Federal Communications Law Journal

Volume 61 | Issue 1 Article 9

12-2008

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I. INTRODUCTION

Having worked on the economics of competition and regulation in telecommunications since before AT&T's divestiture of its local telephone operating companies was announced in early 1982,[1] I have learned at least one lesson: issues never die. Even after a quarter century, we (taken in both the national and international senses) continue to cope with the extent to which competition can and should displace regulation in this sector and the degree to which telecommunications companies can vertically integrate. Nationally, struggles over the scope of regulation have taken place over the

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The author thanks Christopher Yoo for including him in this Symposium.

1. United States v. AT&T, 552 F. Supp. 131 (D.D.C. 1982).

definition and terms of access to "network elements."[2] An international example of that struggle is the recent proceeding in Canada in which the national government intervened to force the Canadian regulatory agency to set relatively favorable terms for the deregulation of local telephone service.[3]

Vertical integration was a central issue in the antitrust case leading to the AT&T divestiture, which itself was a vertical remedy. There, the concern was that AT&T used its control over the local monopoly to discriminate in the amount and quality of access against competitors in long-distance and terminal equipment markets.[4] Regulation provided the incentive to discriminate, by preventing AT&T from directly profiting from its local monopoly, giving it the impetus to create and exploit market power in those less regulated or unregulated sectors.[5] A second vertical concern was that AT&T allegedly could force its local ratepayers to bear the costs of its operations in less regulated markets, allowing it to cross-subsidize and price without regard to cost.[6] This created credible predatory threats that would discourage entry into otherwise competitive markets, particularly private line services.[7] In the present, a notable example of concern regarding vertical integration is the debate over "net neutrality," which to some degree deals with the ability of broadband providers to determine, if not outright own, the content that goes over their facilities.[8]

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2. Verizon Comm., Inc. v. FCC, 535 U.S. 467, 523 (2002) (upholding the FCC's pricing methods for network elements); U.S. Telecomm. Ass'n v. FCC, 359 F.3d 554, 576 (D.C. Cir. 2004) (denying the FCC's use of uneconomic entry to meet the statutory definition of "impairment" necessary to justify supplying a network element to competitors); Covad Comm. v. FCC, 450 F.3d 528 (D.C. Cir. 2006) (upholding, on its fourth attempt, the FCC's tests for "impairment").

3. *See* Timothy Brennan, *Skating Toward Deregulation: Canadian Developments*, 60 FED. COMM. L.J. 325 (2008).

4. *See* Timothy Brennan, *Why Regulated Firms Should Be Kept Out Of Unregulated Markets: Understanding the Divestiture in* U.S. v. AT&T, 32 ANTITRUST BULL. 741 (1987).

5. *See* Michael Crew, Paul Kleindorfer & David Sumpter, *Bringing Competition to Telecommunications by Divesting the RBOCs, in* OBTAINING THE BEST FROM REGULATION AND COMPETITION 21 (Michael Crew & Menahem Spiegel eds., 2005). For an earlier critique of the discrimination argument and a response, see Dennis Weisman, *Regulation and the Vertically Integrated Firm: The Case of RBOC Entry into InterLATA Long Distance*, 8 J. REG. ECON. 249 (1995); David Reiffen, *A Regulated Firm's Incentive to Discriminate: A Reevaluation and Extension of Weisman's Result*, 14 J. REG. ECON. 79 (1998).

6. *See* Brennan, *supra* note 4.

7. *See id.*; *see also* Timothy Brennan, *Cross-Subsidization and Cost Misallocation by Regulated Monopolists*, 2 J. REG. ECON. 37, 37-51 (1990).

8. *See* Timothy Wu, from his presentation at "The Enduring Lessons of the Breakup of AT&T: A Twenty-Five Year Retrospective." Space here does not allow a full discussion of this issue, but I note here that one could view the issue not as requiring that all Internet content be treated identically, but that all content be handled with some minimum level of quality. This would respond both to consumer protection concerns and a universal-service-like

Although the issues may remain relatively constant, perspectives on them can change. This Article illustrates this first by comparing the outcome in *U.S. v. AT&T* to the recent and substantively similar 2004 Supreme Court decision in *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko*.[9] Comparing the two, and reviewing other decisions contemporaneous with both, indicates a radical change in the relationship between competition law and regulation law. At the time of *U.S. v. AT&T*, the courts applied antitrust law to regulated industries absent a "plain repugnancy"[10] test regarding antitrust in the regulatory statute. In *Trinko*, the Supreme Court took the contrary position that the benefits of antitrust enforcement in the presence of regulatory authority covering the conduct at issue were minimal, despite an explicit "savings clause" in the underlying statute—the Telecommunications Act of 1996.[11] This Court's view was not gratuitous; it reinforced it in granting securities law precedent over antitrust in its 2007 decision in *Credit Suisse Securities v. Billing*.[12]

The implicit assumption in the recent decisions is that regulation and antitrust are substitute methods for controlling market power. In fact, regulation and antitrust are complementary in this context, as well as in others.[13] Absent regulatory constraints on the direct exercise of market power over the local exchange (*AT&T*) or network elements (*Trinko*) through monopoly pricing, the regulated firm would have no incentive to subvert competition in related markets. Failure to see this has affected not just telecommunications and antitrust, but other monopolization cases as well, notably *United States v. Microsoft Corp.*[14]

The change in legal presumptions from *AT&T* to *Trinko* and *Credit Suisse* can be thought of as an assertion that in regulated industries, a sector-specific regulator should do both antitrust and regulation, rather than leave the former to a separate body of law and enforcement agency.[15] Ironically, a hallmark of *Trinko* was the Court's explanation of why it rejects the

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expectation that links supplied by a content provider on its Web site will be accessible by its readers.

9. 540 U.S. 398 (2004).

10. *See, e.g.*, MCI Comm. Corp. v. AT&T, 708 F.2d 1081, 1102 (7th Cir. 1982).

11. Telecommunications Act of 1996, Pub. L. No. 104-104, § 601(b)(1), 110 Stat. 56, 143 (1996) (codified as amended at 47 U.S.C. § 152 note (2000)).

12. 127 S. Ct. 2383 (2007).

13. *See* Timothy Brennan, *Regulation and Competition as Complements*, *in* OBTAINING THE BEST, *supra* note 5, at 1.

14. U.S. v. Microsoft Corp., 87 F.Supp. 2d 30 (D.D.C. 2000); *see infra* note 35 and accompanying text.

15. Interestingly, the U.S. enforcement agencies supported the eventual outcome in *Trinko*. *See* Brief for the United States and the Federal Trade Commission as Amici Curiae Supporting Petitioner, Verizon Comm., Inc. v. Law Offices of Curtis V. Trinko, L.L.P., 540 U.S. 398, 410-11 (2004) (No. 02-682).

application of an "essential facilities" (EF) doctrine to monopolization law.[16] One reason that defining an EF remains problematic is because to identify one in theory, one has to ask whether regulation would increase output.[17] Unfortunately, this precludes logically using EF doctrine as a prior justification for regulating.

The irony is that the EF doctrine rejected in *Trinko* makes exactly the same institutional point as does the *Trinko* decision overall—the same institutions should both regulate price and enforce antitrust law. This is because effective relief in an EF case requires price regulation. This Article elaborates the points made above, and concludes with a brief assessment of whether, as both *Trinko* and the EF doctrine say, it is best if price regulation and antitrust are left to the same entity, whether it be a sectoral regulator or an antitrust court.

II. COMPARING *AT&T* AND *TRINKO*: CHANGES IN ATTITUDES, CHANGES IN LATITUDE[18]

U.S. v. AT&T and *Verizon v. Trinko* were in many respects substantively identical, as Table 1 indicates.[19] First, the structural relationships were parallel. In *AT&T*, the defendant possessed a regulated monopoly over local telephone service generally, and also provided competitive long-distance service. In *Trinko*, the regulated monopoly was over the physical loops themselves, while the competitive market opened by the Telecommunications Act of 1996[20] was the retailing of services over those loops. In both contexts, we had entrants. During the 1970s, new suppliers of long-distance service included MCI and Sprint, while the post-Telecommunications Act world was designed to encourage competitive local exchange carriers, including AT&T, which switched from being the local service provider to a local service entrant, prior to its acquisition by Southwestern Bell.[21]

In both cases, the vertically related competitors needed services from the regulated monopolies. In the 1970s and 1980s, long-distance carriers

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16. *Trinko*, 540 U.S. at 410-11 (2004)

17. *See* accompanying text, *infra* notes 43-46.

18. *See* Timothy Brennan, Trinko v. Baxter: *The Demise of* U.S. v. AT&T, 50 ANTITRUST BULL. 635 (2006).

19. *See infra* p.138, tbl.1.

20. Pub. L. No. 104-104, §§ 251-52, 110 Stat. 56, 61-70 (1996) (codified as amended at 47 U.S.C. § 251-52 (2000)).

21. The law firm of Curtis V. Trinko, the plaintiff in the case, was not a local carrier alleging discrimination against itself, but a customer of AT&T alleging harm as the result of Verizon's alleged discrimination. Three of the nine Supreme Court Justices ruling for Verizon argued that they would have done so simply on the basis that Trinko was not directly harmed and thus lacked standing. *Trinko*, 540 U.S. at 416 (Stevens, J., Souter, J., & Thomas, J., concurring).

needed local access to serve their customers. More recently, those wanting to serve retail customers needed access to loops to be able to connect customers to their switches and networks.[22] Similar discriminatory allegations were made involving denials of access, outages, and inferior quality and technical support, leading to accusations that such conduct led to monopolization of the erstwhile competitive markets in long-distance (*AT&T*) and local retailing (*Trinko*). Not only were the economic settings essentially identical in both cases, the FCC exercised oversight regarding interconnection in both contexts as well.

22. In recounting this story, I do not intend to assume that the Telecommunication Act's procedures for facilitating entry by local carriers relying on incumbent facilities were justified, nor that the prices proposed for such access were justified. For a critique of the pricing proposal from a "regulatory takings" perspective, see Timothy J. Brennan, *Comparing "Stranded Costs" Arguments in Telecommunications and Electricity*, *in* REGULATION UNDER INCREASING COMPETITION 79 (Michael Crew ed., 1999). The purpose here is only to illustrate that the economic settings of *AT&T* and *Trinko* were the same. No differences in the decisions can be attributed to claims that the economics were different, e.g., that the loop market in *Trinko* was competitive despite the Telecommunication Act's access requirements.

Table 1: Similarities (Except the Outcome) Between *AT&T* and *Trinko*[23]

Aspect	*U.S. v. AT&T*	*Verizon v. Trinko*
Regulated monopoly	Local telephone service	Loops, wholesale local service
Competitive adjacent market	Long-distance service	Retail local telephone service
Competitors; entrants	MCI, Sprint	CLECs including AT&T
Needed facility from regulated firm	Local access	Network elements
Discriminatory accusation	Inferior interconnection, service outages	Denial of network elements, operation support
Alleged monopolization	Leverage local monopoly to monopolize long-distance service	Maintenance of monopoly in retail local service, "one-stop shopping" telecommunications
FCC entry regulation	Allowing resale of private microwave networks to provide long-distance service	Designation of network elements, interconnection rules, pricing guidelines
Outcome	Separation of regulated local service from competitive long-distance service through divestiture, line-of-business restrictions	Supreme Court determination that refusal to provide new interconnection services not an antitrust violation

Nonetheless, the outcomes could not have been more different. In *U.S. v. AT&T*, the result was AT&T's divestiture of its local operating companies, along with requirements that all who use the exchange get equal access.[24] In addition, the divested local telephone companies were forbidden from entering vertically related markets. This restriction gener-

23. This figure taken from Brennan, *Demise*, *supra* note 18, at 649.
24. United States v. AT&T, 552 F. Supp. 131, 226-27, 232-34 (D.D.C. 1982).

ally persisted until the Telecommunications Act of 1996 replaced the *AT&T* settlement decree with detailed regulatory procedures to allow the divested companies to reenter prohibited lines of business—particularly long-distance service—and to facilitate competitive entry in local services, as carriers using the incumbent's facilities or their own. The divestiture in *AT&T* was the result of a settlement rather than a completed trial, but it was adopted prior to trial court rulings that arguably indicated that the court believed the government had presented a compelling case.

The decision in *Trinko* was exactly the opposite. Rather than apply the antitrust laws because a firm was monopolizing a market in order to evade regulatory profit constraints, the Supreme Court invoked regulation as a justification not to apply the antitrust laws. One justification was that the Supreme Court regarded Verizon's conduct, not in terms of regulatory evasion, but as simply a refusal to deal with a competitor. The Court properly regarded duties to deal as rarely justified, on the grounds that such obligations are likely to chill innovation and require extensive oversight to implement.[25] It viewed regulation as a substitute means for ensuring competitive conduct, and thus found that the costs of antitrust enforcement in this sector would outweigh any benefits. This was despite an explicit antitrust savings clause in the Telecommunications Act of 1996, which created the regulatory process to which the Supreme Court granted precedence over the Sherman Antitrust Act[26]—a clause which the Court clearly wished was not part of the Act.

It is worth reviewing some decisions to illuminate just how radical the change of focus has been between *AT&T* and *Trinko*. As noted, *U.S. v. AT&T* itself did not result in a litigated decision, but other parallel private cases at the time did. A passage from the 7th Circuit Court's decision upholding MCI's private monopolization case against AT&T is instructive:

> It is well established, however, that regulated industries "are not *per se* exempt from the Sherman Act." "Repeal of the antitrust laws by implication is not favored and not casually to be allowed. Only where there is a '*plain repugnancy* between the antitrust and regulatory provisions' will repeal be implied." As a further limitation, repeal is to be regarded

25. *Trinko*, 540 U.S. at 411-15. In doing so, the Court explicitly rejected an "essential facilities" justification for duties to deal. For a discussion of essential facilities, see *infra* notes 38-41 and accompanying text. Other aspects of the Court's decision, including refusing to impose a duty because Verizon did not sacrifice profits to refuse interconnection and providing such interconnection only because of statutory and regulatory obligations, are criticized in Brennan, *Demise*, *supra* note 18, at 655-57, relying on a general critique of "profit sacrifice" tests in Timothy J. Brennan, *Saving Section 2: Reframing U.S. Monopolization Law*, *in* THE POLITICAL ECONOMY OF ANTITRUST 417, 428-31 (Vivek Ghosal & Johan Stennek eds., 2007).

26. 15 U.S.C. § 2 (2000).

> as implied only where necessary to make the regulatory scheme work, and even then, only to the minimum extent necessary.[27]

It is a long way from "plain repugnancy" in 1983 to the following from *Trinko* in 2004:

> Indeed, a detailed regulatory scheme such as that created by the 1996 Act ordinarily raises the question whether the regulated entities are not shielded from antitrust scrutiny altogether by the doctrine of implied immunity. In some respects the enforcement scheme set up by the 1996 Act is a good candidate for implication of antitrust immunity, to avoid the real possibility of judgments conflicting with the agency's regulatory scheme "that might be voiced by courts exercising jurisdiction under the antitrust laws."
>
> Congress, however, precluded that interpretation. Section 601(b)(1) of the 1996 Act is an antitrust-specific saving clause providing that "nothing in this Act or the amendments made by this Act shall be construed to modify, impair, or supersede the applicability of any of the antitrust laws." This bars a finding of implied immunity.[28]

Lest this be seen as just dicta,[29] the Supreme Court reiterated its view that regulators should be handling antitrust in its 2007 decision, *Credit Suisse Securities v. Billing*:

> Where regulatory statutes are silent in respect to antitrust, however, courts must determine whether, and in what respects, they implicitly preclude application of the antitrust laws. Those determinations may vary from statute to statute, depending upon the relation between the antitrust laws and the regulatory program set forth in the particular statute, and the relation of the specific conduct at issue to both sets of laws.
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> . . . .
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> [T]o permit antitrust actions such as the present one [allegations of collusion] *still* threatens serious securities-related harm. For one thing, an unusually serious legal line-drawing problem remains unabated. In the present context only a fine, complex, detailed line separates activity that the SEC permits or encourages (for which respondents must concede antitrust immunity) from activity that the SEC must (and inevitably will) forbid (and which, on respondents' theory, should be open to antitrust attack).[30]

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27. MCI Comm. Corp. v. AT&T, 708 F.2d 1081, 1102 (7th Cir. 1982) (emphasis added) (citation omitted) (quoting Georgia v. Pa. R.R., 324 U.S. 439, 456 (1945), Gordon v. N.Y. Stock Exch., 442 U.S. 659, 682 (1975)).

28. *See Trinko*, 540 U.S. at 406 (citation omitted) (quoting United States v. Nat'l Ass'n of Sec. Dealers, Inc., 422 U.S. 694, 734 (1975), 47 U.S.C. § 152 note (2000)).

29. Roger Noll suggested this in commenting on a pre-publication presentation in Boston at the American Economics Association Meetings in January, 2006 of Brennan's Article, *Demise*, *supra* note 18.

30. Credit Suisse Sec. LLC v. Billing, 127 S. Ct. 2383, 2389 & 2394 (2007).

III. REGULATION AND ANTITRUST AS COMPLEMENTS, NOT SUBSTITUTES

It is easy to understate the difference between viewing antitrust as relevant to regulated sectors and viewing regulation as effectively preempting antitrust enforcement. It is not simply a divergence in law from whether a statute of general application, such as an antitrust law, should take precedence over a statute of specific application, such as a regulatory statute. It reflects a paradigm shift in the underlying law and economics as well. The view of the Court in *Trinko* is that regulation and antitrust are substitutes in the economics textbook definition of the term; if regulation is present, the demand for antitrust falls.

In contrast, the view of regulation and antitrust embodied in *AT&T* is not merely that they are two independent means for limiting the exercise of market power. Rather, regulation creates circumstances under which antitrust becomes relevant, in ways that antitrust would not if a firm with monopoly power were not regulated. In that sense, regulation does not diminish demand for antitrust, but should boost it. By economics textbook definitions, regulation and antitrust are complements—not substitutes, as implicitly and erroneously held in *Trinko*.

Regulation boosts demand for antitrust because in limiting the ability to exercise market power directly through setting the price that the market will bear—activity which is perfectly legal under the antitrust laws—it creates incentives to enter and to suppress competition in regulated markets that would not otherwise exist. Absent regulation, a firm with a monopoly prefers competition in vertically related markets, since lowering price in those markets boosts demand and thus profits for the monopolist's service. Hence, practices that nominally limit competition in those markets—be it vertical integration, tying, or exclusive franchising—would, to a first approximation, be entered into by a monopolist if they would enhance profits through efficiency, since the monopolist already has the ability to extract market power.[31]

But when the ability to exercise monopoly power is eliminated by regulation, a firm has an incentive to get around that restraint. In the telecommunications context, it could enter an unregulated market for a service (e.g., long distance) that requires access to its regulated service (e.g., the

31. If a monopoly is already present, the effect of such conduct is less harmful and may be beneficial, as the "Chicago School" argument posits. That perspective does not apply if the conduct creates a monopoly in a setting where there would otherwise be none, for example, by using exclusive dealing contracts over distributors to eliminate competition in distribution, and thus create a new monopoly or perpetuate a monopoly that would otherwise have fallen apart. *See* Timothy J. Brennan, *Bundled Rebates as Exclusion Rather Than Predation*," 4 J. COMPETITION L. AND ECON. 335, 367-38 (2008).

local network), and deny or give lower-quality access to its competitors. This reduces or eliminates competition in the unregulated market, allowing it to raise the price. The source of the profit is control over access to the regulated product combined with the regulation. Absent the regulation, the firm would lack this incentive to discriminate; it would make more money charging a high price for access to competitors in the unregulated market. This concern is not unique to telecommunications; it stands behind policies to limit the degree to which electricity-generation companies, in a competitive sector, can control operations of the monopoly transmission and distribution facilities needed to deliver energy to consumers.[32]

As noted above, a second concern is what in telecommunications is called "cross-subsidization." That practice entails charging costs of labor, equipment, or services used to provide unregulated services to the accounts of a regulated service. If the rates for that regulated service are based on costs, and if regulators are not able to determine how that labor, equipment, or other services are used, charging these costs to the regulated side of the business raises the rates. On paper, the regulated side of the firm earns only the regulated profit rate. The profits from the higher price are realized from sales of the unregulated service where the costs have been shifted.

Not only can cross-subsidization essentially force ratepayers to pay rates above what regulators intend, the ability to shift costs may deter entrants into the unregulated markets, who may find it unprofitable to compete against a rival who can charge costs to regulated firms. This predatory threat is not credible without the regulation that allows a firm to raise prices through cross-subsidization; absent regulation, the firm cannot shift the cost of those subsidies.

The shift in attitudes from *AT&T* to *Trinko* reflects a declining influence of this view that regulation and antitrust are complements, not substitutes. This has not only affected antitrust in telecommunications in the quarter century since the AT&T divestiture. In January 1982, during the press conference at which Assistant Attorney General William Baxter announced the settlement of the AT&T case through divestiture, he also said that the other longstanding antitrust case against IBM "'is without merit and should be dismissed.'"[33] The difference between IBM and AT&T was that the latter was regulated and the former was not. In contrast, nearly twenty years later, in announcing a similar proposed divestiture remedy in

32. *See* Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities, FERC Order No. 888 (codified at 18 C.F.R. pts. 35, 385 (2008)); *see also* Regional Transmission Organizations, FERC Order No. 2000 (codified at 18 C.F.R. pt. 35 (2008)); *see also* TIMOTHY BRENNAN, KAREN PALMER & SALVADOR MARTINEZ, ALTERNATING CURRENTS: ENERGY MARKETS AND PUBLIC POLICY 71-80 (2002).

33. Christopher Byron, *Windup for Two Supersuits*, TIME, Jan. 18, 1982, at 38.

the government's case against Microsoft, Assistant Attorney General Joel Klein said:

> I don't want to make light of it, it's a big thing, but it is a one-time division that will then enable the companies to grow and move on. If you think about it—think about the AT&T breakup again. You know how long they tried to regulate AT&T.[34]

Klein erred in analogizing Microsoft in 2000 to AT&T in 1982 in that he failed to appreciate that AT&T was regulated and Microsoft was not. In the end, and not surprisingly, the Microsoft divestiture was rejected by the D.C. Court of Appeals.[35]

IV. "ESSENTIAL FACILITIES" AND *TRINKO*: TWO SIDES OF THE SAME COIN

One of the hallmarks of *Trinko* was its rejection of the EF doctrine. An almost surely unintended irony went unnoticed, at least by the Court. Another hallmark of *Trinko* is that the same entity—in this case a sector-specific regulator—should both set prices when competition does not work, and also apply structural and behavioral remedies to the sector to protect competition where it could work. The EF doctrine does the same, substituting only antitrust enforcers and courts for regulatory agencies as the institutions charged with carrying out both tasks. If the basis for opposing the EF doctrine is that antitrust agencies are poor price regulators—a position with which I agree, for reasons discussed in the final section of this Article—one should also be skeptical of the similar cohabitation of antitrust and regulation envisioned by *Trinko*.

The *Trinko* Court dismissed the EF doctrine on four grounds: (1) the Court has never recognized such a doctrine in the past; (2) unavailability of access (and presumably not just a high price) is essential; (3) the EF doctrine does not apply when "a state or federal agency has effective power to compel sharing and to regulate its scope and terms"; and (4) the EF argument was not distinct, at least in this case, from a "general § 2 argument."[36] Outside the regulated context, this is a sound finding. Without the court getting involved in setting prices, ordering access to an essential facility will not improve economic performance or competition. If the owner of an essential facility can charge the monopoly price for access, merely ordering

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34. *NewsHour: Newsmaker with Joel Klein* (PBS television broadcast June 8, 2000), *available at* http://www.pbs.org/newshour/bb/cyberspace/jan-june00/klein_6-8.html.

35. *See generally* Timothy J. Brennan, *Do Easy Cases Make Bad Law? Antitrust Innovation or Missed Opportunities in* U.S. v. Microsoft, 69 GEO. WASH. L. REV. 1042 (2001) (assessing the economics of the *Microsoft* case, including a critique—on multiple grounds—of the remedy in light of not only this problem, but also a general disconnection between the intended theory of the case and the actual facts presented).

36. Verizon Comm. Inc. v. Trinko, 540 U.S. 398, 410-11 (2004) (quoting PHILLIP E. AREEDA & HERBERT HOVENKAMP, FUNDAMENTALS OF ANTITRUST LAW 150 (3d ed. 2003)).

that access be made available does nothing fundamental about market power. In addition, such an order may forego efficiencies from vertical integration if the owner of the facility restricts access to itself. Only in the presence of regulation, as seen above, where the price is already set below the monopoly level, could using antitrust to ensure access improve market performance. It could do so through a divestiture or other separation that would thwart a regulated firm's incentives to evade price controls and exercise market power by favoring vertically related affiliates through discrimination or cross-subsidization.[37]

The role of regulation is important for the EF doctrine in terms of crafting remedies. It turns out to be crucial, at least hypothetically, in deciding how one would determine if a facility is "essential." For antitrust purposes, the question is whether a firm's ownership of a facility in question, such as a network of telephone lines to customers' premises, gives it market power over a good or service, such as providing telephone service. Defining when a firm has market power is a long-standing conundrum.[38] The primary problem is that a firm with market power will raise prices up to the point where buyers start to view others' products as substitutes, so the presence of substitutes is consistent with market power rather than an indicator of competition.[39] High profits or prices fail because they can also result from unanticipated increases in demand or rents accruing during peak demand periods.[40] The methods used to identify markets in merger cases, based on whether consumers would turn to substitutes if a set of firms were to institute a small but significant, non-transitory increase in price (SSNIP), are appropriate for seeing if a merger would increase prices above current

37. *See* T. Randolph Beard, George Ford & Lawrence Spiwak, *Why ADCo? Why Now? An Economic Exploration into the Future Industry Structure for the "Last Mile" in Local Telecommunications Markets*, 54 FED. COM. L. J. 421 (2002) (suggesting a proposal along these lines that would apply to incumbent telephone companies after the Telecommunications Act).

38. *See* Philip Nelson & Lawrence White, *Market Definition and the Identification of Market Power in Monopolization Cases: A Critique and a Proposal* (Stern Sch. of Bus., New York University Working Paper 03-26, 2003), *available at* http://www.stern.nyu.edu/eco/wkpapers/workingpapers03/03-26White.pdf.

39. The erroneous inference of competition from the presence of substitutes is known as the "Cellophane fallacy," after the Supreme Court made this mistake in its decision in United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377, 394 (1956).

40. *See* Franklin Fisher & John McGowan, *On the Misuse of Accounting Rates of Return to Infer Monopoly Profits*, 73 AMER. ECON. REV. 82 (1983); *see also* Timothy Brennan, *Preventing Monopoly or Discouraging Competition? The Perils of Price-Cost Tests for Market Power in Electricity*, *in* ELECTRIC CHOICES: DEREGULATION AND THE FUTURE OF ELECTRIC POWER 163 (Andrew N. Kleit ed., 2006).

levels, but for the reasons listed here, cannot tell us if an individual firm possesses market power.[41]

In light of these difficulties, one has to go back to first principles. The behavioral distinction between a firm with market power and a firm lacking it is that the former acts as if it can increase price by reducing output, while the latter takes price as a given. This suggests that to ascertain whether a firm has market power, we ask the following question: what would a firm do facing a small but significant, non-transitory *reduction* in price?[42] If a firm has no market power, it would likely *reduce* output; at most, it would keep output constant. Taking prices as a given, it would be producing up to the point where price equals marginal cost. At lower prices, a firm lacking significant market power would thus reduce production, unless it happens to be operating at full capacity, in which case it would still find it profitable to produce to its limit. On the other hand, if a firm has market power, it would hold output down in order to keep prices up. Were it to face a ceiling on the price it could charge below the price it is charging it would *increase* output, as it no longer has anything to gain by holding back supplies.

The good news is that we have a theoretically sound test for whether an individual firm has market power and, specifically, whether its facilities are "essential." Instead of hypothesizing whether a theoretical cartel could impose a SSNIP, as in the Merger Guidelines,[43] one posits what would happen if a hypothetical regulator were to impose a small but significant, non-transitory *reduction* in price. If output goes up, the firm has market power; if output does not go up, it does not have market power. The bad news is that the validity of the test is matched by its impracticality. One is extremely unlikely to have any sort of natural experiment in which a price ceiling was imposed, where one could observe whether or not the firm reduced output. More to the point, rather than identifying essential facilities to see whether regulation is justified, the test looks to see whether regulation is justified (by increasing output) to identify essential facilities—putting the policy cart before the theoretical horse, as it were.

Casting implementation practicality aside, what remains is the common institutional implication of the EF doctrine and the *Trinko* decision that repudiated it—regulation and competition policy should be formulated

41. *See* U.S. DEP'T OF JUSTICE & FTC, HORIZONTAL MERGER GUIDELINES (revised Apr. 8, 1997), *available at* http://www.usdoj.gov/atr/public/guidelines/hmg.pdf; *see also* Lawrence White, *Market Definition in Monopolization Cases: A Paradigm is Missing*, *in* ISSUES IN COMPETITION LAW & POLICY (Wayne D. Collins ed., 2007), *available at* http://ssrn.com/abstract=852844.

42. *See* Brennan, *Skating Toward Deregulation*, *supra* note 3, at 352-53; *see also* Timothy Brennan & Alan Gunderson, *2006 in Competition Policy and Enforcement: An Economic Perspective*, 22 CANADIAN COMPETITION RECORD 67, 81-83 (Summer 2007).

43. *See* U.S. DEP'T OF JUSTICE & FTC, *supra* note 41, §1.11.

by the same institution. The EF doctrine essentially asks antitrust agencies and courts to become price regulators as well. Not only does effective limitation of the market power inherent in an EF require setting the access price, the very determination of an EF requires that one engage in an inquiry to see if regulation would increase the output of the firm that owns it.

Trinko says the same thing, only delegating the role of price setter and competition enforcer to the regulatory agency, rather than to antitrust enforcement. If there is a regulator in place with the authority to oversee competition, the benefits of additional enforcement through antitrust are outweighed by the costs associated by the imposition of duties to deal.[44] At least implicitly, the *Trinko* opinion suggests that the Court would have granted outright regulatory immunity but for the explicit antitrust savings clause in the Telecommunications Act of 1996.[45] *Credit Suisse*, three years later, only reinforced this perspective.[46]

V. SHOULD ANTITRUST AND REGULATION BE COMBINED?

Both *Trinko* and the EF doctrine suggest putting antitrust and regulation together, inviting us to ask whether that is a good idea. The skepticism expressed here regarding both *Trinko* and EF could lead to a negative answer, but that would be premature. While expressing general support for antitrust over regulation, Carlton and Picker observers have supported *Trinko*, although primarily on the grounds that antitrust courts should not be imposing duties to deal.[47]

More generally, one can imagine potential virtues of coordination, particularly when antitrust and regulation are complements. When the incentives to subvert competition are created by regulation, one might "internalize" the enforcement "externalities" by having the same body that imposes regulations bear the burden of enforcing the industry structures necessary to make regulation work. Similarly, an agency assessing how to control market power of a firm under its jurisdiction may want to decide how best to combine price controls, structural requirements, and behavioral injunctions in fashioning effective responses to market power concerns. On

44. *C.f.* Canadian Competition Bureau, *Technical Bulletin on 'Regulated' Conduct*, pt. III (June 2006), *available at* http://www.competitionbureau.gc.ca/epic/site/cb-bc.nsf/en/02141e.html (detailing a similar policy adopted by Canada, in which competition enforcement defers to a parliamentary grant of authority to a sector-specific regulator).

45. Dennis Carlton & Randal Picker, *Antitrust and Regulation*, 30 (Univ. of Chicago Law & Econ., Olin Working Paper No. 312, Oct. 2006), *available at* http://ssrn.com/abstract=937020.

46. See text accompanying notes 29-30 *supra*.

47. See text accompanying notes 33-34 *supra* (disagreeing with my more pessimistic reading of the *Trinko* case, in discussing this paper at the International Industrial Organization Society meetings in 2006).

the antitrust side, one may want to add to the arsenal of legal weaponry against direct price control through market power as well as rules against collusion, excessive concentration through merger, and monopolization.[48]

However, arguments on the other side are compelling, most importantly regarding the clashes between incompatible institutional cultures. The core presumption of a regulator is that competition cannot work in substantial segments of the sectors under its jurisdiction. For that reason, a central planner needs to step in to determine prices, product quality, and other dimensions that the market would fail to provide. On the other hand, antitrust enforcement is motivated by a faith that markets do work. The role of policy is simply to eliminate fundamentally artificial impediments in the form of collusive agreements, concentrated mergers, or exclusionary and predatory practices that create monopolies in markets that would otherwise be competitive.

To combine antitrust and regulation institutionally asks people committed to the idea that markets succeed to design and enforce policies based on their failure, and vice versa. *Trinko* and the EF doctrine both pose the following questions: (1) Do we want antitrust agencies thinking about central planning rather than markets as an option?; and, (2) Do we want regulators responsible for policing competitive performance in unregulated markets?

I doubt it, but the debate surely will go on.

48. *C.f.* SWEDISH COMPETITION AUTHORITY, THE PROS AND CONS OF HIGH PRICES (Arvid Fredenberg, ed. 2007) (recently assessing proposals to grant competition authorities direct control over prices).