# Telecommunications

## Are Class Actions Lawyers Systematically Targeting Regulated Industries?

*Remarks by William Barr and Barbara Hart**

**MR. WILLIAM BARR:** On June 20 of this year, the Second Circuit decided a case called *Law Offices of Curtis V. Trinko v. Bell Atlantic Corp.*, the so-called *Trinko* case, which, we believe, radically changed the antitrust law in two respects: it expanded the scope of duties that incumbent firms owed to rivals; and it changed the traditional standing limits that barred suits by indirect purchasers. It significantly broadened the kind of conduct that, it could be argued, violated the antitrust laws, and it significantly broadened the scope of the people who can bring these claims.

Since *Trinko* was decided, 25 class actions have been filed in the Second Circuit. Among those, I believe, twelve were filed against Verizon, six against SBC. Others have been filed outside the Second Circuit against Qwest, and BellSouth.

A fellow named Dan Berninger, who appears to be something of a class action apparatchik, has said that the goal is to turn the Bell companies into the next "asbestos" and "big tobacco". I think we all know what he means by that. I contend that these actions are really an end run around the regulatory process and will stultify the whole regulatory regime that has been developed by the FCC.

Generally, antitrust laws don't require companies to help their rivals. Even monopolies have no obligation to assist in any way companies that are attempting to compete against them. Basically, the antitrust laws impose negative duties and enjoin certain objectionable conduct. There are no affirmative duties to help or cooperate with their rivals.

Something that may appear, at first blush, to be an extremely narrow exception that has never been recognized by the Supreme Court and has rarely been invoked by lower courts is the so-called Essential Facilities Doctrine. It has been sparingly employed, and in certain narrow contexts it has been held that firms have to provide access to their facilities to other firms.

But in the context in which it's been previously applied, it has involved two markets—market one and market two. The notion has been that if facilities in market one are essential to competing in market two, then under certain circumstances, they will be made available to someone who is trying to compete in market two.

This has been done where the company that has the facilities in market one has voluntarily made them available to others. So the terms and conditions have been established in the marketplace. They are things to be set by courts in the abstract, but there's a course of dealing that essentially sets the benchmark. In that context, the courts have said that you can't refuse to deal with someone to keep them out of market two. You have to allow them access to your facilities on the terms and conditions that you've essentially set as reasonable by your own course of dealing.

Moreover, in these contexts the incumbent who owns the facilities has not been displaced from their facilities and they are not being required to reconfigure their business. This has only heretofore been a claim for access that a rival firm or a competitor can bring. Customers or consumers have never been allowed previously to make claims that business that they're buying from should have Essential Facilities rights in someone else's facilities.

That's the antitrust background.

In 1996, the Telecommunications Act was passed, and, as most of you know, the so-called Incumbant Local Exchange Carriers (ILECS), or primarily the Baby Bells, have been required under that act to provide access to their facilities to competing firms that are coming in to provide local phone service. This is a situation in which you're dealing with one market, and Congress is trying to get people to come in and compete in that market, and as part of that regime, Congress is saying to the incumbents that those entrants have to be allowed to use your facilities on certain terms.

The Act tells the FCC to set out elaborate rules about what has to be provided on what terms and conditions, and at what price. Accordingly, the FCC has set up what has to be one of the most complex and pervasive regulatory regulatory regimes in history.

It involves hearings before state regulatory commissions on the setting of pricing. Complex and numerous rule-makings on the various pros and cons of allowing access to certain parts of the facility are weighed. There are processes for adjudication of complaints that insufficient access is being provided. There are working groups where all sectors of the industry, the entrants and the incumbents alike, get together to discuss how to provide access.

This has required substantial reconfiguration of the local telephone network. It's involved billions of dollars of investment in new software and processes. These networks were not designed to provide a platform for multiple providers, and now they have to accommodate multiple providers. Extremely elaborate software, systems, and databases have had to be developed to do this.

The carrot for the ILECs to do this is that, once it's done and the FCC says that you've done this and therefore your market is sufficiently contestable or open to competition, then the local company can compete in the long-distance markets that heretofore the local companies had been prohibited from competing in.

In short, there's an elaborate process by which the issue of whether you have complied with the Act—and there-

fore, whether you can now compete to provide long-distance service—is adjudicated. These fights have been going on for several years. Basically, the long-distance companies are also CLECs (Competitive Local Exchange Carriers), and they're coming competing in local markets against the ILECs. They're among the companies that are trying to get access and use the facilities of the incumbents in local markets.

Long distance providers are coming in and using those facilities at very low prices, and at the same time they're trying to keep the local companies from moving up into the long-distance market. So there are usually scorched-earth regulatory battles as to whether the local companies are complying. The InterXchange Carriers—the long-distance companies—would say that you're not complying; you failed to do this, you failed to do that, you haven't done this well enough. They're trying to block the local company from the *quid pro qu*o of moving up and competing in the long-distance market.

So that's the framework.

Two years ago, the Seventh Circuit, in *Goldwasser v. Ameritech*, dealt with a case brought by a CLEC that was complaining about the quality of access that was being provided by the local company and saying that the local company wasn't going far enough in providing access to them. The District Court dismissed the case and the Seventh Circuit upheld the District Court.

Barbara Hart will give her view of the case, but the *Goldwasser* case, in my view, said that the claims brought by the CLEC were really duties not under the antitrust laws, but under the statute. They were affirmative duties to help that were created by Congress specifically in this area.

Furthermore, it's not proper to invoke the Essential Facilities Doctrine under the antitrust law in this particular context because it was incompatible with this regulatory regime that was established by Congress. More than a dozen district courts have followed *Goldwasser* and have dismissed these cases as they've been brought.

*Trinko* was then brought in New York. Trinko is a plaintiffs' class action law firm. It was a customer of AT&T, which, as I said, was a CLEC and therefore was trying to buy products on a wholesale basis from Verizon to resell to its customers.

There was an incident during Verizon's entry into long-distance in New York in which a piece of software in our wholesale order-processing apparatus, which was provided by a third party, failed. As a result, when CLEC's competitive companies were placing their wholesale orders, the orders were being fulfilled, but the part of the software that notified the CLEC that its order had been received and was being processed wasn't working in some cases.

AT&T made a huge fuss about this in the regulatory regime because it was asking the FCC to take away our permission to go into long distance, saying that our systems weren't up to snuff and that they were being impeded from competing. Largely to resolve this situation so that our ability to go into the long-distance business was not taken away, we agreed with the FCC that we would pay CLECs $10 million because of this problem, namely, the failure to notify them in a certain group of orders over a relatively brief period of time.

Again, there was no evidence of actual service disruption—these orders were in fact filled, and the customers did get the service.

The Trinko firm brought a class action based on this incident for the customers at AT&T on the grounds that AT&T's business was disrupted by this and therefore they as AT&T customers suffered injury. We petitioned the Second Circuit to dismiss, on the grounds that there is no antitrust duty to spend money and create this kind of elaborate software and processing system.

These were affirmative duties to assist created by the Act, not under the antitrust laws. Moreover, this would be the first time in history that an indirect purchaser, a customer of the firm, would be allowed to bring an Essential Facilities case. We lost on those grounds. As far as the case, we're seeking cert to the U.S. Supreme Court.

Among other difficulties with this case, it requires inquiry as to whether this is a proper area to expand the concept of Essential Facilities and develop this court-fashioned doctrine and to expand access to the courts to indirect purchasers, in this regulated context.

This idea of allowing hundreds of district court juries and treble damage actions to be deciding the terms of access to our facilities is fundamentally incompatible with the regulatory regime and Congress's plan under the Telecommunications Act.

The Telecommunications Act is clearly consistent with the notion that the FCC should be the one determining whether rivals need access. The Act did not give blanket access to rivals. It said that the FCC under a particular statutory standard should determine what parts of the network they would get access to.

The courts have said that this requires a balancing test. The purpose here is not just to be as profligate as you can in turning over parts of the networks to rivals, because that is counterproductive in terms of investment.

The intent of the Act was that you balance various public interests in determining how much access you give and for how long, and to stimulate investment not only by entrants, but also to keep the incentives for investment by the incumbents. That is a judgment call that the FCC is supposed to make by weighing a number of circumstances.

In a number of these cases, the basis of the claim is that the customer should have access to something that they weren't given access to; the FCC hadn't yet ordered access, but they should have had access under the antitrust laws. The FCC is meanwhile in the process of determining whether they should have acted, and whether, in fact, public policy should allow access to these facilities.

*Trinko* also seems to create a completely separate regime that is potentially inconsistent with FCC determinations of terms of access. The FCC sets highly articulated rules, such as that you have to provide something in 90 days after the order. Or it has to be at such and such a price. The

prices, by the way, are huge discounts that have never been required in the Essential Facilities context.

So as the FCC sets these terms and conditions, but part of these class actions suits have to do with the terms and conditions that we provided access on. They said that we didn't provide it fast enough. Well, we provided it within the time required by the FCC. Yes, they said, but our claim is not under the Act; it's under the antitrust laws—and under the antitrust laws, you may have had a duty to provide it faster.

The third area is the multiplicity of entities making the decision. The whole rationale for the Telecommunications Act and for the FCC setting out its multi-thousand-page orders dictating all the details to the states as to how this was to be implemented was that you could have one national entity that could make some of these decisions—because in many respects, these are national markets.

Under *Trinko*, we could have every district court judge and jury in America making these decisions as to what terms and conditions of access are reasonable under those circumstances.

It's also fundamentally inconsistent with the ultimate finding of competitive injury. In order to have an antitrust case, the issue is whether competition has been adversely affected. The FCC is ruling precisely on that issue when it determines whether the local company can get into long distance. In 80 percent of the markets that we've applied to so far to move into long distance, there have been huge battles as to whether the market is open. They get to put in their proof, and we put in our proof. They throw in everything but the kitchen sink, and they show every little flaw and glitch in our software system to claim that ours is an inadequate performance. The duly appointed commissions, the state commission, and the FCC make a ruling. We have won every one of those cases. The markets are open, and competition has not been adversely affected. Yet the core of the antitrust case is that we've impaired competition in that market.

The other area that is affected is the skewing of the regulatory process. Once you allow this second front—litigation in district courts under the broad principles of the antitrust law—to open up, then what parties ask for and are willing to agree to in the regulatory process, to the extent to which the parties actually come in and treat the regulatory process with respect and make their full case, are fundamentally altered.

We may be less willing to agree in the regulatory process to make certain concessions because now they've become the floor of district court treble damage antitrust liability. By the same token, companies may be changing what they seek in the process in order to position themselves for their second bite of the apple in court.

We've already seen evidence that some actors are essentially sandbagging the regulators, because rather than fighting out the battles in the regulatory process, they think that they don't have to worry about the regulatory process because they can hold this thing up and make their case in a district court.

This represents a radical expansion of antitrust principles, and is clearly not an arena for judges to be fashioning and expanding this Essential Facilities Doctrine because it's incompatible with the very detailed regulatory regime that was put in place by Congress.

**MS. BARBARA HART:** I have some prepared remarks, but unsurprisingly, I want to comment that I couldn't differ more strongly on the rendering of the *Trinko* decision. The *Trinko* decision was not a breakthrough in terms of antitrust standing, given that it followed Supreme Court and Third Circuit precedent to the letter in analyzing who the injured party and who an appropriate party is, and it was squarely within the *McCready* decision of the Third Circuit on *Illinois Brick*. Moreover, it was not a breakthrough decision on the issue of clear repugnancy that there was some type of conflict between the Telecommunications Act and application of the antitrust laws.

Finally, on the *Trinko* decision, the Second Circuit is very measured in its approach. It talks about damages as not being disruptive to the regulatory process or interfering with the regulators' oversight of the industry, whereas it would be more cautious in applying a remedy of injunctive relief.

So it's a very well-measured decision and within the confines of a great deal of precedent. I would actually wonder what ramifications it has for our *Goldwasser* decision, which we had the unfortunate experience of losing in the Seventh Circuit for reasons that Bill articulated.

As for what I had intended to say, I guess the not-at-all-subtle issue for today's caucus is to ponder whether class actions are engaging in undue or counterproductive efforts by targeting regulated industries. This discussion is akin to saying that the problem is not that there are maggots in your meat, but that Upton Sinclair dared to write about them.

In today's environment, where companies are regulated by the FCC or the SEC, or local regulatory authorities, and are imploding as Enron and WorldCom did, it's almost laughable to think that regulations are sufficient or vigorously enforced and that there's no role for the class action bar.

Uniformly, courts and regulators, including numerous previous SEC chairs and recently, the Seventh Circuit in the *ADM High Fructose* antitrust case, have recognized the significant role that the class action plaintiffs' bar plays in augmenting enforcement and regulatory efforts.

The government agencies are stretched beyond their abilities in light of budget constraints, and therefore also in light of staffing constraints. Let's face it: corporations engage a very high-powered, very sophisticated defense bar. They're not sitting there like pigeons for us to attack. They have their own defenses, which certainly are used in response to government inquiries.

Moreover, the idea that we target highly regulated industry is just not well taken. Undertaking cases where one is likely to encounter doctrines such as filed rate preemption, implied repeal, or primary jurisdiction is not typically what we do, for a variety of reasons, including the fact that those cases are expensive and we often lose them. So it doesn't make a lot of sense.

In the *Goldwasser* case, as has been discussed, we alleged violations of the Sherman Act and the Telecommunications Act based on allegations that Ameritech was routinely failing to comply with collocation requests and interconnection requests, akin to what has been alluded to regarding access for the carriers, which is mandated under the 1996 Act.

The idea is that these entities are already monopolies and that they are supposed to give access. We spent a lot of money on experts investigating the facts of this case; they even found that the fax machine was intended to run out of paper. The fax machine was supposed to take a lot of calls, but it would be busy for hours and hours so that the interconnection requests were going unanswered. It was intended not to comply with the requirements of the 1996 Act.

That case was very costly for my firm and for other firms that undertook the effort. We were dismissed by the district court based on filed rate and ultimately by the Seventh Circuit, based on the idea that the Telecommunications Act had imposed its own regulatory regime and that the antitrust laws wouldn't apply.

It's hard for class action lawyers to stay in business that way. We aren't targeting highly regulated industries.

Similarly, we've encountered issues such as implied repeal or plain repugnancy, which was alluded to in the *Trinko* case in the *In re options antitrust litigation*. Our firm and others spent significant time and resources litigating claims that the exchanges were not competing on the listing of options.

We all know what the benefits of competition are, and we all want to enjoy those benefits. We were alleging that the exchanges were not competing on the listing of options. All the exchanges, except the New York Stock Exchange, which had the most *de minimus* risk in this case, settled the case for $84 million. The New York Stock Exchange has thus far successfully held up that settlement by arguing the doctrine of implied repeal.

Judge Conway Casey agreed with the NYSE that plaintiff's claims were preempted despite the amicus views of the Justice Department and the SEC to the contrary. Judge Casey pointed to the fact that the SEC, in establishing the options market, had originally required only single listing of options.

In light of the prior regulation of the options market, Judge Casey found that the SEC, despite its argument in support of the application of the antitrust laws, could ultimately reassert its jurisdiction. He therefore held that he lacked jurisdiction to approve the settlement.

The idea was that somehow the SEC could whipsaw the exchanges by regulating, and then not regulating, and then one day deciding to reenter and reregulate. Therefore, the speculation regarding this whipsaw effect precluded—clearly, there was a plain repugnancy between the antitrust laws and the application of the antitrust laws—the possible reentry to regulate the options market.

The appeal in that case has been pending before the Second Circuit for over a year. So that $84 million settlement is just hanging in limbo. I would tend to say that the *Trinko* decision bodes well for the outcome that the Second Circuit will ultimately reach in light of the *Trinko* decision's holdings on the issue that there has to be a clear repugnancy between the specific regulatory regime and the antitrust laws for there to be a non-application of the antitrust laws.

My point being, we don't target regulated industries, except that, to some extent, all American industries are regulated. And to the extent that an industry is extensively regulated, it typically sends up flags as we analyze our cases, that we may have a hard row to hoe if we decide to undertake such a case for the reasons of the doctrines that I've already mentioned.

Yet when we do undertake such cases, we bring a real benefit. First, we compensate the victims. You'll find that almost no regulator compensates the people who have been injured.

For instance, in the CFTC case against Sumitomo, where the allegation was manipulation of the copper market, the CFTC got a breakthrough fine and a breakthrough recovery for the CFTC. Notwithstanding that, while a small portion of those monies was available to the victims of the copper-market manipulation, that small amount of money was not compensatory.

In fact, the class action bar—and I am involved in this case—will have ultimately recovered close to $100 million for the companies. In this instance, we're talking about companies—small businesses and large businesses and probably some telecommunications carriers—that purchased the manipulated copper, and they will get back money. Not from the regulators, but from the class action bar.

Second, we push the dialogue about issues. Look at tobacco. The tobacco industry argued vigorously that it was a highly regulated industry. That was its effort to take the sword and turn it into a shield. It said no, the class action bar and the attorneys general cannot sue us; we are a highly regulated industry.

The plaintiffs' bar and the attorneys general, through discovery of the fact that the tobacco industry was less than forthcoming with regard to additives in cigarettes that increased addictiveness and other knowledge that the tobacco companies had, helped bring about an enormous recovery that has changed the public's perspective about both the trustworthiness of big tobacco and the health effects of smoking.

Ultimately, we will have saved lives. So the dialogue, the pushing forward, where some might say we shouldn't be engaged in a policy discussion—to silence this additional voice would be very unfortunate.

This is also illuminated by the issue of prescription drugs. Class actions brought regarding monopolization by the brand name manufacturers will probably ultimately recover close to $1 billion cumulatively when you look at the monopolization of drugs such as Synthroid, Coumadin, Partisem, and some that are still pending regarding Buspar and Hytrin.

There the brand-name drug manufacturers have gamed the system, a highly regulated industry answering to the FDA. The Hatch-Waxman Act has supposedly put all

kinds of incentives into the industry for generic competition. Yet the industry is still gaming the system, and the class action bar has led to hundreds of millions of dollars in recoveries. In the end, it'll be close to a billion dollars in recovery for health-insurance companies as well as for consumers, and for union health and welfare funds that are paying the increased cost for prescription drugs.

In participating in that action, we've shaped the dialogue. Probably all of you are well aware that the Bush administration has come out in support of amendments to the Hatch-Waxman Act. We made that a hot-button and a palatable issue that the Republicans had to get behind. Drugs are clearly a regulated industry, yet I would argue that they weren't effectively regulated and that there was a role for the class action bar to play.

The other benefit that we bring to bear is our independence. Class action lawyers have the incentive to bring viable lawsuits, unlike the regulators, where we often see a revolving door from government to industry and sometimes back again.

I don't know why the plaintiffs' class action securities lawyers are never chosen to chair the SEC or even to act as a commissioner. Instead, you have the selection of someone whom the accountants are obviously comfortable with, a selection of cold comfort to investors and pensioners.

In this regard, the SEC is not unique. Regulated industries are big lobbying, big contributing, big players, and the regulators are not immune. Because the class action bar has the incentive to scrutinize, we will shine the harsh light on these industries, and we do have a role to play.

* William Barr is Executive Vice President & General Counsel, Verizon Communications. Barbara Hart is an attorney with Goodkind Labaton Rudoff & Sucharow LLP. Their remarks were part of The Federalist Society and Manhattan Institute's conference: "The New Class Action Targets: Are Class Actions Undermining Regulation in the Fields of Financial Services, High Technology, and Telecommunications?", held on October 30, 2002 at the Harvard Club in New York City.