FCC Reform: Does Governing Require a New Standard?

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and
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Executive Summary

The Telecommunications Act of 1996, which sought to transform the regulatory landscape of communications, contemplated the creation of competition even in areas such as local telephone service. It did not, however, address the issue of reform of the Federal Communications Commission (FCC), a topic of long-standing interest. Some suggest that the Commission should be abolished, while others recommend curtailing some of its responsibilities.

Reform of the FCC would probably need to take into account a continuing central role for the agency in shaping the telecommunications industries. Instead of dismantling the FCC or curtailing its powers, this paper suggests a different option for Congress: redefining the public interest standard under which the FCC operates.

The Communications Act of 1934 charged the Commission with protecting the public interest, but Congress implicitly left it broad discretion to define what the term "public interest" means. Historically, the FCC's view of the public interest has been influenced by the concept of scarce communications resources, but as scarcity has turned to abundance, rethinking is appropriate.

The report suggests that Congress should explicitly direct the FCC to adopt a public interest standard that incorporates procompetititve antitrust principles.

In memory of

William H. Read

February 17, 1941–February 3, 1999

whose ideas, encouragement, and support
helped launch and sustain this Program

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Chapter One

Introduction

The fundamental—even perennial—national issue in telecommunications is: Should the federal government economically regulate the telecommunications industry? And if so, how?

The Telecommunications Act of 1996 (the "1996 Act"),[1] the first major revision of the United States's basic communications law in more than sixty years, seems to accept the need for continuing regulation and the established means for undertaking it. The 1996 Act keeps in place the Federal Communications Commission (FCC), the specialized regulatory agency created by the 1934 Communications Act,[2] amended but not replaced by the new law. The 1996 Act also keeps in place the "public interest" standard under which the Commission operates.

This report offers a new option that might be considered should Congress wish to visit the issue of whether the government should economically regulate the telecommunications industry. This option would hasten the demise of administrative agency regulation of communications by amending the public interest standard of the 1934 Communications Act[3] through incorporation of pro-competitive antitrust doctrine. A public interest standard based on competitiveness may be appropriate to conditions of technological abundance and convergence, such as those that have replaced the communications scarcity and media separation of an earlier era and that gave rise to administrative agency regulation.

Although recommendations to abolish the FCC may make headlines and proposals to cut its budget may appeal to budget-balancing members of Congress, the option presented here recognizes that the agency has important responsibilities in any transition to full competition and that it offers reform by removing the agency's political discretion to define the public interest in any manner it sees fit by mere majority vote.

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[1]S. 652, The Telecommunications Act of 1996.

[2]47 U.S.C. Sections 214(a), 307(a), 309(a) (1976).

[3]Id.

Chapter Two

Background: Arguments and Issues

Since the late 1960s, at least among academics, technological convergence has been said to be occurring in the sciences of communications and computing.[4] More recently, in the 1990s, this convergence has been the subject of articles in the business and trade press:

> The telephone, television and computer are merging into a single intelligent box...a telecomputer...which will be linked to the rest of the world by high-capacity smart wires.[5]

Some observers have predicted that the "telecomputer" will be widely available and in use by the end of the 1990s.[6] The introduction of convergent technologies linked by "smart wires" is perceived as profound, because it erodes technological boundaries that have long separated historically distinct industries of telephony, computing, broadcasting, cable television, and consumer electronics. President Clinton has predicted that this technological revolution will bring an economic and social development equal to the one that accompanied the introduction of the railroads in the nineteenth century.[7]

2.1 Technology Meets Regulation

The question of how government will adapt to this new condition of abundance and digital unity in communications has prompted public debate.[8] The Clinton administration's response was to establish an Information Infrastructure Task Force, with committees on telecommunications, information policy, and applications, this last with responsibility for implementing recommendations of Vice-President Gore's *National Performance Review* (also called *Reinventing Government*) in the area of information technology (also called "the information superhighway").

Vice-President Gore believed that the FCC should be empowered to "create a unified regulatory scheme" that would somehow combine a flexible regulatory environment with free

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[4]See, generally, Oettinger, Berman, and Read *High and Low Politics: Information Resources* (1977).

[5]George Gilder, *Forbes* (April 13, 1992).

[6]Lippman, MIT Media Lab, Video, September 1993.

[7]President William J. Clinton, "Technology for America's Economic Growth," Feb. 22, 1993.

[8]For example, Peter W. Huber, *Issues in Science and Technology*, Fall 1993 and American Enterprise Institute for Public Policy Research project prospectus on "Telecommunications Deregulation," February 1993.

and open markets.[9] In an era when technologies are converging and when the declining costs of computing are enabling decentralization in communications networks, it indeed makes sense to argue for a policy of free and open markets. But did it make sense to argue at the same time for some sort of new "unified regulatory scheme"? Given that economists justify economic regulation as a surrogate for competition, how can new regulation bring the American consumer the benefits of converging technologies through free and open markets? Does not regulation impede competition? These questions were significant as Congress contemplated a revision of the Communications Act.

The traditional agenda of federal regulation of communications has produced such results as the FCC's inflexible zoning system for the spectrum, which has slowed the introduction of new technologies and become an entry barrier to a communications service in need of spectrum. Given the continuing advances of converging technologies, a regulatory scheme that both divides various communications firms and circumscribes the services they offer may be arbitrary, if not obsolete.[10]

As the FCC implements the provisions of the new law, what is now needed is not regulation based on precedents under the public interest standard, but, rather, an amended standard. This standard would be based on the competitive principles of antitrust law, not on the limited resource principles of regulatory law. Put another way, the conditions of scarcity and inflexibility in communications are changing to conditions of abundance and versatility. With the costs of communications and computing declining, abundance increases; with spreading acceptance of digital formats, versatility abounds. These technological imperatives produce a convergence that, in turn, creates new choices. Video programming offers an example: consumers at home no longer rely solely on over-the-air television (TV) for video programming; cable TV and videocassette recorders (VCRs) are widely available. From a technological standpoint, telephone companies are capable of entering the home video market, as are multimedia computer companies. The true public interest would be to see many competing firms in the market, not regulation of some already in this market nor regulation preventing those wishing to enter it.

Thus, the federal communications act today might be amended to reflect the following intent: *The public interest is best served when the private communications system functions in competitive markets and therefore any regulatory economic intervention should be premised on the principles of antitrust law.*

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[9]"Gore Rides the Highway," *Washington Technology*, Jan. 13, 1994.

[10]See Kellogg, Thorne, and Huber, *Federal Telecommunications Law* (1992).

2.2 The Public Interest

The 1934 Act[11] established the FCC[12] and gave it broad jurisdiction to regulate "interstate and foreign communication by wire or radio," including common carriers (discussed in this section) and radio broadcasting (discussed in section **2.3**). Over-the-air and cable television did not yet exist,[13] nor computers, over which the FCC has no jurisdiction.

The 1934 Act, which consolidated federal regulation of communication into one agency,[14] had its legal origin in the late 1800s, when Congress focussed on railroad regulation and the public interest standard.[15] The regulation that evolved, using the public interest standard, covered two related activities, (1) government-granted monopolies, such as railroads, telephone companies, and electric utilities, and (2) public resources made available to private entities for private gain, including again, railroads, telephone, and electric companies that used public land. In 1910, wireless, as radio was then called, was added to this list when Congress amended the Interstate Commerce Act[16] to bring interstate and foreign wire and wireless communication under federal jurisdiction. The Radio Act of 1912,[17] which followed the sinking of the *Titanic*, represented the first comprehensive radio legislation. It adopted, among other things, the international distress signal.[18]

The 1934 Act requires that the FCC shall determine "whether the public interest, convenience, and necessity will be served by the granting of [broadcast facility construction permits and station licenses."[19] The law provides that "No [wireline common] carrier shall undertake the construction of a new line or of an extension of any line...unless there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity require or will require the construction...."[20] Although the key

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[11]47 U.S.C. 35 (1934).

[12]Id. at 151.

[13]Television was not mentioned in the Act, however the service uses radio frequencies. The FCC asserted jurisdiction over Cable Television. *Cable Television Report and Order*, 36 F.C.C. 2d 143 (1972).

[14]Jurisdiction of wire and radio communication was split among three federal agencies: the Federal Radio Commission, the Interstate Commerce Commission, and the Postmaster General. See Head, *Broadcasting in America*, 3rd ed. at 133 (1976).

[15]*Munn v. Illinois*, 94 U.S. 113 (1877). The Supreme Court held that states may regulate the use of private property when the use was "affected with the public interest."

[16]36 Stat. 539 (1910).

[17]Pub. L. No. 62-264, 37 Stat. 302 (1912).

[18]Id. at section 4.

[19]47 U.S.C. section 309(a).

[20]47 U.S.C. Section 214(a).

words in the statute vary for broadcasters and common carriers, the Supreme Court has rejected efforts to distinguish between the terms.[21] Indeed, although both the agency and the courts have struggled to interpret what Congress meant by those words, given they are not defined in the 1934 Act, there is no doubt that "the statutory standard...leaves wide discretion and calls for imaginative interpretation."[22]

Problems of statutory construction are common in administrative law,[23] but the review in this paper of FCC decisions leaves no doubt that the Commission has so tortured the public interest standard through its applications in both broadcast and common carrier regulation that, in the view of the authors, the public interest of the United States in communications might be better served by an amended standard. The review begins by examining how the FCC has defined the public interest in allocating access to the radio spectrum.

2.3 Spectrum Scarcity

The regulatory rationale for broadcast regulation is the scarcity of frequencies: "The radio spectrum simply is not large enough to accommodate everybody," Justice Frankfurter observed in 1943.[24] Spectrum's "inherent physical limitation"[25] has been considered justification for federal imposition on broadcasters of public service obligations in return for the "free and exclusive use of a limited and valuable" public resource.[26]

The scarcity rationale, which supports regulation of broadcasting in the public interest, has yielded many problems, not least among them the lack of scarcity. In 1927, the United States was served by fewer that 600 AM radio stations. No FM stations, TV stations, cable TV, low-power TV, video cassettes, electronic publishing existed then, nor any of the other current or planned technological alternatives that undermine the scarcity rationale—and in the 1990s, there are eight times as many AM radio stations on the air as were operating in 1927.

In 1927, Congress, apprehensive that a few special interests might monopolize the radio frequencies, passed the Radio Act to safeguard the public interest.[27] The public interest

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[21] *Interstate Commerce Commission v. Railway Labor Executives Assn.*, 315 U.S. at 376 (1942).

[22] *Federal Communications Commission v. RCA Communications, Inc.*, 346 U.S. at 86, 90 (1953).

[23] See, e.g., Federal Power Commission, 16 U.S.C. sections 797(g), 800(a) (1982); Interstate Commerce Commission, 49 U.S.C. section 1(18) (1976).

[24] *National Broadcasting Co. v. United States*, 319 U.S. 190, 213 (1943).

[25] *CBS v. Democratic National Comm.*, 412 U.S. at 101 (1973).

[26] *Office of Communication of United Church of Christ v. Federal Communications Commission*, 359 F.2d 994, 1003 (D.C. Cir. 1966).

[27] See, generally, Deregulation of Radio, 73 F.C.C. 2d 457.

standard that has governed broadcasting since then has become controversial, mainly because, coupled with the scarcity rationale, it was used to justify extensive government intrusion into the First Amendment rights of broadcast journalists, exceeding anything imposed on "the platform or the press."[28] Of all the intrusions, the most despised was the Fairness Doctrine,[29] which provoked forty years of controversy.

2.4 The Fairness Doctrine

The Fairness Doctrine, which was abolished by the FCC on August 7, 1987,[30] imposed twin public interest obligations on broadcasters licensed to use specific frequencies of the "scarce" spectrum:

> Broadcast licensees are required to provide coverage of vitally important controversial issues of interest in the community served by the licensees and to provide a reasonable opportunity for the presentation of contrasting viewpoints on such issues.[31]

The evolution and demise of the Doctrine reveals the problematic state of the public interest standard. The slippery slope first began in 1929, when the Federal Radio Commission[32] discussed the obligation of broadcasters to provide equal time to political candidates as set forth in section 18 of the Radio Act.[33] The Commission said:

> It would not be fair, indeed it would not be good service to the public to allow a one-sided presentation of the political issues of a campaign. In so far as a program consists of discussion of public questions, public interest requires ample play for the free and fair competition of opposing views, and the commission believes that the principle applies not only to addresses by political candidates but to all discussion of issues of importance to the public.[34]

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[28]*Supra* at note 25.

[29]47 C.F.R. sections 73.1910, 76.209 (1987).

[30]*Syracuse Peace Council*, Memorandum Opinion and Order, 2 F.C.C. rcd. 5043 (1987).

[31]*In re Inquiry into Section 73.1910 of the Commission's Rules and Regulations Concerning the General Fairness Doctrine Obligations of Broadcasting Licensees*, 102 F.C.C. 2d 143, 146 (1985).

[32]Federal Radio Act, Pub. L. No. 690632, 44 Stat. 1162 (1927).

[33]Id. at section 18.

[34]*Great Lakes Broadcasting Company*, 3 F.R.C. Ann.Rep. at 33.

The Doctrine became an FCC policy in 1949,[35] and in 1969, in *Red Lion Broadcasting Co. v. FCC*,[36] the Supreme Court upheld the constitutionality of the personal attack component of the Doctrine. The Court's approval of the Doctrine as a necessary regulation of spectrum scarcity has frequently been cited as justifying regulation of broadcast content. Justice White, writing for a unanimous Court, determined that Congress, when it amended the Communications Act in 1959,[37] had intended to include the Fairness Doctrine in the public interest standard:

> [The] language makes it very plain that Congress, in 1959, announced that the phrase "public interest," which had been in the Act since 1927, imposed a duty on broadcasters to discuss both sides of controversial public issues. In other words, the amendment vindicated the FCC's general view that the Fairness Doctrine inhered in the public interest standard.[38]

The implication here—that, according to the Supreme Court, unless the public interest standard could be eliminated, the Fairness Doctrine could not be eliminated—made it difficult for the FCC later to revisit the Doctrine. Thus, to abolish it, the FCC had to determine that the media marketplace had changed drastically since the *Red Lion* decision and that the Doctrine no longer served the public interest.[39] Although the FCC's 1985 Fairness Report[40] challenged the Doctrine on both the scarcity rationale and the First Amendment rights of broadcasters, the Commission had to avoid the appearance of not following the teachings of *Red Lion*. The public interest standard was therefore reinterpreted to mean that the Doctrine inhibited, rather than encouraged, dissemination of information.

The year after the issuance of the Fairness Report, the U.S. Court of Appeals for the District of Columbia held that Congress had not codified the Fairness Doctrine in its 1959 amendment to the Communications Act.[41]

With the demise of the Fairness Doctrine, the broadcast industry was relieved of a despised regulation, but the FCC made it clear that broadcasters were still required to observe other programming obligations:

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[35]*In the Matter of Editorializing by Broadcast Licensees*, 13 F.C.C. 1246 (1949).

[36]395 U.S. 367 (1969).

[37]Pub. L. No. 86-274, 73 Stat. 557 (1959).

[38]395 U.S. at 380.

[39]See 1987 *Syracuse*, *supra*, note 30.

[40]*Fairness Reports*, *supra*, note 31.

[41]*Telecommunications Research and Action Center v. FCC*, 801 F.2d 501 (D.C. Cir. 1986).

> The fact that government may not impose unconstitutional conditions on the receipt of a public benefit does not preclude the Commission's ability, and obligation, to license broadcasters in the public interest, convenience, and necessity.... The Commission may still impose certain conditions on licensees in furtherance of this public interest obligation. Nothing in this decision, therefore, is intended to call into question the validity of the public interest standard under the Communications Act.[42]

2.5 Broadcast Deregulation

While continuing to acknowledge that it was mandated by Congress to regulate in the public interest, the FCC in the 1980s, under then Chairman Mark S. Fowler, assumed a new agenda—deregulation of the broadcast industry. Fowler viewed the economic efficiency of broadcast licensees and voluntary discretion in programming as better ways than regulation to serve the public interest. In a seminal article, Fowler and his legal advisor, Daniel L. Brenner, stating that the historic justifications for regulation did not withstand close scrutiny, advocated allowing broadcasters to respond to public demand.[43] Support for their thesis could be found in economics, especially among economists who advocated marketplace solutions. As Ronald Coase noted as early as 1959,[44] all resources are scarce, and the ideal way to allocate them is not through regulation but by a market-based system that uses prices to ensure that scarce resources go to those who will make the best use of them.[45]

Fowler went further, contending that the FCC second-guessed business judgment and that this discouraged risk-taking and innovation by entrepreneurs.[46] The Fowler Commission, acting on this new agenda, took steps to deregulate both ownership and operation of broadcast stations. Restrictions on multiple ownership were relaxed,[47] "trafficking" rules that limited

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[42]1987 *Syracuse*, *supra* note 30, at para. 80.

[43]Mark S. Fowler and Daniel L. Brenner, *A Marketplace Approach to Broadcast Regulation*, 60 Tex. L. Rev. 207, 207-257 (1982).

[44]Coase, *The Federal Communications Commission*, 2 J. L. & Econ. 1, 14 (1959).

[45]Fowler and Brenner, *supra*, note 43, at 221.

[46]Fowler, *Foreword*, 32 Cath. U.L. Rev. 523, 524-26 (1983).

[47]*In re Amendment of Section 73.3555 of the Commission's Rules, the Broadcast Multiple Ownership Rules*, 4 F.C.C. Rec. 1741 (1988).

alienation of licenses were eliminated,[48] and restrictions on the content of programs were eliminated.[49]

These regulatory changes reflected Fowler's belief that the marketplace best serves the public interest.[50] The argument can be made, however, that a revised public interest standard failed to address the fundamental challenge—to reassess the power of the FCC when the FCC implements the public interest standard.

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[48]*In re Amendment of Section 73.3597 of the Commission's Rules (Applications for Voluntary Assignments or Transfers of Control)*, 55 Rad. Reg. 2d 1081 (1982).

[49]*In re Deregulation of Radio*, 84 F.C.C. 2d 968 (1981); *In re the Revision of Programming and Commercialization Policies*, 98 F.C.C. 2d 1076 (1991).

[50]Fowler's philosophy and policy were controversial. See, e.g., Sunstein, *Preferences and Politics*, Phil. & Pub. Affairs 3, 28-29 (1991); Comment, *Deregulating Commercial television: Will the Marketplace Watch Out for Children?*, 34 Am. U. L. Rev. 141, 143 (1984); Comment, *Radio Deregulation and the Public Interest: Office of Communication of the United Church of Christ v. Federal Communications Commission*, 4 Cardozo Arts & Enter. L.J. 169 (1985).

Chapter Three

Counter Arguments: Regulation, Reregulation, and Deregulation

3.1 An Illegitimate Standard

Professor William Mayton has argued that the public interest standard used by the FCC is illegitimate in that it "implicates a derangement of constitutional structure, a structure put in place to assure that government power is used circumspectly."[51] This powerful argument draws on the precedent of deregulation of the press in 1694 by the "Regulations of Printing Acts."[52] In the words of Blackstone, "the press properly became free, in 1694; and has ever since so continued."[53] In modern times, given technological convergence among media, the argument is compelling that the power the FCC holds under the public interest standard should be held unconstitutional. According to Professor Mayton, all media should be free. The law that governs the press, he argued, should be precedent for the electronic media, to the benefit of American democracy.[54]

A second point by Mayton, with respect to FCC power is that, when read correctly, the 1934 Act does not delegate an open-ended public interest power to the FCC.[55] Mayton is not alone in contending that Congress did not delegate general power to the FCC to regulate broadcasting in the public interest. Professor Jaffe has argued that

> [T]he use of "public interest" in the statute did not manifest a congressional intent to give the Commission general powers to "regulate" the industry or to solve any "problems" other than the problem of [radio] interference which gave rise to the legislation.[56]

In 1940, in its first decision concerning FCC power under the 1934 Communications Act, the Supreme Court agreed:

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[51]William Mayton, *The Illegitimacy of the Public Interest Standard at the FCC*, 38 Emory L.J. 715 (1989).

[52]*Parliament's Remonstrances Against the Renewal of the Licensing Act*, XI H.C. Jour. 305-06.

[53]4 Blackstone, Commentaries 152 n(a).

[54]See *Lovell v. City of Griffin*, 303 U.S. 444, 451-52 (1938); *Schneider v. State*, 308 U.S. 147, 164 (1939); *Grosjean v. American Press Co.*, 297 U.S. 233, 245-48 (1936); *Near v. Minnesota*, 283 U.S. 697, 713-16 (1931).

[55]Mayton, *supra* note 51, at 763.

[56]Jaffe, *The Illusion of the Ideal Administration*, 86 Harv. L. Rev. 1183, 1192 (1954).

> [T]he Act does not essay to regulate the business of the licensee. The Commission is given no supervisory control of the programs, of business management or of policy.[57]

But three years later, the Court opened the public interest door to expanded FCC powers. In *NBC v. United States*,[58] Justice Frankfurter combined different parts of the 1934 Act to describe broad FCC authority: "[T]he 'public interest' to be served under the Communications Act is thus the interest of the listening public in the 'larger and more effective use of the radio.'"[59]

Read together, *NBC v. United States*[60] and *Red Lion Broadcasting Co. v FCC*[61] legitimated expansive powers for the FCC under the public interest standard. Since these decisions were handed down much has changed—so much that efforts have been under way, starting as far back as 1976, to rewrite the Communications Act.[62] At the same time, given these changing conditions, the FCC has been working to redefine the public interest—yet the issue is not one of redefinition but, as Professor Mayton argued, reassessment.

3.2 Telecommunications Reregulation

When the Communications Act became law in 1934, there were three parts to the paradigm for regulating telephone and telegraph companies:

- The utility had a protected franchise based on the economic concept of natural monopoly.
- It was quarantined from entering competitive markets.
- Government would thoroughly regulate the company's prices, business practices, and conditions of service.[63]

As recently as 1984, this model helped shape the thinking of government decision makers. That year, the U.S. District Court in Washington, D.C., began regulating the regional Bell

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[57]Federal Communications Commission v. Sanders Brothers Radio Station, 309 U.S. 470, 475 (1940).

[58]*Supra*, note 24.

[59]Id. at 216.

[60]Id.

[61]*Supra*, note 36.

[62]See Krasnow, Longley, and Terry, *The Politics of Broadcast Regulation*, 240-69 (3d ed. 1982).

[63]Kellogg, *supra*, note 10, at 1-2.

telephone companies, following the AT&T Divestiture Decree,[64] which created these companies. The model has been significantly altered by both the FCC and state public service commissions, which have adopted alternative forms of regulation by implementing rate-freeze or price-cap regulation.[65] The model was further eroded when the U.S. District Court in Alexandria, Virginia, agreed with Bell Atlantic that the federal government had imposed an unconstitutional quarantine on one of its telephone companies (Chesapeake & Potomac) by banning such companies from entering the cable TV business in the same area in which they provided telephone service.[66] The Court held that the ban infringed on the company's First Amendment rights, thus indirectly challenging the inferior constitutional protection the Supreme Court afforded electronic speech in *Red Lion*.[67]

The principal reason for this evolution of the model, culminating in the 1996 Act, has been the changing conditions in communications, which have led to increasing competition, which in turn, has led commentators and regulators to see economic efficiency as a primary goal of telecommunications regulation.[68] One commentator has argued that the FCC has changed its focus from the goal of universally available and affordable residential telephone service to economic efficiency: "The federal redistributory or *equity* goal," he contends, has become "secondary to the pursuit of economic *efficiency* through reliance on a change in markets and competition."[69]

The FCC first adopted these concepts of efficiency and competition in telecommunications in a series of decisions that began in 1956 with telephone accessory equipment and culminated in 1968 in *Carterfone* and the FCC's decision to open the public telecommunications network to equipment provided by vendors other than telephone companies.[70] In the area of long-distance telephone, the Commission adopted a similar policy

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[64] *United States v. American Telephone & Telegraph Co.*, 552 F.Supp. 131 (D.D.C. 1982), *aff'd*, 103 S.Ct. 1240 (1983).

[65] Although price cap regulation is preferred by telecommunications companies to the more comprehensive rate-of-return regulation, it is not without problems. See Braeutigam and Panzar, *Effects of the Change from Rate-of-Return to Price-Cap Regulation*, 83 Am. Econ. Rev. Papers & Proc. 191 (1993).

[66] *Chesapeake & Potomac Tel. Co v. United States*, 1993 U.S. Dist. LEXIS 11822 (E.D. Va. Aug. 24, 1993).

[67] *Supra*, note 37.

[68] See, e.g., Baumol and Sidak, *Toward Competition in Local Telephony* (1994).

[69] Noam, *Federal and State Roles in Telecommunications: The Effects of Deregulation*, 36 Vand. L.R. 949, at 950. (1983).

[70] See *Hush A Phone Corp. v. United States*, 238 F.2d 266 (D.C. Cir. 1956); *Use of the Carterphone Device*, 13 F.C.C. 2d 420 (1968); *Proposals for New or Revised Classes of Interstate and Foreign Message Toll Telephone Service (MTS) and Wide Area Telephone Service (WATS)*, 56 F.C.C. 593 (1975), *aff'd sub nom. North Carolina Util. Comm'n v. Federal Communications Commission*, 552 F.2d 1036 (4th Cir.), *cert. denied*, 434 U.S. 874 (1977) (equipment registration decision); *Use of the Carterfone Device in Message Toll Tel. Serv.*, 13 F.C.C. 2d (continued...)

by opening the market to new entrants.[71] It also encouraged the entry of new technologies into the marketplace, such as direct broadcast satellites and cellular telephones.[72] Finally, it relaxed some quarantine restrictions on telephone companies to allow them to enter the competitive markets of "enhanced," i.e., computerized, services and "customer premises," i.e., terminal, equipment.[73]

3.3 Regulate Structure or Performance

All the Commission's actions were initiated pursuant to the public interest standard, which on the one hand, enabled the Commission to adopt freedom of entry positions based on convergence of technology, while, on the other hand, it allowed the Commission to segregate segments of the industry and restrict participants in one area from entering another. For example, cellular telephony was authorized as an unregulated duopoly, with one franchise reserved for the local telephone company and the other allocated by the Commission to a competitor.[74] In effect, the Commission substituted formal control of market structure for deregulation of price and quality. Increasingly, regulation of structure was replaced by that of performance as more in the public interest.

At the same time that it was placing increased reliance on marketplace forces, accompanied by structural controls on entry to the market, the FCC was also placing heightened emphasis on antitrust law.[75] An example was the 1982 staff report of the Office of Policy and Plans entitled *Measurement of Concentration in Home Video Markets*,[76] which argued that when local video markets (broadly defined) are reasonably competitive, the FCC's goals are realized.[77]

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[70](...continued)
420 (1986); *Jordaphone Corp. v. United States*, 18 F.C.C. 644 (1954); *Use of Recording Devices in Connection with Tel. Serv.*, 11 F.C.C. 1033 (1947).

[71]The FCC began cautiously in its *Allocation of the Frequencies in the Bands Above 890 Mz*, 27 F.C.C. 359 (1959), but ten years later, in *Microwave Communications, Inc.*, 18 F.C.C. 2d 953 (1969), it put federal regulation on a successively liberalized road to market entry.

[72]90 F.C.C. 2d 676 (1982); 86 F.C.C. 2d 469 (1981).

[73]*Amendment of Section 64.702 of the Commission's Rules and Regulations, Third Computer Inquiry* (CC No. 85-220), Notice of Proposed Rulemaking, 50 Fed. Reg. 33581, at para. 141 (August 20, 1985), Report and Order, 104 F.C.C. 2d 958 (1986).

[74]See *An Inquiry into the Use of the Bands, 825-845 Mhz & 870-890 MHz for Cellular Communications Sys.*, 86 F.C.C. 2d 469 (1981).

[75]See Botein, *New Communications Technology: The Emerging Antitrust Agency*, 4 Comm. & Ent. L.J. 685 (1981).

[76]Levy and Setzer, *Measurements of Concentration in Home Video Markets 81*, Office of Plans and Policy, Dec. 23, 1982.

[77]Id.

The FCC was hardly embracing the consumer welfare model of antitrust law. To do that would have meant avoiding the imposition of structural regulations that raised barriers to market entry, vertical integration, and efficient exploitation of economies of scale. It was permissible, the Commission implicitly reasoned, for regulation, at times, to restrain trade. The public interest standard could accommodate such an outcome. One jurist, Judge Posner of the Seventh Circuit, reflected on this curious situation:

> If the Commission were enforcing the antitrust laws, it would not be allowed to trade off a reduction in competition.... Since it is enforcing the nebulous public interest standard instead, it is permitted, and maybe even required, to make such a tradeoff—at least we do not understand any of the parties to question the Commission's authority to do so.[78]

The issue was not the Commission's authority: "the nebulous public interest standard" is just that—nebulous. The question then, is how the standard should be defined in light of changing conditions in communications.

3.4 Regulation and Competition

Where regulation is concerned, less presumably is better and competition presumably is best.[79] This theme was heard often in the mid-1980s, when Washington was filled with calls for regulatory reform and deregulation and the FCC, under Republican control, interpreted the public interest to mean more competition and less regulation. Intellectually, the theme was fed by the "Chicago School" of economists, who challenged much regulation as being economically without merit.[80] The success of the Japanese in international business reinforced the view that the competitiveness of the American economy had been weakened, in part at least by too much regulation.

The FCC, apparently caught up in this "regulatory failure" theory, sought to promote less restrictive means of favoring competition. Arguably, what the Commission created was "regulated competition." Congress did not help, for example, by enacting, first, cable TV regulation legislation in 1984[81] and, then, just eight years later, reregulating the industry.[82] The reregulation bill left implementation to the FCC, and when the Commission rolled back

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[78]Schurz, 982 F.2d at 1049 (citing *Federal Communications Commission v. National Citizens Comm. for Broadcasting*, 436 U.S. 775 (1978)); *Federal Communications Commission v. Pacifica Found.*, 438 U.S. 726 (1978); *National Broadcasting Co. v. United States, supra*, note 24.

[79]See Breyer, *Regulation and Its Reform* (1982).

[80]See, e.g., Stigler, *The Theory of Economic Regulation, 2 Bell J. Econ. & Mgmt. Sci.* in (1971).

[81]Pub. L. No. 98-549, 98 Stat. 2779 (1984).

[82]Pub. L. No. 102-385, 106 Stat. 1460 (1992).

cable rates, not only did the industry howl but the planned Bell Atlantic-TCI merger collapsed, dealing a setback to the Clinton administration's ambitions for an information superhighway built by converging industries with private monies.[83]

"Our mission was to protect the public against unreasonable prices, while promoting business," Reed Hundt, the FCC chairman, commented after the decision.[84] The regulatory tool can be a difficult instrument to use in attempting to achieve these twin reasonabilities. Classical regulation often fails, as Justice Breyer has argued, because of a fundamental mismatch between the tool and the evil it is intended to fix.[85] A more appropriate tool in communications might be antitrust law rather than precedents of the FCC that apply the ill-defined public interest standard. This tool can be made available by amending the 1934 Act to define the public interest in pro-competitive, antitrust terms.

By adopting the antitrust approach, Congress could correct a continuing omission, place a safeguard against infringement on the First Amendment rights of the growing electronic media, and at last come to grips with the fundamental question of the FCC's authority. Put another way, Congress could correct a problem described this way by former FCC General Counsel Henry Geller:

> [In effect, Congress has said to the FCC] Here is a new field, communications; we have no idea how it will develop so we leave it to you to do the best you can in the public interest.[86]

In the late 1990s, the nation knows how the field of communications has developed and may develop further. By defining the public interest in communications in antitrust terms, the nation can have both reasonable prices and business progress.

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[83]*Supra*, notes 7, 9.

[84]*The Wall Street Journal*, March 2, 1994, A12.

[85]Breyer, *supra*, note 79.

[86]Henry Geller, *A Modest Proposal to Reform the Federal Communications Commission* (1974).

3.5 The Antitrust Perspective

> *The United States telephone industry has been shaped more by antitrust law than by any aspect of federal or state regulation.*[87]

No event in the history of communications jurisprudence better reinforces this statement than the 1982 AT&T Divestiture.[88] AT&T, with assets worth more than those of General Motors, Ford, Chrysler, General Electric, and IBM combined,[89] was divested in an effort to separate the competitive aspects of AT&T's business from the remaining elements of the Bell monopoly. Changes in the telecommunications market brought about by the settlement of the government's antitrust suit against AT&T represented a dramatic impact of antitrust law on the industry.

Even in instances in which divestiture infused competition into the communications market, the anticompetitive restrictions of the "public interest" standard has remained prohibitive.[90] Incorporating the pro-competitive theory of antitrust law into the standard might encourage uniformity of outcomes in the governance of communications.

Before examining the value that a pro-competitive standard would offer both the communications industry and consumers, this paper looks at the history and nature of the various antitrust laws and the relationship of those laws to regulated industries.

In theory, application of the antitrust laws serves the interest of the public and the industry by prohibiting the exercise of market failures, curbing cartel-like behavior, and promoting vigorous competition.[91] Would such outcomes would be better served in the communications industry by the application by the FCC of antitrust standards rather than the ill-defined public interest standard? Under what kind of policy initiative are the consumer-oriented ends of quality, access, and reasonable pricing most likely to meet the market ideals of robust competition and independence from constant and inefficient government intrusion?

The time may have come to streamline the public interest standard of the 1934 Act[92] or replace it with a competitive model that could assure that the public interest truly id served by

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[87]Kellogg, Thorne, and Huber, Telecommunications Law, *supra*, note 10.

[88]*Supra*, note 64.

[89]See Harry M. Shooshan III, *Disconnecting Bell: The Impact of the AT&T Divestiture* (1984), vii.

[90]See section 2.2 (discussion of the negative effects of the public interest standard).

[91]See Joseph F. Brodley, The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress, 62 N.Y.U. L.Rev. 1020 (1987), which asserts that, contrary to populist debate by economic scholars, antitrust laws encompass noneconomic goals, such as serving the public interest and promoting fair competition, and assure the purely economic objectives of market efficiency.

[92]*Supra*, note 11.

incorporating antitrust principles into the working definition of the public interest standard. Section **3.6** discusses regulated industries in which comparable deregulation has been instituted, and section **3.7** presents, in more detail, how an antitrust regime could be administered.

3.6 Traditional Regulation of Natural Monopolies

In contrast to the antitrust laws, economic regulation of an industry is intended as a surrogate for competition in which one firm has a natural monopoly over public goods.[93] Historically, the justification for economic regulation has been that the regulatory scheme protects the public interest because market failures prevent the market from serving the public interest.

One of the earliest examples of government regulation came from state regulatory initiatives aimed at controlling the dominant railroad monopoly and its discriminatory market abuses. In 1877, the Supreme Court, in the case of *Munn v. Illinois*,[94] upheld the right of a state to regulate pricing and licensing requirements that directly affected railroad practices. The rationale was that certain activities uniquely affected the public interest and must therefore be constrained to maintain the public good. The assumption is that the public interest will be served if consumers can be assured least-cost purchasing of a service. Government regulation strives toward this end through approximating least cost and determining regulated pricing.[95]

Regulated markets reveal quite a different story. Traditional government regulation of the "natural monopolies" has often resulted in a failure to meet consumer needs.[96] The corollary of regulation been a trend toward the emergence of deregulation, often as a result of pro-competitive policy. This trend may be attributed to the belief that competition is more capable of bearing beneficial economic implications in a post-industrial international marketplace.[97] Further, given advances in technologies, a regulation justifiable in 1934 may no longer be warranted in the late 1990s. After trucks and planes were invented, railroads were no longer a natural monopoly.

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[93]A "natural monopoly" is a market structure in which one firm can satisfy the demand in a market at a lower cost than two or more firms could. See Marshall Howard, *Antitrust and Trade Regulation* (1984) and F. M. Scherer, *Market Structure* (3rd ed.)

[94]*Supra*, note 15.

[95]See Kenneth M. Parzych, *Public Policy and the Regulatory Environment* (1993).

[96]Again, the failure of the government and the courts to provide adequately and consistently a definition of "public interest" accounts for why the standard is nearly impossible to claim as satisfied.

[97]See Carol Tucker Foreman, *Regulating for the Future: The Creative Balance* (1991).

3.7 Deregulation of Natural Monopolies

The airline industry was deregulated in 1978.[98] Although initially unregulated, Congress created the Civil Aeronautics Board[99] in 1938, on the theory that, like the railroad and other common carrier transportation industries, air transportation should be viewed as a public utility.[100] Before deregulation, the airline industry had an inefficient regulatory structure, which ultimately led to high rates for consumers and low profits for the industry.[101] The early policies on which regulation was predicated contributed to these market inefficiencies.[102] Regulations included assigning airline companies specific markets, controlling schedules, and uniform consumer price setting. The Airline Deregulation Act of 1978[103] attempted to curb market imperfections by increasing entry opportunities for new airlines and introducing greater flexibility and discretion for individual airlines to lower and raise fares. The Civil Aeronautics Board was eliminated in 1985, although many of its administrative functions were transferred to the Department of Transportation (DOT).[104]

The impact of deregulation on the airline industry was, and is likely to remain, debatable.[105] Whether the industry actually was deregulated is in question. Although it is too early to assess the substantive long-term effects of deregulation, many short-term consequences have occurred. The introduction of intense competition into the market resulted in an overall expansion of service options at reduced prices for consumers.[106] The sudden increase in supply outpaced the demand, leading to a number of highly publicized

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[98]Air Transportation Regulatory Reform Act of 1978, Pub.L. No. 95-504, 92 Stat. 1705.

[99]Civil Aeronautics Act, ch. 601, 52 Stat. 973 (1938) (codified at 49 U.S.C. ss 1301-1542)(1980).

[100]See George W. James, *Airline Economics* 169 (1982); Paul S. Dempsey, *Airline Deregulation and Laissez-Faire Mythology: Economic Theory in Turbulence*, 56 J.Air L. & Com. 305, 309-312 (1990); *see also*, Paul S. Dempsey, *The Rise and Fall of the Civil Aeronautics Board—Opening Wide the Floodgates of Entry*, 11 Transp. L.J. 91, 95 (1979).

[101]Elizabeth E. Bailey and David Graham, *Deregulating the Airlines* (1985). Although standard services were provided to a number of smaller markets, which would be considered inefficient in an economy of scale rationale.

[102]See Parzych, *supra*, note 95, 176-180.

[103]49 U.S.C. section 1301 *et seq*.

[104]Transportation Act of 1940, Title 49, generally.

[105]The vast quantity of materials written since the deregulation of the airline industry are exemplary of the different schools of economic and regulatory theorists. Because this was the first major regulated industry to undergo massive deregulation, it has provided a fertile ground for all commentators interested in criticizing and examining its development and the consequences. Whether deregulation ultimately is successful is not likely to deter critics of deregulation as an alternative public policy.

[106]David G. Monk, *The Lessons of Airline Regulation and Deregulation: Will We Make the Same Mistakes In Space?*, 57 J. Air L. & Com. 715 (1992).

bankruptcies and mergers.[107] Ticket prices for consumers have slowly begun to increase again as the industry has reverted to a concentrated oligopolistic structure.[108]

The absence of any antitrust jurisdiction in the hands of a specialized airline agency that could effectively monitor day-to-day business operations is notable. This is not to imply that airlines do not need to consider antitrust issues, for these are necessarily part of any business with substantial market power. Antitrust enforcement would be more vigorous, thus a more effective deterrent to anticompetitive activities, were a centralized antitrust jurisdiction to exist within a *specialized* administrative agency.

What does exist is the ability of the DOT to authorize antitrust immunity for certain actions, for example, the DOT's approval and grant of antitrust immunity for a commercial cooperation and integration agreement between Northwest and KLM airlines.[109] Although this agreement can be seen as pro-competitive, it exemplifies the type of authority that threatens to inhibit the antitrust presence, which can artificially stimulate competition. Rather than grant antitrust exemptions, the focus of the overseeing federal agency might better be on whether the proposed activity would have an anticompetitive impact and, hence, violate antitrust standards.

The airline industry is not the only regulated market to experiment with deregulation without abandoning antitrust immunity and like exemptions. Throughout the latter half of the twentieth century, railroads experienced little economic success, especially in passenger service. The industry was originally regulated by the Interstate Commerce Commission[110] in an attempt to minimize competition, provide universal service, and protect agricultural product shippers from exploitation by the railroad cartels. In response to growing competition to the railroads from airlines and motor carriers, Congress passed the Railroad Revitalization and Regulatory Reform Act of 1976[111] and soon afterward the Staggers Rail Act of 1980,[112] intending to intensify competition and allow for greater pricing discretion by individual carriers.

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[107]*Supra*, note 106, 179.

[108]Paul S. Dempsey, *The Social and Economic Consequences of Deregulation: The Transportation Industry in Transition*, 18 (1989).

[109]See *Acquisition of Northwest Airlines by Wings Holdings, Inc.*, D.O.T. Order No. 93-1-11, at 1 (1993); also, James T. McKenna, *Northwest-KLM Package Challenges Competition*, Aviation Wk. & Space Tech., Feb. 15, 1993, at 31.

[110]Interstate Commerce Act, 49 U.S.C. section 1 *et seq.*

[111]45 U.S.C. 821 (1976).

[112]49 U.S.C. Sections 10101.

The effects have been similar to those of airline deregulation. The railroads' ability finally to abandon costly and unprofitable markets[113] they had previously been obligated to serve[114] was a significant benefit. Once again, deregulation was not accompanied by adequate active antitrust supervision where previously there had been a regulatory framework.

Without the worry of having a special industry agency to monitor antitrust concerns, and to no one's surprise, monopolistic concentration of market power has evolved within the modern railroad industry.[115] The Interstate Commerce Commission's authority to immunize mergers of rail carriers from antitrust review when it finds the merger to be consistent with public interest is noteworthy.[116]

There are lessons to be learned from the regulation of the airline and railroad industries. Economists, lawyers, and industry insiders have offered suggestions about how to modify the structure of deregulation to ensure market conditions that properly balance the goals of service, quality, efficiency, and competition.[117] While scholars debate the economic implications of regulation, the message of the airline experience seems to have been lost. That message seems to be that more attention to the initial structuring of the deregulatory scheme may be needed.[118]

Market inconsistencies and variables such as technological development and international competition add to the difficulty of structuring a regulatory framework for the communications industry. Absolute and instantaneous deregulation is neither competitively advantageous nor politically tolerable. The most practical strategy for those who oppose the current regulatory process may be to fortify gradual deregulation by superimposing strictly enforced antitrust principles on the regulatory system. This approach would offer the advantage of maintaining government and judicial oversight of anticompetitive conduct through the application of existing antitrust laws. A means would thus exist to guard against the market imperfections associated with deregulation.

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[113]Although this might bring to mind concerns of universal service in the telecommunications market, technological advances have made the provision of near-universal service more cost-efficient than ever before.

[114]See Parsych, *supra*, note 95, 175-178

[115]Id. at 177.

[116]See *Penn Central Merger & N. & W. Inclusion Cases*, 389 U.S. 486 (1968).

[117]See, e.g., Bruce B. Wilson, *Railroads, Airlines, and the Antitrust Laws in the Post-Regulatory World: Common Concerns and Shared Lessons*, 60 Antitrust L.J. 711 (1991); Michael E. Levine, *Airline Deregulation: A Perspective*, 60 Antitrust L.J. 687 (1991); Richard D. Cudahy, *The Coming Demise of Deregulation*, 10 Yale J. on Reg. 1 (1993); Abner J. Mikva, *Deregulating Through the Back Door: The Hard Way to Fight A Revolution*, 57 U. Chi. L. Rev. 521 (1990).

[118]See Chapter Five (proposing a jurisdictional and administrative organizational structure for the FCC).

Stated another way, antitrust policies should be vigorously enforced to ensure that after deregulation market conditions would be in place that would benefit consumers and industry players equally. This would best be achieved through granting to the administrative agency with the most specialized knowledge of the particular industry[119] an antitrust jurisdiction that would include the power to enjoin potential anticompetitive activities, rather than, as is now the case, the power to grant such ventures antitrust immunity. The remedy for such an antitrust violation? Partial, if not complete, reregulation, until the anticompetitive influences have been alleviated.

Through the incorporation of antitrust principles into the public interest standard, many fringe applications of antitrust exemptions and defenses[120] would be intrinsically truncated. Related antitrust concerns of time, cost, and extensive discovery would be comparably diminished by agency review as opposed to full-blown litigation. A similar functional strategy would serve the communications industry well.

A delicate blending of the competitive goals and industrial freedom of the antitrust laws and of the business sector's fear of reregulation offers the greatest potential to facilitate convergence of the public interest with market stability. Of no regulated industry is this truer than communications, in which for reasons already discussed, the existing regulatory structure has become obsolete. The antitrust influence within the industry is historically well established and pervasive.[121] The FCC, under the leadership of Chairman Reed Hundt, has already started to undertake the types of analysis that must be applied in antitrust cases,[122] for example, in its September 1994 decision approving the AT&T–McCaw merger, in which the Commission stated:

> We now address the competitive impact of the proposed merger in each of the markets we have identified. In each market we must examine, the issue is whether the proposed merger will violate antitrust policies. In the case of a proposed merger, we are particularly mindful of Section 7 of the Clayton Act, which generally proscribes mergers "where in any line of commerce in any section of the country" the effect of the merger

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[119]The granting of antitrust jurisdiction should be only enough to review industry activities. It is meant as a supplemental device by which the FCC may coordinate its actions with existing antitrust jurisdiction of the Department of Justice (DOJ), the Federal Trade Commission (FTC), state attorneys general, and private parties while not subtracting any antitrust jurisdiction from these groups. While all of these potential players in antitrust litigation will retain their current roles, the FCC would merely act as a "screening bureau" for industry activities. See Chapter Five.

[120]See sections 4.2–4.7 (summarizing the various antitrust exemptions and defenses available to regulated industries).

[121]See, generally, sections 4.2–4.6, (discussion of antitrust influence on the communications industry).

[122]The FCC, in the *Cable Competition Report*, the *AT&T–McCaw* decision, and the *TV Ownership NPRM*, has addressed issues such as mergers, product and geographic market definition, and identifying barriers to entry.

> may be "substantially to lessen competition, or to tend to create a monopoly."[123] We also take care to examine the proposed merger for equally serious but less broad-sweeping violations of antitrust principles, such as theft of confidential information, tie-in sales, unjustified price discrimination, and other abuses of market power.[124] The principal way in which the commentators allege that the proposed merger will violate antitrust principles is by abuses which, it is said, will flow from the combination of McCaw's "bottleneck" cellular exchange and AT&T's power in other markets. In general, after careful consideration of the voluminous antitrust arguments made by all parties, we conclude that the competitive component of our statutory public interest standard will be satisfied by the imposition of two major conditions on our approval of the proposed merger:
>
> (1) that AT&T shall not discriminate in favor of McCaw and against its other customers for cellular network equipment under existing contracts; and
>
> (2) that AT&T and McCaw shall each take appropriate steps to prevent third parties' proprietary data from falling into the other's hands.

3.8 Antitrust Enforcement upon Regulated Industries

Inevitably, in any regulatory structure that seeks to protect monopolies in order to serve the public interest, some antitrust issues will exist. In theory, antitrust laws act as a check on anticompetitive behavior by persons with market power to ensure competition and avoid such evils as predatory pricing and tying.[125]

The conflict between command and control regulations and general antitrust laws has been met with guarded protection of the regulated industries through judicially crafted immunity exceptions to antitrust enforcement,[126] but, because such protection offers an attractive opportunity to abuse the regulatory system, the public interest might be better served by a government regime that would emphasize open competition and discretionary pricing in conjunction with active antitrust enforcement, without the illusory protection immunity doctrines have historically provided. This is not to say that the communications

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[123] 15 U.S.C. section 18.

[124] "Market power is the power to force a purchaser to do something that he would not do in a competitive market.... It has been defined as the ability of a single seller to raise price and restrict output." *Eastman Kodak Co. v. Image Technical Services, Inc.*, 112 S. Ct. 2072, 2080-81 (1992).

[125] See section 5.2 (discussing predatory pricing principles associated with Section 2 of the Sherman Act).

[126] This is not to say that regulations and antitrust cannot coexist. The theory of "contestable markets" argues that the appropriate market structure consists of competition for control of a market rather than within one. Under such a notion, pricing within the market is influenced by both actual and potential competition. See, e.g., Morrison and Winston, *Empirical Implications and Tests of the Contestability Hypothesis*, 30 J.L. & Econ. 53 (1987).

industry has not been largely shaped and influenced by the antitrust laws.[127] Yet, although the history of the communications industry reflects episodes of active antitrust enforcement, pervasive application of different immunity doctrines has led to an equal amount of exception from the antitrust laws.

[127]See section 3.5.

Chapter Four

Ins and Outs of Enforcement and Competition

4.1 Inclusionary Antitrust Enforcement and Competitive Sustenance

When competitors enter into agreements whereby their conduct interferes with interstate commerce, the agreement is considered a horizontal restraint.[128] Section 1[129] of the Sherman Act[130] concerns market behavior, such as agreements to restrict output or to increase prices in order to limit or exclude competition. Such cartel behavior implicates Section 1 by restricting the normal supply and demand functions of the marketplace.[131] Violations of Section 1 have rarely come into court. Unlike other antitrust provisions, such as exclusive dealings and vertical agreements, the conduct prohibited by this provision has not been relevant to a communications market in which competition has been severely restricted by the natural monopoly structure that resulted from the public utility regulatory scheme.[132]

Section 2[133] of the Sherman Act[134] prohibits predatory and exclusionary conduct by one firm with market power, or which attempts to gain market power, against actual or potential competitors. Examples include monopolization,[135] attempts to monopolize, or any

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[128]See, generally, Sullivan and Harrison, *Understanding Antitrust and Its Economic Implications* (1988).

[129]"Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding one million dollars, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court." 15 U.S.C. Section 1 (1983).

[130]26 Stat. 204, ch. 647 (1890), *codified at* 15 U.S.C. section 1 *et seq*.

[131]*Society of Professional Engineers v. United States*, 435 U.S. 679 (1978).

[132]Such antitrust provisions stand to become increasingly relevant, however, as the natural monopoly structure gives way to open competition in the near future. Faced with multiple market entrants vying for previously protected market shares, the dominant firms may be tempted to enter into violative agreements in order to fend off new competitors.

[133]"Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding one million dollars if a corporation, or, if any other person, one hundred thousand dollars, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court." 15 U.S.C. Section 2 (1983).

[134]*Supra*, note 128.

[135]Monopolization has been defined by the Supreme Court in *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966) as consisting of two elements: (1) the possession of monopoly power in the relevant market; and (2) the willful acquisition or maintenance of that power as distinguished from the growth or development of a superior product, business acumen or historic accident.

conspiracy to monopolize.[136] The concerns of Section 2 go beyond size in itself. In the seminal case of *United States v. Aluminum Company of America*,[137] Judge Learned Hand emphasized that offending firms required not just market power[138] but also anticompetitive conduct.[139] Unlike Section 1 of the Sherman Act, this provision has been the basis of a good deal of antitrust litigation within the communications industry.[140]

One common arrangement is the "tie-in" (also called a tying arrangement), which occurs when a sale of goods is conditioned on the buyer's purchase of other additional goods or services from the same seller.[141] Tying arrangements are prohibited by Sections 1 and 2 of the Sherman Act[142] and by Section 3[143] of the Clayton Act.[144] Tying problems among regulated industries are typically attempts by a firm to bypass regulation by leveraging its market power into related but unregulated markets.[145]

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[136]See Sullivan and Harrison, *supra*, note 128, 207.

[137]148 F.2d 416 (2d Cir. 1945).

[138]Market power has been explained and defined in a myriad of ways since the inception of antitrust jurisprudence. The context-based analysis is fact-sensitive and subject to different economic probes. The Supreme Court, in *U.S. v. Du Pont de Nemours & Co.*, 351 U.S. 377, 391-92 (1956), defined it as "the power to control prices or exclude competition." See, generally, Landes and Posner, *Market Power in Antitrust Cases*, 94 Harv. L.Rev. 937 (1981).

[139]This second element is even more slippery than the concept of market power. Although no singular standard has evolved, it seems to require a minimum of conduct that, independent of competitive merit, has as its primary purpose the predatory elimination of competition. The Supreme Court, in *United States v. Grinnell*, 384 U.S. 563 (1966), stated that such behavior must exhibit a "willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." Id. at 570-571.

[140]See, e.g., *Phonetele, Inc. v. AT&T*, 664 F.2d 716 (9th Cir. 1981); *TV Signal Co. v. AT&T*, 1980-1 Trade Cas. (CCH) para. 63,242 (8th Cir. 1980); *MCI Communications Corp. v. AT&T*, 708 F.2d 1081 (7th Cir. 1983); *Mid-Texas Communications Sys. v. AT&T*, 615 F.2d 1372 (5th Cir. 1980); *Six-twenty-nine Productions, Inc. v. Rollins Telecasting, Inc.*, 365 F.2d 478 (5th Cir. 1966); *Northeastern Tel. Co. v. AT&T*, 651 F.2d 76 (2d Cir. 1981), *cert denied*, 455 U.S. 973 (1982).

[141]*Supra*, note 10, 185.

[142]*Supra*, notes 131 and 135.

[143]"It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies, or other commodities, whether patented or unpatented, for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce." 15 U.S.C. Section 3 (1983).

[144]15 U.S.C. Section 14 (1976).

[145]*Jefferson Parrish Hospital District No. 2 v. Hyde*, 466 U.S. 2 (1984). See also Kaplow, *Extension of Monopoly Power Through Leverage*, 85 Colum. L.Rev. 515 (1985).

In the communications industry, application of antitying enforcement was evident as early as 1962, in the case of *United States v. Loew's, Inc.* Loew's, a motion picture distributor, conditioned the sale of its more popular films on the additional sale of a block of films with less appeal. Such a coercive effect is precisely what the antitrust laws are intended to eliminate from the market place. Telephony, in particular, lends itself to frequent tying scrutiny, because the market lines and boundaries of offered products and services are often unclear.[146]

There are many other antitrust laws and concepts that communications firms are commonly accused of violating but which immunity has, by and large, protected them from prosecution. Two frequently cited complaints are predatory pricing[147] and monopoly leveraging.[148] Were a new or revised antitrust standard of the kind discussed here incorporated into the public interest, convenience, and necessity standard of the 1934 Act,[149] these antitrust theories would play a more significant role in the regulation of the communications industry. Application of these competition-promoting laws would require more than instituting a suitable antitrust archetype into existing communications law. As discussed, communications firms have, for the most part, been immune to antitrust jurisprudence. For a new governing regime to achieve optimum market conditions, restrictions on antitrust enforcement would need to be removed. Removing them would not in any way restrict traditional antitrust oversight of industry behavior by the DOJ and others,[150] but were the legal environment purged of overly complicated procedural defenses, antitrust standards might become better focused on actual anticompetitive effects and less attentive to impedance by inefficient governance.

4.2 Exclusionary Jurisprudence and the Suppression of Competition

The degree to which the current (late 1990s) regulatory scheme displaces the application of antitrust principles largely depends the pervasiveness of the regulation in question. This is, in one way, a matter of jurisdiction: When do the courts have jurisdiction to enforce antitrust principles against a regulated industry, and when does the relevant agency have sole territorial

[146]*Supra*, note 10, 141.

[147]Commonly understood as occurring when one firm with market power and the possibility of recoupment reduces its prices with the intent not to compete for customers but to injure or destroy a competitor.

[148]When a firm that competes in several markets and has monopoly power in one but not another leverages the monopoly power in one market to gain a competitive advantage in a market in which no monopoly power exists. See *United States v. Griffith*, 334 U.S. 100 (1948).

[149]*Supra*, note 132.

[150]*Supra*, note 121.

province to dictate antitrust approval? Can, at times, regulations and antitrust enforcement coexist?

Congress or the courts or both have in some instances granted express antitrust immunity to a specific industry.[151] Congress did it with the communications industry, at least as applied to consolidations and mergers of telephone companies that the FCC considered within the public interest.[152] Other actions may not be similarly exempt from antitrust enforcement,[153] nor has statutory exemption played a significant role in modern legal history.[154]

4.3 Express Immunity

Explicit antitrust immunity has been granted to the communications industry in a number of areas, generally out of the belief that the industry was a natural monopoly and a product to which all should have universal access, and thus, competition was trumped by the public interest standard.[155] The communications industry has often been viewed as a public utility in the sense that the entire economy works better if there is a global communications network. As previously discussed, technological advances have changed the common perception that the market cannot accommodate competition. Many of the express antitrust immunity provisions that exist today, however, may instead impede the public interest and inhibit development of the information superhighway, as well as other goods and services eagerly awaited by consumers.

The case of *ITT World Communications, Inc. v. New York Tel. Co.*[156] affirmed the FCC's exclusive jurisdiction over rate-making issues within the telecommunications industry. Rate matters were foreclosed from other parties wishing to assert antitrust jurisdiction. Congress expressly gave the Commission exclusive jurisdiction over mergers of telephone and

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[151]Examples include insurance, railroads, agriculture, and fisheries. See Sullivan and Harrison, *supra*, note 132, 52-55.

[152]Section 221(a) of the 1934 Act, *supra*, note 11: "If the Commission finds that the proposed consolidation, acquisition, or control will be of advantage to the persons to whom service is to be rendered and in the public interest, it shall certify to that effect; and thereupon any Act or Acts by Congress making the proposed transaction unlawful shall not apply...."

[153]See *Mid-Texas*, 615 F.2d at 1378 n.3 ("The existence of an explicit exemption in one part of the Act does not provide authority for the proposition that other actions not directly covered are impliedly exempt."); *Industrial Communications Systems, Inc. v. Pacific Tel. & Tel. Co.*, 505 F.2d 152, 156 (9th Cir. 1974).

[154]The statutory exemption referred to has rarely been used since the 1920s. Yet the exemption exists as a matter of law, therefore enforcement of the statute by a court may be only a matter of a party premising its case upon the exemption.

[155]See, generally, David C. Hjelmfelt, *Antitrust And Regulated Industries*, 218-223 (1985).

[156]381 F.Supp. 113 (S.D.N.Y. 1974).

telegraph companies.[157] Regulatory approval of such a merger, typically granted on the basis of the vague, if not arbitrary, public interest standard, creates antitrust immunity for communications firms.

4.4 Pervasive Regulation

Courts may grant implied immunity to an entire industry function if two conditions are met:

> 1. If antitrust enforcement would directly interfere with Congressionally approved regulatory action that approved the conduct in question... and;
>
> 2. If the pervasiveness of regulatory control by one agency over the conduct of an industry is such that Congress is assumed to have determined competition to be an inadequate means of vindicating the public interest.[158]

The courts have gone as far as to allow a defense of acting in the public interest. In *Southern Pacific Communications v. AT&T*,[159] it was held that when AT&T makes telephone interconnecting determinations on the basis of the public interest standard,[160] it would be contrary to public policy to subject AT&T to antitrust liability. Two further supplementary methods by which courts can exempt the communications industry from antitrust enforcement are the *Noerr–Pennington*[161] and state action doctrines.

4.5 The *Noerr–Pennington* Doctrine

Noerr–Pennington provides antitrust immunity to a firm or firms even if competitors individually or in combination petition the government with the intent of influencing the decision-making process of an agency. This case is frequently cited as a defense to allegations that continual tariff filings to the FCC are attempts to restrain competition through delay and complication tactics. In 1991, MCI Communications successfully used the *Noerr–Pennington* defense when confronted by allegations from competitor TeleStar that MCI's petitioning activities before the Commission were actually a subversive attempt to impede TeleStar's petition for a license.[162]

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[157]47 U.S.C. Sections 221, 222 (1983).

[158]*United States v. AT&T*, 461 F.Supp. 1314, 1322 (D.D.C. 1978).

[159]740 F.2d 980 (D.C. Cir. 1984).

[160]Section 201(a) of the 1934 Act (47 U.S.C. Section 201(a) (1976)).

[161]*Eastern R.R. Presidents Conference v. Noerr Motor Freight, Inc.*, 363 U.S. 127 (1961); *UMW v. Pennington*, 381 U.S. 657 (1965).

[162]*TeleStar, Inc. v. MCI Communications Corp.*, 1991-2 Trade Cas. (CCH) 69,654 (10th Cir. 1991).

If, on the other hand, efforts by competitors to petition and influence the government are illusory, the defense is voided. Such efforts have been appropriately labeled the "sham" exception to the *Noerr–Pennington* defense.[163] When Litton Systems sued AT&T claiming that AT&T's tariff filings, which required the use of special interface devices when connecting competing terminal equipment to AT&T lines, were intended only to inhibit competition, AT&T asserted the *Noerr–Pennington* defense. Even though the FCC initially allowed the tariff to go into effect without questioning its reasonableness, a jury found AT&T's actions to be in bad faith. On appeal, this verdict was affirmed, because the court agreed that AT&T had no bona fide expectation that the challenged tariff was reasonable. AT&T had monopolized the telephone terminal equipment market, and the sham exception to the *Noerr–Pennington* doctrine was applied.[164]

4.6 The State Action Doctrine

The state action defense to antitrust enforcement potentially provides incidental immunity to the communications industry in a complex manner. Broadly speaking, this judicial doctrine exempts certain state actions, such as regulations promulgated by state legislatures or state public utility commissions, from the scope of the *federal* antitrust laws.

The state action doctrine was introduced in the landmark case of *Parker v. Brown*,[165] in which a California statute mandated that raisin producers set their levels for prices and output according to standards established by the industry. The plaintiff, a producer who wished to bypass the regulations and set his own levels, challenged the law as violating the Sherman Act and therefore, as preempted by federal law. The court, while recognizing the conflict, refused to preempt the state law and instead said that the purpose of the Sherman Act was not to prohibit states from regulating their domestic economies. In essence, the dichotomy the court found was between the Sherman Act (and other federal antitrust laws), intended to restrain *private* individual acts that adversely affect competition, and *public* actions by the states. The court made it clear that states cannot simply give blanket protection from antitrust laws to a particular industry within the state's economy. The theoretical foundation on which the court rests its holding is economic federalism, and inherent in a federal system of government is a license for states to regulate their own economies, however inefficient their regulations may be.

In 1985, the Supreme Court decided, in *Southern Motor Carriers Rate Conference, Inc. v. United States*, that a defendant can use state action as a defense to an antitrust suit by

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[163]365 U.S. at 149.

[164]See, generally, *Litton Systems, Inc. v. AT&T Co.*, 700 F.2d 785 (2d Cir. 1983).

[165]317 U.S. 341 (1943).

claiming that state policy sanctioned its activities.[166] In this case, a state statute that required a regulatory commission to set interstate common carrier rates was challenged by the federal government as a price-fixing scheme. The rate bureaus claimed that the statute authorized them—although admittedly, it did not expressly compel them—to agree on joint rate making. As with the entry of telcos into cable television, the rate bureaus had submitted proposals to the state public service commission and had received approval.

The actions were held to be immune under the state action doctrine even though the activities of the rate bureaus were not, in the strict sense, compelled by the state. Instead, the Court articulated a two-prong standard whereby a regulatory action is presumed to be state action, thus immune from antitrust liability, (1) if the activity is "clearly articulated and affirmatively expressed as state policy" and (2) if the actor is a private party relying on state regulation and it can demonstrate that its anticompetitive conduct was "actively supervised" by the state.[167] While expressly rejecting a "compulsion" requirement because it reduces the "range of regulatory alternatives available to the State,"[168] the Court made sure to resurrect the federalism notion that was the foundation of the *Parker* decision, noting that "the *Parker* decision was premised on the assumption that Congress, in enacting the Sherman Act, did not intend to compromise the State's ability to regulate their domestic commerce."[169]

Shortly after this opinion was rendered, this highly deferential standard was criticized as abstract and too easily satisfied.[170] The deference to state flexibility was fleeting. In 1988, the theoretical underpinnings of antitrust federalism were dealt a blow in *Patrick v. Burget*, when the Supreme Court elected to interpret the concept of "active supervision" strictly.[171] The Court held that for active supervision to exist, the State must "have and exercise ultimate control over the challenged anticompetitive conduct.... [T]he mere exercise of some state involvement or monitoring does not suffice."[172] Active supervision will exist only if the regulatory agency has statutory authority to review the substance of the peer review process, not just the proceedings. The Court's analysis focused on two elements: (1) whether the state agency had the statutory authority to exercise active supervision and, (2) if so, whether the state's involvement reached the level of "active supervision." Once again, the Court failed to

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[166]471 U.S. 48 (1985).

[167]Id. at 60.

[168]See note 166, at 61.

[169]Id. at 56.

[170]See M. Shawn McMurray, *The Perils of Judicial Legislation: The Establishment and Evolution of the Parker v. Brown Exemption to the Sherman Antitrust Act*, 20 N. Ky. L.Rev. 249 (1993).

[171]486 U.S. 94 (1988).

[172]Id. at 101.

address the question of what level of activity by the state is necessary to immunize private actions undertaken pursuant to state regulatory schemes.

This latest reshaping of the state action doctrine left other questions unanswered. The effects of the 1988 decision will take time to materialize, but the momentum is clear. The basic concept of federalism, which was the theoretical foundation of both the Sherman Act and the original *Parker* doctrine, has significantly deteriorated. For private parties that rely on state regulatory approval to protect them from federal antitrust enforcement, more is now demanded than ever before, although just what is needed remains to be clarified by the Court.

Motions to dismiss by private parties in communications that raise state action immunity probably should be denied, except in cases in which states actually supervise the communications industry. In line with this thinking, industry participants would not be able to neglect antitrust enforcement merely because regulatory approval was initially granted to permit a certain activity. One of the main reasons for the questionable success of much antitrust enforcement is abuse of such defenses and immunities by regulated industries, including the communications sector.[173]

As the status of the state action doctrine shows, simplicity is greatly needed in the application of antitrust jurisprudence. Tedious manipulation of the state action defense by the private sector over the years has obscured the goals of efficiency and competition. Unencumbered antitrust enforcement may be needed to mold economic and jurisprudential pedagogy into market actuality.

4.7 Summary

The doctrinal application of the state action defense to an antitrust allegation is still available to communications firms that act pursuant to state legislative or regulatory mandates. Although such arguments have rarely been made in recent antitrust cases, the doctrine remains potentially fruitful for achieving the preemption of the antitrust laws as they affect the communications industry. In conjunction with explicit statutory exemptions, implied antitrust immunity, and the *Noerr–Pennington* doctrine, the state action defense insulates all but the smallest percentage of anticompetitive activity in the communications marketplace.

In attempting to embark on a new governing standard that would emphasize open markets the better to satiate both public and private interests, these shields to effective antitrust enforcement must necessarily be alleviated. A redefinition of the public interest

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[173]This is not to imply, however, that when and where states do actually "supervise" the communications industry, there should not be a defense. Then again, this would not be an issue at all if the states did not interfere with the industry.

standard premised on pro-competitive findings would be counterintuitive to continuing to allow communications firms to raise regulation as a defense in an antitrust lawsuit.[174]

[174]Again, this concept extends only to activities directly related to the new standard. The traditional exemptions would still be available in areas of regulation that have not yet incorporated the antitrust doctrines.

Chapter Five

A New Option for Administrative and Jurisdictional Composition

The FCC serves a useful function in maintaining order in the communications industry, but, as explained in the previous chapters, the premises that have supported the cradle-to-grave regulation of the industry through proscribed natural monopolies are being forced into extinction by rapid technological progress and evolution. Antitrust principles may offer a common-sensical solution to governing an industry in which technologically converging resources offer the greatest hope of advancement.

5.1 Swift Congressional Fiat

The option proposed here may gently steer the market toward fulfilling the public interest. Ironically, no monumental government restructuring would be needed. The current (late 1990s) regulatory framework, which apportions authority to both the FCC and state Public Utility Commissions, would remain remarkably unchanged.

In particular, nothing proposed would alter or amend the jurisdiction of the states. Further, antitrust jurisdiction would endure with the Department of Justice (DOJ), the Federal Trade Commission (FTC), the State Attorneys General, and private third parties. All that might be necessary would be to amend the wording of the "public interest" standard of the 1934 Act.[1] In so doing, Congress would simply be codifying the broad holding of the D.C. Circuit's opinion in the 1980 case of *United States v. FCC*,[2] in which the court held that consideration of competitive issues is a necessary part of the FCC's determinations pursuant to the public interest standard. Hence, the Commission has discharged its antitrust responsibilities when it "seriously considers the antitrust consequences of a proposal and weighs those consequences with other public interest factors."

Congressional amendment of the 1934 Act[3] to incorporate the competitive concepts of antitrust laws in the relevant public interest standards would dramatically facilitate the reality of an "information superhighway." Although other legislative suggestions merit attention, none is so wonderfully simple. The amended section might read:

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[1] *Supra*, note 11.

[2] 652 F.2d 72, 88 (D.C. Cir. 1980) (en banc).

[3] Id.

> Competition in communications best serves the national interest. Therefore the Federal Communications Commission shall act in the public interest, convenience and necessity with respect to radio frequency licenses, and in the public convenience and necessity with respect to wireline common carriers by refraining from regulation where such regulation impedes competition. Competition shall be defined in accordance with the principles of federal antitrust law.

5.2 Antitrust Jurisdiction

Although the FCC currently has no congressionally authorized antitrust jurisdiction, little would be needed to transfer to the agency for such a new administrative system to function, because the FCC will never litigate antitrust allegations. Antitrust jurisdiction would remain with the DOJ and the FTC. The only amount of antitrust jurisdiction needed to be instituted at the Commission would be enough to review the activities of communications firms sufficiently in order to insure a finding of "no anticompetitive effect." The FCC's Office of Policy and Plans, which is already staffed with economists and lawyers with a strong mix of antitrust and telecommunications experience, would review licensing or prior approval circumstances, or both, which are now governed solely by the public interest standard. In short, the purpose of the FCC review would be to define legislatively the public interest standard with the procompetitive concepts employed by the antitrust laws.

Such a "screening" function would provide quality agency review of questionable anticompetitive activities without unduly restraining industry behavior. Just as important, no party seeking to bring an antitrust action against a communications firm would be precluded from doing so merely because of the Commission's heightened antitrust capacity. The FCC, being a specialized agency, can vastly enhance competition through its ability to have rule-makings and make general policy. Transaction-specific agencies, such as the DOJ and FTC, typically act only on specific instances of isolated conduct. Thus, the roles of the FCC and DOJ would naturally complement each other. The FCC's "finding" would offer persuasive evidence in federal antitrust litigation but would not be binding in and of itself.

5.3 Administrative Operation

Any finding of "anticompetitive effect" (hence, violative of the public interest) would be afforded an automatic right of review by an oversight bureau to be created by Congress. After exhausting all administrative avenues of review, the disproved applicant might choose to petition the federal court for judicial review, and such appeals could be litigated by the DOJ, representing the federal government. Like other judicial trials reviewing the actions of a federal agency, deference would be given to the Office of Policy and Plans, owing to its specialized insight and to the technical nature of the subject matter.[178]

Such a procedure would more than adequately equip the FCC with the needed authority to review the competitive impact of a proposed industry development without undermining the antitrust jurisdiction of the DOJ. Keeping general purpose bodies like the DOJ and the courts in the equation would balance the administration of the laws, thus guarding against any threat of "regulatory capture."

Moreover, no alteration to the antitrust laws would be necessary. Firms competing in the communications marketplace would simply be regarded as having nonregulated status in relation to practices and activities falling within the gamut of the public interest competitiveness standard of the amended statutory authority.

This treatment would effectively de-immunize the communications industry from antitrust scrutiny, previously estopped. Approval by the Office of Policy and Plans would not act as a form of implied immunity, but it might be asserted at trial as evidence of good faith and procedural compliance. This would be comparable to the traditional relationship between regulatory approval and antitrust law. It has been held that in allowing a tariff to go into effect, the FCC does not contend that the tariff is needed to make the regulatory scheme work[179]; thus, antitrust immunity is never insured by federal agency approval.[180]

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[178]See *Chevron, U.S.A., Inc. v. natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

[179]*Phonetele, Inc. v. AT&T*, 664 F.2d 716, 733 (9th Cir. 1981).

[180]See, e.g., United States v. RCA, 358 U.S. 334 (1959), in which the DOJ brought an antitrust action against swapping TV stations in different cities by NBC and Westinghouse even though prior approval of the exchange had been granted by the FCC.