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SECOND CIRCUIT REVIEW

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Antitrust and the Telecommunications Act of 1996

CUSTOMERS WHO have received poor local telephone service as a result of a monopolist's failure to properly share local networks with less-expensive providers should be permitted to pursue antitrust claims in federal court, the Second Circuit held in a surprise decision last month.

Reversing the Southern District of New York's dismissal of the case, the Second Circuit revived *Law Offices of Curtis V. Trinko v. Bell Atlantic Corp.*,[1] finding that the plaintiff's complaint alleged direct injury to local phone service customers as a result of Bell Atlantic's monopolistic behavior. The court rejected defendant's claim that the dispute had to be resolved through the regulatory process provided for in the Telecommunications Act of 1996, concluding instead that plaintiff-appellant had standing to bring an antitrust claim under §2 of the Sherman Act.

The decision poses a significant threat to incumbent local telephone carriers, who could be forced to pay treble damages to thousands of customers who have sought less-expensive service from new competitors that have emerged since Congress passed the 1996 act. Until this decision, federal courts had restricted antitrust remedies for alleged violations of the Telecommunications Act.

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The Second Circuit's decision is further notable as it conflicts with the Seventh Circuit's decision in *Goldwasser v. Ameritech*,[2] which has been followed by numerous lower courts.[3] The Supreme Court ultimately may have to resolve this conflict among the circuits.

Facts

In the case before the Second Circuit, plaintiff Curtis V. Trinko LLP (Trinko) filed a class action claiming that it and other local telephone customers in the area served by Bell Atlantic, the incumbent local exchange carrier (ILEC), had received inferior phone service from AT&T, one of Bell Atlantic's competitors. The poor service, the plaintiff alleged, was a direct result of Bell Atlantic's failure to fulfill its responsibilities under the Telecommunications Act. The 1996 act broke up existing monopolies in the local phone service market and mandated that each incumbent local exchange carrier give emerging competitors an "interconnection with its network that is at least equal in quality to that provided by the local exchange carrier to itself."[4] Under the act's provisions, new competitors request interconnection with the ILEC and then enter into a binding contract with the ILEC that must be approved by a state agency. That contract establishes dispute resolution procedures for disputes arising from the interconnection agreement. AT&T's 1997 agreement with Bell Atlantic, for example, stated that the procedures set forth therein would be the "exclusive remedy for all disputes."

Asserting its rights to pursue an action under §206 and §207 of the Telecommunications Act, plaintiff-appellant Trinko alleged that Bell Atlantic had violated its duties as a common carrier under §202(a) of the Telecommunications Act and its duties as an ILEC under §251(b) and (c) of the Telecommunications Act. Rather than providing equal access to its network as mandated by statute, Bell Atlantic had allegedly fulfilled other local phone service providers' customer orders only after fulfilling its own and, in some cases, had completely failed to fulfill orders placed with its competitors.[5] Additionally, Trinko claimed that Bell Atlantic had violated §2 of the Sherman Act. Trinko alleged that without access to the "local loop" in the Northeast, which was controlled by Bell Atlantic, new competitors were being excluded from the market in violation of the federal antitrust laws.

The Southern District dismissed each of Trinko's claims, both those brought under the Telecommunications Act and those brought under the Sherman Act. Although §202(a) of the Telecommunications Act prohibited common carriers, such as Bell Atlantic, from "subject[ing] any particular person, class of persons, or locality to any undue or

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unreasonable prejudice or disadvantage," the district court found that the nondiscrimination duty imposed on common carriers by §202(a) was owed only to the common carriers' immediate customers (such as AT&T) and not to its indirect customers (such as Trinko). Similarly, the district court found that the interconnection duty imposed on incumbent local exchange carriers by §251 of the Telecommunications Act created an obligation vis-á-vis other telecommunications carriers, but none as to those carriers' customers. Having found that neither §202 nor §251 bestowed any rights upon Trinko as an indirect purchaser, the district court dismissed Trinko's Telecommunications Act claims on the doctrine of prudential standing, under which one person lacks standing to assert the rights of another person.

Dismissing Plaintiff's Antitrust Claim

Significantly, the district court also dismissed the plaintiff's antitrust claim. Trinko argued that the defendant's alleged violation of §251 of the Telecommunications Act was simultaneously a Sherman Act violation. According to the complaint, Bell Atlantic's failure to cooperate with local competitors as required by the Telecommunications Act constituted impermissible exclusionary behavior. The district court, however, deemed the plaintiff's antitrust claim insufficient because the complaint failed to allege "any 'willful acquisition or maintenance' of monopoly power by Bell Atlantic" as required by §2 of the Sherman Act. According to the district court, the fact that a monopolist has violated another statute does not "transform such offense" into an antitrust violation. Citing the Seventh Circuit's *Goldwasser* decision, the district court found that even had the plaintiff made out a §251 claim, the "affirmative duties imposed by the Telecommunications Act are not coterminous with the duty of a monopolist to refrain from exclusionary practices."[6]

After dismissing the original complaint, the district court allowed Trinko to replead both its §202 claim and its antitrust claim. In the amended complaint, plaintiff alleged that AT&T had acted as its agent in negotiating the interconnection agreement with Bell Atlantic, and thus attempted to avoid being characterized as a third party under the Telecommunications Act. Plaintiff also narrowed its antitrust claim, presenting the defendant's conduct as monopoly leveraging in violation of the Sherman Act. The district court again granted Bell Atlantic's 12(b)(6) motion and dismissed the amended complaint in its entirety.

Second Circuit Analysis

With respect to plaintiff's claims under the Telecommunications Act, the Second Circuit affirmed the district court's dismissal of plaintiff's claim under §251, but reversed the dismissal of plaintiff's claim under §202. In reinstating plaintiff's §202 claim, the Second Circuit emphasized a consumer's right to bring an action against a common carrier under §206 and §207 of the Telecommunications Act.[7]

The Second Circuit held that the dismissal below, on prudential standing grounds, rested on the erroneous assumption that a plaintiff's right to sue for a §202 violation emanates from §202 itself. In fact, however, a plaintiff's right to sue actually arises out of §206 and §207, which provide that any party injured by conduct violating the Telecommunications Act has the right to bring an action in federal court. Despite defendant's argument that the plaintiff had not suffered direct injury as a result of defendant's conduct, the court of appeals held that Trinko had sufficiently alleged direct injury. "While the district court may find otherwise after discovery and a motion for summary judgment, it is too early to conclude on this record that the plaintiff only suffered a wholly derivative injury."[8]

The Second Circuit affirmed dismissal of Trinko's §251 claim, but rejected the district court's reasoning. It was, said the Second Circuit, unnecessary to apply the doctrine of prudential standing because plaintiff's complaint failed to allege conduct that violated §251. Once an ILEC such as Bell Atlantic enters into an interconnection agreement with an emerging competitor, the ILEC has fulfilled its duties under subsections 251(b) and (c) of the Telecommunications Act. The conduct of both the ILEC and the new service provider are then governed by the contractual provisions of the interconnection agreement, rather than by the statute. Although Bell Atlantic may have breached the interconnection agreement, allowing a lawsuit to proceed under the act's generic language would undermine the purpose of interconnection agreements and thus defeat the statutorily mandated regulatory structure.

Pursuit of Antitrust Claim

In the portion of its decision posing the most significant threat to incumbent local exchange carriers who have breached interconnection agreements with new competitors, the Second Circuit found that such conduct could constitute a violation of the antitrust laws. The court of appeals rejected the defense's assertion that plaintiff and other AT&T customers had suffered only an indirect injury and therefore lacked standing to bring an antitrust action under the Clayton Act.

To have standing to bring an action under the Clayton Act, a plaintiff must show "antitrust injury." Bell Atlantic argued that plaintiff, who purchased its phone services from AT&T, who in turn contracted with Bell Atlantic, was an indirect purchaser and therefore lacked standing under *Illinois Brick Co. v. Illinois*, 431 US 720 (1977) (holding that a customer of a customer who is overcharged by a monopolist does not have antitrust standing). But, the Second Circuit found that the *Illinois Brick* rule did not apply here. AT&T was not only a customer of Bell Atlantic, but also a competitor, and according to the Second Circuit, plaintiff's complaint alleged that AT&T's customers suffered direct antitrust injury because Bell Atlantic had interfered with AT&T's opportunity to compete with it. The plaintiff was, said the court, left with only two choices: 1) stay with AT&T and receive poor phone service; or 2) switch to

Bell Atlantic. The plaintiff chose the first option and consequently "suffered the requisite antitrust injury."[9] Citing the Supreme Court's decision in *Blue Shield of Virginia v. McCready*,[10] the court found that a "customer of a competitor can suffer a direct injury from an anticompetitive scheme aimed principally at the competitor."[11]

Having determined that plaintiff had alleged antitrust injury, the appeals court departed sharply from the Seventh Circuit's *Goldwasser* decision, holding that the district court had erred when it dismissed plaintiff's Sherman Act claim on the grounds that plaintiff alleged nothing more than a breach of §251 of the Telecommunications Act. While the anticompetitive behavior alleged by the plaintiff might violate §251, it could, the Second Circuit held, also be construed independently as an antitrust violation. If the plaintiff were able to prove that Bell Atlantic denied AT&T access to the so-called "network loop," and that such access is essential to providing local phone service, the plaintiff could demonstrate a violation of the essential facilities doctrine. Alternatively, the court found the plaintiff might be able to prove that Bell Atlantic engaged in monopoly leveraging, using its monopoly power to gain a competitive advantage in the local phone service market. Whether or not plaintiff is ultimately able to prove its allegations, the court found that plaintiff deserved the opportunity to have its claims considered.

The mere fact that a complaint successfully alleges a violation of the Telecommunications Act does not preclude the same complaint from asserting — on the basis of such a violation — a freestanding antitrust claim, the Second Circuit determined. Absent a "plain repugnancy" between the two, a regulatory statute does not implicitly repeal the antitrust laws, the court held. Because the court found there to be no plain repugnancy between the Telecommunications Act (which was designed to foster competition) and the antitrust laws, the court found it irrelevant that the plaintiff's antitrust claim was predicated on an alleged violation of the Telecommunications Act.

Circuit Split

The Second Circuit rejected the Seventh Circuit's analysis in *Goldwasser*. The Seventh Circuit had found that an antitrust claim "inextricably linked" with an alleged violation of the Telecommunications Act necessarily fails as a matter of law. The Second Circuit, by contrast, held that Congress did not intend for the Telecommunications Act to immunize an ILEC from antitrust scrutiny. "If there is no such implicit immunity," said the Second Circuit "as a long as a set of allegations states an antitrust action on its own terms, the fact that it closely resembles an action brought under another statute in itself is unproblematic."[12]

In the eyes of the Second Circuit, Seventh Circuit's *Goldwasser* decision failed to give adequate consideration to the importance of allowing injured consumers to bring antitrust actions against ILECs such as Bell Atlantic. The *Goldwasser* court had stated that the "antitrust laws would add nothing to the oversight already available under the 1996 law."[13] The Second Circuit concluded, however, that allowing a competitor's customers to sue under the antitrust laws would promote the Telecommunications Act's goal of fostering competition in the local telephone service market.

Finally, the Second Circuit rejected the Seventh Circuit's contention that permitting antitrust claims to be brought by consumers would disrupt the regulatory process envisioned by the Telecommunications Act. Citing *Otter Tail Power Co. v. U.S.*,[14] in which the Supreme Court allowed an antitrust suit against an electric utility company to proceed notwithstanding the regulatory scheme imposed by the Federal Power Act, the Second Circuit deemed antitrust suits an insignificant threat to the regulatory structure established by the 1996 act. "Specific legislation meant to encourage competition," said the Second Circuit, does not take "precedence over the general antitrust laws."[15]

Conclusion

Verizon, Bell Atlantic's successor in interest, petitioned the Second Circuit for rehearing on July 11, 2002, with support from USTA, Bell South and SBC. The incumbent local carriers argue that the court's unprecedented decision will burden local telephone service providers with endless class action suits demanding treble antitrust damages.

The Second Circuit's decision preserves interconnection agreements as the principal device through which ILECs and emerging carriers negotiate and remedy violations of the Telecommunications Act. But the Second Circuit decision, unlike that of the Seventh Circuit in *Goldwasser*, bestows significant rights on the emerging carriers' customers, thus potentially tipping the balance of power against the incumbents. This decision suggests for the first time that federal antitrust laws are available as a means for local telephone customers to challenge the exercise of monopoly power by incumbent carriers.

(1) 2002 U.S. App. LEXIS 12233.

(2) 222 F.3d 390 (7th Cir. 2000).

(3) See, e.g., *Cavalier Telephone v. Verizon Virginia, Inc.*, 2002 U.S. Dist. LEXIS 11131 (E.D. Va. 2002); *Covad Communications Co. v. Bell Atlantic Corp.*, 201 F. Supp. 2d 123 (D.D.C. 2002); MGC *Communications, Inc. v. BellSouth Communications, Inc.*, F. Supp. 2d 1344 (S.D. Fla. 2001).

(4) 47 USC §251(c)(2)(C).

(5) 123 F. Supp. 2d at 739.

(6) 123 F. Supp. 2d at 742.

(7) Section 206 and §207 are the Communication Act's liability and damages provisions.

(8) 2002 U.S. App. LEXIS 12233 at 26.

(9) 2002 U.S. App. LEXIS 12233 at 41.

(10) 457 U.S. 645 (1982).

(11) 2002 U.S. App. LEXIS 12233 at 40.

(12) 2002 U.S. App. LEXIS 12233 at 47-8.

(13) Id. at 50 (citing Goldwasser at 401).

(14) See 410 US 366 (1973).

(15) 2002 U.S. App. LEXIS 12233 at 52.