Application of US antitrust law in the telecommunications industry in an era of rapid change

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No other industry is experiencing the rapid and fundamental changes occurring throughout the telecommunications sector. These changes will profoundly alter both the commercial marketplace and the regulatory environment in which these services are offered. As FCC chairman Kevin Martin recently said:

"Advances in technology are leading to a convergence of multiple platforms. This development of intermodal competition is fundamentally changing the way that both carriers and their customers use telecommunications and technologies. Given these market changes, we can move towards a more deregulated, competitive environment. One undistorted by regulatory arbitrage and artificial distinctions. And one with competition leading to higher quality, more innovative services, and cheaper rates." 1

The marketplace and regulatory changes have led, and will continue to lead, to changes in the application of US antitrust laws to this industry. They will alter how courts and regulators define product and geographic markets and how they assess the existence of market power. Moreover, since the scope of the obligations imposed by antitrust law on larger industry players is affected by the scope of regulation, regulatory changes will affect the outcome of antitrust litigation.

Impact of dramatic technological change

It would be difficult to overstate the pace and extent of change in telecommunications technology over the past few years, or the impact the changing technology will have on the business, as well as on antitrust and regulatory oversight. The two most fundamental results of these technology developments are seen in the manner in which services can be provided over a network, and in the vastly improved bandwidth capability of wireless technology.

Dramatic improvements in digital compression, IP data traffic handling, communications protocols, and related technologies make it inevitable that, in the near term, all 'telecom' services will be provided as applications over a common broadband network. One example is IP-based voice, commonly known as 'voice over IP' or 'VoIP', which converts analogue voice signals to data bits at one end, and converts back to analogue (sound) at the other end. Between the ends, the voice signals travel as packetised bits that can be handled more or less as any other data. 'Video' similarly can be converted and transmitted as bits (as it is for digital cable). So long as the physical network ('Layer 1' in OSI terms) is capable of supporting the required data speed, any of these services will produce at least as good quality in digital form, and most will appear to the user in higher quality than their analogue equivalents.

Equally dramatic improvements in wireless technology, both standards-based and proprietary, mean that wireless networks now can provide nearly the same bandwidth, and the same quality of transmission, as their wired counterparts. Wireless transmission has been widely used in telecommunications for more than five decades, in long-haul and network backbones since the advances in microwave transmission technology funded by the government during World War II. But only in the last 25 years has wireless connectivity for user telecom devices been feasible in the mass market. While penetration rates for wireless telephony ('cellular') services grew slowly in the early 1980s, today wireless telephony has overtaken wired telephony in many parts of the world, and is close to the same achievement in the US. The number of wireless subscribers in the United States has increased from less than 90,000 at the end of 1984, 2 to nearly 194 million at the time of writing, as compared with a total US population of nearly 296 million. 3

The Federal Communication Commission recognised the rapid and massive shift to wireless voice technologies, and the impact that the shift has had on all services within the traditional telephone industry, as early as two years ago:

"The long distance, local, and the payphone segments of wireline telecommunications have all been losing business to wireless substitution. Long-distance volumes and revenues are down at AT & T, MCI, and Sprint as customers shift to wireless services to make their calls. Verizon, SBC, and Bellsouth saw business and consumer access lines fall 3.6, 4.1, and 3.2 per cent, respectively, in 2002, for a total decrease of 5.5 million lines, with wireless substitution being a significant factor." 4

While the data on 'cord-cutting' among businesses is limited, there is no disputing that the migration of local calls from wireline to wireless is significant. According to an In-Stat survey, "[w]ireless phone penetration [in 2004] is highest in the smallest companies—approximately 92 per cent of employees at [these] companies (4 or fewer employees) use wireless phones." 5 Small businesses (those with 5 to 99 employees) have a penetration rate of 67 per cent and mid-sized businesses (those with 100 to 999 employees) are at 50 per cent penetration.

The group of wireless telephony services collectively referred to as 'cellular' have significant inherent bandwidth limitations, because the systems and technologies were designed for voice, rather than for data. But a new set of wireless technologies, which began to emerge in the late 1990s, have an entirely different premise: to provide a broadband platform over which all services could be provided as applications. Several of these are already in commercial use at the time of writing, and others are in commercial trial.

The first to gain mass market acceptance was the 802.11 standards-based technology now known as WiFi, which initially offered up to 2 M bps in bandwidth, and soon increased to 11 M bps in the 802.11b specification for the 2.4 GHz band. 6 The 802.xx standards have continued to evolve since 802.11, leading more recently to 802.16, commonly known as WiMAX, which is capable of 40 M bps in fixed and nomadic applications, and 15 M bps in mobile deployments and has greatly increased range. A different wireless approach is taken by Qualcomm's CDM A 20001xEV-DO technology, which is a form of wideband CDM A (WCDMA), and is compliant with the 3G standards of CDM A2000, and is currently offered by Verizon and Sprint. 7

Several companies have developed proprietary technologies for which they claim even greater bandwidth and range, as well as improved security and traffic handling capability, than is offered by the standards-based technologies. IP Wireless has deployed commercially in several countries and is trialling in the US a proprietary technology that is based on the 3G UMTS-CDMA standard. 8 Aertoire's proprietary technology that is based on the 3G UMTS TD-CDMA standard. 11 Aperto Systems and others are in commercial use at the time of writing and others are in commercial trial.
offers its branded PacketWave technology, which uses a form of
down in a somewhat similar to that adopted by the IEEE 802.16a Work-
ing Group, in which Aperio played a part. N e x t e t c l a i m s coverage
across a cell footprint of 18 miles (30 km) for its NLLOS (non-line-of-sight) technology, with commercial deployments in Asia, North America,
and elsewhere in Latin America. 13

And, while these technologies are still in the early stages of limited
deployment, Verizon’s deployment of 1xEV-DO is among the first of
what are likely to be major deployments by large-scale US companies.

Most recently, as a condition of receiving FCC permission to com-
plete their merger, the combined Sprint-Nexel agreed to use its nation-
wide spectrum allocation at 25 GHz to offer fixed wireless broadband
service to 15 million subscribers within four years, and double that
number within six years. 14 This may well jump-start the deployment
of fixed wireless broadband service—by both nationwide and regional
providers, and by both incumbents and several well-funded newer
providers, such as Clearwire15—and therefore could signal a tipping
point in terms of both number of providers, and number of subscribers.
If so, it would mean that what has recently become a contest between
existing cable and telephone companies, could soon be a race among
three or four or more providers offering broadband service to upwards
of 80 per cent of the population.

These tectonic technology changes push against the constraints of
traditional regulatory ‘pigeonholes’ and are rapidly undermining tradi-
tional antitrust ‘product market’ definitions as well. Historic regu-
lation focused on discrete categories of services (voice, data, video), as
well as of customers (business, residential), as well as of distance (local
and long distance). New technologies already have made nonsense of
these distinctions. Cellular telephony has taught users that they can
communicate from anywhere—their capability is no longer tethered to a
physical location. The Internet (particularly, Layer 3 routing) has taught
users that they can interact with information that is located anywhere;
a user’s computer can put that user simultaneously in the Louvre in
Paris and the Metropolitan Museum in New York, all with little cost
and virtually no delay. And, of course, WiFi has taught users that they
can be anywhere and interact with information anywhere; both the
user’s and the information’s location are irrelevant. If a user is work-
ing from a park bench in California having a worldwide four-way
VoIP/video conference call from her computer to jointly edit a docu-
ment, the appropriate regulatory ‘pigeonholes’—offered the traditional
choice of local/long distance/voice/data/residential/business—are
either ‘all of the above’ or, more realistically, ‘none of the above’.

Regulators have begun to take notice. In the US, for example, the
FCC first dealt formally with this issue in the 1998 Stevens’ Report,16
which announced that the Commission would not draw any final con-
cusions in the absence of a more developed record, and offered three
preliminary conclusions: (1) ‘computer-to-computer’ IP telephony is
an ‘information service’ that is not subject to traditional telephony reg-
ulation; 17 (2) ‘phone-to-phone’ VoIP may be treated as a regulated
telecommunications service if it had other characteristics of PSTN tele-
phony; 18 and (3) VoIP calls between ‘computers’ and ‘phones’ could
not be classified without a full record developed in a formal proceed-
ing.19

More recently, in the Free World Dialup Petition, the Commission
decided that a service consisting of a server-based intermediation
among peer-to-peer SIP-based VoIP subscribers, is neither ‘telecom-

munications’ nor a ‘telecommunications service’ subject to telephony
regulation, but rather is an unregulated ‘information service’.20 The
FCC noted its decision was taken “to remove any regulatory uncer-
tainty that has surrounded Internet applications such as FWD. We fore-
malise the Commission’s policy of non-regulation to ensure that
Internet applications remain insulated from unnecessary and harmful
economic regulation at both the federal and state levels... [D] lure action
is part of a number of initiatives that are designed to bring the bene-
fits of Internet protocol-based (IP-based) services to American con-
sumers.”21

However, the Commission attached significant caveats to its deci-
sion: “This declaratory ruling addresses FWD only to the extent it facil-
itate free communications over the Internet between one on-line FWD
member using a broadband connection and other on-line FWD mem-
ers using a [sic] broadband connection. Therefore, we specifically
decline to extend our classification holding to the legal status of FWD
to the extent it is involved in any way in communications that origi-
nate or terminate on the public switched telephone network, or that
may be made via dial-up access.”22

The FCC deferred those larger questions to its then-promised pro-
cceeding to examine and determine all issues related to IP-enabled ser-
VICES, a proceeding in which the FCC has still not released an order.

So, despite seven years since the issuance of the Stevens’ Report,
the FCC has not moved much beyond those tentative conclusions.
While there is little controversy today about the first determination of
‘computer-to-computer’ VoIP, the other two pronouncements—that
‘phone-to-phone’ VoIP is regulated telephony, and that it is ‘too soon
to determine’ the classification of ‘phone-to-computer’ VoIP—are
unlikely to be sustainable, as VoIP services and customers become ever
more sophisticated and widely used.

For example, a call that originates or terminates on a ‘regular’ tele-
phone is subject to traditional telephone regulation, even if a portion
of the call is handled as IP in the network. The problem with this
approach is even shown by current market realities; many VoIP
‘providers’ are selling an integrated device that provides connectivity
to a traditional telephone instrument through an RJ-11 jack, and con-
tains the microprocessor and software to convert between analogue
and digital IP.

The FCC continues to have significant difficulty in deciding the
more important issues relating to how it will treat calls that involve
interconnection between IP-telephony and the traditional dial-up pub-
lic network (PSTN). A decision in November 2004 appeared to offer
promise of deciding these questions, as it pre-empted an effort by the
Minnesota PUC to apply state regulatory rules to Vonage’s VoIP ser-
vice; however, the Commission explicitly declined to declare what the
federal rules would be.23

And, despite releasing a notice of proposed rulemaking in March
2004 entitled ‘In the Matter of IP-Enabled Services’, FCC 04-28, as of
this writing, the Commission has still not released even a first report
and order on the fundamental issues of IP telephony.24

The FCC has been somewhat more forthcoming in its analysis of
telecommunications markets on the issue of the fit between wireless
and wired telephony for purposes of defining markets. In recent merger
analyses, the FCC determined that there is only ‘one-way’ substitution
between wired and wireless telephony: wireless is a substitute for (and
therefore should be included in the market when analysing issues in)
wired telephony, but when analysing issues in wireless telephony, wired
telephony is not in the same market.25 This distinction is both rational
and sustainable in the near term. And the fact that wired telephone
tethers a user to a particular location for network access, while wire-
less does not, means that the distinction should be sustainable in the
long term as well.

The Commission is also attempting to harmonise its approach to
historically disparate technologies that are converging on delivering
similar services. So, for example, the Commission recently determined
in the ‘Brand X’ case that cable-system-based Internet access, like tele-
phone-system-based Internet access, should properly be recognised as
a single ‘information service’, not subject to traditional telephone reg-
ulation, and not as a combination of a more regulated telephone ser-
vice (the transport medium/service) plus a less-regulated information
service (the Internet access service).26 While an intermediate federal
court disagreed, the Supreme Court recently upheld the Commission’s
right to decide the issue, as well as the validity of the Commission’s determination.\textsuperscript{27}

These examples from the realm of regulation illustrate equally well the tension between new technologies—or rather the uses to which these technologies will be put by entrepreneurs and their customers—and traditional antitrust definitions in the industry.

Traditional market definitions have a questionable future. For example, cable television and satellite video are most often viewed as in the same ‘market’, whereas broadcast is traditionally viewed as being in a different market. The internet has not traditionally been analysed as part of either video product market. But these conceptions may change. As digital video compression improves and broadband becomes both faster and more ubiquitous, consumers can get both streaming real-time video\textsuperscript{28} as well as on-demand movies for viewing on their computers. A company called Movielink\textsuperscript{29} is already making a limited set of movies available for viewing on an Internet-connected computer. And Hollywood studios recently have agreed on standards for digital distribution of movies, at least to movie theatres, but possibly also signalling that they hope to do for movie distribution what the iPod and its imitators have done for music distribution.\textsuperscript{30} Once ‘online’ movies become a significant factor, it may become logical that at least the satellite, cable, and online movie markets would be analysed together, or that broadcast and Internet-streamed video would be in the same market, or that online movies and rental movies would be in the same market, or that all would.

As voice, data, and video all become IP-based ‘applications’ that can be delivered over any broadband infrastructure, the cost structure of delivery changes dramatically. The traditional copper-based wired telephone network was based on technology for which the costs varied directly (and even dramatically) with distance. The evolution over the past few decades to fibre deployed ever closer to the edge of the network decreased significantly the distance sensitivity of the network’s cost structure. And in many new services, the pricing structure followed, with prices based on available capacity rather than on time or distance or ‘units’ of information moved. The cost structure of fibre-based networks has also resulted in prices that are not only structured differently, but also are significantly lower, for a given amount of information moved between two points.

The transformation of all traditional telecom services—voice, data, and video—into IP-based applications will both benefit from and accelerate this pricing trend. Indifferent to the Layer 1 physical infrastructure, these applications will migrate to the most efficient physical networks, which will also price services based on capacity used, rather than on units of information moved or distance or time. The end-to-end connection between the content provider and the consumer, including content aggregation and network provider, will be transparent bandwidth, priced according to the required capacity/bandwidth/speed.

This price structure, enabled by the cost structure of the new technologies, will result in dramatically reduced barriers to entry. The physical infrastructure will be required to be increasing transparent, and therefore increasingly undifferentiated. The value will be in the content, whether that content is a conversation, a home video shared with family, a movie rented online, or any work product.

To achieve the transparency that will be required by users, the network (Layer 1) providers will have to offer universal connectivity, which in turn will require them to interconnect with each other as efficiently as possible; a network provider who attempts to impose limits on ‘reach’ or to artificially reduce the ‘quality’ of transport will quickly suffer loss of market share, as the ‘bits’ move to more efficient, higher quality, networks with better reach.

And pressure on wired networks will intensify as wireless technologies are more widely deployed. The network world will continue to evolve rapidly from the wired telephone and cable networks, to a multi-provider environment of telephone, cable, fixed broadband wireless, and the next generation of ‘cellular’ wireless networks. Add to these the public networks (both ‘free’ and subscription), and it is clear users, not network providers, will be paramount.

This evolution in technology and services also challenges the utility, for antitrust analysis, of traditional measures of market power. Under the Horizontal Merger Guidelines, the DoJ and the FTC note that they will consider both the post-merger market concentrations as well as the increase in concentration resulting from a merger. However, the Guidelines stress that “in some situations, market share and market concentration data may either understate or overstate the likely future competitive significance of a firm or firms in the market or the impact of a merger”.\textsuperscript{24} These situations include where a new technology important to long-term competitiveness in the market is available to other firms in the market, but not available to a particular firm. In addition, DoJ/FTC will consider “reasonably predictable effects of recent or ongoing changes in market conditions in interpreting market concentration and market share data”.\textsuperscript{32}

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Trinko, a customer of a new entrant local telephone service alleged that an incumbent local telephone company (Verizon) had violated its obligations under the Telecommunications Act of 1996 to provide non-discriminatory access to its network. As a result, Trinko alleged the ILEC had monopolised and attempted to monopolise in violation of Sherman Act Section 2.

The Supreme Court rejected Trinko’s claims, holding that violations of regulatory duties are not, in and of themselves, violations of the antitrust laws. Indeed, the existence of a regulatory scheme aimed at fostering competition reduces the need to rely on, and therefore limits the appropriate application of, antitrust remedies. As the Supreme Court stated, “Antitrust analysis must always be attuned to the particular structure and circumstances of the industry at issue. Part of that attention to economic context is an awareness of the significance of regulation… One factor of particular importance is the existence of a regulatory structure designed to deter and remedy anti-competitive harm.”\textsuperscript{35}
In addressing Trinko’s claims that Verizon’s actions amounted to an illegal refusal to deal, the Supreme Court reaffirmed that the antitrust laws generally do not require firms—even those with monopoly power—to assist competitors. One of the more significant comments was that Aspen Skiing Co v Aspen Highlands Skiing Corp.36 was “at or near” the outer limit of what was required. In that case, the Court had held that termination of a voluntary and profitable course of conduct and refusal even to sell a product to a competitor at full retail prices violated Section 2. In Trinko, Verizon had not terminated a voluntary course of conduct; it was providing access to its network only because it was compelled by regulation to do so. Moreover, Verizon did not refuse to sell any service it offered to end-users at the retail price Verizon charged.37

Trinko also had alleged that Verizon breached its duty to make ‘essential facilities’ available to competitors. The Supreme Court again declined to recognize the essential facilities doctrine, but noted that in any event, a fundamental element of any such claim would be that the plaintiff does not have access to a facility it needs to compete. In this case, Trinko had access to that facility under the terms of the Telecommunications Act.38 Thus, the existence of a regulatory requirement providing access eliminated any potential argument that such access was required by antitrust law.39

The Trinko decision has had a significant, if inconsistent, effect on other telecom antitrust litigation. Most courts have followed Trinko in dismissing antitrust claims that an incumbent carrier has unlawfully refused to assist or otherwise deal with a competitor.40 One appellate court, however, refused to dismiss a claim that a incumbent local telephone company engaged in a predatory refusal to deal with a competitor’s customers (as opposed to the competitor itself). In Covad Communications Co v Bell Atlantic Corp, Covad alleged that Bell Atlantic refused to sell high-speed DSL internet access service to customers who had purchased a competing, but not yet available, service from Covad. The appellate court ruled that this claim could not be dismissed on summary judgment, because the complaints sufficiently alleged that the refusal to deal resulted in a short-term loss.41

The greatest area of disagreement has been in the application of Trinko to allegations of a predatory ‘price squeeze’. The basic allegation is that a firm sells to end-users at retail a good or service that it also sells at wholesale to its retail competitors, and the spread between the wholesale and retail prices is insufficient to provide its wholesale customer/retail competitor an opportunity to compete profitably. One appellate court has recognized that, if the antitrust laws do not compel an ILEC to deal or otherwise assist its competitors, those laws cannot compel the ILEC to sell wholesale service at a price the plaintiff finds to be reasonable.42 It quoted a leading treatise: “it makes no sense to prohibit a predatory price squeeze in a circumstance where an integrated monopolist is free to refuse to deal.”43

Other courts, however, have refused to dismiss price squeeze claims against ILECs. They have ruled that a price squeeze can be a form of predatory pricing, and that predatory pricing is a form of conduct that courts have found to fall squarely within the prohibitions of Section 2. Thus, in this view, an allegation that (1) the defendant is effectively pricing its retail service below an appropriate measure of cost, and (2) there is a dangerous probability that the defendant will be able to recoup its investment in below-cost prices by later being able to charge a monopoly price, states a valid claim, even if the wholesale transaction was not a voluntary one from defendant’s perspective.44

Conclusion

Developments in 2005 continue to demonstrate that the application of US antitrust law and remedies in the telecommunications industry remains dynamic, as it is affected by changes in the marketplace and the scope of regulation.

Notes

1 Remarks by Chairman Kevin J Martin, Federal Communications Commission, to the NARUC summer meeting, Austin, Texas, 26 July 2005.
6 Becky Diercks, In-Stat, Corporate Buying of Wireless Services and Equipment: 2005’, February 2005 at 8. The survey takes its averages from a total of 611 interviewees (97 small office/home offices, 111 small businesses (five to 99 employees), 211 mid-size businesses (100 to 999 employees), and 212 large businesses or enterprises (1,000+ employees)). Id at 5.
7 Id at 8. See also IDC, ‘SMB Vertical Market Profile, 2003’, January 2004 (“The mean annual spending for SMBs for wireless is $3,438, which equals $286.49 a month. The mean annual phone bill is $9,941, which equals $828 a month. Thus, SMBs are spending about 34 per cent of their monthly phone bill on wireless.”).
8 See, generally, http://groupier.ieee.org/groups/802/111/main.html, initially designed to be a wireless complement to corporate networking (‘wireless LAN’) with limited range between a wireless device and the ‘hub’ through which it connects to the wired LAN, the rapid advances in affordability and capability of the technology soon led to widespread deployment of ‘hotspots’ or publically-available areas of wireless connectivity. Like all LAN technologies, at the heart of connectivity is a broadband connection to a larger network: a corporate LAN in the enterprise sector, and the internet in the case of hotspots and most home WiFi networks.
9 http://www.wimaxforum.org/about
10 http://www.qualcomm.com/technology/1xev-do/migration.html (for Qualcomm description of 1xEV-DO technology; http://www.verizonwireless.com/b2c/mobileoptions/broadband/index.jsp (for “Verizon description of its Wireless Broadband Access” service); http://www.motorola.com/mediacentr/ news/detail/0,4932-4221-23.00.html (for description of technology and equipment for Sprint’s deployment of 1xEV-DO); http://www.sprint.com/business/products/phones/aircard580-connectionCards.jsp (for description of Sprint PCI card used for Sprint’s 1xEV-DO service). While currently sold as a ‘wireless DSL substitute’ and therefore used for data connectivity with a user computer augmented with a PCI card containing the 1xEV-DO radio, future generations of the technology will support multiple services simultaneously including voice, data and video on a single device, whether a computer (with a PCI card, currently) or a handset. This means that a personal ‘handset’ would be a broadband device capable of supporting voice, data, and video, and networking seamlessly with the same applications running on desktop computers at the user’s enterprise.
11 http://www.ipwireless.com/technology/
13 http://www.nextwireless.com/products.asp
14 “First, within four years from the effective date of this Order, the merged company will offer service in the 2.5 GHz band to a population of no less than 15 million Americans… Second, within six years from the effective date of this Order, the merged company will offer service in the 2.5 GHz band to at least 15 million more Americans in areas within a minimum of nine additional BTAs in the 100 most populous BTAs, and at least one additional BTA less populous than the nation’s 200th most populous BTA.
In these additional ten BTAs, the deployment will cover at least one-third of each BTA’s population.” In the Matter of Applications of Nextel Communications, Inc and Sprint Corporation For Consent to Transfer Control of Licenses and Authorizations, FCC 15-048, 8 August 2005 (paras 164-165).

Clearwire boasts ownership by Craig McCaw, as well as the technical and operational involvement of many key players in the team that made McCaw Cellular a success. See, http://www.clearwire.com/company/leadership.htm

In 1998, the FCC prepared and presented to Congress the so-called Steven’s Report, which addressed how evolving technology, including most significantly the internet, might affect universal telephone service. In the Matter of Federal-State Joint Board on Universal Service cc Docket No. 9645, 13 FCC Rcd 11501, release Number 98-67 released 10 April 1998. The Steven’s Report, among other things, discusses the classification of VoIP services as either ‘telecommunications’ or ‘information’.


However, the Commission did release a first report and order, FCC 05-116, 20 FCC Rcd 10245, in June 2005, deciding that providers of VoIP services that interconnect with the PSTN have obligations to provide 911 services, including enhanced 911 (E911). The Commission will likely continue to insist on such social obligations as 911 and E911, as well as wiretap capability such as is required in the CALEA legislation, Section 103(a) of CALEA, 47 USC Sec 1002(a). A more telling issue is whether and how VoIP will be required to “contribute to universal service” as is traditional telephony.


Covad Communications Co v Bell Atlantic Corp, 398 F.3d 666 (DC Cir 2005), pet rehearing den, 407 F.3d 1220 (2005); MetroNet Services Corp v Qwest Corp, 383 F.3d 1124 (9th Cir 2004); Covad Communications Co v BellSouth Corp, 374 F.3d 1044 (11th Cir 2004). See also linkLine Communications, Inc v SBC California, Inc, Order Granting in Part and Denying in Part Defendants’ Motion on the Pleadings, Case No. CV 03-5265 SWV (CD Ca, 25 Oct 2004).


Covad v BellSouth, supra, 374 F.3d at 1050-52. See also linkLine v SBC, supra, slip op at 28-29.

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