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THE ROLE OF PRIVATE EQUITY IN THE COMMUNICATIONS MARKETPLACE

HEARING

BEFORE THE

SUBCOMMITTEE ON TELECOMMUNICATIONS AND THE Internet

OF THE

COMMITTEE ON ENERGY AND COMMERCE
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

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THE ROLE OF PRIVATE EQUITY IN THE COMMUNICATIONS MARKETPLACE

TUESDAY, MARCH 11, 2008

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON TELECOMMUNICATIONS
AND THE INTERNET,
COMMITTEE ON ENERGY AND COMMERCE,
Washington, DC.

The subcommittee met, pursuant to call, at 9:30 a.m., in room 2123 of the Rayburn House Office Building, Hon. Edward J. Markey (chairman) presiding.

Members present: Representatives Markey, Harman, Gonzalez, Inslee, Eshoo, Green, Dingell (ex officio), Stearns, Shimkus, Pickering, Fossella, Walden, Terry, and Ferguson.

Staff present: Amy Levine, Tim Powderly, Mark Seifert, Maureen Flood, Colin Crowell, David Vogel, Philip Murphy, Neil Fried, Courtney Reinhard, and Garrett Golding.

OPENING STATEMENT OF HON. EDWARD J. MARKEY, A REPRESENTATIVE IN CONGRESS FROM THE COMMONWEALTH OF MASSACHUSETTS

Mr. MARKEY. Good morning. Today's hearing is on the role that private equity plays in our Nation's telecommunications markets. Private equity and other instruments of risk capital have long nurtured start-ups and grown new industries, particularly in the area of telecommunications. For instance, many pioneering companies in the cable business, the wireless industry, and the Internet marketplace might not exist today if it had not been for the seed capital extended by private equity firms. Over the last few years, however, private equity firms have moved beyond fostering start-up companies and have played an increasing role in acquiring mature telecommunications assets. These acquisitions have included well-known companies in the mass media, wireline telephone, cable and wireless markets. These companies include IntelSat, Alltel, Univision, Clear Channel and Hawaii Telcom, amongst others.

This hearing is designed to examine the effect that private equity may have on the important public policies that have historically been advanced in the telecommunications sector. In conducting this analysis we hope to shed light on the impact private equity financing has on innovation, competition, employment, diversity, localism and universal service. Proponents of private equity often note that taking a hitherto public company private has the benefit of relieving senior management of intense pressure to report high quarterly earnings and to produce significant shareholder dividends. It also

removes the disincentive to invest that Wall Street cultivates when stocks are punished after companies announce increased capital spending for infrastructure upgrades on research and development.

In short, private equity supporters suggest that private equity ownership permits companies to invest in the long-term health of the commercial enterprise acquired.

Another view of private equity's role suggests that achievement of long standing telecommunications policies may be put at risk by private equity owners who seek to quickly flip an acquired company after cost-cutting measures are employed. These cost savings, they assert, come at the expense of workers who lose jobs, service quality, newsroom budgets, and underfunded research and development. A potential policy benefit of private equity ownership that some have noted is that a sell-off of assets performed in order to reduce debt may result in the desegregation of media conglomerates. This has occurred in several transactions, most notably with respect to Clear Channel, which is shedding radio stations in a deconcentration of media ownership. Another issue that has been raised by the rise of private equity ownership is the alleged lack of transparency in ownership and control. A lack of transparency may frustrate the ability of regulators at the federal and state levels to adequately fulfill their statutory responsibilities. The Federal Communications Commission, for instance, has rules governing disclosure of ownership and control in order to police cross ownership, licensing and foreign ownership laws. With private equity firms, the consortia of private equity firms now having so much ownership stakes throughout is an issue. It is unclear whether the regulatory apparatus at the Commission or in state commissions has sufficiently caught up with changes in the financial and capital markets.

I would like to welcome our distinguished witnesses.

Mr. MARKEY. I now turn to recognize the ranking member of the Subcommittee, the gentleman from Florida, Mr. Stearns.

OPENING STATEMENT OF HON. CLIFF STEARNS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. STEARNS. Thank you, Mr. Chairman, and good morning. I also welcome the witnesses here this morning.

Mr. Chairman, as far as I can remember serving on the Telecom Subcommittee, most of my career, the issue of private equity in the communications marketplace is not something that this subcommittee has ever examined. Be that as it may, we will follow wherever you aspire to go, Mr. Chairman. So we are with you here on this important issue, and we look forward to hearing from our witnesses.

My colleagues, private equity firms typically buy or invest in companies that are undervalued or under-performing or need capital to expand. Without the pressures from public shareholders looking for short-term gains, private equity owners can focus on what is required to improve long-term performance in making an investment needed to become more competitive. Private equity investment can help companies focus on long-term strategies for improving service, rather than the quarterly earnings, and can bring troubled companies back to health. We know that from experience.

This past July, Chairman Dingell and Chairman Markey sent a letter to the FCC Chairman, Mr. Martin, asking whether private equity ownership leads to a lack of transparency and an unhealthy focus on cost cutting. In responding, Chairman Martin said that the FCC applies the same ownership reporting requirements regardless whether a company is owned by private equity investors or not. Parties must identify their organizational structures, their owners, their equity, and their voting interests. According to Chairman Martin, the FCC's rules identify financial and ownership interests including those held by private equity firms that affect the programming and other decisions of media entities. And there is no evidence of private equity having a negative impact on quality of service.

Private equity offers telecommunications and media companies an important option for funding, and the FCC rules appear to apply to privately funded entities no differently than publicly funded ones. So my colleagues, in the end, consumers in the marketplace will determine a company's success, not its particular source of financing. The involvement of private equity in the communications marketplace has indeed a very long history. For example, private equity funding enabled early wireless operators, like Aerial Communications, Omni, Voice Stream, to build out networks and launch new services. The company eventually grew to become T-Mobile, which now provides nationwide service, which is in competition with Verizon Wireless and AT&T. Also, when Wall Street was looking unfavorably on rural markets because of the high cost of deployment, private equity firms invested in Western Wireless and helped improve cellular coverage for millions of people. Western Wireless is now part of regional wireless provider Alltel. Private equity owners similarly invested in Hughes Communications, helping to launch a new satellite giving 10 million rural Americans access to high speed service. With billions of dollars of private equity investment, competitive local exchange carriers such as Brooks Fiber, Niklea, entered the domestic telecommunications market with significant benefits in terms of both services and prices for their consumers.

Private equity firms can also help preserve a diverse telecommunications and media market. First, they often compete with incumbent providers to buy companies, thereby providing a check to consolidation. For example, by purchasing Alltel, private equity kept the company independent and out of the hands of AT&T, Verizon, Sprint or T-Mobile. Second, private equity often provides funding to small businesses and minority entrepreneurs. Indeed, private equity enabled the Bustos brothers to first form the Z-Spanish Radio Network, Incorporated, in 1992, and then in 2002, Busto Media, which operates both radio and television stations. Private equity also helped Katherine Hughes create Radio One, a radio station group aimed at African American listeners that now owns 54 stations in 17 markets.

As these examples demonstrate, private equity's continued participation in the telecom and media sector helps fulfill the twin policy goals of diverse ownership both in terms of the number of owners, as well as the type of owners.

This is not to say that there are no public policy ramifications in the trend toward private equity. I am interested to hear from our witnesses about the impact of private equity on consumer protection. According to Chairman Martin, private equity owners are covered by industry-wide consumer protection initiatives to the same extent as other owners. However, is this the case in practice? That is the question. And does the FCC hold private equity owners to the same standard?

With that, Mr. Chairman, I yield back.

Mr. MARKEY. The gentleman's time is expired.

The Chair recognizes the gentlelady from California, Ms. Eshoo.

OPENING STATEMENT OF HON. ANNA G. ESHOO, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Ms. ESHOO. Thank you, Mr. Chairman.

And good morning to the witnesses. Thank you for having this hearing, and I look forward to what we are going to learn from it.

In your letter, Mr. Chairman, of July of last year to the FCC, you raised several concerns about private equity firms, including whether their business model is inconsistent with serving the public interest.

I agree that this is a concern, but my broader concern in all of this is the issue of broadcast licenses and whether people are really serving the public interest regardless of who holds the license. I think that that is the larger issue myself. I think there is a real abuse in this area. Licenses are applied for by postcard, and they are rubber stamped, and that is just really one heck of a system. When you think of the power that goes with these licenses and the obligations that people have, I think that we are falling down in this area. And I think the statistics demonstrate it. Television stations devote less than half of one percent of total programming time to local public affairs. Four out of ten commercial TV stations surveyed in 2003—I don't know what has happened since, but since 2003—aired no local public affairs programs. Ninety-two percent of the election coverage aired by the national networks in the 2 weeks before Election Day in 2004 was devoted to the presidential contest, leaving only eight percent for local elections and referendums. The idea that broadcasters are public fiduciaries I think has been lost. I think that the relaxed ownership rules and the rubber stamped postcard license renewals have contributed to the degradation. And when a broadcaster receives a license, I think that they are supposed to be investing in public responsibility and some public service.

So I have introduced a bill, the Broadcast Licensing and the Public Interest Act, H.R. 4882, to revive the public interest standard. So, Mr. Chairman, I can talk more about this, but I want to ask some questions when it comes time to. I think we are in sad shape when it comes to the public interests. Yes, there is an investment both public and private in the companies, and I think it is important to review them, but I think that we need to look at licenses as well, and I would urge you to do that. I think that all the members should have an interest in this public interest and examine exactly how people get their licenses and then what they are living

up to. Public interest has just been stripped out of this as far as I am concerned.

So thanks again, and if I have the 7 seconds I will yield back.

Mr. MARKEY. Thank you. The gentlelady's time has expired.

The Chair recognizes the gentleman from Illinois, Mr. Shimkus.

OPENING STATEMENT OF HON. JOHN SHIMKUS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. SHIMKUS. Thank you, Mr. Chairman. I will try to be brief.

I want to welcome the panel. We got a chance to visit with a few of you prior, and I look forward to hearing your testimony.

I want to thank Chairman Markey and ranking member Stearns for organizing this hearing to discuss the role of private equity. And hearings are an opportunity for us to learn more, and that is what we hope to do.

You know, I have always been a believer in the challenge of raising capital and the assumption of risks that goes with the reason why you are raising the capital and hopefully a return on that. I mentioned that earlier. And I believe that is what the private equity firms do. Maybe I will be disproven in the hearing. I don't think so, but I do think it is an educational opportunity to talk about raising major capital funds in the telecommunications arena and how people can expand—or satellite. And there are probably more examples of benefits versus disadvantages. We don't want to diminish the disadvantages and the challenges and maybe seek to have transparency. But I do believe that we need—if we have issues with employment in this country, we have to have employers and we have to have business. And that is all good for our country, and sometimes it doesn't seem like that from the voices you hear in Washington.

So again, I look forward to the testimony. I am keeping my opening statement short. Thank you for coming. And I hope to listen and learn from your testimony.

I yield back, Mr. Chairman.

Mr. MARKEY. Great. The gentleman's time is expired.

The Chair recognizes the gentlelady from California, Ms. Harman.

OPENING STATEMENT OF HON. JANE HARMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Ms. HARMAN. Thank you, Mr. Chairman.

I am camped out over here because I have to leave shortly for another hearing, and I thought I would try not to be disruptive.

But I appreciate the fact that you are holding this hearing and think it is very important that we collect information on this topic. In as little as a week or two, the FCC may reveal that many of the 700-megahertz option licenses have been purchased by privately held companies. Over $19.5 billion worth to be exact. In telecommunications and media, private equity injects a new dimension into old questions about who owns news outlets and who controls public goods such as spectrum. But transactions such as the Tribune buyout and the privatization of Clear Channel aren't necessarily bad for the public. I agree with comments that have been made by other speakers. Private equity is not a dirty word. These

firms have played an important part in some of telecom's biggest success stories, such as the emergence of T-Mobile and Western Wireless.

Private investors often take risks where Wall Street will not. In this sense, private equity can bolster competition by restructuring and salvaging failing companies that would otherwise be out of business. That said, however, as Ms. Eshoo just said, the FCC has the authority and the obligation to ask tough questions about these transactions when they involve media and telecommunications companies. I see nothing wrong with, as Commissioner Copps suggests, the FCC asking those questions. If private equity challenges the traditional ways the FCC oversees competition and diversity in the market, then we must think harder about how to protect the public interest. And I would note that articles like this one in today's New York Times headlined, "Buyout Industry Staggers Under Weight of Debt," raise very serious questions. If some of the major private equity firms are staggering and they may possibly have to shed some of their assets, then that ricochets down the chain. And those who have invested in some of these communications assets may face bankruptcy or at least some very hard times. That will impair the public interest, and the FCC has to be vigilant, and so do we.

Thank you, Mr. Chairman.

Mr. MARKEY. I thank the gentlelady.

The Chair recognizes the gentleman from Nebraska, Mr. Terry.

Mr. TERRY. Thank you, Mr. Chairman.

And my thought is I am just outraged that private equity would be involved in infrastructure. There is just no room for it in our socialist society.

I yield back.

Mr. MARKEY. I thank the gentleman very much.

The Chair recognizes the gentleman from Texas, Mr. Gonzalez.

Mr. GONZALEZ. Waive opening.

Mr. MARKEY. The gentleman's time will be preserved.

The Chair recognizes the gentleman from Oregon, Mr. Walden.

OPENING STATEMENT OF HON. GREG WALDEN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OREGON

Mr. WALDEN. Thank you very much, Mr. Chairman.

And as fate would have it, for 21 years and 7 months my wife and I were in the radio broadcasting business. We are licensees of the FCC and believed in the public good and being involved in our communities. And we bought the beginnings of our company from my parents, who held the debt in trust, and we paid them every month. And when we went to sell we had grown the company to five stations from two, and it was a successful small business.

But you know what? Nobody at Wall Street wanted to buy us out. And we weren't really excited about holding paper for somebody else to come in to very small markets and run our company and hope that every month they paid the bill. And as fate would have it, a small equity group got together, and they were purchasing stations in the region, and they were interested in our market.

Now, the result of that is we had been bought out, which is a good thing. We are paying a hell of a lot of money to the Federal Government and the state government in taxes, as unfortunately we were a C corp for about half of the company. But the company continues to grow and expand, and they have access to capital we never had. They are doing things we couldn't have done, and the market works. The market works. And certainly there can be abuses in the market at any level, but private equity is a good thing. That is what capitalism is all about in America. And I am actually sort of surprised we are even having a hearing given all the other issues that are, I think, far more consequential in the area of media out there. But I understand it and look forward to hearing the testimony.

And I yield back the balance of my time, Mr. Chairman.

Mr. MARKEY. All right. The gentleman's time has expired.

And all time for opening statements has been completed, so we will now turn to our first witness, who is Mr. Carlito—I am sorry. Excuse me.

Let me just suspend for a second and recognize the gentleman from New Jersey, Mr. Ferguson, who has made a request that he waive his opening statement, and that he will be given extra time to ask questions.

So again we will come back to you, Carlito Caliboso. Since 2003 you have served as the Chairman of the Hawaii Public Utilities Commission, and he is also the State Public Utility Representative on the FCC's Intergovernmental Advisory Committee. We welcome you, sir. Whenever you are ready, please begin.

STATEMENT OF CARLITO P. CALIBOSO, CHAIRMAN, HAWAII PUBLIC UTILITIES COMMISSION

Mr. CALIBOSO. Good morning. Good morning, Chairman Markey and members of the Committee.

Mr. MARKEY. Can you move the microphone up a little bit closer to you?

Mr. CALIBOSO. Can you hear me now?

Mr. MARKEY. Yes.

Mr. CALIBOSO. Well, aloha and good morning, Chairman Markey and members of the Committee.

My name is Carlito Caliboso. I am the Chairman of the Public Utilities Commission of the State of Hawaii. I am privileged to be here, and I thank you for this opportunity to testify.

We were asked to provide testimony on the role of private equity in the communications marketplace and to share our unique perspectives and experiences as a state regulator. We wish to be responsive and hope that our testimony can be helpful to the subcommittee.

We currently regulate a telecommunications public utility known as Hawaiian Telecompany, Inc., which is ultimately owned or controlled by a private equity firm known as the Carlyle Group. First, it should be recognized that each situation would probably be unique in its own way, and the proposed private equity investment would need to be reviewed in detail in the context of its industry, its market and service area. Second, the risks and concerns that may be associated with private equity ownership may not be

unique to private equity ownership and may apply to other forms of ownership.

In addition, the risks associated with private equity ownership can be appropriately managed and addressed in well-balanced, flexible state regulatory frameworks that give companies an opportunity to earn a fair rate of return while protecting the interests of consumers and the public interest in general.

With respect to our transaction, although the Commission recognized certain benefits of the proposed transaction involving the Carlyle Group in Hawaii, it also recognized several risks and was able to approve the transaction only with the addition of several conditions and requirements intended to address these risks.

I would like to highlight a few of the pertinent conditions that the Commission adopted as safeguards. First, we imposed a rate case moratorium condition, essentially a rate freeze, until 2009, where this acquisition occurred in 2005. We imposed an equity commitment condition which required the infusion of additional equity and debt reduction immediately upon closing of the transaction. We imposed a dividend restriction condition to prohibit payment of dividends to investors until debt was reduced sufficiently. We also established a collaborative committee involving competitive local exchange carriers to monitor transition issues for the competitive local exchange carriers, otherwise known as CLECs. We also scheduled a service quality investigation commencing 6 months after the cutover to monitor service quality for consumers. And we also imposed a transfer restriction condition for directory assets where the buyer was required to obtain Commission approval prior to sale of any of its directory assets, or Yellow Pages.

In addition to these specific conditions, any further sale or change in ownership, including any initial public offering or any form of transfer, encumbrance or mortgaging of assets, will require the review and approval of this Commission.

Nonetheless, the transition to a stand-alone Hawaii company has not been smooth for Hawaiian Telcom. In fact, the transition could be described by some as very problematic, to say the least. Although actual telephone service has not been an issue, Hawaiian Telcom experienced many back office systems transitioning problems. At this time, however, I have not received any indication that these problems were necessarily due to private equity ownership. The same transition issues could have been present where the transaction involved transforming the company into a stand-alone operation that needed to redevelop all of its back office systems, whether the ownership was by private equity, publicly traded company or even a cooperative.

Although this story's still being written and the investors' actions will eventually speak for themselves, it does appear that the investors have the capability and do intend to invest needed capital and resources into Hawaiian Telcom. However, whether the investors continue to follow through with their indicated commitment to continue to invest in Hawaiian Telcom remains to be seen.

In conclusion, the risks of private equity investment in telecommunications companies can be appropriately managed with measured and balanced regulatory approaches as one would with any other form of ownership. In situations where regulatory au-

thority exists, this can be done without the need for flexible nationwide approaches, which may not be appropriate or necessary in every situation. Such approaches may result in deterring needed investment in communications technologies and infrastructure, which could ultimately be to the detriment of consumers.

With that, I appreciate this opportunity to testify today, and I hope our testimony has been helpful to this subcommittee. Please, let me know if we can be of further service. I will be happy to try to answer any questions that you may have.

[The prepared statement of Mr. Caliboso follows:]

STATEMENT OF CARLITO P. CALIBOSO

INTRODUCTION

Aloha and good morning Chairman Markey and members of the Subcommittee. My name is Carlito Caliboso, Chairman of the Public Utilities Commission of the State of Hawaii (the "Commission"). I am privileged to be here today, and I thank you for this opportunity to testify.

We were asked to provide testimony on the "Role of Private Equity in the Communications Marketplace" and share our unique perspective and experiences as a State regulator. We wish to be responsive and hope that we can be helpful to this Subcommittee.

We currently regulate a telecommunications public utility known as Hawaiian Telcom, Inc. ("Hawaiian Telcom"), which is ultimately owned or controlled by a private equity firm known as The Carlyle Group ("Carlyle").

First, it should be recognized that each situation would probably be unique in its own way, and the proposed private equity investment would need to be reviewed in detail in the context of its industry, market, and service area. Second, the risks and concerns that may be associated with private equity ownership may not be unique to private equity ownership and may apply to other forms of ownership.

As you know, there may be benefits to private equity investment in the communications marketplace, including the ability to infuse additional investment capital and resources that may not have otherwise been available to be invested in technology and communications infrastructure. Private equity ownership of a communications company may involve certain risks, such as a high-debt structure, and possible effects on employment and levels of customer service.

The risks associated with private equity ownership can be appropriately managed and addressed in existing, well-balanced and flexible State regulatory frameworks that give companies an opportunity to earn a fair rate of return on their investments, while protecting the interests of consumers and the public interest in general.

THE HAWAIIAN TELCOM EXPERIENCE

In 2005, a company controlled by Carlyle sought to acquire Verizon Communications' Hawaii operations, known as Verizon Hawaii Inc.[1] Verizon Hawaii Inc. was Hawaii's statewide incumbent local exchange carrier or "ILEC." The proposed transaction would convert the ILEC from a small part of a large regional and international telecommunications carrier to a stand-alone ILEC serving primarily the State of Hawaii, which is now Hawaiian Telcom.

Although the Commission recognized certain benefits of the proposed transaction, it also recognized several risks and was able to approve the transaction only with the addition of several conditions and requirements intended to address these risks.[2]

Potential benefits of the transaction advocated by the applicants included renewed local focus in the telephone company and the establishment of several back office systems[3] in Hawaii (along with the jobs required to establish these functions), which were previously consolidated and operated out-of-state by Verizon Communications. In addition, more attention would be given to the local market and its needs, with the introduction of new products, services, and technology. The risks in-

[1] See Docket No. 04-0140.

[2] See Decision and Order No. 21696, filed on March 16, 2005 ("D&O No. 21696"), at 28-29.

[3] Examples of such functions performed on the mainland were billing, a network operations center, wholesale ordering, human resources, payroll, accounting, and marketing, among others.

cluded the proposed high-debt capital structure of the new telephone company, which was proposed to be 82.5% debt and 17.5% equity, and the daunting requirement to re-establish all back office systems in Hawaii, which was necessary because Hawaiian Telcom would be a stand-alone telephone company.

In short, after a detailed review, the Commission found that it needed to impose several conditions to address these and other concerns in an effort to mitigate the risks identified for the protection of consumers and the public interest.[4] I would like to highlight a few of the pertinent conditions the Commission adopted as safeguards:

• Rate Case Moratorium Condition (rate freeze): The buyer committed to not applying for a general utility rate increase that would utilize a test year earlier than 2009.

• Equity Commitment Condition: The buyer was required to immediately infuse additional capital to reduce its debt structure from 82.5% to 76.3% on a consolidated basis, with a goal to reduce its debt level to 65% in a shorter period of time.

• Dividend Restriction Condition: Dividends to any equity investor were prohibited without prior Commission approval until it reduced its debt to 65% on a consolidated basis.

• Collaborative Committee with CLECs: A collaborative committee was established that included competitive local exchange carriers, or "CLECs," to monitor and resolve transition issues to minimize any adverse effects to competitive carriers.

• Scheduled Service Quality Investigation: A service quality investigation was scheduled for approximately 6 months after the transition from Verizon to Hawaiian Telcom's back office systems to monitor service quality standards and issues.[5]

• Transfer Restriction Condition for Directory Assets: The buyer was required to obtain Commission approval prior to any sale of its directory assets (or yellow pages) and that any sale would be conditioned on the imputation of revenues in a future rate case.[6]

In addition, any further sale or change in ownership, including any initial public offering, or any other form of transfer, encumbrance, or mortgaging of assets, will require the review and approval of the Commission. The Commission also has broad authority to investigate the public utility and all of its dealings and operations.[7]

These are just examples of some tools that may be available to address certain risks, when there is private equity ownership or any other form of proposed acquisition of a regulated company. We recognize that there may be other techniques that could be used in addressing issues raised in these types of transactions.

Nonetheless, the transition to a stand-alone telephone company has not been smooth for Hawaiian Telcom. In fact, the transition could be described by some as very problematic, to say the least. Although actual telephone service has not been an issue, Hawaiian Telcom experienced many back office systems transitioning problems. These problems primarily involved billing systems and the ordering of services, where the amount of time needed to process customer orders and resolve billing matters increased tremendously. This was very frustrating to Hawaii consumers. At this time, however, I have received no indication that these problems were necessarily due to private equity ownership. The same transition issues could have been present where the transaction involved transforming the company into a stand-alone operation that needed to redevelop all of its back office systems whether the ownership was by private equity, a publicly traded company, or even a cooperative.

Although this story is still being written and the investors' actions will eventually speak for themselves, it does appear that the investors have the capability and do intend to invest needed capital and resources into Hawaiian Telcom. For example, the company has expended additional resources to retain new executive management and senior leadership to guide the company. The company has also informed us that it has invested necessary resources to allow it to offer higher speed broadband Internet services and is developing offerings for video services to its customers. In addition, the company has stated that despite a recent reduction of approximately 100 management positions, its total count of employees of approximately 1,550 is approximately equal to the number of employees at the time of acquisition.

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[4] D&O No. 21696 at 29-50.

[5] This matter is the subject of an ongoing and open Commission investigation. Docket No. 2006-0400.

[6] Hawaiian Telcom has since requested and received Commission approval to sell its directory assets, conditioned upon, among other things, the use of all sales proceeds to pay down and reduce debt. Docket No. 2007-0123, Decision and Order No. 23825, November 13, 2007.

[7] Chapter 269, Hawaii Revised Statutes, as amended.

However, whether the investors continue to follow through with their indicated commitment to continue to invest in Hawaiian Telcom remains to be seen. In the meantime, the regulatory authority and additional conditions I described earlier can be used to oversee the company's operations and actions to protect the interests of the consumers.

CONCLUSION

Accordingly, the risks of private equity investment in telecommunications companies can be appropriately managed with measured and balanced regulatory approaches, as one would with any other form of ownership. In situations where regulatory authority exists, this can be done without the need for inflexible nationwide approaches, which may not be appropriate or necessary in every situation. Such approaches may result in deterring needed investment in communications technology and infrastructure, which could ultimately be to the detriment of consumers.

I appreciate this opportunity to testify today, and I hope our testimony has been helpful to this Subcommittee. Please let me know if we can be of any further service. I will be happy to try to answer any questions that you may have.

SUMMARY OF MAJOR POINTS

• Each situation would probably be unique in its own way, and the proposed private equity investment would need to be reviewed in detail in the context of its industry, market, and service area.

• The risks and concerns that may be associated with private equity ownership may not be unique to private equity ownership and may apply to other forms of ownership.

• The risks associated with private equity ownership can be appropriately managed and addressed in existing, well-balanced and flexible State regulatory frameworks that give companies an opportunity to earn a fair rate of return on their investments, while protecting the interests of consumers and the public interest in general.

• Although the Commission recognized certain benefits of the proposed sale of Verizon Hawaii to Carlyle, it also recognized several risks and was able to approve the transaction only with the addition of several conditions and requirements intended to address these risks.

• In addition to these conditions, any further sale or change in ownership, including any initial public offering, or any other form of transfer, encumbrance, or mortgaging of assets, will require the review and approval of the Commission.

• The transition to a stand-alone telephone company has not been smooth for Hawaiian Telcom and has been frustrating to Hawaii consumers. At this time, however, I have received no indication that these problems were necessarily due to private equity ownership. The same transition issues could have been present where the transaction involved transforming the company into a stand-alone operation that needed to redevelop all of its back office systems, whether the ownership was by private equity, a publicly traded company, or even a cooperative.

Mr. MARKEY. Thank you, sir, very much.

Our next witness is Mr. Richard Bressler. He is a managing director at Thomas H. Lee Partners, one of the largest private equity firms in the United States. He has served as the chief financial officer at both Viacom and Time Warner and sits on the boards of the Nielsen Company, Univision, and Warner Music Group. We welcome you, sir.

STATEMENT OF RICHARD BRESSLER, MANAGING DIRECTOR, THOMAS H. LEE PARTNERS

Mr. BRESSLER. Thank you. Thank you very much. Good morning, Chairman Markey, ranking member Stearns, and other members of the Committee.

I am pleased to be with you today. At the outset, let me note for the record that I am speaking with you today in my capacity as a managing director of THL Partners, as well as the private equity

counsel, the trade association, representing many of the largest private equity firms doing business in the United States today, including my firm, THL.

I have been with THL for 2 years, which is, as you may know, Chairman Markey, is in the great city of Boston. We at THL focus on working with growth-oriented companies that can benefit from our managerial and strategic expertise to create not only value for our partners, but also competitive benefits for the consuming public. Prior to joining THL Partners, I held senior management positions at Viacom and Time Warner, and I worked closely with both the editorial and business units at those companies. So I, like many of my colleagues in the private equity business, come here with a unique and important perspective. My extensive background in broadcasting, cable and content have given me a durable respect and sensitivity to the special public interest obligations facing companies in the media and telecommunications sectors. And at the same time, my experience in private equity has shown me how powerful and transformative private equity investments can be for media and telecommunications companies. So I can tell you, without equivocation, that private equity investment is entirely consistent with the public interest considerations that are important to this subcommittee and to the FCC.

We at THL, as well as the experienced leaders of our portfolio companies, recognize the uniqueness of telecom and media in today's economy and in tomorrow's democracy.

Now, let me just say a few words about private equity in general. My written testimony provides more background on precisely how private equity works. For now, suffice it to say, that you probably all know more about private equity than you think. Toys-R-Us, Hertz, Baskin Robbins, Burger King, J. Crew, Hilton Hotels, these are only a limited number of examples of how private equity interacts with the American people each and every day, sometimes multiple times in one day. Our success is based on two key ingredients: patience and commitment. As many CEOs and academics will note, public ownership tends to put a premium on short-term results and gains, which can put a heavy burden for a company that needs to break from the intense glare of quarterly reports and analyst quotes. Imagine if Members of this House had to run for office every 3 months, instead of every 24 months. And I recognize that that analogy is not a neat one, but I think you get a sense of how that would be a distraction to everyone involved. True, not all private equity investments succeed, but independent research consistently demonstrates that private equity firms invest for long-term and seek to build stronger and more competitive companies.

Let me say a few words about private equity and its role in telecom and media, which is why we are here today. Here again, private equity has played an important and patient role in many of the companies that subcommittee knows quite well. Companies like MCI, the iconic symbol of telecom competition, IntelSat, Voice Stream, which is now known as T-Mobile; Resna Communications; Alltel; and Sirius Satellite Radio. I could go on and on, but I think it is clear that private equity is not new to this sector. We have contributed much to the competitive and convergent nature of these industries, all the while mindful of the rules and obligations

that come in serving the public interest. Moreover, private equity can help solve the ownership conundrum that I know the subcommittee is focused on. In cases involving companies like Alltel we have helped to contribute to the total number of owners, which helps mitigate against consolidation by strategic encumbrance. And in cases involving companies like Clear Channel, we are helping to contribute to the type of owners and in doing so seeking to address the minority ownership in today's media marketplace.

Finally, let me say a few words about THL's work in this sector, and in particular its efforts to promote the long-term viability of free over-the-air television and radio. As this subcommittee knows quite well, broadcast services are different. Because it is free and because it is ubiquitous, broadcast media serves a vital role in our economy and our democratic society. But it is also true that the broadcast sector faces daunting competitive challenges from other digital platforms, many of which are subscription-based and can use the dual revenue streams that come from advertising and subscriptions to capture more and more of a fragmented media market. And because of these structural changes, some in the investor community have avoided the broadcast sector, assuming that its future is too cloudy. But we at THL perceive things differently. That is why we have worked with various broadcast groups such as Univision and Clear Channel to chart a strategic future in today's market.

We believe there is a bright future in free over-the-air television and radio. We put our money where our mouth is. And in each of these instances we have made contributions to some broader policy and issues. For example, in the case of Univision, THL and its private equity partners are working with experienced broadcast management to enable Univision to maintain its position as the leading Spanish language broadcast network in the United States. And in the case of Clear Channel, private equity has enthusiastically supported Clear Channel's plan to deconsolidate its holdings so that it can renew its focus on radio in fewer markets with fewer stations.

Again, I thank you for the opportunity to be with you today to present this testimony. I will be pleased to answer any questions at the appropriate time.

[The prepared statement of Mr. Bressler follows.]

Testimony of Richard Bressler

Managing Director, Thomas H. Lee Partners

on behalf of the Private Equity Council

Subcommittee on Telecommunications & the Internet

March 11, 2008

Introduction

Good morning. I am pleased to be here today to share some perspectives on the role of private equity in today's rapidly evolving media and telecommunications market. I appear in my capacity as a Managing Director at Thomas H. Lee Partners (THL), but my views are also offered on behalf of the Private Equity Council, the trade association representing many of the largest private equity firms doing business in the United States today.[1]

I have been with THL for two years. THL is a leading private equity firm based in Boston, Massachusetts. We focus on identifying and obtaining substantial ownership positions in large, growth-oriented companies where, in partnership with outstanding managers, we bring managerial and strategic expertise to accelerate the long-term growth of our portfolio companies. We have found, throughout our long history, that building good companies into great ones is the best way to create value for our investors, our portfolio company employees and all stakeholders. As one of the oldest and most successful private equity firms, THL has raised approximately $22 billion of equity capital and invested in more than 100 businesses with an aggregate purchase price of more than $125 billion. We seek to build companies of lasting value while generating superior returns for our investors and operating partners.

Prior to joining the firm, I held senior management positions at Viacom and Time Warner, where I served as CFO and as a senior executive with a close working relationships with, and a deep understanding of, both the editorial and business units. So I believe I come here with a unique perspective. I have a strong respect and sensitivity to the special and critical public interest obligations facing companies in the media and telecommunications sectors, and I also have seen from the inside the powerful ways that private equity investment can jump start companies. I can tell you without equivocation that private equity investment is entirely consistent with the public-interest values so central to our media and telecom regulatory regime. Let there be no doubt: private equity owners take very seriously all of the regulatory and legal obligations that come with having stake in a licensed entity.

What Is Private Equity?

Let me start with a brief description of private equity, something that is widely misunderstood. Private equity touches the lives of tens of millions of Americans every

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[1] PEC members are Apax Partners, Apollo Global Management LLC, Bain Capital Partners, The Blackstone Group, The Carlyle Group, Hellman & Friedman LLC, Kohlberg Kravis Roberts & Co., Madison Dearborn Partners, Permira, Providence Equity Partners, Silver Lake Partners, THL Partners and TPG Capital (formerly the Texas Pacific Group).

day. Consumers eat at Burger King, they shop at J Crew, they rent cars from Hertz, and they stay in Hilton Hotels. And when they do so, they're interacting with private equity, and hundreds of others just like them – some of which are household names; and some may be less well known, but vital to the economic makeup of this country.

Private equity firms acquire or invest in companies – either public or private – that are undervalued, underperforming, or need critical growth capital to compete in rapidly evolving business sectors. Over the last few decades, many experts, including leading CEOs and academics, have complained that the public markets create tremendous pressure on companies to generate quarter-to-quarter results, often at the expense of the long-term growth and health of these companies. For example, faced with a major R&D investment that could depress earnings and the company's stock price, management often is under great pressure to avoid making the investment so that they can "make" their quarterly numbers. Similarly, a public company CEO might not pursue a strategic acquisition that makes long-term sense, if the short-term effect would be to dilute the earnings that large institutional investors use as a quarterly guide in their course of buying and selling stocks.

In private equity ownership, the pressures from public shareholders looking for short-term gains are absent. As a result, private equity owners and the managers of their portfolio companies – who themselves have invested their own personal assets into the business – can focus on long-term performance and make the investments that enable companies to become more competitive. While not all private equity investments succeed, independent research consistently demonstrates that PE firms invest for the long term and seek to build stronger, more innovative, and more competitive companies. I believe Professor Lerner will address that in his testimony.

But the most important thing to understand about private equity is that the entire business model is predicated on investing in and strengthening acquired companies so they are worth more when they are sold to another buyer or to the public markets. Some critics charge that private equity "strips" a company bare. This defies common sense: who would want to buy a "stripped" company, much less pay a premium over the original purchase price? It would be as if someone bought a house, and then proceeded to tear out the kitchen, the bathrooms, the plumbing and the wiring, and *then* tried to sell the house for a profit. It would not work; and it does not work in private equity either.

Private Equity's Role in Telecom & Media

Over the years, private equity has played a key role in the development and competitive health of the telecom and media sectors. Many industries in these fields are capital intensive. More to the point, they also require patience and a commitment to building a long-term business, two ingredients often missing from companies that depend on public markets for capital. With PE's backing, early wireless operators like Aerial Communications, Omnipoint and VoiceStream created thousands of jobs, built out new networks, launched services and ultimately consolidated into T-Mobile to become a leading independent national wireless provider, bringing pro-consumer competition to the wireless market. Private equity investors provided the resources and expertise to recapitalize and revitalize a bankrupt MCI, the iconic symbol of telecom competition.

Private equity provided the funding allowing Bresnan Communications to provide cable TV and high-speed Internet access to 300,000 consumers in small and medium-sized markets in rural America. And private equity firms invested billions in competitive local exchange carriers (CLECs), bringing competition to the domestic telecommunications market and attendant benefits in service and prices for consumers.

The recent Alltel transaction – a deal in which THL was not involved – is yet another good example. By partnering with private equity, Alltel remained an independent wireless provider, rather than being acquired by one of the four largest strategic incumbents, thus helping to counterbalance recent consolidation among those incumbents.

Then there is the broadcast sector. As this Subcommittee knows quite well, because it is free, and because it is ubiquitous, broadcast media serves a vital role in our economy and our democratic society. But it's also true that the broadcast sector faces daunting competitive challenges from other digital platforms, many of which are subscription-based and can use the dual revenue stream that comes from advertising and subscriptions to capture more and more of a fragmented media market. Because of these structural challenges, some in the investor community have avoided the broadcast sector, assuming that its future is too cloudy.

But we at THL perceive things differently. That's why we have worked with various broadcast groups, such as Univision, to chart a strategic future in today's market. We believe there is a bright future in free, over-the-air television and radio. We've put our money where our mouth is. And in each of these instances, we have made contributions to some broader policy objectives.

For example, private equity is providing the funding necessary for Univision Communications, the largest Spanish-language broadcast group in the U.S., to make the transition to digital, which is an extraordinarily expensive undertaking. Univision estimates that its total cost of purchasing and installing new equipment by the analog television cutoff date will approach $100 million. Univision expects to spend nearly $20 million in 2008 alone. Of course, Univision not only has made significant expenditures for equipment, it also has donated a significant amount of air time to its multi-platform campaign to educate the Hispanic audience concerning the analog television cutoff, in partnership with the FCC and NTIA.

Moreover, private equity's acquisition of Univision has actually resulted in the divestiture of media interests, rather than increased concentration. Univision recently announced the sale of the entire Univision Music Group, as well as the sale of four radio stations in the Albuquerque market.

Our role in the Clear Channel transaction is another good example of the type of beneficial policy outcomes that are possible when private equity participates in these sectors. We at THL and Bain Capital enthusiastically support the new strategic future plotted by Clear Channel, given all of the competitive challenges facing terrestrial radio in today's market. We agree that Clear Channel's future would be best served by de-consolidating itself, with a renewed emphasis on the radio business in fewer markets with fewer stations. This streamlined approach, in our view, enables Clear Channel to

more efficiently deploy and market its digital offerings in the face of competitive challenges from other digital platforms.

This streamlined approach had one other critical policy benefit – one that I know is important to the work of this Subcommittee: minority ownership. The structure of the transaction enables Clear Channel to seek out minority buyers for the radio properties being sold by the company. In fact, to facilitate secondary transactions with minority buyers, Clear Channel, in collaboration with the Minority Media & Telecommunications Council (MMTC) and other private equity funds, hosted a conference in January 2007 to bring all interested parties together. We support these efforts and, in the end, we hope that they will help to address the dearth of minority owners in today's broadcast marketplace. Private equity is pleased to play an ongoing role in that regard.

Finally, I understand one area of concern for this Subcommittee is whether private equity, by virtue of operating outside public markets, is too opaque or too removed for regulators to make informed judgments about matters involving private equity. This is an urban myth, I suspect arising out of the semantic fact that we call ourselves "private" equity funds and not something else. I would note that most major companies in which private equity invests also issue public debt. And having been a CFO at publicly-traded companies, I can tell you that the reports private equity firms file in connection with our public debt are every bit as extensive as any of the reports filed by a public company. So from a regulatory compliance perspective, there is no "lack of transparency" involving private equity and its stakes in any sector, including telecom and media.

Conclusion

Thank you for the opportunity to present our views on private equity and the media and telecom sectors. We look forward to working with the Subcommittee in the months ahead as it continues its exploration of these important issues.

Mr. MARKEY. Thank you, Mr. Bressler, very much.

Our next witness is Eli Noam, who is the Director of the Columbia Institute for Tele-Information, and he is a Professor of Finance and Economics at Columbia Business School, and he served for 3 years as Commissioner of the New York State Public Service Commission. We welcome you back to the subcommittee. When was the last time you testified?

Mr. NOAM. I don't remember. It has been a few years to this Committee, yes.

Mr. MARKEY. To this subcommittee, yes.

Mr. NOAM. But I am very happy to be back, Mr. Chairman——

Mr. MARKEY. Welcome.

Mr. NOAM [continuing]. And members of the subcommittee, and I thank you for convening this meeting. I should also mention that President Bush also appointed me to the IT Advisory Committee, so I have been kind of appointed in a bipartisan way.

I would like to address some concrete issues, concrete examples. We can theorize about——

Mr. MARKEY. Can you move that microphone in just a little bit closer?

Mr. NOAM. OK.

Mr. MARKEY. OK, good.

STATEMENT OF ELI M. NOAM, PH.D., DIRECTOR, COLUMBIA INSTITUTE FOR TELE-INFORMATION, PROFESSOR OF FINANCE AND ECONOMICS, COLUMBIA BUSINESS SCHOOL

Mr. NOAM. We can theorize about the impact of private equity all day long. There are different academic studies and different analysis, but who is to know in the end? Unfortunately, I would like to report on two actual cases in Europe where there are two major national telecom companies that have been taken private—eircom in Ireland and TVC in Denmark—and the dynamics as well as the players are sufficiently similar, so we can actually learn something of what happened there. I actually served for 3 years as an international advisory board member for the Irish regulator. In Ireland, the national telecom company, eircom, has actually gone through a private equity not just once, but twice. And it has not been a good experience for Ireland, which has a first rate technology in software industry but a second rate telecom network. First, the private equity consortium including American funds called Valencia bought eircom, financed the acquisition by increasing the debt almost immediately from 25 percent to 70 percent. In consequence eircom lost most ability to finance upgrades innovation and expansion. So in 2000 and 2001, just before the LBO, eircom invested 700 euros per year, more than the appreciation and retained earnings. But after the Valencia takeover, investment dropped almost instantly from 700 to 300 million, next year to 200 million, and in the following year again to 200 million. In other words, it disinvested. It is not a situation of adding and bringing in new funds. There was a situation of taking funds out. Ireland's network fell further behind to the rest of the euro, but at the same time it paid a special dividend to Valencia of 400 million euros.

In 2006 eircom was taken private again, this time through an Australian fund, through a set of Shell corporations in the Cayman

Islands. Debt grew to 80 percent, and the cost of debt grew to over eight percent. For broadband penetration among the 15 original European countries, Ireland now ranks 14 out of 15. Only Greece is lower. The penetration of broadband is almost twice as high as it is in Ireland. Now, in Denmark, the national telecom company TDC was owned until 2004 by the American company SBC, AT&T now, and did pretty well actually as a public company. Its quality of network was high, its penetration was among the highest in Europe. It was taken private in 2006 by a consortium of big names in American private equity. Its debt went up from 27 percent in 2005, in 1 year, to 94 percent of debt. Its credit rating was downgraded twice in 2 months. It had to pay for its bond at a high of 89 percent. Even so, it issued that year a special dividend of a magnitude of 47 percent of the company's total assets, more than twice—and took out more than twice what the private equity investors put into the company. And meanwhile the cooperating holdover CEO and CFO got special bonuses. Just like in Ireland and Denmark, long-term investment slowed. For example, whereas penetration of broadband almost doubled in 2 years, from 50 to 28 percent prior to being taken private, in the 2 years subsequent to being taken private, penetration rose by only 3.6 percent. In both cases the company came to the regulator for higher prices, so understand, please, what is happening here. These are not competitive markets. These are markets with very substantial incumbent market power, and therefore, the dynamics are really different. What we have here basically is a situation in which the company's being taken over by a PE, taking money out, disinvesting, and then coming back to the regulator and saying raise all prices so that we can reinvest. And that is based then on higher consumer prices. So the investment is being taken out and being brought back only on the back of higher consumer prices. Now, do the same dynamics also hold for America? I think definitely. The PE funds in Ireland and Denmark are pretty much exactly the same players as in America. They are typically Americans, or they are Australians or Europeans, or similar kind. The incentive and MOs are very similar. The legal and regulatory environment is not terribly different, and in fact, if we look at PE-owned telecom companies in the United States, Windstream or Madison River, their debt-to-EBIDTA ratios are quite high. In fact, for Madison River it is just about the highest of any telecom company I know of—almost five times as high as it is for Verizon and AT&T. Now, the problem to me is not whether owners want to take on more debt. That is their business. But here we are dealing with infrastructure that is critical to society and the economy and to democracy, culture, commerce. Why else are we interested and concerned in this Committee and concerned about broadband penetration? Why else did we build—going to other infrastructure—the interstate highway systems, the air traffic control systems?

Mr. MARKEY. If you could wrap up, please.

Mr. NOAM. All right. Will this trend continue? Yes, it probably goes in cycles. There is a lot of opportunity, I think, here for these small independent companies. But let me just—and there are some positives, which I haven't gotten to. So to conclude then is to say I think we can deal with this if the issues and remedies mostly,

not through direct regulations, but through disclosure forms and through self regulation, which I hope that the industry will adopt for itself.

[The prepared statement of Mr. Noam follows:]

STATEMENT OF ELI NOAM

Mr. Chairman, Members of the Subcommittee, thank you for convening this hearing and engaging in a discussion of the role of public equity financial transactions in the communications industry. At a time when aggressive financial arrangements have destabilized the real estate industry and other markets, it is useful to inquire into the potential impact of other finance arrangements on the communications sector.

Some of these issues were also discussed at a conference we held at the Columbia Institute for Tele-Information a few months ago, which provided some data that should be helpful for your deliberations. It is generally agreed that private equity shakes up entrenched management and that it strengthens strategic thinking on the corporate level but that it can also disrupt companies, investments, and employment. We can theorize about the impact of private equity all day long. But empirical evidence is perhaps most useful. One academic study, by my fellow panelist, Prof. Josh Lerner of Harvard, shows that companies which have gone through the public-private -public roundtrip perform better than those which did not and that their patenting levels do not decline after going public again. Another academic study, by Ludovic Phalippou of University of Amsterdam and Oliver Gottschalg of HEC Paris, finds that returns of private equity funds, after fees, are actually 3% lower than for the S&P 500 index. But both of these studies, though they disagree with each other, are not focused on the communications industry, the topic of these hearings.

Fortunately, we can look at two actual cases. In Europe, two major national telecom companies have been taken private, eircom in Ireland and TDC in Denmark. I served for three years on an international advisory board for the Irish regulator COMREG, as did the former chief economist of the FCC, Prof. William Melody, who is now a professor in Denmark and who compiled some of these numbers

In Ireland, the national company, eircom, has actually been through private equity acquisition not just once but twice. It has not been a good experience for Ireland, which has a first rate technology and software industry, but, by general opinion of its own experts, a second rate telecom network.

First, a consortium called Valentia, which also included American financiers, bought eircom and financed the acquisition by raising eircom's debt from 25% to 70% within a year. In consequence of this high leverage, eircom lost the ability to have access to further funds to finance upgrade and expansion, and its cost of capital increased.

In 2000 and 2001, before the Valencia LBO, eircom invested 700 Euros per year, more than its depreciation and retained earnings. But after Valencia took control, takeover investment dropped from 700 to 300 million in 2002, and to 200 in 2003 and 2004. The company disinvested. Ireland's network fell further behind the rest of Europe. But at the same time it paid a special dividend to Valentia of 400 million Euros. It then took the company public at a handsome profit.

In 2006, eircom was taken private a second time by the fund Babcock and Brown of Australia, through a set of shell companies incorporated in the Cayman Islands. Debt grew to 3.8 billion Euros, for a ratio over 80%, and average cost of debt grew to over 8%.

In broadband penetration, among the original 15 EU countries, Ireland now ranks 14th. EU average penetration was almost twice as high as in Ireland.

In Denmark, the national telecom company, TDC, was owned until 2004 by the American regional Bell company, SBC, and did very well as a public company. Its network quality was high, and its broadband penetration was among the highest in Europe. It was then taken private in 2006 by a consortium of big names in American private equity. Its debt went up in one year from 27% in 2005 to 94% in 2006. Its credit rating was downgraded twice in two months. It had to pay for its bonds a high 8-9%.

Even so, it issued that year a special dividend of a magnitude of 47% of the company's total assets, by Melody's analysis, and more than twice what the investors put into the company. Meanwhile, the cooperating holdover CEO and the CFO got large special bonuses.

Just like in Ireland, long term investments slowed. For example, whereas TDC broadband penetration almost doubled from 15% to 28% in two years to 2005, in the two years since going private, penetration rose by only 3.6%.

The ratio of net debt-to-EBITDA for the two PE-owned European companies TDC and eircom grew to 5.1 and 6.9. This debt load is more than three times as high as that of other major European incumbent companies. In both cases did the companies come to the regulator for rate increases. So understand what is happening here. These are not competitive markets but price regulated markets. When people analyze the contribution of private equity, they have in mind competitive markets, but this is not case here. In telecom, PE owners seem to take capital out and then tell the regulator that they can upgrade the dominant national network only if the consumer prices are raised. It puts the regulator over a barrel. This is not a competitive market situation where PE raises efficiency. Instead, it is, in economists' terms, the advance distribution of capitalized monopoly rent.

Thus, whatever one might say in favor as the general advantages of PE, these two specific cases do not support the claims of innovation and investment for the telecom industry.

Do the same dynamics also hold for America? The funds in Ireland and Denmark were the same big PE names as in America, Australia, and Europe. Their incentives and MOs are the same. The legal-regulatory environment is not very different. We observe in America that the PE-owned telecom companies Windstream and Madison River have debt-to-EBITDA ratios of 3.03 and 5.5, respectively. The latter ratio is probably the highest of telecom companies that I know of and almost five times as high as that of Verizon and AT&T. The PE-acquired company Hawaiian Telcom initially planned to raise debt to 82.5%, before the state utility commission, represented here, rolled it back to 76.3%.

The problem is not how much debt owners want to take. That's their business. But here, we deal with infrastructure that is critical for society, economy, and, with the Internet, increasingly for culture, politics and commerce. Why else would this committee be concerned with national broadband penetration figures? Why else did earlier generations support canals, railroads, the interstate highway system, airports, and an air traffic control system? Because the social value of these infrastructure systems significantly exceeds their private value to the owners. Telecom companies have usually understood this and were not pure profit maximizers, for example in rural service. When they did not understand the broader definition of their function they often ended up on the carpet before this Committee. If companies' ability or willingness to invest in infrastructure and in competing networks is reduced everyone will be affected adversely. If we want fiber to the home or to the curb, if we want to have competing networks, we must be alert to this situation.

Some people argue that all telecom firms are already subject to FCC oversight, regardless of ownership. True. But that protects only against breaches of rules, not against a decline in capital investment and upgrade. For these, the incentive should not be reduced.

Will this private equity trend continue? Yes, though the good and affordable deals will become scarcer, and enthusiasm for these financial vehicles tend to be cyclical. Why telecom firms? Private equity firms like the steady and large cash flows, the assets that can support debt, and the large market shares of incumbents. There is opportunity especially among the small independent telecom companies, where consolidation would be accelerated and efficiency might be gained due to private equity. But this would depend on how the cost-savings of such rural consolidations were shared between the private equity company's return and the public's rates.

I focused here on telecom. Let me to turn briefly to mass media. On the positive side, since we are always concerned with media power and concentration, the private equity deals often lead to a breakup of large media conglomerates to reduce debt that paid for the acquisition. Thus, the radio broadcast giant Clear Channel Communications, the poster boy for media concentration, will (or is) selling off almost half of its 1,100 radio stations. And maybe the rest will be broken up and sold if the investor consortium cannot sell the debt. Similarly, private equity has been an instrument of de-concentration for the Tribune Co. and McClatchy newspapers and for Time Warner's music and the New York Times's TV station spin-offs. Where media conglomerates were part of empire building, they are likely to be dismantled by unsentimental cost-cutters installed by the private equity owners.

On the negative side, the same cost-cutting will also have impacts on newsrooms, film budgets, script selection, and R&D. Private equity, though nicely fast-paced, is also basically cautious as it seeks the cash flows to meet debt payments and position the company for subsequent resale. It is less likely to back risky film or R&D projects. Venture capital is more risk taking. The two should not be confused with each other as they often are.

What then to do about private equity in the communications sector without a burdensome regulatory intervention that would throttle a funding mechanism which has positive aspects, too?

First and foremost, for the communications sector, the answer has to be disclosure and transparency. In open societies large media holdings must be in the open. Direct regulation by government of media is undesirable. But disclosure is another matter. For essential infrastructure and media in society, transparency can be a substitute for a direct regulation that is based on the fear of potential problems rather than real tones. Transparency would include the following:

1. Disclosure by regulated private equity-acquired telecom and cable companies above a certain size of the payments made to private equity funds and of their debt levels.
2. Continuation of disclosure of formerly some of the SEC-mandated corporate information by these firms to the FCC, if the firms have been taken private and out of SEC disclosure requirements.
3. For firms with debt above a certain level, disclosure of long term network investment and upgrade plans.
4. Disclosure of significant beneficial ownership. The actual managing owners and substantial beneficiary owners of regulated media firms should be part of the public record, as well as their nationality.
5. A self-regulatory code for disclosure by the private equity industry. This has been the UK approach.

The role of communications is to inform and to distribute information, and their own structure and owners cannot be secretive. Otherwise accountability declines, suspicions abound, and the credibility of all media will suffer. Creating such transparency, especially in concentrated infrastructure industries, will help public policy.

Mr. Chairman, thank you for having these hearings.

WHY PRIVATE EQUITY IS A PROBLEM FOR PUBLIC MEDIA

FEBRUARY 2007

When telecommunications and television networks were privatized in many countries in the '80s, there was much public debate. Today, a second wave of media privatization is sweeping the world, but this time without much public notice even among the activist media reform movement. It is the acquisition by private equity partnerships of stock-market-traded "public" media companies.

In the past year or two, private equity firms such as Bain, Blackstone, Carlyle, KKR, Providence, or Texas Pacific—and their equivalents elsewhere— have acquired major media and communications companies. These include Clear Channel, MGM, Univision, and PanAmSat in America; VNU/Nielsen in the Netherlands, ProSiebenSat in Germany, TDC in Denmark, eircom in Ireland, and SBS in Luxembourg. Other companies such as Vivendi, EMI, and parts of the Tribune Co. have been circled by private equity firms. Still other firms were taken fully private by their majority shareholders, such as Bertelsmann, Cox, and potentially Cablevision.

Private equity has been in the ascendancy, buoyed by cheap debt, rising equity prices, and high liquidity. In 2006, almost a quarter of all M&As was financed in that way, with over 2,500 deals worth $655 billion worldwide. Talent has flocked to PE firms, from ex-CEOs to presidents, prime ministers, and regulators.

This trend has raised questions. Many PE deals are fuelled by a desire to flee the closer regulation and disclosure requirements of public companies. In the aggregate this reduces the transparency of the economy, even as it may make some companies more efficient.

There are additional considerations for media firms.

On the positive side, the PE deals often lead to a breakup of large media conglomerates to reduce debt that paid for the acquisition. Thus, Clear Channel, the poster boy for media concentration, is now in the process of selling off almost half of its 1,100 radio stations. Similarly, private equity has been an instrument of deconcentration for the Tribune Co and McClatchy newspaper divestitures, and for Time Warner music and New York Times' TV station spin-offs. Where media conglomerates were part of empire building, they are likely to be dismantled by unsentimental cost-cutters installed by the PE owners.

On the negative side, the same cost-cutting has also impacts on news rooms, film budgets, script selection, and R&D. PE is basically conservative as it seeks the cash flows to meet debt payments and position the company for subsequent resale, just as venture capital is risk taking. PE is also short-term oriented, and unlikely to undertake major upgrades of communications infrastructure that might have long-term benefits for the economy.

PE also changes the nature of media ownership. Public attention has centered on visible moguls such as Murdoch, Redstone, or Eisner. That personalized portrayal has a certain antiquated quality to it. In reality, most media companies have been

majority owned by institutional investors—mutual and pension funds, endowments, etc.[footnote: See Eli Noam, Media Ownership and Concentration in America, Oxford University Press, forthcoming] Just the top ten of these institutions, such as Fidelity, own in the aggregate over 20% of the 25 largest U.S. media companies. But they rarely interfered with managers beyond a general pressure to keep the stock price up. Company management was accountable to all shareholders and scrutinized by the public and investment analysts and the press.

But this changes under private equity. Now, a PE fund's management company controls the acquired media company fully and installs its management with tough performance mandates. Increasingly, the PE fund partners play a hands-on operational role beyond the merely financial one.

In contrast to the public institutional funds with their numerous small investors, the private equity funds is limited by law and strategy to deep-pocket investors whose identity are not disclosed. The funds themselves keep a low profile. For example, Thomas H. Lee Partners is a $20 billion Boston PE firm that has acquired singly or in partnership the media companies Clear Channel, Univision, VNU/Nielsen, Houghton Mifflin, and Warner Music. Yet the firm does not appear to even maintain a website. In general, little information is available to the press. Securities analysts do not follow the stock. Small investors and activists have no forum. And governments cannot evaluate the soundness of companies that may be essential national infrastructure providers.

All this raises questions about openness, transparency, and control. Where media firms have financial owners with supervisory and operational roles, their economic coverage must not be tainted by suspicion of self-interest of principals or of manipulation from other countries.

What then to do about this without burdensome intervention in a mechanism that has positive aspects, too? The answer has to be to ensure the disclosure of ownership. For example, the actual managing owners and substantial beneficiary owners of media firms that hold government licenses or use favorable postal rates for press mailings should be part of the public record, as well as their nationality. In open societies large media holdings must be in the open. Direct regulation by government of media is undesirable. But disclosure is another matter. The role of media is to inform and shine light, and their own structure cannot be secretive. Otherwise accountability becomes impossible, suspicions abound, and the credibility of all media will suffer.

Mr. MARKEY. Thank you.

Mr. NOAM. Thank you very much, Mr. Chairman.

Mr. MARKEY. Thank you, Dr. Noam.

And our final witness is Dr. Josh Lerner. He is the Jacob Schiff Professor of Investment Banking at the Harvard Business School. He has written extensively on the role of private equity firms and recently completed a study for the World Economic Forum on the impact of private equity on the global economy.

Welcome, sir.

STATEMENT OF JOSH LERNER, PH.D., JACOB H. SCHIFF PROFESSOR OF INVESTMENT BANKING, HARVARD BUSINESS SCHOOL

Mr. LERNER. Thank you for the invitation to testify.

In past decades private equity has grown both in terms of the size and geographic reach. And what we have seen in markets as diverse as China, Germany, U.K., United States is a lot of questioning and concern raised about the impact of private equity on the economy. What we did in the project that you eluded to, Mr. Chairman, under the umbrella of the World Economic Forum, is really try to understand the global impact of private equity. Not at the level of anecdote, because certainly we can think of cases on one side of the—which are favorable or unfavorable,—but instead try to say, let us put together a team of scholars and do really systematic work in a very independent way. We structured it with a

steering committee that included a broad array of perspectives and constituencies to ensure the independence of this effort.

We did a number of studies about the impact of private equity. And I am not going to try to walk through all of them in the 5 minutes I have but just simply highlight a few conclusions that struck us as particularly surprising and important. First, is the relative infrequency of bankruptcy and financial restructuring as outcomes of private equity transactions. When you essentially look at the evidence around one, the rate of bankruptcy or major financial restructuring of a private equity deal is around 1.2 percent per year. If you compare that to U.S. corporate bond issuers of all types, the rate for them is 1.6 percent per year. So over the last four decades the rate of distress or restructuring of private equity deals is actually lower, not higher, over many booms and busts in these cycles.

Secondly, holding periods, rather than having gotten shorter, and certainly from reading many popular business periodicals we might think that this is ubiquitous, have actually become longer, not shorter. Quick flips or transactions which are just simply held for a year or two have actually decreased.

Third, we looked at long run investment. Essentially the question I am saying, is there disinvestment in a systematic way by private equity-backed firms? We looked here at just one measure, not because it was the only measure we wanted to look at, but because it was something we could look at in a rigorous and systematic way across a broad sample, which was investment and innovation. And what we found is that the level of innovation, if measured for instance by patenting, before and after buyouts remains quite constant. But when you actually look at the importance of those innovations measured in a variety of ways that economists have developed over the years, it seems that the patents developed by private equity groups, by private equity-backed firms, are actually more important after the buyouts. It seems they have higher impact largely because research in the more peripheral areas is trimmed in favor of focusing on the core areas that the firms specialized in.

Finally, we looked at the question of employment, whether there had been some earlier efforts to look at employment by private equity firms. There were all sorts of issues and concerns we could talk about with them. Here we focused on employment in the United States, by transactions in the United States, so we didn't want to give private equity groups credit for creating jobs in China or India. We just simply said what happens in terms of employment by private equity-backed firms. What we essentially found was three things. First of all, that even prior to the buyout the private equity-backed firms were losing jobs. That essentially these were sick firms that were already in trouble. Secondly, that in the 2 to 3 years after the transaction the job losses continued, so that one saw this period of continued relative underperformance in terms of job creation relative to firms with the same characteristics. And finally, when you look at the job creation at new facilities, in other words not what is happening at the existing facilities but rather at the new facilities that are being created by these firms they almost—the private equity groups are actually creating more jobs. So one essentially has a situation where private equity-backed firms are both shutting jobs at the existing facilities, but adding

jobs at new facilities that they are opening in a way that almost entirely offsets each other.

Clearly there is considerably more work to be done in terms of this research and many of the issues that we have raised today, which we hope to pursue in the months and years to come.

But I very much want to thank you for the invitation and for your attention here.

[The prepared statement of Mr. Lerner follows:]

STATEMENT OF JOSH LERNER

Thank you for the invitation to testify today.

In the past decades, the private equity industry has grown both in terms of size and geographic reach. In markets as diverse as China, Germany, South Korea, the United Kingdom, and the United States, this growth has triggered anxiety about the impact of private equity on employment, managerial time-horizons, the overall health of companies and the economy more generally.

This anxiety is not unreasonable. While the leveraged buyout transactions of the 1980s were scrutinized in a number of important academic analyses, these studies had two important limitations. First, the bulk of the older research focused on a relatively small number of transactions involving previously publicly traded firms based in the United States. But these represent only a very modest fraction of all buyouts. The second limitation of the older research relates to the fact that the industry has grown and evolved tremendously since the 1980s.

The World Economic Forum's research project on "The Global Economic Impact of Private Equity," which I led, sought to address this problem. The goal was to complete a rigorous study of the impact of these investments around the world, prepared by a team of leading international scholars, including Ann-Kristin Achleitner, Francesca Cornelli, Lily Fang, Roger Leeds, and Per Stromberg, as well as a number of co-authors, and guided by a steering committee that included leaders from the private equity industry, pension funds, organized labor, and the public sector.

Our study involved a broad array of research on private equity's economic impact. In this testimony, I highlight six conclusions that we as authors found particularly interesting.

The first study examined the nature and outcome of the 21,397 private equity transactions world-wide between 1970 and 2007. The key findings were:

• 6% of buyout transactions end in bankruptcy or financial restructuring. This translates into an annual rate of bankruptcy or major financial distress of 1.2% percent per year. This rate is lower than the default rate for U.S. corporate bond issuers, which has averaged 1.6% per year.

• Holding periods for private equity investments have increased, rather than decreased, over the years. 58% of the private equity funds' investments are exited more than five years after the initial transaction. So-called "quick flips" (i.e. exits within two years of investment by private equity fund) account for 12% of deals and have also decreased in the last few years.

The second study examined long-run investments by firms. It was motivated by the lively debate about the impact of private equity investors on the time horizons of the companies in their portfolios. The private status, according to some, enables managers to proceed with challenging restructurings without the pressure of catering to the market's demands for steadily growing quarterly profits, which can lead to firms focusing on short-run investments. Others have questioned whether private equity-backed firms take a longer-run perspective than their public peers, pointing to practices such as special dividends to equity investors.

In this study, one form of long-run investment was examined: investments in innovation. Innovation offers an attractive testing ground for the issues delineated above due to various factors. These factors include the long-run nature of R&D expenditures, their importance to the ultimate health of firms and the extensive body of work in the economics literature that has documented that the characteristics of patents can be used to assess the nature of both publicly and privately held firms' technological innovations.

The key finding was that:

• Patenting levels before and after buyouts are largely unchanged. But firms that undergo a buyout pursue more economically important innovations, as measured by patent citations, in the years after private equity investments. In a baseline analysis, the increase in the key proxy for economic importance is 25%. This results

from firms focusing on and improving their research in their technologies where the firms have historically focused.

A third study examined the impact of private equity on employment. This question has aroused considerable controversy. Critics have claimed huge job losses, while private equity associations and other groups have released several recent studies that claim positive effects of private equity on employment. While efforts to bring data to the issue are highly welcome, many of the prior studies have significant limitations, such as the reliance on surveys with incomplete responses, an inability to control for employment changes in comparable firms, the failure to distinguish cleanly between employment changes at firms backed by venture capital and firms backed by other forms of private equity, and an inability to determine in which nation jobs are being created and destroyed.

We constructed and analyzed a dataset in order to overcome these limitations and, at the same time, encompass a much larger set of employers and private equity transactions from 1980 to 2005. The study utilizes the Longitudinal Business Database (LBD) at the U.S. Bureau of the Census to follow employment at virtually all private equity-backed companies, before and after private equity transactions. We examine 300,000 U.S. establishments (specific factories, offices, and retail outlets where business takes place) that are part of 5,000 firms that received private equity investments, as well as 6 million matching establishments.

Among the key results were:

• Employment grows more slowly at establishments that are bought out than at the control group in the year of the private equity transaction and in the two preceding years. The average cumulative employment difference in the two years before the transaction is about 4% in favor of controls.

• Employment declines more rapidly in bought-out establishments than in control establishments in the wake of private equity transactions. The average cumulative two-year employment difference is 7% in favor of controls. In the fourth and fifth years after the transaction, employment at private equity-backed firms mirrors that of the control group.

• But firms backed by private equity have 6% more greenfield job creation, that is, at new facilities in the United States, than the peer group. It appears that the job losses at bought-out establishments in the wake of private equity transactions are largely offset by substantially larger job gains in the form of greenfield job creation by these firms.

The project has important implications for how to think about the role that private equity plays in the economy. To the authors, a few broader (albeit tentative) observations emerge from the works:

• The discussion of many aspects of private equity's impact on the economy has been characterized by confusion along many dimensions. As the employment study highlights, the evidence supports neither the apocalyptic claims of extensive job destruction nor arguments that private equity funds create huge amounts of domestic employment.

• The substantial periods that firms remain under private equity control and the robust long-run investments in innovation as measured by patents appear consistent with the view that the LBO organizational form is a long-run governance structure for many firms.

• The results regarding private equity's impact on employment—as well as those in the innovation study—fit the view that private equity groups act as catalysts for change in the economy.

More work remains to be done. There is clearly a need for further research that addresses additional questions such as the implications of private equity on productivity, wages, and unionization, as well as that understanding patterns outside the U.S. We intend to pursue these questions in follow-on work. Thank you for your attention.

Mr. MARKEY. Thank you, Dr. Lerner, very much.

And that completes the opening statements from our witnesses. And the Chair will now recognize himself for a round of questions.

Ms. Harman made reference to this, Mr. Caliboso, and that is the headline in the New York Times today about this pressure that is now being applied to the buyout industry. Given the debt which many of these firms carry, and your personal experience with Hawaiian Telephone, what are some of the things a state regulator

should look at closely with private equity ownership in order to protect ratepayers?

Mr. CALIBOSO. Just that as I mentioned, in this particular transaction, the proposal at that level was higher at the beginning. We looked at that and required additional capital infusion right at the beginning to bring the debt level down to a more reasonable level. Throughout the process we are continuing to monitor that level. In fact, I think we are waiting for a current report that will report their current debt structure and also provide for a debt repayment plan to bring down their debt to a more reasonable level. I can't remember exactly when we are going to get that, but I believe we are going to get that this month. So we are monitoring the debt level to try to keep it reasonable.

Mr. MARKEY. So you are concerned, though, that——

Mr. CALIBOSO. Yes.

Mr. MARKEY [continuing]. Investors might look at ratepayers as the bailout mechanism for other problems which they might have in their firm?

Mr. CALIBOSO. I don't think—well, we, like I said, we had initially a 4 year moratorium on rate increases. So when they came into this transaction, they knew that they couldn't just raise rates through the company immediately. So that is one issue. Eventually, the company would probably have to come in for a rate case like any company would have to come in for a rate case, but that is something that we oversee directly.

Mr. MARKEY. Great. Professor Lerner, Congress has historically, since the 1934 Communications Act, attached non-economic values to certain sectors of the economy, most notably broadcasting and media. So given the special place that these companies occupy in our society, what aspects of private equity investments in broadcast and media companies should concern us all?

Mr. LERNER. Well, I think to a certain level the same kind of concerns that would be raised across any industries would be appropriate here. In other words, saying to what extent are—is private equity additive in terms of creating stronger companies, which are going to be viable and competitive, and to what extent is there instead going to be creation of real fundamental economic problems in terms of natural distress. I think it is fair to say that the concerns may be particularly intense in an infrastructural investment such as telecommunications. But in some ways I see this as more similar than different in the sense that if investors are contributing to innovation employment growth. In other indicators it is hard to say that we should use some sort of special sets of concerns. Those are really the same fundamental worries that will be across the economy.

Mr. MARKEY. OK. Dr. Noam, could you talk about that same issue but in terms of transparency and the control of those assets?

Mr. NOAM. I think that the concerns in—that are addressed, for example, in studies like Professor Lerner's ones, which is an excellent study, but in a way it kind of deals with all companies, including the Dunkin Donuts of this world and so on. I think that in these industries there are special concerns. The concerns are the infrastructure concerns and the market power concerns. This is why regulators exist, why the FCC exists. There are historic rea-

sons for that. When these markets become competitive then we don't have to worry about them, but they are not quite yet there. Now as to the transparency, I think I would go one step beyond the Chairman from Hawaii and say that I think that kind of the nature of the ownership should be disclosed. The investment plans of the company beyond the debt issues should also be out there in the public record. Disinfectant as the sunshine is, the best disinfectant I think works here. If you have public debate about various ways in which companies function in this environment, much progress would be made.

Mr. MARKEY. OK. Mr. Bressler, do you want to comment on that in terms of whether or not there is sufficient transparency and whether or not there is sufficient public oversight of private equity ownership of these media firms?

Mr. BRESSLER. Well, Mr. Chairman, thank you.

You know, obviously we take our obligation—our public issues obligations on these free over-the-air broadcast licenses very seriously. And if you look at the subject of transparency, obviously I can only talk to the companies that are most familiar with that that I referred to, both in my written and oral testimony, we have public ventures for all those companies. And actually for some of our companies, like our proposed acquisition with Clear Channel, it will be public ownership in those companies. So in my experience having been a CFO of Time Warner, having been a CFO of Viacom, both public companies, and now being on the other side in terms of private equity, the transparency is identical. You know, we give out full—on a quarterly basis we file information for all of our public bondholders that are out there, even our companies that are fully private like Univision. And in Clear Channel we will have quarterly reporting, since we will have public shareholders also. And to the extent that the FCC, and having just gone through a year long plus process with the FCC and their review and their request for information,we would oblige any information requests that come out either today or in the future about that.

Mr. MARKEY. All right. Thank you. My time has expired.

The Chair recognizes the gentleman from Florida, Mr. Stearns.

Mr. STEARNS. Thank you, Mr. Chairman.

In response to a letter from Chairman Dingell and Chairman Markey, FCC Chairman, as I mentioned in my opening statement, Martin wrote that private equity firms are subject to the same reporting requirements and regulations as any other entity and that there is no evidence that private investment has any harmful effects on the quality of service. So, Mr. Chairman, I ask unanimous consent to enter his letter into the record, if you'd be so kind?

Mr. MARKEY. Without objection.

[The information appears at the conclusion of the hearing.]

Mr. STEARNS. Thank you, Mr. Chairman.

Professor Noam, in looking through your editorial recently in the Financial Times of February 2007, you indicated, in the last paragraph, you went on to say that direct regulation by government of media is undesirable. So you are saying that government—but disclosure is another matter. And so the question is based upon Chairman Martin's letter and what we have heard from Mr. Bressler and also that Dr. Lerner has also provided information talking

about that actually private equity seems to cause less bankruptcy, don't we have this disclosure that you are concerned about? And if we have that then what is the problem?

Mr. NOAM. Well, I was impressed by the testimony we just heard, but it seems that there is a general view that one of the motivations for going private is, in fact, to get out of the more onerous public disclosure requirements that the public corporations have. Now, if just a few companies would do that, presumably we can live with that. But if the entire telecom, cable infrastructure companies and most of the broadcasters would be the same, I think that we would simply not know what is the—about the media environment in which we operate. I would find that troublesome, and I don't think that maintaining the disclosure requirements that companies had before, to the extent that they are regulated telecom companies or licensees of broadcast licenses, that that is a particularly onerous requirement for them to maintain that.

Mr. STEARNS. But if Mr.—the Honorable Caliboso, said that when the companies come to get their rates increase as a regular, he just says no, so then that puts the burden back on them to make it work. So if there is not the transparency and they go ahead and increase their rates and take on this disinvestment with more funding, then when they ask for more rates the regulators say no.

But, Mr. Bressler, there is a perception, I guess, that is out there that basically these private equity firms are just sort of chop shops. They come in, cut costs, dismantle businesses, sell them off for scrap value, and I think that is probably the fear that a lot of people have that that will occur. So the question is, is that an accurate portrayal of what happens?

Mr. BRESSLER. Well, I—yes. Clearly I don't believe that is an accurate portrayal. I mean just maybe one comment or one additional comment on transparency. At least, you know, the companies that I have been involved with, and I think all my colleagues in the private equity industry to be involved with, public disclosure and transparency is not a reason to go private. You know, there is the reason that these companies would like to go private, or the opportunity to go private, is because that may be some of the short-term earnings pressure they feel. Because of the holders who want to hold the stock for three months or four months or five months and they don't feel they can make the right long-term investment for the business. But in the 2½ plus years that I have been involved in private equity and the companies that we are involved in, in our firm, I have yet to hear anybody say they want to go private because of concern about disclosing information. I do think we are transparent. On the subject of the chop shop, as you referred to it, you know, we are long-term investors. I think Professor Lerner alluded to the fact of the average hold. At THL our average hold is probably in a 5 to 7 year——

Mr. STEARNS. Dr. Lerner, is that sort of true what he is saying? That the average hold is there? And I guess the question for you is do you think that they, this chop shop, is a sort of a misnomer? That they actually come and strip the value and then quickly dump them? And in some cases they might do this to create health entities.

Mr. LERNER. I think the important thing to emphasize is that if you look at a typical company over the last 20 years across really all countries, the period that it has remained in private equity ownership from the time of the initial purchase to its sale is around 8 years. So it is very different from, you know, a sort of a quick flip, as it is often popularly portrayed. That is not to say that there is not trimming of underperforming divisions, or add-ons of additional divisions, or fine tuning of a company, but basically this is not a short-term kind of investment as it is often portrayed.

Mr. STEARNS. Thank you. Mr. Chairman, my time is expired.

Mr. GONZALEZ. Thank you very much.

And the Chair will now recognize myself for 8 minutes.

You are probably wondering what you are doing here before this particular subcommittee, and why you may not be in another subcommittee, why he is in meetings and so on. And so I am going to quote Dr. Noam from his written statement, which I think he may have already gone over, but I want to emphasize the reason why I believe that the Chairman of this Committee is expressing his keen interests.

Infrastructure is critical for society and economy. Media are critical for democracy, culture and commerce precisely because their social value exceeds their private value, and the companies have usually understood this and were not simply profit maximizers or were regulated in that direction, for example, in universal service. When they did not they ended up before this Committee. If ability or willingness to invest in infrastructure and in competing networks is reduced, everyone will be affected. So I think that is our special interest here, and I know what we are hearing here. Unfortunately, I think private equity is viewed in maybe not the most favorable light, and I am just going to toss out maybe some reasons why some people may feel that way, and that is private equity firms when they come in and buy a company really aren't part of that particular industry. They are really looked at as outsiders and not having that same institutionalized commitment and dedication to the purpose of that particular industry or entity. The other, of course, some of us, many of us, are not real happy about tax treatment that maybe private equity and managers and such may derive. And that has been addressed, but not successfully. We also presume that in the public sector you have a regulatory scheme that does bring certain scrutiny that is not there when it comes to private equity. That may or may not be true, and we will discuss that, Dr. Lerner. We also may remember the days of the late 80s and early 90s of the leveraged buyouts and say wasn't that private equity, but we simply called them leveraged buyouts back then. And we also have had bad experiences with corporate raiders, not to say that private equity aren't corporate raiders, but nevertheless, I think there are some people that may believe that they are a close cousin. The big question is does the private equity business model expose the telecommunications industry to greater risks? So I am going to now basically read from the story that everyone has alluded to by Michael J. de la Merced in the New York Times. And I know that Congresswoman Eshoo, as well as the Chairman of this subcommittee, already made some reference, and this is that the credit crisis spreads through the financial markets. It is dis-

cussing Blackstone. The firms said earnings tumbled 89 percent in the final three months of 2007 and warned that the deep freeze in the credit markets, and by extension the private equity industry was unlikely to fall soon. "They see the handwriting on the wall," said Martin Fridson, a leading expert on junk bonds. He said of buyout firms, "they are staring into the jaws of hell." That is a pretty strong statement, and I am sure that you will want to address that, and I may ask Mr. Bressler to address that. But, Mr. Lerner, let me ask you. With this credit crisis, which I believe is true and is out there, isn't there greater exposure to a company that basically has been purchased by private equity as opposed to someone like AT&T or Verizon?

Mr. LERNER. I think it is absolutely fair to say that private equity firms, on average, are more leveraged than traditional firms. And typically we think about that as being associated with increased risks. So I think it is a fair statement. At the same time I think it is important to emphasize that the—much of what the discussion I think in that article, and the discussion in the industry more generally, was focused on the origination of new deals and the difficulties the groups were facing in terms of doing new deals. When one thinks about the way in which the existing portfolio of transactions have been structured, in large part the debt, in terms of which the debt has been done, have been locked in. That is not to say that there can't be difficulties. And as you properly alluded to, in the early 1990s there were difficulties in terms of many of the buyout firms that were,many of the buyouts that were completed, they had overleveraged, and as a result he had to go through painful restructurings. But again, just to emphasize what I see as the top line is that, yes, there is more risk. Yes, there is real possibility of failure, but if you look over the absence flows that are from the beginning of the industry until today, you see that the probability of bankruptcy or major financial restructuring is quite modest relative to industry as a whole or corporate debt issue as a whole or even relative to our expectations about private equity.

Mr. GONZALEZ. Dr. Lerner, I guess that one of my concerns is simply when we start looking at telecommunications and the tremendous investment in infrastructure is really an investment that you make long-term. And you have already indicated that there really is not much difference between a private equity owner and let us say the typical corporate owner, public and so on. But wouldn't it be fair to say that if you are really in a tight credit crunch, which impacts the private equity business model much more so than the traditional AT&T or Verizon model, then who is going to bail out quickly or more quickly? Who is not going to make those long-term commitments in investments looking forward when the easier ready money is not there to retire the debt, which obviously was incurred in order to accommodate the purchase in the first place?

Mr. LERNER. Well, I think it is a more complicated story in the sense that when we think about publicly traded companies, down cycles can have tremendous pressures on them as well. When you think about the nature of a private equity fund, we are talking about a fund which has an existence of essentially a decade or po-

tentially extension for another 2 or 3 years thereafter. So there is an ability to ride out the storm as opposed to public companies which often—because they have a highly visible stock price. When that stock price drops they are going to be in a situation in many instances where they feel very intense pressure to do something right away, and often that can lead to decisions with which the benefit of hindsight look short-sighted. That being said, clearly if we go into a downturn which looks more like a depression, rather than a recession, there is going to be a lot of pain to go around, and ultimately the private equity industry will doubtless feel much of that pain as well. But I just simply don't think it is as clear as saying, well, because there is debt, there is more risk, and therefore there is a greater probability of restructuring bankruptcy or just simply foolish decisions being made.

Mr. GONZALEZ. All right, sir. I guess what I am reading here is that everybody is basically in the same position. And so we go into this credit crisis that there really is not going to be any difference between let us say the AT&T telecommunications investment as opposed to that company that has been purchased for a private equity. I guess what I want to know is, who is going to get wheeled into that emergency room sooner?

Mr. LERNER. I think it is a hard question to answer absolutely. I think that when you look at the private equity model, it has got strengths and weaknesses. When you look at the corporate ownership model, it has strengths and weaknesses in terms of dealing with the down cycle. And I think you will end up with, you know, probably both facing challenges if we enter into a prolonged downturn.

Mr. GONZALEZ. Thank you very much, Dr. Lerner.

My apologies to the other witnesses, but I really had a lot to discuss here with the doctor. And the Chair will recognize my colleague from the great State of Illinois, Mr. Shimkus.

Mr. SHIMKUS. Mr. Chairman.

Mr. Bressler, some of these will be redundant. But are there certain communications businesses that might never have gotten off the ground were it not for private equity investments?

Mr. BRESSLER. Well, I think that is absolutely a fair point. That there are communication businesses, you know—what is interesting about the business is that we bought recently in both Univision and our proposed acquisition about Clear Channel, you know, these are businesses that not a lot of people showed up to buy, quite frankly. Which I think tells you something about the over-the-air broadcasting waves and Wall Street's view about the value of those. And from our standpoint we looked at these businesses and said, this is a great opportunity because of digital migration, because of localism. If you take a company like Univision and what we have been able to do since we had our ownership; that is a reminder to the Committee. It is the same management that is out there today in Univision that was there before, that will be there after we exit the company at some point in the future and that is there during our tenure. And I think what we enable a company like Univision to do is to do something like host the Spanish language debates between the Democrats and the Republicans, have a show on Sunday called Apunto. So I can't address directly

the idea, because we do more larger, private buyouts, as opposed to some of the smaller things that enable new businesses to start up. What I do look at within a company like Univision and what we have enabled them to do as a new business, which they were not able to do before. And they are able to do that over a long-term period of time. And I would say that those are things that a public company in this context, in this environment, the commitment to spending $20 million on digital that we are going to do this year, I would really question if Univision was still a public company whether that would happen right now, because of the pressures that are out there. And I do think that is the benefit we bring in private equity.

Mr. SHIMKUS. Thank you. I was going to go onto the chop shop debate, but I think we have covered that. I think there is a different opinion that Dr. Lerner, both a great, smart panel, says the facts speak, that there are benefits, and I think, Dr. Noam, if I can summarize, that there are problems. Is that right with the mentality? Is that fair?

Mr. NOAM. Yes.

Mr. SHIMKUS. I mean I don't—you had a whole testimony ready, and I don't want to summarize in a way that you—but that is really the debate here?

Mr. NOAM. In this particular industry, telecommunications, where there is infrastructure role and it is significant market power of incumbency, there are problems, or there are incentives to problems. And the risks that Mr. Gonzalez referred to, to me the problem is that there are not enough risks, because you know that the rate payers, the users, ultimately will bail you out. Nobody is going to let the telecom company go belly up.

Mr. SHIMKUS. Unless you got a great regulator, Mr. Caliboso, here who says no to the rate increase. Let me go to another question here that deals with the economy of the People's Republic of China. It is the second largest in the world after the U.S. Global private equity firms are rapidly opening up offices. China's leaders recognize that they must build a vibrant private sector. That is the premise. You may agree or disagree. If we were to limit or put more restrictions on private equity investment in the U.S., would we be pushing investors away from the U.S. and hindering innovation? Let me just go, Mr. Bressler and Dr. Lerner. And if you don't want to respond it is not a requirement that you have to.

Mr. BRESSLER. Well, thank you. No, we still—we are a one office firm. Basically we don't have any offices outside the United States, as the subcommittee knows factually. The predominance of our investment is here in the U.S. and North American growth.

Mr. SHIMKUS. That is why you say—I don't have an issue, you know, a fish to fry in that. So then we will go to Dr.—to the professor.

Mr. NOAM. The premise of the question is correct. The question, however, is how far do you want to push this? Supposedly talking about health and environment and so on. You can also make the same argument that having worker protection of some sort for their health and the environment would push business away to China.

Mr. SHIMKUS. Have global climate change debate. Thank you.

Dr. Lerner?

Mr. LERNER. Just one thought on top of Dr. Noam's comment, which is that I think the crucial thing to look at is the extent to which regulations are out of sync with those in other countries. It is clear that this in some sense is a very mobile industry in the sense the key asset is the human capital of the people who are there, as well as the routines within the firms who in fact are to a certain extent seeing a redeployment of resources away from the United States and to emerging markets today, where there seems to be a perception of greater growth. And one could at least worry that in a level of regulation that was out of line with that seen in other developed economies might accelerate that trend, rather than as a result.

Mr. SHIMKUS. Thank you, Mr. Chairman.

If you want—I will end with—if you want employees, you have to have employers.

I yield back.

Mr. MARKEY. Thank you very much.

The Chair will recognize Mr. Green, who hails from the former Republic of Texas.

Mr. GREEN. I wish we had some of those funds that were around the world though, Mr. Chairman. Our oil and gas revenues aren't what they used to be. Those of us from Texas realize that OPEC actually patterned their group after what the Texas Railroad Commission used to do, but we don't have near that production.

I want to thank our witnesses for being here. And I think what we are seeing is the concern that Members of Congress have for something that we really need. The private equity effort, both in telcom, but in lots of other businesses. We need to be able to put that money together and be able to market.

I guess my concern, overriding question, is some of us are concerned about, for example, if a private equity put together to buy AT&T or Verizon—and bear with me for a minute. If I am concerned that the United States Government may have access to our unfettered information, what would happen if it was a private equity firm that had significant ownership from a—whether it be China, whether it be the Gulf States, and how would they still have to comply with U.S. laws to get that information, but being the owner of it? Is there any comment to that? Because that would be my concern. Instead of having a publicly traded, for example, like AT&T or Verizon that would have that. I know we are getting away from the Clear Channel example, but I worry less about media, because there is so much competition in it. Yes, any—Dr. Noam?

Mr. NOAM. Those kinds of problems that you are alluding to can be dealt with, I believe, through general regulations, whether it is the FCC or the State Commissions or some general law. But protection of privacy and of customers and so on, I don't think they are—the ownership is material. I would think that it is more material, since you are alluding to foreign ownership, where the content is a question, and here, at least, when we would want to know if foreign investors are heavily involved in media companies who they are. The identifications, since you are alluding to some issues, some regions of the world where there are—there the U.S. is at tension with.

Mr. GREEN. Well, in a free society we do have, you know, as long as we have that transparency, I guess, and you can see.

Mr. NOAM. Yes.

Mr. BRESSLER. The only thing I was going to add to that is one, I do think we have foreign ownership rules right now, right, that have been mandated. And obviously I think all of us in private equity is no different a buyer than anybody else that may be a company out there. And so with respect to broadcast properties, I believe that foreigners should bolster in place today and to the extent that they may change. We all have to abide by those rules. In terms of transparency, the management of the companies that we have and whether it is the current companies that we own at THL, or I believe as a general statement for the industry, those are the managements that will be there before we owned the companies, to a great extent that the management's not there, when we owned and they will then survive after the ownership ultimately changes and passes down the road. And I will tell you that we expect that management to abide by all the rules. Just as if we have a CFO we expect them to stay a public—to abide by Sarbanes-Oxley. If there is a general counsel and CO, we expect them to abide by the FCC. And if there are public interest obligations and disclosure obligations that are set up by the Congress of the United States, we expect our people to abide by those also. And so I think there is a set of rules that we are very comfortable adhering to as any other buyer would be and are always happy to have the discussion as to how those rules evolve and change.

Mr. GREEN. Dr. Noam, I know you briefly alluded earlier in what we can remedy some of the problems in private equity ownership. Can you expand on that in the 48 seconds I have left?

Mr. NOAM. What we can do to remedy. My point was disclosure. If you know who owns it, if you know what their investments are, if you know what kind of payments they make to the private equity funds, I think then you can have a healthy public debate, and Congress can debate it, too. And then you can report on it, investors can look at it. I think that will take a lot of the problems.

Mr. GREEN. And in closing I think after watching what happened with Dubai purchasing to manage the Port of New Jersey, New York—coming from Houston we have a government agency that runs our port, and frankly that same company leased out certain parts of the Port of Houston. We had no problem with that. But, you know, I saw the furor that erupted over a national company owning an asset. So we could see the same thing probably with what would happen with this.

Thank you, Mr. Chairman, for the time.

Mr. MARKEY. The gentleman's time is expired.

The Chair recognizes the gentleman from New York, Mr. Fossella.

Mr. FOSSELLA. Thank you, Mr. Chairman. Thank you witnesses for coming today, and I appreciate your input.

And we know that there is substantial evidence that private equity has played an important role across the spectrum—industry, whether in communications or retail, auto manufacturing. We know that capital is the life of the economy's strength, and private equity is a critical source of capital where capital may otherwise

be unavailable. But I guess it is depending on perspective. If you want to look for a demon or do you want to see the cross section of the markets. We know that the U.S. market is the deepest in the world, equity and capital at its greatest. So I would like to look at it from—almost follow up Mr. Shimkus's approach. In the last year or so there have been highlights of how America's competitiveness, while still the greatest in the world, is facing competition from not just other markets like London and established markets such as that, but emerging markets. And pools of capital can flow instantaneously. Three major reports, McKinsey or Bloomberg's reports, Chamber of Commerce, and another have spoken to this. So I guess the fundamental question is why do public companies want to go private? You know, what is it about—are there disincentives? I mean Mr. Bressler talked about the pressure for quarterly earnings, the demand to meet expectations. Perhaps it is implementations of legislation that has been passed by Congress or perhaps litigation. I know many overseas refuse to list in the country because of the threat of litigation and class actions. So I would like to hone in on those two aspects of why companies decide to seek private equity groups and to what extent is the regulatory regime we have in place in this country and/or the litigation climate we have in this country incentives for public companies to go private.

And I will start with Mr. Bressler.

Mr. BRESSLER. Thank you. Well, clearly I am not an expert on SEC or regulatory law. But I will say for the companies that I have been involved in and why I believe they chose to go public is they are in extremely competitive industries. If you look at, you know, the free over-the-air broadcasters, they are competing with somebody as—I am sure you all have children. I have got four girls that are 22 to 11. They are competing for their time, whether it is iPods or DVDs or different forms of entertainment. And so they need to have strong healthy companies. They need to build those companies. And how do you get a strong, healthy company, which by the way, is a byproduct—I think to the Chairman's point, if you are going to do the non-financial thing you need to have a strong, healthy company to do those non-financial things and their impact on society. So I believe in the companies that we talked about with Univision and our proposed acquisition of Clear Channel, you know, the ability to continue to invest for the long term. The ability of the digital where we are putting $100 million into Univision and $20 million in 2008 to bring digital to all the TV stations in Univision, to build our HD radio capabilities at both Clear Channel and Univision and to all the television stations that are out there. Now, we don't know the exact impact like in radio that digital is going to have. We do know that it is going to increase by double the number of offerings to the consumers that are out there in the local market. So a very local product with double the offering to the consumers. We believe that is going to create value and be of benefit. But at the same time I think the owners of those companies being the public shareholders prior to us taking ownership didn't see, you know, wasn't enabling management to make those investments that they needed for the long term health of their businesses to be able to compete in this very intense market.

Mr. FOSSELLA. So pointedly is there any aspect to, again, the fundamental questions of litigation or the threat of litigation and class actions and/or the regulatory structure we currently have in place as it applies to public corporations, Dr. Lerner? You were nodding your head.

Mr. LERNER. I will just point to one—there have been a number of studies around these questions, so I will just simply point to one study very briefly, which makes this point in a pretty dramatic fashion. It essentially looked at the companies which were just above and just below the cutoff point for Sarbanes-Oxley, essentially based on the tests around public market float. And what it highlighted is that if you look at the ones who were otherwise almost identical, but who were just above that cutoff, what they have found is not only did the direct expenditures, in terms of accounting, legal fees, go up quite dramatically as we would expect with requirements for Sarbanes compliance, but we also saw in the year after this was implemented—the office also found in the year after it was implemented there a quite pronounced negative stock return for these companies, which suggests investors were really looking at the kind of costs associated with complying with this regulation and translated into bad news for that company. So that is just simply one study. There are several out there, but they do suggest that in addition to whatever kind of positive features of going public are out there, there are also some negative features in public that do impose some real costs.

Mr. FOSSELLA. Thank you, gentlemen.

Mr. MARKEY. The gentleman's time has expired.

The Chair recognizes the gentleman from Michigan, Mr. Dingell.

Mr. DINGELL. Mr. Chairman, thank you.

First of all, this is a very important hearing, and I commend you for going into this very important question. Second, I have a unanimous consent request that I be permitted to insert my opening statement into the record at the appropriate place.

Mr. MARKEY. Without objection it will be inserted at the correct place in the record.

[The prepared statement of Hon. John D. Dingell follows:]

STATEMENT OF HON. JOHN D. DINGELL

During the last several years, more private equity firms have been investing in and acquiring publicly held communications companies. Recent examples include the purchase of Clear Channel, Univision, and Alltel. Today's hearing will examine the implications of this growing trend for communications services that are an integral part of our daily lives. The question for this hearing is whether these transactions serve the public interest.

Is private equity ownership of telecom and media companies a positive development, a negative development, or a bit of both?

On the one hand, private equity ownership suggests a financial management style focused on cutting costs, increasing revenues, and ultimately reselling a more efficient enterprise. Private equity ownership allows for a more nimble management structure than is possible with a publicly-held company. It can also shield companies from Wall Street pressures to produce ever-higher earnings each quarter. Communications and media companies that must sacrifice short-term earnings in order to make long-term investments could benefit from the financial approach associated with private equity. From a purely economic standpoint, the advent of private equity ownership could be viewed as beneficial.

On the other hand, communications properties, especially media outlets, have intrinsic values that are not easily reduced to pure dollars and cents. Congress has

enshrined these non-economic values, such as localism and diversity, as cornerstones of our statutory and regulatory structures. Thus, cost-cutting measures that result in the paring down or removal of local news broadcasts would most certainly not serve the public interest. Nor would the public interest be served by private equity's failure to provide adequate service quality due to insufficient investment in a telecommunications network.

Because there is typically little transparency about private equity firms' ownership and management structure, private equity ownership of communications properties also raises serious questions about ensuring compliance with the Federal Communication Commission's media and foreign ownership rules, as well as other regulatory requirements.

Telecommunications and media firms must be able to survive and thrive in today's marketplace. Private equity ownership may provide an attractive alternative to strengthen a company's long-term financial security. Congress and the FCC must, however, remain vigilant to ensure that private equity firms manage communications properties in ways that serve the public interest and preserve core values such as localism and diversity that are at the heart of our communications regulations. I will be watching the FCC to be sure it is mindful of these matters as it considers transactions involving private equity ownership.

Mr. DINGELL. I have some questions, Mr. Chairman, which I think are very important and go to the center of your concerns and my concerns in this matter. I would like to direct them to Dr. Noam and to Dr. Lerner.

We have a situation here, gentlemen, where we see that the Federal Government requires that corporations who do business and are listed on the exchanges and are publicly held file annual reports. We have a situation where the agencies, which are—rather companies—which are subject to the jurisdiction of the FCC first of all have to file certain annual reports in connection with the creation of the agency and second file periodic annual reports in connection with the activities again of the company. We don't see that situation with regard to companies which are held by these private equity firms. Am I correct in that, yes or no? It is a fairly simple question, gentlemen. Yes or no?

Mr. NOAM. Not correct, sir, on that. In terms of——

Mr. DINGELL. That is sort of a prelude to the other questions I want to ask. So now as a matter of public policy then the government has decided first of all that corporations should file certain annual reports to tell the public what is going on behind the doors of the corporation. Is that right?

Mr. NOAM. That is correct.

Mr. DINGELL. And we have—and in the case of telecommunications companies under the regulation of the FCC, they have to file again certain annual reports about their activities and what they are doing.

Mr. NOAM. That is correct.

Mr. DINGELL. That is a matter of public policy. Am I correct?

Mr. NOAM. That is correct, and on top of that——

Mr. DINGELL. And it——

Mr. MARKEY. Could you turn on the microphone, please?

Mr. DINGELL. It is, I think, a matter of sound public policy that they should do this. Bottomed on years of experience going back to the New Deal days and going back to when we first set up the FCC and the SEC. Is that correct?

Mr. NOAM. That is correct, and I think that while there were sometimes problems in the excesses in the disclosure requirements——

Mr. DINGELL. Well——

Mr. NOAM [continuing]. The basic principle has been a good one.

Mr. DINGELL. We do have the problem of the excesses, but we also have the need to have people know what is going on. And we have had some rather bad experiences with companies which have not had to file these annual reports. Is that right? And the annual reports give a certain openness to the process and enable us to understand what is going on so that we can know exactly whether public policies are being carried out and whether there is an honest administration of the companies. Is that correct, gentlemen?

Mr. NOAM. That is correct.

Mr. DINGELL. And so when we take that situation and allow it to then be subverted by seeing to it that there are no—that the transparency is gone, that the reporting and the disclosure is gone the—first of all, we have no way of knowing whether these firms are functioning in accordance with the law. We have no way of knowing whether or not public policies with regard to all manner of activities that are required by other statutes or by the basic statutes of the FCC are being complied with. Is that correct?

Mr. NOAM. It would be correct, but in fairness, Mr. Bressler made the point that many disclosures are, in fact, taking place. But if they wouldn't take place it would be a real problem, yes.

Mr. DINGELL. Well, as we have found that folks have from time to time failed to file proper reports, and as a result bad things have occurred. And that is easier under a situation where they are exempt by reason of being in private ownership and not publicly held or exempt from the requirements of regulation and reporting that they might confront either under the laws governing the SEC or the FCC and their responsibilities. Is that correct?

Mr. BRESSLER. Well, that would be correct, sir, but most of the companies, I believe, that we own—so I can only speak for those. There is public debt out there, and that is what I was referring to. I just wanted to be clear before. There is public debt out there. That public debt requires quarterly and annual reporting to those public bond holders. That is similar to what is required from the public reporting that is filed in financial statements to the SEC on a 10-Q and a 10-K. You know, having been both the CFO of two large public companies and now on the private equity side, we go through the same process at our private companies. And whether that process is Sarbanes-Oxley or internal controls or transparency with respect to all aspects of financial reporting, it is identical. In my judgment if you have public bondholders, it is as if you were a public company. And that is what I was referring to earlier.

Mr. DINGELL. So this affects everybody, including competitors. It affects customers and investors. It affects the government regulators in knowing whether or not the laws are being properly complied with. And it tends to give, from time to time, advantages that might not be available to persons who had to file the reports. Is that right, yes or no? I mean, am I right or wrong in my assumption?

Mr. BRESSLER. Well, again, just to simply emphasize the point, if you look at the transactions by large buyout groups, the major buyout groups, in the last few years, it has been extremely common for them to essentially not just have debt from banks, but also to

have debt from public markets. And as a result there has been the same kind of SEC filings that would be generated as if it was a publicly traded company. So what might otherwise be a major source of concern is perhaps ameliorated by the fact that one does have these public disclosures taking place as long as there is the public debt.

Mr. DINGELL. Would I be fair in assuming, though, that first of all advantages are achieved by those who are able to function within this particular rubric? And that, perhaps, it might facilitate wrongdoing, since the reporting and the disclosure were put in place to assure that we had transparency and ease of regulation to be assured that behavior was proper? Am I correct or incorrect in that, gentlemen?

Mr. NOAM. It is—that is why there is room in my view for regulated companies that had previously been filing certain information if they are in private situations and do not have to file it and do not have these public bonds to disclose. Then in those situations, and the FCC or state utility commissions should require such similar type disclosures.

Mr. DINGELL. Thank you.

Mr. Chairman, I have overused my time. Thank you for your courtesy.

Mr. MARKEY. And the gentleman's time has expired.

The Chair recognizes the gentleman from Mississippi, Mr. Pickering.

Mr. PICKERING. Thank you, Mr. Chairman, and thank you for this hearing.

As I read through the hearing memos, it strikes me that as we do public policy on the House side, we are elected every two years, we are to reflect the passions of the present. The Senate has 6-year terms; the rule is stay with the minority. Consensus has to be achieved in there to look at the long term. Short term, long term. Founders wanted a balance. Would it be accurate to say that the private equity and Wall Street publicly traded companies kind of strike that same type of balance in the marketplace? Where private capital can give the advantage of a long-term strategic investment, where Wall Street is looking more at the short term and the immediate returns to shareholders and to maximize dividends? Would that be a fair assessment of the balancing of the marketplace? In addition to Wall Street probably favoring the entrenched, the incumbent, the established, and private equity looking at entrepreneurs, innovators, new entrants, competition? One encourages concentration and convergence and private equity giving us new choices, new options, new technologies. Would that be a fair assessment of the balancing of private equity and public, Mr. Bressler?

Mr. BRESSLER. Sure. I think as an overview that is, you know, a fair assessment from their standpoint. Clearly, I liked your analogy in terms of the encumbrance and the center in the House, you know, but private equity, you know, we mentioned earlier about the average hold, and our average hold at THL was 5 to 7 years. I think Professor Lerner actually said, based on his study, which is more widespread, it is probably closer to an 8-year period of time. You know, what I find most interesting if I think about the, you know, four items in terms of these broadcast licenses that we

hear talking about, in particular for the radio and television industry, they need patience. Because we need strong, healthy companies, because again, you know, we are going against a very capital-intensive competitive situation. And I think, again, as I mentioned, all of us that live in the U.S. and have kids understand that. You need commitment to be there as we go through this transformation to digital. But finally, at the same point, you need to have management and management expenses there before to carry us through and to be there after. That is something that Wall Street doesn't recognize in the short term, which this is the law for private equity, particularly in the era we are in right now in these digital licenses.

Mr. PICKERING. As a follow-up, in the marketplace in public policy, we have always tried to treat new entrants differently than established companies, so that we can increase competition. In some way, your requirements of reporting and regulation would be treating you the same as public companies. With that disadvantage, what is happening to give capital to new entrants, new technologies, struggling companies, and the long term? Would that put you at a disadvantage and would it advantage—if we just want a world of incumbents and established and limited competition, it seems like we would try to make everybody do the same thing. And I don't think that this is our public policy objective. Would you agree with that?

Mr. BRESSLER. Well, I am not—if the question is about transparency—and I think the gentleman before is also asking about transparency there too. You know, we are very supportive of transparency, so I don't believe.

Mr. PICKERING. Well, it is not an issue of transparency, but it is the regulatory burden of Sarbanes-Oxley—it does have a cost to it.

Mr. BRESSLER. Right.

Mr. PICKERING. And it increases your cost of your capital. It increases—or it decreases your flexibility to respond to the marketplace, and it decreases your ability to compete against established incumbents. Would that be an accurate way to say it?

Mr. LERNER. Could I take a shot at that question?

Mr. PICKERING. Yes, Dr. Lerner.

Mr. LERNER. I think that, particularly when we look, private equity is a spectrum, right, from big, mature companies being bought out to new companies or start-up companies which are there. And I think, particularly when we look at that end of the spectrum of younger, newer entrant companies, the kind of costs associated with disclosing a strategy that might be a new strategy, that the huge amounts of regulatory requirements where a company working on very thin margins and so forth can potentially impose very real costs and very real burdens.

Mr. PICKERING. And would a big established company possibly use that information to squash competition?

Mr. LERNER. Well, certainly there has been a long literature in economics highlighting the use of regulation and regulatory capture by incumbent firms against potential new entrants.

Mr. BRESSLER. Well, you know, just to add one last thing. That at the same point we are supporting new technologies, disruptive

technologies to some extent, that are out there that ultimately the consumer's going to decide what their choice is.

Mr. PICKERING. And you wouldn't want to tip off those new technologies, new applications, to say a very entrenched incumbent that would then try to keep you out of the marketplace?

Mr. BRESSLER. Well, that is correct. That is correct. And at the same point, obviously, we have what I just have to reiterate what we have earlier with established companies about, you know, that have public debt about being transparent, so——

Mr. PICKERING. So we get the transparency, but we get the new entrant and new investments the way that we have it structured now?

Mr. BRESSLER. That is correct.

Mr. PICKERING. Is that the benefit?

Mr. BRESSLER. That is correct.

Mr. PICKERING. Thank you. Mr. Noam, Dr. Noam, do you want—I mean quickly.

Mr. NOAM. Just, Mr. Pickering, to your point of the short term and the longer term, and maybe that is a good way of looking at it, maybe we can add a third term, which is the really longer term. It is true that maybe a public company has to look at the quarterlies, and your point is that it has a little bit more luxury under private equity, and that is a good point. But at the same time, the facts that I have described earlier about the telecom companies in Europe that were acquired with private equity clearly indicates that the longer term investment, the fiber-to-the-home kind of investment, those kinds of investments are not being undertaken by private equity owners. So that infrastructure investments that benefit beyond the direct owners of the company but has some spillover externalities that impact on the rest of society.

Mr. PICKERING. Mr. Chairman, could I—would you be able to—just a second—to have a follow-up?

Mr. MARKEY. Be glad to.

Mr. PICKERING. I just want a clarification.

Mr. MARKEY. Absolutely.

Mr. PICKERING. Did you say that private equity is investing in infrastructure or not investing in infrastructure?

Mr. NOAM. In Europe, of the two examples, in Belgium and Denmark, would indicate that the investments are not as high by private equity-owned telecom—national telecom companies.

Mr. PICKERING. Now, in the United States the experience, would that be similar to Europe or different than if you look at the satellite investments? If you look at Hughes, if you look at Alltel? If you look at those types of examples, would they be building more networks and multiple platforms more so than incumbents at this point?

Mr. NOAM. Quite possibly, but my concern was where there is market power of infrastructure companies that are more entrenched than those examples that you just mentioned. And those companies do exist.

Mr. PICKERING. Can they——

Mr. BRESSLER. That we helped create the infrastructure. I'm sorry.

Mr. PICKERING. That is OK.

Mr. BRESSLER. The only thing I was going to add is that we helped to create—I don't think it should be—we helped create the infrastructure in the United States. You know, with the number of examples that I gave in my written testimony both in helping kind of recreate MCI to the present example of bringing cable to the world communities. And so I think it is quite different. We did help create it here.

Mr. PICKERING. Thank you.

Mr. MARKEY. The gentleman's time——

Mr. PICKERING. Thank you, Mr. Chairman.

Mr. MARKEY. The gentleman's time has expired.

We will go to a quick second round if that is possible. And I would like to follow up on Mr. Pickering's analogy in the balance that is in the Constitution between the House and the Senate, and the judiciary. So under his analogy the House is Wall Street, the Senate is the equity marketplace and then, you know, that cooling dish. And Dr. Noam's in the super long term, I guess which is the judiciary, and those are these longer term values that we also have to be protecting. And I guess what I would like to do is return to Mr. Pickering's line of inquiry, which is that publicly traded companies complained that Wall Street punished them when they announced some new infrastructure investment in the telecommunications sector. What are you doing, says Wall Street. How can you be taking revenue that we could be taking as profit and investing it in broadband deployment? You know, we are going to lower your stock valuation. And so that obviously hurts competitiveness in the United States. Mr.—Dr. Noam says that the experience in Europe is that when you take the company private they still don't invest. That you wind up with the same problem. And, I guess, it raises the question of whether or not we have to solve the problem through competition policy, rather than depending upon either Wall Street or the equity marketplace, the public or the private markets to do this, that you need actually to have a competition policy so that you get your result. What would you say to that, Mr. Bressler?

Mr. BRESSLER. Well, I would say, you know it is in our interest—back to, Mr. Chairman, your first point. It is in our interest to invest in these companies and build into the long term. So when we go in we are investing, again a theme that we talked about a few times, a factual theme, for a 5- to 7- to 8-year period of time to hold. At the end of that period of time, the outlet for our exit from those companies as we call it, is the public markets that is sold to somebody else. It is critically important that we have got a growing, thriving company. The only way you get that is to invest. And again, I think a very good example, a factual example, is what we are doing in something like Univision, where we are putting $100 million into digital transmission, $20 million into 2008. Now, it is not a public company today. It has public bonds, but it is not a public company today. So I can't, you know, the judge of that would be in today's financial markets that we referred to a number of times today. The pressure I am sure would be enormous——

Mr. MARKEY. But is that——

Mr. BRESSLER [continuing]. Not to invest.

Mr. MARKEY. But is that a good policy for us as a nation, in other words? What Dr. Noam was talking about is how Ireland has now fallen, I think you said, to 14 out of 15 in the rankings in terms of broadband deployment. And in the United States we are falling from 3 to 15 in the OECD rankings since 2001. So for us, we are looking at these trends. And I guess what I would ask you, Mr. Bressler, is your company the rule or the exception? In other words, the very fact that you represent an investment philosophy that has a longer term view might not be shared by other equity companies who are also investing in similar telecommunications properties. And I guess the question is should we derive from your example a rule that applies when companies take—when equity companies take telecommunications companies private, or is this just, say, generous to you and you are not here representing what does happen in general when equity firms do take telecommunications companies private?

Mr. BRESSLER. Well, I am going to defer a little bit to Professor Lerner, because he has studied much more of the industry than I have. You know, I would point out two things. One is I am not familiar with the—personally familiar with the Ireland or the other examples outside the U.S. I am really not equipped to comment on those. But I would also say we talked about the average hold is—the average hold is an 8-year period of time that Professor Lerner said earlier. So he can comment more in terms of whether that is the rule.

Mr. MARKEY. Again, Dr. Lerner, if you could comment briefly, please.

Mr. LERNER. I think one thing to emphasize going in, of course, is that when we look at—there have been a lot of private equity investments, and you can certainly find examples of very successful ones and very unsuccessful ones to point to. But I think the crucial point when we look beyond the case studies and look at the more general evidence, it would suggest that private—that all the studies I have seen suggest that private equity does not translate, in general, to a cutting back of long run investment in firms measured a variety of different ways from capital expenditure to investments and innovation in a variety of other ways. I think that if you look at the broader evidence, it is very hard to find support for an argument that this translates into rapid cutbacks of these measures.

Mr. MARKEY. OK. Thank you, Dr. Lerner.

The Chair recognizes, again, the gentleman from Florida, Mr. Stearns.

Mr. STEARNS. Thank you, Mr. Chairman.

I just wanted to go back to the real purpose of this hearing and to try and establish again the difference between private equity firms and public and dealing with their transparency. I know that Mr. Noam, Dr. Noam, in his editorial said direct regulation by government of media is undesirable. Then he went on to say, but disclosure is another matter. So I just want to emphasize a point before the hearing closes, Dr.—Mr. Bressler, is there any reason why privately owned communications companies would be less transparent than publicly traded ones? Aren't companies controlled by

private equity subject to the same SEC rules and FCC reporting requirements?

Mr. BRESSLER. Yes.

Mr. STEARNS. And, Dr. Lerner, is that true?

Mr. LERNER. With the caveat that if you have a privately held company without debt. So, for instance, a venture backed company——

Mr. STEARNS. Right.

Mr. LERNER [continuing]. Which is a start-up, then essentially you typically would not have to be making filings with the Securities and Exchange Commission until you went public. But, again, as we sort of talked about earlier, there is a variety of reasons from a policy point of view why you might regard that lack of transparency in those particular instances as actually being a good thing, rather than problematic.

Mr. STEARNS. But this is with the FCC?

Mr. LERNER. No, this is simply—I was referring just with the SEC.

Mr. STEARNS. OK. The SEC or the FCC?

Mr. LERNER. The Securities and Exchange Commission.

Mr. STEARNS. Yes, OK. But with the FCC, they are subject to the same SEC and FCC reporting requirements. Isn't that true?

Mr. LERNER. To my understanding.

Mr. STEARNS. Yes. Now, this is a little bit out of the box, this question. We—this is mentioned earlier—this article that was in today's Wall Street Journal, "Buyout industry staggers under weight of debt," and Martin S. Fridson, a leading expert on junk bonds said a buyout firm, they are staring into the jaws of hell. Now, Dr. Lerner, he also went on to say that companies taken private tend to suffer more distress than their peers. Is that your experience?

Mr. LERNER. As I alluded to before, we looked at on the order of 21,000 private equity transactions between 1970 and 2007. And when you look at the numbers, just the facts, it simply suggests that the rate of bankruptcy or major restructuring for private equity-backed firms is actually lower than it is for U.S. corporate bond issuers in general.

Mr. STEARNS. So what he said in this article is false in your opinion?

Mr. LERNER. Well, I can simply report the data, and it doesn't seem——

Mr. STEARNS. No.

Mr. LERNER [continuing]. Air it out.

Mr. STEARNS. Well, let me—I just said that he found that private tended to suffer more distress. You just indicated that statistics——

Mr. LERNER. Yes.

Mr. STEARNS [continuing]. Show it is wrong.

Mr. LERNER. It is wrong.

Mr. STEARNS. It is wrong. There we go. Now, Mr. Bressler, what do you have to say in reference to Mr. Fridson's analysis that taking them private tend to suffer more distress than their peers?

Mr. BRESSLER. Well——

Mr. STEARNS. What is your experience?

Mr. BRESSLER. Again, my experience, which is the only one that I can think to——

Mr. STEARNS. Well, the only one we are talking about.

Mr. BRESSLER. That is right. Thank you. That is just not correct. It is just not correct.

Mr. STEARNS. So what we have here is a false statement by a leading expert on junk bonds. And so I just wanted to establish that fact.

Thank you, Mr. Chairman.

Mr. MARKEY. I thank you gentlemen.

It is one of the great things about getting elected to Congress, that you can force the Harvard Business School Professor to give the answers you want. And since I represent Harvard—up there that is—it is great to see you do that, because whenever I am in my district to see the Harvard questions actually come in the form of answers. OK. So there is no required rule for you, and so in your question and answer here I think it has been highly illuminating.

Anyway, the gentleman from Texas, Mr. Gonzalez.

Mr. GONZALEZ. Thank you very much, Mr. Chairman.

Dr. Lerner, how far back does this collection of data in your response—you are basing it on the data collected. How many years back does that go?

Mr. LERNER. It goes from the period of 1970, which essentially was close to the inception of the private equity industry, through the middle of 2007.

Mr. GONZALEZ. And so when we did have, let us say, the late 80s or early 90s, even if you included that you would say there was no difference then between the leveraged buyout model as opposed to those others when you have, you want to call it a financial crisis of sorts?

Mr. LERNER. Well, I think what I was saying is that when you look at it over that entire period——

Mr. GONZALEZ. OK. That is where I want—I will stop you there, because I am going to ascribe to the Harvard theory here if I can get you to—give you the answer I want you to give. But seriously, what we are looking at here, you know, if you look at snapshots, and snapshots are important here in this analysis only because of circumstances that today may mimic what was going on during another crisis that may have impacted this business model more so than the traditional business model. Do you believe that at this point in time if this credit crisis worsens that the potential for again adverse affects, consequences, are greater on private equity modeled firms than what we would say traditional, public?

Mr. LERNER. Well, I think it is a very interesting question, and one which is difficult to answer. On the one hand you have a situation where the private equity firms have, you know, higher leverage, greater debt than comparable companies in this industry and many other industries. And typically we translate that into greater probability of financial distress.

Mr. GONZALEZ. OK. I should stop you there, because that is a great answer there. The second one. I know Mr. Shimkus indicated that if we don't have all these wonderful vehicles, and I agree that I think private equity is one of those, that we are going to have all these foreign investors coming in. Don't we already have foreign

investors in the private equity model? I mean doesn't China have, I thought they did, but this may be old news—$3 billion or more in Blackstone?

Mr. LERNER. I think it is true that you have a situation where the investors in the private equity groups, which we typically call limited partners, include both institutions in the United States, like public employee pension funds, and include foreign institutions from pension funds to sovereign well funds. On the other hand, I guess it is worth pointing out that they service limited partners, which means that their ability to affect and control the underlying investments, even necessarily to get—data on these underlying investments is often quite limited.

Mr. GONZALEZ. Thank you very much, Dr. Lerner.

I yield back, Mr. Chairman.

Mr. MARKEY. The gentleman's time has expired.

And I know that you have to go, Mr. Bressler, and you have been good enough to stay here. And I am going to recognize Mr. Pickering, but could you just give us your 1-minute summation, Mr. Bressler, what you want us to remember? Because I know you have to run and make an appointment.

Mr. BRESSLER. Sure. Thank you, Mr. Chairman.

I would say, you know, a couple things in summary. One is that I think the private equity does a good job of governing itself, and I think it does a good job of governing itself because we are all in this for the long term. Whether it is the 5- to 7- or the 8-year period of time, we all have the same report card by getting measured by our results at the end of that period of time when we sell our companies or they go public. So I think we have the discipline that is needed to invest in the companies in the future to drive the revenue to invest in the infrastructure that will create powerful companies at the end of our ownership period that is there. The second thing is, as I mentioned, our commitment I think is self evident. And I think the companies that we have bought over the last couple years are housed in capital structures that will allow us to continue to invest in those companies for the future. And we are very focused ourselves, and Mr. Stearns says you can only talk about yourself. When we had bought Univision and our proposed transaction with Clear Channel that was all about digital. That was all about localism. That was bringing choice to the consumer out there. Yes, we think there is an economic benefit there, but we recognize that responsibility first and foremost.

Mr. MARKEY. Thank you, Mr. Bressler. We very much appreciate you being here, and we also appreciate your travel plans, and you have accommodated yourself to the hearing. Thank you.

Now the Chair will recognize the final round of questions to Mr. Pickering from Mississippi.

Mr. PICKERING. Thank you, Mr. Chairman.

And I just wanted to follow up on the Chairman's comments on competitiveness policy and how it affects investment flows. If we were to see a communications industry evolve over the next 3 years so that we basically have three national communications companies, so let us say we have an AT&T, a Verizon, cable, a major cable player converges with wireless to create a national network, and we have basically three companies, and they are all public.

What would happen to investment flows in broadband and infrastructure under that type of concentration? Would Wall Street controlling the major three give them incentives not to invest in broadband, and would it be difficult for private equity to compete in that type of context, Dr. Lerner?

Mr. LERNER. I think it is a fascinating question. It is hard to look in the crystal ball and see it.

Mr. PICKERING. Let us just say hypothetically that is what happens in three years.

Mr. LERNER. Right. But I think that certainly we can point to certainly a number of cases where we have got, you know, very oligopolistic industry structures with just a few players, which have led to deterioration of investment in infrastructure and innovation. And, you know, sort of going back to the writings of Joseph Schumpeter, who argued that in some sense that threat of entry and threat of competition in some sense often serves as the greatest spur to innovation.

Mr. PICKERING. A lot of times we hear that if you just let us consolidate, concentrate, and don't regulate that we will free us up to invest more. Do your studies show that that is true or not true?

Mr. LERNER. Well, there has been very large literature looking at the relationship between innovation and industry structure, and much of it suggests that there is somewhat of an inverted "U" relationship. Which is to say, if you have a situation where there is simply one giant firm, or you have an industry where there are a million little firms, you get less innovation than you do potentially in a situation where you are somewhere in that hump range where you have the sort of dynamism and competition associated with entry in the jostling of different competitors.

Mr. PICKERING. A possible example of that would be in wireless in 1993 we had a duopoly policy. We didn't have near the innovation or the investment. We then went to a seven tier market auction policy and some other competitive things that we did, and then it exploded. So would having four to seven in a market in communications be better than having two or three in a market as far as investment?

Mr. LERNER. Well, I think it is—once again, this underscores the limits of academic research, which we vaguely run some analysis and get this sort of hump shape and declare victory. When it comes to actually making some useful recommendations that actually can guide you guys, we often don't do quite as well in terms of the process. But I would lean toward saying that probably more is better in this instance.

Mr. PICKERING. Mr. Chairman, if you would follow up, I am wondering if openness like we have in the Internet would spur more investment or if we went to closed models with exclusives on content and devices, what would happen to investment if that were to occur in a three major market context?

Mr. MARKEY. I think that is a very important subject. I would actually say—I mean I would be basing it just generally upon the Harvard Business School professor's last comment that five competitors is probably better than two competitors in terms of getting the infrastructure and content investment. But I would need to do

more research in order to make sure that that conclusion was correct. So I would be willing to base that guess upon my——

Mr. PICKERING. We wouldn't want a serious deterioration of our infrastructure and investment by having too much concentration.

Mr. MARKEY. Yes. I think that is an important hearing to have. Do you have one final question, Mr. Stearns?

Mr. STEARNS. Thank you, Mr. Chairman.

There is some concern about the crisis, the economic crisis, worsening. And I guess the question for Dr. Noam and Dr. Lerner is, does a private equity firm if a crisis worsens economically contribute economic distress in this country more so or less so than a publicly held company? And I will start with Dr. Noam.

Mr. NOAM. Let me just address some of the—an issue that was kind of hanging here. There is, in fact, we have some evidence to the question that was raised what the market structure would be, because in broadband there is a theoretical set of cable and telecom and fiber by telecom as opposed to DSL, plus satellite, plus electric utilities and so on, plus independent DSL providers. So we do have, not only in this country but around the world, and what we see is largely in most countries, particularly European countries and many of the Asian countries, a 1 to 1½ competitors. One strong one and a smaller one that is the half. In the United States, however, we have 2½, because of cable, and that has lead to a greater dynamism in the infrastructure. But I think that there is no evidence that I have seen or examples that I have seen that private equity type companies have been the source of this competitiveness in infrastructure provision, the private equity that we have discussed here, because in terms of squishing, everybody thinks of it as almost like an ink blot, and they pick their own examples. But in the infrastructure environment we are not talking about the MCIs. That is not the venture capital type private equity but rather the taking public companies private that I thought was at issue here, infrastructure companies with some market structure, with some market power, taking them private. And that is an issue that is—because private equity is such a large area. And so if we talk about everything we end up talking about nothing. But if we talk about this particular issue, namely market power, infrastructure companies, telecom, the kind of issues that this Committee and subcommittee are interested in then, you see that there is an issue that is beyond the advantages of challenges of competition of letting newcomers enter into this field. I think everybody is in favor of that. But where you don't have that you have a problem, which you still have to address.

Mr. MARKEY. All right. The gentleman——

Mr. NOAM. I have not addressed your question. I do apologize.

Mr. MARKEY. The gentleman's time has expired.

Mr. STEARNS. Can I get an answer to my question?

Mr. MARKEY. OK.

Mr. NOAM. I am sorry with that.

Mr. STEARNS. Do you want me to repeat the question?

Mr. LERNER. Yes, I think that would be helpful. My absent-minded——

Mr. STEARNS. Basically with the crisis there is some talk about——

Mr. LERNER. Right.

Mr. STEARNS [continuing]. The cost for a barrel of oil going up and——

Mr. LERNER. Right.

Mr. STEARNS. And that the sub-prime crisis might be only 30 percent. And so if the crisis continued and got worse, do you think that the private equity market contributes to the economic distress in the country more so or less so than the publicly traded companies?

Mr. LERNER. I think there will be a lot of pain to go around for everybody.

Mr. STEARNS. No, but the question is——

Mr. LERNER. Right.

Mr. STEARNS [continuing]. On those two. If you had to make a choice, is there any—does the private equity increase the distress in the economic, or are they more—their debt is much higher, which would cause more of a problem?

Mr. LERNER. I think it is very—I don't have an answer for you.

Mr. STEARNS. Too speculative?

Mr. LERNER. Right. I think that in some sense there clearly are real costs associated with the greater leverage and the risk that it introduces. But the freedom from the tyranny of the marketplace and the sort of situation where you are sitting watching your stock price going down for 6 months and making some panicked decision to drop an investment project to try to satisfy the market gods, that these push in different directions. And it is very hard to come up with a definitive answer one way or the other.

Mr. STEARNS. All right.

Thank you, Mr. Chairman.

Mr. MARKEY. The gentleman's time has expired.

Now, what I would like to do is to ask each of you to give us your 1-minute summation of what it is that you want us to remember from our testimony.

Mr. Caliboso, we appreciate your coming here. While none of us would have minded going from here to go to testify before your public service commission in Hawaii, we appreciate the sacrifice you made in leaving Hawaii and coming to testify here before us. And so we thank you for that, and we recognize you for one minute.

Mr. CALIBOSO. Thank you, and you are always welcome to come to Hawaii as well.

Just listening to everyone I just have about three points that I would like to make known.

A case by case analysis will always be required in any proposed private equity transaction, whether it is private equity or not. The studies that were mentioned today, the trends that have been studied, are very interesting and are needed to inform the decision-making process in any case-by-case analysis. But you do still need to do a case by case analysis in each one.

With respect to transparency, the state regulatory authority will always allow us to get the information that is required. Even though it might not be filed with the SEC or the FCC, we have broader authority to get that kind of information. In our case, Ha-

waiian Telecom does have publicly traded debts, so they do still file their SEC requirements.

And with respect to this issue in general there is always a balance between regulatory requirements and allowing and encouraging investments, so that is the trick that we always have to take into consideration, balancing the regulatory requirements without deterring the financial investments as needed.

Thank you.

Mr. MARKEY. Thank you, and again thank you for coming here.

At this point, without objection, the letter from Chairman Dingell and myself and Chairman Martin's response will be entered into the record without objection.

Dr. Noam, your final 1 minute.

[The information appears at the conclusion of the hearing.]

Mr. NOAM. Because private equity is such a vast area, I would as I said ask for the subcommittee to focus on the issues and how it affects the particular responsibilities that are under your jurisdiction that you particularly are involved in traditionally. In this case now, the telecommunications sector and the television sector and how the move away from the SEC supervision environment to a non-supervised environment by the SEC and how that affects the industry.

And I think there are some issues there, and they are manageable issues, and they are issues that you can deal with and to the public benefit.

Mr. MARKEY. Thank you, Dr. Noam.

Dr. Lerner.

Mr. LERNER. I will just simply make two points in addition to thanking the Chairman and the members for the invitation.

First of all, I think we have had a candid discussion here, and we have highlighted that private equity is certainly not magic and that it is prone to the same kind of issues that the economy and equity investments generally are going to hold.

But I think we have also highlighted the fact that there has been a lot of distortion, and in some cases it seems really misinformation, about the process that private equity goes through. And that in many respects some of the claims about private equity not being a long-term investment and having a kind of broader perspective are really misinformed.

So thanks again.

Mr. MARKEY. Thank you, Dr. Lerner.

And we thank each of our witnesses. And we can make this promise that the subcommittee is going to be focusing upon this issue more and more as this year unfolds. Because I do believe that economic conditions are going to reveal certain inconsistencies in the telecommunications marketplace that otherwise would never have been revealed but for this economic downturn, and it is our responsibility to make sure that the public interest is not compromised.

We thank each of you.

With that this hearing is adjourned.

[Whereupon, the subcommittee was adjourned at 11:37 a.m.]

[Material submitted for inclusion in the record follows:]

STATEMENT OF HON. ELIOT L. ENGEL

Chairman Markey, Ranking Member Stearns—

Thank you for holding this hearing today regarding private equity funds investing in telecommunications companies.

Private equity investments have benefits and drawbacks. On one hand, there are many equity funds that buy underperforming corporations in order to bring them back to profitability, thus keeping them from declaring bankruptcy. And while it is to be expected that the fund will eventually sell the companies for a profit, great wealth can also be created for the shareholders and employees.

Private equity can also provide necessary funding for a young company that needs capital to grow. To be competitive, national telecom companies must invest massive amounts of money in infrastructure. Even after multiple rounds of venture capital funding, telecommunications companies can leverage a buyout and grow much faster than they would have without the additional cash injection.

On the other hand, we have also seen some equity fund managers buy companies, fire hundreds or thousands of employees to create a positive cash flow (which goes to the fund managers), pay themselves a large dividend, and then sell the companies before they have a chance to get healthy and become competitive again.

Let me be clear: the majority of private equity firms do not have such malicious intentions. However, since we are discussing private equity in the telecommunications marketplace, we must recognize that some companies do employ underhanded tactics. The airwaves belong to the public, and any attempt to degrade the ability of Americans to use the airwaves must be closely scrutinized.

It is also important that we investigate the effect that private equity investment in telecommunications has on localism. For a long time, we have seen a trend away from locally owned media outlets and moving towards nationally owned syndicates. We owe it to our constituents to help ensure that when they need local news, sports, weather, and especially emergency information, they can get it.

I want to again thank you, Chairman Markey, for holding this hearing today. As we all know, private equity investments in telecom companies are a fairly recent occurrence, and therefore we don't have as much data as I would like on it. However, I'm sure we can all agree that we will be paying attention to companies like Alltel, Univision, and ClearChannel, which all have a significant private equity investment in them. As I said before, private equity can have a very positive influence on a company. And we should make sure that the funds investing in those companies I mentioned continue to exert a positive influence.

I yield back the balance of my time.

STATEMENT OF HON. GENE GREEN

Mr. Chairman, thank you for holding this hearing on the growing trend of private equity investment and ownership in communications and media companies.

In many cases it is still too early to determine the long-term effects that will come out of private equity ownership of many of these companies, but it is important that this subcommittee is providing oversight on the issue to develop a record and a dialogue, and I look forward to hearing from our panel today.

The main concern I have with private equity investment in communications companies is the transparency in the makeup and ownership structure of these firms.

I think it is critical for us to know to what extent there is foreign investment and ownership in U.S. communications companies, but because of their structure it is often hard to know.

One way to make this more transparent could be to require disclosure of foreign investment as a condition on every private equity transaction the FCC reviews.

Ownership of critical American infrastructure, and our communications infrastructure is critical infrastructure, should be as transparent as possible, and I am concerned current private equity disclosure requirements do not provide us enough information about the level of foreign investment in communications companies.

The moves by private equity firms over the last year or so to acquire Univision, Clear Channel, and Alltel have certainly brought more attention to this issue, but private equity does have some history of success in the communications industry.

Private equity's backing of companies like Voicestream, which is now T-Mobile, and its acquisition of Alltel, has helped these companies make needed investments and maintained competition and choice for consumers in the wireless marketplace.

The ability of private equity to look at the long-term growth of companies, rather than quarterly profits, puts them in a unique position to make the costly capital in-

vestments that are necessary in the telecommunications industry but that are often not popular with shareholders of publicly traded companies.

To this point, the FCC has taken steps to protect public interest obligations and to limit some of the risks traditionally associated with private equity firms, but it is important we continue to monitor this.

Especially as the current financial crisis and the recent crunch in the credit markets play out, private equity may be forced to take steps they had not initially planned on when investing in communications companies, and it could ultimately be the American public that suffers.

Given the large increase of private equity investments and buy outs over the past several years, the record is yet to be written on what effects it will have on the communications industry, but it is good this committee is providing oversight so that we can address any potential problems that might result from this trend.

Mr. Chairman, I look forward to hearing the testimony from today's panel, and again I thank you for holding today's hearing.

HENRY A. WAXMAN, CALIFORNIA
EDWARD J. MARKEY, MASSACHUSETTS
RICK BOUCHER, VIRGINIA
EDOLPHUS TOWNS, NEW YORK
FRANK PALLONE, JR., NEW JERSEY
BART GORDON, TENNESSEE
BOBBY L. RUSH, ILLINOIS
ANNA G. ESHOO, CALIFORNIA
BART STUPAK, MICHIGAN
ELIOT L. ENGEL, NEW YORK
ALBERT R. WYNN, MARYLAND
GENE GREEN, TEXAS
DIANA DEGETTE, COLORADO
VICE CHAIRMAN
LOIS CAPPS, CALIFORNIA
MIKE DOYLE, PENNSYLVANIA
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ONE HUNDRED TENTH CONGRESS

U.S. House of Representatives
Committee on Energy and Commerce
Washington, DC 20515–6115

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July 12, 2007

The Honorable Kevin J. Martin
Chairman
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Dear Mr. Chairman:

We are writing with respect to the growing trend of private equity ownership of communications-related entities, including mass media outlets. We seek your assistance in ascertaining whether there are policy implications for this trend and whether the Federal Communications Commission's current attribution rules for ownership and control of Commission licenses is adequate.

Private equity firms have acquired many publicly held entities in the last several years. For instance, the Carlyle Group purchased the Hawaiian phone company from Verizon in May 2004. Moreover, on March 27, 2007, the Commission approved the sale of Univision Communications to a group of private equity firms. Subsequently, on May 18, 2007, the shareholders of Clear Channel Communications agreed to be acquired by a group of private equity investors. On that same day, Radio One announced that it had agreed to sell 10 radio stations to a private equity firm. Finally, just two days later, Alltel announced that it, too, had accepted an acquisition offer by private equity firms.

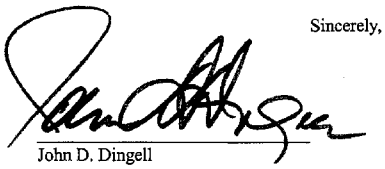
We are eager to obtain your views as to the implications that private equity ownership of entities subject to the Commission's jurisdiction could have on Commission regulations and the public interest. For instance, some observers note that, as a generalization, the history of private equity ownership suggests a financial management style focused on cutting costs, increasing revenues, and the ultimate resale of the enterprise. Such ownership intentions may run contrary, for example, to the historic role of broadcast and other Commission licensees as trustees of the public's airways. On the other hand, supporters of greater private equity involvement in the marketplace assert that by taking entities private, these equity firms are better insulated from the

insulated from the financial market pressures to post ever-higher earnings each quarter. This insulation, it is argued, permits the private equity groups to take a more comprehensive approach to the long-term health of the commercial endeavor.

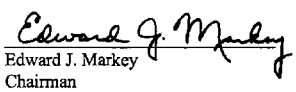
History also suggests that private equity ownership is marked by a management structure that is not overly transparent and by fluid asset management where actual holdings and control may vary significantly, as properties are bought and sold. These historical styles may not be consistent with many of the core public interest and localism values that Congress has assigned to local media outlets and may implicitly undermine the Commission's media ownership rules.

We believe that the trend of increased private equity ownership is deserving of the Commission's attention. Accordingly, please provide the Committee with written responses to the attached questions by July 20, 2007. If you have any questions, please feel free to call us or have your staff contact Tim Powderly or Colin Crowell with the Committee staff at (202) 226-2424.

Sincerely,



John D. Dingell
Chairman



Edward J. Markey
Chairman
Subcommittee on Telecommunications
and the Internet

Attachment

cc: The Honorable Joe Barton, Ranking Member
Committee on Energy and Commerce

The Honorable Fred Upton, Ranking Member
Subcommittee on Telecommunications and the Internet

Questions for Chairman Martin

1. Does the Commission compile data on private equity ownership and control of entities subject to the Commission's jurisdiction in a manner different from information requested from other licensees?

2. Does the Commission compile data on private equity ownership or control for wireless licensees, including broadcast media, in a manner different than that which may be utilized for ownership and control of telecommunications carriers, or other non-wireless entities, subject to the Commission's jurisdiction?

3. Has the Commission considered the impact of private equity ownership on localism? If not, should the Commission specifically do so?

4. Has the Commission considered the impact of private equity ownership on consumer protection and quality of service for telecommunications carriers?

5. Has the Commission fully considered the impact of private equity ownership on the media ownership rules, particularly as it relates to attribution?

6. Do you believe the Commission's "debt-plus-equity" attribution rules need to be revised to more accurately understand actual private equity ownership and control of broadcast properties?

7. Has the Commission encountered any problems concerning the management and financial transparency of licensees and entities that are owned by private equity firms?

8. What issues, in your view, related to private equity ownership, should the Commission be actively aware of and considering? Should the Commission initiate a proceeding to consider these issues?

FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON

OFFICE OF
THE CHAIRMAN

August 31, 2007

The Honorable John D. Dingell
Chairman
Committee on Energy and Commerce
U.S. House of Representatives
2125 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Edward J. Markey
Chairman
Subcommittee on Telecommunications and the Internet
Committee on Energy and Commerce
U.S. House of Representatives
316 Ford House Office Building
Washington, D.C. 20515

Dear Chairman Dingell and Chairman Markey:

Thank you for your letter regarding the private equity ownership of communications-related entities. Attached please find my answers to your questions. Please do not hesitate to contact me if I can be of further assistance.

Sincerely,

Kevin J. Martin

Attachment
cc: The Honorable Joe Barton, Ranking Member
Committee on Energy and Commerce

The Honorable Fred Upton, Ranking Member
Subcommittee on Telecommunications and the Internet

Questions for Chairman Martin

1. **Does the Commission compile data on private equity ownership and control of entities subject to the Commission's jurisdiction in a manner different from information requested from other licensees?**

No. The Commission uniformly applies the same ownership reporting requirements (described in answer #2 below) to its licensees, including licensees acquired by private equity investors.

2. **Does the Commission compile data on private equity ownership or control for wireless licensees, including broadcast media, in a manner different than that which may be utilized for ownership and control of telecommunications carriers, or other non-wireless entities, subject to the Commission's jurisdiction?**

The Commission requires wireless licensees (including broadcast licensees) and telecommunications carriers to provide information about ownership and control in periodic ownership reports and/or as part of license renewal, assignment, and transfer of control applications. This requirement applies to all licensees including private equity owners. In these contexts, licensees and applicants identify their corporate or organizational structure (*e.g.*, corporations, partnerships), attributable owners, and equity and voting interests. This information allows the Commission to identify the party or parties in interest when evaluating compliance with its ownership rules and as part of its public interest analysis in the context of a proposed transaction. Both wireless licensees and telecommunications carriers also must report a 10 percent or greater interest in any entity regulated by the FCC or any applicant for an FCC license. The requirements for broadcast licensees are slightly more stringent; they generally must report voting interests at the five percent or greater level. In addition, pursuant to section 310(b)(4) of the Communications Act, the Commission also collects detailed information about foreign ownership and control.

3. **Has the Commission considered the impact of private equity ownership on localism? If not, should the Commission specifically do so?**

As you observe in your letter, private equity ownership of major communications-related entities is a fairly recent trend. As you note, some argue that the management techniques and lack of transparency generally associated with such ownership run contrary to the historic role of Commission licensees as trustees of the public's airwaves, many with a special focus on local communities. Others argue that such ownership, insulated from the pressures of quarterly earnings reports, is better able to focus on long-term, comprehensive goals and to promote the economic health of the industry, building a stronger foundation from which to serve the public interest. The Commission is still

monitoring media industry developments and the evolving business models for broadcast and the impact, if any, of private equity ownership.

4. Has the Commission considered the impact of private equity ownership on consumer protection and quality of service for telecommunications carriers?

The Commission and its bureaus review all transactions to ensure that they are in the public interest as required by section 310(d) of the Communications Act of 1934 including the impact that the transaction would have on consumers and quality of service. In this review, the Commission considers, where appropriate, the impact of private equity ownership on consumer protection and quality of service for telecommunications carriers.

For example, in reviewing the transfer of Verizon Hawaii, Inc. to the Carlyle Group in 2004, the Commission considered arguments that the sale to a private equity fund would diminish the efficiency of Hawaiian Telcom's operations support systems. The Commission concluded that the purchaser had a reasonable transition plan and would be able to develop the requisite operations support capabilities without raising rates. *See* DA 04-2541, rel. 8/17/04.

Private equity owners also are covered by industry-wide consumer protection initiatives to the same extent as other owners. For example, the Commission's slamming, truth-in-billing, and customer account record exchange rules apply to all owners including private equity owners. Thus far, we have no evidence that there is a difference in quality of service between carriers owned by private equity firms and other carriers.

5. Has the Commission fully considered the impact of private equity ownership on the media ownership rules, particularly as it relates to attribution?

The Commission's consideration of its media ownership rules is ongoing, and we will monitor the role of private equity and consider whether certain changes to our attribution rules may be warranted. The Notice in the ownership proceeding asks how the underlying goals– competition, diversity, and localism – would be best served.

6. Do you believe the Commission's "debt-plus-equity" attribution rules need to be revised to more accurately understand actual private equity ownership and control of broadcast properties?

Our attribution rules attempt to identify those interests and relationships that influence, control, or affect the programming and other decisions of broadcast licensees and other media entities. The Equity/Debt/Plus (EDP) rule applicable to broadcast attribution and the Equity/Debt attribution rule applicable in the cable context are designed to identify such influential interests. Under the EDP Rule, where an investor is either: (1) a major program supplier (providing programming constituting over 15% of a broadcast station's total weekly broadcast programming hours); or (2) a same-market media entity subject to the broadcast multiple ownership rules, its otherwise non-attributable interest in a licensee or other media entity will be attributed if that interest, aggregating both debt and equity holdings, exceeds 33% of the total assets (equity plus debt) of the licensee or media entity. The Equity/Debt attribution rule in the cable context also attributes financial interests that exceed 33% of the total asset value (equity plus debt) of the entity in which the investment is held, but does not require a triggering relationship.

We are not aware of evidence suggesting that the Commission's broadcast and cable attribution rules do not adequately capture private equity ownership and control. Should information come to light indicating that private equity firms hold interests that are not, but should be, captured by our attribution rules, we would need to revise our attribution rules.

7. Has the Commission encountered any problems concerning the management and financial transparency of licensees and entities that are owned by private equity firms?

Thus far, we have not encountered any problems concerning the management and financial transparency of licensees and entities that are owned by private equity firms.

We have recognized, however, that transactions involving multiple layers of equity and debt financing can increase the complexity of determining the real party in interest. This challenge is not unique to private equity transactions however, as both private equity firms and public corporations are often owned by other firms and corporate entities. Similarly, investors in publicly-traded corporations sometimes hold their shares through brokerage firms, raising similar challenges to determining the ultimate shareholders.

8. What issues, in your view, related to private equity ownership, should the Commission be actively aware of and considering? Should the Commission initiate a proceeding to consider these issues?

As you note, advocates of the benefits of private equity ownership generally point to the flexibility, freedom, and incentives that this form of investment can provide to owners/managers, allowing them to focus on improving the value and performance of

under-performing assets. On the other hand, critics of private equity investment question whether the emphasis of some private equity firms on extracting value in a relatively short term may lead to insufficient capitalization and less attention to the non-economic values of an enterprise. The Commission will continue to monitor the impact of private equity ownership on the ability of Commission licensees to make capital investments in the communications infrastructure that will enable them to serve the public interest now and in the future. Given the recent origins of this trend in the communications sector, it is too early to identify all of the issues that this investment vehicle might raise. It is not clear yet that ownership and control by private equity firms create any different or unique issues from ownership by public corporations or sole proprietors. The Commission can and will play a critical role monitoring issues that may arise. In the interim, we will carefully consider private equity transactions that come before us, including any alleged benefits or harms of private equity ownership and control, to make sure they are in the public interest.

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