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# Forum and Substance: Introduction to the Symposium


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The essays in this symposium address two seemingly narrow issues in the long history of efforts by the United States to bring American Telephone and Telegraph Company (AT&T or Bell System) into compliance with the antitrust law. There is first a technical or formal issue: whether jurisdiction to enforce certain standards with regard to the permissible diversification of telephone holding companies should remain where it now is, namely, in the United States District Court, or be transferred to the Federal Communications Commission (FCC). The substantive issue is whether the newly divested Bell Operating Companies (BOCs) should be free to engage in unrelated non-telephone businesses.

This substantive issue is at the core of the controversy explored in the present symposium, though much of the discussion addresses the formal issue of transfer of jurisdiction from the court to the FCC.[1] It seems clear that the legislation introduced by Senator Robert Dole (R-Kansas),[2] seeking to transfer jurisdiction, herein much discussed, has little point other than to substitute the more accommodating substantive standard of the FCC for the stricter standard of the district court. In the coming legislative struggle over the Dole Bill, controversy will center on conditions to be attached to the transfer; for example, whether the transfer should be conditioned on maintaining, to some degree, the policy against phone company diversification. A sophisticated judgment on the issues of forum and substance requires some background on the history of relations between the United States and the Bell System.

For three-quarters of a century the United States has con-

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1. The U.S. District Court for Washington, D.C. currently oversees the continuing process of divestment which most recently began in 1982. *See* United States v. American Tel. & Tel. Co., 552 F. Supp. 131, 226 (D.D.C. 1982) [hereinafter *AT&T*].

2. S. 2565, 99th Cong., 2d Sess., 132 CONG. REC. S7744 (1986).

fronted AT&T in recurrent legal contests over AT&T's alleged monopolistic power and predatory behavior. The monopoly derived originally from patents for telephone inventions lawfully granted by the government itself. As the patents on this unique communications technology ran out, the monopoly—now no longer authorized by law—was extended by classic industrial tactics that evoked application of the antitrust laws: systematic preemption of the field by improvement patents; patent pooling to dominate electrical technology and to divide the enlarged market among powerful potential competitors; use of patent power to control trade in unpatented supplies and service; acquisition of competing enterprises; extension of control to alternative technologies like the telegraph, wireless, and satellite communications; and abuse of monopoly franchises in telephone exchange operations to impede competitors from offering various services and commodities.[3]

One can see a remarkable pattern in the outcome of the periodic legal confrontations of AT&T and the government. The government always appears to win, but victory is embodied in an agreement between AT&T and its prosecutors rather than in an independent adjudication and judgment of a court. In other words, AT&T "cops a plea," and the plea bargain proves advantageous to AT&T.

Such was the case in the historic Kingsbury Commitment of 1913, ending the first antitrust suit against AT&T. The basic structure of the Bell System was not disturbed. AT&T remained in control of both long distance and local service, but was simply required to desist from further acquisitions of competing independents. The independents were guaranteed interconnection with the Bell System, but remained heavily dependent on AT&T for major sources of their income in the form of a subsidy share of tolls derived from use of joint facilities. The integration of the regulated telephone operations with the manufacture and sale of telephone equipment by Western Electric Company, another Bell System company, continued, giving the Bell System a protected market for its own nonregulated manufactures. AT&T was required to divest itself of Western Electric, presumably to prevent the potential for technological competition between "record" communication

3. This history is discussed in detail in McKenna & Slyter, *The Modification of Final Judgment: An Exercise in Judicial Overkill*, 9 COMM/ENT L.J. 9, 13 (1986).

(telegrams) and "voice" communication (telephone). But a system of patent cross-licensing soon developed whereby the parties insulated each other from inter-technological competition.[4]

In 1932, another consent decree, directed mainly at the division of fields by the patent pool, also detached RCA from General Electric in an effort to free the broadcasting market from the control of a giant equipment supplier. But that decree, although it struck down provisions of the patent pool arrangement forbidding the pool participants from licensing competing manufacturers, did not disturb the practice of restricting licenses to designated fields of application. This validated and facilitated non-competitive exploitation of patented technology, since partners in the patent pool could be assured against invasion of reserved market domains by other pool partners.[5]

In 1956, an antitrust initiative against the Bell System foundered when the Department of Justice acquiesced in a notoriously lenient consent decree[6] under circumstances summarized and sharply criticized by Judge Harold H. Greene when he came to review still another AT&T consent decree in 1982.[7] Judge Greene's opinion, drawing on Congressional committee hearings, disclosed that AT&T attempted to have the 1956 case dismissed by enlisting the Department of Defense's intercession with the Department of Justice. This effort failed but was renewed when the Eisenhower administration came into office. Eisenhower's Attorney General Herbert Brownell was recorded as believing that "a way ought to be found to get rid of the case" and that AT&T "could readily find practices that [they] might agree to have enjoined with no real injury to their business."[8] Not surprisingly, the resulting 1956 consent decree included no divestiture of Western Electric or other structural reorganization of the Bell System. Its injunctive provisions

4. *See* WOOD, PATENTS AND ANTITRUST LAW 128-45 (1942) *cited in* L. SCHWARTZ, J. FLYNN & H. FIRST, FREE ENTERPRISE AND ECONOMIC ORGANIZATION: ANTITRUST 936 (6th ed. 1983); General Talking Pictures Co. v. Western Elec. Co., 305 U.S. 124, 126 (1938).

5. *See* criticism of this decree and its successor in *Hearings on Proposed Reorganization of AT&T before the Antitrust Subcommittee of the House Judiciary Committee*, 85th Cong., 2d Sess. (1958); *Hearings on the Consent Decree Program of the Department of Justice*, 86th Cong. 1st Sess. (1959), *as cited in AT&T*, 552 F. Supp at 136.

6. *See* 1956 Table of Cas. (CCH) 71, 134 (Jan. 24, 1956).

7. *AT&T*, 552 F. Supp. 131 (D.D.C. 1982) *aff'd sub nom.*, Maryland v. U.S., 460 U.S. 1001 (1983).

8. *Id.*

were later characterized as "inadequate" by the Department of Justice itself when it filed a new antitrust action against AT&T in 1974.[9]

The new action, once again, sought structural relief including divestiture of Western Electric and the Bell telephone operating subsidiaries. Once again, the controversy was resolved by a deal (a negotiated consent decree, hereinafter referred to as the Modified Final Judgment (MFJ)) between the Department of Justice and AT&T.[10] The Department of Justice was represented by William Baxter, head of the Antitrust Division and, as an adherent to the Chicago School of Economics, dedicated to the narrowest possible view of the antitrust laws and to maximum freedom of businessmen from governmental interference. The AT&T deal was announced simultaneously with Baxter's decision to drop a long-pending suit against IBM.

The MFJ gave AT&T what it wanted most: retention of Western Electric and freedom to engage in unregulated commerce, a diversification prohibited (albeit ineffectually) by the 1956 injunction. However, the government was also able to claim an impressive victory, because the price exacted for the concessions to AT&T seemed staggering: a vast structural reorganization of the Bell System. AT&T was required to divest itself of the Bell operating subsidiaries constituting two thirds of its assets. This divestiture was accomplished by spinning off the stock of the subsidiaries to seven independent Regional Bell Operating Companies (RBOCs). The operations of the RBOCs were to be confined to regulated communications, pursuant to the underlying theory of the settlement, which will now be described briefly.

In Baxter's view, the evil to be remedied by the MFJ was the integration of unavoidably noncompetitive government-regulated telephone communications with competitive, unregulated business enterprises where fair competition among them might be distorted.[11] Such a distortion could result either from subsidizing non-telephone operations out of high rates charged to captive telephone customers or by giving special business concessions to affiliated suppliers. Accordingly, the central theme of the Baxter consent decree was to isolate the regulated mo-

9. *AT&T*, 552 F. Supp. at n.18.

10. The MFJ is appended to *AT&T*, 552 F. Supp. at 226.

11. Competitive Impact Statement in Connection with Proposed Modification of Final Judgment, 47 Fed. Reg. 7170 (1982).

nopoly components of the Bell System from components of the system that were or should have been competitive.

Fundamental to this approach was the view that AT&T, shorn of its control of local monopoly telephone service, would be effectively competitive with other suppliers of long distance service to the RBOCs. This view seemed plausible in view of the appearance of MCI, Sprint, and other competitors even prior to the MFJ. However, subsequent experience has somewhat undermined belief in the possibility of effective competition in long distance service. AT&T persistently retains upwards of eighty percent of the market. It can be plausibly maintained that new rivals survive not on their unaided merit but by reason of the artificial inflation of AT&T's costs and artificial restraints on AT&T's marketing efforts.

The cost inflation was primarily attributable to the higher rate AT&T was required to pay for access to the local exchanges. The discount enjoyed by AT&T's rivals was rationalized as reflecting only the superior access arrangements enjoyed by AT&T. More pragmatically, the higher access charge to AT&T reflected political opposition to any sudden deprivation of the long lines subsidy to local telephone service. In any event, the crucial cost advantage of AT&T's rivals is about to disappear for two reasons: (1) the disparity of access service has been virtually eliminated by vast re-engineering required by the MFJ's equal access provisions; and (2) the access cost itself is being shifted from the long distance suppliers to telephone subscribers, on the controversial theory that the long distance connection is a facility purchased by the subscriber rather than an input cost of providing long distance service.

The artificial restraint on AT&T's marketing of long distance service consists of resistance by the government against predatory low rates offered to big customers. The alleged predation lies in the asserted failure of these rates to cover total costs or even marginal costs. Such a price war can be waged more readily by a financial giant than by smaller rivals even if, by some measure, the rivals are more efficient. Economic justification for rates that radically discriminate in favor of big customers is found in the fact that these customers can resort to alternative non-regulated communications systems, and so may bypass the regulated system. It is arguably desirable to keep such customers on the regulated system at rates that exceed incremental costs however slightly, since that will make some contribution to fixed and overhead costs to the benefit of smaller users. Otherwise, fixed costs—a high proportion of total costs in telecommunications—would have to be borne entirely by the small customers remaining in the system. The whole question of cost of serving various groups of customers and the ultimate impact of price discrimination and bypass is so fraught with accounting and policy perplexities that no attempt is made here to do more than alert the reader to this stumbling block in the way of establishing fair and free competition in telecommunications.

The theory of the MFJ — safeguarding competition by segregating lawfully monopolized local telephone service from unregulated business — has been compromised in a number of significant respects. In the first place, the decree permitted a great deal of integration of local telephone service with other putatively competitive businesses. The RBOCs were, for example, awarded the immensely profitable Yellow Page directory business, although publishing advertising directories is a competitive, unregulated field.[12] Notably the RBOCs maintained an immense share of the long distance business under the MFJ by the device of defining "local" areas so generously as to embrace hundreds of miles of toll service. Moreover, non-Bell systems remained free to conglomerate their operations since they were not defendants in the Bell antitrust case and since the FCC's deregulation program substantially liberated "non-dominant" firms from federal regulation.

However, the most striking of the seemingly "anticompetitive" aspects of the MFJ have been the overt restrictions on the kinds of non- telephone businesses in which the RBOCs might engage. They were forbidden to provide data processing or other information services over their own communications network, i.e., prevented from competing with some of their own customers, including the press. The RBOCs were restrained from competing in the long distance market (other than the portion thereof allotted to them by definition as "local"). Even more unwelcome to the RBOCs was the restraint against diversifying into non-telephone business. Such ventures require specific permission or "waiver" by the antitrust court. Waiver has been granted freely where the court has perceived no substantial likelihood that competition would be impaired by using the

12. *AT&T*, 552 F. Supp. at 152.

telephone monopoly to favor the affiliated enterprises.[13] However, irksome constraints against conglomeration continue and are the principal target of proposed legislation.

Readers of this symposium may find useful background not only in the foregoing historical sketch, but also in some indication of the main criticisms that have been leveled at the MFJ generally. These may be listed as follows:

1) The MFJ "broke up" the Bell System in the wrong way by attempting to segregate local and long distance service. Customers are most inconveniently served by fragmentation of billing and repair responsibilities. It would have been better to place the entire responsibility for an integrated service on the locally regulated phone companies. That would have left them free to procure the long distance component of their service from competing suppliers. Moreover, the MFJ was deficient in failing to divest Western Electric from the overwhelmingly dominant long distance company.

2) The antidiversification policy must be strengthened. It is not enough to veto a particular venture on the basis of anticompetitive potential for diversion of telephone revenues in favor of affiliated enterprises. Such a policy favors conglomeration into the most remote and exotic ventures — for example, overseas ventures or ventures in risky new technologies with which telephone managements have little familiarity. The dominant concern in regulatory conglomeration of telephone companies is not an antitrust but a regulatory concern: keeping the management's attention squarely on its core task of providing an essential public service. It should be recognized as particularly baneful to allow a conglomerate holding company's management to intervene between the regulated enterprise and the regulating agency. Such a management will have frequent occasions to intervene, on account of its own diverse financial concerns, against proposals that a free telephone management might make — for example, to expand or replace a plant, to change dividend policy, or to lower or raise rates.

3) The MFJ unjustifiably restrains competition when it bars telephone companies from investing in other fields. This objection is mentioned here mainly to refute it. Not every constraint on entry is necessarily against public policy. Any such proposi-

13. *See* Schwartz, *Diversification and Regulated Industries—What's Next for the Telephone Company?* 7 COMM/ENT L.J. 195 (1985).

tion runs counter to numerous restraints imposed on utilities, banks, and broadcasters, for example, with regard to diversification and affiliation. Restraints on imports to protect infant industries are another example. More to the point are the antitrust precedents imposing restraints against entry by a dominant firm into competition with a newly-divested subsidiary.[14] The propriety of a particular restraint on entry is therefore open to examination. However, as I stated earlier, an important general consideration, in the case of public utilities, is the desirability of focusing the management's attention on the core responsibility of providing vital public services for which there are no substitutes or alternative sources.

4) The MFJ imposes too much regulatory responsibility on the Department of Justice and on the district court. Partial and intermittent intervention by these agencies cannot be an effective permanent substitute for unified supervision and coherent policy of one administrative agency. That must be said even though one recognizes the complementary nature of antitrust and regulation and the utmost importance of recurrent antitrust intervention when regulation proves ineffectual or the agency gives inadequate recognition to competitive concerns. Vindicating justice is a different and perhaps higher function than managing vast enterprises. Boredom and mortality set a temporal limit on a single judge's administrative policy; that of his successor will be almost accidentally determined by political influences on appointment and assignment.

The crucial issue, therefore, is not whether regulatory responsibilities should be revested in the FCC, but what the terms of that transfer will be, including the conditions to assure that the proper substantive goals will be pursued. Ultimately, a change of forum should not be a cover for subversion of substantive goals.

14. Ford Motor Co. v. United States, 405 U.S. 562 (1972).