If It Ain't Broke, Don't Fix It

John R. Worthington

Follow this and additional works at: https://repository.uchastings.edu/hastings_comm_ent_law_journal

Part of the Communications Law Commons, Entertainment, Arts, and Sports Law Commons, and the Intellectual Property Law Commons

Recommended Citation

John R. Worthington, If It Ain't Broke, Don't Fix It, 9 HASTINGS COMM. & ENT.L.J. 583 (1987).
Available at: https://repository.uchastings.edu/hastings_comm_ent_law_journal/vol9/iss4/2

This Article is brought to you for free and open access by the Law Journals at UC Hastings Scholarship Repository. It has been accepted for inclusion in Hastings Communications and Entertainment Law Journal by an authorized editor of UC Hastings Scholarship Repository.
If it Ain't Broke, Don’t Fix it

by JOHN R. WORTHINGTON

Law reviews dealing with issues facing the communications industry, like the industry itself, are vulnerable to being overtaken by events. This law review recently published a Symposium devoted to last year’s hottest telecommunications topic — legislative proposals to transfer authority to enforce the historic judgment in United States v. AT&T from the federal courts to the Federal Communications Commission (FCC). At present, these legislative proposals are on hold in Congress; the underlying substantive issues, however, are now being litigated in the United States District Court for the District of Columbia.

The Department of Justice (Department) and the Bell Operating Companies (BOCs) are now trying to persuade the court to do directly what the transfer legislation sought to accomplish indirectly — to allow the BOCs into telecommunications lines of business from which the Modification of Final Judgment (MFJ) had excluded them. On February 2, 1987, the Department of Justice released its first triennial report on the continuing need for the MFJ’s line-of-business restrictions. These

---

1. United States v. American Tel. & Tel. Co. 552 F. Supp. 131 (D.D.C. 1982), aff’d mem. sub nom. Maryland v. United States, 460 U.S. 1001 (1983) [hereinafter AT&T]. This judgment is often called the Modification of Final Judgment or MFJ. See Worthington, The Case for Continued Judicial Enforcement of the AT&T Decree, 9 COMM/ENT L.J. 75 n.1 (1986) [hereinafter Worthington]. The divested Bell Operating Companies (BOCs) have recently confirmed that this transfer legislation is unconstitutional. Commenting on an AT&T proposal that the FCC rather than the Department of Justice screen BOC requests for waivers of the line-of-business restrictions, BellSouth, one of the BOCs, stated that “the Constitution itself appear[s] to forbid the transfer of antitrust law enforcement jurisdiction from the Justice Department to any other agency.” Comments of BellSouth Corporation on the Justice Department Recommendations Concerning Section II(D) of the Modification of Final Judgment at 47 (filed Mar. 13, 1987), United States v. Western Elec. Co., Civil Action No. 82-0192 (D.D.C.). A fortiori, separation of powers principles forbid transfer of antitrust enforcement jurisdiction from a federal court to an executive branch agency. For a discussion of the constitutional issues, see generally Worthington, supra at 89-97.

restrictions limit the BOCs to local telephone service unless they show that the proposed diversification would not create any significant possibility of abuse of their local monopoly power. In its report, the Department recommended that these restrictions should be all but eliminated.

A broad range of commentors on the Department's report agree that the Department's and the BOCs' frontal attack on the line-of-business restrictions, like the indirect assault of the proposed transfer legislation, should fail. This article, building on the foundation laid by an article published earlier in the Symposium, explains why the Department's recommendations are fundamentally flawed and totally unprincipled. The article also responds to the article written for this Symposium by U S West, the holding company for three of the divested BOCs, and addresses, in particular, U S West's unfounded claim that regulation can prevent the anticompetitive conduct that the MFJ was crafted to prevent.

The line-of-business restrictions take the BOCs' incentive to use control of their local telephone monopolies to compete un-

3. Section II(D) of the MFJ prohibits the BOCs from providing interexchange (i.e., long-distance) telecommunications services or information services, manufacturing telecommunications equipment, or providing any other product or service (other than exchange communications, marketing of customer premises equipment, and directory advertising) that is not a natural monopoly actually regulated by tariff. See AT&T, 552 F. Supp. at 227-28.


5. Worthington, supra note 1, discusses the rationale of the MFJ and some of the public policy reasons why its line-of-business restrictions remain vital to the preservation of a competitive and responsive telecommunications industry.

fairly in related markets that they seek to enter.\textsuperscript{7} As long as the BOCs retain control of the local bottlenecks and competitors in related markets must depend on the BOCs to reach their customers, the line-of-business restrictions, enforced by the federal courts, will be the only effective means to preserve fair competition. Regulatory prohibitions against discrimination and cross-subsidy cannot contain the BOCs' virtually unlimited opportunity for bottleneck abuse.\textsuperscript{8} None of the factors that required imposition of the line-of-business restrictions in 1982 have changed. For the same reasons that the district court approved those restrictions as in the public interest,\textsuperscript{9} and that the Supreme Court affirmed its decision,\textsuperscript{10} they remain an "essential ingredient of the decree"\textsuperscript{11} necessary to "prevent recurrence of precisely the same structural and economic incentives that divestiture was designed to eliminate."\textsuperscript{12}

I

The Decree's Successes

When the MFJ was proposed, many complained that divestiture would destroy the best telephone system in the world. The rallying cry was, "If it ain't broke, don't fix it." Divestiture-driven events have since proved that our telephone system was indeed broken and in need of fixing. The elimination of the Bell System's domination of virtually all aspects of telecommunications has permitted an ever-widening array of new services and products to become available to American consumers at steadily declining prices. Notwithstanding predictions that AT&T had garnered for itself the most profitable portions of the System's business and condemned the divested BOCs to the dregs, the BOCs have succeeded, probably beyond their own expectations, and AT&T has yet to achieve the pre-divestiture financial targets that it set for itself.\textsuperscript{13}

\textsuperscript{7} Worthington, \textit{supra} note 1, at 77-78.
\textsuperscript{8} \textit{Id.} at 78-80.
\textsuperscript{9} \textit{AT&T}, 552 F. Supp. at 186-95.
\textsuperscript{10} \textit{Maryland v. United States}, 460 U.S. 1001 (1983).
\textsuperscript{12} \textit{Brief of the United States in Response to the Court's Memorandum of May 25, 1982}, at 7 (filed June 14, 1982), \textit{AT&T}, 552 F. Supp. 131.
\textsuperscript{13} See \textit{The Baby Bells are Outrunning Their Parent}, Philadelphia Inquirer, July 11, 1986, at 1-c; \textit{AT&T's Comments on the Report and Recommendations of the United States} at 7 (Mar. 13, 1987).
Although the Department and the BOCs are calling for further monumental change, there is no need to fix a telephone system that, by any measure, is generally performing well, with excellent prospects for continuing improvement. The Department's triennial report points with pride to the many examples of the MFJ's success: tremendous strides in implementing equal access;\(^\text{14}\) the unprecedented growth of competition in the interexchange,\(^\text{15}\) information services,\(^\text{16}\) and equipment markets;\(^\text{17}\) and a promised redesign of BOC "local networks to accommodate the maximum number of information service providers."\(^\text{18}\) It is ironic that the DOJ and the BOCs are citing the MFJ's successes as justification for its repeal.

II

The Department's About-Face

Perhaps it is not surprising that the BOCs want to do away with any restriction on their activities — even though one BOC consultant recently suggested that the line-of-business restrictions have probably saved the BOCs from wasting "\$5 billion in

\(^{14}\) DOJ Report, supra note 2, at 18-23, 68-70. While substantial progress has been made, equal access, unfortunately, is far from complete. AT&T's competitors still receive low-grade, discriminatory access from more than one fourth of the BOCs' access lines. Huber Report, supra note 2, at Table IX.7. MCI has requests outstanding for equal access in more than one thousand end offices across the country. See MCI's Objections to the [Regional Bell Operating Companies'] August 1 Filings Concerning Bona Fide Requests for Equal Access Conversions at 3, United States v. Western Elec. Co. (filed Aug. 15, 1986); see Memorandum of the United States Regarding Bell Company Schedules for Equal Access at 25, United States v. Western Elec. Co. (filed Nov. 21, 1986) (conversion schedules of two BOCs, including U S West, are unreasonable). Serious questions remain whether the BOCs are providing technically equal access to all long-distance companies. MCI's Comments on the October 31, 1986 Report by the United States Concerning the Status of Equal Access at 7-9, United States v. Western Elec. Co. (filed Jan. 9, 1987). The BOCs have yet to meet their equal access obligations under the MFJ for nondiscriminatory access for other services, including 800 service, cellular radio services, credit cards, and pay telephones. Id. at 10-21.

\(^{15}\) DOJ Report, supra note 2, at 65-67.

\(^{16}\) Id. at 112.

\(^{17}\) Id. at 182-63, 171 (central office equipment), 198 (PBX equipment), 200 (terminal equipment).

\(^{18}\) AT&T, 552 F. Supp. at 189; see DOJ Report, supra note 2, at 109 (affirming that the information services restriction was intended "to provide an incentive for the BOCs to develop 'open' networks conducive to information services competition"). Open Network Architecture (ONA), if ever implemented, would therefore be one of the restriction's predictable successes. Moreover, to the extent that ONA separately provides the elements of information service access, ONA merely represents compliance with Section II(A) of the MFJ, which obligates the BOCs to provide "unbundled" information access.
The position taken by the Department of Justice is, however, a great surprise. The Department's recommendations represent a complete break with its earlier, consistent support for the line-of-business restrictions. This abrupt about-face remains largely unexplained.

The dramatic change in the Department's position is easily demonstrated:

- The Department previously recognized that "there is little possibility that regulation is capable of detecting or preventing the very subtle forms of discrimination that would be available to the BOCs." But now the Department would rely on regulation to prevent discrimination — and cross-subsidization as well.

- The Department previously stated that "careful scrutiny of line-of-business requests is not regulatory intrusion," and that it "never sought" to have the court assume regulatory functions. But now it characterizes the court's activities as "judicial regulation."

- The Department previously urged the court that an equal access injunction could not be effective. But now it would rely on just such an injunction.

- The Department previously recognized, in the post-divestiture context, that it is impossible to separate alleged "'efficiencies of vertical integration' from the abuses of monopoly power" and that "where a meaningful potential for cross-subsi-
dization exists, the choice made by the decree is to presume that the benefits of such efficiencies [of integration] are outweighed by the potential for harm to competition. But now the Department wants to jettison the information services restrictions because of theoretical efficiencies that the Department itself admits may not exist or be significant.

- The Department previously stated that the court should consider the impact on local ratepayers in evaluating requests for waiver of the line-of-business restrictions. But now the Department argues that the MFJ "is not intended to address issues that relate primarily to the level of local telephone rates."

- The Department previously called it "disingenuous" and equivalent to "a request that... the Court suspend all ability to comprehend reality" to argue that the potential for new antitrust actions was an adequate substitute for continued enforcement of the MFJ. But now it advances just this argument.

- The Department previously stated categorically that "[t]here is simply no basis for the conclusion that the Department lacks either the competence or the will effectively to enforce the [decree]." But it now suggests that it lacks the competence, the resources, or perhaps both, to discharge its enforcement responsibilities.

There is simply no way to account for this 180-degree change of course — other than by a change in personnel, a change in personnel, a change in

---

27. DOJ 1984 Reply, supra note 22, at 34, 36-37.
30. DOJ Report, supra note 2, at 47. Applauding the Department's current position, U S West criticizes as unlawful judicial revision any reliance by the court on the MFJ's "principles and purposes." McKenna & Slyter, supra note 6, at 60-62. But this approach is completely consistent with settled precedent. See, e.g., White v. Roughton, 689 F.2d 118, 119-20 (7th Cir. 1982) ("it is not true" that a court must read one provision of a decree "without reference to the decree's evident purpose").
31. DOJ 1984 Reply, supra note 22, at 49. The court agreed that "[i]f the level of the prohibited activity had to rise to that of an antitrust violation, these provisions would have been unnecessary and redundant." United States v. Western Elec. Co., 592 F. Supp. at 869.
32. DOJ Report, supra note 2, at 53, 75 n.152, 124 n.254, 141, 170.
34. DOJ Report, supra note 2, at 135.
the Department's commitment to enforcing the antitrust laws, or by special interest, high pressure politics.

III

Continued Conditions Requiring the Restrictions

Since the court entered the judgment, nothing has occurred which would diminish the BOCs' ability or incentive to use their local bottleneck power to cripple competition in telecommunications markets where they are permitted to compete. The BOCs' stranglehold on virtually all domestic and international telecommunications remains intact. The Department concedes that local exchange networks carry 99.9 percent of all interexchange traffic and 99.999 percent rely on them.\(^3\) Those networks — millions of miles of copper wire strung on poles, buried in conduits and tied together by BOC switches — still provide the only practical means of making and completing virtually every telephone call.

Nor has there been any change in the inability of regulators to prevent the abuses that inevitably accompany BOC competition in markets dependent on fair access to the local exchange. "At the heart of the government's case in *United States v. AT&T* was the failure of regulation to safeguard competition in the face of powerful incentives and abilities of a firm engaged in the provision of both regulated monopoly and competitive services."\(^4\) This failure of regulatory protection continues.

U S West describes in detail the FCC's efforts, beginning in the 1960s, to promote competition.\(^5\) However, it omits the critical fact that it was the antitrust laws which were ultimately required to provide effective enforcement and remedies to achieve competition. The findings in the *MCI* and *Litton* cases demonstrated that the Bell System effectively ignored regulatory controls and that the regulators could do nothing about it.\(^6\) Further, none of the allegedly "new" regulatory ap-

---

35. DOJ Report, *supra* note 2, at 80; Huber Report, *supra* note 3, at 3.9, Table IX.5.
37. McKenna & Slyter, *supra* note 6, at 28-42.
38. See MCI Communications Corp. v. American Tel. & Tel. Co., 708 F.2d 1081, 1139-60 (7th Cir. 1983) (Bell System engaged in anticompetitive conduct against interexchange carriers without regard to pro-competitive policies of FCC), *cert. denied*, 464 U.S. 891 (1983); Litton Systems v. American Tel. & Tel. Co., 700 F.2d 785, 790-802 (2d Cir. 1983) (discrimination against competing equipment manufacturers in knowing vi-
Approaches devised since 1984 have been tested in the context in which the Department and U S West claim the regulations will work, that is, the context of anticompetitive incentives rekindled by BOC re-entry in telecommunications businesses dependent on access to the local exchange.

As growing competition has accelerated the pace of change in the telecommunications business, regulators have become even less able to deal with the myriad ways in which BOCs can leverage their bottleneck power to impede competition in telecommunications markets dependent on fair, nondiscriminatory access to the local exchange. The Department argued in 1982 that regulatory efforts are doomed, not necessarily by lack of good intentions, but rather by the impossibility of determining "in advance the discriminatory potential inherent in tomorrow's technology." U S West emphasizes regulatory reliance on Open Network Architecture (ONA) to prevent discrimination and cross-subsidization, but ONA is today, as U S West's chairman put it, simply "a state of mind." The Department admits that "full implementation of ONA is several years away," and the Department's consultant stated, "even when fully deployed, ONA will be available only on digital switches, which will then still serve under one quarter of all access lines."

Regulatory protections against cross-subsidization are equally illusory and untested. U S West would rely on the FCC's "new" cost accounting rules. But the methodology that U S West and the FCC claim is new is in fact the same method...
ology that the FCC has used for the last decade, and the FCC itself concedes that it "never succeeded in actually" using this methodology prior to divestiture.

Even if there was a sound theoretical framework for the illusory goal of cost allocation, the FCC cannot put theory into practice without the resources to audit the Bell Companies' accounting submissions. As the Department recognizes, "[t]he failure to devote sufficient resources to the audit process will reduce any prophylactic program, no matter how sound in theory or principle, to a sham that deceives rather than protects ratepayers and state regulators." The FCC's resources are inadequate to the task: "the Commission currently employs only 24 auditors, and they have very limited funds for travel;" the FCC's recent budget request cut one of its audit teams; the FCC admits that its current resources do not permit it to "monitor, audit and investigate cost allocations [among carriers' de-regulated and regulated businesses] on an item-by-item basis;" and the FCC Chairman just characterized its funding in recent years as "inadequate." In 1982 the court accurately noted "the problems of supervision by a relatively poorly-financed, poorly-staffed government agency" over a gigantic corporation "with almost unlimited resources in funds and gifted personnel are no more likely to be overcome in the future than


47. Report and Order, para. 11, Separation of Costs of Regulated Telephone Service From Costs of Unregulated Activities, CC Docket No. 86-111 (released Feb. 6, 1987). The reasons given by the FCC for its past implementation problems — "the massiveness and complexity of the data," "the extreme fungibility of the plant," and "the high degree of substitutability amongst the services" — apply equally today. Id.


49. Id. at 36 n.63.

50. Written Statement of Mark S. Fowler, Chairman, FCC, before the Subcomm. on the Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies of the Senate Appropriations Comm. at 3 (Feb. 18, 1987).


52. Telecommunications Reports, Feb. 23, 1987, at 25 (quoting Mark S. Fowler's testimony before a Senate appropriations subcommittee).
they were in the past.”\textsuperscript{53} Nothing has happened in the last four years to change that conclusion.

\textbf{U S West does not discuss the role of state regulators.\textsuperscript{54} State regulators probably would not — although they should — play an important role in preventing cross-subsidization. “[T]he possibility of challenge from cross-subsidized [BOC] affiliates is a large concern” to providers of information services (which are often intrastate in character); on the other hand, cross-subsidy constitutes “an almost negligible concern for rate payers.”\textsuperscript{55}} Cross subsidy problems for the providers of information services “must be weighed in light of the fact that local exchange operations are huge, and electronic information service markets are comparatively tiny.”\textsuperscript{56} State regulators would therefore have little incentive to allocate their limited resources to this problem.\textsuperscript{57}

\textbf{U S West fails also to come to terms with the costs of its “regulatory solution.”} U S West bemoans the uncertainty and delay associated with the procedure for obtaining waivers from the line-of-business restrictions.\textsuperscript{58} Yet, FCC proceedings to obtain approval of new services are often more protracted than the MFJ’s waiver process.\textsuperscript{59} The Department and the Bell System explored the possibility of injunctions regulating the behavior

\textsuperscript{53.} See 552 F. Supp. at 168.

\textsuperscript{54.} McKenna & Slyter, supra note 6, at 13 & n.14. U S West implies that most states promote intrastate competition, id. at 47 n.195; but that proposition is demonstrably false. Approximately 26 states expressly prohibit local exchange competition, Huber Report, supra note 2, at 2.11, and many states prohibit resale of local exchange facilities in the form of shared tenant services arrangements, id. at 2.10-2.11.

\textsuperscript{55.} Huber Report, supra note 2, at 6.36.

\textsuperscript{56.} Id.

\textsuperscript{57.} Even if state regulators focused on information services and had adequate tools, “[t]he broad sweep of the Regional Companies, with their various competitive and non-competitive subsidiaries and affiliates, constitutes a significant impediment to effective oversight by local regulators who are confined to a single state.” United States v. Western Elec. Co., 627 F. Supp. 1090, 1097 n.22 (D.D.C.), rev’d in part on other grounds, 797 F.2d 1082 (D.C. Cir. 1986), cert. denied, 55 U.S.L.W. 3607 (1987). State regulators have been particularly critical of U S West with respect to cross-subsidization. See National Association of Regulatory Utility Commissioners, “Summary Report on the Regional Holding Company Investigations,” Sept. 18, 1986, at 21.

\textsuperscript{58.} McKenna & Slyter, supra note 6, at 57-58.

\textsuperscript{59.} For example, New Jersey Bell’s request for a Computer II waiver regarding an enhanced service involving protocol conversion was pending for nearly one year before being conditionally granted and for another nine months before final approval. See Protocol Conversion Waiver Order, 100 F.C.C.2d 1057 (1985); In re New Jersey Bell Tel. Co., Mimeo No. 1426 (FCC Dec. 13, 1985). An FCC investigation into New Jersey Bell’s tariff for this service remains open. See In re New Jersey Bell Tel Co., Memorandum Opinion & Order, Mimeo No. CC-2381 (FCC Feb. 4, 1986).
of the integrated Bell System as an alternative to the structural relief of divestiture, but ultimately labeled those efforts "Quagmire I" and "Quagmire II." 60 That characterization is equally apt for federal and state regulatory proceedings.

More fundamentally, history shows that regulatory approval of new BOC services is many times just a prelude to years of antitrust litigation — litigation that usually begins with ultimately unsuccessful Bell claims that federal regulation preempts the antitrust laws. 61 U S West acknowledges what a "costly process" antitrust litigation can become. 62 Yet antitrust litigation is exactly what would follow a repeal of the MFJ's line-of-business restrictions. By providing structural relief that ended years of litigation and legislative turmoil, the MFJ has given the industry a significant measure of well needed predictability and stability. 63 To reverse this accomplishment makes no sense.

IV
Conclusion

The Department and the BOCs would tear up the decree and rewrite it to suit their current ideological preferences. U S West openly admits that it advocates "a de novo look at this time" in the line-of-business restrictions. 64 The Department has, as a practical matter, taken the same approach. The Department's treatment of monopoly leveraging illustrates that its current proposals reflect a change in economic philosophy. During the AT&T trial, the Department argued, and the court agreed, that the antitrust laws prohibit a firm's use of "its monopoly power in one market to gain a competitive advantage in


61. See McKenna & Slyter, supra note 6, at 25 & nn. 81-82 (acknowledging uniform judicial rejection of the Bell System's antitrust immunity arguments).

62. Id. at 11.


another market” even if “[r]elatively small market shares” in the second market would be foreclosed to fair competition.\textsuperscript{65} Now, however, so long as “sales to a majority of the market would still be open,” the Department regards with equanimity the prospect that unaffiliated equipment manufacturers would be foreclosed from large segments of the equipment market if the BOCs were permitted to manufacture and bought exclusively from their manufacturing affiliates.\textsuperscript{66}

Until 1982, the history of the Department of Justice’s attempt to deal with the Bell monopoly had not been encouraging. As Professor Schwartz accurately stated in his introduction to this Symposium, while the government always seemed to win, the plea bargain ultimately proved advantageous to the Bell System.\textsuperscript{67} The Department now appears poised to repeat this reprehensible scenario. After the nation has endured the upheaval of divestiture and is beginning to enjoy the competitive benefits of that wrenching event, the BOCs and the Department want to recreate “precisely the same structural and economic incentives that divestiture was designed to eliminate,”\textsuperscript{68} and “to exchange one nationwide monopoly with the incentive and ability to exploit monopoly power and injure competition for several smaller monopolies with the identical incentives and abilities.”\textsuperscript{69} Consumers and competition deserve a better fate.\textsuperscript{70}


\textsuperscript{66.} DOJ Report, supra note 2, at 176.


\textsuperscript{68.} DOJ June 1982 Brief, supra note 23, at 7.


\textsuperscript{70.} While success does not always come to the deserving, it has here. On September 10, 1987, the court, in a lengthy opinion, upheld the core line-of-business restrictions in the decree.