Biting the Hand That Feeds: Can Telecommunications Competitors and Consumers Bring Antitrust Claims Based on Incumbents' Non-Antitrust Duties?

Decisions May Spur New Class Action Litigation

*By Robert Pambianco**

The telecom mess has gotten messier. Thanks to the ingenious efforts of enterprising class action lawyers, a split has emerged among three federal courts of appeals, further complicating the legal swamp created by the 1996 Telecommunications Act. The divergence occurs on the road where that statute intersects with the antitrust laws. And it involves this question: do allegations of inadequate performance of duties imposed by the 1996 Act—specifically duties that compel cooperation with competitors—state an antitrust claim?

The three cases at issue each involved suits brought against regional local telephone companies, specifically Ameritech, Bell Atlantic (now Verizon), and BellSouth. These companies, progeny of the old Bell System, are known as Incumbent Local Exchange Carriers, or ILECs. And all three suits involved allegations relating to the ILECs' obligations to open their respective markets to competition from entrants in the market for local telephony. These new entrants are commonly referred to as CLECs, or Competitive Local Exchange Carriers, a group that encompasses everything from the smallest upstart to established telecommunications giants like AT&T.

All three suits involved claims under both the antitrust statutes and the 1996 Act, as well as various state law claims. Each was an appeal from a district court decision granting a Rule 12(b)(6) motion to dismiss (for failure to state a claim) filed by the defendants in each case. In the first case, decided in 2000, the Seventh Circuit upheld the dismissal. In the two subsequent cases, both decided last year, the Second and Eleventh Circuits reversed the dismissals. Hence the Circuit split, and the petition for certiorari filed by Verizon last November in the Second Circuit case.

If the Supreme Court chooses to resolve this dispute, its decision would have profound implications for the future of competition in local telephony; it may also set the stage for a fresh onslaught of class action litigation.

The First Case: *Goldwasser v. Ameritech*, 222 F.3d 390 (7th Cir. 2000).

The first case in this story was a class action suit against Ameritech, now part of SBC Communications. It was brought in Illinois on behalf of a class of Ameritech's customers who asserted that Ameritech failed to comply with the 1996 Act's sharing requirements, thus violating both the antitrust laws and the 1996 Act itself. Interconnection is the primary method by which the 1996 Act seeks to achieve competition in the market for local telephone service. Put simply, the Act requires that the incumbent carriers—the ILECs—allow new entrants to connect to their networks. In theory, this would jump start competition by enabling new market participants to offer local phone service without surmounting the hurdle of building their own facilities (telephone lines, switches, and so forth). The purpose of this article is not to explore the pros and cons of interconnection. But suffice it to say, interconnection has produced at best mixed results.

The *Goldwasser* opinion contains three main holdings. First, the court held that the plaintiffs had standing to sue under the antitrust laws. (They were customers of Ameritech and thus not indirect purchasers. They satisfied the antitrust injury requirement by alleging that they were charged monopoly prices. And they were not improperly asserting the rights of third parties, i.e. Ameritech's CLEC competitors.) Second, the court held that the plaintiffs failed to state a claim under Section 2 of the Sherman Act, which addresses monopolistic behavior. And third, the court held that plaintiffs' claims were barred by the filed-rate doctrine. It is the court's second holding (failure to state an antitrust claim) with which this article is primarily concerned.

Contrary to some press reports, *Goldwasser* did not hold that1996 Act provides ILECs with immunity, implied or otherwise, from antitrust suits. As the court observed, "Such a conclusion would be troublesome at best given the antitrust savings clause in the statute."[1] Rather, the court held that the1996 Act imposed a myriad of obligations on ILECs that go beyond what the antitrust laws require. And that those "more specific and far-reaching obligations" are not "coterminous with the duty of a monopolist to refrain from exclusionary practices."

More importantly, the court held that antitrust claims cannot be divorced from claims under the1996 Act when the antitrust allegations are inextricably linked to allegations pertaining to an ILEC's duties under the Act. In other words, when the supposed antitrust violations "are covering precisely the same field" as an allegation that the1996 Act has been violated, then the antitrust claims must yield to the Act's more specific requirements.[2] The Seventh Circuit reasoned that the two were incompatible and that allowing antitrust claims to proceed would undermine Congress' decision to deal with the competitive problems in the local market through regulatory mechanisms rather than through the "unadorned" antitrust statutes. Said the court, "the elaborate system of negotiated agreements and enforcement established by the 1996 Act could be brushed aside by any unsatisfied party with the simple act of filing an antitrust action."[3]

The Second Case: *Law Offices of Curtis V. Trinko LLP v. Bell Atlantic Corp.*, 294 F.3d 307 (2d Cir. 2002).

Trial courts around the country relied on the *Goldwasser* ruling to dismiss similar suits. It seemed that the issue had been put to rest—until the Second Circuit proved that nothing relating to the1996 Act is easily settled.

Trinko originated in New York and was in many ways similar to *Goldwasser*. Like *Goldwasser*, it was a class action suit. But unlike *Goldwasser*, the plaintiff class did not consist of customers of the ILEC—in this case Bell Atlantic. Instead, the class consisted of CLEC customers, i.e., consumers who purchased their local telephone service from companies other than Bell Atlantic, which in turn partly relied on Bell Atlantic in order to provide telecommunications services.

Because the *Trinko* plaintiffs were not Bell Atlantic's customers, the indirect purchaser doctrine was clearly in play. Normally, under the Supreme Court's ruling in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), indirect purchasers lack antitrust standing. But the Second Circuit held that the plaintiffs had antitrust standing because AT&T was not only a purchaser of services from Bell Atlantic, but also Bell Atlantic's competitor. "Action meant to injure a competitor," said the court, "can directly harm the consumer who chooses to do business with the competitor."[4] Thus the alleged injury in *Trinko* was not that the plaintiffs were forced to pay monopolistic overcharges (as alleged in *Goldwasser*), but rather that they received poor service from AT&T as a result of the ILECs' alleged interference with AT&T's ability to compete.

The court then addressed the Sherman Act claims themselves. After taking considerable time to explain that the1996 Act did not provide implicit immunity from antitrust claims, the Second Circuit held that the plaintiffs had met their burden of stating an antitrust claim. In doing so, the court sought to distinguish the underlying factual allegations from those in *Goldwasser*. In essence, the court said that *Goldwasser* was different because there the antitrust allegations amounted to no more than allegations that the defendant had violated its duties under the1996 Act. In other words, in *Goldwasser* the plaintiffs alleged that Ameritech's failure to comply with the1996 Act constituted illegal conduct under the Sherman Act. But since the *Trinko* plaintiffs had styled their antitrust claim without mentioning Section 251,[5] the court was able to find that their complaint may have successfully described conduct that would support an antitrust claim under such theories as the essential facilities doctrine or monopoly leveraging. According to the court, "there is no requirement that an allegation that otherwise states an antitrust claim must not rely on allegations that might also state a claim under another statute."

Such semantics miss *Goldwasser*'s essential point: there is no antitrust claim if the allegations supporting that claim are inextricably linked to an ILEC's duties under the1996 Act. This seems only logical since it is hard to imagine the existence an antitrust suit existing outside the parameters of the1996 Act. The *Trinko* opinion seems to acknowledge this when it discusses the need to provide a cause of action to consumers.

The court explained that the1996 Act provides a legal remedy to carriers injured by an ILEC's failure to comply with its statutory obligations, while offering no legal recourse to consumers. So by allowing the antitrust suits, consumers will be able to sue somebody for violations of the1996 Act. The implication is unmistakable: Whatever the social benefits of creating a new cause of action for consumers, the allegedly illegal conduct, regardless of its name, is inseparable from the1996 Act.

The Third Case: *Covad v. BellSouth*, 299 F.3d 1272 (11th Cir. 2002).

The Second Circuit's concern with ensuring that consumers not be denied access to the courthouse was not a factor in the third case in this trilogy, because this case was not a consumer class action. *Covad* was filed in District Court in Georgia. The plaintiff was an Internet service provider, specifically a provider of DSL service (high speed Internet service that is delivered over local telephone lines and comparable to that provided by a cable modem or other broadband service).[6] Consequently, standing was not an issue; the plaintiff was neither an indirect purchaser nor somehow standing in a third party's shoes.

In *Covad*, the Eleventh Circuit's opinion picks up on the immunity issue, offering an even more elaborate analysis than that provided in *Trinko*—with an extensive discourse on the legislative history, replete with quotes from Congress, the FCC, and even former President Clinton. The court's decision: there is no express or implied immunity. Interestingly, in each of the three opinions discussed in this article, the immunity issue was explored in progressively greater detail, even though none of the opinions argued that the1996 Act provided immunity.

Finally, and again with considerably more analysis, *Covad* held that, at least for purposes of surviving a motion to dismiss, the plaintiff had successfully stated an antitrust claim. The reasoning is similar to that employed in *Trinko*. According to the court, Covad's complaint adequately alleged three antitrust claims: first, that BellSouth used its monopoly power to deny access to an essential facility ("namely its network of telephone lines"[7]); second, that BellSouth's conduct amounted to an impermissible refusal to deal; and third, that BellSouth had engaged in an illegal price squeeze. The court recognized that all three theories flowed from "Covad's allegation that BellSouth engages in what is known as 'monopoly leveraging.'"[8]—i.e., that BellSouth was able to use its dominant position to deny competitors access to the market.

The court stressed that it was not venturing an opinion on the ultimate viability on the merits of such claims, or even whether any of them would survive a Rule 56 motion for summary judgment. Instead, the Eleventh Circuit emphasized that it merely held that Covad's complaint had met the "exceedingly low threshold" that applies to Rule 12(b)(6) motions to dismiss for failure to state a claim.

Problems with1996 Act

At the outset, it should be noted that much of the confusion here is rooted in the unsatisfactory nature of1996 Act. As the Supreme Court has observed, "It would be gross understatement to say that the Telecommunications Act of

1996 is not a model of clarity. It is in many important respects a model of ambiguity or indeed even self-contradiction."[9]

The apparent conflict between the antitrust savings clause and the Act's mechanisms for encouraging competition in the local market (chiefly 47 U.S.C. §§ 251, 252) is but one of many inconsistencies contained in a statute that very much reflects the process that lead to its passageThe much-heralded1996 Act was the product of years of lobbying by the various parties in the telecommunications industry. These factions had different goals. And Congress' response was to give a little bit to everybody, so that no one went a home a loser. The result has been anything but pretty. As shown by the ensuing rulemakings, lawsuits, appeals, remands, subsequent appeals, and further remands, the1996 Act has largely failed to live up to its promise of creating a telecom utopia of convergence and competition.

That said, however, it appears that the Seventh Circuit in *Goldwasser* did a better job—both from the standpoint of logic and in terms of fidelity to the1996 Act—of reconciling the apparent disparity created by the savings clause.

The *Trinko* and *Covad* opinions argue convincingly and exhaustively that the1996 Act provides no immunity from suits under the Sherman or Clayton Acts. But this is largely a one-side argument, since the *Goldwasser* court never held that the1996 Act provided such immunity. To the contrary, *Goldwasser* observed that immunity would most likely conflict with the antitrust savings clause.

Goldwasser's holding was that no antitrust claim exists when the antitrust allegations are inseparable from claims arising from an ILEC's obligations imposed by the1996 Act. Both *Trinko* and *Covad* strive to explain the theoretical possibility of a freestanding essential facilities antitrust claim.[10] But such analysis seems to miss the whole point of the1996 Act, the premise of which is that the local loop (the copper wires connecting your telephone to the local central office) is a bottleneck that creates an obstacle to competition. The theory is that it would be too expensive for a competitor to build the infrastructure to compete with the incumbent carrier. So the Act mandates interconnection as an alternative to facilities-based competition.[11]

Alleging that an ILEC uses its monopoly power to control a strategic bottleneck (essential facilities) is nothing more than saying that the ILEC is violating the1996 Act's local competition provisions. Moreover, as a matter of law, it would seem problematic to suggest that the ILEC is able to improperly leverage monopoly control over essential facilities. Whether or not they are essential, the1996 Act requires ILECs to provide access to those facilities. It seems only logical that an antitrust claim cannot be based on an incumbent's refusal to deal, when the incumbent is statutorily required to deal.

Indeed, in enacting the1996 Act, Congress may well have been aware of the antitrust laws' limitations when it comes to imposing a duty to deal with competitors.
One may choose those with whom he does business, and the general rule in antitrust is that a firm can refuse to deal with another firm. Any compulsion to deal is narrowly construed. The essential facilities "doctrine," upon which the *Trinko* and *Covad* opinions rely so heavily, is at best a thin reed; the 11th Circuit's assertion notwithstanding, it is anything but "well-established."[12] To the contrary, it is widely condemned as inimical to the competitive goals of antitrust. The authors of the leading antitrust treatise argue that enforcement of the doctrine does nothing to benefit consumers and can have the perverse affect of perpetuating a monopoly:

> Forcing a firm to share its monopoly is inconsistent with antitrust basic goals for two reasons. *First*, consumers are no better off when a monopoly is shared; ordinarily, price and output are the same as they were when one monopolist used the input alone. *Second*, the right to share a monopoly discourages firms from developing their own alternative inputs.[13]

The treatise authors explain that antitrust strives to "…permit firms to enter and operate in markets *to the extent they are capable of supplying their own inputs*…." And they express the view that the essential facility doctrine is "both harmful and unnecessary and should be abandoned."[14]

Criticism of the doctrine is rooted in economics and is not unlike the arguments against free riders: competition does not thrive not when a competitor can rely on assistance from a dominant firm by sharing a network. As Justice Breyer famously observed, "It is in the *un*shared, not in the shared, portion of the enterprise that meaningful competition would likely emerge."[15]

Antitrust Litigation is Incompatible with the Regulatory Approach Favored by Congress

Where does all this leave the savings clause? According to the Seventh Circuit's *Goldwasser* decision, it applies to those telecommunications markets not subject to the "detailed regulatory regime" established by the1996 Act:

> There are many markets within the telecommunications industry that are already open to competition … as to those, the antitrust savings clause makes it clear that antitrust suits may be brought today. At some appropriate point down the road, the FCC will undoubtedly find that local markets have also become sufficiently competitive that the transitional regulatory regime can be dismantled and the background antitrust laws can move to the fore.[16]

Thus it is incorrect to read *Goldwasser* as saying the Seventh Circuit would affirm all dismissals of antitrust claims; in those cases where competitors are alleging anticompetitive behavior unrelated to imposed duties, antitrust claims could proceed. Certainly, one could envision hypothetical situations where antitrust claims were raised with respect to an illegal group boycott or horizontal restraint of trade or price fixing arrangement. Likewise, it would take little imagination to speculate on merger issues arising under the Clayton Act. Further, were a CLEC to attempt to compete on an equal basis with an ILEC and not take advantage of the 251 and 252 mechanisms, this might be a scenario where the savings

clause could come into operation and allow a theoretical antitrust claim.

On a superficial level, the *Trinko* and *Covad* holdings may seem more compatible with the savings clause, particularly if that clause is considered in a vacuum. But *Goldwasser* seems the only correct view when the savings clause is read in the context of the whole statute, which reflects Congress' decision to rely on regulation—rather than antitrust litigation—as its preferred remedy for the competition issues in the local market.

Congress could have opted to simply deregulate telecommunications—to fling the doors wide open to competition, leaving the antitrust statutes and the courts to deal with anticompetitive behavior. There is much to commend such an approach. But it is not the one Congress chose. Indeed one of the key purposes of the1996 Act was to end judicial oversight of the telecommunications industry. The one thing in the legislation about which there has never been any dispute is that it removed federal district court Judge Harold Greene's from his role as enforcer of the antitrust consent decree that had largely governed the industry ever since the AT&T breakup.

The1996 Act spelled out a policy for encouraging competition in the local telephony market; the heart of that policy is interconnection, i.e., mandating that ILECs open up their networks to competitors, allow competitors to collocate equipment in their facilities, and provide access to unbundled network elements according to some Byzantine formula for determining prices. Further, Congress gave responsibility to implementing and overseeing this process to the FCC. Put another way, Congress recognized that there was a competition (antitrust) issue in the local market. And Congress provided a remedy—which exceeded what would be required by the antitrust laws (since even monopolists are not typically required to allow their competitors use of their property).

What this means is that a CLEC cannot have its cake and eat it too. The1996 Act gives CLECs a leg up in offering services that compete with the incumbent, because Congress wanted to encourage CLECs to enter the market. And it did so by enabling them to offer service with a minimum of investment—forcing the incumbent carrier to cooperate with them, and laying down rules for how that cooperation will unfold, and (in the ILECs' view) forcing ILECs to provide access at below market rates.

The Act, however, does not require CLECs to follow this approach. There is nothing than prevents facilities-based competition (although there is a strong argument that it unintentionally discourages such competition). But it makes no sense to say that a carrier can avail itself of all the advantage of the Telecom Act, piggyback on the incumbent carrier, but still avail itself of the traditional antitrust remedies.

Not only does the1996 Act require ILECs to cooperate with their competitors, it also places restrictions on the ILECs' ability to offer long distance service. Under Section 271, ILECs are prevented from providing in-region interlata service until such time as the FCC decides (via a 14-point checklist contained in the Act) that the ILEC in question has sufficiently cooperated in opening its local market to competition. It is hard to conceive how this process would not be seriously undermined by antitrust suits such as those in *Goldwasser*, *Trinko*, and *Covad*. The result would be a situation where the FCC decided (as it has many times) that an ILEC had met its obligations under Section 271 (in other words, finding that it was not engaging in improper monopolistic behavior), but a jury in a civil case could decide that the same ILEC had violated the Sherman Act. And it is precisely that point that the *Trinko* and *Covad* decisions fail to grasp; antitrust litigation in an environment where the government has prescribed exactly how competition will occur is absurd.

Conclusion: Legislation Plus Regulation Equals Litigation

The notion of antitrust litigation in the context of the telecommunications industry always carries with it a certain amount of amusement. Indeed, the history of telecommunications policy in the United States stands as testimony to the theory that monopolies are largely the product, intentionally or otherwise, of government regulation. The great irony of this litigation is that before the 1996 Act, it would be extremely difficult (although not impossible[17]) for a party to sue an ILEC on antitrust grounds because they were state-sanctioned, state-protected monopolies. But after the1996 Act, when the ILECs are no longer monopolies, they can be sued—at least according to two federal appeals courts. In other words, so long as you are an official monopolist, you are safe from antitrust lawsuits. But if Congress passes a statute that make you cooperate with your less-dominant competitors, *then* you can be sued for being a monopolist.

Of course, none of this makes any sense. But that could be said of many things associated with the1996 Act. And so perhaps this is one time where it is hard to blame the courts for being confused. If you are not confused, you should be.

Up until now, however, most of this confusion has been confined to battles about regulation. Now, a new element has been introduced. No doubt attracted by the prospect of the treble damages available in antitrust, as well as the nearly limitless supply of potential class members (do you have a phone?), the trial lawyers have decided to get in on the act.

The1996 Act produced enough legal headaches apart from this problem. Indeed, as mind boggling as the Telecom Act and its regulatory and judicial progeny have been, they appear almost manageable when compared to the intractable legal, social, and public policy problems associated with class action litigation. One mess at a time.

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Footnotes

[1] The antitrust savings clause provides that "[N]othing in this Act … shall be construed to modify, impair or supercede the applicability of any of the antitrust laws." 47 U.S.C. § 154.

[2] 222 F.3d at 401.

[3] *Id*.
[4] 294 F.3d at 325 (relying on the Supreme Court's decision in *Blue Shield of Virginia v. McCready*, 457 U.S. 465 (1982)).
[5] 294 F.3d at 326.
[6] Many Internet service providers are also CLECs because they use the ILECs' telephone lines (the twin copper wires) to operate their service. Indeed, in the years following passage of the1996 Act, much CLEC activity was taken up by Internet providers. Partly because of economics and partly because of regulatory changes relating to access charges, much of that business has evaporated.
[7] 2002 WL 1777009, at *7
[8] *Id.* at *8.
[9] *AT&T Corp. v. Iowa Utilities Bd.*, 525 U.S. 366 (1999).
[10] The *Covad* decision discusses three potential antitrust claims. But they all proceed from the central premise that the allegedly illegal behavior springs from the ILEC's monopoly control of its telephone lines and network.
[11] This process arguably has had the opposite effect than what was envisioned. By enabling new entrants to use the incumbent's existing facilities, the1996 Act has produced a poor substitute for genuine competition, while discouraging carriers from investing in building new facilities.
[12] 2002 WL 1777009, at *9.
[13] III A Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* § 771b.
[14] *Id*. at § 771c.
[15] *Iowa Utilities Bd.*, 525 U.S. at **429** (Breyer, J., concurring in part and dissenting in part).
[16] 222 F.3d 401-02.
[17] MCI successfully sued AT&T on some antitrust theories in a famous 1983 case. *See MCI Communications Corp. v. AT&T Co.*, 708 F.2d 1081 (7th Cir. 1983).