I. Introduction

Under the Telecommunications Act (TCA) of 1996, incumbent local exchange carriers (ILECs) are obliged to assist competitive local exchange carriers (CLECs) in entering the incumbent’s market and in competing with the incumbent.\(^1\) In particular, the incumbent must provide access to its network on terms that will not preclude effective competition. Since this is bound to reduce the incumbent’s profit, one might expect the incumbent to resent its obligation and resist full cooperation. At times, incumbents have delayed entry or sabotaged the entrant’s efforts to compete by not cooperating to the extent required by the TCA. An incumbent’s failure to cooperate satisfactorily can result in punishment by state regulators pursuant to state statutes and by the Federal Communications Commission pursuant to the TCA. The central question raised in the recent Supreme Court case, Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko,\(^2\) was whether a failure to cooperate, as required by the TCA,

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\(^1\) See §§ 251-252 of the Telecommunications Act of 1996.

\(^2\) 124 S. Ct. 872 (2004). Although Verizon’s predecessors were also involved at earlier dates, we refer to them collectively as “Verizon” in what follows.
exposed the incumbent to antitrust liability for violating §2 of the Sherman Act.\(^3\) Resolving a split in the circuits,\(^4\) the Supreme Court found that it did not. Even though an incumbent that fails to provide assistance to would-be competitors may maintain its monopoly, it does not violate §2 of the Sherman Act in doing so.

The Court’s *Trinko* opinion is clear enough on the central issue, but it raises a variety of questions. First, are the sanctions available to state and federal regulators adequate to deter misconduct by incumbents? Second, who is hurt by an ILEC’s failure to cooperate and do the injured parties have adequate remedies under the TCA? In this paper, we analyze the *Trinko* decision and these questions. In doing so, we will also examine a legislative effort to overrule *Trinko*.\(^5\)

### II. The Telecommunications Act of 1996

The production of local telephone service is marked by substantial economies of scale, which means that average cost declines with increases in

\(^3\) 15 U.S.C. §2 forbids monopolization, attempts to monopolize, and conspiracies to monopolize.

\(^4\) In Goldwasser v. Ameritech Corp., 222 F. 3d 390 (7th Cir. 2000), and Cavalier Telephone, LLC v. Verizon Virginia, Inc., 330 F. 3d 176 (4th Cir. 2003), the courts found no antitrust coverage. In Covad Communications Co. v. BellSouth Corp., 299 F. 3d 1272 (11th Cir. 2000) and Law Offices of Curtis V. Trinko v. Bell Atlantic Corp., 305 F. 3d 89 (2nd Cir. 2002), the courts found that violations of the TCA invoked antitrust liability.

\(^5\) Representatives Sensenbrenner and Conyer introduced H.R. 4412, Clarification of Antitrust Remedies in Telecommunications Act of 2004. If enacted, this would make ILECs vulnerable to antitrust sanctions for failures to meet their obligations under the TCA.
output and marginal costs are below average cost. As a result, textbook competition, which involves marginal cost pricing, is infeasible as all firms would have negative profits. The result of competition is the economic demise of the competitors and, eventually, there is only one firm left standing. Thus, we say that local telephone service is a natural monopoly, “natural” in the sense that it results from competitive market forces. As we shall see, this market structure involves a market failure and a need for some form of market intervention.\(^6\)

Typically, this market intervention takes the form of public regulation. Efforts at regulation generated the problem that surfaced in the *Trinko* litigation.

In Figure 1, \(D\) represents the demand for telephone services, \(MC\) is the marginal cost of providing service, and \(AC\) is the average cost. Competition results in marginal cost pricing, which is socially desirable, but prices equal to marginal costs result in losses because average cost exceeds marginal cost. Eventually, we end up with one supplier, i.e., a monopolist. This firm will maximize its profits by supplying that quantity where marginal revenue (\(MR\)) equals marginal cost. Thus, the (natural) monopolist will restrict its supply to \(Q_1\) and will charge a price of \(P_1\). As is plain to see, \(P_1\) exceeds average cost (\(AC\)) at a quantity of \(Q_1\). This solution results in a deadweight social welfare loss equal to

\[\frac{1}{2}P_1Q_1\]

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\(^6\) Not everyone agrees. Nobel Laureate Milton Friedman, *Capitalism and Freedom* 28 (1962), observed that under conditions of natural monopoly, we have three choices: private monopoly, public monopoly, and public regulation. He concludes that “if tolerable, private monopoly may be the least of the evils.”
triangle abc in Figure 1.\textsuperscript{7} At the competitive solution, price and output would be \( P_2 \) and \( Q_2 \), respectively. This is socially optimal in a sense, but unsustainable because \( P_2 \) is less than average cost (\( AC \)) at that point. In industries characterized by elements of natural monopoly, competition is economically infeasible, but monopoly is objectionable on social welfare grounds. With unrestrained monopoly, the firm enjoys positive profits and, therefore, the solution is sustainable, but it is suboptimal as price exceeds marginal cost. One way of dealing with this dilemma is to regulate the monopolist. In most cases,\textsuperscript{8} this results in average cost pricing: \( P = P_3 \) and \( Q = Q_3 \). This regulatory result does not eliminate the deadweight social welfare loss, which is now equal to the area of triangle \( dec \). But we can see that this is an improvement since \( abc \) is clearly larger than \( dec \). Subject to the constraint that profits be non-negative, this would appear to be as close to the social optimum as we can get.

In order to enjoy the productive efficiency of a single producer while minimizing the allocative inefficiency of monopoly, local telephone service had been subject to traditional forms of public utility regulation.\textsuperscript{9} Dissatisfied with the results of this regulation, Congress decided to enhance competition in local

\textsuperscript{7} This deadweight social welfare loss is the basis of the economic objection to monopoly. See, e.g., Dennis W. Carlton & Jeffrey M. Perloff, Modern Industrial Organization 95-96 (4th ed. 2005).

\textsuperscript{8} See, e.g., Dennis W. Carlton & Jeffrey M. Perloff, Modern Industrial Organization 664-666 (3rd ed. 2005).

\textsuperscript{9} Traditional forms of regulation amounted to price regulation that was designed to cover the producer's costs including a competitive return on investment. This sounds simple enough, but the devil is in the details and regulation has never been easy in practice.
telephone service markets. But the difficulty was how to overcome the natural monopoly problem. The solution appeared to be deceptively simple: permit multiple firms to use those assets that exhibit substantial economies of scale. In this way, there would be no increase in productive inefficiency and, of course, no need for unnecessary and socially wasteful duplication of those assets exhibiting substantial scale economies. To achieve this outcome, Congress passed the Telecommunications Act of 1996. Among other things, the TCA imposed certain obligations on incumbents that would facilitate the entry of rivals. Section 251 requires that an incumbent share its network with its competitors. Of course, an incumbent could make entry economically infeasible by imposing exorbitant access charges that would render entry unprofitable. In this way, the incumbent could claim to be willing to accommodate entry, but never actually have to do so. In order to make entry economically feasible for the competitors, therefore, the charges for using the elements of the network were confined to regulated rates that approximate marginal cost.

The TCA requires that an incumbent provide access to its network elements on an unbundled basis at rates that are “just, reasonable, and nondiscriminatory.” Although the incumbent can charge a “just and

10 In Figure 1, for example, an access charge in excess of $P$, would allow the incumbent to charge monopoly prices to its customers with no fear of entry. This, of course, would thwart the intentions of Congress.

11 In effect, Congress chose to regulate price in the input market rather than in the output market. Many of the same regulatory problems remained after the change.

reasonable”\textsuperscript{13} rate for the unbundled network elements (UNEs), what is just and reasonable is in the eye of the beholder. The FCC decided on the so-called TELRIC (total element long-run incremental cost) standard. TELRIC rates, i.e., UNE prices, are “based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of the incumbent LEC’s wire center.”\textsuperscript{14} Although the Supreme Court upheld the TELRIC pricing rule,\textsuperscript{15} access charges equal to TELRIC rates may fall short of the incumbent’s actual marginal costs of operating the network elements that are in place. The TELRIC rates are forward looking. They are equal to the marginal cost that an ILEC would incur if the most efficient (cost-reducing) technology were in place. But switching to new technology only makes economic sense when the average cost associated with the new technology is less than the average variable cost of the technology in place. Thus, TELRIC rates, which are calculated as though all cost-reducing technological changes have been adopted, can lead to access charges that are below actual cost—at least as calculated on the basis of historical investments.\textsuperscript{16} As a result, the incumbents would not willingly supply UNEs at the mandated rates. Thus, compliance must be compelled by the FCC.

\textsuperscript{13} 47 U.S.C. §252 (d)(1).
\textsuperscript{14} 47 CFR §51.505 (b)(1).
\textsuperscript{16} The idea is that entrants should not be saddled with the costs of currently inefficient technology.
The TCA requires that an incumbent provide access to its network on an unbundled basis so an entrant can pick and choose which elements to lease from the incumbent and which to acquire from third parties. In this way, entrants would not have to unnecessarily duplicate the telephone infrastructure, but would be able to offer competitive telephone service. Ideally, the new entrants would offer attractive features, innovative pricing plans, and services that were missing under the former regulatory regime. This sounds attractive, but consider the economic consequences for the incumbent. TELRIC rates are below the ILEC’s marginal cost. Suppose that the cost functions are as depicted in Figure 2. New entrants will have marginal costs equal to TELRIC pursuant to the regulation while the incumbent will have marginal cost equal to \( MC \). Bertrand price competition will lead to prices equal to TELRIC, i.e., \( P = P_1 \). At the corresponding quantity of \( Q_1 \), the ILEC’s average cost is \( AC_1 \). While consumers benefit from reduced price and expanded quantity, the ILEC suffers a loss of \((AC_1 - P_1)Q_1\). In this scenario, the incumbent is priced out of the market. It sells nothing in the output market because \( MC \) exceeds \( P_1 \), but it produces everything in the input market as the entrants use its network. The entrants do not bear their fair share of the capacity costs. In this scenario, it is not surprising that an incumbent would resist cooperation.

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17 Most (if not all) of the successful entrants have leased all of the network elements from the incumbent. <Source: David Kaserman; see if there is further foundation.>

18 Even if TELRIC > \( MC \), quantitatively similar results emerge as long as Bertrand price competition leads to prices below average cost.
Suppose that TELRIC exceeds marginal cost \((MC)\) as depicted in Figure 3. Traditional price regulation would lead to price equal to average cost, i.e., \(P = P_1\), and quantity would be \(Q_1\). Replacing output price regulation with competitive entry will make matters worse for consumers. Bertrand price competition will lead to a price of \(P_2\) and the reduced quantity \(Q_2\). The incumbent will not care who sells the service because its profits will equal \((P_2 - P_1)Q_2\) whether it sells all of the service or none of it. Since incumbents generally resist entry, this model would not appear to depict empirical reality.

The contractual arrangement between an incumbent and an entrant is contained in an interconnection agreement that sets out the terms and conditions of access to the incumbent’s network. Reaching such agreements, however, is complicated because of technological complexity, the breadth of the agreement, and the natural reluctance of an incumbent to reach any agreement at all (at least for the cases described in Figures 1 and 2). The agreement that ultimately led to the *Trinko* litigation was no exception. Eventually, however, Verizon and AT&T signed an interconnection agreement. Among other things, Verizon agreed to provide access to its operations support system (OSS), which is how competitors interface with their customers regarding (1) pre-ordering support, (2) ordering support, (3) maintenance, and (4) billing. Disputes regarding the quality of AT&T’s access to Verizon’s OSS resulted in the *Trinko* litigation.
III. The *Trinko* Litigation

In spite of Verizon’s obligation to process AT&T’s orders, many orders went unfilled. Following a series of competitor complaints, the New York Public Service Commission (PSC) and the Federal Communications Commission (FCC) opened separate investigations into Verizon’s alleged misconduct. Ultimately, the PSC ordered Verizon to pay $10 million to the entrants for various breaches of contract and the FCC consent order involved a $3 million fine euphemistically referred to as a “voluntary contribution” to the U.S. Treasury by Verizon.\(^{19}\)

On the heels of the FCC consent order, Trinko filed a class action suit seeking injunctive relief and treble damages for the injuries suffered as a result of Verizon’s stalling tactics. Trinko was an AT&T local service customer who alleged that Verizon delayed filling some competitors’ customer orders and failed to fill others. Verizon’s purpose was alleged to be an effort to sabotage the quality of the service provided by its competitors and thereby to discourage customers from switching to a competitive LEC. In effect, this behavior was aimed at preserving Verizon’s monopoly in local telephone service by deterring potential customers from switching to rivals that were trying to get a foothold in the market. The antitrust issue was whether this conduct violated §2 of the Sherman Act.\(^{20}\)

\(^{19}\) In addition, Verizon was subject to additional reporting requirements and heightened monitoring by the PSC and the FCC. These added measures were lifted prior to the *Trinko* decision; 124 S. Ct. at 877.

\(^{20}\) 124 S. Ct. at 877.
Illegal Monopolization

To address this issue, it is useful to review what constitutes illegal monopolization. First, it is well known that the structural condition of monopoly without more is not a violation of §2 of the Sherman Act, which holds in relevant part that “[e]very person who shall monopolize…any part of the trade or commerce among the several States…shall be deemed guilty of a felony…” It is the act of monopolizing that offends the Sherman Act rather than the structural condition of monopoly. A compact statement of the test for illegal monopolization was provided in the Supreme Court’s Grinnell decision: “The offense of monopoly under §2 of the Sherman Act has 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 growth or development as a consequence of a superior product, business acumen, or historic accident.” To the extent that this test separates the deserving from the undeserving, it is a useful standard. There are three evidentiary burdens for a successful plaintiff. First, the plaintiff must define a relevant antitrust market, which has two components: a relevant product market and a relevant geographic market. Second, having defined

24 For a useful survey of product market definition issues, see Phillip E. Areeda, Herbert Hovenkamp, & John L. Solow, Antitrust Law, ¶¶ 560-565.
25 Id. at ¶¶ 550-556.
the relevant market, the plaintiff must prove that the defendant has monopoly power in that market. This requires a showing that the defendant is able to profitably raise price above the competitive level for a sustained period of time.\footnote{Abba Lerner, \textit{The Concept of Monopoly and the Measurement of Monopoly Power}, 1 Review of Economic Studies 157 (1934), proposed the following measure:

\[ \lambda = \frac{P - MC}{P} \]

where \( P \) is the price charged and \( MC \) is marginal cost, which is equal to the competitive price. Thus, \( \lambda \) measures the monopoly mark up as a percent of the monopoly price. Lerner’s concept was adapted to the dominant firm by William M. Landes & Richard A. Posner, \textit{Market Power in Antitrust Cases}, 94 Harvard Law Review 937 (1981). Also see, Areeda, Hovenkamp, & Solow, id. at ¶¶ 501-526.}

Once these two hurdles have been negotiated, the first prong of the \textit{Grinnell} test has been satisfied. The third evidentiary burden is to show that the defendant has engaged in exclusionary conduct. That is, the monopolist’s success must be attributable to some sort of predatory or otherwise exclusionary conduct.\footnote{Frank H. Easterbrook, \textit{On Identifying Exclusionary Conduct}, 61 Notre Dame Law Review 972 (1986), points out that distinguishing aggressive \textit{competitive} conduct by a monopolist from aggressive \textit{exclusionary} conduct is no mean feat. “Competitive and exclusionary conduct look alike.” \textit{Id.}}

Those incumbents that, in fact, delay the entry of rivals or sabotage their efforts would appear to fail the \textit{Grinnell} test. It is unclear how one could characterize such behavior other than as the “willful…maintenance” of monopoly power. If the incumbents were in the widget industry, efforts designed solely to retard entry or sabotage the efforts of those who did manage to enter would
clearly offend §2.\textsuperscript{28} But the incumbent local exchange carriers are not in the widget industry; they are in the extensively regulated telecommunications industry and this may make a difference. Moreover, an incumbent monopolist is rarely (if ever) obligated to assist a rival to its own detriment under the Sherman Act,\textsuperscript{29} which may also make a difference here.

**TCA Obligations and Antitrust Exposure**

When an incumbent LEC fails to meet its sharing obligations under the TCA, it tends to preserve its monopoly. The question then becomes whether such conduct violates §2 of the Sherman Act.\textsuperscript{30} The TCA contains an antitrust savings clause: “nothing in this Act or the amendments made by this Act shall be construed to modify, impair, or supercede the applicability of any of the antitrust laws.”\textsuperscript{31} The Supreme Court reasoned, however, that this clause merely preserved claims that satisfy existing antitrust standards. It did not create new

\textsuperscript{28} Gregory J. Werden, *The “No Economic Sense” Test for Exclusionary Conduct*, ___ Journal of Corporation Law (2005), explains that a monopolist’s conduct that makes no economic sense but for its tendency to eliminate or lessen competition should be deemed predatory or exclusionary.

\textsuperscript{29} This may be disputed since the Supreme Court’s decision in Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585 (1985), condemned a dominant firm’s withdrawal from a cooperative arrangement that clearly helped a rival to the dominant firm’s detriment. Similarly, Eastman Kodak Co. v. Image Technical Services, 504 U.S. 451 (1992), condemned a refusal to supply repair parts to a group of competitors in the aftermarket for service.

\textsuperscript{30} The lower courts were evenly split on this issue; see note 4 *supra*.

\textsuperscript{31} See § 601 (b) (1) of the TCA.
claims that go beyond existing antitrust standards.\textsuperscript{32} As a result, the Court turned to an analysis of whether existing antitrust standards were violated by Verizon’s failure to meet its obligations under the TCA. The Court found that existing standards were not violated.\textsuperscript{33}

**Identification of Directly Injured Parties**

When an ILEC fails to meet its obligations under the TCA, two groups are directly injured. First, the CLECs are injured because entry is delayed or its post-entry performance is sabotaged in one way or another. To the extent that the CLECs’ profits are reduced by the ILEC’s behavior, the CLECs have suffered damages. In general, lost profits are not available to the CLECs under the TCA. Second, to the extent that the TCA’s sanctions fail to deter abusive behavior – foreclosure or delay or sabotage – customers of the abused CLEC will suffer various sorts of overcharges and inconveniences. This group, however, will not be able to recover for those injuries because the TCA provides no compensation for customers of an abused CLEC.\textsuperscript{34} In principle, consumers should be protected

\textsuperscript{32} *Trinko*, 124 S. Ct. at 878.

\textsuperscript{33} This holding raises a host of questions surrounding earlier decisions. First, does *Trinko* sap the life out of *Aspen Skiing*? Does *Trinko* implicitly overrule *Otter Tail Power Company v. United States*, 410 U.S. 366 (1973)? Finally, protestations to the contrary notwithstanding, does *Trinko* repudiate the essential facilities doctrine? These are interesting questions but we do not address them here.

\textsuperscript{34} Of course, all customers suffer from the lack of prompt, effective entry as the ILEC will not face the enhanced competition that such entry would provide.
by the regulators who are supposed to serve as a substitute for competitive market forces. The efficacy of regulation as a substitute for market forces is very mixed due to the possibility of regulatory capture.35

As far as the Trinko Court is concerned, the majority ignored the consumer issue. Instead, it directed its attention on whether the ILEC violates the antitrust laws when it fails its TCA obligations. The concurring justices found that customer injury was indirect as it was derivative of the injury suffered by the CLECs.36 As a result, consumers would have no standing under Illinois Brick.37

IV. Deterring ILEC Misconduct

The Supreme Court placed great faith in the efficacy of regulation to prevent any significant antitrust harm flowing from misconduct on the part of incumbent LECs. This is curious given the fact that four antitrust claims reached appellate courts and the facts of the Trinko case included complaints by multiple entrants.38 In spite of factual evidence that incumbents have failed to cooperate satisfactorily, the Supreme Court’s review of the regulatory framework led to its conclusion that significant antitrust harm was unlikely.39 For this to be accurate,

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38 It is also curious since Justice Scalia appears to have betrayed his “Chicago” heritage, which is generally skeptical about the efficacy of regulation.
however, the regulatory authorities must be able to deter misconduct by incumbents.

Incumbent local exchange carriers are presumably profit maximizing firms.\textsuperscript{40} No doubt, incumbents will be tempted to resist fulfilling their obligations imposed by the TCA because doing so will raise profits. Outright refusals are unlikely, but an incumbent can drag its feet and thereby delay its eventual cooperation. An incumbent can also cooperate after a fashion while sabotaging an entrant’s effectiveness.\textsuperscript{41} In either case, the incumbent does not act out of malice; it is motivated by the additional profit that it will earn through these tactics. This, however, is the key to effective deterrence. At least in principle, deterring misconduct is simple: make it unprofitable. In other words, the sanction for delay or sabotage must be large enough so that delay or sabotage is unprofitable. If the imposition of sanctions were certain, the sanction would only have to be a dollar more than the incremental profit that is attributable to the delay or sabotage.\textsuperscript{42} If there is some chance of avoiding sanctions, the amount will have to be enhanced, but should be related to the profits earned through the misconduct.

\textsuperscript{40} These firms are, of course, subject to regulations that impose some constraints on their ability to maximize profit. But subject to those regulatory constraints, incumbent LECs will try to do as well as they can financially.


\textsuperscript{42} The sanction would have to take into account any time lags to ensure that an uncooperative incumbent does not get what amounts to an interest-free loan.
We can make these points more concrete. Suppose that cooperation (i.e., accommodating entry) results in incumbent profits of $\pi$, while delay leads to profits of $\pi + \Delta \pi$. Let $p$ denote the probability that the incumbent will be sanctioned for the delay, $(1 - p)$ be the probability of avoiding the sanction, and $S$ be the sanction. Then a risk-neutral incumbent will be deterred if

$$\pi > p(\pi + \Delta \pi - S) + (1 - p)(\pi + \Delta \pi).$$

That is, if the profit that results from accommodating entry exceeds the expected profit that accompanies delay or sabotage, then the risk-neutral incumbent will cooperate with the entrant. This expression can be written as

$$\pi > \pi + \Delta \pi - pS$$

which clearly requires that $pS > \Delta \pi$. If the expected sanction, $pS$, is to exceed $\Delta \pi$, then $S$ must be enhanced to $S = \Delta \pi / p$. In other words, the sanction for failing to fulfill the TCA obligations must be enhanced if the delaying tactics are to be unprofitable in an expectations sense and, therefore, deterred. For example, if $p$ is 0.8 and $\Delta \pi$ equals $10.0$ million, then $S$ will have to be above $12.5$ million to make the misconduct unprofitable in an expectations sense ($S = 10.0$ million/0.8=$12.5$ million). If the probability of a sanction were only 0.25, then the actual sanction would have to be above $40.0$ million to be an effective deterrent ($S = 10.0$ million/0.25=$40.0$ million).

As these examples show, to be an effective deterrent, the actual sanction must vary from case to case and will be a function of $p$ and $\Delta \pi$. For any given value of $p$, the optimal penalty for noncompliance will be larger the more lucrative
that noncompliance is, i.e., the larger is $\Delta \pi$. Similarly, for any given $\Delta \pi$, the optimal sanction will be larger the smaller that $p$ is.

The Supreme Court appears to be convinced that the state and federal regulators are capable of sufficiently punishing recalcitrant incumbents to deter misconduct. This ultimately is an empirical matter, but we can review the regulatory arsenal.

The Telecommunications Act of 1996 does not involve private enforcement and, therefore, does not contain any provisions for private remedies for an ILEC’s failure to meet its obligations under the TCA. The Federal Communications Commission (FCC) can impose forfeiture penalties (i.e., fines) for failing to meet the obligations prescribed in the TCA. The forfeiture penalty may not “exceed $100,000 for each violation or each day of a continuing violation, except that the amount assessed for any continuing violation shall not exceed a total of $1,000,000 for any single act or failure to act” when the ILEC “willfully or repeatedly failed to comply with any provision of the statute or any FCC regulation promulgated under it.”\(^\text{43}\) These penalties are subject to judicial review and are neither procured by nor awarded to private parties – CLECs or telephone customers.\(^\text{44}\)

State regulatory authorities can also impose sanctions on ILECs for abusive behavior. In New York, for example, a public utility that commits a

\(^{43}\) 47 U.S.C. §§ 503(b)(2)(B) and 503(b)(1)(B).

\(^{44}\) Thus, in the Trinko setting, AT&T and Trinko can sue for lost profits or other injuries resulting from Verizon’s failures only if those failures amount to antitrust violations.
knowing violation of the statute or a PUC rule can be fined “a sum not exceeding $100,000…for each and every offense and, in the case of a continuing violation, each day shall be deemed a separate and distinct offense.” 45

Once a CLEC enters into an interconnection agreement with an ILEC, the CLEC will enjoy the protection of contract law. The terms of the interconnection agreement, which can contain liquidated damages provisions, can be used to discipline breaches of an ILEC’s contractual obligations. A state regulatory commission can impose these liquidated damages in arbitration. 46 This authority was confirmed in MCI Telecommunications Inc. v. BellSouth Telecommunications Inc.: 47 “Clearly, enforcement and compensation provisions, including the liquidated damages provision desired by MCI, fall within the realm of ‘conditions….required to implement’ the agreement. [citing 47 U.S.C. §252(b)(4)(C)] For example, 47 U.S.C. §252(c) – to which §252(b)(4)(C) expressly refers – specifically mandates that the state commission “provide schedule for implementation of the terms and conditions by the parties to the agreement.” 47 U.S.C. §252(c)(3). “A schedule for implementation would be potentially meaningless without some mechanism to enforce it; thus, enforcement mechanisms, like those desired by MCI are clearly contemplated by the Act and within the FSPC’s authority.” 48

45 New York Public Service Law §25(2).
46 TCA, §252(c)(3).
47 298 F. 3d 1269 (11th Cir. 2002).
48 Id. at 1274.
In the *Trinko* opinion, the Supreme Court reports that “[w]hen several competitive LECs complained about deficiencies in Verizon’s servicing of orders, the FCC and PSC responded.” 49 The FCC found Verizon “in breach of its sharing duties under §251(c)” 50 and the PSC found Verizon in breach of its state obligations under state requirements. The financial penalties amounted to $13 million. 51 On the basis of this, the Court concluded that “[i]n short, the [regulatory] regime was an effective steward of the antitrust function.” 52 But the Court cannot know this unless it knows that

\[ S \geq \Delta \pi / p, \]

i.e., unless it knows that the sanction made the misconduct unprofitable in an expectations sense. There is nothing in the Court’s opinion to suggest that the Court was informed about this matter. There is nothing in the Court’s opinion to suggest that it had any idea whatsoever how much Verizon had profited by its tactics. But absent this information, the Court cannot be confident that such behavior will be deterred in the future.

Given the continued delay and sabotage tactics employed by incumbent providers, there is ample evidence to suggest that the penalties under the TCA

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49 *Trinko*, 124 S. Ct. at 882.

50 *Id.*

51 *Id.* at 876. In addition, the FCC and the PSC imposed weekly and daily, respectively, reporting requirements for purposes of monitoring Verizon’s performance.

52 *Id.* at 882.
are inadequate. Cendan\textsuperscript{53} argues that with a lack of compliance, the goals of the TCA could be compromised due to the maintenance of monopoly power through anticompetitive practices. Without appropriate sanctions, an incumbent is likely to choose noncompliance, even with the possibility of sanctions, since its behavior appears to be profitable and successful in maintaining its monopoly.

Due to a perceived weakness in the design of the TCA in terms of its ability to deter anticompetitive conduct, Cendan argues for applying the antitrust laws as a necessary complement to the TCA. He contends that antitrust law should be the minimum standard applicable for conduct under the TCA. The aim of the TCA is ultimately to make the telecommunications industry increasingly more competitive. If deregulation continues and more traditional competition emerges in the industry, antitrust regulation will become increasingly relevant. If traditional regulation disappears, the antitrust laws will govern the telecommunications industry in the same manner as they govern other competitive markets. Cendan argues that during this transitional phase, it is important to let the antitrust laws complement the TCA in fostering the procompetitive intent of the TCA.

If the antitrust laws were applicable to substantial violations of the Act, the possibility of trebled damages may deter this kind of behavior. If a plaintiff could prove the impermissible maintenance of monopoly power while pursuing treble damages, defendants would be more likely to find it unprofitable to block their

competitors’ access. According to Cendan, allowing private antitrust actions should not hinder the effectiveness of the TCA in promoting competition and the deregulation plan for the industry. Instead, it would protect the very goal of the Act.

V. Legislative Reaction to *Trinko*

Frustrated by the Supreme Court’s *Trinko* decision, Rep. Sensenbrenner and Rep. Conyer introduced H.R. 4412 to amend the Clayton Act. The proposed amendment would add §3A(a) to the Clayton Act which would then provide that

“[i]t shall be unlawful for an incumbent local exchange carrier or an affiliate to create or to preserve ( or to attempt to create or to preserve) a monopoly in any part of commerce by using its network...to engage in an anticompetitive practice (which may include a failure to comply with either section 251 (c) or 271 of the Communications Act of 1934 or with any agreement, rule, or order in effect under such sections).”

Although the Supreme Court found that an incumbent’s failure to meet its TCA obligations is not “anticompetitive conduct” under the antitrust laws, the clear intent of the proposed §3A (a) is to define such conduct as “anticompetitive.” If enacted, this would certainly “clarify the application of the antitrust laws in the telecommunications industry.” It would also effectively overrule the *Trinko* decision. A failure to cooperate satisfactorily with a would-be entrant would then constitute an antitrust violation and expose the incumbent to public and private
enforcement actions. The threat of such suits would provide a powerful deterrent to illegal stalling tactics.

Public Enforcement

The proposed H.R. 4412 does not amend §2 of the Sherman Act, but it renders unlawful conduct that is committed by a local telephone monopolist. As a consequence, a court could find that such conduct violated §2 of the Sherman Act. In that event, the amendment would expose the incumbent to criminal sanctions. Recently, Congress has substantially increased the criminal sanctions for antitrust violations. With the enactment of H.R. 1086 in 2004, the criminal sanctions for violations of §2 are corporate fines of $100 million and individual fines of $1.0 million and up to 10 years in jail. In many cases, the maximum corporate fine will be a powerful deterrent as the increment in profit (\(\Delta \pi\)) is not apt to exceed the maximum fine, but this is also an empirical issue.

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54 In principle, DOJ could file a criminal action. In practice, however, DOJ does not pursue criminal actions in §2 cases. Typically, criminal charges are reserved for per se violations of §1.

55 15 U.S.C §2. These are the maximum sanctions, which may be well above the sanctions actually imposed by a court.
Private Enforcement

The proposed §3A (a) would certainly expose the incumbent to private suits. Private actions provide for treble damages plus the costs of the suit.\textsuperscript{56} In the case of the damages suffered by excluded or impaired rivals, the proper measure of damages will be lost profits attributable to foreclosure. The expected sanction for a violation will then be

\[ E[S] = q(3\Delta\pi_e + C) \]

where \( q \) is the probability of being convicted of a §2 violation, \( \Delta\pi_e \) is the entrant’s lost profit, and \( C \) is the cost of the suit to the plaintiff.\textsuperscript{57} As a general proposition, the incremental profit to the incumbent, \( \Delta\pi_i \), need not equal the loss to the entrant, \( \Delta\pi_e \). It depends upon the relative efficiencies of the incumbent and the entrant.

As a general proposition, an antitrust violation will be deterred if it is unprofitable, i.e., if the expected sanction exceeds the gain from the violation. Accordingly, delay and/or sabotage will be deterred if

\[ q(3\Delta\pi_e + C) > \Delta\pi_i. \]

If we assume equal efficiency, i.e., that \( \Delta\pi_i = \Delta\pi_e \), then the conduct will be deterred if

\[ \Delta\pi(1 - 3q) < qC, \]

\textsuperscript{56} 15 U.S.C §15. “Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefore….and shall recover threefold the damages by him sustained, and the cost of the suit, including a reasonable attorney’s fee.”

\textsuperscript{57} In addition, the defendant will have to pay for its own costs of the suit.
which will hold if \( q \) is at least equal to one-third.

But this is not the end of the story. As we have argued elsewhere, consumers are also antitrust victims in such cases of exclusionary conduct. Consumers, no doubt, will add their claims to those of the abused CLECs, which will add to the deterrent effect of private antitrust enforcement.\(^{58}\)

When an ILEC delays or sabotages the entry of rivals, all consumers are denied the benefits of competition. In most instances, consumers will find that they have been overcharged, i.e., the price that they actually pay is higher than the price that they would have paid in absence of such tactics. As a result, the damage (\( D \)) is the price difference (\( \Delta P \)) times the quantity actually purchased (\( Q \)):

\[
D = (\Delta P)(Q).
\]

Now, the expected sanction for abusing consumers would be

\[
E[S] = q(3(\Delta P Q) + C).
\]

Since both CLECs and consumers should be expected to sue for injuries suffered, this expected sanction must be added to the others.

Summary

If an incumbent engaged in significant stalling tactics or sabotaged the success of an entrant in violation of the TCA, antitrust exposure would surely get

\(^{58}\) Consumers may have to pursue their claims through class action suits, which may be problematic. In what follows, we ignore the difficulties associated with maintaining a class action suit and focus on the deterrent effect of consumer claims.
the incumbent’s attention. Corporate fines of up to $100 million plus the treble damages would surely exceed the increment in profit earned by the incumbent:

$100 \text{ million} + 3(\Delta \pi_e) + C + 3(\Delta PQ) + C > \Delta \pi_i.$

Even though the left-hand side must be weighted by the relevant probabilities, the inequality is apt to hold.

VI. Conclusion

In the *Trinko* decision, the Supreme Court ruled that a failure by an incumbent to cooperate satisfactorily with an entrant, as required by the TCA, does not violate §2 of the Sherman Act. Without the applicability of the antitrust laws, noncompliance can only be sanctioned under the TCA. In this paper, we have examined the current sanctions available and their ability to deter potential misconduct by ILECs. We have also examined which parties are injured as a result of an ILECs noncompliance, potential damages that may result, and the ability of injured parties to recover such damages. An ILEC has strong incentives to maintain its monopoly and may attempt to do so by providing inferior network access to an entrant. We conclude that sanctions must be set with economic theory in mind; induce the desirable behavior by making the undesirable behavior unprofitable. The competitive goals of the TCA may be compromised unless sufficient penalties are in place to induce behavior in accordance with the TCA.