Testimony of John Thorne
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Mr. Chairman and Members of the Committee, thank you for the opportunity to testify before the Committee regarding *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, No. 02-682 (U.S.). I am the counsel of record for Verizon in the *Trinko* case. I also teach telecommunications law at the Columbia Law School and have written several academic treatises on these subjects.[1]

Competitors and class action plaintiffs' lawyers have widely tried to turn Section 2 of the Sherman Act for the first time into a supplemental mechanism for redoing what the 1996 Telecommunications Act already does – but doing it through radically different and inappropriate means, including jury decisions, treble damages, and class actions. This inappropriate attempted expansion of antitrust, not the 1996 Act's Savings Clause, is the core issue in the Supreme Court in *Trinko.* The transformation of Section 2 that the plaintiffs in *Trinko* and other cases ask for is not just unjustified, but tremendously draining of resources in an industry that cannot afford it. Editorials about the case have recognized

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[1]The 2004 supplement to P. Huber, M. Kellogg & J. Thorne, Federal Telecommunications Law (2d ed. 1999), which will be published later this month, reviews the FCC and court decisions under the 1996 Telecommunications Act and antitrust law in this area. I will provide to the Committee's staff a copy of the supplement when it is available.

that the proposed expansion of antitrust is a "Frankenstein" monster created by plaintiffs' lawyers who "see a gold mine here."[2]

The *Trinko* and other complaints ask the courts to recognize a new Section 2 duty. They ask that Section 2 require a monopolist to turn over its sales to rivals by sharing assets at specially discounted prices – that is, they seek to impose on every monopolist a duty to dismantle itself. But that hasn't ever been a Section 2 duty and shouldn't now be made into one. The 1996 Act does impose such duties, through Sections 251 and 252 as they've been implemented. But the 1996 Act is a comprehensive regime for making, calibrating, and flexibly adjusting the judgments that are unavoidably needed to implement a duty to share at special discounts. The required judgments cannot properly be transformed into <u>antitrust</u> judgments. And the existence of the 1996 Act regime, with all its statutory guarantees of fast regulatory and judicial response to access demands, is one good reason to <u>avoid</u>, not to <u>start</u>, expanding Section 2 into what would unmistakably be new territory.

The claim by Trinko and other plaintiffs would change Section 2 into a condemnation of monopoly itself. But Section 2, going back at least to the 1920 *US Steel* case, has <u>not</u> done that. *US Steel* declares that Section 2 "does not compel competition" and does not condemn "size."[3] Other cases have reaffirmed that <u>possession of a monopoly</u>, if obtained without violating the Sherman Act, is <u>not</u> a Section 2 offense. What that means is that Section 2 doesn't compel a monopolist to give rivals a helping hand in displacing its

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[2]Editorial, *Son of Frankentobacco*, Wall St. J., Aug. 23, 2002, at A12.

[3]*United States v. United States Steel Corp*., 251 U.S. 417, 451 (1920).

own sales, that is, in dispossessing itself of its monopoly. Although the 1996 Act does impose a duty to create competition, Section 2 of the Sherman Act has never imposed that duty. It has been restricted to preventing monopolists from interfering with independently arising competition through conduct that can properly be condemned.

That distinction is fundamental and has always been respected. Section 2 has never required a retailer to change itself into a wholesaler, or a service provider to transform itself into a renter of facilities, as made clear, for example, in the Fourth Circuit's *Laurel Sand* decision.[4] In common sense and doctrinal terms, it is a legitimate business decision as a matter of law to just continue making one's sales and enjoying the fruits of one's investments, as much for a monopolist as for any other firm. In a system premised on competition, not cooperation, any firm may refuse to turn over its business to rivals, let alone to create an elaborate and burdensome apparatus for dealing with any would-be intermediary that asks for a piece of the business – an apparatus that, in the telecommunications context, has required billions of dollars in expenses to create special ordering systems, multi-level responses to customers, constant negotiations and disputes over the prices of individual access elements and the when and how of making them available.

There are a host of reasons why Section 2 has quite properly never been applied to impose a duty to start sharing assets with rivals at special discounts. One short-hand

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[4] *Laurel Sand & Gravel, Inc. v. CSX Transportation, Inc.*, 924 F.2d 539, 545 (4th Cir. 1991).

summary might be as follows. Any such antitrust duty presents unmanageable risks of doing more harm than good – of impairing the short-run and long-run investment incentives that the Sherman Act most fundamentally protects, and of generating transaction and administrative costs that offset benefits. The antitrust system just isn't institutionally suited to reliably counterbalancing those risks and costs. The antitrust system therefore has never taken on the challenges that are inherent in implementing duties of sharing – challenges that Justice Breyer recognized in his opinion in the *Iowa Utilities Board* case a few years ago[5] and that the D.C. Circuit, speaking through Senior Judge Williams, recognized in the *United States Telecom Ass'n* case somewhat more recently.[6]

These are challenges that historically have been left to regulatory regimes, not the antitrust system. Then-Judge Breyer explained this in his opinion for the First Circuit in the *Town of Concord* decision.[7] Today, the 1996 Act assumes those challenges in the telecommunications setting.

The 1996 Act "access duties" require decisions about what network elements and services must be shared, at what prices, on what other terms, and for how long. These judgments are technically complex, requiring an understanding of the operation and economics of telecommunications networks and services. They must be based on facts and

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[5] *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366 (1999).

[6] *United States Telecom Ass'n v. FCC*, 290 F.3d 415 (D.C. Cir. 2002), *cert. denied*, 123 S. Ct. 1571 (2003).

[7] *Town of Concord v. Boston Edison Co.*, 915 F.2d 17 (1st Cir. 1990).

reasoned economic analysis and must operate within the statutory constraints of the 1996 Act, like any agency decisions. But the judgments are necessarily experimental in assessing, on the one hand, when sharing on particular terms seems likely to produce the kinds of benefits contemplated by the statute and, on the other hand, when such sharing, by making piggybacking too attractive, is likely to undermine the kind of independent competitive investments the statute seeks to promote. The judgments must therefore be ever-changing. The 1996 Act is comprehensively undertaking the task of making those judgments, at both the federal and state levels. And it does so through an expert, flexible, agency-centered process that is more suited to making, and constantly adjusting, the necessary judgments. That separate regime highlights why the antitrust system is not suited to the task.

The only circumstances where Section 2 has recognized a single-firm duty to engage in some kinds of dealing with rivals is a narrow one: where the firm has refused to sell to rivals (or rivals' customers) what the firm was already voluntarily selling to others on the desired terms. That particular kind of stark discrimination has been present in <u>every one</u> of the cases finding liability for a refusal to deal – in *Lorain Journal*,[8] in the 1920s and 1990s

[8] *Lorain Journal Co. v. United States*, 342 U.S. 143 (1951).

Kodak decisions,[9] in *Otter Tail*,[10] and in *Aspen Skiing*,[11] as well as in the concerted action cases of *Terminal Railroad*[12] and *Associated Press*.[13] It was also present in the Seventh Circuit's *MCI* case,[14] apparently the first and only case of liability under the there-formulated "essential facilities doctrine." (That doctrine, as Justice Breyer has noted, is not a Supreme Court doctrine. It was formulated in *MCI*, but it got little attention there because its application was not even contested by AT&T on the local-access claims; AT&T's sole argument was a defense of good-faith practice under a changing regulatory regime. No later appellate application of the doctrine has resulted in affirming liability, and such later interpretations of this doctrine have made clear its proper limits – including the Fourth Circuit's *Laurel Sand* decision mentioned above.)

The discrimination situation – the stark refusal to make available to competitors (or their customers) the very services and terms being voluntarily made available to other customers – has been the pre-condition to demanding of a monopolist an explanation for a refusal to share: if you're selling this to others at a price that is profitable and lets you

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[9] *Eastman Kodak Co. v. Southern Photo Materials Co.*, 273 U.S. 359, 368-69, 375 (1927); *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451 (1992).

[10] *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973).

[11] *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985).

[12] *United States v. Terminal Railroad Ass'n*, 224 U.S. 383 (1912).

[13] *Associated Press v. United States*, 326 U.S. 1 (1945).

[14] *MCI Communications Corp. v. AT&T*, 708 F.2d 1081 (7th Cir. 1983).

recoup your investment, what reason is there for not selling the same thing at the same price to a rival? There might be answers – differential treatment can be justified; it isn't by itself illegal – but without that discrimination there has not been liability for refusals to share. There are at least two basic reasons. First, where the defendant is already voluntarily offering the desired terms, there is no antitrust intrusion on the basic competitive choices of (a) what to sell and (b) at what price – the choices through which a firm enjoys the rewards of successful investments. There is, accordingly, much less reason to worry about deterring long-run and short-run investments by requiring the results to be shared. Second, the institutional task for courts is much more manageable in this situation. The voluntarily sales furnish a standard of conduct – <u>equality</u> – that the courts do not have to define on their own.

It is worth highlighting how different is the situation where a claim is made for sharing on newly forced terms (as opposed to terms already being offered voluntarily) and, therefore, why Section 2 has never recognized such a claim. Any effort to demand sharing of assets on new terms requires something antitrust juries and judges, through a treble-damages system, can't reliably do. To elaborate a little on what I've summarized above, the problem that has never been undertaken in the antitrust system is to strike a balance so as not to do more harm than good, both in the short run <u>and</u> in the long run.

Long-run investment incentives would be threatened by a <u>Section 2 rule</u> that says you must share the reward if your investments turn out successful enough. The essence of the *US Steel* point about the limited reach of Section 2 is that antitrust respects that truth.

Indeed, this is a fundamental reason for having property rights in the first place, as Professor Elhauge has recently elaborated in his Stanford Law Review article.[15] *US Steel* and the *Standard Oil*[16] case note that the Sherman Act respects these property rights.

Even in the short run, there are at least three problems with sharing duties – as recognized in the FCC's *Triennial Review Order* and in the opinions of Justice Breyer and Senior Judge Williams mentioned above. <u>First</u>: a duty to share assets risks diminishing the incumbent's investments in creating those assets in the first place, and in maintaining and upgrading them, for the rewards must be shared but the risks fully borne. Local telephone networks in particular need such investment: they do not spring from the ground, but require the constant attention of hundreds of thousands of employees and billions of dollars investment. <u>Second</u>: a duty to share risks deterring independent investments by new entrants: sharing may be cheaper, and is certainly less risky, than investing in one's own facilities. <u>Third</u>: a duty of incumbents to share can harm the <u>best</u> new entrants, those who <u>do</u> build their own facilities: they are faced with competition not just from the incumbent but from all the rivals who can cheaply share the incumbent's assets. On top of these risks, the costs of implementing and administering any sharing duty can be very substantial, so that any market benefits must be large enough to exceed those costs. <u>And</u>: if the incumbent can't reliably determine the required sharing terms in advance – if there are vague legal

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[15]Elhauge, *Defining Better Monopolization Standards*, 56 Stan. L. Rev. (forthcoming Nov. 2003), www.law.harvard.edu/faculty/elhauge.

[16]*Standard Oil Co. v. United States*, 221 U.S. 1 (1911).

standards requiring years of costly and uncertain litigation – the risk of retrospective treble damages skews choices toward overgenerous sharing.

Again, my point is not that, conceptually, there is no situation where these risks and costs could be outweighed by the possible benefits in encouraging investment in unshared assets that compelled sharing of some assets might make possible. The Supreme Court recognized in the *Verizon v. FCC* case that it is "not obviously unreasonable" to conclude that there are such situations where compelled competition has net benefits and that the 1996 Act is Congress's experiment to identify such situations.[17] But that experiment is being conducted through expert agencies and administrative processes that can be flexible – in adopting and revising and abandoning particular sharing duties; in quickly responding to access demands; in knowledgeably evaluating complaints about implementing complex interconnection agreements; in designing performance measures, with accompanying levels of penalties, that reflect the newness and complexity of the tasks they are imposing.[18] The antitrust system, without this kind of expertise and flexibility, has thus never recognized sharing duties on newly forced terms.

The importance of flexibility was illustrated just recently in the FCC's recent *Triennial Review Order*.[19] A few years ago the FCC required incumbents to share pieces

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[17]*Verizon Communications Inc. v. FCC*, 535 U.S. 467, 510 (2002).

[18]Current available annual penalties regarding Verizon's performance exceed $1.24 billion. Attachment A summarizes the performance regime and these penalties.

[19]Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, CC Docket

of the spectrum available on their loops, so-called line-sharing. But it now has concluded that that judgment is mistaken, as it actually can discourage independent competition.[20]

That is just one illustration of the judgments that regulators at both the federal and state levels must make. The many massive FCC orders, and the numerous state-level orders that have been issued over the years, display the magnitude and complexity of the task and the range of subjects that must be addressed, and re-evaluated, in light of changing circumstances. They address access to different kinds of switch-to-customer connections (different kinds of "loops"), different kinds of interoffice trunks and switches, different forms of access to central offices, varieties of computerized ordering, billing, and other operation-support systems. With respect to all these matters, the agencies must determine the terms on which they think that there will be greater benefit than harm in forcing the incumbents to share, rather than forcing new entrants to take the risks of investing on their own. Yet the cases brought by Trinko and other plaintiffs would have all these judgments made under Section 2 of the Sherman Act before juries and judges, working alongside the agencies but applying different standards and operating under different timeframes.

The sharing duties alleged in those cases would not only be novel as a matter of antitrust law and unjustifiable for the substantive and institutional reasons I've mentioned. The 1996 Act is itself a good reason for not expanding Section 2 newly to recognize such duties. Doctrinally, the comprehensive regime of the 1996 Act furnishes one reason not to

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Nos. 01-338, et al., FCC 03-36 (released Aug. 21, 2003) (*Triennial Review Order*).

[20]*Triennial Review Order* ¶¶ 255-261.

expand Section 2 under the often-recognized principle that a general statute, especially a common-law like one such as the Sherman Act, shouldn't be newly expanded to cover what more specific federal regimes already are addressing. That familiar principle has been recognized by the Supreme Court in a number of contexts, including in the ERISA context in the 2003 *Black & Decker* case,[21] and it is reflected in the Seventh Circuit's *Goldwasser* decision[22] in this area particularly.

Expanding Section 2 in this context is distinctly unnecessary in this area, given the 1996 Act. The 1996 Act gives statutory rights to quick decisions for regulators on access demands, subject to judicial review. That system, including the reviewing courts, cannot be expected to fail unless the antitrust system, including the same courts, would fail as well. Then-Judge Breyer relied on a similar point for the First Circuit in the *Town of Concord* decision.

Expanding Section 2 in this context is particularly unwise in this area. Doing so would raises serious problems of disruption of and interference with the regulatory processes for implementing the 1996 Act. Expanding Section 2 in this area, in fact, would re-introduce the very kind of judicial regulatory regime that Congress rejected when it effectively ended Judge Greene's role in the 1996 Act, returning the task of fine-tuned telecommunications regulation to administrative agencies.

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[21]*Black & Decker Disability Plan v. Nord*, 123 S. Ct. 1965 (2003).

[22]*Goldwasser v. Ameritech Corp.*, 222 F.3d 390 (7th Cir. 2000).

Expanding Section 2 would reduce the agencies' flexibility in performing their delicate balancing task demands, especially their ability to enforce ceilings on sharing duties, which are as important as floors in that regime, for it is the refusal to allow sharing that induces the independent investments by new entrants that constitutes genuine competition. The process of weaning entrants off no-longer-justified sharing, or excessively favorable terms of sharing, can only be impaired by adding antitrust – the threats of treble-damages, class actions, hard-to-change injunctions, and, even, the sheer expense of defending complex antitrust suits, even while participating in the two-level regulatory proceedings superintending the very same matters.[23]

There are hundreds, maybe thousands, of agreements between incumbents and competitors. They are lengthy, complex, and detailed, all doing something new and involuntary. Disputes are inevitable under many of the open-ended and technical terms of the agreements, which is why there are built-in performance standards and penalties and expeditious dispute-resolution mechanisms, like the one that resolved the problem here in months. Yet recognizing the claims of Trinko and others would allow all these disputes to be made into antitrust cases simply by adding the allegation of a pattern of violations intended to slow overall marketwide entry. Those suits threaten years of costly, uncertain,

[23] *E.g.*, Remarks of John A. Rogovin, FCC General Counsel, Manhattan Institute (Oct. 30, 2002), available at www.manhattan-institute.org/html/clp_10-30-02.htm ("unquestionably there is going to be a lot of tension" between antitrust and FCC implementation of the 1996 Act; "[I]t's difficult to imagine how a private case getting into this 'essential facilities' issue – dealing, for example, with the local loop – is not going to bump up quite seriously into what the commission is doing").

and risky litigation before diverse juries deciding whether the incumbents dismantled themselves rapidly or helpfully enough. That prospect tilts the 1996 Act balance in only one direction.

In particular, it impairs the expeditious resolutions of problems under the 1996 Act. In the *Trinko* case itself, for example, AT&T and Verizon had a state-approved agreement saying "don't go to court to redress grievances," but instead use fast nonjudicial processes to resolve problems. They used those processes: the underlying problem was fully resolved, with compensation paid, in a few short months. The prospect of treble-damages antitrust class actions can only impair the ability of the 1996 Act regulatory regime to achieve such efficient resolutions – and only drains resources from telecommunications investment, which is now so sorely needed.

Thank you again for the opportunity to testify before the Committee today. I am happy to answer any questions.

Attachment A

Each state has adopted a Performance Assurance Plan that defines automatic penalties to be paid by incumbent local carriers to the CLECs for performance deficiencies. These PAPs have been repeatedly adjusted in their details as state commissions have found different aspects of performance to require different levels of motivation. The total level of available penalties is quite high. The first PAP, established in New York, was justified as sufficient because it put at risk a sizeable fraction of Verizon's annual profits from the state. In reviewing New York's PAP, the FCC concluded: "We believe it is useful to compare the maximum liability level [under the PAP] to Bell Atlantic's net revenues derived from local exchange service – after all, it is primarily its local service profits that Bell Atlantic would have a theoretical incentive to 'protect' by discriminating against competing local carriers. * * * In 1998, Bell Atlantic reported a Net Return of $743 million in New York: $269 million [the amount then at risk under the PAP] would represent 36% of this amount." Application of Verizon New York, 15 FCCR 3953, ¶ 436 (1999). The New York PAP subsequently was increased to $293 million, or 39% of Verizon's Net Return.

The current total of available annual penalties in Verizon's states (not counting New Jersey) is $1.24 billion. New Jersey has no annual cap on the penalties that could be incurred. Aside from New Jersey, the total amounts of available penalty levels were set initially as a fraction of profits from the state (usually 39%), but because profits have declined while the penalties have stayed the same or increased, the fraction of Verizon's profits that could be forfeited is generally much larger than 39%. For example:

State	Annual Available PAP Penalties	2002 Net Return	Available Penalty as a % of Net Return
New York	$293 million	$68 million	433%
Massachusetts	$155 million	$130 million	119%
Virginia	$206 million	$323 million	64%
Pennsylvania	$197 million	$481 million	41%
Maryland	$161 million	$253 million	64%
D.C.	$44 million	$56 million	78%
New Hampshire	$43 million	$45 million	96%
Rhode Island	$22 million	$14 million	154%
Delaware	$18 million	$17 million	102%