

The Decline and Fall of AT&T: A Personal Recollection

Richard A. Posner*

Thank you very much, Chris. I needed a generous introduction because I realized, listening to the very interesting talks this morning, that I hadn't thought about telecommunication policy since 1981. I'm a kind of Rip van Winkle here, invited to give an antiquarian talk.

I was struck by Mr. Weber's very lucid discussion of the history of telecommunications technology. He made a powerful argument that everything that's happened in telecommunications policy has been the result, ultimately, of technological progress, and that the lawyers and the economists and the judges and the legislators and the bureaucrats are corks bobbing on the technological waves. So my talk will be not only antiquated but epiphenomenal. Moreover, it is a talk from memory, and I do not warrant its complete accuracy.

In the fall of 1967 I left the Solicitor General's office to become General Counsel of President Johnson's Task Force on Communications Policy. "General Counsel" was a rather grandiose title for my role—the entire staff of the task force consisted of no more than five or six persons, only one other of whom was a lawyer. The staff was under the direction of a very able young fellow named Alan Novak, a Yale Law School graduate who was a personal assistant to Eugene Rostow. Rostow, the former Dean of the Yale Law School, was the Undersecretary of State for Political Affairs and the chairman of the task force. It was noted at the time that the fact that Rostow had been made chairman of this task force was a testament

* Judge, U.S. Court of Appeals for the Seventh Circuit; Senior Lecturer, University of Chicago Law School. This is the slightly revised draft of a luncheon talk given on April 18, 2008, at a conference at the University of Pennsylvania Law School on "The Enduring Lessons of the Breakup of AT&T: A Twenty-Five Year Retrospective."

to his unimportance, because the third-ranking official in the State Department would not be given such a modest and peripheral task if he were really an important official. All I remember of him is his beautiful office in the State Department and that he was the best-tailored man I had ever met. He was elegant and lordly but didn't seem to have anything to say about telecommunications policy. I do remember that his favorite word seemed to be "démarche"—a diplomatic word meaning, actually, just "statement."

A curiosity that didn't strike me until today is that there didn't seem to be anyone between Gene Rostow and Staff Director Novak. You'd think there would be a task force with members and a staff of young people reporting to it. But there was just Rostow, and he took no interest, as far as I could tell at any rate, in the project.

There was a fine economist on our staff whom we called the Director of Research—Leland Johnson—a very good price theorist from Rand who had achieved a measure of academic celebrity for what was called the "Averch-Johnson" effect—the incentive of price-regulated firms to overinvest because their capital costs were not constrained as effectively as their operating costs. Lee Johnson was excellent, and I learned a lot from him about price theory.

The task force had a very broad mandate, and much of what we dealt with had nothing to do with the regulation of AT&T. Cable television was just emerging from its original, very limited role of overcoming topographical obstacles to broadcast transmission, but already dreamers were talking about hundreds of channels and how that plenitude would transform American culture. We also became involved in intense debate over pay television—whether allowing it would erode a sense of community somehow created by free (to the viewer, that is) television. And we spent much time discussing companies that you've probably never heard of called "record carriers," obscure common carriers that handled international telex traffic (telex—another fossil). There were policy issues concerning them and also concerning satellites—communication satellites were just coming on line. But we did talk extensively with and about AT&T, and Bill McGowan, the founder of MCI, came and lobbied us, as of course did AT&T.

We were skeptical about the social value of AT&T's monopoly of telephone service, and about common carrier regulation in general. Even though the 1960s was an era of renewed collectivism—the era of the Great Society programs—the collectivist impulse somehow coexisted with skepticism about public utility and common carrier regulation, which seemed old-fashioned and anticompetitive. That skepticism had arisen in the 1950s, and in the 1960s George Stigler and other distinguished

economists published highly critical articles about regulation. This skepticism was magnified when one met the regulators and regulatees. Moreover, hostility toward monopoly was an aspect of the antitrust culture of the 1950s and 1960s, and antitrust was a “liberal” policy that coexisted comfortably with the liberal thrust of the Great Society.

I left the task force to join the faculty of the Stanford Law School in the summer of 1968. I think we had pretty much finished—we the staff at any rate—the task force’s report. But before it was released to the public it was submitted to the White House and there I think it got diluted in some ways. The report was finally issued in December of 1968, at the very end of the Johnson administration; and then Nixon came in. So I don’t know what effect on policy the report had. But the very able engineer on our staff, Walter Hinchman, became the head of the Common Carrier Bureau of the FCC, which was already beginning to turn against AT&T, and Hinchman helped it turn further. What Weber told you in his talk was very pertinent. New technologies had arisen that facilitated competition, such as microwave towers for long-distance telephone service, which were much cheaper than building underground cables.

I also think that AT&T’s attitude of never yielding an inch irritated people, including the officials and staff of the FCC. *Hush-a-Phone* (a rubber cup-like device that one attached to the speaking end of the phone so that other people in the room couldn’t hear what you were saying, and that AT&T claimed was a forbidden “foreign attachment” to the telephone network) was the famous example of that absurdity. And so in 1968 the FCC issued the *Carterfone* decision, which for the first time permitted “foreign” interconnection with AT&T’s network (over AT&T’s objection)—it was just acoustical coupling, but nevertheless the decision was a portent. The logjam was beginning to break at the FCC, and maybe the task force report (or just the existence of the task force) had some effect in encouraging the FCC in its new course.

I had become interested in telecommunications policy as a result of my work on the task force; the first course I taught at Stanford Law School was on telecommunications policy. I started writing about regulation, and published an article in the first issue of Paul McAvoy’s *Bell Journal of Regulation* on cross-subsidization in regulated industries. Other articles followed. And then in 1973 the AT&T suit was filed, and shortly after that I was asked to give a talk in New York, I think mainly to securities analysts, about the case. I recall saying that the suit seemed like a long shot—a suit to break up such a large and heavily regulated common carrier. All of AT&T’s services were provided by tariffs approved by the FCC, and it seemed unlikely that an antitrust suit would be allowed to disrupt this system of tariffed pricing and limited entry. But of course it turned out that

the FCC, which became progressively more hostile to AT&T, was happy to allow the antitrust suit to proceed, and it made sure that it didn't create regulatory obstacles to the suit by approving exclusionary tariffs.

At the end of my talk to the analysts, an AT&T lawyer came up to me—I think it was Harold Levy, who was the senior AT&T lawyer on the case under AT&T's general counsel, Mark Garlinghouse—and asked me whether I might be interested in consulting for AT&T on the case. So I said: sure, why not? I was interested in telecommunications policy and I was pleased at the thought of making some welcome money consulting. That began what became a pretty heavy involvement in the case for a period of about four years. But oddly, I don't remember a great deal about those four years of consulting. I think the reasons are that most of my work consisted of attending meetings in New York (though I must have written memos before and after the meetings, but I don't remember any of that and I have no copies) and that the meetings were always the same.

There were two major law firms involved on AT&T's side of the case—Dewey Ballantine and Sidley & Austin. George Saunders, then a youngish partner at Sidley and extremely able and colorful, was the principal outside lawyer. He attended all these meetings as did lawyers from AT&T, usually led by Harold Levy. In addition, AT&T formed something called “Administration D,” a gigantic in-house paralegal and support apparatus, bursting with engineers and functionaries of all sorts.

The reason the meetings were so repetitious, which is why they're such a blur in my memory, was captured in a joking comment that George Saunders used to make to me about Will Baumol, the principal economic adviser for AT&T on the case—a very distinguished economist then at Princeton, very articulate, and a regular participant in the meetings. George used to say: “You know, Baumol has made a great deal of money by telling AT&T that two plus two is four. If you then take away two, you're back to two. But if you add one, you then have three. And if you double it you've got six. And if you then divide by three . . .” What he meant was that Baumol (and George and I and others, as well) would explain in these meetings over and over again the very most basic elements of regulatory economics—economies of scale and scope, cream skimming, vertical integration with nonregulated entities (such as Western Electric, the manufacturing arm of the Bell System), limitations on entry, and so forth. The audience—the AT&T lawyers and engineers—was stubbornly unreceptive. They didn't like this stuff, and they didn't understand it. So it had to be repeated to them over and over again.

One thing that struck me early on was that AT&T did not match my impression of a private company. It reminded me of the government; I had been in the government for several years before becoming an academic.

AT&T was very bureaucratic. And, remarkably, it didn't seem to have any interest in customers. It didn't like competition; that was clear. But more fundamentally, there didn't seem to be any entrepreneurial spirit. I didn't know much about private companies, but this was certainly not what I expected.

AT&T believed for example that nobody should be permitted to interconnect with the network except GT&E and a couple of other small vassal-like telephone companies that were also permitted to interconnect with it. In particular there must be no interconnection by MCI, AT&T's *bête noir*, and no attachment of terminal equipment by customers (that is, no "foreign attachments"). That was AT&T's absolute line of defense: not one step backwards, as Stalin said when the Germans were approaching Stalingrad.

We told AT&T that it would have to be able to give reasons for its position to a court. We heard three reasons, or at least that's all that I remember. The first was that if someone bought his own piece of terminal equipment, attached it to the network, and sent a powerful electric current through it, a telephone lineman working many miles away might be electrocuted. I don't know whether that was even a theoretical possibility. When we asked whether there had ever been an accident of that sort, the AT&T engineers said no. But it could always happen; there could always be a first time. As far as I know, there's still never been such an accident, because the power that goes through the phone lines is very low. A big surge would just blow a fuse rather than cause death by electrocution. So that argument was a loser.

The next argument they pushed on us involved the Department of Defense. The Department had asked AT&T to harden its microwave towers and underground cables, at AT&T's own expense, against a nuclear attack (to win that nuclear war, we would need survivable communications!). The Department had also (I think, though my memory is hazy on this point) pressed AT&T to build another underwater cable, so that Soviet submarines would have greater difficulty interrupting our global communications. And so AT&T said: look, MCI is not hardening its microwave towers. It has these flimsy towers and when the bomb goes off they're going to be blown down. And it would be unfair therefore to allow MCI to compete with AT&T because MCI wouldn't incur these tremendous expenses.

I thought this a dubious point. It seemed strange that a military measure should be financed by telephone ratepayers rather than by federal taxpayers. But worse than that, the argument had the odor of conspiracy between AT&T and the Defense Department: AT&T would finance a military defense measure so it wouldn't be in the Defense Department's

budget and in exchange the Defense Department would support AT&T's monopoly. Military officials testified (and argued inside government, as they did in trying to get the antitrust case against AT&T dropped) that AT&T was an integral part of the defense community and must not have its willingness to invest in defense measures undermined because it would be competing with companies that didn't incur any of that expense (AT&T might have been content with the alternative of the FCC's requiring MCI to harden its facilities, because MCI couldn't have afforded to do that).

AT&T's third argument, and the one it pressed hardest on us, was related to the electrocution argument; it was that you couldn't trust customers, whether businesses or individuals, to maintain their terminal equipment. It was essential that they be required to lease it from Western Electric. Then AT&T would replace it when it malfunctioned or wore out. If you let customers attach their own equipment, they'd buy lousy equipment, not maintain it, and when it broke down, blame the telephone network, and then AT&T would have to spend a lot of time and money trying to figure out whether it was an equipment failure or a network failure. The company didn't want that expense.

So I said to the AT&T lawyers and engineers at one of our meetings: By the same token, shouldn't manufacturers of television sets refuse to sell the set but instead lease it only, so that they wouldn't have to worry about customers who kept it too long or didn't maintain it? And they said: Yes, probably the television-set manufacturers should do that. And then I said: Well, taking that a step further, wouldn't it make sense for clothing manufacturers to refuse to sell clothing but instead just lease it? Suppose a shirt lasts three years on average before it frays or the buttons fall off—the manufacturer would lease the shirt to you for three years, at the end of which time you'd return the shirt and receive a fresh one. At this point the AT&T engineers realized they were being teased, and they said: No, that wouldn't make sense. But they couldn't articulate a reason why, with television sets or telephone equipment, leasing was the way to go but not with clothing.

So I began to think that while the government's case still looked like a long shot, the AT&T people didn't seem to have any good reasons that they could give in support of their position.

At some point during this four-year period I was asked to help organize a meeting for AT&T at which leading economists would come and talk about the case with the AT&T legal team. AT&T was already busy assembling a huge stable of economists as potential witnesses. I think it may have been part of the AT&Ters' generally favorable attitude toward monopolization. They thought (I conjecture) that maybe they could monopolize the economics industry and leave no expert witnesses for the

Justice Department! So we had this session, in Princeton, and a number of very good economists attended. George Stigler was one of them, and George, kind of out of the blue, said to the AT&T people: Of course you're going to lose the case; the only question is what kind of relief you may be able to negotiate. I don't remember the reason he gave, but I think it was something along the lines of: you are so big, you are a monopoly, they're going to have to find that you violated the Sherman Act. The AT&T people were really taken aback by this—they knew that George was a very distinguished economist and also a very conservative one. So I think they began thinking: Yes, we could lose it. They also started getting negative signals from Judge Greene, who was presiding over the case in the federal district court.

My work for AT&T came to a rather abrupt end, I think around 1978. By this time, I was a member of the company's informal steering committee for the case. The steering committee held a meeting chaired by the company's general counsel, Mark Garlinghouse, who I later learned, to my surprise, had actually wanted to open AT&T up to competition. That was not the impression he gave at our meetings, but apparently behind the scenes he was losing faith. At this meeting—there were probably about a dozen people there, mainly, I think, lawyers—Garlinghouse passed out a one-page document outlining AT&T's strategy in the case. It said that the strategy was to delay the litigation—to stretch it out as long as possible. Garlinghouse asked who agreed that this was the correct strategy. Everyone agreed except me. And I said (I'm not sure why; I haven't seen the document since that day thirty or so years ago, because we were told to turn it in before we left the meeting, but there must have been something in it beyond just touting the benefits of dragging their heels) that I didn't think we should adopt this strategy, because this was not an ordinary private litigation. This was a Department of Justice lawsuit and I feared that we could be accused of obstruction of justice by adopting a deliberate policy of delay. That was not a popular suggestion! George Saunders told me later that Garlinghouse had wanted to fire me, but that George had dissuaded him. Nevertheless, there was very little demand for my services after that, which was fine because I had other things to do and also I was worried about that obstruction of justice issue. I didn't want to be implicated.

My last involvement with the case came in 1981, shortly before I became a judge. I was summoned to meet with Charles Brown, the CEO of AT&T, and another person—probably the president of AT&T, but I have forgotten. Brown told me that AT&T was thinking of making a deal with the government whereby it would divest itself of the local operating companies and in exchange would be relieved from the 1956 consent decree that had forbidden it to go into the computer business. He asked me

what I thought of such a deal and he reminded me—though this is something that had been said for a long time, and as far I know was true—that Western Electric’s electronic switching systems, installed throughout the Bell network, were based on the most sophisticated computer technology in the world. He said we (AT&T) have this sophisticated computer technology, the computer industry is booming, and so we think we can—if freed from this incubus (my word I’m sure, not his) of the 1956 decree—be tremendously successful in the computer industry, and so giving up the local companies would be a fair swap. I replied: I don’t think that will work for you, because what I’ve noticed over the years is that AT&T does not have a marketing culture. I remembered from discussions during the consulting meetings I mentioned how derisive the AT&T people had been about customers wanting colored telephones. They thought that was ridiculous. Why on earth would anyone want a colored telephone? I also remember that I had heard of great dissatisfaction with AT&T on the part of its business customers, because if they went to AT&T and explained that they needed a system say for connecting up their offices, AT&T would say fine, we’ve studied your needs, this is your system. And they’d reply: Well, that’s fine, but we’d like to see some alternatives, or we’d like to see something changed here or changed there. And AT&T would say: No, we’ve studied your needs, this is your system. That was the attitude; they did not respect their customers. And this morning we heard about the instabilities that can afflict a business in which you can’t predict your demand. AT&T did a lot of innovation, but they wanted every new thing to be introduced gradually, they wanted uniformity not variety, single not multiple products, and they didn’t want customers buffeting them with demands.

So this was AT&T—a gigantic, bureaucratized company, with a million employees during the 1970s—and I said to Brown that I did not think the culture of the company would adapt to the computer industry, because in that industry, even more than in business telephone services, it’s not enough to have the very best equipment. The really important thing is to be able to integrate the equipment with the customer’s business. Can you explain it to them? Can you make it usable for them, even if their needs are idiosyncratic? That didn’t sound like AT&T.

I obviously didn’t make any impression on Brown. But whether he really thought that AT&T had a future in the computer industry or whether he just thought he was going to lose the case because of Judge Greene’s hostility, because of Bill Baxter’s extreme hostility, because AT&T had spent ten years trying to get legislation in Congress to preserve its monopoly and had failed, I don’t know. Anyway, that ended my

involvement with AT&T. It was lucrative, it was fun, I learned a lot. What I learned is irrelevant to 2008, but I can't help that.

