supp. 1199, 1209-10 & n.33 (E.D. Mich. 1973).

101. *Southern Pac. Com. Co. v. AT&T Co.*, 556 F. Supp. at 825, 885-86 (D.D.C. 1983).

102. *Alcoa*, 148 F.2d at 416 (increasing capacity to supply all demand before a competitor could enter the field); *United States v. United Shoe Mach. Corp.*, 110 F. Supp. 295 (D. Mass. 1953), aff'd per curiam, 347 U.S. 521 (1954) (providing machinery to customers only under long-term leases).



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discriminatory basis.<sup>103</sup>

As pointed out above, the government endeavored to establish, through numerous case studies, that many of AT&T's actions were carried out with a monopolizing purpose. The government also relied heavily on *Continental Ore Co. v. Union Carbide*,<sup>104</sup> which suggested that an aggregation of actions, each in and of itself lawful, could taken together constitute a "course of conduct" that violates the antitrust laws. The Justice Department contended that the episodes demonstrated a monopolizing purpose, while AT&T responded that they reflected little more than the sometimes confused, but always well-intentioned, efforts of a regulated company to adapt to rapidly changing commercial and regulatory circumstances. In fact, many of the episodes admit to both interpretations. The interpretation of these episodes is so problematic that the government would probably not have succeeded in showing that AT&T's actions were carried out with the purpose of monopolizing telecommunications. Indeed, *Southern Pacific*, which involved much of the same evidence of allegedly anticompetitive conduct, supports this view.<sup>105</sup>

### 1. *Predatory Pricing*

A major part of the government's case rested upon allegations that AT&T engaged in exclusionary pricing in the intercity services market, i.e., that AT&T raised rates in either local services markets or uncontested intercity markets in order to lower rates and exclude competitors in contested long-distance markets. This raises the question of what constitutes—or should constitute—predatory pricing under the antitrust laws.

Competition—the object of the antitrust laws<sup>106</sup>—is said to be the process by which producers share their surplus with consumers, an outcome ordinarily accomplished by price cuts made in the face of competitive entry. Thus, price reductions by a monopolist are not always predatory, much less socially undesirable. Too rigid or unbending a standard for predatory pricing may discourage price cutting and, as a result, keep prices above competitive levels. Too flexible a standard may allow predation to go undetected, thus substantially inhibiting competitive entry.

Areeda and Turner contend that both errors would be minimized under a standard that defined as predatory those responsive prices that are below the average variable costs of a given product or service.<sup>107</sup> Other antitrust

103. *United States v. Terminal R.R. Ass'n*, 124 U.S. 383 (1912).

104. 370 U.S. 690 (1962).

105. 556 F. Supp. at 1095-99.

106. *United States v. Topco Assocs., Inc.*, 405 U.S. 596, 610 (1972); *Northern Pac. R. Co. v. United States*, 356 U.S. 1, 4 (1958).

107. Areeda & Turner, *Predatory Pricing & Related Practices Under Section Two of the Sherman*

scholars, such as Joskow and Klevorick, have argued for a somewhat higher, average total cost standard, especially for firms that enjoy significant market power.<sup>108</sup> Note, however, that this latter standard is unworkable for assessing the pricing behavior of a multiservice, regulated firm with substantial joint and common costs, since average total costs for any one service cannot be identified.

Several difficulties confronted the Antitrust Division in applying these traditional antitrust pricing doctrines in the AT&T case. The first was that virtually none of the numerous FCC decisions dealing with the rates AT&T proposed in the face of competition had determined that the company had in fact violated the Areeda-Turner standard or even the Joskow-Klevorick standard, to the limited extent that the latter could be applied. While the FCC had found that profit margins varied among services, the Commission itself did not conclude that prices on services other than DDS failed to cover the short-run or long-run costs, variable or marginal costs, or any other hypothetically correct costs. Second, what evidence there was indicated that the regulators had often required prices that were artificially high, not predatorily low. Faced with competitive entry, AT&T submitted responsive rate cuts to the FCC and to state commissions only to have them successfully resisted by the competitive entrants in prolonged hearings. For example, throughout the 1960's and 1970's, the AT&T "Telpak" bulk discount rates gave rise to numerous complaints by SCC's, in both regulatory and appellate proceedings, that AT&T's rates were noncompensatory.<sup>109</sup> The FCC took steps to ensure the elimination of this bulk offering, even though the Antitrust Division itself, in an appeal of the FCC ruling, claimed that the rates were not predatory—that, in fact, "what evidence . . . [the FCC] did have showed that the rates were not only compensatory [i.e. high enough to cover all costs], but excessively so."<sup>110</sup>

In its antitrust suit against AT&T, the Antitrust Division did not concern itself with establishing that Bell's pricing practices met any predation standard. As the government's chief trial attorney told the court, "Your Honor, we don't know whether they were pricing above any particular

Act, 88 HARV. L. REV. 697 (1975).

108. Joskow & Klevorick, *A Framework for Analyzing Predatory Pricing Policy*, 89 YALE L.J. 213 (1979).

109. See, e.g., TELPAK, 37 F.C.C. 1111, 38 F.C.C. 370 (1964), *aff'd sub nom.* American Trucking Ass'n v. FCC, 377 F.2d 121 (D.C. Cir. 1966), *cert. denied*, 386 U.S. 943 (1967); AT&T, Private Line Servs., 61 F.C.C.2d 587 (1976). See also *Aeronautical Radio, Inc. v. FCC*, 642 F.2d 1221 (D.C. Cir. 1980), *cert. denied*, 451 U.S. 920 (1981); *MCI Telecom. Corp. v. FCC*, 627 F.2d 322 (D.C. Cir. 1980); *AT&T Co. v. FCC*, 602 F.2d 401 (D.C. Cir. 1979).

110. Brief for the United States at 28, *Aeronautical Radio, Inc. v. FCC*, 642 F.2d at 1221.

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standard of cost. . . .”<sup>111</sup> Instead, the Government alleged that AT&T had priced its intercity services *without regard to cost*, and that this “strategic pricing” constituted the functional equivalent of predatory pricing.<sup>112</sup> The gravamen of this argument is that wherever competition broke out, AT&T responded with price cuts, while increasing rates elsewhere under regulatory guidance.

Surely the application of orthodox standards would have been difficult. When the prices charged are for regulated services that are produced using joint and common plant, applying these standards may be close to impossible. As Judge Greene himself noted, there was no legal basis for DOJ’s novel theory that pricing by a regulated utility without regard to costs constitutes an antitrust violation.<sup>113</sup> Indeed, pricing without regard to cost is a most peculiar standard to apply in an industry that is required by regulation to deviate from cost-based pricing. It is not surprising that *Southern Pacific* rejected this theory.<sup>114</sup>

In any event, AT&T had a potentially powerful defense to the government’s predation arguments: that any monopoly power had been innocently, or at least accidentally, acquired in the course of complying with and furthering the purposes of regulation. To foster universal service, regulatory authorities had imposed rate constraints that made revenues from local service substantially lower than the access and operating costs of providing that service. Thus, even if Bell used its control over local service to maintain monopoly power in long-distance service, Bell did so using rates set, with the repeated blessings of regulators, at levels necessary to subsidize local service.

### 2. Denial of Access

The episodes that depicted Bell as denying or forestalling interconnection of independent long-distance systems to local networks further illustrate the importance of this regulatory rationale. Under FCC policies adopted in the late 1960’s and early 1970’s, independent carriers paid substantially lower access charges to local exchange facilities than did the Bell System’s Long Lines. The SCC’s were not required to contribute to joint and common costs via the separations process.<sup>115</sup> Long-distance competitors threatened to drive prices down to levels that would make it impossible for Bell to meet the separations requirements necessary to subsi-

111. Transcript at 13,113, *United States v. AT&T Co.*, 552 F. Supp. at 131.

112. *United States v. AT&T*, 524 F. Supp. 1336, 1364 (D.D.C. 1981).

113. *Id.* at 1370. Nevertheless, by denying a motion to dismiss following the close of the government’s presentation, Judge Greene refused to reject the theory. *Id.* at 1369.

114. *Southern Pac.Com. Co. v. AT&T Co.*, 556 F. Supp. at 914.

115. See *ENFIA*, 71 F.C.C.2d at 440.

dize local service. In response, however, Bell could not unilaterally deaverage its long-distance rates, setting lower rates for only high volume long-distance services. Nor could AT&T unilaterally abandon the regulation-created rate structures and move toward cost-based rates for all its services. Such responses would have been contrary to the universal service and common carrier goals of the FCC and state regulators, as well as to the desire of state agencies to avoid local rate increases.

AT&T's failure to comply immediately with interconnection requests from the SCC's should be evaluated in this context of conflicting regulatory goals. The company was caught in the middle of a tug-of-war between the need for competitive pricing responses and regulatory requirements for continued rate averaging and cross-subsidization. It did not have the option, as DOJ alleged, of responding to new entry by cutting rates for some services and then raising rates for others, because overall rate levels were closely controlled and specific rates had to conform to regulatory requirements. AT&T's response to the pricing dilemma was to delay compliance with interconnection requests until the regulatory agencies gave measured and detailed guidance on the scope of the SCC's interconnection privileges.<sup>116</sup> This strategy, moreover, was consistent with the FCC's concerns over the cream-skimming. In *Southern Pacific*, Judge Richey observed: "Had the FCC not engaged in its usual regulatory lag and dealt forthrightly and properly with the problems as they arose, then few, if any of the cases would now be before the antitrust Courts, such as this one."<sup>117</sup> Moreover, regulators should have postponed or at least slowed the specialized carriers' interconnection requests until Congress had had an opportunity to resolve the conflict between the goal of competition and regulatory goals of high quality and universal service.

The Justice Department, however, alleged that AT&T had manipulated the regulatory process and thus caused the FCC delays, and that AT&T's actions therefore fell under the "sham exception" to the *Noerr-Pennington* doctrine.<sup>118</sup> Under that doctrine, any firm may seek regulatory

116. The delays encountered by specialized carriers seeking Bell interconnection were in fact no different from those experienced by entrants into new services. For example, the introduction of cable television service was accompanied by long delays while the Commission queried whether the competitive services of cable companies would prevent conventional broadcasters from providing a full range of programming, especially the unprofitable public affairs portion. The FCC eventually allowed competitive entry in cable, citing recent court decisions and rapid technological developments in satellite transmission as justification. See, e.g., *FCC v. Midwest Video Corp.*, 440 U.S. 689 (1979); *Home Box Office, Inc. v. FCC*, 567 F.2d 9 (D.C. Cir.), cert. denied, 434 U.S. 829, reh. denied, 434 U.S. 988 (1977). See generally Pearson, *Cable: The Thread by Which Television Competition Hangs*, 27 RUTGERS L.J. 800 (1974).

117. 556 F. Supp. at 1097.

118. *Eastern R.R. Presidents Conf. v. Noerr Motor Freight Inc.*, 365 U.S. 127 (1961); *United Mine Workers v. Pennington*, 381 U.S. 657 (1965).

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action even if unfavorable to competing firms. The “sham exception” is applied when misrepresentation or unethical conduct results in a subversion of the regulatory process.<sup>119</sup> All but one of DOJ’s contentions that Bell’s conduct fell within the sham exception were thrown out by Judge Greene at the prior motion-to-dismiss proceeding.<sup>120</sup> Under the standard of proof enunciated by Greene, this meant that the Department’s own evidence, unrebutted, preponderated against itself on these claims. This makes sense, in particular because of the FCC’s lack of clarity regarding interconnection requirements following its *Specialized Common Carriers* decision.

The charges regarding monopolization in the equipment market are easily dispensed with. First, Judge Greene dismissed the claims of predatory pricing in equipment markets.<sup>121</sup> The other claim—that it was a violation of the Sherman Act for AT&T to supply its equipment needs from its own sources—is without legal basis. Finally, in the decree itself, Judge Greene expressed his doubts as to the strength of the equipment market charges: “[W]here the government was able to show that AT&T’s market share was high, it was generally unable to demonstrate significant anticompetitive behavior; where evidence of behavior was more damning, it had difficulty establishing market power.”<sup>122</sup> Hence, the equipment charges were likely to have gotten nowhere.

Did AT&T monopolize long-distance service markets? Its reaction to intercity competition was constrained by FCC and state regulation, so that it could not even mount a normal competitive response to new entry. Bell was not permitted to introduce its own new services, or to deaverage its rate structure to bring its prices into line with the costs of its existing services. The Bell tariff changes that were ultimately allowed did not adjust Bell System rates to fully competitive levels. The resulting rates were not predatory, but were in fact higher than competitive levels and thus protected rather than threatened new entrants.<sup>123</sup> Since AT&T’s policies permitted it to continue subsidizing local service, moreover, AT&T’s behavior was intentionally proregulatory, rather than illegally anticompetitive.

119. *California Motor Transp. Co. v. Trucking Unltd.*, 404 U.S. 508 (1972).

120. *United States v. AT&T Co.*, 524 F. Supp. at 1364. The only exception was the Datron/DDS episode. See *supra* text accompanying notes 64-69. In *Southern Pacific*, all such claims were dismissed. 556 F. Supp. at 881.

121. 524 F. Supp. at 1380.

122. 552 F. Supp. at 174.

123. See, *Aeronautical Radio, Inc. v. FCC*, 642 F.2d at 1245 (Wilkey, J., dissenting).

### C. *Likelihood of Divestiture*

The Department of Justice would probably not have convinced the court to break up AT&T, even in the unlikely event that it had prevailed on liability. Although a court, once monopolization has been established, must fashion a remedy that will bring monopoly power to an end,<sup>124</sup> divestiture or dissolution is appropriate only where necessary to the health of competition in the industry. As was said in *Alcoa*, "[d]issolution is not a penalty, but a remedy. If the industry will not need it for its protection it will be a disservice to break up an aggregation which has for so long demonstrated its efficiency."<sup>125</sup>

Even though Judge Greene, in approving the settlement, thought that injunctive relief was insufficient as a remedy,<sup>126</sup> massive divestiture imposed after a full trial and determination of liability would probably not have been sustainable on appeal. It is noteworthy that an FCC administrative law judge in the 1976 *Phase II* proceeding, addressing the allegedly anticompetitive Bell System structure, concluded that divestiture would be "most unwise and may even be catastrophic."<sup>127</sup> While the FCC declined in that instance to render a judgment on the merits of divestiture,<sup>128</sup> having been confronted with much the same evidence that was before Judge Greene the Commission opted for injunctive, not structural, remedies. If marketplace developments sufficed in 1976 to ameliorate the allegedly anticompetitive Bell structure, it is difficult to see how in the early 1980's, by which time competition in telecommunications had intensified, the court could have determined that the dismemberment of Bell was essential.

AT&T's strongest argument against divestiture would have been that, as discussed above,<sup>129</sup> its shares of the equipment and long-distance service markets were declining. This is a strong indication that even if AT&T had been a monopolist at one time, it had since lost the power to exclude competitors and was thus no longer a monopolist. In *Alcoa*, for example declining market shares of the monopolizing firms were a major factor in determining that divestiture was unnecessary.<sup>130</sup>

AT&T could also have argued, persuasively, that the continuing presence of FCC regulation and the availability of private enforcement proceedings by actual or potential competitors were sufficient to protect com-

124. *United States v. United Shoe Mach. Corp.*, 391 U.S. 244, 250-52 (1968).

125. *Alcoa*, 148 F.2d at 446.

126. 552 F.Supp. at 167-68.

127. *AT&T & Associated Bell System Cos.*, 64 F.C.C.2d 1, 6 (1977).

128. *Id.* at 11.

129. *Supra* text accompanying notes 93-96.

130. *United States v. Aluminum Co. of Am.*, 91 F.Supp. 333, 349-59 (S.D.N.Y. 1950).

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petition in the industry. It is thus reasonable to conclude that AT&T would have avoided substantial restructuring, even if it had lost the liability part of the proceeding.

### IV. Economic Effects of the Settlement

#### A. *Effect on Competition*

The dissolution of the Bell System under the Baxter-Brown settlement is supposed to lead to increased competition in the long-distance and equipment markets. In theory, it separates competitive long-distance enterprises from local exchange activities, where scale economies require a single company. The first are to be placed in the new stripped-down and unregulated AT&T and the second in the regulated local operating companies. This structural redesign is flawed in major ways. First, economies of scale are not limited to local services, but are present in both long-distance and equipment supply. In fact, the divestiture will specifically convey some natural monopoly advantages to AT&T. Second, the competition currently in existence has survived only because of the regulatory "umbrella" that kept AT&T rates up. When the umbrella folds and the SCC's are made to pay full access charges, the competition will also fold.

At present, there is limited competition in intercity services. The Competitive Impact Statement filed by the Justice Department on February 10, 1982, however, goes too far in conceding that "all segments of the [intercity services] market now are characterized by some degree of competitive activity," and that "many of the specific disputes that arose in the early 1970's regarding local access for private line services were eventually resolved through [private] litigation and negotiated compromise."<sup>131</sup> This is an artificial condition because the competition arose as a result of regulatory practices in the 1970's and cannot be sustained in the absence of regulation.

Competition in an open, unregulated market cannot continue if there are significant economies of scale. Research on Bell system costs has found such scale economies across a broad range of long-distance operations, particularly over the major trunk routes.<sup>132</sup> In *Southern Pacific*, Judge

131. Competitive Impact Statement in Connection With Proposed Modification of Final Judgment (filed Feb. 17, 1982), *United States v. AT&T Co.*, No. 82-0192 (filed Nov. 20, 1974) (reprinted at 47 Fed. Reg. 7170 (1982)).

132. There have been both engineering and econometric studies of economies of scale in the telecommunications industry. One engineering study found pronounced economies of scale in long-distance transmission and switching, but less substantial economies for local distribution and none for the provision of local service. Systems Applications, Inc., *The Domestic Telecommunications Industry: Economic Behavior, Competition, and Public Policy* (June 1974) (prepared for the Office of Telecommunications Policy). A second study considered six segments of the Bell System and found significant

Richey concluded that "substantial" economies of scale were present, particularly in "networking".<sup>133</sup> In the present decree, Judge Greene specifically allowed AT&T a system-wide scale economy—joint billing of the new AT&T's long-distance services with the divested companies' local services—and estimated that the cost advantage conferred may be as great as five dollars per customer per month.<sup>134</sup>

The magnitude of AT&T's scale economies after divestiture depends to some degree on the manner in which the local/long-distance split within Bell is accomplished. However the routes are divided, though, the new AT&T will own a network of profitable long-distance routes and will therefore enjoy the economies of scale that characterize long-distance operations. The intermediate distance operations exhibiting scale economies are scheduled to be transferred to the surviving AT&T, leaving the local exchange and transport areas (LATA's) to the operating companies.<sup>135</sup> But numerous intermediate routes not exhibiting such economies may be transferred into oversized LATA's, and become "intra-LATA" routes that AT&T and its competitors cannot enter. This would compel independent carriers to compete with AT&T only along the major trunk routes, where AT&T's economies of scale and scope are greatest.<sup>136</sup>

economies of scale in each—routing, multiplexing, trunking, switching access, and especially long-distance transmission. R. Skoog, *The Design and Cost Characteristics of Telecommunications Networks* (1980) (published by Bell Labs). Each of four recent econometric studies estimates that Bell System costs decline as the scale of production increases, i.e., that the elasticity of costs coefficient is less than one. L. Mantell, *An Econometric Study of Returns to Scale in the Bell System* (1974) (unpublished staff research paper for the Office of Telecommunications Policy); H. Vinod, *Application of New Ridge Regression Methods to a Study of Bell System Scale Economies and Estimation of Joint Production Functions* (1976); H. Vinod & B. Raj, *Bell System Scale Economies from a Randomly Varying Parameter Model* (1978); L. Christensen, D. Christensen, & P. Schoech, *Single-Product Cost Function Analysis of the Bell System 1947-1977* (Aug. 1979) (unpublished working paper, Laurits R. Christensen Associates); L. Christensen, D. Christensen, & P. Schoech, *Econometric Estimation of Scale Economics in Telecommunications* (Aug. 1980) (Social Sys. Res. Inst., Univ. of Wisconsin-Madison Working Paper No. 8013); L. Christensen, D. Christensen & P. Schoech, *Multi-Product Cost Function Analysis of the Bell System, 1947-1967* (Dec. 1979) (unpublished working paper, Laurits R. Christensen Associates); Nadiri & Schankerman, *The Structure of Production, Technological Change, and the Rate of Growth of Total Factor Productivity in the U.S. Bell System*, in *PRODUCTIVITY MEASUREMENT IN REGULATED INDUSTRIES* 219-47 (Cowing & Stevenson eds. 1981). All of these studies are also discussed in Testimony of James N. Rosse, Defendants' Exhibit D-T-119, *United States v. AT&T Co.*, 552 F. Sup. at 131.

133. 556 F. Supp. at 868-70.

134. 552 F. Supp. at 198-99.

135. See *supra* text accompanying note 75.

136. As GTE has noted in its comments to the court opposing the AT&T LATA plan:

The inclusion of many [metropolitan areas] and scattered noncontiguous parts in the massive LATAs permits the operating companies to carry as exchange traffic intercity telephone traffic between distant cities within the LATA boundaries. . . . [This] could result in creating the potential for continued dominance by the operating companies and AT&T. This in turn, through the creation of new bottlenecks, could possibly destroy viability of the independents and their practical accessibility to competitive interexchange carriers.

Comments of GTE Corporation on Application for Approval of Exchange Areas or Local Access & Transport Areas (LATA's) Established Pursuant to the Modification of Final Judgment at 14-15



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Not only will this restrict the competitive opportunities available to AT&T's toll competitors, but it will also increase their costs. The settlement contemplates the eventual assessment of a uniform LATA access charge payable by all interstate carriers to replace the separations payments now covering joint and common costs.<sup>137</sup> That access charge, presumably, will be based on the revenue requirement of all basic exchange facilities contained within a given LATA. The inclusion of low-density rural facilities within the LATA will have the practical effect of requiring all inter-LATA carriers, through their access charge payments, to bear some of the costs of maintaining these more expensive facilities. This shifts much of the burden of subsidizing non-compensatory basic exchange services from AT&T to the local companies and, ultimately, to AT&T's competitors as well.<sup>138</sup>

The advantages for AT&T due to scale economies and to spreading cross-subsidy obligations is not mitigated by market segmentation, i.e., by smaller firms entering only highly specialized or differentiated service markets. MCI, Southern Pacific, and Datran all argued for economies in *Specialized Common Carriers*, proposing competition only in specialized markets.<sup>139</sup> Instead, their subsequent interconnection requests were for regular long-distance service, in response to AT&T's high, cross-subsidizing long-distance rates.<sup>140</sup> It is now probably too late for the SCC's to find a secure niche in specialized services other than bulk message and data transmission—which they have been cream-skimming for the past five years—because of different equipment and skills requirements.

The specialized carriers still claim that they possess their own cost efficiencies, that even their conventional services cost significantly less than comparable Long Lines offerings because of newer plant and superior productivity. Although the independent carriers' newer facilities and more efficient personnel might account for some of their present rate discounts,

(filed Nov. 3, 1982), *United States v. AT&T Co.*, No. 82-0192 (filed Nov. 20, 1974).

137. 552 F. Supp. at 196-97, 196 n.271, 227, 232-34, 169 n.161.

138. There may also be substantial economies of scale in research and development. Here again, AT&T has a clear headstart on its competitors, since it retains Bell Laboratories. Bell Labs has made virtually every major technological breakthrough in the communications industry since World War II, see Testimony of William D. Nordhaus at 73-83, *United States v. AT&T Co.*, 552 F. Supp. at 131, but, under the 1956 *Western Electric* consent decree, was required to license its patents to Bell competitors. *United States v. Western Elec. Co.*, at 71,139-41. The decree removes this requirement. 552 F. Supp. at 176-77. To the extent that future technological advances developed by Bell Labs decrease costs, AT&T will have an even greater advantage over its competitors.

139. *Specialized Common Carrier Servs.*, 29 F.C.C.2d 870, 872-76 (1971), *aff'd sub nom.* *Washington Util & Transp. Comm'n v. FCC*, 513 F.2d 1142 (9th Cir.), *cert. denied*, 423 U.S. 836 (1975). See Testimony of James N. Rosse at 53-75, *United States v. AT&T Co.*, 552 F. Supp. at 131.

140. Economies of specialization seem particularly unlikely for independent resale and value-added carriers which typically lease bulk capacity from AT&T and then resell it in segments, since the lower prices they charge are strictly a result of AT&T's present tariff structure.

most of their rate advantage stems from the fact that they do not pay as much for local exchange access as does AT&T Long Lines. Under the decree, the regulators are to decide whether to decrease Long Lines' access costs or to increase the SCC's share of separations to the present AT&T level. Either way, the proposed LATA access charge system requires that intercity carriers pay equal fees for equivalent access, so that the principal cost advantage of the independent carriers will disappear.

At present, the local access charges paid by the specialized carriers are determined by a complicated formula set forth in AT&T's ENFIA tariff.<sup>141</sup> Variables in the formula that would raise ENFIA charges to levels comparable with AT&T's separations payments have been artificially depressed to prevent rate increases that might put the specialized carriers out of business. The present ENFIA charge is only forty-five percent of comparable separations charges.<sup>142</sup> After LATA charges are put into effect, specialized carrier prices, while now generally lower than Bell's (see Table Six) would probably not differ by more than an amount reflecting the lower quality of SCC services.<sup>143</sup> The resulting disappearance of the price advantage enjoyed by the specialized carriers from not paying equivalent access charges will pit their claimed higher productivity, as limited as that may be, against Bell's scale economies.<sup>144</sup>

The decree will not strengthen competition in various equipment markets. The trial court noted that the customer-premises equipment (CPE) field is already substantially competitive,<sup>145</sup> and that the government's equipment monopolization claims were either baseless or weak.<sup>146</sup> To facilitate new entrants, moreover, the FCC, in its *Second Computer Inquiry*<sup>147</sup> decision, has already required that virtually all new CPA installations be deregulated effective January 1, 1983. Judge Greene declined to

141. Exchange Network Facils. for Interstate Access (*ENFIA*), 71 F.C.C.2d 440 (1979).

142. Exchange Network Facils. for Interstate Access (*ENFIA*), 51 RAD. REG. 2D (P & F) 677, 678 n.2 (1982); see TELECOMMUNICATIONS REPORTS, Oct. 4, 1982 at 1-5.

143. See *Bypassing Ma Bell*, CONSUMERS REPORTS, Mar. 1981, at 164.

144. Of course, the regulatory authorities might attempt to save the SCC's by refusing to equalize access charges as contemplated by the decree. See *supra* note 137. However, their ability to preserve an access charge differential is still limited, to some degree, by the absolute level of access charges. (The lower the access charges, the smaller the differential between them can be.) As discussed *infra* text accompanying notes 149-51, the existence of bypass or "leapfrogging" technology will probably prevent access charges from rising substantially, and may even force them down. This will make it more difficult for the regulatory authorities to preserve a sufficient differential between the access charges for AT&T and for the SCC's.

145. 552 F. Supp. at 191.

146. *Id.* at 163 n.137, 174. See also *United States v. AT&T Co.*, 524 F. Supp. 1336, 1380-81 (D.D.C. 1981) (dismissing monopolistic pricing claims in equipment markets).

147. *Second Computer Inquiry*, Notice of Inquiry and Proposed Rulemaking, 61 F.C.C.2d 103 (1976); Supplemental Notice of Inquiry, 64 F.C.C.2d 771 (1977); Final Decision, 77 F.C.C.2d 384 *on reconsid.*, 84 F.C.C.2d 50 (1980), 88 F.C.C.2d 512 (1981), *aff'd sub nom.* *Computer & Communications Indus. Ass'n v. FCC*, No. 80-1471 (D.C. Cir. Nov. 12, 1982).

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impose further requirements. The settlement, therefore, cannot significantly add to competition in the customer premises segment of the equipment market.

With regard to switching and central office equipment—the “big ticket” items of the phone equipment business—Western Electric enjoys a monopoly that is likely to continue with or without the decree, the trial court’s statements to the contrary notwithstanding. The Department of Justice endeavored to explain Bell’s dominance in the switching equipment market by contending that it had unlawfully compelled its operating companies to buy solely from Western Electric. The trial court, as already mentioned, found this portion of the case untenable. Yet Western’s share in this equipment submarket has not only been dominant, but has remained stable throughout the last two decades. The court’s prediction of increased competition in switching equipment is therefore unjustified, since it assumes what seems clearly not to be the case: that Western’s market dominance in switching equipment is due to anticompetitive practices. In reality, the decree merely requires that AT&T exchange its local operating and equipment bilateral monopoly for a supplier’s monopoly in large equipment products.

TABLE SIX

PRICE COMPARISONS  
AT&T AND SPECIALIZED CARRIERS  
(NEW YORK TO MINNEAPOLIS FOUR MINUTE CALL)

Service	Start-up Fee	Monthly Service Charge	Price	Percentage Difference from Bell
Bell Direct Dial	none	none	\$2.40	—
Out-WATS (1-line)	\$174.80	\$31.65	\$1.53	36% less
MCI Execunet	none	\$10.00	\$1.92	20% less
SPCC-GTE Sprint	none	\$10.00	\$1.92	20% less
ITT Longer Distance	\$30.00	\$10.00	\$1.89	21% less
WU MetroFone	none	\$8.00	\$1.80	25% less
U.S. Tel/All America	none	none	\$1.75	27% less
ALLNET (Combined Network)	\$25.00	\$10.00	\$1.72	28% less

SOURCE: DUN’S BUSINESS MONTH, Nov. 1982, at 61.

Although under the decree, Western Electric and the local operating

companies will no longer be under common legal ownership and control, the commercial and economic relationship between them with respect to the purchase of central office equipment will remain unchanged. The decree does not require the operating companies to alter their current purchasing arrangements. Western Electric will surely remain the principal supplier of components used to upgrade the current base of switches and should continue to be the principal supplier of new equipment as well.

Thus, there are no realistic prospects for accelerated competition, as contemplated by Judge Greene's decree, in either the long-distance services or equipment fields. The decree adds potentially independent sources of demand (the new regional companies) to telephone equipment markets, but there is no basis to suppose that more sources of supply will materialize. In intercity services, where there now are competitors, price and service competition probably cannot be sustained absent the current regulatory umbrella. An outbreak of vigorous price competition with reduced FCC regulation should establish that the new AT&T, as the dominant long-distance carrier, can price below the average total costs of the SCC's and still reap substantial profits. The end result should be that AT&T puts its competitors out of business, or settles for monopoly prices that are high enough to sustain fringe competitors.

#### B. *Effect on Local Telephone Rates*

The decree's impact on local exchange customer charges is most likely to be the opposite of the price reductions that might typically be expected from an antitrust action. In fact, the decree will cause some combination of increased rates and decreased service quality, especially for home subscribers.

The goal of prevailing regulatory policies has been to keep local rates below costs to ensure maximum residential and business participation in the local exchange system. State and federal regulators have subsidized local service out of long-distance revenues on the theory that local customers should be allowed to "share" in the productivity gains of AT&T's long-distance enterprise. Moreover, there appears to be an economic justification for subsidization of local rates: The addition of each new local subscriber benefits existing users by expanding the reach of their telephones; thus (long-distance) subscribers should subsidize others to stay on the system.<sup>148</sup>

148. See Artle & Averous, *The Telephone System as a Public Good: Static and Dynamic Aspects*, 4 BELL. J. ECON. & MGMT. SCI. 89 (1973); Rohlfs, *A Theory of Interdependent Demand for a Communications Service*, 5 BELL. J. ECON. & MGMT. SCI. 16 (1974). These articles indicate that the

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In order to cover costs now subsidized by Long Lines, the local operating companies must either raise local service rates to consumers or increase access charges to the various long-distance companies. There are two problems that make it unlikely that the regulators will take the latter route to higher revenues. First, since the decree requires that access charges to AT&T and the SCC's be equalized and since AT&T now pays higher access charges, substantial increases in access charges would jeopardize the viability of the SCC's by increasing their costs proportionately more than AT&T's. Such a result would contravene the FCC's present policy of encouraging competition in long-distance markets. Second, the ability of the regulators to raise access charges is limited by the ability of long-distance companies to "leap-frog" over the local exchanges in serving their valued business customers.<sup>149</sup> The higher the access charges, the more attractive such bypassing becomes, so that, at some point, an increase in access charges will actually decrease the revenues derived therefrom.<sup>150</sup> The decree specifically allows AT&T to bypass local facilities in this manner.<sup>151</sup>

Given only limited increases in long-distance access charges, local rates will have to rise significantly in order for the local companies to survive.<sup>152</sup> Recent regulatory changes in accounting requirements, depreciation adjustments, and inflation will also cause significant increases. The Commerce Department projects that these conditions alone will cause lo-

positive externalities are insufficient to justify the magnitude of the present subsidies.

149. A microwave tower positioned on the borders of a local exchange calling area, for example, can easily transmit to a downtown office building much of its specialized business traffic. Such technology is readily available and its cost is rapidly decreasing. Indeed, the Merrill Lynch "Teleport" facility, which will soon service the entire New York City financial district, is little more than an effort to "leapfrog" the facilities of New York Telephone Company. The trial court apparently assumed that state regulatory authorities must approve construction of the facilities needed for such bypassing. While this may be true for intrastate toll offering, it is not true for facilities used to provide interstate services, which are subject solely to FCC approval. See, e.g., National Ass'n of Reg'y Util. Comm'rs v. FCC, 525 F.2d 630 (D.C. Cir.), cert. denied, 425 U.S. 992 (1976); California Interstate Tel. Co. v. FCC, 328 F.2d 556 (D.C. Cir. 1964).

150. The fact, discussed *infra* text accompanying note 156, that business demand for long-distance service is highly concentrated means that even a relatively small increase in access charges might trigger significant bypassing.

151. 552 F. Supp. at 175-76.

152. An examination of prices established by regulatory commissions during the 1970's reveals rates of return insufficient to cover Bell's costs of capital. In fact, AT&T's return was consistently below the return for a composite of Standard & Poor's 400 industrials. Even the return on other high-grade utilities exceeded that of AT&T for each year of the period, although their stocks are considered no more risky than AT&T stock. Testimony of Virginia A. Dwyer, United States v. AT&T Co., 552 F.Supp. at 131. Another estimate of AT&T's rate of return employs James Tobin's *q* ratio as an indicator of monopoly rents. The *q* ratio (the market value of the firm divided by the replacement cost of its assets) is expected to approximate one for a competitive firm, and to be significantly higher for a firm making monopoly profits. In their study of the average *q* ratios of 257 firms for the period 1960-77, Lindenberg and Ross found AT&T's average *q* ratio to be 1.09, certainly below that expected of a firm receiving monopoly returns. (Average *q* ratios for all firms ranged from .45 to 8.53.) Lindenberg & Ross, *Tobin's q Ratio and Industrial Organization*, 54 J. OF BUS. 1, 2-3, 18 (1981).

cal rates to increase over the next five years from their present average of \$9.16 to about \$16.16 a month.<sup>153</sup> In fact, Florida regulators recently predicted monthly local rates of \$25 to \$30 by 1986.<sup>154</sup>

Of course, there could be mitigating circumstances, such as advances in technology, that may aid local companies in achieving new operating efficiencies. Since the settlement modifies existing separations payments, which have until now given local phone companies an incentive to overinvest in local plant, there may also be some cost-saving changes in local company investment patterns. But capital and operating costs of local companies will not vanish in the near term.

Thus, there are no available alternatives to significantly higher local telephone rates if service quality is to be sustained. Because local rates are subject to regulation, necessary rate increases may come only after extensive delay. Service quality, however, is not subject to comparable direct control by state regulators, nor is investment in new equipment to meet future calling demands. Faced with a profit margin squeeze resulting from regulatory delay and reluctance to pass on to consumers the subsidy burdens previously borne by AT&T Long Lines, local companies are likely to cut back investment and thus degrade the quality of telephone service. Low-budget customers, as a result, will see a return to delays in both repair service and the placement of calls. Even more likely, investment cutbacks will lead to delayed introduction of technological improvements. All of these changes would run counter to the FCC's mandate to provide universal, high-quality service.<sup>155</sup>

The trial court notes that the intercity carriers initially will have an interest in maintaining the integrity of local exchange operations, since poor local service would adversely affect their long-distance revenues. Local exchange companies, however, might simply provide higher quality service only to long-distance callers. Major long-distance business consumers, for example, could be given priority service, while residential customers could be required to wait during periods of excess demand. Long-distance revenues are quite concentrated—in the case of business users, for example, four percent of the customers account for nearly sixty-two per-

153. *Impact of Federal Communications Commission Decisions on Local Telephone Service: Hearings before the Subcomm. on Gov't Information and Individual Rights of the House Comm. on Gov't Operations*, 97th Cong., 2d Sess. 4-6 (1982) (testimony of Ass't Sec'y of Commerce, Bernard J. Wunder, Jr.). This estimate, however, does not take into account possible changes in the cost of capital once the present Bell System financial "umbrella" folds. Capital costs of local operating companies will increase once they become primarily single-product companies functioning in a cyclically sensitive and low-profit part of the telephone business. The estimate also assumes that revenues from access charges and separations and settlements will remain constant.

154. N.Y. Times, Mar. 23, 1983, at D1.

155. See *supra* note 6 and accompanying text.

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cent of long-distance billing<sup>156</sup>—so it is technically feasible for the telephone companies to give preferential treatment to particular customers. Thus, contrary to the FCC mandate, there could be increasing disparities in the quality of telephone service, with business subscribers benefiting while home subscribers in high cost areas experience reduced service quality.

### V. The Continuing Tension Between Antitrust and Regulatory Policy

In addition to its effects on competition and prices in telecommunications specifically, the decree has important implications for antitrust and regulatory policy generally. In particular, the decree leaves unresolved a number of important issues concerning the proper role of antitrust law in regulated industries.

First, the settlement precluded a determination of whether a fully regulated industry can possess monopoly power. AT&T argued that pervasive entry and rate regulation by the FCC and state agencies made any market share definition of monopoly power meaningless. It is in fact the *raison d'être* of such regulatory bodies to contain monopoly power.<sup>157</sup> Antitrust liability under Section Two of the Sherman Act requires a finding of monopoly power, yet such a finding here would have implied that the FCC and state regulators had been remiss in their duties. Can the inadequacy of regulation be the basis for imposing antitrust liability on a regulated firm?

Second, the decree leaves undefined the appropriate standard by which to evaluate regulated prices set in response to competitive entry. The court, in approving the settlement, offered no guidance as to whether DOJ's novel concept of pricing without regard to cost can be used as a predatory pricing standard. Neither the government's contention that rate disorientation is inherently predatory, nor AT&T's defense that such rate disorientation was required by regulation, was addressed. This means that a regulated company that modifies its prices in an otherwise non-predatory response to competition may be more vulnerable to antitrust attack than an unregulated company that engages in similar pricing behavior. An unregulated company has as a defense that it set prices greater than some measure of cost, while a regulated company, according to DOJ's theory, would not. This makes no sense from an antitrust policy viewpoint. To the extent that rate disorientation is caused by regulation, DOJ's theory would elevate antitrust law over the valid concerns of regu-

156. HOUSE STAFF REPORT, *supra* note 7, at 88, 89.

157. See, e.g., Policies & Rules Concerning Rates for Competitive Common Carrier Servs. & Facils., 84 F.C.C.2d 445, 457, 459 (1981).

lation. The alternative is to follow *Southern Pacific* and explicitly reject the standard of pricing without regard to cost.<sup>158</sup>

Third, in approving the settlement, Judge Greene did not address the conflict between the hostility of antitrust to restrictions on entry and the need for regulatory control of entry to prevent creamskimming. The Communications Act of 1934 imposes on common carriers an obligation to interconnect with other carriers, but only upon an FCC finding that such access is "in the public interest."<sup>159</sup> The antitrust laws, however, impose an open-ended obligation on those in control of essential facilities to allow full access to competitors.<sup>160</sup> Was AT&T required to provide interconnection to competitors under the antitrust standard, even though it was not explicitly required to do so by the FCC or state agencies—and even though interconnection would have undermined its regulation-based rate structure? Was AT&T so required, even though the FCC and, indeed, an earlier Antitrust Division, had supported AT&T's refusal to provide access?<sup>161</sup>

A final unresolved antitrust question is the appropriateness of the divestiture remedy. The settlement seems to suggest that massive structural relief would have resulted if the case had been adjudicated, but that suggestion also ignores the presence of regulation. Simple injunctions combined with private enforcement, particularly in the presence of watchdog regulatory bodies, would seem a more than sufficient remedy. Yet Judge Greene indicated that the FCC was not up to the task.<sup>162</sup> Is one judge's condemnation of a regulatory board's effectiveness sufficient to require divestiture?

Although the AT&T settlement generates many questions about the application of the antitrust laws, it leaves unanswered a more important question that strikes at the very existence of regulation, given that most of the allegations against AT&T involved actions that were the inevitable consequence of regulation. Should these actions, which serve the goals of regulation, be prevented by the antitrust laws and the courts?

Restrictions on entry, controls over price, and suppression of competition are found in most regulatory schemes. They are the regulatory tools

158. 556 F. Supp. at 946.

159. 47 U.S.C. § 201(a) (1976).

160. *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973); *American Trucking Ass'n v. Atchison, T. & S.F. R.R. Co.*, 387 U.S. 397, 406, *reh. denied*, 389 U.S. 889 (1967); *United States v. Terminal R.R. Ass'n*, 224 U.S. 383, 402-03 (1912).

161. *Execunet I*, 561 F.2d at 365; *Execunet II*, 580 F.2d at 590. The Department of Justice, as statutory respondent pursuant to 47 U.S.C. § 402(a) (1976), was a party to both actions, and supported both the FCC's and AT&T's contentions that the service for which MCI sought interconnection was unauthorized.

162. 552 F. Supp. at 168.



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with which goals favoring certain groups of consumers are implemented. Separating prices from specific costs allows for cross-subsidization, but only if coupled with entry restrictions to prevent creamskimming. Hence, anticompetitive behavior is required under regulation and is in direct conflict with the antitrust laws. By conferring his blessing on a private agreement, Judge Greene implicitly resolved this conflict between regulation and antitrust in favor of the latter without bringing the issue to appellate review. At the same time AT&T embraced the settlement, exasperated by the unwillingness of Congress to establish groundrules for the transition from closed monopoly to open competition.

Absent direct legislative action, Congress has entrusted the FCC with the determination of what in telecommunications is the “public interest.” The settlement in essence removes this public interest determination from the FCC’s control. Should the settlement in effect emasculate the FCC in its own field?<sup>163</sup> A partial answer is that the AT&T settlement and decree seem likely to achieve neither sound antitrust nor traditional regulatory policy objectives. The AT&T suit presented an ideal opportunity for judicial resolution of conflicting goals, because its central issue was whether Bell’s “anticompetitive” response to entry could be justified as furthering the goals of regulatory policy. But instead, the decree creates only the impression that antitrust laws have overturned the entire field of regulation.

The antitrust objective of fostering competition is not likely to be measurably furthered. What competition existed in long-distance before the settlement was artificially supported by the regulatory practices that kept up Bell’s long-distance rates. Now, as access costs are equalized, AT&T’s full competitive power will be unleashed, and there is no reason to believe that the level or intensity of its competition in long-distance services will increase. The opposite seems more likely, and Bell may be transformed from a regulated monopoly into an unregulated one, which belies the rationale for allowing competition in the first place.

The objectives of regulatory policy will not be furthered by the decree. Telephone rates will be deaveraged, unbundled, and, for local services,

163. At least Judge Richey in *Southern Pacific* thought not:

[T]he antitrust laws were never intended to destroy an essential public utility. . . . [S]ound and honest regulation of telecommunications at the federal and state level is our only guarantee of access to this necessity throughout the *whole* country and not just part of it. [emphasis in original]

556 F. Supp. at 1097. The resolution of this tension between antitrust and regulation may lie in using the implied immunity doctrine to expand the range of regulatory decisions that should be out of the reach of the antitrust laws. As Judge Richey showed, immunity can be expanded indirectly by taking into account regulatory goals in determining whether regulated conduct violates the Sherman Act.

increased by as much as eighty percent.<sup>164</sup> This should end the expansion of and reduce the quality of local service. Regulatory standards for common carriers will no longer prevail, as unregulated competition will drive resources away from universal low-cost service and toward packaging low-cost bulk service for a small fraction of the business community.

Who then stands to gain from the AT&T settlement? Clearly AT&T has won by losing, by having been left with the cream of its old services but with the restrictions on its ability to compete in those services removed. Bell has simultaneously freed itself from both the antitrust laws and regulatory control. As for the public, we seem to have lost by winning.

164. See *supra* note 153 and accompanying text.