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Frederic D. Tennenbaum

Michael P. Hurst

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THE AT&T AGREEMENT: REORGANIZATION OF THE TELECOMMUNICATIONS INDUSTRY & CONFLICTS WITH ILLINOIS LAW

FREDRIC D. TANNENBAUM* & MICHAEL P. HURST**

INTRODUCTION***

On January 8, 1982, the American Telephone and Telegraph Company (AT&T) and the United States Department of Justice (DOJ) signed a stipulation,¹ seeking to dismiss the largest anti-trust case in history.² Under the proposed stipulation, the DOJ's suit against AT&T would be dismissed without prejudice and the provisions of the 1956 consent decree would be substantially

* Assistant Attorney General of Illinois, Public Utility Division; J.D. University of Wisconsin, 1981; B.A., *magna cum laude*, Phi Beta Kappa, economics, Ohio Wesleyan University, 1978.

** Technical Supervisor of Public Utilities Division of the Attorney General of Illinois, M.A., with honors, Roosevelt University 1979.

*** This article represents the individual opinions of the authors and does not necessarily represent the position of the Attorney General of Illinois.

1. FED. R. CIV. P. 41(a)(1)(ii).

2. United States v. AT&T, Western Electric Co., Inc., and Bell Telephone Laboratories, Inc., Civ. No. 74-1698 (D.D.C. filed November 20, 1974).

The DOJ filed suit against AT&T and its Western Electric and Bell Telephone Laboratories, Inc. subsidiaries on November 20, 1974. The complaint charged defendants with unlawfully monopolizing the domestic telecommunications industry in violation of § 2 of the Sherman Act (15 U.S.C. § 2 (1976)) in three ways. First, the DOJ alleged that AT&T entrenched itself as the dominant supplier of telecommunications, telephones and other terminal equipment through its Western Electric subsidiary with leasing fee and tie-in arrangements. Second, the government contended that AT&T foreclosed competition in interexchange services by charging discriminatory access charges to competitors. Finally, the complaint charged that AT&T created unnatural incentives to encourage the 22 Bell Operating Companies (BOCs) to purchase from Western Electric.

The trial began before U.S. District Court Judge Harold Greene in Washington D.C. on January 15, 1981. The court denied defendants' motion to dismiss on September 11, 1981, finding that the government in its case-in-chief had shown that "the Bell System has violated the antitrust laws in a number of ways over a lengthy period of time [T]he burden is on defendants to refute the factual showing made in the government's case-in-chief." United States v. AT&T, 524 F. Supp. 1336, 1381 (D.D.C. 1981).

modified.³ As modified, the agreement substantially restructures the telecommunications industry. Broadly speaking, AT&T is compelled to forfeit its role as the country's principal purveyor of local telephone service. In return, the agreement allows AT&T to retain its stronghold over every other marketable aspect of the industry and to expand into the information market.

Removal of AT&T from the local service market is accomplished via a spin-off⁴ of the Bell Operating Companies (BOCs) to AT&T shareholders.⁵ Presently, the BOCs, which are wholly-

3. In 1949, the Justice Department filed suit against AT&T and its equipment manufacturing subsidiary, Western Electric, alleging that the two companies had conspired to restrain and monopolize trade in violation of the Sherman Act. *United States v. Western Electric Co.*, Civ. No. 17-49 (D.N.J. filed Jan. 14, 1949). Among other requested relief, that suit sought AT&T's divestiture of Western Electric. In 1956, the parties entered into a consent decree which, although not requiring divestiture, prohibited AT&T from engaging in a number of business activities. *United States v. Western Electric Co.*, 1956 Trade Cas. (CCH) ¶ 68,246 (D.N.J. 1956) (consent decree). In particular, section V of the decree, subject to certain exceptions, prohibited AT&T from engaging in *any* business other than providing "common carrier communications services" or services "incidental" thereto. *Id.* Further, Section IV of the decree, with certain exceptions, prohibited AT&T and Western Electric from manufacturing for sale or lease any equipment *not* of a type sold by AT&T and its operating companies for use in furnishing "common carrier communications services." *Id.*

4. Stipulation for Voluntary Dismissal, *AT&T*, Nos. 74-1698, 82-0192, 82-0025(pl), Section I(A)(4). A "spin-off" occurs when, for example, A corporation forms B corporation and places part of its assets in B corporation in return for all of the B corporation's stock. A corporation then distributes the B corporation's stock *pro rata* to A's shareholders so that A's shareholders now own all of the stock of both A and B.

5. The 22 wholly-owned BOCs are:

- Bell Telephone Company of Nevada
- Illinois Bell Telephone Company
- Indiana Bell Telephone Company, Incorporated
- Michigan Bell Telephone Company
- New England Telephone and Telegraph Company
- New Jersey Bell Telephone Company
- New York Telephone Company
- Northwestern Bell Telephone Company
- Pacific Northwest Bell Telephone Company
- South Central Bell Telephone Company
- Southern Bell Telephone Company
- Southwestern Bell Telephone Company
- The Bell Telephone Company of Pennsylvania
- The Chesapeake and Potomac Telephone Company
- The Chesapeake and Potomac Telephone Company of Maryland
- The Chesapeake and Potomac Telephone Company of Virginia
- The Chesapeake and Potomac Telephone Company of West Virginia
- The Diamond State Telephone Company
- The Mountain States Telephone and Telegraph Company
- The Ohio Bell Telephone Company
- The Pacific Telephone and Telegraph Company

owned by AT&T, provide diversified telephone service, including local and long distance service, to the twenty-two regions in which they are located. Once AT&T transfers ownership of the BOC's under the terms of the stipulation, the BOCs would be prohibited from providing "interexchange telecommunications services," (basic intrastate or interstate long distance service), manufacturing or providing "telecommunications products or customer premises equipment," (*e.g.*, telephones, switchboards, switching systems), and from engaging in "any product or service . . . that is not a natural monopoly service . . ."⁶ (*e.g.*, Yellow pages, Phone Center Stores, tone paging services, two-way radio communication). In other words, the newly autonomous BOCs would be restricted in their operations to providing local service only and, although independently owned, would pose no competitive challenge to AT&T in the long-distance and customer premises equipment markets.

In exchange for its forfeiture of the BOC's, AT&T is permitted to retain its Bell Telephone Laboratories, Western Electric Company, and Long Lines Division. Bell Labs is the AT&T subsidiary which conducts the research and development of new products and enhanced services (*e.g.*, computerized telecommunications equipment). Western Electric manufactures and supplies the products developed by Bell Labs. Retention of the extraordinarily sophisticated Bell Labs and Western Electric subsidiaries assures AT&T continued leadership at the forefront of technological innovation and manufacturing capability. Long Lines provides long distance service and will enable AT&T to continue to compete in the interexchange market.

Although AT&T is prospectively divested of its twenty-two BOCs, which comprise two-thirds of its assets, it is amply compensated. AT&T currently uses the profits derived from long distance and enhanced services to subsidize and maintain its BOCs. Once AT&T is divested of its BOCs, it is concomitantly relieved of responsibility for their financial survival. Moreover, AT&T would be operating outside of the highly regulated structure in which the BOCs and the independent telephone companies interact. In essence, the proposed agreement frees AT&T to better exploit lucrative and expanding markets in products and services while only giving up the closely regulated profits now generated by the BOCs. Presumably whatever AT&T loses at the local level will be converted into a gain in other markets.

The independent telephone companies (ITCs)⁷ which were not represented in the lawsuit or negotiations culminating in the

Wisconsin Telephone Company.

6. Stipulation for Voluntary Dismissal, *AT&T*, Section II(D).

7. There are 49 independent telephone companies in Illinois.

settlement, are affected as much if not more than the BOC's. The BOCs interact with the ITCs under a highly regulated scheme guaranteeing the independents access to the interexchange network at reasonable rates and with reasonable returns. The stiffer rates implicit in implementation of the agreement potentially isolate some rural independent telephone companies from the long distance network and impede the independents' ability to support their existing investment in local exchange equipment. Specifically, isolation results from the dissolution of the division of revenues (DR) process for toll settlements and separations,⁸ and the requirement that the BOCs cannot provide intrastate, interexchange connections.⁹

As will be explained, the BOCs, under the DR system, share their AT&T subsidy with the independents. Divestiture of the AT&T monopoly and dissolution of the DR process removes what traditionally has been an important source of revenue to the independents.

An additional, albeit equally serious, concern involves the market entrenchment which the decree assures AT&T. The BOCs, moreover, may confront a competitive disadvantage *vis-a-vis* AT&T and the surviving independent companies. This spectre arises because the agreement permits AT&T to engage in any profit-making enterprise it wishes, including competition with the BOCs.¹⁰ The BOCs, on the other hand, are constrained solely to providing "natural monopoly service."¹¹ This constraint is severely and unnecessarily restrictive.

Finally, intertwined with the aforementioned problems, are inherent conflicts between the agreement and well-settled Illinois law and public policy. The agreement, in many respects, reverses consistent national and state policies, and ignores the power of the Illinois Commerce Commission to effectuate these policies. Preeminent among them is the objective, codified in both the Communications Act of 1934¹² and the Illinois Public Utilities Act,¹³ that phone service be universally available. The remainder of this article explores these problems in greater de-

8. Stipulation for Voluntary Dismissal, *AT&T*, App. B, ¶ B(1). See, 47 C.F.R. Part 67 (1980).

9. Stipulation for Voluntary Dismissal, *AT&T*, Section II(D)(I).

10. AT&T can compete with the BOCs in specialized intraexchange services utilizing coaxial cables, cellular radio, and microwave and satellite transmissions. AT&T will also be supplied with BOCs' customer premises equipment, phone center stores, yellow pages, tone paging services, and inside wiring.

11. Stipulation for Voluntary Dismissal, *AT&T*, section II(D)(3).

12. 47 U.S.C. §§ 151 *et. seq.* (1975).

13. ILL. REV. STAT. ch. 111-2/3 §§ 1 *et. seq.* (1981).

tail, explains their ramifications on the Illinois ratepayers, and recommends possible approaches or solutions.

THE PROPOSED CONSENT DECREE ADVERSELY AFFECTS AND
POTENTIALLY HARMS INDEPENDENT TELEPHONE
COMPANIES AND RURAL COMMUNITIES IN
ILLINOIS

Present Industry Structure in Illinois

The Illinois Commerce Commission (ICC or Commission) regulates fifty telephone utilities in the State of Illinois, forty-nine of which are independent telephone companies.¹⁴ The ITCs provide local service throughout the state in areas not encompassed by the local BOC, Illinois Bell Telephone (IBT). Their service territories are, therefore, relegated to the vast majority of small rural communities.

The ITCs' relationship with IBT is one of dependence. To place a call from one ITC service territory or exchange to another, IBT currently provides most interexchange services. Intrastate interexchange rates (what one utility charges another to interconnect with its exchange) are within the jurisdiction of the ICC.¹⁵ The Commission sets these tariffs as "joint rates,"¹⁶ which are common to all telephone utilities in Illinois.¹⁷ Under the requirements of these joint rates, all telephone companies, big and small alike, are required to interconnect to provide necessary service.¹⁸ To facilitate their interexchange connection, ITCs contract with IBT. Under these contracts, each party collects its share of the revenue generated from interexchange calls placed from its service territory. The revenues received are then divided among the companies. The process of dividing revenues between IBT and the ITCs is commonly referred to as the division of revenues (DR, settlements, or cost) system. Two approaches may be used.

The first approach employed to divide revenues among the companies, utilized by most of the larger ITCs, is a "cost" method. Part 67 of the FCC Regulations specifically delineates

14. These companies have no affiliation with Illinois Bell or AT&T. They range in total capitalization from \$240,381 (Chandlerville Telephone Company) to \$58,143,482 (Illinois Consolidated Telephone Company). *Operating Statistics of Telephone Companies in Illinois*, Accounts and Finance Department, Illinois Commerce Commission (May 1981).

15. ILL. REV. STAT. ch. 111-2/3 § 40 (1981).

16. I.B.T. Ill.C.C. No. 5 Part 2 section 7, Part 4, Part 6, Part 9, Part 1 sections 4-6, 8-10, Part 3 sections 2, 13, 15, 16.

17. ILL. REV. STAT. ch. 111-2/3 § 42 (1981).

18. *Id.* at § 44.

the methods and procedures for assigning "cost."¹⁹ Assigning cost between the two contracting companies equitably divides revenue between them.

Those ITCs not employing the cost approach use the "average schedule" method. An average schedule contract provides for a schedule of costs per call to determine the proper allocation of toll revenues between contracting companies. The average schedule method approximates cost based on industry trends and experience. Schedules are periodically reviewed and renegotiated by IBT and the ITCs. The average schedule method is preferred, and most frequently used, by small rural ITCs because it circumvents the itemization entailed in the cost method and saves an administrative expense.

Under either approach, the local company (*i.e.* IBT or the ITC) collects the revenue. This revenue is then divided among the utilities by both the contracts and the DR process. The dependency of the ITCs on IBT for interexchange access is dramatized by considering that approximately sixty percent of a typical ITC's *total* revenue is derived from the division of revenue process.²⁰

In sum, the ITCs interact with IBT and the ICC, in three important ways. First, the Commission certifies exchanges or service territories for local service. Service territories do not overlap.²¹ Second, to provide interexchange service, telephone companies enter into contracts. The contracts must first obtain the "consent and approval of the Commission."²² The contracts utilize either the cost or average schedule method in the DR process to allocate the revenue collected and costs incurred between the parties. Finally, roughly sixty percent of all the ITC's total revenue is derived from settlements under these contracts. Some of this revenue is used to carry investment in so-called local plant and equipment. This is commonly referred to as the subsidy from toll to local services.

Illinois Law Promotes Limited Monopolies

The proposed consent decree between AT&T and the Department of Justice radically alters both the industry structure

19. 47 C.F.R. Part 67 (1980).

20. The average of Class "A" companies, excluding Illinois Bell Telephone Co. and General Telephone Co. of Illinois, is 57.5%. The average of Class "B" companies is 63.9%. *Operating Statistics of Telephone Companies in Illinois*, Accounts and Finance Department, Illinois Commerce Commission 34, 50 (May 1981).

21. See *infra* notes 23-30 and accompanying text. See also ILL. REV. STAT. ch. 111-2/3 § 56 (1981).

22. *Id.* at § 27.

described above and conflicts with current Illinois law. The proposed agreement requires that the BOCs shall not "provide interexchange telecommunications services or information services" ²³ This provision will require IBT to transfer its investment in plant and equipment used to provide interexchange service. By disallowing IBT from providing intrastate interexchange service, and by theoretically inviting any or all toll carriers to compete in this lucrative market, the proposed agreement undermines almost seventy years of consistent state policy. "Limited monopolies" in interexchange service will be replaced with potentially ruinous competition.

Illinois courts and regulators have long been guided by the principle that:

The method of regulation of public utilities now in force in Illinois is based on the theory of a regulated monopoly rather than competition The power of the state to regulate a utility carries with it the power to protect such utility against indiscriminate competition, and such power should be exercised to that end. ²⁴

The Illinois Supreme Court has expounded several justifications for adhering to the policy of protecting the limited monopoly of the utility "first in the field." First, granting a limited monopoly to the first in the field provides "the public with efficient service at a reasonable rate, by compelling an established public utility occupying a given field to provide adequate service and at the same time protect it from ruinous competition." ²⁵ Second, "protecting the pioneer in the field is based on a consideration of the time and money expended by the pioneer in developing its business and rendering adequate service to the public . . . and the pioneer utility having taken the 'bitter with the sweet' throughout the years of development of the utility business in the area." ²⁶ Finally, the protection of the first in the field under the limited monopoly theory is not "designed for the benefit of the carrier alone, but for the benefit and convenience of the public in general as well. . . ." ²⁷

23. Stipulation for Voluntary Dismissal, *AT&T*, section II(D)(I).

24. *Egyptian Transportation System, Inc. v. Louisville and N.R. Co.*, 321 Ill. 580, 587-88, 152 N.E. 510, 512-13 (1926). See also *Illinois Highway Transp. Co. v. Commerce Comm'n*, 404 Ill. 610, 90 N.E.2d 86 (1950); *Chicago & West Towns Railways, Inc. v. Illinois Commerce Comm'n*, 383 Ill. 20, 48 N.E.2d 320 (1943).

25. *Bartonville Bus Line v. Eagle Motor Coach Line*, 326 Ill. 200, 201, 157 N.E. 175, 176 (1927) cited in *Chicago & West Towns Railways v. Illinois Commerce Comm'n*, 383 Ill. 20, 27, 48 N.E.2d 320, 323 (1943).

26. *Eagle Bus Lines, Inc. v. Illinois Commerce Comm'n*, 3 Ill.2d 66, 70, 119 N.E.2d 915, 918 (1954).

27. *Gulf Transport Co. v. Illinois Commerce Comm'n*, 402 Ill. 11, 16-17, 83 N.E.2d 336, 340-41 (1949).

The statutory device which empowers the Illinois Commerce Commission to grant a limited monopoly to the first in the field is a "certificate of public convenience and necessity."²⁸ The Commission certifies telephone utilities on an exchange by exchange basis. No exchanges overlap. Once the Commission has awarded a certificate to a utility to serve a particular exchange, the utility's preeminence will generally remain unchallenged. Only in rare instances will the Commission either dislodge the first in the field or certify a rival utility in the same exchange. First, "[t]o authorize an order of the Commerce Commission granting a certificate of convenience and necessity to one carrier though another is in the field, it is necessary that it appear first that the existing utility is not rendering adequate service."²⁹ Then, "the existing utility should be permitted to show that it can furnish the needed service, and the Commission must find that the existing carrier has failed or is unable to provide the additional service."³⁰

In *Illini State Telephone Co. v. Illinois Commerce Commission*,³¹ the Commerce Commission granted a certificate of public convenience and necessity to a telephone company which sought to compete with a phone company which was already first in the field. The circuit court affirmed the Commission order. The Illinois Supreme Court reversed and remanded. The Court reasoned: "Before one utility is permitted to take the business of another already in the field it must be shown that the existing one is rendering unsatisfactory service and is unable or unwilling to provide adequate facilities."³² The Court concluded that Illini State was "in these premises, 'first in the field,' and entitled to the benefits of that doctrine as heretofore announced by this Court."³³ If additional or extended service is required, "and a utility in the field makes known its willingness and ability to furnish the required service, the Commerce Commission is not justified in granting a certificate of convenience and necessity to a competing utility until the utility in the field has had an opportunity to demonstrate its ability to give the required service."³⁴

28. ILL. REV. STAT. ch. 111-2/3 § 40 (1981).

29. *Egyptian Transportation System, Inc. v. Louisville and N.R. Co.*, 321 Ill. at 587, 152 N.E. at 512.

30. *Eagle Bus Lines, Inc. v. Illinois Commerce Comm'n*, 3 Ill.2d at 70, 119 N.E.2d at 918.

31. 39 Ill.2d 239, 234 N.E.2d 769 (1968).

32. *Id.* at 243, 234 N.E.2d at 771.

33. *Id.* at 244, 234 N.E.2d at 771.

34. *Chicago & West Towns Railways v. Illinois Commerce Comm'n*, 383 Ill. at 27, 48 N.E.2d at 323. See *Illini State Telephone Co. v. Illinois Commerce Comm'n*, 39 Ill.2d at 243, 234 N.E.2d at 771.

Interexchange Toll Carriers are Public Utilities under Illinois Law and Subject to Illinois Commerce Commission Regulation

All interexchange carriers, including AT&T, will be operating under Illinois law as public utilities. "If a person or corporation assumes to act as a public utility and exercises the power thereof . . . it will be considered a public utility."³⁵ Even if the business is not presently incorporated or regulated, it may nonetheless "be in fact a public utility."³⁶ Such corporations providing interexchange services will undoubtedly be public utilities and subject to regulation by the Illinois Commerce Commission. Under Illinois law:

"Public utility" means and includes every corporation, company . . . that owns, controls, operates, or manages, within this State, directly or indirectly, for public use, any plant, equipment or property used or to be used for or in connection with, or owns or controls any franchise, license, permit or right to engage in: . . . the transmission of . . . telephone messages between points within this State . . .³⁷

Illinois law has clearly provided numerous policy, financial, and administrative obstacles to competing utility operations within the State.

The Sherman Act Does Not Pre-empt the Illinois Public Utilities Act

The proposed agreement creates considerable conflicts with Illinois law. The conflicts remain because the proposed agreement would not pre-empt the Illinois Public Utilities Act. Only "the constitutional laws enacted by Congress . . .,"³⁸ the constitution or treaties can displace valid state law. A federal court order, which does not purport to interpret federal law, the constitution, or treaties cannot, by itself, pre-empt valid state law.

The only federal statute at issue, although it is not mentioned in the stipulation, is the Sherman Act.³⁹ A state's sovereign power to enact a statutory scheme to regulate public utilities operating within its borders is not preempted by the

35. *Illinois Power & Light Corp. v. Consolidated Coal Co.*, 251 Ill. App. 49, 75 (3d Dist. 1928) *cited in* *Danville Redipage v. Illinois Commerce Comm'n*, 87 Ill. App.3d 787, 410 N.E.2d 328 (4th Dist. 1980).

36. *Eagle Bus Lines, Inc. v. Illinois Commerce Comm'n*, 3 Ill.2d at 71, 119 N.E.2d at 918.

37. ILL. REV. STAT. ch. 111-2/3 § 10.3 (1981).

38. *McCulloch v. Maryland*, 17 U.S. 415, 439 (1819). *See also*, *Hisquierdo v. Hisquierdo*, 439 U.S. 572, 581 (1979), *Davis v. Elmira Sav. Bank*, 161 U.S. 275 (1896).

39. 15 U.S.C. §§ 1 *et. seq.* (1976).

Sherman Act. In *Parker v. Brown*,⁴⁰ the district court struck down a California statute which created a statewide regulatory system for the raisin industry on the ground that such a law violated the Sherman Act. The Supreme Court, on direct appeal, reversed. The Court reasoned:

[The program] derived its authority and its efficacy from the legislative command of the state We find nothing in the language of the Sherman Act or in its history which suggests that its purpose was to restrain a state . . . from activities directed by its legislature⁴¹ [And concluded:] The Sherman Act makes no mention of the state as such, and gives no hint that it was intended to restrain state action⁴²

The Court emphasized repeatedly that state, not private action, was approved, supported, or directed by the state statute.⁴³

In *Exxon Corp. v. Governor of Maryland*,⁴⁴ a Maryland trial court invalidated a state statute regulating the economic activity of oil companies in the state. The state appellate court reversed. The United States Supreme Court affirmed, holding that the state act was not pre-empted by either the Robinson-Patman Act or the Sherman Act because "[t]his Court is generally reluctant to infer pre-emption"⁴⁵

The Court went on to reason that even if the state statute is anticompetitive and "there is a conflict between the statute and the central policy of the Sherman Act—our 'charter of economic liberty' . . . this sort of conflict cannot itself constitute a sufficient reason for invalidating the Maryland statute."⁴⁶ The Court, without citing *Parker v. Brown*, concluded that: "[I]f an adverse effect on competition were, in and of itself, enough to render a state statute invalid, the States' power to engage in economic regulation would be effectively destroyed."⁴⁷

In *New Mexico Vehicle Board of California v. Orrin W. Fox Co.*,⁴⁸ the Supreme Court reversed a district court which invalidated a state statute regulating retail motor vehicle dealerships. The Court, citing *Parker v. Brown*, held: "The dispositive answer is that the Automobile Franchise Act's regulatory scheme is a *system of regulation, clearly articulated and affirmatively expressed*, designed to displace unfettered business freedom

40. 317 U.S. 341 (1943).

41. *Id.* at 350-51.

42. *Id.* at 351.

43. For a more thorough delineation of Justice Stone's opinion in *Parker*, see *Cantor v. Detroit Edison Co.*, 428 U.S. 579 (1976).

44. 437 U.S. 117 (1978).

45. *Id.* at 132.

46. *Id.* at 133.

47. *Id.*

48. 439 U.S. 96 (1978).

. . . ." The regulation is therefore outside the reach of the anti-trust laws under the 'state action' exemption.⁴⁹ The Court further held that the statute did not conflict with the Sherman Act for precisely the reasons it had articulated in *Exxon Corp. v. Governor of Maryland*.⁵⁰

The Court has thus recited two standards of antitrust immunity for state statutes. First, the state statute must "clearly articulate and express" an intent to regulate a particular field.⁵¹ Second, the state must directly supervise the regulatory activity.

In *California Liquor Dealers v. Midcal Aluminum*,⁵² the California Department of Alcoholic Beverage Control enforced a state statute which authorized wine growers, wholesalers, and rectifiers to set and regulate wine prices. The California Court of Appeals granted an injunction against enforcement of the statute, holding that it violated the Sherman Act. The United States Supreme Court, on *certiorari* after the California Supreme Court declined to hear the case on appeal, affirmed. The Supreme Court struck down the state statute reasoning that although the legislative policy is forthrightly stated and clear, it nonetheless "does not meet the second requirement for *Parker* immunity."⁵³ The Court held that the state *itself* must regulate the particular industry. The responsibility cannot be improperly delegated and placed on the shoulder of private parties. With respect to the instant case, the Court observed that:

The State neither establishes prices nor reviews the reasonableness of the price schedules; nor does it regulate the terms of fair trade contracts. The State does not monitor market conditions or engage in any "pointed reexamination" of the program. The national policy in favor of competition cannot be thwarted by casting such a gauzy cloak of state involvement over what is essentially a private price-fixing arrangement.⁵⁴

Because the Illinois Public Utilities Act⁵⁵ satisfies both prongs of the *Parker-Midcal* doctrine, it is not preempted by the Sherman Act. The Illinois statutory scheme clearly reflects a legislative intent to regulate the public utilities field. Additionally, the Illinois Commerce Commission, like the agencies in *Parker* and *New Mexico Vehicle Board* and unlike the agencies

49. *Id.* at 109 (emphasis added). See also *Bates v. State Bar of Arizona*, 433 U.S. 350 (1977). Cf. *Cantor v. Detroit Edison Co.*, 428 U.S. 579, 591 (1976); *Goldfarb v. Virginia State Bar*, 421 U.S. 773, 788-91 (1975).

50. 439 U.S. at 111.

51. See *Parker v. Brown*, 317 U.S. 341; see also *New Mexico Vehicle Bd. of Cal. v. Orrin W. Fox, Co.*, 439 U.S. 96, 109 (1978).

52. 445 U.S. 97 (1980).

53. *Id.* at 105.

54. *Id.* at 105-06.

55. ILL. REV. STAT. ch. 111-2/3, §§ 1 *et seq.* (1981).

in *Cantor and Midcal*, directly supervises the regulation of the industry.

Distinguishing features affirm the social import of the Illinois Public Utilities Act. Under the Act, the Illinois Commerce Commission regulates the activities of public utilities which are also public corporations and which, most importantly, are socially necessary. The regulation of raisins, automobiles, and wine, although important, is not as indispensable to the public as is the regulation of electricity, gas, water, and telephones. Moreover, every state in our nation has enacted a statutory framework for regulating public utilities. Chaos and uncertainty would prevail if a consent decree entered in one federal court could pre-empt fifty states' and one district's laws.

*The Proposed Order, As Written, Would Be An
Unconstitutional Invasion of the State's Tenth
Amendment Powers*

The Tenth Amendment also protects the integrity of Illinois' statutory scheme. The threshold question is, as it was in determining pre-emption, to determine whether there is a "congressionally imposed displacement."⁵⁶ If the order were entered in its present overbroad form, no present federal legislation would be interpreted. As such, the states' "reserved" power is secure.

Assuming *arguendo* that the order, if entered, would have the power of federal law, the order would then be an unconstitutional invasion of powers reserved to the states under the Tenth Amendment. The Supreme Court has held that a congressional enactment violates the Tenth Amendment if three requirements are met:

First, there must be a showing that the challenged statute regulates the "States as States." Second, the federal regulation must address matters that are indisputably "attributes of state sovereignty." And third, it must be apparent that the States' compliance with the federal law would directly impair their ability to "structure integral operations in areas of traditional facilities."⁵⁷

All three requirements are met in this case.

First, the proposed settlement would in effect regulate the "States as States." In Illinois, although the order would still allow the Illinois Commerce Commission to regulate intrastate public utilities, it would have the effect of ordering the Illinois

56. *National League of Cities v. Usery*, 426 U.S. 833, 842 (1976). *See also*, *FERC v. Mississippi*, 50 U.S.L.W. 4566, 4570 (1982); *Transporation Union v. Long Island R. Co.*, 50 U.S.L.W. 4316 (1982); *Fry v. United States*, 421 U.S. 542 (1975); *Testa v. Katt*, 330 U.S. 386 (1947).

57. *Hodel v. Virginia Surface Mining & Reclamation Ass'n.*, 452 U.S. 264, 287-88 (1981), *citing* *National League of Cities v. Usery*, 426 U.S. at 852, 854.

Commerce Commission to constrain the nature and scope of its regulation. The Commission, for example, would be compelled to cease use of the division of revenue process, value transfers of certain assets, and re-issue certificates of convenience and necessity for interexchange service. The directives imposed on the Commission would be commands, not merely "condition[s] that they *consider* the suggested federal standards."⁵⁸ The Commission, a state agency, would have no choice but to adhere to federal guidelines in executing its state function.

Second, the settlement infringes on matters which are "attributes of state sovereignty." "[T]he authority to make . . . fundamental . . . decisions' is perhaps the quintessential attribute of sovereignty. . . . Indeed, having the power to make decisions . . . is what gives the State its sovereign nature."⁵⁹ The settlement order could wrest the direction of public policy from effective control of the Commission and transfer it to the drafters of the agreement. The Commission would no longer have the authority to determine appropriate areas of cross-subsidization. The decree would potentially preclude Commission control over the relationships between urban and rural Illinois customers, toll and local services, and customer premises equipment and local rates. By so doing, the decree "impose[s] conditions on state activities in fields that are not pre-emptible, or that are solely of intrastate concern."⁶⁰

Finally, the agreement substantially impairs "integral operations in areas of traditional governmental functions." Public utility regulation has historically been "defer[red] to state prerogatives—and expertise. . . ."⁶¹ That the regulation of public utilities is an integral state function which cannot be federally usurped is consistent with holdings in *United Transportation Union v. Long Island Railroad Co.*,⁶² and *United States v. California*.⁶³ In both cases, state operation of interstate railroads was held not to be an integral role of state government. Regulation of intrastate rates and the operations of public utilities operating solely within the state, however, are traditional and inherent functions of the states and their commissions. This agreement would alter dramatically the nature and scope of utility regulation in Illinois.

58. *FERC v. Mississippi*, 50 U.S.L.W. at 4572 (emphasis in original).

59. *Id.* at 4571, citing *National League of Cities v. Usery*, 426 U.S. at 851, and *Bates v. State Bar of Arizona*, 433 U.S. 350, 360 (1977).

60. *FERC v. Mississippi*, 50 U.S.L.W. at 4573 n.32.

61. *Id.* at 4572 n.29. See also, *id.* at 4576 n.7 (O'Connor, J., dissenting).

62. 50 U.S.L.W. 4315 (1982).

63. 297 U.S. 175 (1936).

*Ramifications of Reorganized Structure of
Interexchange Services*

Two major problems arise within Illinois once IBT (the Illinois BOC) is forbidden under the proposed settlement from providing intrastate interexchange service. First, toll carriers seeking certificates of public convenience and necessity to provide interexchange service may choose not to be certified in certain high cost rural areas. Several toll carriers may seek certification in the same high-density urban exchange. Second, the financial integrity of the ITCs could be jeopardized.

Toll Service to Certain Exchanges may be Discontinued

The cost required to interconnect to a sparsely populated rural exchange may exceed the revenues an interexchange carrier may recover. No rational carrier will provide service if its costs exceed revenues. The carrier will thus not seek to serve such exchanges, leaving many rural communities isolated. If the rural ITCs lowered the charges for interconnecting with their exchanges, to attract interexchange carriers, the concomitant increase in local rates might be excessive. The Illinois Commerce Commission is empowered to solve this dilemma in three ways. All the alternative solutions, however, conflict significantly with the letter and spirit of the proposed settlement agreement. First, the Commission may grant a certificate to an interexchange carrier for the *entire* state. The Commission can thereby require the carrier to connect to all exchanges, rural and urban, high and low cost, which seek access. Undoubtedly, under the first in the field doctrine, discussed earlier, AT&T will receive the sole certificate. Possession of the only interexchange certificate will serve to entrench AT&T's monopoly position, and decrease competition. These two results diametrically counter the objective of the proposed decree.

Second, the Commission may continue to enforce existing contracts between IBT and the ITCs. The present contracts for intrastate interexchange service between IBT and the major ITC "remain in effect until terminated by thirty days written notice by either party." The contracts contain no successor clause to maintain IBT's commitment upon completion of the spin-off. If IBT terminates its contracts with companies providing service to rural communities, no guarantee exists that these communities will continue to receive service. The spectre of disconnected and discontinued service to rural exchanges looms large. To forestall a return to the pre-1930's isolation in the rural areas, the Commission is empowered to assure continued service to all areas within Illinois. The Illinois Public Utility Act provides:

"[N]o public utility shall abandon or discontinue any service without first having secured the approval of the commission"⁶⁴ Thus the Commission may refuse to release IBT from its contractual obligations, and compel it to adhere to the contracted terms. By enforcing the contracts, the ICC can order IBT to provide interexchange service. Such enforcement, concomitantly, will compel IBT to violate the proposed settlement agreement.

Finally, the Commission may select and compel, at its own discretion, any telephone utility in Illinois to provide service to any or all rural exchanges. The Commission may: "[After] determin[ing] that public convenience and necessity requires a physical connection for the establishment of a continuous line of communications between any two or more public utilities for the conveyance of messages or conversations . . . order that such connections be made."⁶⁵

The Proposed Agreement Jeopardizes the Financial Integrity of the ITCs

The proposed agreement jeopardizes the ITC's investment in telephone plant and equipment by replacing the division of revenues (DR) process with access tariffs.⁶⁶ The DR process was negotiated and designed to serve the entire regulated telecommunications industry. The ITCs may, technically, still employ that method. As a practical matter, however, removing the BOCs from the interexchange market assures the DR process' demise.

The elimination of the DR process will financially constrain the ITCs by reducing revenue from toll service. The DR process had generated revenue for the ITCs by recognizing a portion of customer premises equipment outside plant investment as a cost for interexchange service.⁶⁷ This procedure thereby reflected local investment costs in interexchange rates. The proposed settlement disallows this cost allocating method. The proposed exchange access charge shall not "require an interexchange carrier to pay for types of exchange access that it does not utilize."⁶⁸ Effectively, this provision eliminates the present subsidy from interexchange to the local loops. By removing this

64. ILL. REV. STAT. ch. 111-2/3 § 49a (1981). *See also* Institute of Shortening & Edible Oils v. Illinois Commerce Comm'n, 45 Ill. App. 3d 98, 359 N.E.2d 231 (1977).

65. ILL. REV. STAT. ch. 111-2/3 § 47 (1981) (emphasis added).

66. Stipulation for Voluntary Dismissal, *AT&T*, App. B, section B(1).

67. 47 C.F.R. Part 67 (1980).

68. Stipulation for Voluntary Dismissal, *AT&T*, App. B, section B(2).

benefit, ITCs may have no alternative but to raise their respective local rates to such a prohibitive level as to curtail the number of customers seeking access. The number of customers conceivably could diminish so much as to bankrupt the utility.

The proposed consent agreement threatens to isolate some rural ITCs from the interexchange network. The ITCs which do interconnect with the interexchange network may discover that the revenue generated from interexchange calls will not include a factor for recoupment of local exchange investment. Local rates would rise accordingly and might be so dramatic as to curtail local access significantly.

THE PROPOSED AGREEMENT UNNECESSARILY RESTRICTS THE
BOCS' OPERATIONS AND HARMS ILLINOIS RATEPAYERS.

The proposed consent decree relegates the BOCs to providing only local service; the BOCs may no longer provide interexchange service or sell terminal equipment. These restrictions would severely impede the BOCs' operating efficiency and raise legitimate concerns of regulators. The relevant section of the decree reads:

After completion of the reorganization specified in Section I, no BOC shall, directly or through any affiliated enterprise:

1. provide interexchange telecommunications services or information services;
2. manufacture or provide telecommunications products or customer premises equipment (except for provision of customer premises equipment for emergency service); or
3. provide any other product or service, except exchange telecommunications and exchange access service, that is not a monopoly service actually regulated by tariff.⁶⁹

Developments in the Telecommunications Industry Prior to the Proposed Agreement

To understand how radical a departure from current industry trends is the restriction of the BOCs' operations solely to local loop service, a historical perspective of industry development is helpful. Through the late 1960's, the common carrier segment of the telecommunications industry was an enormous but dormant market. The use of the telephone was the industry's central focus. AT&T, through Western Electric, manufactured the overwhelming majority of telephones, switchboards, and related equipment. The BOCs then leased the equipment to residential and business customers. The BOCs also provided the facilities for placing local phone calls and for

69. *Id.* at section II(D).

billing interexchange calls offered by the AT&T Long Lines Department.

State or federal governments regulated almost every facet of the industry—from the range and quality of equipment and services to their prices. State public utility commissions regulated local BOC services and customer equipment. The Federal Communications Commission (FCC) regulated AT&T's long distance services and interstate customer equipment.

In the last decade, rapid technological breakthroughs and a spreading commitment to deregulation of the economy transformed the industry into a far more complex, fluid environment. The FCC and courts began to open a number of markets to competition. The *Carterfone*⁷⁰ decision allowed competition in the terminal equipment market. Long distance telephone service markets were opened to new suppliers.⁷¹ This has encouraged alternative interexchange services such as MCI and Southern Pacific. AT&T, nevertheless, still accounts for 95.3% of total Wide Area Telecommunications Services (WATS) revenues,

70. *Carterfone*, 13 F.C.C.2d 420 (1968), *reconsideration denied*, 14 F.C.C.2d 571 (1968) (a tariff's blanket prohibition of interconnection of customer premises equipment was unlawful); First Report and Order in Docket No. 19528, 56 F.C.C.2d 592 (1975), *on reconsideration*, 57 F.C.C.2d 1216 (1976), 58 F.C.C.2d 716 (1976) and 59 F.C.C.2d 83 (1976); Second Report and Order in Docket No. 19528, 58 F.C.C.2d 736 (1976), *aff'd sub nom.* North Carolina Utilities Comm'n v. FCC, 552 F.2d 1036 (4th Cir.), *cert. denied*, 434 U.S. 874 (1977) (laying the foundation for the FCC's registration program to permit direct connection of customer-provided terminal equipment to the nationwide telephone network); Final Decision in Docket No. 20828 (Second Computer Inquiry), 45 Fed. Reg. 31319 (FCC 1980) (requiring, *inter alia*, detariffing of carrier-provided customer premises equipment by March 1, 1982); *modified in part on reconsideration*, 46 Fed. Reg. 59976 (FCC 1981) (extending the date for detariffing of "new" carrier-provided customer premises equipment from March 1, 1982, to Jan. 1, 1983). Such competitors include Digital Equipment Corp. and Rolhm Corp. Note that terminal equipment is the instrument at customer premises through which messages are transmitted, *viz.*, a telephone.

71. See *Microwave Communications, Inc.*, 18 F.C.C.2d 935 (1969), *reconsideration denied*, 21 F.C.C.2d 190 (1970). See also *MCI Telecommunications Corp. v. FCC*, 561 F.2d 365 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1040 (1978); *MCI Telecommunications Corp. v. FCC*, 580 F.2d 590 (D.C. Cir.), *cert. denied*, 439 U.S. 980 (1978) (*Execunet* decisions authorizing new suppliers to begin competing with AT&T in the offering of long distance services); *MTS/WATS Market Structure Inquiry*, Dkt. No. 78-72, 45 Fed. Reg. 55777 (FCC 1980) (further opening up long distance service markets to competition); First Report and Order, Dkt. No. 79-252, 45 Fed. Reg. 76148 (FCC 1980) (reducing common carrier regulation of nondominant telecommunications carriers); *Resale and Shared Use of MTS and WATS*, Dkt. No. 80-54, 45 Fed. Reg. 83580 (FCC 1980) (authorizing firms to share AT&T's WATS service or to resell it for a profit).

88% of total message toll service revenues, and 87.6% of total private line service revenues.⁷²

Perhaps the most significant change in the telecommunications industry in the last decade was the increasing demand for "enhanced services." Enhanced services are communication services that involve not just the basic transmission of data, but also its computer processing or other modifications. Certain enhanced services permit businesses to hook up their computers to "talk" to each other electronically.

The 1956 consent decree, however, prohibited AT&T from engaging in any business other than "common carrier communications services" or services "incidental" thereto.⁷³ AT&T thus sought relief from the courts, the FCC, and Congress to permit it to enter non-common carrier fields. In 1980, the FCC, in its *Computer II*⁷⁴ decision, held that AT&T could offer unregulated enhanced services if it did so through a "fully separated subsidiary," *viz*, "American Bell." A New Jersey federal court in September 1981 ruled that the 1956 decree permitted AT&T to establish an unregulated subsidiary as required by *Computer II*.⁷⁵

Besides seeking court and commission relief from the constraints of past decrees, AT&T has been seeking a Congressional deregulation bill to affirm its right unequivocally to provide enhanced services. The Senate passed a bill in October 1981 which, *inter alia*, authorized AT&T to sell enhanced services through American Bell.⁷⁶ The House Telecommunications Subcommittee passed the Telecommunications Act of 1981⁷⁷ which is more restrictive on AT&T's operations than the Senate bill.

The courts and the FCC have thus increasingly encouraged competition in the terminal equipment and long distance markets over the last fifteen years. The consent decree, however, removes the BOCs, AT&T's most formidable present potential competitor, from competing with AT&T in any products or services market.

72. See S. Rep. No. 97-170, *Telecommunications Competition and Deregulation Act of 1981*, 97th Cong., 1st Sess., App. I (1981).

73. See *supra* note 3.

74. Final Decision in Docket No. 20820 (Second Computer Inquiry), 75 Fed. Reg. 31319 (FCC 1980), *modified on reconsideration*, 46 Fed. Reg. 5984 (FCC 1981), *effective date extended*, 46 Fed. Reg. 59976 (FCC 1981). This case is on appeal. *Computer & Communications Industry Association v. FCC*, Civ. Nos. 80-1471 *et al.*, (D.C. Cir. lead case filed May 5, 1980).

75. *United States v. Western Electric*, 1981-2 Trade Cas. (CCH) ¶ 64, 275 (D.C. N.J. filed Sept. 3, 1981), *on appeal*, *United States v. Western Electric*, Civ. No. 81-2837 (3rd Cir. filed Nov. 6, 1981).

76. S. Rep. No. 97-170, *Telecommunications Competition and Deregulation Act of 1981*, 97th Cong., 1st Sess., App. I (1981).

77. H.R. 5158, 97th Cong., 1st Sess. (1981).

The Proposed Agreement Restricts the BOCs from Directly Competing with AT&T in Interexchange Services

The consent decree prevents the BOCs from competing with AT&T in interexchange (toll) service. This restriction effectively eliminates from competition AT&T's most threatening challenger. As mentioned, potential interexchange competitors are not likely to enter the rural market. Urban regions, on the other hand, will receive a virtual plethora of vendors vying for the relatively high-volume low-cost routes between urban centers. In Illinois, IBT would have been the strongest company, in terms of finances, administration, and skill to mount a formidable challenge to AT&T in this market. The proposed agreement renders IBT the *only* telecommunications firm unable to compete with AT&T.

The effect of removing IBT from direct competition with AT&T in the interexchange market will be an increase in local phone rates. Current regulatory practice in Illinois computes revenues earned from toll calls placed by ratepayers into IBT's operating income and the earned return on rate base.⁷⁸ The inclusion of toll revenue thus increases the overall earned return. Accordingly, the loss of revenue from interexchange service reduces the overall earned return. Local service expense will be less subsidized, if at all. To compensate the utility for this loss of revenue, and to maintain a stable rate of return, an increase in local rates will be essential. IBT has consistently argued in various rate proceedings before the ICC⁷⁹ that state toll rates recover their associated costs and provide a substantial contribution to local service. This substantial contribution is commonly referred to as the subsidy from toll to local service. AT&T apparently concurs in its subsidiary's position. The parent is now seeking to capture for itself most of this subsidy.

The Proposed Agreement Restricts the BOCs from Directly Competing with AT&T in Customer Premises Equipment

A second restriction eliminates BOC competition with AT&T in the provision of "telecommunications products or customer premises equipment."⁸⁰ The BOCs thus may not compete with AT&T in markets for, *inter alia*, telephones, switching systems, inside wiring, terminal equipment, and Phone Center

78. See, e.g., Illinois Bell Tel., Ill. C.C. Dkt. 81-0478 (May 25, 1982). The rate comprises those corporate assets which are purchased and maintained with money received from ratepayers.

79. See, e.g., Illinois Bell Tel., Ill. C.C. Dkt. 81-0478 (May 25, 1982).

80. Stipulation for Voluntary Dismissal, *AT&T*, Part II (D)(2).

Stores. This restriction, much like the restriction on inter-exchange competition, hinders the ability of the BOCs to earn their revenue requirement. The revenue generated from sales of customer premises equipment (CPE) covers costs and provides a subsidy to local service. This particular restriction raises an additional and important concern. IBT's capitalized investment in station connections⁸¹ will probably become dead-weight investment.

Recent changes in accounting procedures now permit telephone utilities to expense the installation costs of station connections, instead of capitalizing them. The undepreciated value of previously capitalized station connections will amortize over ten years. While the proposed consent decree clearly transfers CPE from the BOCs to AT&T, it does not clearly specify the fate of the investment in station connections. The Illinois ratepayer may be disadvantaged by the vagueness of the proposed decree if AT&T receives the investment in CPE while the BOCs retain already capitalized station connection costs. If the station connections are not transferred to AT&T, the BOCs will incur maintenance and net depreciation expenses which cannot be offset by a corresponding revenue.⁸² Even if the station connections account is transferred to AT&T, the BOCs will, nonetheless, be disadvantaged by being the *only* telecommunications firm restricted from competing in the CPE market.

The Proposed Agreement Permits the BOCs to Provide Only Natural Monopoly Service

The final restriction forbids the BOCs from providing any service that is "not a natural monopoly service."⁸³ The proposed agreement fails to define "natural monopoly service," a term lawyers and economists have perennially debated. Although the proposed agreement supplies no definition, certain assumptions are safe to make. The category of natural monopoly service presumably does not include yellow pages, tone paging services, and two-way radio communications. Depriving the BOCs of the revenues derived from these services would severely cripple their ability to maintain constant rates. Yellow pages alone, according to figures supplied by IBT, contribute as

81. Account 232, 47 C.F.R. Part 31.232 (1980). Station connections are, simply, the wiring from the customer's phone to the telephone pole.

82. The BOCs would recover their expenses by charging their customers for maintaining inside wiring. Electric companies have been reluctant to adopt such an approach.

83. Stipulation for Voluntary Dismissal, *AT&T*, Part II (D)(3).

much as sixty-eight million dollars over cost per year.⁸⁴ Prohibiting the BOCs from providing non-monopoly services renders these independent entities the *only* telecommunications firms not allowed to compete in the yellow pages, tone paging services, and two-way radio communications markets.

Natural monopoly service has been defined as "where [a] monopoly is inevitable because it is the cheapest way of organizing an industry, . . . [or where] average costs are declining at the point where demand intersects marginal costs."⁸⁵ This definition requires the measurement of both the firm's demand and marginal costs functions. No standard, generally accepted, method currently exists, however, for measuring marginal cost function of a telephone utility. Thus, to allow the BOCs to provide only natural monopoly services is unreasonable because of the difficulty in determining which services are natural monopolies.

Paradoxically, AT&T may be competing with the BOCs in the local service market, ostensibly a natural monopoly service. Two-way radio communications may eventually develop as a substitute for local exchange service. Armed with this technology as well as coaxial cables, cellular circuits, microwave discs, and satellites, AT&T is capable of actually challenging the BOCs in select local exchange services. These select exchange services would utilize the very customer premises equipment that the BOCs are compelled to transfer to AT&T.⁸⁶ The CPE would enable AT&T to bypass the BOCs' local exchange switches for intracorporate calling. Since AT&T has the capability of competing with the BOCs for local exchange services, such service may not literally be termed "natural monopoly service." By competing with AT&T in local exchange service, the BOCs would violate the proposed decree.

84. The DOJ maintains that the BOCs can recover their profits from yellow pages, with licensing and bidding arrangements. Its "Competitive Impact" Statement asserts:

Each BOC, however, retains the rights inherent in its file of telephone subscribers including machine-readable listings and copyright interests in the printed alphabetic directory. Hence, by granting use-specific licenses for the listings, including use for the purpose of compiling and publishing Yellow Pages, each divested BOC effectively will have the ability to sell the Yellow Pages "franchise" to the highest bidder through whatever mechanism or pricing scheme the divested BOC or appropriate regulatory commission deems appropriate.

Competitive Impact Statement, filed for United States v. AT&T, No 82-0025 (PI) at 28-30 n.24 (filed in D.D.C. March 1982). This solution is not tenable, since customers of the yellow pages services give their numbers directly to the provider of the service; no need for the BOC's middleman services remains.

85. R. POSNER, *ECONOMIC ANALYSIS OF LAW* 251 (2d ed. 1977).

86. Preeminent are the private branch exchanges (PBX).

In conclusion, the proposed agreement restricts the BOCs to providing service only in local exchanges. It prevents the BOCs from entering any market except local exchange service. It unleashes every conceivable telecommunications firm to compete fully with AT&T—except the BOCs. The BOCs, in reality, are the most efficient potential challenger to prevent an AT&T market stranglehold. In addition, the proposed decree eliminates many subsidies which have heretofore served to reduce local rates.

THE PROPOSED AGREEMENT CONFLICTS WITH ILLINOIS ADMINISTRATIVE REVIEW AND PUBLIC POLICY

The third and final concern raised by the proposed settlement agreement is potential conflict with well-settled Illinois law and public policy. Three provisions in the proposed agreement either require Commission review and approval or conflict directly with Illinois public policy. First, the proposed agreement requires IBT to transfer certain assets to AT&T.⁸⁷ Under the Illinois Public Utilities Act, the ICC may review and approve or reject any such transfer.⁸⁸ The Act also requires AT&T, as a public utility,⁸⁹ to seek ICC approval of its rates.⁹⁰ Of additional concern is the proposed agreement's requirement that access tariffs be nondiscriminatory and "cost justified."⁹¹ The proposed agreement does not, however, prescribe the type of cost which will be recognized. Moreover, the present subsidy of rural and local exchanges is a direct result of deliberate discrimination. Non-discrimination thus impairs the state's ability to limit the monopoly⁹² and undermines the long-standing state and national policy promoting "universal service."

Transfer of Facilities

The proposed agreement requires IBT to transfer, within six months of the spin-off, certain assets to AT&T. AT&T will receive from IBT, *inter alia*, customer premises equipment, private branch exchanges (PBXs) and inside wiring.⁹³ The Illinois Public Utilities Act subjects such transfers to the jurisdiction of the ICC. The Act provides:

87. Stipulation for Voluntary Dismissal, *AT&T*, Section I.

88. ILL. REV. STAT. ch. 111-2/3 § 8a (1981).

89. *Id.* at § 10.3.

90. *Id.* at § 41.

91. Stipulation for Voluntary Dismissal, *AT&T*, App. B, ¶ B(2).

92. *See supra* notes 23-27 and accompanying text.

93. Stipulation for Voluntary Dismissal, *AT&T*, Section IA(4).

The Commission shall have jurisdiction over affiliated interests having transactions, . . . with public utilities under the jurisdiction of the Commission, to the extent of access to all accounts and records of such affiliated interests relating to such transactions, including access to accounts and records of joint or general expenses⁹⁴

The United States Supreme Court upheld the constitutionality of these provisions in *Natural Gas Pipeline Co. of America v. Slattery*.⁹⁵

An "affiliated interest" includes "[e]very corporation and person owning or holding, directly or indirectly, 10% or more of the voting capital stock of such public utility."⁹⁶ AT&T, as 100% owner of the voting capital stock of IBT, is the local company's "affiliated interest." As IBT's affiliated interest, AT&T is subject to ICC jurisdiction. The ICC, consequently, must approve any asset transfer which the proposed agreement requires. The eighteen-month period for completion of the transfers⁹⁷ may be unfeasible, given the realities of the state administrative and appellate processes.

The Commission is ultimately empowered to disapprove any of the terms of any proposed transfer mandated by the agreement. The Illinois Public Utilities Act provides:

No management, construction, engineering supply, financial or similar contract and no contract or arrangement for the purchase, sale, lease or exchange of any property or for the furnishing of any service, property or thing, hereafter made with any affiliated interest, as hereinbefore defined, shall be effective unless it has first been filed with and consented to by the Commission. The Commission may condition such approval in such manner as it may deem necessary to safeguard the public interest. *If it be found by the Commission, after investigation and a hearing, that any such contract is not in the public interest, the Commission may disapprove such contract.* Every contract or arrangement not consented to or excepted by the Commission as provided for in this Section is void.⁹⁸

Jurisdiction over Tariffs

The proposed agreement requires that all the BOCs "begin to offer to all interexchange carriers exchange access on an unbundled, tariffed basis"⁹⁹ The proposed agreement further requires that "[t]he BOCs are ordered and directed to file, to become effective on the effective date of the reorganization . . .

94. ILL. REV. STAT. ch. 111-2/3 § 8a(c) (1981).

95. 320 U.S. 300 (1937).

96. ILL. REV. STAT. ch. 111-2/3 § 8a(2)(a) (1981).

97. Stipulation for Voluntary Dismissal, *AT&T*, section I(A).

98. ILL. REV. STAT. ch. 111-2/3 § 8a(3) (1981) (emphasis added).

99. Stipulation for Voluntary Dismissal, *AT&T*, App. B, ¶ (A)(1).

tariffs for the provision of exchange access"¹⁰⁰ The proposed agreement, however, fails to define which Commission, the FCC or ICC, has jurisdiction over the tariffs. It also neglects to account for the provision which requires thirty days notice to the Commission before filing new tariffs.¹⁰¹

The Illinois Public Utilities Act clearly affords the ICC jurisdiction over the tariffs the proposed agreement requires. Pertinent provisions state:

When any change [in tariffs] is proposed . . . such proposed change shall be plainly indicated on the new schedule filed with the Commission . . . [T]he Commission shall have power, and it is hereby given authority . . . to enter upon a hearing concerning the propriety of such rate or other charge . . . On such hearing, the Commission shall establish the rate or other charges, classifications, contracts, practices, rules of regulations proposed, in whole or in part, or others in lieu thereof, which it shall find just and reasonable.¹⁰²

Conflict arises from the proposed agreement's restrictions on the structure and content of the tariffs. The proposed agreement depicts tariffs which are "unbundled . . . specifying each type of service, element by element, and no tariff shall require an interexchange carrier to pay for types of exchange access that it does not utilize."¹⁰³ Nothing in the Illinois Public Utilities Act, however, requires the Commission to enforce tariffs with such restrictions.

Corporate Form

The Illinois Commerce Commission may assert jurisdiction over all intrastate interexchange carriers as public utilities.¹⁰⁴ If the BOCs spin-off into one national corporation, or even a few regional corporations,¹⁰⁵ separate Illinois subsidiaries, akin to IBT, would have to be established. Certainly the ICC could not retain total jurisdiction over all subsidiaries. Preeminent among potential problems is misallocation of costs and revenues between states by a multi-state corporation creating a subsidy from one state to another.

100. *Id.* at ¶ (B)(1).

101. ILL. REV. STAT. ch. 111-2/3 § 36 (1981).

102. *Id.*

103. Stipulation for Voluntary Dismissal, *AT&T*, App. B, ¶ (B)(2).

104. *See supra* note 37.

105. The proposed agreement permits any number of permutations of BOCs. Stipulation for Voluntary Dismissal, *AT&T*, Section I(H)(4).

The Proposed Agreement Potentially Deprives the ICC of Its Power to Determine Costs and Reasonably Discriminate on Rates

The proposed agreement requires that "charges for each type of exchange access shall be cost justified."¹⁰⁶ "Cost" justification is required implicitly by disallowing BOCs to discriminate between customers "in the charges for each element of service"¹⁰⁷ Two problems arise. First, the proposed agreement fails to define "cost." Accountants and economists employ several major types of cost criteria, *e.g.*, marginal costs, embedded direct costs, fully distributed costs.¹⁰⁸ Each cost criterion produces different service and customer class cost relationships. Vastly different results may occur, depending on which cost criterion is adopted. The appropriate forum to determine the cost criterion is also not specified. The FCC, ICC, and federal courts could adopt widely differing approaches. The agreement, moreover, neglects to specify the requisite burden of proving which cost criterion is appropriate.

Second, the proposed agreement's restriction on "discrimination" by the BOCs in charging AT&T for interconnections¹⁰⁹ conflicts with Illinois regulatory practices. The Illinois Public Utilities Act, although disallowing discrimination in the provision of *service*, permits reasonable differences in *rates* charged different service or customer classes. The Act provides: "No public utility shall establish or maintain any *unreasonable difference* as to rates or other charges, services, facilities, or in any other respect, either as between localities or as between classes of service."¹¹⁰ The Act, further, does not require rates to be identical, only "just and reasonable."¹¹¹ "A mere difference in rates alone does not constitute undue discrimination."¹¹² Allowing some degree of reasonable discrimination is a difficulty the ICC faces in reconciling the cost of service and the "revenue requirement" (which varies from densely populated to sparsely populated regions) needed to generate a fair return on investment. Rates must generate revenue sufficient to achieve a fair

106. *Id.* at App. B, ¶ (B)(2).

107. *Id.* at section II(B)(3).

108. Many variations of each type of cost criteria exist. The FCC, for example, has considered seven different definitions of fully distributed costs.

109. Stipulation for Voluntary Dismissal, *AT&T*, section II(B)(3).

110. ILL. REV. STAT. ch. 111-2/3 § 38 (1981). See *St. Charles v. Illinois Commerce Comm'n*, 21 Ill.2d 259, 172 N.E.2d 353 (1961).

111. ILL. REV. STAT. ch. 111-2/3 § 36 (1981).

112. *Illinois Cent. R.R. v. Illinois Commerce Comm'n*, 359 Ill. 563, 568, 95 N.E. 32, 34 (1935).

return on investment.¹¹³ The revenue required to achieve a fair return, however, may be difficult to assess. The revenue requirement will depend on which cost of service criterion is adopted, and whether rates are actually set at cost. Price discrimination between service and/or customer classes serves to adjust rates both to meet a revenue requirement and implement public policy goals such as universal service. The Commission, therefore, must inevitably adopt some form of "discrimination."

The Proposed Agreement Undermines the Goal of Universal Service

National and state policy has long promoted the goal of "universal service." The Communications Act of 1934 envisioned: "a rapid, efficient, nationwide, and worldwide wire and radio communication service with adequate facilities at reasonable charges, . . . for the purpose of promoting safety of life . . ." ¹¹⁴ Illinois law and policy, through certification, contracts, and limited monopolies, effectuate this goal.

The proposed consent decree jeopardizes the continuation of the policy of universal service. First, the proposed agreement does not guarantee that high cost areas will be connected. Rural areas face the threat of losing local and long distance service.¹¹⁵ Second, the proposed decree fails to guarantee the financial integrity of the BOCs. The transfer of customer premises equipment to AT&T and the elimination of revenue generated from the yellow pages deprives the BOCs of vital revenue sources.¹¹⁶ Finally, the proposed agreement attempts to circumvent ICC supervision over local companies and rates.¹¹⁷ The proposed agreement, in thirteen pages, reverses half a century of consistent nationwide and statewide policies.

113. ILL. REV. STAT. ch. 111-2/3 § 32 (1981) requires Illinois public utilities to seek rates which are "just and reasonable." Just and reasonable rates permit utilities to earn a fair return on their investment. *Union Elec. Co. v. Illinois Commerce Comm'n*, 77 Ill.2d 364, 385 N.E.2d 510 (1979); *Monarch Gas Co. v. Illinois Commerce Comm'n*, 51 Ill. App. 3d 892, 366 N.E.2d 45 (1977); *People's Gas Light & Coke Co. v. Slattery*, 287 Ill. App. 379, 5 N.E.2d 285 (1937).

114. 47 U.S.C. § 515 (1976). The harbinger of this Act was the arrangement between Theodore Vail and the Justice Department. Vail, as president of AT&T, was guaranteed a monopoly in exchange for his promise to promote universal usage.

115. *See supra* pp. 576-77.

116. *See supra* pp. 577-78.

117. *See supra* pp. 574-75.

CONCLUSION

The proposed settlement agreement in *U.S. v. AT&T* is far broader than necessary to effectuate its procompetitive goals. Above all, the consent decree would actually reorganize the entire telecommunications industry—a province reserved to Congress. Only a legislative enactment should attempt to restructure the relationships between AT&T, the BOCs, the ITCs, the FCC and State Commissions, and non-common carrier corporations. Second, prohibiting the BOCs from providing long distance, CPE and other services eliminates AT&T's most viable potential competitors, and entrenches AT&T's monopoly position in these unregulated markets. The decree thus not only fails to foster competition, it promotes two monopolies—one in local service, one in unregulated service. Third, relegating the BOCs to provide only natural monopoly services removes many subsidies which had heretofore contributed to the local companies' revenue requirements. Without these subsidies, higher local rates will be the only source available to generate the required revenue. Fourth, the agreement eliminates the division of revenues process, which accounts for the independent telephone companies' primary source of revenue. This fact, coupled with the high cost of connection to sparsely populated rural areas, will potentially cripple the financial integrity of many ITCs and could cause either precipitous price increases or vast disconnections in rural areas. Fifth, the dramatic acceleration of local rates and potentially diminishing interconnection of rural areas undermines a half century of national commitment to the goal of universal telephone service. The spectre looms large of a return to the era when phones were considered a luxury. Finally, the agreement creates unnecessary and irreconcilable conflicts with well-settled state laws and policies. These conflicts remain because state regulation of intrastate public utilities is protected by both the state action doctrine and the tenth amendment.

The court, in deciding whether to enter this decree, is faced with two choices. One, it could refuse to enter the order and await congressional action. Two, it can suggest¹¹⁸ to the parties that they amend the settlement to provide for a complete divestiture of the BOCs, in their present form.

118. Under the Tunney Act, 15 U.S.C. § 16 (1976), a court has the power only to suggest, but not order, modifications before entering a consent decree. See *U.S. v. Gillette Co.*, 406 F. Supp. 715 (D. Mass. 1975). Of course, the court can withhold approval of any proposed decree which conflicts with the letter and spirit of the Tunney Act. *United States v. Central Contracting Co.*, 531 F. Supp. 133 (E.D. Va. 1982).

With the BOCs spunoff immediately in their present form, the court can then suggest one of three provisions. One, the court could recommend an order which would allow the BOCs to compete freely in any market. This would promote both the competitive goals of the settlement and the financial integrity of the BOCs. Two, the order could compel the BOCs to *sell* their CPE, long distance, and other non-natural monopoly services to AT&T at a price derived from arms-length bargaining. A fair price is difficult to establish between AT&T and the BOCs in their present parent-subsidiary relationship. The revenue generated by the sale of assets, moreover, can replace some of the BOCs' lost subsidy. Finally, the court could order the BOCs to sell the above services to *any* purchaser, presumably the one with the best offer. This provision would assure a competitive, free market price for the services and guarantee that AT&T would face ready competition.*

* This article went to press in April, 1982. On August 11, 1982, Judge Green issued a 178-page opinion which stated that he would not enter the consent decree unless the parties agreed to certain major modifications, namely, that the BOCs retain yellow pages and customer premises equipment marketing services. The court denied the DOJ's subsequent petition to reconsider the latter suggestion. The consent decree was entered, with these modifications, on August 24, 1982. Intervenor status was granted certain states (including Illinois), state commissions, competitors, and public interest groups on August 26, 1982. Appeals from the consent decree, which must be filed by September 25, 1982, will most likely focus on two issues: the continued restriction on the BOC's providing of toll services and the role of state regulatory commissions.