Should the Flamingo *fly?* *Using competition law to limit the scope of postal monopolies*

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I. INTRODUCTION AND SUMMARY

A. Context

Postal services remain one of the last services provided widely as public monopolies. The postal monopoly is accompanied with a universal service obligation (USO), to provide some level of postal service (days per week, rapidity of delivery, geographically uniform rates) to all households and businesses throughout a country. The extent to which the postal monopoly should be limited to specific markets, is a question previously faced in other sectors, notably telecommunications, electricity, and rail. In its Directive 2002/39/EC, the European Parliament amended weight and price criteria set 4 years previously, opening markets in January 2003 for parcels weigh-

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ing above 100g or costing three times the tariff, and extending potential competition for mail weighing above 50g or costing no more than 2.5 times the basic tariff by January, 2006.[1] Other markets that are or might be opened to competition include presorted or unaddressed "bulk" mail supplied to the incumbent postal operator for delivery under a work-sharing tariff.

Maximizing the benefits of competition within the sector—leaving aside external competition from electronic mail and bill payment—requires economically justified and politically tractable methods for delineating monopolies that require ongoing regulation while facilitating entry into the remaining competitive markets. Regulatory agencies and processes may not be effective, however. Agencies may be susceptible to "capture." Particularly when the monopolies are state-owned, there may be no institutionally independent regulator to prevent market power from being exercised in other sectors.

A case recently before the U.S. Supreme Court, *USPS v. Flamingo Industries*,[2] seemed to offer an intriguing alternative: subject public postal monopolies to antitrust laws. Flamingo claimed that the United States Postal Service (USPS) anticompetitively cancelled contracts to provide mail delivery sacks, replacing them with imported sacks form Mexico. The Supreme Court ruled that USPS is immune from suit because Congress, in creating the quasi-private USPS, did not explicitly change its sovereign status to make it liable under the antitrust laws. Otherwise, antitrust would presumably apply to USPS as it does to any other regulated monopolist.

B. Summary

Despite the perhaps questionable merits of the plaintiff's complaint and logic behind the Supreme Court's decision, *Flamingo* illuminates how antitrust could facilitate competition by limiting the scope of postal monopolies. Such limitations, while controversial,

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1 European Parliament, *Directive 2002/39 Amending Directive 97/67/EC With Regard to the Further Opening to Competition of Community Postal Services*, 176 O. J. 21 (2002), especially clauses 16–18.

2 124 S. Ct. 1321 (2004).

have been employed in other regulated industries, e.g., telecommunications, to separate competitive markets from regulated monopolies. Within the postal sector, antitrust could provide a vehicle for allowing entrants into sectors such as express mail and urban document delivery, with equal access to still-regulated postal monopoly delivery networks. Such policies could justify excluding the public postal monopoly from these markets in order to prevent anticompetitive discrimination and cross-subsidization.

Antitrust is not a substitute for regulation. Regulation may be necessary to get natural monopolies to offer their services at prices that promote economic efficiency, mitigate undesirable wealth redistribution, and address social goals such as universal service. As discussed in section II.C, the rationale for separating monopoly from competitive sectors depends on the presence of effective regulation. Our task is to examine whether antitrust might be better than regulation for delineating monopolies and fencing them in to allow competition to flourish in other markets within the postal sector. Such flourishing may be achieved either by keeping the monopoly out of the competitive markets, or by instituting ownership conditions and rules that "keep the playing field level," i.e., preventing a regulated monopoly from distorting the market on behalf of affiliates competing in related markets. Moreover, the best competition and regulatory policies will not facilitate entry in markets that are most efficiently served with just one provider.

Differences between European Union (EU) and United States competition law may have recently become quite relevant and pronounced. In the late 20th century, the leading antitrust case setting limits on the scope of the actions of a regulated monopolist was *U.S. v. AT&T*.[3] Although that case was settled rather than decided, the agreed-upon relief, divestiture by AT&T of its regulated local telephone monopolies accompanied by restrictions on the lines of businesses those companies could pursue, survived extensive antitrust review.

However, the applicability of U.S. antitrust law to discriminatory dealing by a regulated firm is now quite doubtful,

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3 552 F. Supp. 131 (D.C.D.C. 1982).

following the recent Supreme Court decision in *Verizon v. Trinko*.[4] *Trinko* may well have turned out differently under the stricter scrutiny European Union competition law applies to unilateral conduct by a dominant firm. The *Deutsche Post* case[5] suggests that the EU may have a greater ability to rely on competition law rather than specific regulations to set limits on the scope of a postal monopoly's activities.

C. *Outline*

The remainder of the article proceeds as follows: section II outlines the principles behind keeping regulated monopolists from diversifying into unregulated markets. This principle has been acknowledged, if not always paramount, in U.S. policy regarding the partial deregulation of sectors (telecommunications, electricity) in which competitive and regulated sectors continue to coexist. Section III applies these theories to the postal sector. The most compelling example of why courts rather than regulators may be the best means for quarantining monopolies is AT&T's divestiture of its local telephone operating companies in 1984. Section IV reviews the arguments for relying on courts rather than regulators, assesses U.S. telecommunications policy up to *U.S. v. AT&T* in that light and describes the drawbacks of using regulation to expand competition in electricity.

The story becomes less optimistic when we look at recent decisions. Section V reviews the recently completed *Flamingo* litigation; section VI discusses *Trinko*. In light of the declining ability in the U.S. to use competition law to separate regulated monopoly and competitive sectors, section VII discusses the EU alternative. It briefly assesses the benefits and potential risks of applying its article 82 to such situations, as exemplified by the 2001 *Deutsche Post* case. Section VIII summarizes.

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4 124 S. Ct. 872 (2004).

5 Commission Decision 2001/354, *Deutsche Post AG*, 125 O. J. 27 (2001).

II. RESTRICTING THE SCOPE OF REGULATED MONOPOLIES

A. *Identifying monopoly markets to regulate*

The purpose of economic regulation is to prevent firms significantly isolated from competition from raising prices above competitive levels. Determining significant isolation from competition is complex and ambiguous.[6] Almost every seller faces some buyers who will keep buying at prices above cost. Much of the litigation in the *U.S. Microsoft* antitrust case was over the seemingly uncontroversial question of whether the Windows operating systems are a monopoly.[7] Similar market delineation questions affect postal markets, e.g., the extent to which e-mail, electronic funds transactions, and voice telephony would preclude a postal monopolist from having meaningful market power,

Nevertheless, in some cases, we might begin with Justice Potter Stewart's (in)famous Supreme Court test for obscenity, "I know it when I see it,"[8] to the question of whether a firm holds a monopoly. If so, economic welfare could in theory be improved by price controls that discourage privately profitable but socially inefficient output reductions. In sectors such as telecommunications, electricity, or postal service, regulation could prevent inequitable or politically intolerable redistribution of wealth.

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6 *See* P. Nelson & L. White, *Market Definition and the Identification of Market Power in Monopolization Cases: A Critique and Proposal* (2003), http://www.stern.nyu.edu/eco/wkpapers/workingpapers03/03-26White.pdf (accessed Apr. 7, 2004). Market delineation is more difficult in monopolization than with mergers. With a merger, the question is whether it will raise prices above premerger levels. This inquiry does not require identifying a competitive price, only whether a merger will make matters worse. DEPARTMENT OF JUSTICE AND FEDERAL TRADE COMMISSION, 1992 HORIZONTAL MERGER GUIDELINES (WITH 1997 REVISIONS TO SECTION 4 ON EFFICIENCIES) (1997). Whether a firm has a monopoly, however, requires one to ascertain the possibility that the firm has reduced output to raise price. The more difficult counterfactual is whether the firm would have supplied more if it faced substantially elastic demand at a lower price.

7 United States et al. v. Microsoft Corporation, 87 F. Supp. 2d 30, 36–37 (D.D.C 2000), *aff'd in part and rev'd in part*, 253 F.3d 34 (D.C. Circ. 2001).

8 Jacobellis v. Ohio, 378 U.S. 184, 197 (1964).

Price regulation, however, has numerous imperfections. These arise from the relative rigidity of public administration, the inability of a regulator to obtain accurately information on cost and demand, and the propensity of regulators to respond to political clout rather than overall welfare. In many sectors, however, economic and political considerations preclude complete deregulation. Policy makers have had to confront how to demarcate parts of an industry that may remain regulated from those that are competitive. In the 1980s, for example, the U.S. had to determine where in the telephone switching hierarchy competitive long-distance service began and monopoly local service ended.[9]

B. Boundary problems

In most if not all industries where competition is being introduced, services had been supplied by vertically integrated enterprises. Competition means that some markets within that sector now have new, independent entrants. In telephony, entrants were new equipment and long-distance service companies. In electricity, new participants have been independent power producers and marketers. In the postal sector, independent providers offer sorting, bulk mail, express service, and package delivery among others.

These new entrants typically have to compete with incumbents in the opened markets, while the incumbents retain their regulated monopolies. This situation creates three potential threats to competition.[10]

1. DISCRIMINATION Suppose that firms operating in the competitive sector require the regulated service. For example, independent power producers need access to regulated transmission and distribution services to be able to sell electricity to end users.[11]

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[9] American Telephone and Telegraph Company, 1982. Plan of Reorganization, filed at the U.S. District Court for the District of Columbia, U.S. v. Western Electric and AT&T, Civil Action No. 82-0192 (Dec. 16, 1982).

[10] T. 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).

[11] P. JOSKOW & R. SCHMALENSEE, MARKETS FOR POWER (1983). If only wholesale electricity markets are opened to competition, independent power producers

The incumbent then has an incentive to engage in nonprice discrimination against its unaffiliated competitors in the downstream market. The incentive arises because successful favoritism in access to the regulated service at a regulated price will raise prices and reduce competition in the downstream market. Discrimination in quality or timeliness of access effectively ties the regulated service to the downstream service, allowing the firm to evade the regulatory price ceiling.

2. CROSS-SUBSIDIZATION Suppose the incumbent's monopoly offerings are regulated on the basis of reported costs. The incumbent would have an incentive to allocate costs of inputs used in competitive markets to the regulated service.[12] The first effect of cross-subsidization is regulatory evasion, as the price of the regulated service (e.g., first class mail) goes up, with profits recorded on the books of the competitive sector (e.g., express mail or parcel delivery). Expansion of the incumbent's operations via the subsidy may displace efficient firms. Cross-subsidization may also allow the incumbent to make credible predatory threats, to deter entry into the otherwise competitive sector.

3. INFLATED TRANSFER PRICES A regulated monopolist vertically integrated into a competitive input market may be able to charge itself an inflated price for that input. A classic example is a regulated electricity generator that buys coal from an affiliated mine. The

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need access to only transmission networks, leaving retail sales to monopoly local distribution companies. Transmission is a monopoly because electricity goes over all wires in an interconnected grid between where it is generated and where it is used, regardless of who owns which physical line. For an argument that competition could set transmission rates, *see* P. VAN DOREN, THE DEREGULATION OF THE ELECTRICITY INDUSTRY: A PRIMER (1998).

[12] T. Brennan, *Cross-Subsidization and Cost Misallocation by Regulated Monopolists*, 2 J. REG. ECON. 37 (1990). G. FAULHABER, TELECOMMUNICATIONS IN TURMOIL (1987) notes that cross-subsidization relies on a potential paradox, in which a regulator is diligent about tying prices to costs but lax in verifying that costs are accurately reported. Cross-subsidization also depends on cost-of-service regulation. Under price-caps, shifting costs into the competitive sector would have no effect on prices in the regulated sector. *See* R. Braeutigam & J. Panzar, *Diversification Incentives Under 'Price-Based' and 'Cost-Based' Regulation*, 20 RAND J. ECON. 373 (1989).

immediate harm is that customers of the regulated service pay higher rates. The added competitive harms are analogous to those for cross-subsidization. In the short run, the propensity of the regulated firm to deal with itself can lead to substitution of higher cost affiliate output for lower cost production from unaffiliated input suppliers. Strategically, a commitment by the regulated firm to deal with itself can deter entry into the upstream market altogether.

C. *The importance of regulation*

Regulation of the monopolist is a crucial component to each of these three stories.[13] Cross-subsidization and transfer pricing require that misallocated costs of competitive services or higher prices of unregulated inputs be passed on to customers, causing the price to rise closer to the monopoly price. If the customers were already paying the monopoly price, the firm would have no incentive to misallocate costs or self-deal in these artificial ways.

Similarly, the driving impetus behind discrimination is to obtain the monopoly price for the regulated service, by conditioning access at the regulated price on the purchase of a product from an affiliate at an unregulated price. If the regulated price is $1 and the monopoly price is $3, the monopolist could evade regulation by denying unaffiliated suppliers access to the competitive product, and have its affiliate supplier raise its price for the competitive product by $2. If the monopolist could charge $3 directly, this incentive to integrate and discriminate disappears.

D. *Remedies*

Remedies can be differentiated along at least two dimensions. One is *ex ante* vs. *ex post*: Should one institute penalties if these problems arise to discourage regulated firms from discriminating in favor of, cross-subsidizing, or purchasing at inordinate prices from affiliated companies? If so, one needs to ascertain some sense of the

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[13] Brennan, *supra* note 10; Noll & Owen, *The Anticompetitive Uses of Regulation:* United States v. AT&T, *in* THE ANTITRUST REVOLUTION (J. Kwoka & L. White eds., 1989).

likelihood that violations would go undetected and whether penalties can or should be inflated to take imperfect observation into account.[14]

If *ex post* enforcement is unlikely to be effective, a second option is *ex ante* remedies, structural rules to prevent the regulated firm from engaging in these anticompetitive tactics. An *ex ante* approach introduces a second dimension—the degree of formal institutional separation. At one end of the continuum is allowing the regulated firm to remain whole, but allowing the regulator or competition authority to oversee its operations to prevent these tactics from occurring. At the other end is full corporate separation, to strip from the regulated firm any ability to evade regulation through these anticompetitive tactics. In between are structural rules, e.g., requiring nondiscriminatory, arm's-length dealing with separated subsidiaries.

The most complete solution, full separation, is typically more difficult to bring about, in part because it eliminates any possibility of realizing some beneficial scope economies. However, divestiture normally will typically have lower continuing oversight costs and greater effectiveness than remedies that allow some degree of corporate integration. By preserving the potential to profit from anticompetitive favoritism, remedies short of divestiture force regulators to expend effort to detect and prevent anticompetitive conduct. Such enforcement is likely to foreclose scope economies that might have warranted keeping the firm together in any event.[15] In U.S. telecommunications, separate subsidiaries were attempted without success[16] and later preempted by AT&T's divestiture of its regulated monopolies, described below.

III. POTENTIAL POSTAL SECTOR APPLICATIONS

These different theories may apply in the postal sector. Inflated transfer pricing seems relatively unlikely, although one could imagine scenarios in which a postal agency entered the commercial

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[14] G. Becker, *Crime and Punishment: An Economic Approach*, 78 J. POL. ECON. 169 (1968).

[15] I owe this observation to Ken Baseman.

[16] R. CRANDALL & L. WAVERMAN, TALK IS CHEAP: THE PROMISE OF REGULATORY REFORM IN NORTH AMERICAN TELECOMMUNICATIONS 51, 52 (1995).

real estate business and leased itself office space at inflated rates. Perhaps the most likely anticompetitive scenario would be cross-subsidization, where costs of competitive express package delivery were reported as costs of first-class mail delivery.[17] The cross-subsidization problem is particularly intense in the postal sector because of the existence of internal or explicit state subsidies necessary to cover USO costs.[18]

For discrimination to take place, one would need a service a postal monopolist could provide to both itself and potential competitors. One example, at least in the U.S., is access to mailboxes. USPS's monopoly is protected by statutes preventing others from depositing material in mailboxes unless it has been stamped.[19] An EU example would be access of cross-border mail from one country to the monopoly postal distribution network in another.[20] An example relevant to both areas could be where an incumbent postal operator provides delivery services to independent providers of unaddressed or presorted mail that it provides to mail that it takes and processes internally.

Unlike some other price-controlled services, postal service is generally provided by a state monopoly rather than a private firm. A state-owned enterprise cannot be assumed to maximize profit, and

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17 In the EC's *Deutsche Post* case *supra* note 5, cross-subsidization of parcel delivery was the primary anticompetitive allegation.

18 PRESIDENT'S COMMISSION ON THE UNITED STATES POSTAL SERVICE, EMBRACING THE FUTURE: MAKING THE TOUGH CHOICES TO PRESERVE UNIVERSAL MAIL SERVICE 67 (2003). In 2003, the European Court of Justice in the *Altmark* case set out four conditions for when USO-related payments do not constitute anticompetitive state aid: (1) the USO is defined clearly, (2) compensation is calculated transparently beforehand, (3) the compensation does not exceed the USO cost (including a reasonable return), and (4) absent a public procurement procedure, the costs should be calculated on the basis of those of a "typical undertaking that is well run." Case C-280/00 *Altmark*, C 226 O. J. 1 (2003).

19 39 U.S.C. § 609.

20 European Parliament, *Directive 97/67 on Common Rules for the Development of the Internal Market of Community Postal Services and the Improvement of the Quality of the Service*, 15 O. J. 14 (1998), especially articles 7 & 13.

thus may lack the incentives to exploit monopoly through discrimination, cross-subsidization, and inflated transfer pricing. In some cases, notably New Zealand, the incumbent postal operator may be under instruction to maximize profits.[21] Even when state-owned firms may not be profit-maximizing, they may have incentives to undertake these activities to discourage competition and maximize the size of its bureaucracy.[22] The ability to carry out these anticompetitive activities will be enhanced to the extent that the publicly owned enterprise has access to tax revenues or loan guarantees that could cover the costs of predatory pricing targeted against potential entrants.

Even if profit maximization or bureaucratic preservation underlies incentives for anticompetitive conduct, private and public enterprises may have different legal vulnerabilities with respect to competition law. As we see below, the U.S. Supreme Court has found such a distinction with USPS. Before turning to that, we examine U.S. telecommunications for insight into whether regulation or competition law is the best route to minimize the degree to which regulation is necessary in a sector and prevent a regulated enterprise from distorting competition in the rest of the sector.

IV. REGULATION VS. LITIGATION: INSTITUTIONAL CHOICES

A. Institutional choice for setting boundaries

The first step in introducing competition into a regulated sector is to identify which markets within the sector are potentially competitive. The second is to determine how best to prevent the regulated, noncompetitive sectors from evading regulation through discrimination, cross-subsidization, or inflated transfer pricing. But prior to embarking on this journey is an institutional decision: Can the industry regulator draw the right boundaries and prevent

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[21] G. Harford, New Zealand—A Liberalization Success Story, Center for Research in Regulated Industries, Rutgers University, 12th Conference on Postal and Delivery Economics, Cork, Ireland (2004).

[22] D. Sappington & J. Sidak, *Incentives for Anticompetitive Behavior by Public Enterprises*, 22 REV. INDUS. ORG. 183 (2003).

untoward crossings? Or should the decision be left to courts enforcing general competition law?

The primary argument that supports relying on sector-specific regulators is that delineating competitive from regulated markets may require considerable knowledge of technological and demand considerations determining the extent of scope and scale economies. Scale economies are crucial for indicating which markets within the sector are likely to remain monopolies with sufficient market power to make continued regulation worthwhile. These may arise from supply-side technologies that cause average cost to fall with output, and demand-side "network externalities," when one's willingness to pay depends positively on the number of other consumers using the same supplier.

Scope economies similarly depend on both supply-side and demand-side considerations. On the supply side are savings arising from planning, production, and sales externalities when products are produced jointly. On the demand side, consumers may prefer to purchase multiple products and services from a single supplier, to reduce search costs and the likelihood that the items purchased will not work well together.

Accurately distinguishing monopoly from competitive markets requires identification of products and services for which scale economies are substantial, with significant market power arising from the lack of competition within the sector and from other sectors (e.g., trucking vs. rail). Effective competition among separately owned firms requires that scope economies with other products and services are relatively insubstantial, to ensure that these other products can be produced efficiently and independently of the monopolist. Determining whether these hold can take detailed knowledge of the industry; "obvious" distinctions between monopoly and competitive sectors may not play out well in practice.[23]

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[23] A distinction between railroad tracks as monopoly and running of trains on those tracks as competitive may be invalid, because of the difficulty of coordinating separately owned rail services on a particular track. *See* R. Pittman, *Vertical Restructuring (or Not) of the Infrastructure Sectors of Transition Economies*, 3 J. INDUSTRY, COMPETITION & TRADE 5 (2003).

The advantages a sector-specific regulator may have should be balanced against the advantages general competition law and the courts bring. Courts do have institutional disadvantages, in that they cannot act on their own initiative but require a case be brought before them. They also may be less able to make factual findings (e.g., on the scope of monopoly) that have precedential force.[24] But in support of using competition law, Stigler pointed out that competition agencies with economy-wide responsibilities are less likely to be subject to undue influence from individual firms wishing to limit competition.[25] Such agencies might also be less prone to inertia, i.e., less resistant to pursue more significant changes than a regulator used to traditional ways incumbent monopolies are structured. Finally, at least for major cases, the legal burdens of proof necessary to impose significant changes require competition agencies and the courts to develop and provide expertise sufficient to ensure that remedies are likely to be feasible, responsive and not unduly burdensome. Those requirements reduce the relative advantages in expertise that sector-specific regulators may initially possess.

B. The U.S. telecommunications experience

1. THE REGULATORY RECORD The experience of introducing competition in telecommunications in the U.S. supports using competition law rather than regulatory rulemaking. During the latter half of the 20th century, technological changes indicated a potential to introduce competition in markets (long-distance communications, customer premises equipment, enhanced "information services"[26]) in a telecommunications sector essentially monopolized from top to

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[24] I thank Russ Pittman for this suggestion. The PRESIDENT'S COMMISSION ON THE UNITED STATES POSTAL SERVICE, *supra* note 18, at 22, 62–65, recommended that a new Postal Regulatory Board be charged with the responsibility of clarifying and narrowing the USPS monopoly.

[25] G. STIGLER, THE CITIZEN AND THE STATE 166 (1975).

[26] These events took place prior to the introduction of cellular telephones and the Internet. Absent public policy to introduce competition in telecommunications, AT&T may well have obtained monopolies over these services as well.

bottom by AT&T.[27] During that time, local telephone service was generally regarded as a monopoly. The cost of duplicating local conduits was prohibitive, and each caller valued having all others on the same network.[28]

In customer premises equipment markets, the regulator—the Federal Communications Commission (FCC)—was reasonably successful at promoting competition, although it had to overcome numerous false starts. Prior to establishing standard physical interfaces, the FCC adopted rules that allowed AT&T to prohibit connection of third-party devices, or require expensive interfaces that did more to bar entry than to protect the network.

The FCC's record on entry in other telecommunication sectors was less satisfying. With respect to enhanced services, the FCC unsuccessfully struggled for decades on how to design fully separated subsidiaries, arm's-length dealing requirements and accounting rules that would assure potential entrants of nondiscriminatory telecommunications service and no cross-subsidization. Long distance was even less successful, with new entrants facing impairments in their ability to offer per-minute toll calling, inconvenient and technologically inferior connections to local networks, and arguably cross-subsidized predatory prices.

2. TURNING TO THE COURTS While the FCC struggled with these issues, a competition authority, the U.S. Department of Justice's Antitrust Division filed an antitrust case against AT&T, arguing anticompetitive discrimination, refusal to deal with competitors, abuse of the regulatory process, and "pricing without regard to cost."[29] After the trial court ruled that the U.S. had a strong case, and

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[27] G. BROCK, THE TELECOMMUNICATIONS INDUSTRY IN THE UNITED STATES (1975).

[28] The Telecommunications Act of 1996 (Pub. L. 104-104) in the U.S. was predicated on the premises that, on the supply side, technological change made entry feasible. On the demand side, regulated interconnection among local service providers (47 U.S.C. § 251) would allow transparent connections between customers of any local provider, taking network externalities out of the hands of a single enterprise.

[29] Noll & Owen, *supra* note 13.

facing continued regulatory uncertainty, AT&T agreed to a settlement in which it would divest its regulated local monopolies.[30] With some exceptions, these divested entities were generally prohibited from entering competitive lines of business. The terms of the settlement of *U.S. v. AT&T* largely held until the Telecommunications Act of 1996 instituted conditions to allow the divested local companies to offer long-distance service.[31]

The ability of the antitrust authorities and the courts to institute a solution that regulators were unable or unwilling to implement suggests that general competition law might be better than regulation for extending regulation into competitive sectors. Unfortunately, as a settlement rather than a court-ordered decision, the divestiture in *U.S. v. AT&T* has turned out to have little precedential value. As we will see, this has raised significant questions as to whether U.S. competition law can limit what a public postal monopoly, or any regulated monopoly, can do.

C. *Electricity: lessons not learned?*

We briefly can contrast the record of U.S. telecommunications policy with that in electricity. Electricity is similar to telecommunications as a sector formerly served by vertically integrated regulated firms but with some markets recently opened to competition. The primary boundary between the competitive and regulated sectors is that between generation of electricity and the transmission and distribution systems that deliver energy to users. The U.S. was more a follower than a leader in opening markets, with its efforts taking place after initiatives taken in the U.K. and concurrently with those taken by the EU, in South America, and around the globe.

In the U.S., Congress authorized such competition, with its implementation in the hands of the national regulator (the Federal Energy Regulatory Commission, "FERC") and state public service commissions. FERC's preferred method of preventing anticompetitive

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30 *See supra* note 3.

31 47 U.S.C. § 271.

exercise of market power in transmission has been to let vertical integration continue but to vest grid control in independent "regional transmission organizations (RTOs)." However, FERC has been unable to muster the political authority to require electric utilities to join RTOs with strong functional separation between ownership and control; mandatory divestiture is even less likely. Moss finds that data on transmission availability are consistent with anticompetitive discrimination.[32] Stagliano and Hayden claim that discrimination persists only where utilities remain vertically integrated into transmission and generation.[33]

V. QUASI-PUBLIC FIRM IMMUNITY? *USPS V. FLAMINGO*

The U.S. experience with telephones and electricity suggests that competition policy through the courts may be more effective than regulatory agencies in optimizing deregulation through structural means. One might then want to use antitrust to set similar controls on postal services, if not keep the USPS out of such markets altogether. This tactic for expanding competition in the postal sector, however, has been ruled out by the U.S. Supreme Court in *USPS v. Flamingo Industries*.[34]

A. The trial court: USPS immunity

The litigation began with an antitrust suit against USPS filed in the Northern District of California by Flamingo Industries. Flamingo held a contract with USPS to produce sacks used by USPS to deliver mail.[35] According to Flamingo, USPS deceptively terminated the

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[32] D. Moss, *Competition or Reliability in Electricity? What the Coming Policy Shift Means for Restructuring* (2003) American Antitrust Institute, http://www.antitrustinstitute.org/recent2/288.cfm (accessed Apr. 15, 2004).

[33] V. Stagliano & J. Hayden, *The Electricity Transmission Paradox*, 17 ELECTRICITY J. 37 (2004).

[34] *See supra* note 2.

[35] This description comes from Flamingo v. USPS, 302 F. 3d 985 (9th Cir. 2002).

contract in order to import cheaper sacks from Mexico, sacks that Flamingo alleged violated safety and quality standards. Flamingo claimed that these actions were the result of collusion among USPS and Mexican sack manufacturers to monopolize the U.S. mail sack market and thus violated the antitrust laws.

The trial court in California did not determine whether Flamingo's characterization of the facts was correct and, if so, whether those facts would present a violation of the antitrust laws. Despite the problems with price-controlled monopolies expanding into related markets, it is not clear how USPS would gain from this deal other than through the socially beneficial way of getting mail sacks at a lower price. Neither discrimination nor cross-subsidization seems plausible. Flamingo's most meritorious claim may be that USPS breached the contract, which if characterized as an antitrust violation, would treble the damage award Flamingo would get. At worst, Flamingo may simply be trying to use antitrust to protect itself from competition.[36]

The district court did not rule on the facts and the antitrust merits, because it dismissed Flamingo's claim on the grounds that the antitrust laws did not apply to USPS. The court found that USPS is "an instrumentality of the federal government." Although the statute creating USPS allows it to "sue and be sued," USPS is not subject to the antitrust laws absent "an attempt by Congress to impose liability in the first place [citations omitted]."

B. The court of appeals: USPS liability

Flamingo appealed the decision to the 9th Circuit Court of Appeals, which ruled in its favor regarding the potential antitrust liability of USPS. The court of appeals reached this result by reversing the burden of proof.[37] The court found that Congress, in allowing USPS to sue and be sued, stripped USPS of claims to sovereign immunity, creating a "presumption" that USPS is vulnerable to suits

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[36] W. Baumol & J. Ordover, *The Use of Antitrust to Subvert Competition*, 28 J. L. ECON. 247 (1985).

[37] *See supra* note 35.

of any sort, including antitrust suits. To obtain immunity, USPS would have to show that antitrust liability was inconsistent with the statute creating USPS, would preclude USPS from carrying out nominally governmental duties, or was otherwise not intended by Congress.

According to the court, USPS failed to meet this burden. Citing prior Supreme Court decisions, the court of appeals found that Congress intended USPS to function primarily like a private business, and thus be subject to laws governing such enterprises. The court of appeals doubted USPS could argue antitrust immunity, as the statute creating USPS failed to include antitrust in its list of other specific limitations on suits against USPS. The court of appeals acknowledged that federal government bodies are not legal "persons" eligible to sue or be sued under the antitrust laws, but found that the USPS was not such a body.

C. The Supreme Court: USPS wins the final round

On February 25, 2004, the Supreme Court unanimously (9-0) reversed the Ninth Circuit Court of Appeals.[38] Justice Kennedy's opinion began by reviewing the history of postal service in the U.S. as a government entity, characterizing the creation of USPS as primarily just a vehicle "to increase the efficiency . . . and reduce political influences." (124 S. Ct. at 1325) USPS retains government functions and obligations, including the power of eminent domain, entering into international agreements, and the duty to provide universal service.

Justice Kennedy's opinion noted two prior cases in which USPS was held subject to laws requiring garnishing of unpaid state taxes from employee wages and liable for damages in employment discrimination lawsuits. However, he found that the court of appeals erred in leaping from the conclusion that USPS was no longer subject to general sovereign immunity to the conclusion that it was subject to the antitrust laws. Justice Kennedy found that USPS still has "government status" as an "independent establishment of the

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38 *See supra* note 2.

executive branch of the Government of the United States," (124 S. Ct. at 1326) even though it can "sue or be sued" by statute (124 S. Ct. at 1327). As such, it is not a person as defined by the relevant U.S. antitrust statutes.[39]

The opinion concluded with two notable arguments. A first was that because USPS cannot set prices or close offices without permission from a separate regulator (the Postal Rate Commission, or PRC), it lacks the discretion of private businesses subject to antitrust. He also found that although the Postal Service does operate businesses not subject to PRC regulation, those are not substantial enough to void USPS's status as a governmental entity. Taken together, these suggest that the Court has raised the bar in bringing antitrust cases against regulated firms, even when they involve unregulated businesses. In fact, that is the case.

VI. PRIVATE FIRM QUASI-IMMUNITY? *VERIZON V. TRINKO*

A. Conflicts regarding exchange interconnection

The Telecommunication Act of 1996 was expected to bring about competition in local telephone service by mandating interconnection between the incumbent monopoly and new entrants. This interconnection could take place in one of three ways, depending on the nature of the new entry. For entrants that provided complete facilities to customers, interconnection would allow the one supplier's customers (e.g., an entrant) to complete calls to customers of another supplier (e.g., the incumbent). The second would allow entrants needing some of the incumbent's facilities to obtain access to them at nondiscriminatory, cost-based prices. The third interconnection mechanism would allow entrants with no local facilities to resell local service obtained from the incumbent at wholesale discounts.

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[39] 124 S. Ct. at 1328. Section 404(e) of S. 2468, the Postal Accountability and Enhancement Act introduced in Congress in 2004, would eliminate antitrust immunity for USPS conduct "with respect to any product which is not reserved," but would face no financial liability for conduct "with respect to a product in the market-dominant category of mail." *See* http://thomas.loc.gov /cgi-bin/query/D?c108:3:./temp/~c108CdO5zS:: (accessed June 28, 2004).

The experience with interconnection under the Telecommunications Act has proven to be no less controversial than that leading up to *U.S. v. AT&T* or with electricity restructuring. In 2000, the Seventh Circuit Court of Appeals issued a ruling in *Goldwasser v. Ameritech*[40] regarding allegations that Ameritech, the incumbent telephone company, had violated the antitrust laws by engaging in a host of discriminatory practices that prevented local competition from developing. That court's key finding was that Ameritech's practices took place in a setting established by the Telecommunications Act, hence that the regulatory processes established by that statute should take precedence over the antitrust laws. The judge issued this ruling despite a "savings clause" in the Telecommunications Act stating 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."[41]

The Second Circuit Court of Appeals took the opposite position in a similar case, *Trinko v. Verizon*, in which Trinko, a customer of AT&T's local service, alleged that Verizon failed to provide nondiscriminatory local interconnection to AT&T.[42] This court held that the savings clause subjected Verizon's conduct to liability under the antitrust laws as well as the Telecommunications Act, overturning a lower court's dismissal of the case following *Goldwasser*. Moreover, it found that Verizon's conduct could constitute monopoly leveraging and anticompetitive refusal to grant access to "essential facilities," apart from whether it conformed to the interconnection provisions of the Telecommunications Act.

B. The Supreme Court decides

Faced with a clear conflict between appellate courts on the relationship between the antitrust laws and the Telecommunications Act, the Supreme Court granted Verizon's appeal, unanimously

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40 222 F.3d 390 (7th Cir. 2000).

41 47 U.S.C. § 152.

42 305 F.3d 89 (2d Cir. 2002). Ironically, AT&T is now the alleged victim of discrimination by its divested former local telephone companies.

finding in Verizon's favor.[43] In so doing, the Court went beyond finding if and when the Telecommunications Act preempted the antitrust laws. It accepted the Second Circuit's finding, at least insofar as to say that the antitrust laws had to be considered.

However, the Court then went on to rule that Verizon's alleged discrimination against AT&T did not violate the antitrust laws. The Court claimed that refusing to deal with competitors is anticompetitive only if it involves termination of services that had been voluntarily provided. Interconnection agreements under the Telecommunications Act, being mandated by statute and hence involuntary, did not raise antitrust issues if not carried out. The Court also found that Verizon's termination was not anticompetitive because it was, at least not obviously, sacrificing profits by discriminating against AT&T.

The Court did cite the relevance of the Telecommunications Act in two respects. First, it refused to apply an "essential facilities" doctrine—one that the Court said it had never recognized in any event—when there is prior state or federal regulation regarding access. Second, it argued that any case requiring dealing with competitors involves an uncertain comparison between possible gain from increasing competition against the risk of discouraging competition from entrants by forcing incumbents to share facilities with them. With the Telecommunications Act in place, the added potential benefits of antitrust enforcement are small, in the Court's view, while the risk of discouraging competition remains significant, tilting the balance against mandatory interconnection under the antitrust laws.

C. *Implications for postal competition*

The practices found not to be anticompetitive in *Trinko*, and the circumstances rationalizing that finding, were little different from key findings in *U.S. v. AT&T*. In the *AT&T* case, discrimination

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[43] *See supra* note 4. Six of the nine Justices found for Verizon on the basis of the antitrust analysis described in the Court's opinion. The other three found for Verizon on the grounds that Trinko, as only a customer of AT&T and not a direct recipient of Verizon's interconnection services, lacked appropriate standing.

against long-distance entrants was a withholding of service mandated by regulators and courts, just as involuntary as the facially similar service allegedly withheld by Verizon in *Trinko*. Its refusals were not a discontinuation of apparently profitable prior dealings, and thus no sacrifice of profits to reap monopoly gains later can be inferred. In addition, at the time of the *AT&T* case the FCC was exercising oversight of interconnection, tilting the cost-benefit test invoked by the *Trinko* Court away from antitrust enforcement.

These similarities imply that the theory underlying *U.S. v. AT&T* retains little if any precedential force in U.S. antitrust jurisprudence. The *Trinko* Court did not cite the *AT&T* case, because there was no decision as such to cite. The AT&T divestiture was the result of a negotiated settlement between the parties, not a court-ordered remedy following a finding of antitrust liability. There is little reason to believe that antitrust courts in the U.S. will be willing and able to insulate competitive markets from potential abuses from regulated monopolists. Adding the *Flamingo* finding that the USPS, as a government entity, fails to qualify as a legal "person" under the U.S. antitrust laws, the prospects for using the courts to limit the scope of the postal monopoly in the U.S. are quite slim.

VII. EU SOLUTION? DEUTSCHE POST AND ARTICLE 82, MODIFIED

A look at whether the European Union competition law is as constrained as U.S. law begins with article 82 of the European Commission Treaty, which deals with abuse of a "dominant market position."[44] The article states, in its entirety, that

> Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market insofar as it may affect trade between Member States. Such abuse may, in particular, consist in:

[44] European Commission, *Abuse of a Dominant Market Position By Companies—What Can the Commission Do?*, CITIZEN'S GUIDE TO COMPETITION POLICY (2004), available at http://europa.eu.int/comm/competition/citizen/citizen_dominance_en.html (accessed Apr. 22, 2004).

(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;

(b) limiting production, markets or technical development to the prejudice of consumers;

(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

The European Commission (EC) defines a "dominant firm" as one that can operate "without taking into account of the reaction of its competitors or of intermediate or final consumers."[45] By this definition, it is hard to imagine any firm being "dominant," in that demand elasticity constrains price, even absent the threat of expansion by actual competitors or entry by potential competitors.

Nevertheless, the EC has successfully brought abuse of dominance cases under article 82. Most pertinent is the *Deutsche Post* case,[46] described by the European Commission as "the first formal Commission decision in the postal sector under Article 82 of the EC treaty, which prohibits abuses of a dominant position."[47] The decision

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45 *Id.* As with U.S. antitrust, having a dominant market position is not itself illegal, only its abuse.

46 *See supra* note 5.

47 European Commission, Antitrust Proceedings in Postal Sector Result in Deutsche Post Separating Competitive Services From Letter Monopoly, Press Release (March 20, 2001). EC competition law has also been used to address mergers in the postal sector. With one exception, however, remedies have allowed mergers to proceed but with the imposition of nondiscrimination and transparency rules to prevent cross-subsidization. In one instance, a joint venture of the British, Dutch, and Singapore postal services was approved on the condition that TPG, the Dutch partner, divest the part of its service that delivered mail to other countries. *See* D. Geradin & D. Henry, *Regulatory and Competition Law Remedies in the Postal Sector* 21 (2003), Social Science Research Network, http://ssrn.com/abstract=500002 (accessed Apr. 22, 2004), citing Case no. COMP/M 1915, *The Post Office/TPG/SPPL* (2001).

followed an allegation by United Parcel Service that Deutsche Post was charging below-cost prices for its parcel delivery service, funded by cross-subsidies from its monopoly in letter delivery. The EC found cross-subsidization, in that the revenues from the competitive service did not cover its incremental costs.[48] To remedy the situation, the EC required that Deutsche Post form a separate subsidiary to provide business parcel services.

The *Deutsche Post* case is an especially apt example. It shows that, unlike in the U.S. after the *Flamingo* decision, the EC is able to and will bring cases against postal firms, even if state-owned. Unlike in *Trinko*, courts in the EC are willing to act against regulated monopolies that abuse their dominance.[49] EU courts are willing to mandate structural relief to deal with this problem, albeit with only a separate parcel delivery subsidiary rather than a fully divested and independently owned entity.[50]

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[48] Brennan, *supra* note 12, shows that an incremental cost test is inadequate. A diversified regulated monopolist may be able to substitute nonincremental fixed costs for incremental variable costs, distorting technology to fund a cross-subsidy that passes an incremental cost test.

[49] *Trinko* and *Deutsche Post* differ in that the former was primarily concerned with discriminatory access, while the latter focused on cross-subsidization. However, U.S. courts may not be much more willing to look at the harms caused by cross-subsidization. Sullivan & Hertz find that U.S. courts will accept cross-subsidization as a justification for divestiture only if the incumbent regulated monopolist "possessed or threatened to obtain market power in the market it was seeking to enter." *See* L. Sullivan & E. Hertz, *The AT&T Antitrust Consent Decree: Should Congress Change the Rules?*, 5 BERKELEY TECH. L.J. 233, 245 n.38 (1990), citing U.S. v. Western Electric, 900 F.2d 283 (D.C. Cir. 1990). As noted above, cross-subsidization also creates economic harm by raising prices in the regulated market (funding the cross-subsidy) and displacing some more efficient capacity from competitors in the unregulated market, even if the latter remains competitive. Thus, the viewpoint expressed in this case indicates that, with *Trinko*, U.S. courts are much less likely than are EU courts to find conduct by regulated monopolists anticompetitive.

[50] Geradin & Henry, *supra* note 47, at 36. However, four other EC postal cases had only behavioral, non-structural remedies. *Id.* at 42–43.

The above analysis suggests two cautionary notes. The first is that stopping short of full divestiture preserves incentives to cross-subsidize, requiring additional regulatory monitoring over prices and transactions to attempt to mitigate it. The second is that article 82 can reach too far. Whatever its other ambiguities, it is not restricted to *regulated* firms holding a dominant market position. Section II.D above noted that regulation is crucial in applying theories of discrimination or cross-subsidization. Absent regulation, the dominant firm can exploit its market power directly by charging high prices, leaving ambiguous any incremental welfare affects associated with vertical integration or exclusionary conduct.

VIII. CONCLUSION

Delineating monopoly services and appropriately isolating them from related competitive markets are necessary for expanding competition in previously regulated sectors, including telecommunications, electricity, and postal services. Until recently, U.S. experience suggested that courts rather than regulators were more suitable venues for accomplishing these tasks. Decisions since late 2003, rejecting the applicability of antitrust laws to the USPS and to exclusionary discrimination by incumbent telephone monopolists, indicate a reversal of this trend in the U.S.[51] The EC's *Deutsche Post* decision indicates that EU antitrust law under article 82 shows more promise, if article 82's reach can be limited to regulated monopolies.

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[51] *See* D. Geradin & J.G. Sidak, European and American Approaches to Antitrust Remedies and the Institutional Design of Regulation in Telecommunications 19 (2003), American Enterprise Institute, http://www.aei.org/news/filter.all,newsID.19747/news_detail.asp (accessed Apr. 22, 2004), also claim that in the telecommunications sector, antitrust is playing a declining role in the U.S. but it is playing an increasing role in the EU.