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MERGERS IN THE TELECOMMUNICATIONS INDUSTRY

HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

NOVEMBER 8, 1999

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SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

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MERGERS IN THE TELECOMMUNICATIONS INDUSTRY

MONDAY, NOVEMBER 8, 1999

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The committee met, pursuant to notice, at 9:35 a.m. in room SR–253, Russell Senate Office Building, Hon. John McCain, chairman of the committee, presiding.

Staff members assigned to this hearing: Lauren Belvin, Republican senior counsel; Paula Ford, Democratic senior counsel; and Al Mottur, Democratic counsel.

OPENING STATEMENT OF HON. JOHN McCAIN, U.S. SENATOR FROM ARIZONA

The CHAIRMAN. Good morning. Today, the Commerce Committee is going to examine the implications of megamergers in the telecommunications industry. Let me thank our witnesses for agreeing to share their perspective with us this morning.

Our first panel consists of our Government witnesses, William Kennard, chairman of the Federal Communications Commission, and Robert Pitofsky, chairman of the Federal Trade Commission, both of whom are well-known to this committee, very well-respected and highly regarded, and we are grateful that they would take the time to be with us this morning.

Following their testimony, a second panel will present the views of a cross-section of non-Government interests. Representing the telecommunications interests are Mike McTighe, chief executive officer, Global Operations, Cable & Wireless, and John Sidgmore, vice chairman of MCI/WorldCom, Scott Cleland, managing director of Legg Mason Precursor Group, and Paul Glenchur, director Charles Schwab Washington Research Group, who will represent the investment community on the second panel, and Gene Kimmelman, codirector, Consumers Union, will testify to the interests and concerns of consumers, as he has so capably done in virtually every telecommunications hearing I have held since I have become chairman of this committee. Some allege that he is a member of this committee.

[Laughter.]

I stoutly reject such allegation. Welcome to you all. I look forward to your views and responses to our questions.

Let me briefly set the stage for why we are meeting today. Anybody who pays attention to the headlines can reel off a list of recent telecommunications industry megamergers. SBC/Ameritech, BellAtlantic/NYNEX, GTE/USWest/Qwest, MCI/WorldCom—excuse me, USWest/Qwest, MCI/WorldCom and MCI/Worldcom Sprint, Time Warner/Turner and, of course, AT&T/TCI/Media 1.

Huge as these deals are, they represent only a fraction of the consolidation that is taking place in the telecommunications industry. As Chairman Pitofsky notes in his written testimony, since 1995 the number of telecom mergers filed for governmental approval has increased almost 50 percent, and their combined dollar value has increased eightfold.

Why this sudden urge to merge? Part of the credit goes to the 1996 Telecommunications Act. By redrawing the ownership and competition rules that govern the industry, it has created incentives, both intended and unintended, for companies to merge. Also empowering these mergers are the growing globalization of commerce, the advent of digital convergence, and the general state of the American economy.

As a result of all these factors, telecommunications companies are restructuring to align themselves to better compete using one of two alternative business strategies. Some are focusing on strengthening their positions in one specific core market, while others are expanding to compete in new markets.

Either way, most Americans tend to view increased concentration of control as a negative and, unfortunately, this is often the case, at least for the average consumer. For while merging industries enjoy the cost-saving benefits of increased efficiency, the average consumer doesn't always reap the benefits of lower prices and better service. These worries are already apparent in the context of telecommunications mergers. We worry whether increasing consolidation in the radio broadcasting industry will homogenize radio programming. We worry whether Bell Company mergers will ultimately create only two surviving companies, Bell East and Bell West, and we worry whether AT&T will be reincarnated as Ma Cable, dominating the markets for voice, video, and high speed data services.

There is another valid reason why we disfavor undue industry concentration. The more industry becomes consolidated, the harder it is for new companies to enter the market, or for small companies already in the market to survive. This challenge is a bedrock principle of our free enterprise system, that every business should have a fair opportunity to enter the market and to succeed or fail based on initiative and hard work, and if small businesses cannot compete in the telecom market in the information age, what stake will small businesses have in our economy as a whole?

Unfortunately, these valid concerns sometimes prompt the wrong responses. For example, Government sometimes confuses the notion of leveling the playing field with reconstructing the stadium. That is, instead of making sure that incumbent firms cannot exercise the power to eliminate competition, Government sometimes tries to deprive incumbent firms of virtually any advantage of incumbency.

Similarly, in an attempt to preserve ownership opportunities, Government tends to retain outmoded ownership restrictions or adopts regulations creating new services that the market does not need and will not support.

Have we reached the point at which further industry mergers should be regarded as unthinkable? If not, what different standards, if any, should apply to telecom industry mergers in the year 2002 and beyond, as the industry becomes more concentrated? Who should apply these standards and do they become harder or easier to articulate and enforce?

Finally, of course, there is the most important question of all. Who is being benefited by these mergers, and what more must we do to assure that all Americans can enjoy these benefits?

So the Commerce Committee meets today to examine where the current trend of telecom mergers is taking the industry, what it all means for small businesses and for the average consumer, and what Government's response should and should not be?

This may not be the last hearing we have on this issue, but I thought it was very important as we are winding down here to at least start in our proper and appropriate oversight responsibilities of this committee.

These are very, very interesting, exciting, stimulating, and incredibly unusual activities that are taking place, the likes of which have probably not been seen in history, or at the time of the early stages of the industrial revolution, therefore I view this hearing as one of education and information, and I believe that in the future we need to have additional hearings to determine what, if any, actions the Congress, or what involvement the Congress of the United States should have.

I would like thank Senator Wyden and Senator Bryan for being here.

Senator Wyden.

STATEMENT OF HON. RON WYDEN, U.S. SENATOR FROM OREGON

Senator WYDEN. Thank you, Mr. Chairman, and let me begin by commending you for taking on a series of issues that is especially important to consumers.

I will tell you, Mr. Chairman, I hope that this will be just the beginning of an effort by this committee to examine the impact of mergers on our economy. Among our responsibilities on this committee is jurisdiction over the Federal Trade Commission, which reviews mergers in a wide variety of industries providing goods and services that affect millions of Americans each day, not just telecommunications but oil and gas and pharmaceuticals and a wide variety of areas. It is not just telecommunications, but it is Barnes and Noble threatening small bookstores, Mobil and Exxon, BP and Arco, Alcoa and Reynolds Aluminum, Phelps Dodge and others.

I hope that we will on this committee examine these questions more generally. My gut feeling is that a fair number of these mergers do not threaten the interest of consumers. They are more likely to be responses to global competition, technology, and productivity.

But I do think a relatively small percentage of these mergers are truly serious for consumer interests, and of those that represent a problem, a disproportionate percentage are in the telecommunications sector. It is becoming clear to me from the merger surge in telecommunications that what is needed are some rules of the road for the information superhighway.

In the past, for example, regulators tended to find problems mostly in cases where merging companies were direct head-to-head competitors. For example, the proposed deal between MCI/WorldCom and Sprint is the kind of merger that is always brought antitrust scrutiny, but especially with high tech and new economy industries the old approach to merger review does not cut it any more.

BellAtlantic and NYNEX were never direct competitors because for years they were regulated monopoly utilities, but after deregulation, they could have been competitors if the merger had not gone forward.

Now, it is hard to measure this loss of potential competition from the marketplace, and that makes it hard for regulators to hold up mergers that only reduce potential, not actual competition, yet these same regulators are willing to allow mergers between U.S. companies to go forward when the merging companies can point to potential overseas competition that might come into U.S. markets.

So I want to wrap up with a few theories that we might examine. First, if potential overseas competition is a valid reason to let these mergers of U.S. telecommunications firms go forward, then the loss of potential domestic competition also should be an equally valid reason to hold up mergers in some other cases.

One theory I would like to examine is exploring whether a more consistent standard should be applied when evaluating the impact of mergers both pro and con and potential competition.

A second concern, besides losing potential competition, is that combinations like BellAtlantic and NYNEX can also mean the loss of critical information necessary to protect consumers.

For example, one way regulators can implement regulations is to compare local exchange companies in different parts of the country to see if one is overcharging customers. If they all merge, you cannot do that any more.

In some cases, regulators have required divestitures or imposed conditions on particular mergers to address these concerns, but it has been ad hoc. For example, in the SBC/Ameritech merger, regulators imposed conditions for providing broadband access to low income areas. That is a laudable goal, but these conditions raise other questions. Is this approach the best way to achieve universal broadband access, and how does it affect competition with unmerged companies that have no similar requirement, and what is going to happen to the customers of unmerged companies in low income areas?

Third, in the past, regulators generally have been favorable toward vertical combinations that involve companies at different levels of the same industry, such as a manufacturer and a retailer merging together. In general, when both companies are in unregulated and competitive markets, these types of combinations make for efficient competition in the industry, but when these types of mergers involve regulated companies, or companies with tremendous market power, as is the case in telecommunications, the merger may need special scrutiny to ensure that benefits of greater efficiency outweigh the potential for unfair competition.

When a company that already dominates one market merges with a company in a competitive market, then that combined company may be able to dominate both markets, and a possible example there is TCI and AT&T. In evaluating these mergers, how do we make sure that the merged company cannot leverage its market power to compete unfairly in other sectors?

Finally, when evaluating the type of megamergers we are seeing today, should the regulators take a broader view that considers not only the immediate merger proposal but how competitors in the industry are likely to respond? Even if the particular deal looks OK, another merger in the industry may go over the top in terms of too much market concentration and not enough competition. Regulators do not have to be soothsayers to be able to anticipate that one megadeal will prompt others to follow.

In certain cases, it should be fairly obvious that once the door is open with one megamerger, others will follow. For example, the clear channel AM/FM merger can be seen as an effort to remain competitive with the merged CBS/Viacom Company.

Mr. Chairman, the merger surge may in fact be contagious, but I am not prepared at this point to impose a quarantine on all mergers. I think it is time to look at some of the distinctions between what constitutes a merger that is in the consumer's interest and a set of factors that may constitute mergers that hurt consumers.

So we want to look at these issues. I appreciate your holding this hearing, and I hope that this will, in fact, begin a series of hearings so that we can, in fact, look at the enormous ramifications that mergers do have on our society.

I thank you.

The CHAIRMAN. Senator Gorton.

Senator GORTON. No statement.

The CHAIRMAN. Senator Bryan.

STATEMENT OF HON. RICHARD H. BRYAN, U.S. SENATOR FROM NEVADA

Senator BRYAN. Thank you very much, Mr. Chairman. Let me join with my colleagues in commending you for your leadership in having this hearing. We will hear shortly from the chairman of the Federal Trade Commission, but I think in his prepared statement there is an interesting statistic that I think underscores, Mr. Chairman, both what you have said as well as what Senator Wyden has said, and that is, he goes on to point out that there has been an unprecedented merger wave in this country. In fiscal year 1999, we received almost 4,700 Hart-Scott-Rodino filings. That is nearly three times the number that we received only 4 years ago.

Mr. Chairman, we had a similar situation, at least in terms of the numbers of mergers and combinations that occurred in the last century that led to a whole regulatory structure that protected consumers from unfair combinations, the Sherman Act, the Clayton Antitrust Act. I am not suggesting that the merger wave that we have seen in the last decade suggests that we need some type of new regulatory model or constraint, but I think it does raise some serious questions, and hopefully we can get some of the answers this morning.

There is no question, at least if you follow the television ads, that it appears that long distance carriers are highly competitive. Ad after ad after ad have one company competing against another.

Less clear, Mr. Chairman, in my judgment is the situation with respect to local service.

We are fortunate in Southern Nevada. Sprint does a fine job in terms of the technology and the quality of the service they provide, but I must say I have some questions in terms of what are the long-term implications of these mergers. Does the consumer benefit? Are there some things we ought to be concerned about down the road? I would hope we might get some of those answers this morning.

You know, the Congress, in its enactment of the 1996 Telecom Act I think expected a number of things to occur, but its underlying premise was to generate more competition. I think that has occurred in some aspects of the telecommunications industry. Regrettably, I think that has not been the case with respect to local service generally, and so it is not without precedent that our legislative enactments create the doctrine of unintended consequences.

I do not know whether that is true in this case, but our first two witnesses I think can provide us considerable insight into these questions, and I look forward to hearing their testimony and again, Mr. Chairman, I thank you for your leadership in providing us with this hearing.

The CHAIRMAN. I thank my colleagues for being here. I thank the witnesses for being here. I do not know who is senior here, but if we go by age, Mr. Pitofsky, I think we would start with you.

[Laughter.]

STATEMENT OF HON. ROBERT PITOFSKY, CHAIRMAN, FEDERAL TRADE COMMISSION

Mr. PITOFSKY. Thank you, Senator.

Mr. Chairman, Members of the Committee——

The CHAIRMAN. Somehow I have become more and more cognizant of that.

[Laughter.]

Mr. PITOFSKY. It seems to happen to all of us.

I am delighted to be here, and to present testimony of the Federal Trade Commission on this extremely important subject of mergers, and especially mergers in the telecommunications industry.

As each of your opening statements pointed out, there is a remarkable merger wave going on in this country. It is the most active in terms of the percentage of national assets acquired since the end of the 19th Century.

In each of the last 2 years, the Department of Justice and the Federal Trade Commission reviewed roughly 4,700 mergers. In 1998, $1.6 trillion in assets were scooped up in merger activity. When I say 4,700 mergers, by the way, we only look at mergers where the acquired asset is valued at $15 million, so we're talking about fairly substantial deals.

Nevertheless, I do not believe that the merger wave—that is the 4,700 merges is the problem. Rather, I think it is a symptom of a successful, unusually dynamic economy.

Many of these mergers are reactions to global competition, firms trying to position themselves to compete in an increasingly global market. Many of them involve high tech firms where there is a lot of moving around, a lot of changing, a lot of restructuring and, of course, many of these mergers are a response to deregulation, including the wave of mergers in the telecommunications field.

The Department and the FTC challenge about 2 percent of all the mergers that are filed. That is a good deal more than the 1980's, but not too different from averages over recent decades. The problem I think is not the 4,700 mergers, it is the increasing number of megamergers involving very large firms, usually often direct competitors, at the top of their markets. We find mergers proposed among firms that are numbers 1 and 2 in the market, 1 and 3, 2 and 3, and that is a little different than in past decades. I think that is a change from what we saw 10 and 20 years ago, and I think some of that is going on in telecommunications as well.

Now, I should say that most telecommunications mergers are handled by the Department of Justice, certainly the long distance instances, mergers among the RBOC's and so on. We have traditionally taken the lead with respect to cable, and I thought I would talk about that today.

We have challenged several instances in which there were cable overlaps, although in most regions of the country there is only one cable company, but if there are two and they try to merge, we have successfully challenged those transactions.

The most important and complicated case that we handled in this area had to do with the proposed TCI/Time Warner/Turner merger. It was a very complicated transaction, but reduced to essentials the merger would have produced at the programming level—i.e. firms that create programming for cable and TV—a 40 percent market share, and at the distribution level, 44 percent market shares. Those are very high. It was essentially a vertical merger, but those are still very high market shares.

We settled the case with an elaborate order. Step 1 was to assure that TCI essentially stepped out of the deal, and they did that by giving up voting rights in the stock that they would have owned in Time Warner.

Step 2 was slightly unusual for us, and that was a regulatory order which dealt with the possibility of discrimination against the smaller companies that were trying to get into this market. The programmers were fearful of discrimination, that they would not have a fair opportunity to compete for space on the Time Warner cable systems if they were competing against Turner materials. Possible competitors of cable—direct broadcast was the most obvious example—were very concerned, were fearful that they would not have access to programming.

We negotiated with the consent of the parties, an order which provided that there should be no discrimination, and that parties would be treated no differently whether they were part of that Time Warner/Turner corporate family or not.

I do not usually like orders like that. They are difficult to monitor, they are difficult to administer. In this case, however, I think this probably worked out rather well. We have not received a complaint in the 2½ years since we entered that order by any programmer or by any cable competitor that they have been denied fair access to materials.

Finally, let me say a word about the standards that ought to be applied to telemarketing mergers. In one sense, it is not appropriate to have different standards for the oil industry, the steel industry, and communications industries. The Clayton Act does not draw any distinctions.

On the other hand, I have always felt that the history of antitrust, the policy of antitrust, should involve more than economics. It is more than dollars and cents. It is more than supply curves and demand curves. Therefore, when we are talking about telecommunications and cable networks, we are talking about competition that affects the marketplace of ideas. We are talking about elements that impact on the First Amendment.

When we look at a merger involving two firms in the defense industry, we take national security into account. Judges have said: of course if we need this merger for national security purposes that is a factor that we would consider.

Again, I do not think the legal standards can be different, but certainly we can give close scrutiny to mergers that impact on the First Amendment and the marketplace of ideas.

Finally, let me just join the comments of Senator Wyden that there is no more important issue on the economic side of domestic policy, certainly on the antitrust side, than this wave of mergers and the introduction in just the last few years of megamergers.

We never saw $60 billion and $80 billion and $120 billion mergers until quite recently. Now we see them every several months. We thought we had the record merger at the FTC when Exxon and Mobil proposed a merger of $80-something billion. That record lasted for about 4 months.

Telecommunications mergers touch upon important issues, and it deserves and merits the attention of this committee, and I compliment the committee on taking the time and effort to address these problems.

Thank you.

[The prepared statement of Mr. Pitofsky follows:]

PREPARED STATEMENT OF HON. ROBERT PITOFSKY, CHAIRMAN, FEDERAL TRADE COMMISSION

I. Introduction

Mr. Chairman and members of the Committee, I[1] am pleased to appear before you today to present the testimony of the Federal Trade Commission concerning the important topic of mergers in the telecommunications industry. This is an industry experiencing rapid technological and regulatory change leading to new products and services not only in telecommunications, but also in industries that use telecommunications products as inputs, such as computers, data retrieval and transmission, and the defense industry. Anyone whose business depends on faster and more reliable data movement is benefitting from these kinds of changes in the telecommunications industry.

At the same time, we have seen a growing number of significant structural reorganizations, both in telecommunications and in other industries. Such reorganizations may be a legitimate response to economic needs, but may in other instances threaten competition and the rights of consumers. A vigilant merger policy is particularly important so that the forces pushing consolidation do not result in unilateral or collusive anticompetitive effects, which would result in a lost opportunity to

[1] This written statement represents the views of the Federal Trade Commission. My oral presentation and response to questions are my own, and do not necessarily represent the views of the Commission or any other Commissioner.

strengthen competition in this vital industry and would defeat the purpose of your recent legislative efforts at deregulation.

II. The Merger Wave

Our country is clearly in the midst of an unprecedented merger wave. In fiscal year 1999, we received almost 4700 Hart-Scott-Rodino [2] filings. That number is approximately at the level of the record number of filings from the previous fiscal year, and is almost three times the number we received only four years ago. The total dollar value of mergers announced in 1998 was over $1.6 trillion, an increase by a factor of 10 since 1992. [3]

The telecommunications industry has been swept up in the merger wave. The telephone, cable, entertainment, data transmission, and other industry or market segments have recently experienced both fast growth and significant consolidation. Some flavor of the increase in telecommunications transactions can be gleaned from the number of HSR filings. The number of transactions filed under the Standard Industrial Code classification for communications has increased by almost 50 percent since 1995, while the total dollar value has increased eightfold to more than $266 billion.

The antitrust agencies have been actively monitoring these areas. Since 1995, the FTC has investigated or brought cases in video programming and cable distribution, [4] several cable overbuild matters, and the acquisition of a movie studio by a cable company. [5] The Department of Justice has been similarly active, challenging acquisitions in satellite communications and broadcasting, [6] cellular and PCS telephone service,±[7] and Internet backbone service. [8] Although the Commission has been active in cable and entertainment industries, most of the mergers involving telephones and commercial satellite services have been analyzed by the DOJ pursuant to the two agencies' clearance agreement, which divides matters on the basis of recent expertise. Moreover, the Commission is barred by Section 11 of the Clayton Act and Section 5 of the FTC Act from exercising jurisdiction over common carriers.

Despite little growth in resources since 1992, the Commission has established a strong track record of promptly identifying and remedying problematic mergers. In 1999, the Bureau of Competition issued 43 requests for additional information from potentially merging parties and brought 17 enforcement actions. In another 12 cases, the parties abandoned their proposed transactions based on concerns raised by Bureau staff. In 1998, the Commission litigated three merger cases: *FTC v. Cardinal Health, Inc.,* [9] *FTC v. McKesson Corp.,* [10] *and Tenet Healthcare Corp.* [11]

Why do merger waves occur, and what are the forces behind the current one? This is not the first time the United States has experienced a period of rapid consolidation. In the 1980s many larger acquisitions were fueled largely by junk bond financing, corporate raiders, and management-led leveraged buy-outs. Many companies were acquired for their financial break-up value. [12] Current consolidations are more likely to be motivated by strategic goals and to involve competitors, suppliers, purchasers, or manufacturers of complementary goods. They are therefore more likely to raise competitive issues and to require more resource-intensive scrutiny. Among the current factors behind the current merger wave are:

Increasing Global Competition

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[2] *See*Pub. L. No. 94-435, 90 Stat. 1383 (1976) (codified as amended in scattered sections of 15 U.S.C.).

[3] *See* Economic Report of the President 39 (1999), *available at* http://www.gpo.ucop.edu/catalog/erp99.html

[4] *Time Warner, Inc.,* 123 F.T.C. 171 (1997) (consent order).

[5] *Tele-communications, Inc. and Liberty Media Corp.,* FTC File No. 941 0008, 58 Fed. Reg. 63167, 5 Trade Reg. Rep. (CCH) ¶23,497 (Nov. 15, 1993) (consent order accepted for public comment). The transaction was subsequently abandoned and the consent agreement was withdrawn.

[6] *United States* v. *Primestar, Inc.,* Civ. No. 1:98CV01193 (JLG) (D.D.C. May 12, 1998) (complaint). The transaction was abandoned.

[7] *United States* v. *Bell Atlantic Corp.,* Civ. No. 1:99CV01119 (D.D.C. May 7, 1999) (consent decree).

[8] *United States* v. *Concert PLC,* Civ. Ac. No. 94-1317 (TFH) (D.D.C. June 14, 1994) (consent decree).

[9] 12 F. Supp. 2d 34 (D.D.C. 1998).

[10] *Id. Cardinal Health* and *McKesson* were joint actions by the FTC to enjoin two related, but separate, mergers of prescription drug wholesalers.

[11] 17 F. Supp. 2d 937 (E.D. Mo. 1997), *rev'd,* No. 98-2123, 1999 WL 512108 (8th Cir. July 21, 1999).

[12] *See* "Merger Wave Gathers Force as Strategies Demand Buying or Being Bought," Wall St. J., Feb. 26, 1997, at A1.

In 1995, the Commission held hearings on Competition Policy in the New High-Tech, Global Marketplace. During those hearings, many witnesses commented on the substantial increase in competition from foreign corporations.[13] In many of the most important product markets for consumers, international competitors have captured substantial market share. Automobiles, commercial aircraft, and financial services are now sold in world markets. The Commission's international workload component has grown accordingly. Approximately 25 percent of all mergers reported to the FTC and DOJ involve parties from two or more countries, and 50 percent of the FTC's full merger investigations involve a foreign party, or assets or information located abroad.

This increased international competitiveness is reflected in the telecommunications industry as well. With the erosion of trade restrictions and other regulatory barriers, the amount of telecommunications services flowing across borders, such as telephony, data transmission, and entertainment, has grown, as have the number of mergers and joint ventures among firms headquartered in different countries.

Deregulation

A significant part of the merger wave is taking place in industries that are either undergoing or anticipating deregulation. In the past few years, deregulation has occurred in the natural gas industry and the airline industry, leading to a number of mergers in each.[14] Deregulation is now occurring in other industries, including electricity, financial services, and telecommunications, and we are beginning to see merger activity increasing in these industries also.

Deregulation of an industry often results in structural change and increased competition. Firms can take advantage of economies of scale and scope that were previously denied them. Mergers are often a way for these firms to acquire quickly the assets and other capabilities needed to expand into new product or geographic markets. They can also facilitate market entry across traditional industry lines. Firms in deregulated industries frequently seek to provide a bundle of products and services. We see all of these factors at work in telecommunications, particularly in the technological convergence of the cable and telephone industries.

Not all mergers that occur in response to deregulation are necessarily procompetitive, however. The lessons from the airline industry teach us that merger scrutiny in industries undergoing deregulation is necessary to prevent consolidations that are harmful to consumers. In the airline industry, the Transportation Department, which, at that time, had final merger authority, approved a number of mergers over the objection of the DOJ. Some antitrust experts believe that the result was higher fares, less service, and the domination of a number of major airports by a single carrier. Moreover, firms may react to deregulation by attempting to combine with other firms that threaten to enter historically protected product and geographic markets.

Technological Change

Technology is often an important factor in analyzing a merger. Rapid technological development may help a market self-correct any competitive problems. Now, technology also has become increasingly important as a catalyst for merger activity. We are increasingly certain that technological progress is vital to long-term economic growth. Increased merger activity in telecommunications is clearly a response to new technologies. For example, the extension of broadband access into consumers' homes is a key factor behind many telecommunications mergers. Once again, however, incumbent firms threatened by technological change may attempt to acquire new competitors instead of developing their own technologies, which may deprive consumers of the technological horse races that we see in many high-tech industries today.

Strategic Mergers

More recent mergers have involved strategic considerations. Firms have become more interested in pursuing leadership or dominance in their industries or market segments. There are several reasons for this trend. Concern about the large size of foreign competitors that dominate their home markets may lead to the conclusion that bigger is better. Anxiety about technological change may lead companies to hedge their bets through acquisitions or equity investments in a variety of firms. Firms may believe that efficiency continues to increase with size, or that profits will

[13] *See* FTC, Anticipating the 21st Century: Competition Policy in the New High-Tech, Global Marketplace (May 1996).

[14] *See* CMS Energy Corp., Dkt. No. C-3877 (June 10, 1999) (consent order); *Arkla, Inc.,* 112 F.T.C. 509 (1989) (consent order).

inevitably accrue from the acquisition of large market shares. These kinds of mergers may have serious competitive consequences by increasing a firm's unilateral ability to increase prices or reduce output.

Financial Market Conditions

Mergers need financing, and current financial conditions are ideal for an expansive supply of capital—low inflation, low interest rates, and a booming stock market. These conditions have led to an increasing number of deals financed through exchanges of stock. To the extent that mergers are strategic, and that is reflected in stock prices, the mergers will more likely be financed through exchanges of equity.

III. Competitive Concerns in Deregulating Industries

The elimination or substantial reduction of regulation is a laudable goal. As a believer in the efficiency of markets and of market-based incentives, the Commission applauds movement in these deregulating industries to more competitive marketplaces. During such a transition, effective antitrust oversight is critical to prevent private accumulation of control over important sectors of the national economy and to forestall abuses of market power. As the telecommunications industry is deregulated, we must be aware of a few general principles applicable to deregulating industries.

First, participants in an industry undergoing deregulation, accustomed to coordinated action among themselves or to the protection of regulators who guarantee a monopoly franchise, often seek to maintain or extend their market power after deregulation occurs. This effectively substitutes private regulation for public regulation, depriving consumers of efficiency without public accountability or supervision. Cartel behavior in place of government price restrictions is a classic example. This has not been a problem with respect to broadcast networks, cable distribution and cable programming. But there can be strong incentives for incumbents to keep new entrants out of what used to be a market protected by regulatory barriers. We can see aspects of this problem as the long distance telephone companies attempt to enter local markets through local exchange networks that are supposed to be, but may not effectively be, non-discriminatory. This can be a serious anticompetitive problem.

Second, transition out of a regulatory regime is almost never complete and immediate. Rather, a patchwork of state, federal and international rules continues to apply even as parts of a market are opened to competition. In the telecommunications area, Congress is still wrestling with the issue of direct broadcast satellites and the transmission of local stations. Serious regulatory problems may arise where some players in an industry are regulated and others are not. It is difficult and often unfair to try to maintain a system where direct competitors are subject to substantially different regulatory rules. For example, many believe that a principal reason truck transportation was regulated for a time in the United States was to level the competitive playing field between trucking and the heavily regulated railroad industry. But if deregulation is to succeed, the more consistent strategy is to aim to equalize treatment by reducing regulatory burdens for all rather than by increasing them for new unregulated competitors.

Third, some policy goals that can be handled comfortably in a regulatory regime are difficult to achieve through antitrust enforcement. During a transition, some regulation may continue to be necessary—for example, caps on cable rates or mandated access to local markets—to assist during the period before full competition emerges. While antitrust agencies can employ such remedies, we have been more successful with structural remedies than with behavioral relief. For example, we almost never use rate regulation remedies, and mandatory access remedies are seldom used.

Fourth, as a result of the factors discussed above, application of the antitrust laws to newly deregulated industries often raises difficult and unconventional issues from the point of view of traditional antitrust policy. The very fact that an industrial sector was regulated suggests the possibility of some past actual or perceived market failure, or at least some competitive peculiarities, and therefore calls for a special sensitivity in applying conventional antitrust rules.

IV. Competitive Concerns in Telecommunications Industries

A number of competitive concerns may be raised by the kinds of telecommunications mergers that we are seeing. A horizontal combination of competitors through merger, joint venture or other agreement can result in a direct loss of competition. An acquisition of a potential competitor might have significant current or future competitive effects. And a vertical merger of complementary but non-competing businesses might have foreclosure or bottleneck effects. Some mergers might have several of these effects. Several of these potential anticompetitive effects are illustrated by the Commission's enforcement action in the Time Warner/Turner Broadcasting/TCI merger.[15] This transaction involved the proposal by Time Warner to acquire Turner Broadcasting to create the world's largest media company. These were two of the leading firms selling video programming to multichannel distributors, which in turn sell that programming to subscribers. Time Warner held a majority interest in HBO and Cinemax, two premium cable networks, and Turner Broadcasting owned several "marquee" or "crown jewel" cable networks such as CNN, Turner Network Television ("TNT"), and TBS SuperStation, as well as several other cable networks. Together, the two companies accounted for about 40 percent of all cable programming in the United States.

In addition, both firms were already linked with large cable operations, and the merger would have increased the level of vertical integration, and potentially foreclosed competitors in both the programming production and multichannel distribution levels. Time Warner was already the second largest distributor of cable television in the United States, with about 17 percent of all cable households. Turner Broadcasting already had strong ties to TCI, the largest operator of cable television systems in the United States, with about 27 percent of all cable television households.

As a result of the proposed transaction, over 40 percent of programming would have been integrated by full or partial ownership with two cable companies that collectively controlled over 40 percent of cable distribution in the United States. In addition, as another part of the deal, TCI would have entered into a mandatory carriage agreement with Time Warner, which would have required TCI to carry four of Turner's top cable channels for 20 years, but at preferential prices. In effect, this was a form of partial integration by contract, and it would have further affected TCI's incentives to carry non-affiliated programming.

Both horizontal and vertical competitive issues were present in this case. The key horizontal issue was defining the relevant market when the merger combined different kinds of programming. In this case, Time Warner owned HBO and Turner owned CNN. For most customers, they might not be direct substitutes. However, from the point of view of the direct buyers of video programming—the multichannel distributors—a program like CNN can constrain anticompetitive pricing of other channels. Before the merger, a cable system operator could go without HBO as long as another marquee program such as CNN was available for packaging with other programs into a network that consumers would be willing to buy. That gave cable operators some leverage to resist anticompetitive pricing on HBO. However, if HBO and CNN were available to cable operators only as a bundle, cable operators would lose that leverage.

The key vertical issue in this case was access. By that, we mean not only access in absolute terms, but also the relative cost of access among competing firms. This transaction raised those concerns at two levels. The first was upstream access to video programming by firms that distribute multichannel video programming to households and other subscribers. Upstream access was a concern because a merged Time Warner and TCI could block entry into their distribution markets or raise their rivals' costs through their control of a large portion of video programming. Potential entrants into local cable markets could be impeded from entering if they could not gain access to those "must have" channels at non-discriminatory prices. Other firms, such as a direct broadcast satellite service, could have their input costs raised to noncompetitive levels. In sum, increased vertical integration could create an incentive for the merged entity to use market power over programming to eliminate competition or potential competition at the distribution level.

The second concern was downstream access to multichannel distribution by producers of video programming. At the downstream distribution level, the acquisition was likely to make it more difficult for other producers of video programming to gain access to the distribution market. Time Warner's cable systems, and TCI through its financial interest in Time Warner, were likely to favor Time Warner and Turner programming over a competitor's. And since Time Warner and TCI together controlled such a large percentage of the distribution market, a competing video programmer would have found it difficult to achieve sufficient distribution to realize economies of scale.

Development of alternative programming also would have been discouraged by TCI's long-term carriage arrangement with Time Warner. That carriage agreement would have lessened TCI's incentives to sign up better or less expensive alternatives to the existing Time Warner programming that is already committed under contract. The mandatory carriage commitment also would have reduced TCI's ability

[15] *Time Warner, supra* n. 4.

to carry alternative services, because current cable distribution is capacity-constrained to a large extent.

We dealt with both the horizontal and vertical concerns in this case by imposing a number of conditions on the transaction that were designed to control the specific mechanism by which competitive harm could occur. The FTC consent order included both structural relief and other provisions designed to prevent the exercise of market power resulting from the merger.

First, the order required TCI and Liberty Media to divest all of their ownership interests in Time Warner. Alternatively, the order would cap TCI's ownership of Time Warner stock and deny TCI and its controlling shareholders the right to vote the Time Warner stock. This divestiture provision addressed the concern that TCI's financial interest in Time Warner would make it difficult for competing producers of video programming to gain sufficient distribution to be competitively viable.

Second, the order required the parties to cancel the 20-year programming service agreement between Time Warner and TCI. The order permitted renegotiation of a carriage agreement after a six-month "cooling off" period, to ensure that negotiations are conducted at arm's length and are not influenced by considerations related to the merger. Any new carriage agreement is limited to five years.

Third, the order prohibited Time Warner from bundling HBO with any Turner networks, and it prohibited the bundling of Turner's CNN, TNT, and WTBS with any Time Warner networks. This provision addressed the concern that the acquisition could have enabled Time Warner to exercise market power through leveraging tactics by bundling "marquee" channels, either together or with less attractive channels.

Fourth, the order prohibited Time Warner from discriminating against rival service providers at the distribution level in the provision of Turner programming. This ensures that new entrants at the distribution level would not be unfairly disadvantaged in the pricing of Turner programming. It thus preserved reasonable access to programming for new services such as direct broadcast satellite services, wireless systems, and telephone company entrants.

Fifth, the order prohibited Time Warner from discriminating against rival video programmers that seek carriage on Time Warner distribution systems.

Sixth, the order required Time Warner to carry a 24-hour all news channel that would compete with Turner's CNN. This provision was included because the all-news segment is the one with the fewest close substitutes, and the one for which access to Time Warner distribution is most critical.

Time Warner was a large and complex transaction. Many of the concerns we had in that case may also be present in other telecommunications mergers.[16] We see several common characteristics in many recent mergers, all of which have implications in the telecommunications industry.

First, many transactions involve a consolidation between firms at different functional levels. Economic theory teaches that most vertical mergers are more likely to have procompetitive aspects and less likely to have anticompetitive effects, but that this is not necessarily true in any given case. Moreover, both effects can be present in the same merger. Our task is to sort out those effects and correct the problems, while allowing companies to achieve efficiencies that will benefit consumers.

Second, some transactions threaten to create or tighten a potential bottleneck somewhere in the chain of production or distribution. A bottleneck transaction can have adverse effects at two levels. First, the acquisition can exacerbate competitive conditions at the downstream level by raising the costs of current rivals or by blocking potential entry. That is, the transaction can create or increase market power of the merged firm through control over upstream inputs that are essential or important to competitors or potential competitors. Second, a bottleneck acquisition can disadvantage competitors or potential competitors at the upstream level by impeding their access to customers. Therefore, the transaction can enable the parties at

[16] For instance, cable overbuild mergers are usually defended by pointing to the efficiencies of consolidating two competing systems, as well as the necessity of preparing for impending competition from the telephone companies. However, the consolidation that creates these efficiencies simultaneously eliminates competition that may benefit consumers through lower prices, a higher number of channels, and better service. As for telephone company entry into cable, most of that so far has been by purchase, rather than de novo entry. *See* "Amid All the Bets, One Stands Out: AT&T Ventures Into Cable," Wall St. J., Nov. 5, 1999, at A1. The Commission investigated a cable overbuild merger in Anne Arundel County, Maryland that raised all of these concerns. In addition, the merger raised potential competition problems since one of the systems had plans for expansion into parts of the county currently occupied only by the other system. The parties abandoned the transaction in the face of opposition from FTC staff and antitrust officials from the State of Maryland.

both levels to increase their market power and protect their turf against new competitors.

Third, many transactions occur in rapidly changing marketplaces. We frequently hear the argument that rapid technological change will prevent a firm from exercising market power, because a new competitor with a new technology will soon take its place. But that is not necessarily the case. In some situations, a merger can create a roadblock to technological change and prevent a new technology from reaching the market. Of course, a necessary condition for adverse effects to occur is that the bottleneck really must be a constraint, i.e., it cannot be easily expanded or circumvented. For example, we would not be concerned about foreclosure of new entry if an entrant could enter easily at both the upstream and downstream levels. But sometimes that may not be so easy.

In sum, acquisitions that raise bottleneck concerns are difficult to analyze, present difficult problems of proof, and raise difficult issues of relief. But it is important that we take a hard look at such acquisitions because a bottleneck can be an effective barrier to entry, and it can be used strategically to disadvantage rivals. Further, it can raise competitive concerns at both the upstream and downstream levels of the merging firms' operations. The key policy objective is to ensure that access to inputs and markets will not be eliminated by mergers and acquisitions.

V. Conclusion

Mergers and acquisitions in the telecommunications industry are occurring at a record pace, caused by technological change, deregulation, and other market forces. Many of these transactions have been good for the economy and consumers, bringing the ferment of innovation and new efficiencies to vital industries. Some transactions, however, may be an attempt to stifle new forms of competition. Sensible antitrust enforcement remains necessary so that the consumers may begin to enjoy the promise of deregulation—whether it be lower prices, greater choices, or new and innovative products and services.

The CHAIRMAN. Thank you very much, Mr. Pitofsky.

Chairman Kennard.

STATEMENT OF HON. WILLIAM E. KENNARD, CHAIRMAN, FEDERAL COMMUNICATIONS COMMISSION

Mr. KENNARD. Thank you, Mr. Chairman, members of the committee. I, too, appreciate the opportunity to testify before the committee today on this important issue. It is also an honor to testify with Chairman Bob Pitofsky, someone who has been a leading thinker on these issues, and someone whom I have admired for many years.

As you said at the outset, Mr. Chairman, these are extraordinary times for consumers in telecommunications. We are seeing glimpses of a future where phone lines will deliver movies, cable lines will deliver phone calls, and the airwaves will carry both.

Economic indicators are up across the board for the industry. Over the past 3 years alone, revenues in the communications sector have grown by $140 billion, climbing to a level of $500 billion in 1998, and creating over 160 billion jobs during that period.

In the wireless industry, capital investment has more than quadrupled since 1993, for a cumulative total of over $60 billion, and now over 80 million Americans have a mobile phone.

As we see more competition developing in some of these sectors, we are seeing consumer gains, particularly in the long distance marketplace. By the end of 1997, there were over 600 long distance providers competing for customers. We have seen prices for interstate long distance calls drop dramatically by 35 percent since 1992, while prices for international calls have fallen by around 50 percent.

Although we would like to see more competition in the local phone sector, we are also seeing some encouraging signs. Wall Street is pouring money into the CLEC community. At the time that the 1996 Act was passed, there were only about six competitive local exchange carriers with a market cap collectively of $1.3 billion. Today, there are over 20 publicly traded CLEC's with a market cap of over $35 billion.

We also are seeing a lot of investment pour into the cable sector, as that sector tries to compete in new market areas. Operators in the cable field have invested nearly $8 billion per year since 1996 to upgrade their systems. By the end of the year, it is estimated that 65 percent of homes passed by cable will have been upgraded, bringing in more channels and enabling more services, such as high speed Internet access and cable telephony.

The cable industry also is driving residential broadband deployment, with the number of households connected expected to triple in 1999 to more than 1.5 million.

Now, as we see these investments pouring into the industry, and with communications firms scrambling to provide services, these firms are looking for ways to take advantage of economies of scale, which can lead to lower prices and higher quality services. They see mergers as an important way to take advantage of changes in technology and changes in the marketplace and changes in the law.

As has been pointed out, some mergers are beneficial to consumers, but it is the FCC's job to make sure that no transfer of control creates a conglomerate so large and so dominant that it kills competition and undermines the intent of the Telecommunications Act of 1996.

The worries that were outlined by Chairman McCain in his opening statement are exactly true. We must make sure that this consolidation does not undermine consumer welfare, and it is the FCC's job to make sure that the promises that these merging parties make when they come before the FCC and argue that their merger is in the public interest are kept. We must hold these merging parties to their promises—promises to the American consumer.

Now, the Department of Justice and the FTC are, of course, charged with ensuring that the public reaps the benefits of a competitive communications marketplace, but those agencies are governed by different laws. They apply differently in practice in the marketplace.

The FTC and DOJ administer the antitrust laws. The FCC is charged with ensuring that license transfers serve the public interest. Now, the FCC's review of these transactions is not an antitrust analysis cloaked in public interest rhetoric. It is a fundamentally different approach to viewing these transactions.

DOJ and the FTC do not duplicate the role of the FCC under the Communications Act, nor are they charged, like the FCC, with creating more competition. Their mandate is to protect existing competition from well-defined abuses, including mergers that substantially lessen competition and mergers that tend to create monopolies.

The FCC, by contrast, has the responsibility to make sure that no transaction will subvert the goals of the Communications Act. So we at the FCC have a statutory obligation to ensure the mergers will result in tangible benefits for American consumers, namely, more choices, lower prices, better services, benefits for all American consumers.

When the FCC considers license transfers, it is acting like a court in its quasi-judicial role. In this capacity, the FCC follows procedures that are well-defined. In the Administrative Procedures Act, the process is open. The FCC develops a public record. The FCC explains its decisions in writing, and the FCC's decisions are subject to judicial review.

During my tenure as chairman, the FCC has been presented with mergers of breathtaking size and scope that will affect consumers for many years to come. I have insisted that the public have a role in these decisions. It is not possible to define the public interest without public participation, and so I have insisted on an open process.

I have insisted on a process in which we hold public hearings; a process that allows many people who are affected by our decisionmaking but who do not always have a voice in our decisionmaking to be heard—like state regulators and national and state consumer groups, and small businesses. I think it is important to put this process in context.

Since the passage of the 1996 Act, the number of mergers presented to the Commission has increased to historic proportions. Never before have we been faced with this number and complexity of transactions to review. And, we have had to handle these responsibilities with no increase in resources.

Frankly, I believe that much of the current controversy concerning the FCC's merger review role is a result primarily of one transaction: the FCC's review of the SBC/Ameritech merger. That transaction involved a proposal by one company seeking to acquire fully one-third of the telephone lines in the United States, one-third of all telephone lines in this country.

That merger has profound implications for the future structure of the telecommunications industry and the ability of the FCC to fulfill its mandate to bring competition to telephone consumers, as required by the act that you passed.

In reviewing that merger, we designed a process to ensure the public would be heard, and that the pro-competitive benefits that the parties came forward and promised would be delivered and would actually be realized by the public. In thinking about our review of that particular transaction, I was going over the points that Senator Wyden made, the four points that he outlined that should be considered in review of a merger. Clearly the FCC looked hard at three of the four of those issues in the context of that merger.

The fourth one, leveraging market power into another area, did not directly apply. But I assure you, Senator Wyden, that in the context of that transaction, your concerns that you stated earlier were, indeed, addressed.

Now, having dealt with a number of mergers since the 1996 Act was passed, including mergers like SBC/Ameritech, we have learned much about the process of handling these huge megamergers. We have listened to the concerns of the Congress, particularly the concerns of Senator McCain and others, and we are in the process of developing procedures to ensure that the application of our public interest standard is even more clear and predictable.

I have charged our general counsel, Chris Wright, to organize an intra-agency transaction team to streamline and accelerate the transaction review process, the primary goal being to bring more clarity to better explicate our own case law on mergers with written guidelines. We also will look at ways to leverage the specialized skills of the staff and to minimize the resources needed for processing the most complicated transactions. The team also will work to make the process even more transparent.

In conclusion, Mr. Chairman, these are indeed extraordinary times in the telecommunications industry. No one can predict with precision how this marketplace will develop, but of one thing I am certain: unbridled consolidation in this field will subvert the aims of the communications laws to bring competition and deregulation to this marketplace, and unbridled consolidation will reverse the progress we have made thus far toward competition and more consumer welfare.

So I respectfully suggest, Mr. Chairman, that now is not the time to strip away the FCC's historic authority to protect consumers. Now is the time, more than ever before, to ensure that any merger approved will serve the public interest.

Finally, on a somewhat related topic, I wanted to commend you, Mr. Chairman, for your leadership in introducing the Telecommunications Ownership Diversity Act. In this era of consolidation, we must continue to look for ways to ensure that small businesses, particularly those owned by minorities and women, have an opportunity to participate in this exciting marketplace, and I commend you and your colleague, Senator Burns, for recognizing that and introducing this historic legislation.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Kennard follows:]

PREPARED STATEMENT OF HON. WILLIAM E. KENNARD, CHAIRMAN, FEDERAL COMMUNICATIONS COMMISSION

Thank you Chairman McCain, Ranking Member Hollings, and Members of the Committee. I appreciate the opportunity to testify before the Committee this morning.

As we enter the Information Age, the Department of Justice (DOJ), the Federal Trade Commission (FTC), and the Federal Communications Commission (FCC) are working to gether to ensure that the American public reaps the benefits of a robust and dynamic communications marketplace. Each agency has a distinct and vital role to play in this process.

As you know, the Telecommunications Act of 1996 charges the FCC with the critical function of *creating* competition in markets where it did not exist before. We have a statutory obligation to follow the pro-competitive and de-regulatory framework of the Act, and to ensure that markets move from monopoly markets to competitive ones and that all Americans have access to the digital tools of the next century.

The Department of Justice and the Federal Trade Commission administer the antitrust laws. They do not duplicate the statutes laid out by the Communications Act, nor do they create more competition. Instead, they protect *existing* competition from a few well-defined abuses, including mergers that "substantially lessen competition" and mergers that "tend to create a monopoly."

We have different laws for different agencies, and each of the three agencies has an important role to play in this process. And together the three agencies are working on behalf of consumers and Americans nationwide. The public spends billions of dollars on communications and entertainment services every year, and as such the public has a huge stake in the development of our nation's communications infrastructure. Congress understood this vital interest when it passed the 1996 Act and charged the Federal Communications Commission with ensuring that competition develops in all communications markets.

In the less than four years since passage of the Act, competition and growth in communications markets have grown more rapidly than anyone could have imagined. Companies are investing billions of dollars in advanced telecommunications networks in our urban and rural areas. And consumers are reaping the benefits of this competition and growth. Grandparents are now able to talk to their grandchildren hundreds of miles away at a rate of seven cents per minute. Husbands and wives enjoy the increased security that comes from travelling with a wireless telephone. And millions of Americans are discovering the convenience of doing their holiday shopping over the Internet.

This rapid growth of technology and services has taken place far more rapidly than anyone could have expected. Even greater progress would have been possible had the monopoly carriers put their energy into complying with the Act's market-opening provisions instead of challenging nearly every part of the Act and nearly every decision implementing the Act in nearly every court in the country.

As a result of these legal and technological changes, communications firms ae understandably looking for ways to take advantage of increased economies of scale, which can lead to lower prices and higher quality services. They are also seeking to combine services into packages or bundles, which can benefit consumers through the convenience of "one-stop shopping." Communications firms see mergers as an important way to take advantage of changes in technology and changes in the marketplace.

"Good" mergers can spur competition by creating merged entities that can compete more aggressively and that can move more quickly into previously monopolized markets. If such competition develops, we can substantially deregulate the formerly monopolized markets, just as strong competition justified the substantial deregulation of the long distance and wireless markets. Thus, the focus must remain on eliminating bottlenecks and ensuring that consumers have adequate choices to ensure meaningful competition.

As Adam Smith pointed out, however, there will be no competition (and no invisible hand) if business owners are left to their own inclinations. Instead, they will quickly decide that cartels and monopolies are far better for their interests. "Bad" mergers are likely to slow the development of competition. "Bad mergers" have many anti-competitive harms, such as: eliminating firms that would have entered markets; raising barriers to entry; discouraging investment; increasing the ability of the merged entity to engage in anti-competitive conduct; and making it more difficult for the Commission and State Public Utility Commissions to monitor and implement pro-competitive policies. Accordingly, the public interest demands constraints on the ability of a handful of large communications to consolidate communications assets that our vital to our nation's economy.

Discussion of "the public interest" in merger cases too often focuses on the "interest" side of the equation—industry interests, shareholder interests and economic interests. The FCC, on the other hand, has a unique statutory responsibility to keep the "public" side of the equation—consumers—in sharp focus. The FCC is in many ways the last defense for consumers, and we have a statutory obligation to ensure that mergers will result in tangible benefits for American consumers, namely, more choices, lower prices, and new and better services.

Although many mergers may be beneficial to the public, it is the FCC's job to make sure that no transfers of control create a conglomerate so large and so dominant that it kills competition and undermines the intent of the Telecommunications Act of 1996.

If the Commission did not review mergers under the "public interest" standard, it would be possible under traditional antitrust analysis for all the regional Bells and GTE Corp. to merge into a single, national local phone company. The country might be taken back to the days of Ma Bell and her helpings of higher prices, poorer service and stifled innovation. And American consumers would suffer as a result.

In response to assertions that have been made in the press, I'd like to be clear that the Commission is not engaging in any "shakedowns" of companies who have merger applications pending before it. The Commission is standing up for American consumers by eliminating the harms that will be caused by transfers of control and ensuring that the benefits reach communications consumers. The Commission does this by working with the companies and consumers to arrive at conditions that preserve the benefits of mergers while eliminating or adequately mitigating their harmful effects. Particularly where markets are changing rapidly (as with new technologies), conditions like those adopted in the SBC-Ameritech case are the most effective way to ensured the development of competition and protect consumers.

The Commission clearly is following, and has long been following, adequate procedures and adhering to consistent, well-defined legal standards as set forth in the Administrative Procedure Act. As required by the APA, the applicants, opponents, and the public have the opportunity to make known their views and have their perspectives taken into account. The process is open, the Commission explains its decisions in writing, and all decisions are subject to judicial review. If the Commission were not already following adequate procedures and adhering to consistent legal standards, its decisions would have been reversed by the courts.

Like the common law—the law of property or contracts—the public interest test proceeds on a case-by-case basis. This is more efficient, and much less regulatory, than writing extensive rules attempting to anticipate every way in which any possible transaction might violate any part of the Communications Act or the FCC's rules. The public interest is a fundamental legal concept, akin to "good faith," "reliance," "negligence," and "compensation." As such, its meaning is inherently fact specific and can only be defined based on the circumstances of each individual case. This is particularly true in rapidly changing times. Accordingly, case-by-case analysis is often superior to writing volumes of rules attempting to explain the application of a legal standard to every conceivable fact pattern.

In the future, the application of the public interest test will be even more clear and predictable than today. I have asked our General Counsel, Chris Wright, to organize an intra-agency transaction team that will be in place by January 3, 2000 to streamline and accelerate the transaction review process. A primary goal is to supplement the case law explicating the application of the public interest test with written guidelines. In addition, we will be looking at ways to leverage the specialized skills of the staff involved in reviewing transactions to reduce the effort needed to ensure consistency between decisions and to minimize the resources needed for processing even the most complicated transactions.

The new intra-agency transaction review team will establish deadlines for rapid processing of transfers of control associated with transactions. The goal will be to complete even the most difficult transactions within 180 days after the parties have filed all of the necessary information and public notice of the petitions has been issued. Finally, the new team will also work to make the transaction review process even more predictable and transparent, so that applicants know what is expected of them, what will happen when, and the current status of their application. This is consistent with the focus of the restructuring of the FCC to operate in a flatter, faster, and more functional manner.

The CHAIRMAN. Thank you very much, Chairman, Kennard, and thank you for your endorsement of the recent legislation that Senator Burns and I introduced. I hope we can move on it.

I think it is very clear that one of the unintended consequences I referred to in my opening statement has to do with fewer and fewer minority owned businesses, and involvement in the telecommunications industry. That is not appropriate, and we ought to give a level playing field to every American.

Chairman Pitofsky, because of its recent acquisition of TCI and other cable companies, according to Mr. Kimmelman AT&T now serves 60 percent of all cable customers.

Notwithstanding this, AT&T/TCI is now attempting to acquire Media I, which owns 25.5 percent of Time Warner. How is this acquisition not at odds with the FTC's Time Warner/Turner decision, the point of which was to separate these cable conglomerates?

Mr. PITOFSKY. That is a good question, but I have not really looked into the more recent proposals. The market shares at the level you described certainly are matters of concern, and while I have not looked at these particular facts, I do know that our goal was to keep access open. If there is one shorthand way of looking at what we did in TCI/Turner/Time Warner, it was access, access, access, and I would want to look very carefully at the impact on access of these new proposals.

The CHAIRMAN. Well, as you know, in the Time Warner/Turner you were concerned that the combined company would leverage its programming market power to kill competition and distribution by denying competitors must-have cable channels at nondiscriminatory prices. Does this bring into play again your concerns?

Mr. PITOFSKY. Yes. You would want to look at these new proposed mergers very carefully.

The CHAIRMAN. In your testimony, you refer to the local telephone companies' cartel behavior in insulating themselves from competition by maintaining local exchange networks that are supposed to be but may not effectively be nondiscriminatory, and you state that this could be a serious anticompetitive problem.

Based on these views, could you analyze the competitive impact of the cable industry's attempts to bundle their high speed Internet service with their proprietary ISP and insulate this arrangement from any type of open access requirement?

Mr. PITOFSKY. I am not sure that I fully understood the question, Senator.

The CHAIRMAN. Well, in your testimony you referred to local telephone companies' cartel behavior in insulating themselves from competition by maintaining local exchange networks that are supposed to be but may not effectively be nondiscriminatory. That is in your statement.

Then what is the competitive impact of the cable industry's attempts to bundle their high speed Internet service with their proprietary ISP and insulate this arrangement from any type of open access requirement? Do you believe that is the case?

Mr. PITOFSKY. Again, we have not had an opportunity to look at that issue, because those cases are at DOJ and not at the FTC. If, in fact, a consequence of these transactions is to raise barriers to entry, deny access, then we have taken the position in this industry that access is critical, and I would expect the Department would take a very careful look at that issue.

The CHAIRMAN. I thank you, Mr. Chairman.

Mr. Kennard, in your statement you characterize a good merger as one in which the combined company can, quote, move more quickly into monopolized markets.

You have already approved the AT&T/TCI merger last February. You stated, and I quote, I am optimistic because the combined resources of AT&T and TCI surely will generate a very substantial effort to expand the choices now available to residential phone subscribers in TCI territory. I am especially pleased by the commitment of AT&T chairman Michael Armstrong that AT&T will offer service uniformly in all neighborhoods in every city it serves.

Did you impose any conditions on this merger to assure that AT&T does, in fact, move quickly to roll out residential telephone service, and did you impose any conditions on the merger to assure that AT&T does, in fact, offer this service in virtually all neighborhoods in every city it serves?

Mr. KENNARD. Actually, Mr. Chairman, AT&T did make representations in the record that they would roll out telephone service and broadband services ubiquitously. We did rely on those representations when they, in fact, filed their transaction and we issued an order granting it.

The CHAIRMAN. Have they so far complied, lived up to your optimism?

Mr. KENNARD. I think it is too early to tell. We are watching carefully, and we will continue to monitor the roll-out. I know that they are investing heavily in upgrading their systems, and it is my hope that they will be able to bring consumers new telephone services, in particular to compete against the incumbents in that market.

The CHAIRMAN. Can you tell us what they are doing to comply with its commitment to give TCI subscribers direct nondiscriminatory access to the Internet service provider of their choice?

Mr. KENNARD. Well, we did not impose a condition in the merger that they provide nondiscriminatory access to ISP's. That was an issue that was raised in the merger, but the FCC decided ultimately not to impose that particular condition.

The CHAIRMAN. Chairman Kennard, it takes the FTC an average of about 4 months to issue decisions on merger cases. How long has it taken the FCC recently?

Mr. KENNARD. Well, it takes different amounts of time, depending upon the size and complexity of the transaction. We sort of have to look at this question in terms of the type of transaction involved. We deal with license transfers and approvals of that nature. The small ones go forward very quickly, in a matter of days or a couple of months. The more complex transactions, the megamergers, if you will, take us longer, on average.

If you look at the category of large mergers, they go through in about 6 months. We have taken a lot longer in cases where we have these megamergers of huge size and scope involving many issues of first impression and the public interest standard as I stated earlier, I have made sure that we open up the process so that States' Attorneys General and State regulators, consumer representatives and others have an opportunity to be heard, and that takes longer.

The CHAIRMAN. Finally, Chairman Kennard, in his testimony Mr. Kimmelman states that the number of regional Bell Operating Companies has shrunk from seven to four. MCI and WorldCom have merged. Now MCI/WorldCom is attempting to acquire Sprint, together representing the majority of long distance revenues. A majority of cable TV companies are either owned or operated by AT&T or in the process of being owned or operated by AT&T, and the rest are busy making nice with each other in order to consolidate their service territories. Do you agree with Mr. Kimmelman's testimony?

Mr. KENNARD. I agree with Mr. Kimmelman that we should be quite concerned about the pace and the scope of consolidation that we are seeing in these markets. If you look just at the history of Bell Operating Company mergers since the Act was passed, beginning with SBC/PacTel and then BellAtlantic/NYNEX and then SBC/Ameritech, you can see in our decisions an increasing level of concern about the pace of this consolidation and also an increase in the nature and enforceability of the conditions that we have imposed to make sure that this consolidation does not subvert the goals of the Communications Act.

The CHAIRMAN. This is a tough question for both of you to answer. How concerned should the Congress be?

Mr. KENNARD. I think Congress should be very concerned. This is an area that represents fully about one-third of our economy. It is producing a lot of economic growth and jobs, and that is a function primarily of competition, companies being able to move into new markets. The last thing we want to see is for that engine of competition to be somehow just squelched by monopoly power and consolidation, so I think we have to be very, very watchful in this area.

The CHAIRMAN. Chairman Pitofsky, how concerned should we be?

Mr. PITOFSKY. Very concerned. I agree with everything Chairman Kennard has said, and I would just add this dimension. It is not just the question of where we are now, it is where we are going, and that is the hardest question for regulators looking at mergers and antitrust generally. You look at the first deal, you say, well, that one is OK, we can live with that. Then the next proposal comes along and its sponsors say, well, you cleared that deal, what about ours, and then the third and the fourth and the fifth.

One must ask the question, particularly in this sector of the economy, where is it all going to end, and I think Congress should be very concerned with that question.

The CHAIRMAN. Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman. Both of you have been excellent, and Bob Pitofsky's last point raises a question that is central to me in this communications area, and I think that when you look at some of these deals in the communications area you are talking about what is potentially a threat to the First Amendment. I think we are going to have to start factoring in the First Amendment in a very specific way as we look at these deals.

Time Warner/Turner, 40 percent of cable programming is being merged. As you know, the reason I pushed you all so hard on the Barnes and Noble/Ingram merger is, I was very troubled about what would happen if a retailer and a wholesaler merged, and I thought we would lose a lot of the diversity of ideas in our country. So my first question to you, Mr. Pitofsky, would be, how should antitrust regulators incorporate First Amendment concerns in decisionmaking, given where we are headed?

Mr. PITOFSKY. Unless Congress wants to direct us otherwise, I think it is through close scrutiny. I think one should simply pay more attention when communications, news and so forth is involved. I thought we did that in Barnes and Noble.

Incidentally, we did that in Time Warner. One of the conditions of the order was that there would be a second 24-hour news service introduced, because we were concerned that a combination of CNN and Time Warner would produce such a dominant player that others would not be able to compete. In fact, a second and then a third news service came into play.

Is that because a wholly different set of rules apply to networks and cable? No, I do not think that is fair, but we should be more alert, more sensitive, and give more careful consideration.

Senator WYDEN. I obviously do not want to get you into the area of nonpublic information, but what can you tell us simply from a theoretical standpoint about the proposed CBS/Viacom merger, which would give the combined company control over broadcast television stations that reach more than 40 percent of the national audience, and in addition what they would get through cable interest?

Set aside the matters of nonpublic information and, if you can, touch on it in theory.

Mr. PITOFSKY. An answer to that question is awkward for me. Not only is it an ongoing investigation, but it is not our ongoing investigation. That merger is under review at the Department of Justice, and so I think I probably should limit myself to the sort of thing I have said so far this morning, and that is, those are very large companies, very significant market power at both levels, and therefore it deserves the most careful and thorough review.

Senator WYDEN. The next area I wanted to touch on are copycat mergers, which I think are getting to be an increasing problem as well.

What is your sense about what antitrust regulators ought to do if they foresee imposing conditions on a merger are going to cure an immediate antitrust problem with that merger, but that the likely effect will be that other companies in the industry followup with copycats, and we end up with more consolidation and less competition?

What I am trying to do, in addition to the points I made earlier, and I appreciate Mr. Kennard's statement, is to try to set out what I think are some key new problems. The First Amendment is one that we touched on in the last minute or so, but copycat mergers strike me as another very serious one, and what is your sense about how this committee and the Senate ought to look at those?

Mr. PITOFSKY. Let me take the first shot at it, and then I will ask Bill to direct an answer to that.

I think everything considered, it is the toughest call we have to make, and part of that is, there are two reasons why copycat mergers could be occurring. One is, everybody in the industry recognizes that the first merger was very efficient and sensible and pro-consume, and therefore the trend toward concentration is really energized by the fact that the first merger was a good idea.

On the other hand, you have other copycat mergers in which the first firm achieved substantial market power and then the second pair and the third pair come to the conclusion that they have to be the same size as the first pair in order to compete in global markets, or even in a domestic market.

One of the things that they teach in the business schools these days, and I am not sure it is such a great idea, is that you cannot really be successful in a market unless you are number 1 or number 2. I worry that the trend toward mergers, the trend toward consolidation in some industries, is motivated simply by a concern to have as much market power as anybody else in that industry.

Playing those two things off against each other is exceptionally difficult, especially when the first merger is one that the courts are very unlikely to strike down, and it is only because it will lead to the second, third, and fourth that you are concerned.

Senator WYDEN. Let me see if I can touch on one involving the Microsoft decision. Some of the analysts have been arguing in the last couple of days that the Microsoft decision has set some limits for when a company can use marketplace power to compete in what amounts to another marketplace sector.

Again, without forcing you into areas that are sensitive, if that is the case, how would you foresee it applying to cable companies, or local telephone service companies with marketplace power in one area seeking to compete in other markets?

Mr. PITOFSKY. I beleive these are conventional antitrust rules, and they will apply regardless of the industry involved.

I have seen the reports from Silicon Valley and elsewhere that we are changing the rules of the game in the way in which we regulate large firms. The Federal Trade Commission sued and then settled with Intel. The Department of Justice has this long-running antitrust controversy with Microsoft.

I want to fundamentally disagree with people who say we are changing the rules of the game. On the contrary, I think what these cases are doing is reestablishing what fundamental rules under the Sherman Act really are, and I think in the long run they will help us encourage innovation rather than discourage innovation in high tech markets. That is true across the markets you mentioned.

Senator WYDEN. Mr. Kennard, let me ask you one about that noncontroversial matter in my home town involving AT&T and TCI and broadband. The Legg Mason analyst who is going to testify, I guess this morning, states, and I quote, it's clear that the market doesn't demand a closed network in order to justify broadband investment, and AT&T/TCI argued that open access to their cable network is going to dry up investment needed to upgrade the network.

Now, WorldCom and Sprint and some of the local carriers have invested heavily in upgrades so their networks can carry broadband, and they all have open access requirements. Given that my constituents feel so strongly about this, what is it about AT&T that it cannot attract investment without closed networks?

Mr. KENNARD. Well, we have had many conversations, you and I, about this topic over this past several months, and I think it is fair to say that we agree on what the end game should be here. I certainly want to see broadband deployed not only by the cable industry, but by many players in an open environment, in a competitive environment, and we need to get those broadband pipes built quickly.

It is important for the country, it is important for electronic commerce, it is important for us to maintain world dominance in the Internet community, and I would not dispute the fact that companies like AT&T I think would go ahead and deploy broadband even if you had some sort of open access regime.

But I think the fundamental question is, is regulation necessary at this time, particularly when we have a very nascent industry, the broadband industry, and you have the prospect, the hope that multiple players are going to deploy it, not only on the DSL platform but also on wireless platforms.

As Chairman Pitofsky stated, I thought very eloquently in his testimony, when you are transitioning from a monopoly environment to a competitive environment there is always the urge to impose more regulation on the new competitors, the new entrants in those markets, but I think that our goal as policymakers should be to try to promote competition and ease regulation on all of the players, and that is why I have advocated consistently that that is the approach we should take with respect to broadband deployment on cable, at least at this juncture.

If we find that consumer welfare is being undermined in some way, or consumers lack choice, we will have opportunities to step into that marketplace and intervene, but I just do not think now is the time.

Senator WYDEN. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Brownback.

STATEMENT OF HON. SAM BROWNBACK, U.S. SENATOR FROM KANSAS

Senator BROWNBACK. Thank you, Mr. Chairman, and thanks for holding this hearing. I think it is a very timely and very important hearing to hold, and I thank the two chairmen for coming up to testify and to meet with us.

I am listening and gaining input on the last merger that took place involving—Sprint is headquartered in Kansas and has a lot of direct impact on constituents of mine, so I have a concern not only for the impact it is having across the marketplace and legalities, but the impact it is having on constituents and job dislocation that could potentially happen there.

I would like to ask Chairman Kennard, if I could, a year ago we had MCI, WorldCom, and Sprint, two, three, and four all competing in this long distance marketplace, and here we are a year later, and all three of them are together. As you look at that fast year that took place, what levels of concern does that raise in your mind for the public interest of having those three major competitors in that long distance market merging together here in a short, fast year?

Mr. KENNARD. Well, Senators, as you know, that merger will soon be before the FCC, so I do not think it would be appropriate for me to forecast what the decision will be there. I will say that, as I have said before, I think that we should be concerned when the number 2 and 3 competitors in residential long distance marketplace propose a combination like this before us, so we will be looking very carefully at that question.

Senator BROWNBACK. I would think, as we look forward, we would be deeply concerned. If I could ask, actually, both of you, in looking forward, if we were to project out in 3 years, how many national, full service THATcommunications providers do you anticipate that there will be, and how many do you think to provide adequate, aggressive competition that there should be?

Mr. KENNARD. It is hard to predict at this point. We do know that companies are scrambling to gain economies of scale and provide national footprints so they can roll out bundled packages of telecommunications services.

In many cases, that is a good thing, and that maximizes consumer welfare, and I think that trend will continue. We are working hard at the FCC to accomplish a situation where you have a number of national players, but also lots of niche players that are able to serve discrete market needs. That is why we have worked hard at the FCC to assist companies, smaller companies that want to get in and compete head-to-head against the large incumbent historic monopolies.

But I think the best way to answer your question is from a consumer point of view, what is best for the consumer. The consumer should be able to have a range of product choices, three, preferably four or more in each product sector, and so what we strive to do is make sure consumers have choice in all of these different sectors, be it wireless, local, long distance, high speed Internet access or video. And we have accomplished that in some areas, long distance and wireless being probably the best examples, but we have a ways to go in the other areas.

Senator BROWNBACK. So you would look for an optimal situation to be three or four competitors?

Mr. KENNARD. I would say optimal would be four or more in each product sector.

Senator BROWNBACK. Is that something you will be pressing for as you look and put forward these orders and rulings that will be shaping much of this landscape?

Mr. KENNARD. As a very general matter, yes, sir.

Senator BROWNBACK. Mr. Pitofsky, do you have a comment regarding that question of looking down the road, where we would anticipate being and where we should be?

Mr. PITOFSKY. I share Chairman Kennard's sense—let me just say that one of the things we have learned compared to 30 and 40 years ago is, you ought not to do this analysis on the numbers alone. There will be sectors where two or three are enough. There are others where you need five or six in order to be assured that there is vigorous competition and consumers will not be taken advantage of.

But certainly it is true in virtually every sector of the economy that when you see monopolies and duopolies, where you get just one or two firms, it is very unlikely that they are going to compete at a level that is optimum, that is going to serve consumers well, and therefore it is a rare case in which you do not try to prevent mergers that concentrate a market to the point where there are only two firms or maybe three left.

Senator BROWNBACK. So you look at it as more of a rolling—you would not put a hard and fast three or four competitors in each place, but would look at it in differing standards and different parts of the industry?

Mr. PITOFSKY. Very much so. It depends on barriers to entry, whether homogenous products are involved, what is the level of communication between the players and so forth. There are about half a dozen, or more factors you look at in addition to market slaves. But I have always said that while numbers are not dispositive, as they may have been thought to be 30 years ago, it is the ramp that leads you into the analysis, and one must not forget how many players are left after this string of mergers takes place.

Senator BROWNBACK. Well, I think we need to look at, I would say the level of competition and the ability of consumers to be able to get some choices in their services, but we are obviously concerned about what impact it has on places, and to constituents of Sprint and other facilities around the country that have built up large groups, and I have not stated one way or another where I am on the merger, but I just have a deep concern when people contact and call and they are wondering what is going to happen to them in the future. That is something that you folks need to watch clearly as well.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. Senator Bryan.

Senator BRYAN. Thank you very much, Mr. Chairman.

Chairman McCain asked each of you a question, how concerned should we be about these trends that we have been discussing, and Mr. Kennard, your response was very concerned. Mr. Pitofsky, you said you joined in that.

If you are very concerned, I suspect we ought to be very concerned, and the American public ought to be very concerned about this. Are you recommending any course of action that we should consider in the Congress that we have not done, either a review of the basic legislation that gives you the power to review, or any other changes in law? What should we make of your very concerned, and what should our response be to that?

Mr. KENNARD. Well, Senator, I would not presume to suggest any legislation to you at this time. All I would ask is that you continue to support agencies like the FCC, the FTC, and the Department of Justice that are on the front lines making sure that there is a strong counterforce in Government against this consolidation that has the threat of undermining the gains that we have made in creating competition in these markets.

Senator BRYAN. When you say support, I take it you are talking about resources, financial support in terms of appropriation level. Any other kinds of support?

Mr. KENNARD. Well, certainly just an affirmation that when the FCC goes out and seeks to protect the public interest in the context of these mergers, that you are supportive of our efforts and understand that what we are trying to do here is not undermine the ability of these businesses to grow, or to hamper their prospects, but fundamentally to support the competition that we have in consumer markets and ensure that consumers have the choice that we have been talking about today.

Senator BRYAN. Chairman Pitofsky, your thoughts.

Mr. PITOFSKY. I would urge that legislation is not the right way to go here. For over 100 years, we have had an unusual regulatory situation in this country. We have a Sherman Act that is roughly two paragraphs long, and a relatively short Clayton Act. Most of antitrust is judge-made law, and I think the courts have done well in this field.

I must say now, and I have not said it in the past, our resources are being terribly stretched by this merger wave, including mergers that are of such enormous size that frankly we have never dealt with mergers like this before.

The members of this committee have been very supportive of us, and the Commission has done reasonably well. It is not that we will not look at the mergers. It is that virtually all of the other responsibilities of antitrust that we have are being pushed to the side by this merger wave.

We spend over two-thirds of all of our antitrust resources doing merger review, and I suspect in the present year that figure may be even higher because of the frequency and the size of the mergers we are seeing.

Senator BRYAN. I take it, Mr. Chairman, you are suggesting we need to be much more attentive to your request in terms of levels of appropriation to carry out these functions.

Mr. PITOFSKY. That would help.

Senator BRYAN. I suspect it would, although this is not the committee that does that, as you know.

Mr. PITOFSKY. But you have been supportive of us throughout, and we really appreciate it.

Senator BRYAN. Well, I think your point is well-taken. If we are concerned, as all of us have shared these concerns about what the implications are for us with all of these mergers that are occurring, it is incumbent upon the Congress to provide each of you the necessary resources to conduct that oversight function.

Let me followup with a process question, and that is, we have the two of you and the Department of Justice involved in these decisions. Does the process itself, and I am not talking about the substance of the decision but the process, is it working? Do we need to revisit the process, or are you comfortable with the process, and maybe we will start with you, Chairman Pitofsky, first this time.

Mr. PITOFSKY. Maybe I am not the most objective about this. I think the process between the DOJ and the FTC has never been better. We never investigate the same transaction at the same time. We clear transactions to each other much more promptly than we did in the past. We finish our investigations more quickly than we have in the past. This is not a system that is "broke."

I am sure we can do even better, but things are going very well in terms of that division of responsibility.

Senator BRYAN. Chairman Kennard.

Mr. KENNARD. Yes, thank you, Senator. I think the process is working reasonably well under a very difficult strain. We at the FCC have continued to process the many thousands of proposals that come before us. I think we have learned a lot in the past year or two on how to deal with these megamergers that present us with difficult questions of first impression, and we are working internally to come up with ways to handle the megamergers better.

We also have dealt with huge records in these mergers. In the SBC/Ameritech transaction we had tens of thousands of pages of public comment. Our role, which is somewhat different from the antitrust agencies, is to develop a record and distill all of these facts into an order that will withstand judicial scrutiny. So these mergers are putting a tremendous strain on our resources, but we are coming up with better ways to do more with less, because that is all we can do at this time.

Senator BRYAN. Well, later on this morning we are going to hear testimony that points out that SBC and BellAtlantic have about two-thirds of the local phone lines in the country, that with AT&T's proposed acquisition, that they will own about 60 percent of the customers in their field of endeavor, all of which tends to suggest that there is a real threat to continued competition, and an incentive for more consolidation. Is that a concern that you have and, if so, what actions should be taken?

Mr. KENNARD. It is a concern that we have had. I guess fundamentally what we are dealing with here is a marketplace that was historically governed by the monopoly regulation that kept all of these companies in neat little regulatory boxes. A lot of those restrictions were taken away by the 1996 Act.

Now, many of these companies, including the largest companies in our country, want to leverage their economies of scale to compete in new markets. Sometimes that is a good thing. If a cable company is able to aggregate its resources and capital and compete in rolling out broadband in competition with incumbent Bell Companies, that is a good thing.

The question is, are consumers going to be harmed by historic monopolies that are allowed to get bigger, and that has really been the question we have asked in all of these major proceedings, and that is why we have imposed conditions when we felt them appropriate.

Senator BRYAN. The last question I would have, after every Sunday you see some plays that are called in which the quarterback would say, you know, I wish I had the ball back. Now, you all make some very, very tough decisions, and I think both of you are doing a very good job.

I have been very pleased with the working relationship we have had with each of you, but you are making these decisions and you are trying to make the judgment as best you can, looking ahead at what the implications are, but none of us have a Promethean vision. What happens at the end of the day if you say, based upon the experience in a year or two, whoops, I wish I had the ball back, I did not fully understand?

That is not to offer any pejorative observation. None of us can fully anticipate what the future will be. What do you do?

Mr. KENNARD. That is what the court of appeals is for, Senator. [Laughter.]

Senator BRYAN. What can you do Chairman Pitofsky? I mean, you have made the approval, and all of a sudden it does not work out like you thought it would.

Mr. PITOFSKY. Well, if we bring a case and we are wrong, then the courts will tell us so very promptly. Suppose we let one go by——

Senator BRYAN. Yes, and you are doing it for what you think are all the right reasons, but a year, 2 or 3 years down the road it is clear that in retrospect you should never have done that.

Mr. PITOFSKY. Well, technically we can go back and challenge the mistakes we have made. We could do that under Supreme Court law. You can bring an enforcement action based on the circumstances at the time of the action, and that could be 3 years later. That is technically true. As a practical matter, it is not fair to the parties. They have to plan. They need what is called repose, and therefore if we make a mistake we most likely will live with it, and I am not aware of a situation in which we cleared a deal and then we went back 3, 4, 5 years later and challenged it unless, of course, we were misled on some important facts by the parties.

Senator BRYAN. Chairman Kennard.

Mr. KENNARD. I would agree with Chairman Pitofsky, it is not really practical to go back later. You do the best you can, and you try to develop as comprehensive a record, and hear from as many people as you can, and make your best decision.

Unlike some of the antitrust authorities, we have imposed conditions that give us some ability to maintain continuing oversight, so if promises made are not kept in the context of these mergers, we do have the ability to go in with our enforcement powers and try to rectify things. Fundamentally I think you are left with the challenge of just not making mistakes in the first place.

The CHAIRMAN. Senator Dorgan.

STATEMENT OF HON. BYRON L. DORGAN, U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. Mr. Chairman, thank you very much.

You have been quizzed about a number of very important issues, and some of the headline mergers obviously are important, and there will be other discussion about them today.

I want to talk to you for just a moment and ask you a question about some things that are happening beneath the headlines. There are about 1,200 television stations in our country today. 25 owner groups now own about 400 of those television stations. The top 10 radio groups in 1994, top 10 radio group ownership in 1994 owned 195 radio stations. They now own 1,647.

Let me say that again. I think this is important. 1994, the top 10 radio ownership groups owned about 195 radio stations. Now they own 1,647.

Now, when the Telecommunications Act came to the floor of the Senate I attempted to offer an amendment to scale back the ownership limits, and I actually won the amendment by about 3 or 4 votes. That was about 4 in the afternoon.

Then dinner intervened, and several Senators had some sort of epiphany over dinner, and we had another vote on it because someone had changed their vote and wanted to have it reconsidered, as is certainly legitimate in the Senate, and there was, as I said, this epiphany, and I lost by 3 or 4 votes about 4 hours later.

I was convinced then and I am convinced now that the lifting of the ownership limits was not in this country's interest.

Andy Anderson died last week. He was 80 years old. He owned a country western station in Bismarck, North Dakota, for many, many, many years, wonderful guy. He could climb up the antennas and fix it all. He did everything. Andy was a great guy.

But people like Andy are not going to be around any more. With the concentration in ownerships that is occurring and the death of localism in broadcasting, the narrow economic calculus of value is in terms of income streams, as some owners that have never visited the area where they own the station. Are we losing something there?

It seems to me we are losing something very significant, and are you concerned. Let me ask you, are you concerned about 10 radio groups holding 195 stations, 5 years later they hold 1,647 stations? Does that concern you, and if so, what do you think we should do about that?

Mr. KENNARD. Senator, I am concerned about that. As you know, the 1996 Act lifted the cap on national radio ownership. It is a statutory right now that these companies may own as many stations as they can nationwide. Notwithstanding that, I think we should be very alert to the amount of consolidation in local markets, and in some of the major markets where you have lots of competing voices it is not as much of a problem. When you get in some of the smaller communities, I believe it is a problem, and I think that we should be very cautious about that.

But I also believe we have got to find ways to bring new voices and new entrants into this field. That is why I think Senator McCain's legislation to reinstitute the tax certificate is so important, because it will create incentives for the creation of whole new radio groups that are now being denied entry into this marketplace. I also think we ought to continue to look for ways to license spectrum more efficiently so we can bring more entrants onto the radio band and the TV band.

Mr. PITOFSKY. Senator, you mentioned TV and radio, but it is happening across the economy. It is banks, it is supermarkets, it is retailing generally. You asked the question, are we losing something, and my answer is, probably we are, especially in areas involving communications.

Now, if the reason these mergers are happening is because they are vastly more efficient, and the combined firm does a better job, then I think we should not get in the way. But if the reason these mergers are happening is just to produce larger firms with more market power, more ability to push their suppliers around and so forth, then I think it is a matter of concern, and it cuts across the entire economy.

Senator DORGAN. But Mr. Pitofsky, your answer seems to suggest the only calculus here is a narrow financial calculus, and with respect to broadcasting I submit to you there is another calculus that you must and Mr. Kennard must consider, and that is public interest.

Mr. PITOFSKY. I completely agree. When you are talking about matters that affect the First Amendment, then if antitrust is just dollars and cents, then we have missed the boat on what antitrust is about in this country.

Senator DORGAN. Well, let me just stick with this for a moment. If we have 10 radio groups owning 647 radio stations and the top 25 radio, or television station owners owning 500 of the 1,200 television stations in the country, and that is where we are, let me ask you to project where we are heading.

Without some restraint, or some kind of restraint that is exhibited somewhere in public policy, either legislative or administrative, are we likely to see continued galloping concentration in both of those areas. Have you studied that, or can you make some projections about it?

Mr. PITOFSKY. We have not studied that. I think that if that is the way things are going—it is what I said earlier, it is not just where we are now, it is where we are going, and if, in fact, by clearing mergers now we open the door to more and more and more concentration, then we have to draw the line somewhere, and maybe this is the place to draw it.

Senator DORGAN. It is true we have cleared mom and pop out of the grocery. The grocery is still there, but it is owned in Texas, and they own thousands of them, and we have cleared out most of the lumber yards, I understand that, and the community loses something from that as well.

But with respect to broadcasting there is a different standard and a different set of interests. Broadcasting includes, and has always included, some feeling that there needs to be localism in broadcasting to contribute to the community, and what I worry about here is limits. Let me ask the question.

The question is, should there be some limits applied to radio station ownership? If the top 10 groups own 1,600 and some radio stations at this point, and it is galloping off in a manner that I think no one could have predicted, should there be some limits attached to radio station owners?

Mr. KENNARD. Well, Senator, there are some limits. The 1996 Act did place limits on the number of stations that any single owner can control in a local market area, but what we are seeing in some of these transactions is that one owner will acquire a number of stations that does not exceed the statutory, the numerical limit, but nevertheless controls so much revenue in that market that it does have an impact on the ability of other smaller businesses to compete. That is how you see the small market, single station owners being, and even large market single station owners being driven out in particular marketplaces, and I think that that is a serious concern.

Senator DORGAN. Would you recommend any additional ownership limits on either television or radio based upon your policy experience at this point?

Mr. KENNARD. Well, I think Congress has spoken in the 1996 Act, but I do believe that under the public interest standard we do have some authority to look at, and certainly the FTC and the Department of Justice have authority to look at, aggregations of market power in a specific marketplace, even if they do not violate the numerical caps in the act.

Senator DORGAN. Congress has spoken, but Congress always has the opportunity to speak again. Would you believe what has happened since Congress spoke should persuade us to review this once again and consider some changes?

Mr. KENNARD. I think it is always appropriate for Congress to be thinking carefully about developments in this market.

Senator Dorgan. That is a careful answer. That is a very careful answer, but I wanted to raise the issue because I know there will be a lot of discussion about the large mergers, but under the headlines these other things are happening in concentrations that are alarming. I appreciate your responses, and would like to communicate more with both of you. Thank you.

The CHAIRMAN. The chief interrogator has one more question. Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman. I will be brief.

My question for you, Mr. Pitofsky, is how do you believe the Senate ought to look at the short-term versus the long-term ramifications of these mergers? And, let me tell you the example that comes to mind is airlines.

The U.S. Congress deregulated the airlines in 1978. Short-term, everybody thinks this is going to be good. More competitors, things look good. Long-term, we have seen some consolidations that have been very anticonsumer in my view. We have got some places that have little or no coverage now in terms of air service.

How would you recommend, as we look at these mergers in telecommunications specifically, but also with ramifications in other areas, how do we factor in the short-term, which may look good for the consumer, with the longer term?

Mr. PITOFSKY. We have to look at both. Let us use airlines for a minute, because it is a classic example. I think deregulation of airlines was a very good idea, and competition thrived for a while. But then there were 24 airline mergers in the 1980's. This was a period in which DOT had control of airline mergers. Some of these mergers took place over the objection of the Department of Justice. 24 proposed mergers, not one was challenged.

I think airline passengers today are paying the price for that inactivity on the antitrust front.

The CHAIRMAN. Alfred Kahn agrees with you, by the way.

Mr. PITOFSKY. If you look back at some of them—or example Ozark-TWA—how could that have been cleared? Those were two horizontal, direct competitors in the same hub market.

You want to be sure when deregulation occurs—and Mr. Kennard said the same thing earlier—you want to make sure the regulatory regime that we decided as a country that we did not want any more, is not replaced by monopoly and duopoly pricing through mergers.

When deregulation occurs, we should be more, not less, attentive to restructuring in those markets, and I think you have got to take into account both short-term and long-term effects. Short-term is really what the courts look at. They will look at 2, 3, 4 years out, but I think as a matter of prosecutorial discretion you have to look beyond the 2, 3, 4 years to where that sector of the industry is going.

Senator WYDEN. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much. I want to thank you both. We have had you here for a long time. I just want to say that I believe that the Committee needs to look at this situation further.

We will probably be going out of session here in the next few days, or at least that is the hope that many have. In the intervening time I am going to ask for some studies, including from the General Accounting Office, from the consumer viewpoint of this entire situation so that the Committee will have a better understanding, and other studies, if we can find those people who are objective and informed, so that the Committee can have a better understanding.

We may ask you to come back to another hearing, because I think from your testimony some of the ramifications of these mergers have not been -- or prospective mergers have not been fully appreciated or understood.

I appreciate your comments that we should be concerned. I view it as our responsibility, and we look forward to working with you, and as you both pointed out, this is an incredibly extraordinary time in the history of this country. I do not know of another time like it, as we were talking about, and so I think we have to be extremely vigilant to make sure that things go well, given the incredible impact that what is taking place now will have on the future of the country in the next millennium.

I thank you both for being with us.

Mr. KENNARD. Thank you, Mr. Chairman.

Mr. PITOFSKY. Thank you, Mr. Chairman.

The CHAIRMAN. Our next panel is Mr. Scott Cleland, managing director, Legg Mason Precursor Group, Mr. Paul Glenchur, director, Charles Schwab Washington Research Group, Mr. Gene Kimmelman, codirector, Consumers Union, Mr. Mike McTighe, CEO, Global Operations, Cable & Wireless, Mr. John Sidgmore, vice chairman of MCI/WorldCom.

While the witnesses are seating themselves, I would like to make one additional comment. If there is any individuals or organizations who felt they were not allowed to speak today, we obviously would appreciate their written testimony, and we would be glad to consider them for inclusion in further hearings on this very important issue, and I would appreciate it if we could keep the noise down so we can hear from our first witness, Mr. Cleland.

Welcome, Mr. Cleland.

STATEMENT OF MR. SCOTT C. CLELAND, MANAGING DIRECTOR, LEGG MASON PRECURSOR GROUP ®

Mr. CLELAND. Mr. Chairman, Thank you for the honor of testifying before your committee. The views expressed here are mine, and mine alone. I offer four insights and a conclusion in hopes that they will be useful to the Committee.

My first point is, telecommunications consolidation is a natural market development. It is a natural, given that this is a highly capital-intensive business requiring economic scale, and both regulation and technologies have been greatly expanding the scale required both globally and across industries.

My second point. Big is not necessarily bad. The pending mergers are not necessarily bad developments for competition and consumers as long as there are two preconditions that are met: number 1, that there is vigilant antitrust enforcement, and it continues to ensure that individual service markets remain competitive, and number 2, the communications networks continue to be public, i.e., open to competition.

That needs to be open to competition on a facilities basis between different broadband pipes and resale competition on each of the local broadband access points to the customer. Open access is essentially what keeps vertical markets competitive going forward.

My third point, companies do not need a closed network to deploy broadband. Other than AT&T and cable, open access is a fact of life, and investors implicitly factor in open access into their business models.

It is clear from the billions being spent in broadband systems, which are open, that the market does not demand a closed network in order to justify broadband investment.

My fourth point is that market forces do not necessarily open networks. I think it is naive to believe that market forces alone will eventually open the cable network to competition. It simply does not square with past experience or market reality.

So my brief conclusion is, broadband access is the bundle platform of the future, and if that bundle platform is not open, then that competition cannot flourish, because the future of communications is broadband, and we want to have a successful, robust competition which depends on open access to those rare broadband access facilities, at least for an initial transition period, so that broadband competition can develop.

Now, other than requiring open and competitive local broadband access to the customer, I think that the Internet and data networks should continue to develop free of intrusive regulation, assuming that we have vigilant antitrust enforcement.

Now, many appear right now to hope that a handful of facilities-based broadband competitors is sufficient to create a competitive broadband market. However, they ignore the reality that there is very little switching or competitive churn, as we call it, in broadband access. One analyst recently quipped that the broadband churn rate is less than moving or death rates.

Unlike long distance competition, people do not switch carriers just by calling up their carrier over the phone, and it is done. Broadband access switching is much more difficult. You have to buy new, expensive equipment, and you have to have somebody come out to your home to professionally install it.

So the competitive reality is, once someone signs up for broadband access, they tend to be a very sticky customer, or they tend to be effectively locked in. Hence, that is the rush right now, to lock customers up through the first mover advantage.

So without cable resale, once cable locks in a local broadband customer, and then bundles them vertically, prices can drift higher on the vertically tied services in their broadband bundle. Furthermore, no competitor can offer the customer a better deal with its alternative bundle, which resells the underlying cable platform.

Now, referring back why I am making such a big point of this on consolidation, the chart we have here talks about—and it is also a chart in my testimony—is that when you have open access you have vertical markets that can become competitive. Through the 1996 Act, through the 1934 Act, through FCC policies in the past, essentially the local teleco's cannot leverage their market power vertically.

Essentially, you have a facility access competitive market, and an Internet access horizontal competitive market. Internet long distance is competitive, and the customer equipment is competitive.

However, if you do not have open access, and you have market power at the local level, as cable does, then you can vertically take that market power all the way through those horizontal markets that are competitive when it is open and walk your way all the way up into e-commerce, and essentially the new economy. That is why this issue is so important. Local broadband access is a rare commodity, and it is the one part of this new economy that requires openness more than anything else.

Thank you for the time, Mr. Chairman.

[The prepared statement of Mr. Cleland follows:]

PREPARED STATEMENT OF SCOTT C. CLELAND, MANAGING DIRECTOR, LEGG MASON PRECURSOR GROUP®

Mr. Chairman, on behalf of the Legg Mason Precursor Group, thank you for the honor of testifying before your Committee on the topic of mergers in the telecommunications industry.

The views expressed here are mine alone. I request that my full written testimony be printed in its entirety in the hearing record.

By way of introduction, I am not a traditional Wall Street sell-side analyst who analyzes companies or recommends the purchase of stocks. For Legg Mason, I run an investment research group that tracks regulatory, technological, and competitive developments in the communications, technology, and e-commerce sectors for large institutional investors. We focus on trying to anticipate major investment-relevant change coming in the next three to 18 months.
In that context, I offer the following insights and observations in hopes that they will be useful to the Committee.

(1) Telecommunications Consolidation Is a Natural Market Development

The current wave of telecom consolidation is a natural and expected market development in a highly capital-intensive business, which demands economic scale.
This natural tendency toward consolidation has been accelerated by: pro-competitive regulatory and trade policies that have created a much larger global marketplace; and, Internet and digital technology that enable competition between previously separate analog industries. Economic scale through consolidation makes deployment of broadband infrastructure less expensive, faster and less risky. This can be pro-competitive, pro-deployment and pro-consumer.

Big Is Not Necessarily Bad

Communications consolidation is not necessarily a bad development for competition and consumers, as long as: vigilant antitrust enforcement continues to ensure individual service markets remain competitive; and, communications networks continue to be "public"—i.e., open to competition with: facilities-based competition between different broadband 'pipes," and resale competition of each and every local broadband access point to the customer. If these pro-competitive preconditions are met, telecom consolidation is not a problem for competition or consumers, because broadband "bundle" competition can flourish. However, any breakdown of competition in the critical component of local broadband access to the customer can have serious anticompetitive implications, because the integrated nature of broadband—i.e., bundling—is like a chain and, like a chain, it is only as strong as its weakest link.

(3) Big Is Not a Problem If Networks Remain "Public," i.e., Open to Competition

Despite confusing rhetoric to the contrary, Congress already has decided overwhelmingly that telecom networks should be "public" — i.e., open to competition. In the 1996 Telecom Act, **Congress overwhelmingly voted that *market forces alone are not enough to develop or sustain competition* in telecommunications,** given the history of monopolization and the presence of economies of scale.
Congress voted overwhelmingly:

(a) to "force access" (a.k.a. mandate interconnection and resale) on all local exchange carriers (which includes cable when offering telecommunications), so competition could develop; and,

(b) to require "interconnectivity...to promote nondiscriminatory accessibility by the broadest number of users...to ***public*** telecommunications networks."(emphasis added)

In 1998, the FCC legally required that local broadband access (advanced services) is a form of telecommunications subject to the market-opening provisions of the 1996 Telecom Act.
Meanwhile, the cable industry has been aggressively converting its broadcast **one-way cable network** in which it chooses the content and sends it to all cable customers, into what now appears to be a **two-way telecom network** in which the user chooses the content and sends it to the person(s) of the user's choice.
In other words, to benefit from the Internet and data growth, cable is reengineering its one-way cable network into a two-way telecom network — at least for voice and data. Despite the transformed physical network, cable maintains that it should not be subject to any of the open-access obligations that every other similarly situated local telecom broadband access provider must comply with.
WorldCom-Sprint, Bell Atlantic-GTE, Quest-USWest, the already-approved SBC-Ameritech, all incumbent local exchange carriers, all competitive local exchange carriers (wireline and wireless), and all long-distance carriers (including AT&T) are "public" networks legally required to be open to both facilities-based and resale competition. All are common carrier public network providers that, by law, have obligations to interconnect and wholesale their service, e.g., "forced access," in order **to maintain interconnectivity and universal service, and to promote competition and innovation.**

AT&T and the cable industry are seeking special government protection from standard resale competition that all of their competitors have accepted. The cable industry's position is bold: cable will agree to deploy broadband and compete on a facilities basis in the local phone market only if the government protects cable's core cable, ISP and long-distance businesses from "regulation," i.e., resale competition.

(4) Don't Need a Closed Network to Deploy Broadband

Other than cable, open-access is a fact of life and investors implicitly factor "public" open-access obligations into their business models. It is clear that the market does not demand a closed network in order to justify broadband investment. The competitive local exchange carriers (CLECs), both wireline and wireless, have raised tens of billions of dollars in capital with "public" open-access obligations. WorldCom and Sprint independently have invested heavily in deployment of broadband wireless despite their "public" open-access obligations. SBC recently committed $6 billion to deploy broadband capability to 80% of its customers in three years despite its "public" open-access obligations. RCN is not having difficulty raising capital to overbuild both the telcos and the cable plant despite its "public" open-access obligations.

(5) Market Forces Don't Necessarily Open Networks

It is naive to believe that market forces alone will eventually open the cable network to competition. It does not square with past experience or market reality.

The relative market advantage of being closed when all of your competitors are open is just too powerful to give up "voluntarily." Why is it not in cable's continuing self-interest to be able to sell to its competitors' customers while preventing its competitors from selling to cable's customers?

When AT&T was a regulated monopoly not subject to market forces, AT&T fought hard to continue as a closed network, but the government broke up the company and opened AT&T's network to competition by mandating "public" open-access obligations, with resulting consumer benefits. Now that AT&T is no longer a regulated monopoly in voice telephony, AT&T still seeks a closed network and is opposing open-access just as strenuously as it did when it was not subject to market forces.

If market forces alone open networks, why did Congress require that 15% of cable channels be available for "commercial use" (leased access) in 1984?

If market forces alone open networks, why did AT&T-TCI deny Internet Ventures, Inc. (IVI) the ability to lease a channel under leased access to offer competitive Internet video programming? And why is IVI having to petition the FCC to gain access? (When will the FCC clarify this fundamental market-opening access issue?)

If market forces alone open networks, why did Congress in the 1996 Telecom Act mandate interconnection and resale, and make state commissions the arbitrator of interconnection and resale negotiation disputes?

CONCLUSION: BROADBAND ACCESS IS THE BUNDLE PLATFORM OF THE FUTURE—IT NEEDS TO BE OPEN IN ORDER FOR COMPETITION TO FLOURISH

The future of communications is broadband. The success of robust broadband competition depends on required open-access to broadband *access* platforms (last-mile *access* facilities) — at least for an initial transition period, so that broadband competition can develop. A fully competitive broadband market depends on the combination of both facilities-based competition between broadband pipes and resale competition on *all* local broadband access pipes.

Other than requiring open competitive *local broadband access to the customer,* Internet and data networks should continue to develop free of intrusive regulatory intervention, assuming vigilant antitrust oversight and enforcement.

While many appear to hope that the handful of facilities-based broadband competitors is sufficient to create a competitive broadband market, they ignore the reality that there is very little switching or "competitive churn" in broadband access. One analyst recently quipped that the broadband churn rate is less than moving or death rates.

Unlike long-distance competition that only requires a phone call to switch carriers, switching broadband providers is much more difficult. One has to buy new, expensive equipment and have it professionally installed to reconfigure the system, which can take more than one visit to the home. The competitive reality is that once a provider signs up local broadband customers, they are very "sticky" customers, hence the current rush for "first-mover" advantage. In other words, customers are practically "locked in" to a local broadband access provider, because of the high cost and "hassle" associated with switching.

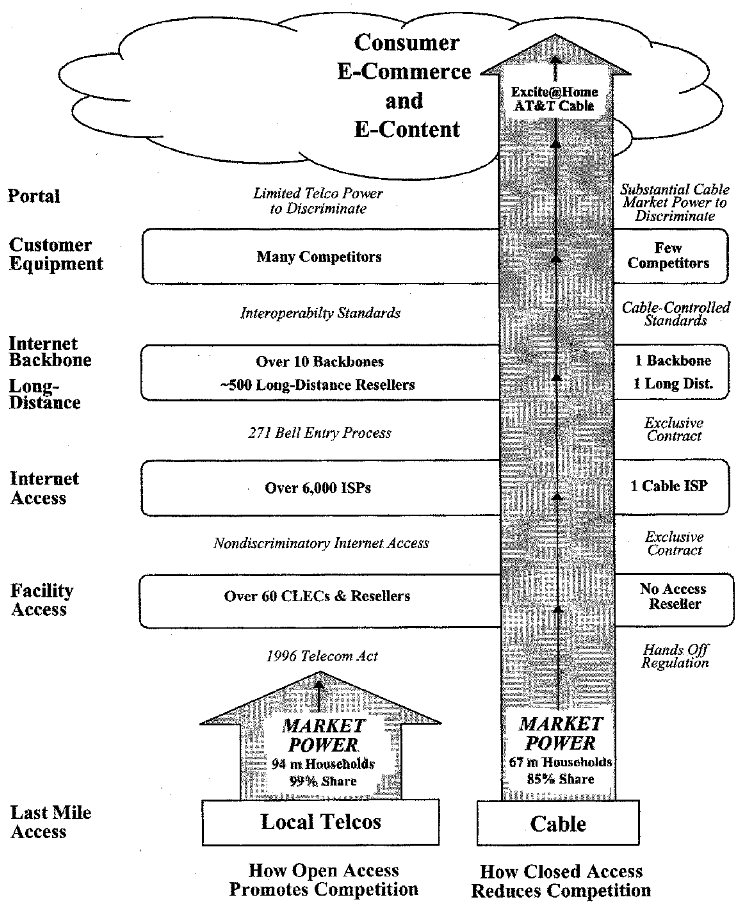
Once a customer effectively is locked into a local broadband access provider, if there is no resale of that underlying last-mile access platform, then there is no competitor that can keep that provider's broadband bundle truly competitive. Once cable locks in a local broadband access customer, then the prices can drift higher on the vertically "tied" services in their broadband bundle. Furthermore, no competitor can offer the customer a better deal with its alternative bundle, which resells the underlying cable local broadband access platform.

Without required open-access of local broadband access platforms in the increasingly complex market for broadband bundles, competitive forces won't develop sufficiently or rapidly enough to ensure that consumers are offered maximum choice and protection from anticompetitive pricing of broadband vertical services.

The attached chart shows how telecom open-access policies have promoted competition in vertical communications markets, preventing anticompetitive leveraging of last-mile access market power. The chart also shows how a closed cable network contributes to less competition in vertical communications markets and allows last-mile access market power to be leveraged all the way into e-commerce.

Attachment: "How Open or Closed Internet Access Affects Competition in E-Commerce"

How Open or Closed Internet Access Affects Competition in E-Commerce



Source: Legg Mason Precursor Group®

The CHAIRMAN. Thank you very much, Mr. Cleland. I found your chart to be very interesting and informative.

Senator Ashcroft could not be here today. He asked to be allowed to submit written testimony of Tod Jacobs from last week's Judiciary hearing on the proposed MCI/WorldCom/Sprint merger. Without objection.

[The prepared statement of Mr. Jacobs follows:]

PREPARED STATEMENT OF TOD JACOBS, SENIOR TELECOMMUNICATIONS ANALYST, SANFORD C. BERNSTEIN & COMPANY

Mr. Chairman...Members of the Committee. Thank you for inviting me here to discuss the proposed merger of MCI WorldCom and Sprint. My name is Tod Jacobs, and I'm senior telecommunications analyst at Sanford C. Bernstein & Company. My job is to forecast the growth and earnings and stock performance of the telecom industry as well as its largest local, long distance and wireless companies. Our firm is somewhat unique among brokerage firms in that we do not engage in investment banking; that is, we don't work for any of the companies we cover as analysts. We therefore avoid conflicts of interest, and have the ability to speak our minds without fear of repercussion. My only clients are institutional investors, and my only mandate is to be right. And for the record, I'm currently favoring long distance companies such as WorldCom, Sprint and AT&T, and have neutral ratings on the baby bells.

I'd like to cover three areas today:

1. Why stories of telecom mergers appear on the cover of the Wall St. Journal more frequently than taxes, health care or Hillary Clinton's newfound love of the Yankees combined
2. Where this merger fits into the changing Internet landscape
3. Where this merger fits into the changing long distance landscape

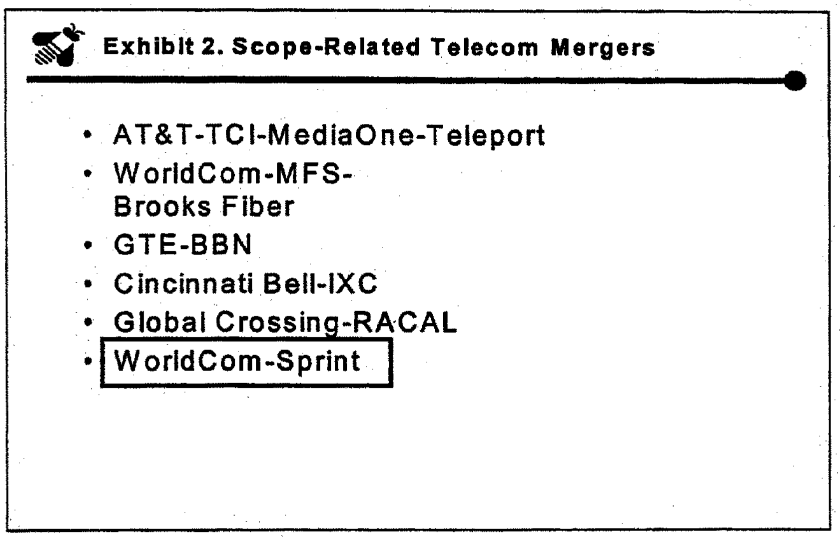
First, On Mergers...

We've attached as an exhibit a piece we released in October on industry consolidation that argues the following thesis: first off, telecom is a high fixed cost business. And like all high fixed cost businesses, the way to compete successfully is to have lots of customers and traffic, so that average cost per unit will fall. Low-cost positions are critical since exploding national and global competition is pushing prices down rapidly, especially in long distance and wireless, if not yet local. So in each category, there's a mad rush to get big fast. Exhibit 1 shows examples of scale-driven mergers.

Exhibit 1. Scale-Related Telecom Mergers

- SBC-Pacific Telesis-Ameritech-SNET
- Bell Atlantic-NYNEX-GTE
- MCI-WorldCom
- Qwest-LCI
- Global Crossing-Frontier
- Voicestream-Omnipoint-Aerial

Second, telecom companies are also attempting to get broad. That is, to assemble the assets that will enable a carrier to offer a full slate of products and services to all the major customer segments. And once anybody can offer multiple products across a single network and a single salesforce, then everybody will have to create the same capability. Why? Because the more products you offer to a given customer, the more you can discount the products and still make money. Thus anyone who remains a single-product company risks seeing their product become someone else's loss leader. And since no single telecom company was born with all the necessary limbs—and growing them takes too long—mergers and acquisitions are the only real solution, as Exhibit 2 shows. The proposed MCI—Sprint merger fits squarely into this category, and is driven by MCI's need for wireless. (See our attached research report from May proposing this very merger as the WorldCorn wireless solution.)



Consumers will delight, because this is how they're going to continue to get lower prices in long distance and wireless and eventually local service.

Second, on the Internet...

For starters, let me tell you what I've already told my clients. Rightly or wrongly, Sprint will almost certainly have to divest itself of its Internet backbone business prior to the merger, just as MCI had to sell its business prior to merging with WorldCom. And I believe the companies know it and are prepared for it. Second, despite complaints to the contrary, I'd point out that Cable & Wireless, which bought MCI's Internet business, is a healthy Internet player despite huge turnover in the very senior management that effected the deal shortly after the deal closed. So clearly it's a viable option, and there will be numerous interested buyers when Sprint internet goes on the block.

As to current competition: as Exhibit 3 shows, we believe the domestic Internet backbone market is about $8 billion. Here, MCI WorldCom leads the pack, with more than $3 billion in revenue. GTE, AT&T, Sprint and Cable & Wireless are numbers 2-5, respectively, so clearly market share has more to do with investment and marketing than with how big your overall company is. Competition has caused MCI WorldCom to lose about 11 % of its share since 1997; by 2003 it will have lost at least a quarter—especially given the entry of the baby bells and numerous new carriers into the space.

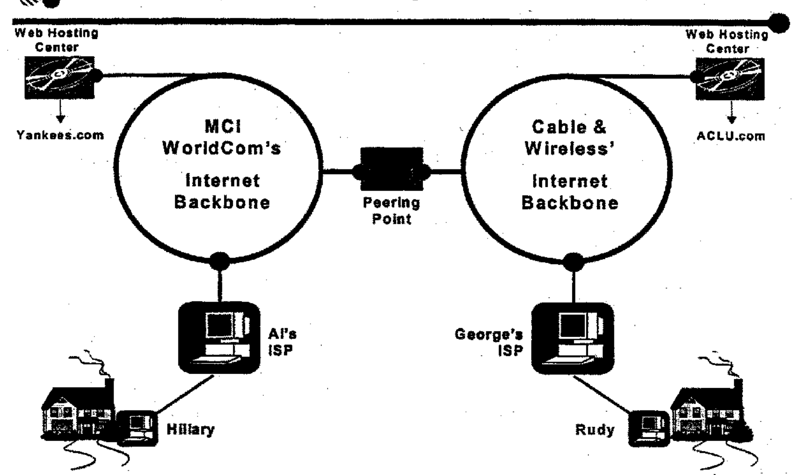
Exhibit 3.
Internet Backbone Revenue and Share Forecast

		Estimates			Avg. Annual Growth	
	1997	1999	2001	2003	97-99E	99E-03E
Revenue ($, Mil.)						
MCI WorldCom	1,151	3,090	5,379	7,051	64%	23%
GTE-BBN	346	1,207	2,375	3,860	87%	34%
AT&T	322	924	2,206	4,120	69%	45%
Sprint	325	728	1,148	1,660	50%	23%
C&W	233	459	869	1,257	40%	29%
All Other	287	1,677	3,326	4,186	142%	26%
Total	2,663	8,085	15,303	22,135	74%	29%
Market Share						
MCI WorldCom	43%	38%	35%	32%		
GTE-BBN	13%	15%	16%	17%		
AT&T	12%	11%	14%	19%		
Sprint	12%	9%	8%	8%		
C&W	9%	6%	6%	6%		
All Other	11%	21%	22%	19%		
Total	100%	100%	100%	100%		

Source: Bernstein Estimates

Point three, we've been asked to discuss so-called peering, which we've portrayed in Exhibit 4. Following the schematic, suppose I'm Hillary, and my Internet service provider is Al's ISP. Al in turn rents access to WorldCom's global Internet backbone. However, 1, Hillary, want to access the ACLU website that is sitting on the Cable & Wireless backbone. Peering allows for unfettered flow of traffic onto each other's backbone networks that makes all Internet service possible. Without peering, WorldCom would be out of the Internet business. And it should be noted that peering arrangements at MCI, which currently number 72, have been rising, not falling.

Exhibit 4. Internet Peering Schematic



Put shortly, the sale of the Sprint business will address all relevant Internet concerns.

Finally, in Long Distance...

The merger would create a company that in consumer long distance is a bit more than half the size of AT&T, as Exhibit 5 shows. While both Sprint and MCI have done a good job competing against AT&T in consumer long distance, the reality is that neither has the size and scale to compete with what is otherwise becoming a two-horse race between AT&T and the baby bells to offer a full bundle of products to consumers. Indeed, either stand-alone company would be highly imprudent to enter that most expensive race without substantial existing market share to justify it. Thus a clear case where the creation of larger scale in consumer long distance will actually motivate further investment and competition. And given the companies' recent complementary investments in a new wireless technology called MMDS as a high-speed data solution, we now expect the development of a third broadband pipe to the home.

Exhibit 5. Share of Long Distance Revenues

		Estimates	
	1995	1999	2003
Total Consumer			
AT&T	71%	59%	42%
MCI WorldCom	20%	26%	22%
Sprint	7%	9%	7%
Memo: MCI WorldCom + Sprint	27%	35%	28%
RBOCs	0%	2%	24%
All Others	2%	4%	5%
Total Business			
AT&T	57%	44%	36%
MCI WorldCom	24%	29%	29%
Sprint	13%	14%	13%
Memo: MCI WorldCom + Sprint	37%	42%	42%
RBOCs	0%	0%	6%
All Others	6%	13%	17%
Total Domestic Voice			
AT&T	65%	52%	39%
MCI WorldCom	22%	27%	25%
Sprint	9%	11%	10%
Memo: MCI WorldCom + Sprint	31%	38%	35%
RBOCs	0%	1%	14%
All Others	4%	9%	11%

Source: Bernstein Estimates

As to business long distance, the short story is that on a combined basis the company will be about the size of AT&T. And when you consider that the amount of new capacity being activated by new carriers over the next 12 months is at nearly 2x greater than the entire capacity of the big three players, it should give you some sense for why business pricing is already low and getting lower and why the company will be very lucky indeed to make our long-term share forecast. To the contrary, if the MCI merger is a guide, the cost savings generated by the merger will in large measure be given back to customers in the form of lower prices.

Thank you for your time.

[Note: Bernstein Research Call, Telecommunications Service, "Presentation to the Senate Judiciary Committee on the MCI World Com-Sprint Merger; Both Rated Outperforming" is maintained in the Committee's files.]

The CHAIRMAN. Mr. Sidgmore, welcome.

STATEMENT OF MR. JOHN SIDGMORE, VICE CHAIRMAN, MCI/WORLDCOM

Mr. SIDGMORE. Thank you, Mr. Chairman. I appreciate the opportunity to share with the committee our vision of how MCI and WorldCom/Sprint will continue to bring increased competition and new technology to the changing world of telecommunications.

I want to say up-front that Bernie Evers, our CEO, sends his regrets. He had a longstanding commitment outside the State today.

The CHAIRMAN. We regret he could not be here, but we fully understand, and we will want to continue our communications with him and with you as we go through this process.

Mr. SIDGMORE. Thank you very much. The question facing us today we think is simple. It is whether or not a competitive long distance provider can survive to fight against the mega-Bell and cable monopolies on a nation-wide basis. We think the answer is yes, and our merger is the pathway to meet that challenge.

Consider the changes we have seen the last couple of years in telecommunications: (1) dramatic decreases in the price of traditional long distance service, (2) explosive growth of wireless telephony, (3) consolidation of the seven Bells into two mega-Bells and two other Bells, (4) their imminent entry into long distance, in traditional long distance, and (5) the growing demand for broadband capacity.

Our conclusion from all of this is that the separate market for long distance that was created by the divestiture of AT&T is eroding, and that successful competitors like ourselves need to be able to fulfill all of the customer's needs for wireless and wire line, and to effectively bring broadband Internet access all the way to a customer's home or business.

In other words, the communications industry of the future requires that our company be able to provide one-stop shopping for economical packages of services and to the maximum extent possible to be able to deliver those services to the customer directly.

The broadband battle is basically about the last mile. It is not about the Internet backbone, which is already open and competitive, despite what some of our competitors have said. In the real world of the last mile there are really two Titans emerging. One is the old Titan reborn through local cable facilities, AT&T, the other is the Bell Operating Companies. The new mega-Bells have maintained their hold over local markets. They are already major wireless providers. They moved swiftly to becoming providers of a full range of communication services.

AT&T, on the other hand, has chosen to buy up the other last mile, which is cable, and is seeking to dominate the provision of high speed Internet access and bundle it with its own wireless local and long distance services.

Faced with these trends, MCI/WorldCom had a tough choice to make. We could have left residential customers to the big Bells and to the big cable company, but that would have been bad for consumers and bad for us. We could have merged with a Bell in order to gain the advantage of controlling the critical last mile into every home, or we could get stronger and even more competitive, and you now know what choice we made.

MCI/WorldCom and Sprint decided to join forces as what we think is the single best hope for a strong and effective alternative to the mega-Bells and emerging AT&T cable monopoly, and we will be able to do -- we know how to do this, and we will be able to do this more efficiently.

Over the next 5 years, the merged company will realize cost savings of almost $10 billion in operating costs, $5 billion in capital expenditures, and these cost savings not only allow the new company to compete aggressively in both business and consumer markets, but will also enable us to aggressively invest in new technologies such as broadband access and next generation wireless. Hopefully, we will have all the piece parts to be a strong competitor to AT&T and the mega-Bells.

Our competitors overseas, who are spurred by mounting competition on their home turf, are making acquisitions and aggressive moves and international investments in key markets around the world. The combined complementary strengths of MCI/WorldCom and Spring we think will make us uniquely equipped to market communications products consumers need and want most, including international, and that together we will have the capital and the proven marketing strength and end-to-end networks to compete effectively against the international incumbents.

Here in the U.S., we can already see hints that this combination is accelerating broadband deployment in competition with the Bells. We, both MCI/WorldCom and Sprint have invested heavily in new broadband technologies over the past year, both DSL and in fixed wireless technology known as MMDS that will allow us to get to customers or even beyond the reach of DSL, often into rural areas, and with these new broadband local assets together we think we are in a strong position to bring consumers, both urban and rural, the broadband access that they need and want.

Now, we know that as we heard this morning that any major merger in this industry is going to be viewed skeptically at this point, but it is important to remember that not all mergers are the same. This is not a merger of monopoly providers. This merger is being done so we can become large enough in scope to compete with the monopoly powers. We think that is a critical difference.

Some regulators have reacted to the news of this potential merger by raising the yellow flag of caution, and we understand that that is their job. We look forward to demonstrating, and we will, that this merger is procompetitive in all markets. The debate we think will benefit everybody, because it will help Government officials and consumers alike to understand how to advance the cause of communications competition in the next century.

Thank you.

[The prepared statement of Mr. Sidgmore follows:]

PREPARED STATEMENT OF JOHN W. SIDGMORE, VICE CHAIRMAN, MCI WORLDCOM

Good morning. I appreciate the opportunity to share with the Committee our vision of how MCI WorldCom and Sprint together will continue to bring competition and innovative technology to the changing world of telecommunications. Mr. Ebbers, our President and CEO would have liked to be here, but had a longstanding commitment in a western state today.

The question facing us is simple: Can competitive long distance providers survive to fight against the mega-Bell and cable monopolies on a nationwide basis? The answer is yes, and our merger is the pathway to meet that challenge.

Consider the changes of the last two years: (1) dramatic decreases in the price of traditional long distance service, (2) explosive growth of wireless telephony that has led to a demand for "all distance" pricing, (3) consolidation of the seven Bells into two mega-Bells and two other Bells, (4) imminent entry into the long distance market by the mega-Bells, and (5) growing demand for broadband capacity from both residential and business customers.

Our conclusion is that the separate market for long distance created by the divestiture of AT&T is eroding; that successful competitors like ourselves need to be able to fulfill all of a customer's needs for wireless and wireline; and that strong competitors must be able to effectively bring broadband Internet access and services all the way to a customer's home or business.

In other words, the telecommunications industry of the future requires that a company be able to provide one-stop shopping for economical packages of services, and to the maximum extent possible, to reach the customer directly.

The broadband battle is basically about the last mile—not about the Internet backbone—which is already open and competitive with thousands of competitors and several major players—despite what some of our competitors say.

In the world of the last mile, two titans are emerging. One is an old titan reborn through local cable facilities—AT&T. The other, ironically, is the offspring of that company—the Bell Operating Companies. The new mega-Bells have maintained their hold over local markets, are already major wireless providers, and have moved swiftly to leverage those assets towards becoming providers of the full range of voice and data services. AT&T, meanwhile, has chosen to buy up the other last-mile—cable—and is seeking to dominate the provision of high-speed Internet access and bundle it with its own wireless, local and long distance services.

Faced with these trends, MCI WorldCom had a tough choice to make. We could have left residential customers to the Bells and big cable, but that would have been bad for those consumers and bad for us. We could have merged with a Bell in order to gain the advantage of controlling the critical last mile of copper wire into every home. Or, we could get stronger, and even more competitive. You now know what choice we made. MCI WorldCom and Sprint decided to join forces as the single best hope for a strong and effective alternative to the mega-Bells and the emerging AT&T cable monopoly.

We know how to do this. Both MCI WorldCom and Sprint were born outside of the Bell system and share an entrepreneurial spirit that has contributed to rapid growth and success. Dedicated to opening markets to competition, both our companies have focused on delivering benefits to customers: lower prices, innovation and higher quality services.

And we'll be able to do all of this more efficiently. Over the next five years, the merged company will realize cost savings of $9.7 billion in operating costs and $5.2 billion in capital expenditures. These cost savings not only allow the new company to compete aggressively in both the business and consumer markets, but also will enable us to aggressively invest in new technologies such as broadband access and next generation wireless. We'll be serving 44 million customers and growing; we'll have local network facilities in more than 2500 markets nationwide; we'll have more than 4 million PCS subscribers and 1.7 million paging and advanced messaging customers. Hopefully, we'll have all the piece parts we need to be a strong competitor to AT&T and the mega-Bells.

Our competitors overseas, spurred by mounting competition on their home turf, are making acquisitions, joint ventures and aggressive international investments in key markets around the world—The U.S. included. The combined, complementary strengths of MCI WorldCom and Sprint will make us uniquely equipped to develop and market the communication products and services consumers need and want most: data, Internet, wireless, local, long distance, and international.

Together, we will have the capital, proven marketing strength and end-to-end, state-of-the-art networks to compete more effectively against the international incumbent carriers. Our self-reliant, facilities-based global strategy positions us well to fully service the rapidly growing global telecom market—a market valued at $1 trillion by the year 2002. Our new company will have the people and the technology required to bring innovative services and the benefits of competition to residential and business consumers across America and around the world.

Here in the United States, we can already see hints that this combination will accelerate broadband deployment in competition with Bell DSL and AT&T cable modems. MCI WorldCom is breaking through in local markets in New York State, already providing over 160,000 residential customers there with two things they've never had before: choice and low cost, flat-rated service. Sprint is going forward with the introduction of its Integrated On-Demand Network (ION) in Kansas City, Seattle, Denver, and eventually, in local markets across the country. MCI WorldCom will be collocated in 1500 central offices for DSL by the end of this year and 2000 by next year. We have both invested heavily in a fixed wireless technology known as MMDS that will allow us to get to customers who are beyond the reach of DSL, usually in predominantly rural areas. With these MMDS and DSL assets, combined with the Sprint ION networks and local facilities; we're in a very strong position to bring consumers—urban and rural—the broadband access that they need and want.

We know that any major merger in our industry will be viewed skeptically at this point—but it's important to remember that not all mergers are the same. This is not a merger of monopoly providers—this merger is being done so we can become large enough in scope to compete with the monopoly powers.

Some regulators have reacted to the news of a MCI WorldCom—Sprint merger by raising a yellow flag of caution. That's their job. We look forward to demonstrating, and we will, that this merger is pro-competitive in all markets. That debate will benefit everybody, because it will help government officials and consumers alike to understand the best ways to advance the cause of telecommunications competition in the next century.

Thank You.

The Chairman: Thank you very much, Mr. Sidgmore.

Mr. Glenchur.

STATEMENT OF PAUL GLENCHUR, DIRECTOR, SCHWAB WASHINGTON RESEARCH GROUP

Mr. GLENCHUR. Thank you, Mr. Chairman, members of the Committee. I thank you for the opportunity to appear before you today. My statement has been submitted for the record, and I would just like to take a brief moment to summarize it.

At the Schwab Washington Research Group, we examine legal, policy and regulatory trends of significance to institutional investors. We cut across several industry sectors, including telecommunications, health care and financial services. And we have looked at the telecom industry's trend toward consolidation. The statements I make today are my own views, however.

I agree with other panelists today as to the reasons for consolidation: greater scale reduces the unit cost of serving customers in what could become an increasingly commoditized business. It also adds capabilities to offer new and better services.

The consolidation trend has emerged against the regulatory backdrop of the Telecom Act of 1996. It articulated a policy objective of creating competition in the local loop and established a process to achieve it, including resale, the leasing of network facilities, and, ultimately, a preference for facilities-based competition. The incentive structure established in the Act promised long distance entry for the Baby Bells if their markets were deemed open to competition under Section 271 of the Act.

The technological and global trends today, however, have expedited the push to consolidate. Cable lines can offer broadband services, digital subscriber lines can offer similar service over phones, and eventually will be adapted to offer voice over DSL service. The need to make huge capital investment in response to this competitive climate should not be surprising. But the rush to consolidate has implications for enforcement policies behind the Telecom Act.

The FCC has pointed to a lack of benchmarking as an example of a possible impairment of its ability to promote competition under the Act. Similarly, the acquisition of long distance backbone networks by the Baby Bells has implications for enforcement of the long distance restrictions of the Act.

The FCC has attempted to sort through situations where the economic and business objectives of mergers collide with the Telecom Act policies of promoting competition in the local loop. Questions have arisen regarding the FCC's time for making decisions regarding license transfers and the standards applied to define the public interest, and the implementation of conditions that may not bear directly on the original public interest concerns that generated public interest scrutiny.

The FCC has announced measures to enhance the predictability of the process and to allow more efficient resolution of license transfer applications. Progress in this regard would prove helpful to investors. When mergers are announced, the investment community understands that regulatory risk is part of the analysis. Primarily, however, they hope to focus on the fundamental, strategic and financial aspects of a given deal. They would welcome greater predictability in the overall process.

Thank you for the opportunity to appear before you. I would be happy to answer any questions you may have.

[The prepared statement of Mr. Glenchur follows:]

PREPARED STATEMENT OF PAUL GLENCHUR, DIRECTOR, SCHWAB WASHINGTON RESEARCH GROUP

Thank you for the opportunity to appear before you this morning. As a director of the Schwab Washington Research Group, I examine regulatory and legal issues affecting the investment decisions of institutional investors. Schwab does not make specific stock recommendations and does not engage in investment banking. Our goal is to provide objective advice to our institutional client base. Obviously, the investment community has a major interest in telecom mergers. They speculate about possible combinations, they react to news of proposed deals, and they monitor the progress of these mergers as they work their way through the regulatory review process.

As a consequence of technological change, deregulation and the emphasis on global market opportunities, the telecommunications industry has experienced significant consolidation, particularly among the top tier players. Seven Regional Bell Operating Companies (RBOCs) have merged into four; significant mergers have also occurred in the long distance and cable industries. Ten years ago, the top seven cable operators served about 25 million subscribers. Today, the top seven multiple system operators (MSOs), including proposed deals, serve about 60 million subscribers, almost 90 percent of all cable subscribers.

We're seeing consolidation in the wireless business as well. Wireless providers have combined to broaden their reach to more subscribers. Consolidation is occurring among wireless providers using the GSM (Global System for Mobile Communications) standard, a development that may encourage integration with a major landline carrier or a possible arrangement with foreign carriers that rely on the GSM standard.

Why is consolidation happening? Telecommunications is a capital-intensive business with very high fixed costs and increasing demands for the integration of new technology. Greater scale allows these costs to be spread over a wide customer base, ultimately reducing the cost of serving each individual customer. With deregulation, providers envision a world in which they offer a package of telecom services over digital, packet-switched networks on a global basis at affordable rates. Carriers are acquiring assets to become end-to-end providers of telecom services, maintaining sufficient control over their networks to enable customer access, ensure timing of service deployments and guarantee network reliability. Greater scale and a more expansive customer reach, in turn, enhance a provider's attractiveness as a potential global partner.

In this environment, we should not be surprised to see rapid consolidation. Looking years ahead, business leaders in the telecom world envision a multi-service broadband environment on a global scale. They're making big bets to prepare themselves for that future. We may reach a point where consolidation will yield a small number of very large industry players.

At the same time, each industry player must pursue its vision in a regulatory climate governed by the Telecommunications Act of 1996. The Act was designed primarily to open the local market to competition. Rather than depend on benevolent compliance with rigid statutory demands, the Act created an incentive structure that would encourage local incumbents to meet the market-opening requirements of the Act. The incentive for local incumbents was entry into the in-region long distance market. The Act offered a legislative judgment that ending the monopoly over local phone service was in the public interest. The Act also recognized that competition was superior to government regulation, including provisions that allow regulatory forbearance where telecom regulation is unnecessary to protect the public interest.

At times, the visions of telecom carriers may collide with the vision of the Telecom Act. This is inevitable if the Telecom Act failed to contemplate the extent of technological change and convergence. Businesses are merging to broaden their reach into new services and to obtain scale in a market where service providers can bring all services over the same pipes. The growth market now and in the future is the data services market. A broader reach means efficiencies that can lower costs for consumers. Yet the FCC must administer an Act that has imposed on the FCC an obligation to ensure competition emerges, particularly in the local service market. Anything that threatens that vision raises public interest concerns as they are expressed through the Telecom Act.

Accordingly, the FCC, in considering license transfers essential to the completion of mergers, examines the impact of a merger on its statutory obligations and its rules. The public interest embodied in the Telecom Act will not necessarily coincide with the business objectives of merging parties. But both sets of objectives are legitimate and, in most cases, the FCC approves license transfers with little fanfare. Where large mergers have sparked public interest concern, the FCC has worked out conditions with the merging entities to allow such deals to move ahead.

Nevertheless, the FCC has been criticized for taking too long to approve license transfers. It has also received criticism for imposing merger conditions that address policy concerns that may not bear directly on the principal competitive concerns that generated initial public interest scrutiny of a particular merger proposal. The FCC has announced efforts to deal with these concerns, and progress in this regard would be useful to the financial community. Investors need as much regulatory certainty as possible as they focus on the strategic and financial merits of particular transactions. Uncertainty about regulatory timing or the potential regulatory consequences attached to a specific deal can muddy the environment in which fundamental analysis takes place. Investors would welcome improvements in the predictability of the overall merger review process.

Thank you again for the opportunity to appear before the Committee.

The CHAIRMAN. Thank you.

Mr. Kimmelman.

STATEMENT OF GENE KIMMELMAN, CO-DIRECTOR, CONSUMERS UNION

Mr. Kimmelman: Thank you, Mr. Chairman, members of the Committee. On behalf of Consumers Union, publisher of Consumer Reports, we once again appreciate the opportunity to testify before you.

Mr. Chairman, I am a little baffled this morning as I listen to the Chairman of the FTC and the Chairman of the FCC. I have great respect for them. They described a world in which there are tremendous concerns, and yet they said, do not do anything. And they described a world in which they said that, of course, if you make a mistake, you have to live with it. And then they told you about the airlines' mistakes. And I think if we go back and review the facts here, we will see that we are beyond just a little concern. And if you apply their own reasoning, we are in a big, big mess.

The CHAIRMAN. In deference to them, Mr. Kimmelman, they did say "very concerned."

Mr. Kimmelman: Very concerned.

The CHAIRMAN. They did not say "a little concerned."

[Laughter.]

Mr. KIMMELMAN. I am sorry, Mr. Chairman. You are absolutely right, very concerned.

I feel like I see policymakers in this Administration staring at a bulldozer, barrelling down the road at them. And they are just caught staring at it. And, frankly, consumers are getting mowed down right and left. Cable rates are up three times inflation, 23 percent since passage of the Telecom Act. Under the leadership of the FCC, we have $4 billion in new fees on consumers' phone bills, a $2 billion net increase for the majority of consumers for long distance service, mostly low-volume customers. We have heard a lot about how wonderful things are but no one in the Clinton Administration mentions these rate increases.

The CHAIRMAN. How much of that is because of the wiring of the schools and libraries to the Internet?

Mr. KIMMELMAN. It is hard to break it apart, Mr. Chairman. But I can tell you that it breaks down to a $1.50 Federal access fee that was not there 2 years ago. From AT&T, they use a flat charge of $1.38 now for universal service, which includes that program and others. One program has a $1.95 fee. One has $4.95. One has a $3 minimum. Another, a $5 minimum. The FCC's numbers show that if you make less than 30 minutes of long distance calls, today you are paying three times, three times as much as 2 years ago. It does not sound like a really robust competitive market.

The Chairman of the FCC said we ideally should have four or more choices for each customer service. I totally agree with him. I do not know how we get from here to there.

What has happened under the 1996 Act, which was supposed to bring us cross-market competition, cable/telephone? The law has, instead, brought us within-sector consolidation. The Bells: two-thirds of the country are controlled by two dominant Bells now.

Cable: AT&T crossed over, appropriately, into the cable sector, but its MediaOne merger is predominantly a cable consolidation transaction now, where the logic applied by the Chairman of the FTC in his review of the Time Warner/Turner transaction would never allow AT&T/MediaOne to go forward. And yet the Chairman of the FCC, who says he wants four or more choices, creates a road map for AT&T, through its horizontal rules, to acquire all these new properties. It makes no sense.

WorldComm with MCI, now with Sprint. We have more and more within-sector consolidation, not cross-market competition.

The theme is today's merger should be justified, as we sort of heard already, by yesterday's merger. And then, of course, tomorrow's merger is justified by the one we allow to go through today. We have mega-merger mania, and it needs to be stopped.

Unfortunately, it is too late at this juncture to get from here to there, the three or four competitors in each product line as the Chairman of the FCC said. Consumers are getting the short end of the stick—higher fees, higher prices—unless you are in the high end of the market, you are a high-volume customer. Then you get choices.

But the Chairman of the FCC says we have promises that are now memorialized through an oversight process, promises of competition tomorrow, promises of entry into the sector that these very companies told you in 1995 they were ready to enter then if you just passed the law. No, it did not happen. They consolidated. Consolidation today, monopolies growing, consumers not getting more choice for local service, seeing new fees on their bills, but promises, promises that tomorrow, some day they will enter.

And there are opportunities for the FCC to enforce. The FCC did the very same thing when it looked at the Bell Atlantic/Nynex merger. It said, we are not sure any more of these mergers is OK. We are going to impose strict conditions for opening up networks, for making competition come. If you go down to the FCC, Mr. Chairman, you will see those conditions have not been met. Maybe they are starting to meet them in New York, one State, but not across the region.

There were penalties that could have been imposed. There were penalties that had been suggested. The FCC has done nothing to enforce those conditions. I do not know how consumers can or should rely on those kind of promises.

Mr. Chairman, I think the 1996 Act had numerous weaknesses, as you know. But, more importantly, with this wave of mergers, there is no way it can bring you the goal that you and Congress hoped for: broad-based competition across all communications markets. I think you have to open it up. I think you have to review this law. You have to step in.

There is one critical question that arises over and over again, implicit in what you heard this morning from the chairmen of the FTC and the FCC. And that is, as companies enter new markets, should they be allowed to increase a monopoly in an existing market, increase their monopoly power to raise prices because they plan, promise, hope to enter a new market, or is that inappropriate? I think the antitrust laws should take care of it, but they have not. I think the FCC should take care of it, but it has not.

And so I leave it for you, Mr. Chairman. Should Congress allow consumers to be ripped off in a core market that has monopoly attributes because that monopoly says, I want to go somewhere else and compete? I do not think that is fair. I hope the reports that you are requesting will address these issues and we will see swift action next year to reopen the law and make it truly consumer friendly.

Thank you.

[The prepared statement of Mr. Kimmelman follows:]

PREPARED STATEMENT OF GENE KIMMELMAN, CO-DIRECTOR, CONSUMERS UNION

Consumers Union[1] is concerned that an avalanche of mergers in the telecommunications and cable industries is threatening to undermine the development of broad-based competition for local telephone, long distance, television and high-speed broadband Internet services. The Clinton Administration—including its antitrust and regulatory enforcers—and the Congress appear frozen in place as today's mergers are justified on the basis of yesterday's mergers, and then used to justify even further consolidation in the future. This merger-mania is already so out of hand that the most popular services most consumers want and need may be available from only one or two players in the market.

The proposed merger between the second and third largest long distance companies, MCI WorldCom and Sprint, illustrate this pattern. In defending its proposed merger MCI WorldCom-Sprint argue that:

> . . . the Bell operating companies have consolidated their local operations through a series of mergers and are moving toward becoming full-service providers of voice, wireless and data services. AT&T, meanwhile, will dominate the provision of broadband services over cable while operating its own nationwide wireless network. MCI WorldCom's merger with Sprint would offer consumers a strong and effective alternative—especially in local markets, where neither company can compete as effectively alone against entrenched monopolies.[2]

In other words, MCI WorldCom-Sprint claim that consumers have nothing to fear from a merger that dramatically concentrates control of the residential long distance market (in apparent violation of the Justice Department's merger guidelines) between AT&T (58% market share) and MCI-Sprint (24% combined market share[3]), and consolidates substantial Internet backbone capacity, because the merger will improve chances for these combined companies to compete in the local telephone and broadband Internet markets. Will this competition materialize? Here is an example of what the merging companies said about the likelihood of anyone being able to compete against the consolidated Bell companies:

> The pending mergers of Bell Atlantic and GTE, and SBC and Ameritech, are over the line and must be blocked. The mergers would create two mega Bells owning and controlling two-thirds of the local telephone access lines in this country. The situation is now critical and Federal policymakers must stop the local telephone industry from transforming itself into basically a Bell West and a Bell East monopoly.
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> The conduct of these companies in the two-and-a-half years since the Telecom Act became law has been to fight competition in both local central office and the courts, which causes us to believe that the purpose of these mergers is to fortify against competition and not to embrace it. The result is that local telephone consumers on an even wider scale will continue to be denied the benefits of choice, price, products, quality and service.[4]

While we agree with Mr. Esrey's assessment of these Bell mergers,[5] and have raised similar concerns about AT&T's even more enormous consolidation of cable companies serving almost 60 percent of cable consumers,[6] it is hard to understand

[1] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about good, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of *Consumer Reports,* its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* with approximately 4.5 million paid circulation, regularly, carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

[2] John Sidgmore, "More Choices for Telecom Consumers," letter to editor, *Washington Post,* October 20, 1999.

[3] Trends in Telephone Service, Federal Communications Commission, September 1999, p. 11.

[4] Statement of William T. Esrey, CEO Sprint, before the Antitrust, Business Rights, and Competition Subcommittee of the U.S. Senate Committee on the Judiciary, September 15, 1998.

[5] Testimony of Gene Kimmelman on behalf of Consumers Union, before the Antitrust, Business Rights, and Competition Subcommittee of the U.S. Senate Committee on the Judiciary, September 15, 1998.

[6] Comments of Consumers Union, Consumer Federation of America, and Media Access Project Before the Federal Communications Commission In the Matter of *Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal Ownership Limits,* MM Docket No. 92-264 and in the Matter of *Implementation of the Cable Tele-*

how a merger of MCI WorldCom with Sprint will undo the harm caused by the mergers that have preceded it. The logic appears to be two wrongs—Bell mergers and AT&T/cable mergers—justify a third wrong!

Just consider where this wave of consolidation leaves American consumers. At the time Congress passed the 1996 Telecommunications Act,[7] there were eight large local telephone monopolies (seven Bell companies and GTE); three large long distance companies and a handful of small-but-growing competitors; a comparable number of large cable monopolies; four satellite ventures, and electric companies and independent wireless firms were beginning to show interest in expanding more broadly into telecommunications. With markets and technology converging, the Telecommunications Act's goal of promoting broad-based competition could have yielded industry combinations (e.g., local phone/long distance/satellite, cable/long distance) that would have offered consumers a dozen national firms, with as many as half of them attempting to offer a full package of telecom and television services in each local market.

Instead, merger-mania is shrinking the competitive field: SBC and Bell Atlantic have each gobbled up two other regional companies to control about two-thirds of local phone lines, and are partnering with mid-size long distance companies and one of the two remaining satellite firms.[8] AT&T purchased TCI and is in the process of merging with MediaOne (which has a substantial stake in Time Warner's cable systems,) giving AT&T an ownership stake in cable wires reaching about 60 percent of consumers, plus arrangements to provide local telephone services through other cable companies.[9] Once this degree of horizontal power is established in these entrenched monopoly markets, it becomes more difficult for the few remaining players to challenge the dominant local phone and cable players, increasing incentives for further consolidation and partnership.

And even these two giant consolidated groups are not well positioned to take each other on in most local markets with a full package of services. For example, AT&T's cable empire has not wired businesses, but can offer consumers a high-speed TV-quality Internet service that local phone companies cannot technically compete against.[10]Unless the price of satellite TV hookups and equipment keep falling and local broadcast channels become readily available from satellite TV providers, the Bell companies will not be able to compete against AT&T and other cable companies. As a result, two giants may not be enough to ensure consumer choice for local phone, cable or TV-quality high-speed Internet services. And the "silent majority" of consumers who are modest users of these services are likely to find themselves on the wrong side of a "digital divide" with rising monthly bills.[11]

Of course the consolidating companies have proposed a host of promises designed to alleviate antitrust and competitive concerns about their mergers. SBC and Bell Atlantic promise to invade other territories, AT&T promises to make its cable systems into local telephone competitors, and now MCI WorldCom-Sprint promises to take a hodge-podge of wireless licenses (MMDS which has significant capacity and line-of-sight limitations)[12] added to limited local wireline infrastructure and become "a third" full service provider into the home. Will these promises be kept? Unfortunately, there is no way of knowing, and probably no way of mandating competitive behaviors that would be sustainable in unknown, future market conditions.

For example, recent efforts by the FCC to "require" pro-competitive behavior have proven woefully inadequate. Detailed performance requirements in the Bell Atlantic/Nynex merger, designed to jump-start local telephone competition, have not been achieved and no enforcement actions have been taken to mandate compliance. As a result, it is hard to believe that the Commission's "threat" of penalties which could be imposed on SBC for failure to compete in new markets will effectively promote competitive behavior.

So the tradeoff is simple: allow enormous within-sector consolidation of local telephone companies, then cable companies, and then long distance companies, in the hope that they will then cross sectors and challenge each other for a full package of telecom, Internet and television services.

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vision Consumer Protection and Competition Act of 1992, Review of the Commission's Cable Attribution Rules, CS Docket No. 98-82, August 17, 1999.

[7] Public Law 104-104

[8] Testimony of Gene Kimmelman op. cit.

[9] Comments of Consumers Union, op. cit.

[10] David Lieberman, "On the Wrong Side of The Wires," *USA Today,* October 11, 1999.

[11] Cooper, Mark and Gene Kimmelman, *The Digital Divide Confronts the Telecommunications Act of 1996: Economic Reality vs. Public Policy,* Consumer Federation of America and Consumers Union, February 1999.

[12] Lieberman, op. cit.

The dangers of allowing entrenched monopolies (local phone and cable) to expand their core markets, or actual competitors (MCI WorldCom and Sprint) to merge are obvious. With cable rates continuing to rise about three-times faster than inflation (23 percent rate increases since passage of the Telecom Act)[13] and local phone rates restrained only by regulation, the fact that little competition is emerging casts significant doubt about recent consolidation in these markets. And long distance competition is not nearly as robust as advertisements for new calling plans would lead you to believe.

A careful analysis of consumers' long distance bills reveals that since passage of the Act, the majority of consumers are paying a net increase of about $2 billion a year on their long distance bills. This results from new monthly fees and line-item charges (e.g., federal access, universal service, monthly minimum charges, monthly service charge) added to the lower per-minute rates.[14] These net price hikes are most alarming because they come during a period when the Federal Communications Commission (FCC) reduced the cost of connecting long distance calls by more than $4 billion a year. Apparently, even as costs decline and usage increases, the long distance companies do not feel competitive pressure to pass along savings to a large segment of the consumer market:

> How did the telecom companies maintain their profit margins? The secret is that many consumers are paying monthly fees of about $4.95 in return for the lowest rates. AT&T officials on Monday said revenue per minute has actually increased in part because of these monthly fees. Also, people are talking more because they think their long-distance costs are lower.
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> One other significant but little noticed factor is that the long-distance companies are now paying less to the regional Bell operating companies to originate and terminate calls.[15]

With inadequate competitive pressure in today's market to hold down long distance prices for the majority of consumers who are modest users of long distance services, it is difficult to understand how a merger of the number two and number three companies will benefit consumers. Speculation that some day, the few remaining Bell companies will open their local networks to competition, in compliance with the 1996 Act, and offer long distance service nationwide, is not enough to justify reduced competition for today's long distance consumers.

CONCLUSION

It is time for policymakers to put an end to the telecommunications and cable consolidation that is threatening the growth of broad-based competition. We offer excerpts from a recent "Essay" by William Safire as a wake-up call to reverse course on telecommunications policy:

> Why are we going from four giants in telecommunications down to two? Because, the voice with the corporate-government smile tells us, that will *help* competition. Now each giant will be able to hedge its bets in cable, phone line and wireless, not knowing which form will win out. The merger-manic mantra: In conglomeration there is strength.
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> That's what they said a long generation ago when business empire-builders boosted their egos by boosting their stock to buy the earnings of unrelated companies. A good manager could manage anything, they said, achieving vast economies of scale. As stockholders discovered to their loss, that turned out to be baloney.
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> Ah, but now, say the biggest-is-best philosophers, we're merging within the field we know best. And if we don't combine quickly, the Europeans and Asians will, stealing world business domination from us. The urgency of "globalization," say today's merger-maniacs, destroys all notions of diverse competition, and only the huge, heavily capitalized multinational can survive.
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> Here are two startling, counterintuitive thoughts: *The fewer companies there are to compete, the less competition there is. And as competition shrinks, prices go*

[13] Bureau of Labor Statistic cable and "all items" consumer price indexes

[14] Comments of Consumer Federation of America, Consumers Union, and The Texas Office of Public Utility Counsel, Before the Federal Communications Commission, In the Matter of *Low-Volume Long-Distance Users,* CC Docket No. 99-249, September 22, 1999.

[15] Rebecca Blumenstein, "MCI's Revenue, Operating Profit Surges," *Wall Street Journal,* October 29, 1999.

up and service declines for the consumer. (Say these reactionary words at the annual World Economic Forum in Davos, and listen to the global wheeler-dealers guffaw.)

Who is supposed to protect business and the consumer from the power of trusts? Republican Teddy Roosevelt believed it to be the Federal Government, but the antitrust division of Janet Reno's Justice Department is so transfixed by its cases against Microsoft and overseas vitamin companies that it has little time to enforce antitrust law in dozens of other combinations that restrain free trade.

Our other great protector of the public interest in diverse sources is supposed to be the F.C.C. When MCI merged with Worldcom last year, the chairman appointed by President Clinton, William Kennard, took no action but direly warned that the industry was "just a merger away from undue concentration." Now that is happening.

Why will the F.C.C. after asking for some minor divestiture, ultimately welcome a two-giant waltz? For the same reason that the broadcasters' lobby was able to steal tens of billions in the public's bandwidth assets over the past few years: Mr. Clinton wants no part of a communication consumer's "bill of rights."

Candidates Bradley, Bush and Gore look shyly away lest trust-luster contributions dry up. . .[16]

The CHAIRMAN. I want to thank you for your usual reserved, non-controversial testimony before this committee, Mr. Kimmelman.

[Laughter.]

The CHAIRMAN. Mr. McTighe.

STATEMENT OF MIKE MCTIGHE, CHIEF EXECUTIVE OFFICER, CABLE & WIRELESS, GLOBAL OPERATIONS

Mr. MCTIGHE. Thank you, Mr. Chairman. I would like to thank you for the opportunity for Cable & Wireless to provide its perspective on mergers in the telecommunications industry.

I would also like to thank you personally, because it is the first time that I have had the opportunity to go through this kind of process, being a British citizen. I have to commend you on the transparency of this process. I wish that we had these kind of processes in other parts of the world.

The CHAIRMAN. Well, we wish we had the question period for the leader of the country that you have in the British Parliament.

[Laughter.]

Mr. MCTIGHE. Touche. Thank you.

Cable & Wireless is here this morning to make three points to you. First, the government must address the threat to competition in the Internet backbone market posed by the merger of MCI/WorldCom and Sprint. To prevent UUNet from dominating the Internet, it is essential that the divestiture of one of the merging company's Internet backbones, preferable UUNet, be a condition of the merger.

Second, we wish to share our recent experience with the divestiture of an integrated Internet business. We have found that, absent extreme good faith on the part of the seller and strict continuing oversight by the responsible regulatory agencies, the competitiveness of the divested business will be compromised.

Third, it follows that unless there are assurances that the merging parties will act in good faith and that the regulators will hold them strictly accountable, such mergers should not be allowed to proceed.

[16] William Safire "Clinton's Consumer Rip-Off," Essay, *New York Times* October 11, 1999.

I would like to go through each point in a little more detail.

Internet backbone competition: The Internet backbone is to the 21st century what the railways were to the 19th. The highway created by the Internet backbone will be the transport mechanism for the new e-commerce model of the future. How is it competitively structured is essential to the development of e-commerce over the next two or three decades.

I would like, if I may, to use an analogy to describe the issue that we feel is confronting us. We all are familiar with the highway system. We have highways that are local, national and regional. The Internet is the same. We have highways on the Internet, each of them owned and operated by a number of different companies. These highways intersect, or, to use our jargon for the industry, they peer with one another. The peering process is essential if we are to enable traffic and data to move from one end of the Internet to the other, from one end of the globe to the other.

However, we have a new phenomenon that is emerging. We have a number of four or five global superhighways being provided by companies like Cable & Wireless, MCI/WorldCom, Sprint, GTE, and AT&T/BT. These global superhighways allow more traffic to flow more quickly and with less accidents, if I can continue the analogy. It is essential for the local highways to be able to intersect with these superhighways if they are to truly have access to the content and to the consumers that exist around the globe for this new e-commerce phenomenon.

In addition, these superhighways have on-ramps and off-ramps. And basically, today we have people on the on-ramps, like Yahoo, like Barnes&Noble.com and these other e-commerce companies, and we also have people on the off-ramp, the Internet service providers around the world that we all support. Access to these highways is critical.

Today's situation is relatively straightforward. Largely, these superhighways, these peering arrangements, are toll free, if I can use that analogy. And using the off-ramps and the on-ramps is actually very, very competitive today. The problem that we have is that the combination of MCI/WorldCom and Sprint leads to the creation of a dominant Internet backbone supplier. Many analysts predict that they would have somewhere in excess of 60 percent of the Internet backbone globally.

It is very possible that this dominant position could be used to discriminate in terms of cost and service levels against the other highway providers and in favor of the new combined entity. And therefore, the question for us, in terms of Internet backbone capacity, is a very simple one: Do we want the essentially toll-free environment of a competitive market or the prospect of a tollbooth environment of a de facto monopoly?

And now I would like to touch on the Cable & Wireless experience. What we are confronting today with the MCI/WorldCom-Sprint proposed merger is deja vu. One year ago today we saw exactly the same discussion over MCI and WorldCom. At that time, the European Union, endorsed by the Department of Justice here in the United States, required MCI to divest its highly integrated Internet business.

Cable & Wireless purchased the MCI Internet business, relying on the binding undertakings that MCI had made to the European Union; i.e., that MCI would deliver an operating entity. However, if I can just summarize our experience, the take-away for us is very simple. The bottom line is that successful divestiture of an integrated business requires the seller to disrupt its own business to support the creation of a new competitor.

In this situation, MCI/WorldCom failed to carry this out. And, frankly, I can illustrate that with a number of points that we might want to get to in questions.

That leads me, frankly, to my final point, of enforcement. Cable & Wireless fundamentally believes that it is possible to divest an integrated business. But it is only possible with a high level of oversight and compliance monitoring. If the various regulatory authorities around the world feel that such oversight and such monitoring is inappropriate or they just do not want to do it, then let us not kid ourselves—these kinds of forced divestments are not going to work. So let us not do them.

In summary, Mr. Chairman, the Internet backbone is a key component of tomorrow's global business model. We believe very strongly in the powers of the market. This is not, for us, a question of regulation or deregulation. This is about creating the competitive landscape on which we can allow the market to have full rein. It is, for us, about having a toll-free environment or a tollbooth.

I would like to thank you for this opportunity to provide you with our perspective, and I would be happy to address any questions you may have.

[The prepared statement of Mr. McTighe follows:]

PREPARED STATEMENT OF MIKE MCTIGHE, CHIEF EXECUTIVE OFFICER, CABLE & WIRELESS, GLOBAL OPERATIONS

Mr. Chairman, thank you for this opportunity to provide the perspective of Cable and Wireless on mergers in the telecommunications industry. I joined Cable & Wireless in the spring of 1999 as Chief Executive Officer of Cable & Wireless Global Operations. Cable & Wireless is an international leader in integrated communications, operating in 70 countries worldwide. With its global reach and ownership of one of the largest and fastest Internet networks worldwide, Cable & Wireless is a premier provider of domestic and international data and Internet solutions to business customers. Cable & Wireless headquarters its North American operations in the Tyson's Corner high-tech corridor in Virginia.

I have nearly 20 years of experience in the high technology industry. My career in international telecommunications has encompassed senior positions in Europe and the USA, and has included roles in sales, marketing and operations for General Electric, Motorola, Phillips Electronics and Siemans AG.

Cable & Wireless is here this morning to discuss several public policy issues surrounding mergers in the telecommunications industry. The company offers a unique perspective on this topic, as we are a recent purchaser of assets required to be divested in a merger that, at its inception, was the largest telecommunications merger of all time involving approximately $40 billion. The divestiture of the MCI Internet backbone assets acquired by Cable & Wireless was the largest divestiture of an integrated business in U.S merger history. This experience provides Cable & Wireless with highly relevant expertise in three areas: competition issues; the need for enforcement of conditions placed on mergers; and the efficacy of divestitures of integrated businesses.

I'd like to start my testimony with a story to illustrate our concerns in these areas before speaking more in depth of its relevance to your policy-making goals.

In July 1998, as a condition of their proposed merger, MCI and WorldCom made commitments to the European Commission and the U.S. Department of Justice to divest MCI's Internet backbone business. Internet backbones are the largest national or global networks that carry Internet traffic between smaller networks and consumers.

In its investigation of the merger of MCI and WorldCom, the European Commission had found that MCI and WorldCom competed in a global market for top level networks—those that can reach anywhere on the Internet through their own peering arrangements, without having to pay anyone for transit. The Commission noted that WorldCom's Internet subsidiary, UUNet, already had "very substantial size by comparison with its competitors" and was, by itself, "close to achieving dominance." Thus, "[t]he combination of the Internet backbone networks of WorldCom and MCI would create a network of such absolute and relative size that the combined entity could behave to an appreciable extent independently of its competitors and customers." Such an entity could disadvantage its competitors by "oblig[ing] them to pay for access to its network" or "leverage its position to gain a dominant position downstream." Furthermore, "[b]ecause of the specific features of network competition and the existence of network externalities which make it valuable for customers to have access to the largest network, MCI WorldCom's position can hardly be challenged once it has obtained a dominant position."

Based on these findings, the Commission concluded that the merger of MCI and WorldCom, if unaltered, "would lead to the creation of a dominant position in the market for the provision of top level or universal Internet connectivity." In order to overcome these competition concerns, MCI and WorldCom entered into "Undertakings" that required MCI to divest its Internet business "as an operating entity." The Commission approved the merger of MCI and WorldCom "subject to the condition of *full compliance* with the Undertakings. . . ."

The U.S. Department of Justice specifically relied on the commitments reflected in the Undertakings when it cleared the merger a week later. The Justice Department had assisted the European Commission "in evaluating and implementing the divestiture proposal, which had been submitted to both the Commission and the Department of Justice." In announcing the merger clearance, Assistant Attorney General Joel Klein highlighted the benefits of the divestiture:

> This divestiture benefits anyone who relies on the Internet because it preserves competition among major Internet service providers. Consumers will benefit with lower prices, higher quality, and greater innovation in this dynamic and emerging industry.

Thus, in order to obtain approval of their merger, MCI and WorldCom agreed to detailed conditions embodied in the Undertakings. These conditions required MCI WorldCom, among other things:

to transfer "all necessary employees to support the iMCI Business being transferred";

to transfer "all MCI's contracts with wholesale and retail customers for the provision of Internet access";

to "make available all other necessary support arrangements to fulfill existing contractual obligations of the iMCI Business—and to accommodate growth of that business";

to provide support services "at favourable rates"; and

to refrain from soliciting or contracting to provide dedicated Internet access services to the former MCI Internet customers for specified periods.

One year after the divestiture, we are sorry to report that MCI WorldCom has not honored its commitments to the European Commission and the Justice Department. MCI WorldCom's material violations of the Undertakings include:

Failure to transfer all personnel necessary for the operation of the former MCI Internet business at prior performance and service level standards. For example, MCI transferred only 43 sales and sales support representatives to support more than 3,300 business customers.

Failure to provide contract documentation and other key customer information to Cable & Wireless at closing. For example, MCI WorldCom withheld 2,000 written customer contracts—half of the contracts provided to date—until at least seven months after closing.

Failure to provide necessary services, systems and support, such as competent customer billing services.

Failure to provide services at favorable rates.

Failure to conduct business in the ordinary course, including the reasonable retention and solicitation of customers, prior to closing.

Solicitation of transferred customers, in violation of the non-compete provisions of the Undertakings.

MCI WorldCom's material breaches of the Undertakings threaten to impair Cable & Wireless's competitiveness. The lack of essential personnel, information and services have compromised Cable & Wireless's ability to retain and expand business with existing customers or to secure new customers. Thus, despite the 50 to 100 percent growth rates experienced by MCI prior to the divestiture, and the continued rapid growth of the industry as a whole, Cable & Wireless's Internet revenues have not kept pace. Unless this trend is reversed, Cable & Wireless will, by definition, lose market share and will eventually be unable to provide effective competition in the market. Cable & Wireless has spent a year recruiting and training employees and has announced a nearly $700 million investment into the network to make up for the setbacks caused by MCI WorldCom's refusal to honor their commitments.

We believe that Cable & Wireless's experience as the purchaser of the MCI Internet business should weigh heavily in any antitrust review of the MCI WorldCom/ Sprint acquisition, and should be instructive for other telecommunications mergers.

COMPETITION ISSUES

If our collective goal is competition in the marketplace, we must adequately assess the threat to competition.

MCI WorldCom now proposes to acquire Sprint, another major competitor in the market for top level Internet connectivity. MCI WorldCom's UUNet division is the largest Internet backbone, estimated to carry 50% of the world's traffic. The European Commission found last year that UUNet was nearly dominant by itself, and it has only grown in marketshare since. The European Commission also identified Sprint among the "big four" backbone providers, along with WorldCom, MCI (now Cable & Wireless) and GTE. Sprint's share of traffic in 1998 was estimated at 18 percent, second only to UUNet. UUNet continues to grow at dramatic rates; its executives have been repeatedly quoted as stating that demand for capacity is growing at 1,000 percent per year.

Further, the Internet backbone market is highly susceptible to domination by a large network. Because the nature of network competition makes it advantageous for customers to have access to the largest network, having a large network is a high barrier to entry by competitors. As the European Commission concluded last year, a dominant network could impose costs on or reduce the quality of service to competing backbone networks. A dominant backbone provider could leverage its position to gain a dominant position in downstream market—for example, retail Internet Service Providers.

MCI WorldCom's acquisition of Sprint would constitute the same serious threat to competition in the Internet backbone as MCI's merger with WorldCom just one year ago. Further, a commitment to divest UUNet or Sprint's Internet assets may not adequately protect competition and consumers if our experience with MCI WorldCom and its agreement to divest MCI's Internet backbone to Cable & Wireless is any indication. Absent clear indications that MCI WorldCom would honor such commitments and that the regulators would enforce the agreement, Congress should be concerned about what a combined MCI WorldCom-Sprint would mean for competition and the flow of Internet traffic.

ENFORCEMENT ISSUES

Efforts by the European Commission and Justice Department to ensure competition in telecommunications markets will not be effective if left unenforced. However, little has been done to ensure the "Undertakings" imposed by these agencies are adhered to. If the European Commission and Justice Department do not enforce MCI WorldCom's commitment to divest the MCI Internet business fully, it may conclude that it can breach any commitment made to U.S. or European officials to divest the UUNet or Sprint Internet business without adverse consequences. Lack of enforcement may also compromise the effectiveness of divestiture as a remedy for other mergers in the telecommunications industry and elsewhere.

Failure to enforce MCI WorldCom's commitment to fully divest the MCI Internet business raises additional questions as to the effectiveness of cooperation with the European Commission. The European Commission took the lead in investigating the merger of MCI and WorldCom, entering into the "Undertakings," which laid out the commitment to divest. The Justice Department cleared the merger one week after the European Commission, expressly relying on those divestiture commitments. The Justice Department should not defer to the European Commission and rely on merging parties' commitments to the European Commission absent assurances that the European Commission will demand full compliance with those commitments and/or the Justice Department can and will enforce such commitments independently, if necessary to protect the interests of U.S. consumers.

EFFICACY OF DIVESTITURE OF INTEGRATED BUSINESSES

Another question is whether divestiture in a market containing highly integrated services is doomed to failure. Cable & Wireless believes these divestitures *can* work, but the complexity of the situation should not be taken lightly. At a minimum, they call for a level of involvement and enforcement by regulators that other mergers may not require.

Divestiture of a fully integrated business is much more complicated than simply selling off a separate operating division or wholly-owned subsidiary. MCI's Internet business was highly integrated with its other telecommunications services. The MCI Internet assets were not organized into a separate, free standing division, as is the case with UUNet, for example. Personnel have knowledge about and responsibility for both Internet and non-Internet businesses. The same engineers, sales force, billing mechanism and databases all serve the same customers for a variety of products such as long-distance, wireless, pre-paid calling cards, messaging services and Internet backbone products. Any costs or disruptions resulting from the transfer of these multiple purpose assets must be borne by the seller, which, after all, receives the benefit of merger clearance. Moreover, the seller will likely need to provide additional services to purchaser while it makes a transition to its own systems.

However, this allows the divesting party to hold some very important keys to interfacing with customers. In fact, it gives the divesting party an incentive to degrade service while providing it in the name of another company. Any problems are likely to cause former customers to migrate back to the original service provider.

The European Commission, recognizing this complexity, first suggested that WorldCom should divest the more separate UUNet asset as a way to alleviate some of these concerns. The parties refused and offered MCI's highly integrated Internet business instead. Cable & Wireless's experience demonstrates that it is difficult to adequately divest such integrated businesses. With the knowledge gained from that experience, we suggest that, in the context of the MCI WorldCom/Sprint merger, it is more appropriate to require the divestiture of UUNET rather than again try to effectively quantify the assets of Sprint's integrated Internet backbone business.

CONCLUSION

Policy makers must inquire, if the right choices for divestiture are not made, the conditions are not fully enforced, and companies refuse to live up to their commitments, can we hope to maintain competitive markets?

The Internet is a revolutionary technology that offers enormous benefits to consumers in the next century. It has given rise to countless new information, education and entertainment products while reducing the cost of communication on a global basis. Electronic commerce on the Internet has the potential to lower transaction costs, to give consumers access to better information about available products and services, and to provide producers with more information about the markets they serve. By facilitating the exchange of technical, cultural and commercial knowledge, the Internet encourages product innovation and efficiency in product design, manufacture and distribution. Competition among the backbone networks at the heart of the Internet must be preserved to ensure that the full potential of this critically important technology is realized.

Companies with dominance in the market should not be able to simply hobble their primary competition by agreeing to conditions they never intend to fulfill or by maintaining control over critical elements of service delivery due to integration which allow them to degrade service while acting in a competitor's name. This thwarts the goal of competition. Policy makers must not allow such bad actors to succeed with this strategy in the marketplace.

Cable & Wireless remains committed to being a major competitive force in the Internet market. We have made substantial investments to expand our network and improve our service to customers. In addition, we have pursued every available option to compel or persuade MCI WorldCom to meet its obligations and, thereby, to ensure Cable & Wireless's future competitiveness.

The recent experience of Cable & Wireless, in perhaps the most critical of the marketplaces you are examining today, brings to the fore issues of serious import to your review of merger policy. Congress and regulators must ensure competition. The tools they use to accomplish that goal must include adequate enforcement mechanisms. They also must fully address the complexities of integrated markets. If more scrutiny can not be given, U.S. consumers must be protected by the refusal to allow such mergers.

Again, thank you for this opportunity to provide Cable & Wireless's perspective on telecommunications mergers. I would be happy to address any questions from members of the Committee.

Reuters
Cable & Wireless Takes MCI Complaint To Congress
November 8, 1999
4:04 PM ET

WASHINGTON—British telecommunications and Internet carrier Cable & Wireless Plc complained to U.S. lawmakers Monday that MCI WorldCom Inc. <<*http://quicken.excite.com/investments/quotes/?symbol=WCOM*>> had sabotaged its $1.75 billion Internet asset purchase.

MCI WorldCom officials responded by distributing a Cable & Wireless presentation to securities analysts that touted the British firm's Internet presence and 30 percent share of the U.S. Internet backbone market.

Cable & Wireless last year bought the former MCI's Internet business after antitrust regulators ordered the sale as part of MCI's merger with WorldCom. In March, Cable & Wireless filed suit against MCI WorldCom alleging that MCI had not delivered what was promised, including key personnel and customer information.

Mike McTighe, Cable & Wireless chief executive officer of global operations, told a hearing of the Senate Commerce Committee that MCI WorldCom"s proposed merger with Sprint Corp. <<*http//quicken.excite.com/investments/quotes/?symbol=FON*>> could create a "deja vu" situation if regulators again required an Internet asset sale. He urged stronger enforcement and monitoring by regulators.

"These divestitures can work, but the complexity of the situation should not be taken lightly," McTighe said. "At a minimum, they call for a level of involvement and enforcement by regulators that other mergers may not require."

Should regulators be unwilling to remain involved after a sale, "these forced divestments are not going to work, so let's not do them," he added.

MCI WorldCom vice chairman John Sidgmore said he could not directly respond to some of McTighe's charges, given the ongoing litigation.

But, he said, Cable & Wireless told "a very very different story when they're telling their story to analysts." "We think it was one of the more successful divestitures," Sidgmore added.

At a hearing last week, MCI WorldCom President Bernard Ebbers told the Senate Judiciary Committee that the Cable & Wireless charges were "not sustainable by the facts."

McTighe said some of the problems Cable & Wireless faced were due to the fact that MCI's Internet business was highly integrated with its other businesses.

If MCI WorldCom and Sprint were allowed to merge and an Internet divestiture was required, McTighe said the parties should be forced to spin off MCI WorldCom's UUNet Internet unit.

Bloomberg News
FCC, FTC Warn U.S. Congress of Concerns About Phone Mergers
November 8, 1999

Washington—Federal regulators and antitrust authorities warned a Senate panel that recent multibillion-dollar telecommunications mergers are cause for concern, and that Congress should watch the industry closely.

"I think Congress should be very concerned" by the "pace and scope of consolidation in the telecommunications marketplace," U.S. Federal Communications Commission Chairman William Kennard told the Senate Commerce Committee, which oversees telecommunications policy.

Congress rewrote the nation's telecommunications laws in 1996, setting the stage for local, long-distance and cable companies to compete in each other's markets. While some competition has occurred, the industry also has seen multibillion dollar mergers among companies in the same line of business, reducing the number of competitors.

For instance, the second- and third-largest long-distance companies combined last year to form MCI WorldCom Inc., and that company plans to buy No. 3 long-distance company Sprint Corp. for $128 billion—the largest corporate takeover in history.

The seven regional phone companies formed in the 1984 break-up of American Telephone & Telegraph Co. have become four through mergers since the 1996 Telecommunications Act. In October, SBC Communications Inc. completed its $80.6 billion purchase of Ameritech Corp., creating the largest U.S. local phone company with control of one-third of all U.S. phone lines.

"One must ask the question where it is all going to end, and I think Congress should be very concerned," Federal Trade Commission Chairman Robert Pitofsky said.

MCI WorldCom share fell $\frac{3}{16}$ to 86 $\frac{3}{8}$ and Sprint fell $\frac{5}{16}$ to 72 $\frac{13}{16}$ in late trading. SBC shares fell $\frac{3}{16}$ to 51 $\frac{1}{6}$, and AT&T shares fell $\frac{3}{8}$ to 46 $\frac{5}{8}$.

Mergers Defended
The FTC and the Justice Department look at possible antitrust violations while the FCC reviews whether a communications license transfer is in the "public interest." Senate Commerce Committee Chairman John McCain, who is seeking the Republican presidential nomination, said his committee will hold hearings next year to examine what action, if any, Congress should take.
"While merging industries enjoy the cost-saving benefits of increased efficiency, the average consumer doesn't always reap the benefits of lower prices and better services," McCain said.
MCI WorldCom Vice Chairman John Sidgmore defended his company's proposed purchase of Sprint, saying it'll allow it to better compete as customers demand one-stop-shopping for all of their telecommunications services—local and long-distance phone, wireless phone, and Internet.

Divestiture Urged
Cable & Wireless PLC's chief executive of global operations, Mike McTighe, told the panel that it should be concerned about the MCI WorldCom-Sprint transaction because the new company will dominate the Internet backbone market. When WorldCom purchased MCI last year, it was required by U.S. and European antitrust officials to sell MCI's Internet backbone business. Cable & Wireless purchased it for $1 .75 billion, and in March the company sued MCI WorldCom, accusing it of failing to transfer its Internet customer base and not living up to the agreement.
McTighe said the company should be forced to divest MCI WorldCom's UUNet Technologies unit as a requirement for winning approval of the Sprint purchase.
"We believe that Cable & Wireless's experience as the purchaser of the MCI Internet business should weigh heavily in any antitrust review of the MCI WorldCom Sprint acquisition," said McTighe.

Sprint takeover faces opposition
By Gareth Vaughan,<<*mailto:qvaughan@marketwatch.com*>>
CBS MarketWatch Last Update: 2:21 PM ET Nov 8,1999 NewsWatch
</news/current/newswatch.htx?source=blq/yhoo>

The British telecom group Cable & Wireless PLC outlined its opposition Monday to MCI WorldCom Inc.'s planned $129 billion acquisition of Sprint Corp., saying the merged group would control the flow of worldwide Internet traffic. Mike McTighe, C&W's chief of global operations, told a U.S. Senate panel that Congress and regulators should be concerned about how the proposed MCI WorldCom merger would create a dominant player in the Internet backbone market. If the deal goes ahead it would harm consumer and business customers seeking to maintain low Internet access prices and innovative services from the Net backbone industry, C&W's McTighe said. "Congress should be concerned about what a combined MCI WorldCom-Sprint would mean for competition and the flow of Internet traffic." Cable & Wireless is a competitor of the two U.S. groups.

Reuters
C&W urges UUnet sale in WorldCom/Sprint deal
Monday November 8, 12:55 pm Eastern Time

LONDON, Nov 8—British based telecoms group Cable and Wireless PLC on Monday urged a powerful U.S. congressional committee to help curb the muscle of MCI WorldCom (NasdaqNM:WCOM *<<http://finance.yahoo.com/q?s=wcom&d=t>>—news </n/w/wcom.html>) by making the U.S. carrier sell its prized UUNet Internet arm.*
C&W's Chief Executive Officer of Global Operations Mike McTighe told America's Senate Commerce Committee that MCI WorldCom's record $115 billion bid for peer Sprint Corp (NYSE:FON <<http://finance.yahoo.com/q?s=fon&d=t>> —news </n/f/fon.html>) would otherwise create a dominant force that controlled the flow of Internet traffic around the globe.
"The proposed merger would harm consumer and business customers seeking to maintain low Internet access prices and innovative services from the Internet backbone industry, and create a company that would control the flow of Internet traffic around the world," McTighe said.
"We suggest that...it is more appropriate to require the divestiture of UUNet rather than again try to effectively quantify the assets of Sprint's integrated Internet backbone business," he added.

C&W thought it had bought itself a leading position in servicing the Internet in May 1998 after it snapped up MCI's Internet backbone business, which pipes vast amounts of data through a fibre optic network, for $625 million.

But the UK-based group sued MCI last March for not fulfilling certain terms of the deal, accusing the U.S. group of failing to effectively transfer MCI's Internet customer base, of impeding C&W's ability to operate the business and of targeting former MCI customers for marketing purposes.

WorldCom was forced by regulators to sell MCI's Internet business, which is second in size only to UUNet—which is estimated to carry 50 percent of the world's Internet traffic—in return for regulatory approval for its MCI acquisition.

Sen. McCain: Telecom Mergers Often Bad For Consumers
Dow Jones News Service
November 8, 1999

WASHINGTON—Mergers in the telecommunications industry were once again the topic of a hearing on Capitol Hill, the second time in two weeks.

This time, the hearing was chaired by Sen. John McCain, R-Ariz., chairman of the Senate Commerce Committee and contender for the GOP presidential nomination. Most Americans, McCain asserted "tend to view increased concentration of control as a negative." Unfortunately for the average consumer, he added, "this is often the case."

But worries about concentration "sometimes prompt the wrong responses," said McCain. Government "tends to rely on outmoded ownership restrictions" to solve the problem. McCain has questioned the Federal Communications Commission's rules keeping local telephone companies out of high-speed data markets until they open local markets to competition. He has also introduced legislation further lifting limits on broadcast station ownership. McCain said he plans to hold a series of hearings on the issue, and has ordered a congressional study of the merger wave from a consumer point of view.

According to the Federal Trade Commission, the number of communications mergers has increased by 50% since 1995 to a value of over $266 billion. That compares to a threefold increase in corporate mergers overall McCain questioned whether the proposed merger between AT&T Corp. (T) and cable provider MediaOne Group Inc. (UMG) would raise red flags from antitrust officials, given AT&T's level of ownership in the cable industry. He noted that the FTC imposed strict conditions on Time Warner Inc.'s (TWX) purchase of Turner Broadcasting, a deal that also involved cable, so that Time Warner wouldn't exert undue impact over programming.

AT&T's market share "is certainly a concern," said FTC Chairman Robert Pitofsky. He noted that the Justice Department and not the FTC will be reviewing the AT&T merger. McCain also asked about AT&T's plans to provide high-speed cable Internet solely through *Excite@Home* (ATHM), a company in which AT&T has a stake. Pitofsky said that while he hasn't examined the deal, it would bear scrutiny if found to impede competition.

The panel continued a debate begun last week between MCI WorldCom Inc. (WCOM) and Cable & Wireless Communications PLC (CWZ), sparked by MCI WorldCom's offer to buy Sprint Corp. (FON). Cable & Wireless purchased Internet "backbone" assets that MCI was ordered to sell last year when it merged with WorldCom. But one year after the divestiture, MCI WorldCom "has not honored its commitments" to transfer a working asset to Cable & Wireless, said company executive Mike McTighe. That should be a warning to Congress and regulators if MCI WorldCom and Sprint are forced to get rid of some Internet assets, McTighe said. MCI WorldCom's vice chairman, John Sidgemore, said Cable & Wireless' performance shows that the divestiture was successful.

C&W claims Sprint deal will stifle competition
NEWS DIGEST:
By ALAN CANE
11/09/1999

Cable and Wireless, the UK-based telecommunications group, yesterday told a senate committee the Dollars 130bn merger of MCI WorldCom and Sprint would create a dominant internet force that could inhibit competition for private and business customers. The merger has already attracted criticism from the Republican Senator, Mike DeWine, chairman of the Senate anti-trust committee.

Mike McTighe, C&W's head of global operations, told a senate commerce committee hearing on consolidation in the telecoms business: "MCI WorldCom's acquisition of

Sprint would constitute the same serious threat to competition in the internet backbone as MCI's merger with WorldCom just one year ago," he said, proposing that UUNet Technologies should be divested. Wholly owned by MCI WorldCom, UUNet is a large provider of internet services to the business sector. According to C&W, UUNet owns the world's largest internet backbone (principal transmission channel), carrying about 50 percent of the world's internet traffic.

C&W benefitted from the merger of MCI and WorldCom, buying MCI's internet assets for Dollars 1.75bn after regulators demanded their disposal as the price for approval of the deal.

Telecommunications Reports (TR Daily)
11/8/99

McCain TO SEEK GAO STUDY, MORE HEARINGS ON MERGERS

Concerned about further telecom industry consolidation, Senate Commerce, Science, and Transportation Committee Chairman John McCain (R., Ariz.) intends to ask the General Accounting Office to conduct a study examining the impact of telecom mergers "from a consumer's standpoint." Sen. McCain also announced during a hearing this morning on telecom mergers that he intends to increase his committee's oversight of the issue by holding more telecom merger hearings next year.

Sen. McCain said lawmakers are worried future mergers involving Bell companies could result in formation of a "Bell East and Bell West." And he wondered whether AT&T Corp.'s aggressive move into the cable TV industry will reposition that company as "Ma Cable, dominating the markets for voice, video, and high-speed data services."

Sen. Ron Wyden (D., Ore.) described this morning's hearing as the "beginning of an effort. . .to examine thoroughly the impact of all mergers, not just" telecom-related transactions. Sen. Wyden said his "gut feeling" is that a "fair number of these mergers do not harm the interest of consumers." But he noted that "of those that represent a problem, a disproportionate number are in the telecom sector." Sen. Wyden suggested that additional mergers among communications industry players might become "First Amendment concerns."

FCC Chairman William E. Kennard reprised his role as defender of the Commission's public interest test for reviewing proposed license transfers. He described the FCC as "the last defense for consumers" and told the Senate panel that "if the Commission did not review mergers under the public interest standard, it would be possible under traditional antitrust analysis for all the regional Bells and GTE Corp. to merge into a single, national local phone company."

Federal Trade Commission Chairman Robert Pitofsky reported that the number of communications transactions seeking government approval have increased by about 50% since 1995, with the total dollar value increasing eightfold to $266 billion. Mr. Pitofsky said he was limited in his remarks about telecom consolidation because most of the antitrust work in that area is being carried out by the Department of Justice.

"Although the FTC has been active in cable [TV] and entertainment industries, most of the mergers involving telephones and commercial satellite services have been analyzed by the DOJ pursuant to the two agencies' clearance agreement, which divides matters on the basis of recent expertise," Mr. Pitofsky explained. And the FTC is barred by section 11 of the Clayton Act and section 5 of the FTC Act from exercising jurisdiction over common carriers, he noted.

Messrs. Pitofsky and Kennard agreed that Congress should be "very concerned" about the recent outbreak of telecom megamergers but advised against passing federal legislation to address that concern.

Their stance drew criticism from Consumers Union co-director Gene Kimmelman. "I'm a little baffled," Mr. Kimmelman said after the regulators' testimony. "They describe a world of concern, and then they say don't do anything about it."

An industry witness, Mike McTighe, chief executive officer of Cable & Wireless PLC's global operations, suggested that antitrust officials reviewing the proposed merger of MCI WorldCom, Inc., and Sprint Corp. require MCI WorldCom to divest its Internet backbone unit. "It is more appropriate to require the divestiture of UUNet, rather than again try to effectively quantify the assets of Sprint's integrated Internet backbone business," he said.

C&W acquired MCI Communications Corp.'s Internet backbone business in a divestiture sale framed to satisfy regulators' concerns about combining MCI's asset with WorldCom, Inc.'s UUNet subsidiary.

From Wired News, available online at:
http://www.wired.com/news/print/0,1294,32407.00. html
C&W Brings MCI Beef to US
Reuters

12:35 p.m. 8 Nov 1999 PST

WASHINGTON—Cable & Wireless PLC, the British telecommunications and Internet carrier, complained to US lawmakers Monday that MCI WorldCom Inc. had sabotaged its US$1.75 billion Internet asset purchase.
MCI WorldCom officials responded by distributing a Cable & Wireless presentation to securities analysts that touted the British firm's Internet presence and 30 percent share of the US Internet backbone market.
Last year, Cable & Wireless bought the former MCI's Internet business after antitrust regulators ordered the sale as part of MCI's merger with WorldCom. In March, Cable & Wireless filed suit against MCI WorldCam, alleging that MCI had not delivered what was promised, including key personnel and customer information.
Mike McTighe, Cable & Wireless chief executive officer of global operations, told a hearing of the Senate Commerce Committee that MCI WorldCom's proposed merger with Sprint Corp. could create a "deja vu" situation if regulators again required an Internet asset sale. He urged stronger enforcement and monitoring by regulators.
"These divestitures can work, but the complexity of the situation should not be taken lightly," McTighe said "At a minimum, they call for a level of involvement and enforcement by regulators that other mergers may not require."
Should regulators be unwilling to remain involved after a sale, "these forced divestments are not going to work, so let's not do them," he added.
MCI WorldCom vice chairman John Sidgmore said he could not directly respond to some of McTighe's charges, given the ongoing litigation.
But, he said, Cable & Wireless told "a very, very different story when they're telling their story to analysts."
"We think it was one of the more successful divestitures" Sidgmore added.
At a hearing last week, MCI WorldCom President Bernard Ebbers told the Senate Judiciary Committee that the Cable & Wireless charges were "not sustainable by the facts."
McTighe said some of the problems Cable & Wireless faced were due to the fact that MCI's Internet business was highly integrated with its other businesses.
If MCI WorldCom and Sprint were allowed to merge and an Internet divestiture was required, McTighe said the parties should be forced to spin off MCI WorldCom's UUNet Internet unit.

CNET
British carrier claims MCI sabotage in Net buy
By Reuters
November 8, 1999, 3:20 p.m. PT
http://home.cnet.com/category/0-1004-200-1431967.html

WASHINGTON—British telecommunications and Internet carrier Cable & Wireless complained to U.S lawmakers today that MCI WorldCom sabotaged its $1.75 billion Internet asset purchase.
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November 16, 1999

The Honorable John McCain
Chairman, Senate Commerce, Science & Transportation Committee
253 Russell Senate Office Building
U.S. Senate
Washington, D.C. 20510

Dear Chairman McCain:

In follow-up to your November 8th hearing on mergers, I would like to respectively request that the attached document be included in the formal hearing record. As you know, Mike McTighe of Cable & Wireless was a witness at this hearing.

Senator Ashcroft submitted for the record the testimony of Tod Jacobs of Sanford C. Bernstein and Company from the Senate Judiciary Committee hearing on mergers held on November 4. Cable & Wireless strongly disputes information contained in the study specifically regarding Cable & Wireless. The attached analysis indicates that Mr. Jacobs study relies on underlying assumptions which are false, as well as makes predictions about growth in the backbone industry which have no relation to historical precedent for the companies involved.

We very much appreciate your indulgence in hearing the views of our company in this matter.
Sincerely

Rachel J. Rothstein
Sr. Vice President, Regulatory and Government Affairs
Cable & Wireless Global Operations

Attachment

Attachment

RESPONSE TO TESTIMONY OF TOD JACOBS,
SANFORD C. BERNSTEIN & COMPANY

In testimony before the Senate Judiciary Committee on November 4, 1999, MCI WorldCom CEO Bernie Ebbers cited a forecast by Tod Jacobs, an analyst at Sanford C. Bernstein & Co., predicting that, from 1999 to 2003, Cable & Wireless' Internet backbone revenues will grow faster than MCI WorldCom's revenues. The speculation of this one analyst is unreliable for the following reasons:

- Mr. Jacobs' estimate of Cable & Wireless' 1999 Internet revenues is grossly inaccurate. Rather than $459 million, as Mr. Jacobs suggests, actual revenues will be approximately $341 million. Mr. Jacobs seems to have relied on outdated Cable & Wireless projections made around the time of the divestiture, before the deficiencies in MCI WorldCom's performance had become apparent.
- The suggestion that Cable & Wireless' Internet revenues grew by 40 percent from 1997 to 1999 is similarly inaccurate and misleading. Any growth in "Cable & Wireless" business from 1997 to 1998 occurred before the failed transfer of the iMCI business to Cable & Wireless. Since the divestiture, Cable & Wireless' Internet revenues have been flat or declining.
- In sharp contrast to Mr. Jacobs' contention that Cable & Wireless' business would grow faster than MCI WorldCom's, MCI WorldCom Vice Chairman Jon Sidgmore was recently reported in the financial press as saying that "MCI WorldCom still has the fastest growth rate in the industry on the Internet." (Barrons 9/20/99. "Changing the Net: Forget Long Distance".) (Exhibit 1)
- Mr. Jacobs' estimate that MCI WorldCom's Internet revenues would grow at an average of 23 percent per year conflicts with Mr. Sidgmore's testimony before the Senate Commerce Committee on November 8, 1999, that MCI WorldCom was projecting 40-50 percent growth for the next several years.
- Peter Van Camp, UUNet's President of Internet Markets, was recently quoted as saying "[Our Internet Bandwidth growth rate in 1999] will be ten times on

the previous year and we see no signs of it slowing down." (Bloomberg News. 9/1/99,"MCI WorldCom Internet Unit to have Global Coverage in 18 Months".) (Exhibit 2)

• For the first six months of the current fiscal year, MCI WorldCom reported 60 percent growth in Internet revenues.

• Mr. Jacobs' predictions about MCI WorldCom's future growth cannot be reconciled with his own estimate of historical performance for the last two years—when MCI WorldCom's revenues purportedly grew at 64 percent per year.

In sum, Mr. Jacobs' forecast, which appears to have been prepared specifically to support his testimony in favor of MCI WorldCom's acquisition of Sprint, is pure fiction.

Mr. Jacobs' analysis does confirm that, during the period from 1997 though 1999—the critical period in for the transfer of the MCI Internet business to Cable & Wireless—the revenue growth of that business lagged that of all other competitors. While Cable & Wireless disputes the specific market share figures included in the report, it is clear that Cable & Wireless lost share during that period due to MCI WorldCom's failure to provide all of the assets, personnel and services it had committed to provide. As a result, the market is one step closer to domination by MCI WorldCom.

The CHAIRMAN. I would like to depart from the usual procedures here for a second and allow Mr. Sidgmore to respond, in any way that he wants to, to the previous two witnesses.

Mr. SIDGMORE. Well, if it is any way I want to, this could take 2 or 3 hours, but I will try and keep it brief.

I think many of you are aware that we have a commercial dispute in litigation right now with Cable & Wireless, so it is probably not appropriate to respond to the detailed points. But I have to say, from my perspective, this is kind of an old story. The Department of Justice and the European Union, last year, sought to create an effective competitor to UUNet when we divested InternetMCI. And I think, by virtually any measure, that has taken place.

I must say to Mr. McTighe here that the Cable & Wireless people, including the CEO, Mr. Wallace, and Mr. McTighe, regularly brag to their analysts about how robust their Internet business is. And, in fact, have made statements, which we can make available, that the Internet business and the revenues and so forth are roughly in line with what they expected when they bought the business. They also claim to have 30 percent market share today on the Internet backbone.

So I guess I would just say that they tell a very, very difficult story to their analysts when they are selling their case for why they are strong in Internet than they make here today.

I think, at the end of the day, when you look at the Internet backbone, this is a very robustly competitive environment today, despite what some of the competitors say. I would also say that, with respect to peering, which has received a lot of notoriety, we have more peers every year than the year before. Just to put it in perspective, we have over 70 today. Over 70 other backbones have equal status with MCI/WorldCom's backbone, UUNet, today.

That, to me, does not sound like a very restrictive situation. And each year the number of those peers increases. So if we were really trying to use our market power to stop competition, I think you would see those number of peers go down over time.

Just, in closing, I would like to say that we believe that the Internet MCI disposition, although there were some problems that we are discussing today, was largely as advertised. And we think it was one of the more successful divestitures around. Again, a 30 percent market share by industry analysts and by their own recognition, robust growth in the business, and basically in line with the initial expectations.

Thank you.

The CHAIRMAN. The purpose of this hearing is not to specifically address your pending merger. It is the general issue, and I kind of would like to keep us on that. But I do understand that, obviously, because of recent events. And I hope that our other members of the committee will allow you to respond as we go through this.

Mr. McTighe, I need to ask Mr. Kimmelman a question here.

Mr. Kimmelman, as you know, this week, Congress is expected to vote on legislation intended to help satellite TV compete effectively with cable television. Yet the conference committee's draft satellite TV bill has been criticized as not terribly pro-competitive or pro-consumer. As a spokesman for competition and consumers who represent no special interests, please give me your opinion on what provisions the Satellite Home Viewer Act legislation must contain in order to be truly pro-consumer and pro-competitive.

Mr. KIMMELMAN. Mr. Chairman, we have been very critical of a number of the suggestions. I do not know that it has been resolved yet in the conference committee. We asked for as much parity as possible between satellite and cable companies for the ability to obtain broadcast programming.

As you and everyone else knows, one of the biggest problems satellite providers have in reaching consumers is they are not able to offer the local broadcast channels with the broader package of cable service. We wanted to make sure that for consumers to have more choice and the lowest possible prices that those channels would be available under the same terms and conditions that cable receives them.

Unfortunately, my understanding is there are a number of provisions being discussed that still give advantages to cable in how they may negotiate with broadcasters as opposed to satellite. What all this will do, Mr. Chairman, unfortunately, is slow down the development of competition, creating other barriers to competition that are inappropriate and unnecessary.

And so at a time when we have now no regulation of cable prices, and they are going up three times inflation, we want to see as much competition as quickly as possible. And from what I have seen—I know it is still under negotiation—a number of provisions just do not promote as much competition as is necessary.

The CHAIRMAN. Well, obviously, I have heard the same and know of the same. And that is why I asked this question. This will be terribly disappointing. Good legislation was passed by the House. And it would be terribly disappointing if we, again, stiff these people all over America who have seen their screens go blank and not allow them to have access to the service of their choice.

Chairman Kennard consistently states that long distance rates are going down. You state just as consistently that a majority of consumers are paying $2 billion a year more on their long distance bills since the passage of the Telecom Act. Can you explain why the same industry statistics lead you and Chairman Kennard to mutually inconsistent conclusions?

Mr. KIMMELMAN. I wish I could fully explain it. We are using the chairman's own data from his agency. The easiest way I can explain it is when you aggregate everyone together, people who are on the phone for hours and hours, and they are getting 5 cents a minute, 4 cents a minute, special deals, they have phone companies knocking off the $1.50 charge, the $1.95 charge, offering them an even lower price if they will buy Internet access and something else, there is no doubt in my mind they are saving money and their prices are coming down.

You combine those people with the majority of consumers—and these are just FCC numbers—the majority of consumers who are on the phone for less than an hour for their interstate long distance calling, and you look at the new fees that have been added to their bill, before they ever pick up the phone and get a dial tone, you can homogenize all that and say there are some benefits. But when you pull out that majority of people and say, what have they gotten, it is absolutely clear they have gotten a price hike. There is just no question about it. It is unnecessary and inappropriate.

We believe if the FCC had just done its job effectively—there were more than $4 billion in savings during this period of time we are discussing to long distance companies through access charge reductions for connecting long distance calls to the local phone companies—all consumers would be paying less for long distance. Somebody is getting the benefit of those cost reductions. Unfortunately, it is not the majority of consumers.

The CHAIRMAN. Well, I would appreciate if you would submit for the record corroborating information to your statement.

Mr. KIMMELMAN. We would be happy to.

[The information referred to follows:]

INITIAL COMMENTS OF CONSUMER FEDERATION OF AMERICA, CONSUMERS UNION, AND THE TEXAS OFFICE OF PUBLIC UTILITY COUNSEL BEFORE THE FEDERAL COMMUNICATIONS COMMISSION, CC DOCKET NO. 99-249, SEPTEMBER 22, 1999 (EXCERPT)

EXECUTIVE SUMMARY: LOW VOLUME CONSUMERS HAVE SUFFERED SUBSTANTIAL RATE INCREASES

The Consumer Federation of America,[1] Consumers Union,[2]/ and the Texas Office of Public Utility Counsel[3]/ (hereafter Joint Commenters) respectfully submit these comments in response to the Notice of Inquiry on low volume long-distance users.[4]

[1] Consumer Federation of America is the nation's larest consumer advocacy group, founded in 1968. Composed of over 250 state and local affiliates representing consumer, senior citizen, low-income, labor, farm, and public power, and cooperative organizations, CFA's purpose is to represent consumer interests before the Congress and the federal agencies and to assist its state and local members in their activities in their local jurisdictions.

[2] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about good, services, health, and personal finance: and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of *Consumer Reports,* its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* with approximately 4.5 million paid circulation, regularly, carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry...no advertising and receive no commercial support.

[3] The Texas Office of Public Utility Counsel is the Texas state consumer agency designated by law to represent residential and small business consumer interests of the State. The agency represents over 8 million residential customers and advocates consumer interests before Texas and Federal regulatory agencies as well as the courts.

[4] Federal Communications Commission, in the Matter of Low-Volume Long-Distance Users, CC Docket No.99-249, July 20, 1999 (herein after, "NOI").

The Commission, despite adopting this NOI, has failed to ensure that falling long distance costs are translated into fair prices and continues to postpone relief to over half of all residential long-distance consumers, especially those who make fewer than 50 minutes of interstate long distance calls in a month. While the Commission has acted to reduce access charges for the long distance carriers by over $4 billion since 1997—and by additional billions from earlier rounds of regulatory reductions in these charges—it has passively watched the average per minute rates for low-volume callers rise time and time again.

We estimate that those households making less than 50 minutes of calls have been burdened with a net annual increase in lone distance charges of about $2 billion. The majority of those increases have fallen on the backs of consumers who are least able to pay—lower income households.

The Commission's cost recovery formula for the loop has disproportionately increased costs for the end-user. In effect, the consumer bears the cost of the loop while IXCs get a free ride. The Commission requires consumers to pay for part of the loop costs directly though the Subscriber Line Charge (SLC) and long distance carriers are charged for the remainder of the costs through the Presubscribed Interexchange Carrier Charge (PICC). However, the Commission permitted long distance carriers to pass through their charges onto the consumer as a line-item fee. This loading of all loop costs onto the end user violates principles of joint and common cost allocation pursuant to the Telecommunications Act of 1996.

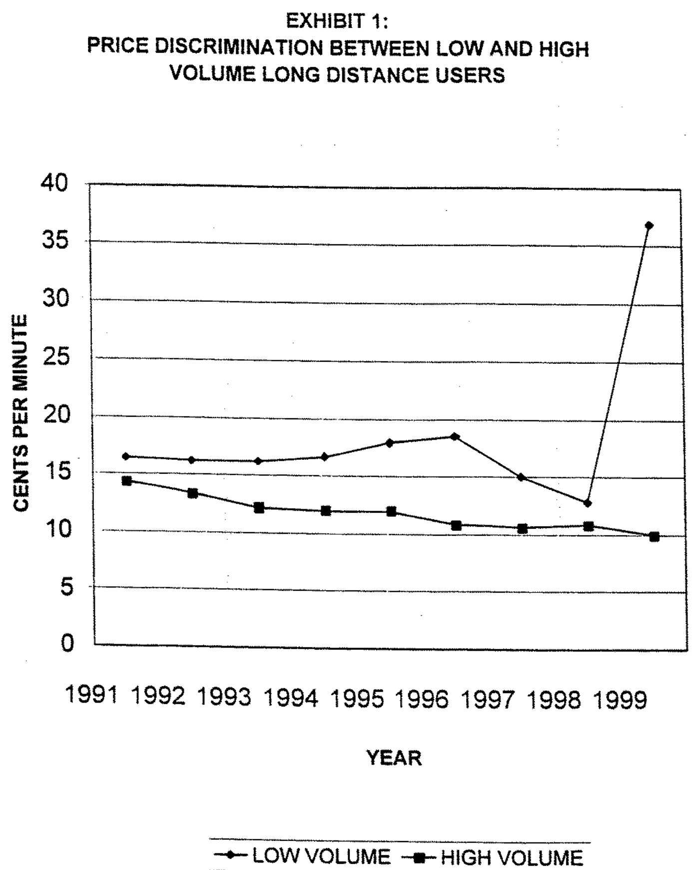
The Commission, in its regulatory proceedings to reduce access charges to the benefit of long distance carriers, had the opportunity to offset the impact of cost increases from the long distance carriers' pass through of the PICC and the federal universal service charges by requiring a dollar-for-dollar or *pro rata* pass-through of saving from access charge reductions. Instead, the Commission chose to rely on presumed "market forces" to compete these charges away. Unfortunately, those "market forces" are nonexistent in the low volume market segment. The major long distance carriers have chosen to play follow the leader by raising prices for consumers by the equivalent of their PICC and their universal services costs. Those making few long distance calls have been the hardest hit by these growing line-item charges.

Making matters much worse is the recent imposition of monthly minimum charges by the major carriers (see Exhibit 1). Now consumers are being billed even when they do not place a single long distance call during the billing cycle. This agency's own calculations estimate that up to 20 million consumers could be faced with monthly charges without ever placing a long distance call).[5] These minimum charges have substantially increased the cost of long distance for low-volume users—especially for low-income consumers. Recent data from a large survey of consumers in Florida shows that over half of all respondents who reported no calls in a given month had incomes below $20,000 and 75 percent had incomes below $30,000. These respondents represented about one quarter of the total. Thus, the burden of rising prices for low volume calling is falling disproportionately on lower income households.

The Commission's own data show that the average per minute rate for those making under 30 minutes of calls a month has skyrocketed to triple what they were in the fall of 1997. This is a distress flare in the sky to the Commission that low-volume users are being crushed by an avalanche of line-item charges and unfair pricing policies. To ensure that all consumers received their fair share of recent long distance cost reductions, the Commission must act expeditiously to remedy the pricing inequity in the bottom-half of the marketplace by reducing or eliminating the Subscriber Line Charge. The Commission could move quickly to provide this bottom-of-the-bill relief because it regulates this end-user charge. The Commission should also prohibit minimum monthly charges, which greatly exacerbate the cost recovery burden of low volume customers.

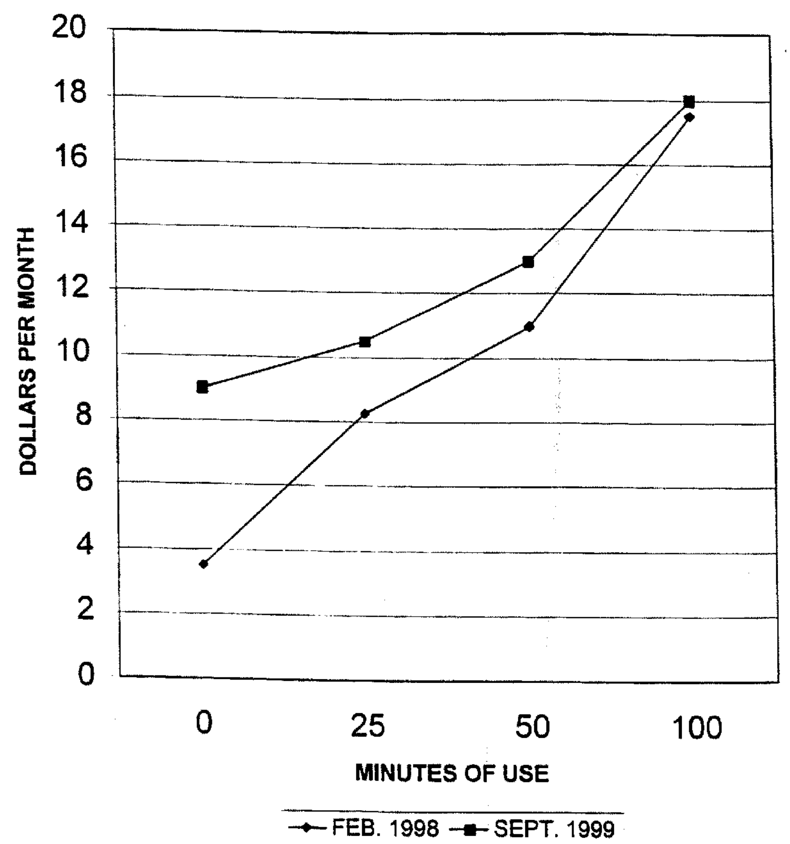
[Included for reference are Exhibits 1 and 4-7, which follow:]

[5] Cindy Skrzycki. "When the Meek Inherit. . . a Surcharge," Washington Post. August 13. 1999, E1.



SOURCE: Phil Chelik, Reference Book of Rates, Price Indices and Expenditures for Telephone Service, Table 2.4 "Average Charge per Billed Minute for Price-Sensitive Residential Callers", Industry Analysis Division, Common Carrier Bureau, FCC, June 1999. Table 2.4

EXHIBIT 4
MONTHLY LONG DISTANCE COSTS FOR LOW VOLUME USERS



SOURCE: See Exhibit 5.

EXHIBIT 5
CHANGES IN THE COST OF HAVING A LONG DISTANCE COMPANY FOR LOW VOLUME CONSUMERS SINCE THE PASSAGE OF THE TELECOMMUNICATIONS ACT OF 1996

(FEDERAL JURISDICTIONAL CHARGES AND AT&T IMPOSED BILL ELEMENTS)

	MONTHLY USAGE								
	NO CALLS		25 MINUTES OF CALLS		50 MINUTES OF CALLS		100 MINUTES OF CALLS		NEW AT&T .07 @ 100 MIN.
	PERIOD		PERIOD		PERIOD		PERIOD		PERIOD
BILL ELEMENT	2/96	9/99	2/96	9/99	2/96	9/99	2/96	9/99	9/99
SLC	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50
PICC	0	1.50	0	1.50	0	1.50	0	1.50	1.50
USF	0	1.00	0	1.00	0	1.00	0	1.00	1.00
MINIMUM BILL/FEE	0	3.00	0	0	0	0	0	0	5.95
TOTAL FIXED FIXED	3.50	9.00	0	6.00	0	6.00	3.50	6.00	11.95
USAGE	0	0	4.75	4.50	7.50	7.00	14.00	12.00	7.00
TOTAL LD BILL	3.50	9.00	8.25	10.50	11.00	13.00	17.50	18.00	18.95
BILL CHANGE	+5.50		+2.25		+2.00		+.50		

Sources: Federal Communications Commission. *Reference Book of Rates Price Indices and Expenditures for Telephone Service*, June 1999, Table 2.4; "Notice of Inquiry," *In the Matter of Low Volume Long Distance Users*, July 8, 1999, para

EXHIBIT 6

LONG DISTANCE USE IS HIGHLY SKEWED

	MINUTES OF USE	
STATISTIC	ALL TOLL	INTERLATA ONLY
AVERAGE USE	149	75
MEDIAN USAGE	88	44

SOURCE: Federal Communications Commission. *Trends in Telephone Service: 1998*, Chapter 16.

EXHIBIT 7
THE IMPACT OF FEDERAL/LONG DISTANCE RATE RESTRUCTURING ON LOW VOLUME USERS

	CUSTOMERS		INCREASE IN COST	
	% of TOTAL	NUMBER (000,000)	MONTHLY	ANNUAL (000,000)
NO CALLS	15	14	$5.40	$ 924
LESS THAN 50 MINUTES	60	42	2.125	1,071
TOTAL				1,995

SOURCE: See text for derivation of estimates.

The CHAIRMAN. And I would appreciate it if representatives of the phone companies, and we will try and get something from the FCC, so perhaps we can match them up. I guess it is one of those examples about liars and statistics, but we will find out about it.

I have exceeded my time. Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman.

All of you have been helpful. The last question I asked Mr. Pitofsky was very much on my mind today. The question of looking short term versus long term as these matters of deregulation are approached of course leads you to the airline example. It was before I was in the U.S. Congress, but the ballyhooed claim was we are going to have more entrants, we are going to have more competition, and this is going to be the greatest thing since night baseball for the consumer. And what, in effect, we have had is very significant consolidation, a lot of areas with one carrier and some not even that.

I would like to just kind of go down the row, we can start with Mr. Kimmelman, and ask you to give us your vision of what things would look like in the communications sector 20 years from now if we essentially stayed in this mode that we are in. What concerns me, of course, because Portland was really in the eye of the storm with respect to broadband, is whether or not 20 years from now we are just going to have a handful of broadband barons, sort of like the airline hubs that control access and basically let the prices go up and harm the consumers.

So, let us let each of you have a crack at sort of what it looks like 20 years from now. And we will start with you, Mr. Kimmelman.

Mr. KIMMELMAN. I do not think anyone can predict accurately. I will give you my concerns based on the market consolidation we have seen.

Everyone is moving to offering a package of services for consumers: local phone, long distance, Internet access, a variety of entertainment and communications services. The difficulty appears to be that no one player can offer everything exactly as some other player because of technological and other barriers at this point in time. What we are seeing is a consolidation of local phone companies offering a package of services with some Internet that is not nearly as fast and cannot offer the video quality that a cable company can offer.

But simultaneous consolidation, through AT&T's transactions involving cable wires around the country, perpetudes monopoly dominance over high-speed Internet and video services. We have an opportunity for more mergers or consolidation here, with two satellite companies left—there used to be four—but they could begin to challenge cable. But that has limitations in terms of two-way Internet, as well. And so you have packages where certain sets of services from the cable wire will be more attractive to consumers and more attractive to businesses from the telephone wire.

If we do not have head-to-head competition across all services we are in danger of either having an unregulated monopoly or a need for a lot more regulation down the road. It includes broadband. It includes video services. And it may include some business services for Internet and data transmission.

So, I am very fearful that the strong concern that has been raised is not enough, that we need more aggressive intervention now to have more players. Finally, I will say that, looking 20 years ahead, I just look back. We made an enormous mistake in 1984, deregulating cable before there was real competition. And Congress came back in and re-regulated in 1992. Whatever one thinks of that, I think everyone concurs that it was an enormous mess coming back in and trying to undo what was perceived as a mistake.

And as much as Chairman Kennard says we can look at broadband down the road, I am fearful that that "down the road" is such a big mess that you cannot undo the mistake.

Senator WYDEN. I am going to let Mr. McTighe answer, but I think your point is critical with respect to the need for preventive kind of action. However you feel about a particular area, you do not want to get to the point where you have to run a lawyers full employment program to resolve some of these areas. And that is also an issue with Microsoft, is that you do not want these questions to reach that kind of threshold. And it is one of the reasons why—and I think you heard several of us say—we are going to try to think anew about this whole area.

I am one who thinks, for example, that a great many of these mergers are not going to have dire consequences for consumers. But I think a fairly small percentage are going to be very, very bad news for consumers. They are really going to threaten the first amendment. And that is why I raised that question earlier.

So, rest assured that this is not going to be something that is going to vanish into vapor. And that is one of the reasons why I have spent the last few hours here and will be pursuing it very vigorously in the days ahead.

Mr. McTighe.

Mr. MCTIGHE. Senator Wyden, I do not think I am particularly qualified to give you a detailed U.S. sense, but perhaps I could give you more of a broader perspective. We believe fundamentally that what is required is to open up all aspects of the value chain. In other words, from the delivery of international services through long distance, through local access, into content, and to ensure that you have a competitive framework in every one of those discrete areas. And if we can do that, then we would allow the free market forces to decide exactly what degree of competition is delivered.

As an observation, the U.S. tends to be one of the most regulated environments that we come across. And it seems to me that more of a holistic view needs to be taken of this, more consideration of all access mediums. So we tend to have discussions about local access in terms of wireline, and then I see local access discussions on wireless, and then I see cable discussed -- these are all mediums.

Senator WYDEN. My time is short. Are any of you interested in commenting on what it is going to look like in 20 years? Yes.

Mr. SIDGMORE. Well, not in 20 years. I just wanted to make the point that with respect to the analog to the airline industry, I think it is very different. If you look at that industry, you wound up with a route-by-route competition model where you really only had two or three potential competitors in the first place, and so any consolidation was bad.

I really do believe, to the points before, that in the communications industry, in the not too distant future, just a couple of years out, you are going to have at least five or six major people competing in all aspects of the market. We can easily name them on one hand or two hands. It is AT&T, MCI/WorldCom, SBC, Bell Atlantic, USWest/Qwest. I think you are going to have at least those and a number of niche players. So I think it is very, very different because the market characteristics are different.

The other thing I would say just briefly is I do not often agree with Scott, and I very rarely agree with Mike, but I would say that I agree on this question of open access. I think we are absolutely pro open access. And I think that is absolutely critical to ensuring that the effects of broadband technology get moved all the way out to the consumer population in the rural areas in the United States, not just the major cities.

Mr. CLELAND. I would like to echo that. If we look 20 years out, what we should be seeing is the future is bundle competition. We see competition in electricity, in gas, in telecommunications. I imagine there will be more competition in cable. And so what you want in the future is everybody competing for the customer in putting together their bundle. One person may say I think the customer wants cable, telecommunications and gas. Somebody else will throw in electricity. Somebody else will do autos. We do not want to limit the bundle capacity that anybody can offer. Let the market, let the consumer choose what they want.

The only way that vision will happen, though, is if we encouraged facilities-based competition for all those with market power and we have resale of all the underlying assets.

Senator WYDEN. Before we move on, you would then share my view that if you have only one provider of broadband Internet access, bundling proprietary information essentially with access in a given area, that would certainly be a free speech and First Amendment question, would it not?

Mr. CLELAND. I am not a First Amendment expert, but it certainly would be economic power being leveraged into vertical markets. Because what you are concerned about is, on broadband, almost all of these different services can be bundled together, because it is one pipe.

Senator WYDEN. Mr. Glenchur.

Mr. GLENCHUR. Thank you.

I think a point to keep in mind in terms of predicting where this all goes is telecommunications is very unique and perhaps very different from the airline industry in this regard: And that is it is at the intersection of communications and technology. We may get to the point where third generation wireless and satellites and other alternatives create options and choices that we really cannot get our arms around at this point. And so it is hard to predict where it goes.

The key thing is to make sure that there are enough players out there to have incentives to innovate and make investments in new technology.

Senator BROWNBACK. I want to thank the panel members for being here today.

Mr. Sidgmore, I have a couple of questions to ask you, if I could. As you look to the future on the merger that you had, the MCI/WorldCom, and then adding into it the one you are projecting in, to bring Sprint into the fold of that, where do you see your major growth coming from in the next year or two? Where are you really projecting to try to grow this business the most?

Mr. SIDGMORE. I do not know whether you are talking geographically or functionally.

Senator BROWNBACK. Functional.

Mr. SIDGMORE. From a market point of view, and we have been very public with this, we think the two biggest growth markets over the next several years will be wireless and Internet. And of course wireless is right at the heart of our acquisition strategy with respect to Sprint.

Senator BROWNBACK. If I could focus just in on the Internet area of that, what do you anticipate your growth to be in that field? What are you anticipating the growth in the next couple of years in that Internet arena and the Internet backbone services, data services, that you have?

Mr. SIDGMORE. Well, we have talked publicly about growth rates in the high 40 to 50 percent range. We are growing today a little over 50 percent per year.

We do think that one of the biggest drivers for growth over the next few years on the Internet will be wireless data. If you can imagine, a number of new devices proliferating, like Palm Pilots, personal digital assistants and so forth, which we believe is going to happen, you can easily see the growth of wireless data sort of skyrocketing over the next few years, particularly when everyday devices like cars will all have Internet interfaces, as well.

So wireless data we think is actually going to be the most significant piece of the growth of the Internet. And, again, this gets back to why we have been so aggressive in attempting to find a wireless solution and why Sprint is right at the center of what we have been thinking about.

Senator BROWNBACK. Does the merger with Sprint, the proposed merger there, work if you do not achieve that rate of growth you are projecting in the Internet backbone business that you were talking about?

Mr. SIDGMORE. Yes, let me just clarify something. We did not count a single dollar of synergy from merging the Internet backbones. And when I am talking about growth and what we were after with Sprint had nothing to do whatsoever with the Internet backbone. It had to do with getting access to the wireless business of Sprint, which we believe will be an important part, as an interface, into the Internet backbone space.

And to the extent that will the merger work without the wireless Internet piece, virtually all of the financial synergies inherent in the deal are based on the non-Internet and non-wireless businesses.

Senator BROWNBACK. What role do you see Sprint's current operations playing in that growth that you are projecting for the overall company over the next few years?

Mr. SIDGMORE. Well, I think if you look at it in pieces, obviously we do not have a wireless business, so it is very highly likely that

Sprint people and the Sprint operations that exist today will actually operate the wireless business for the combined company. I think there is very little question about that.

I think, considering the size, I think the MCI/WorldCom people will probably manage the Internet backbone piece. In terms of traditional local operations, which MCI/WorldCom has none, I think that is going to be virtually 100 percent Sprint. And then you get down to the merging of long distance networks and where we will put people to run that.

I think it is highly like that the concentrations of people around the country will stay largely the same. I do not want to speculate today, because it is way too early, as to which manager will run which division and so forth. I think it is highly likely that the general concentrations of people as they exist today will stay the same.

We have made over 60 acquisitions in the last 4 years. And that has been true just about universally. We have largely kept the operations in the place where they have been before the merger.

Senator BROWNBACK. I believe Mr. Ebbers was in last week in the Judiciary Committee, and he was projecting merger savings of $9.7 billion in operating cost savings. That is what he was projecting last week over the next 5 years. And that is some of what you have elaborated and testified on a little bit. Could you elaborate any further about where you anticipate those operating cost savings coming from over the next 5 years?

Mr. SIDGMORE. There are really three sources. I mean simplistically there are really three sources. First is network synergies, which result from (a) our avoiding access fees by using local facilities or bypass facilities that one of us have.

For example, MCI/WorldCom has significant CLEC facilities which we can then use to originate and terminate Sprint customers. We can terminate Sprint traffic internationally on our, MCI/WorldCom's, own local facilities in Europe, as an example. That is a significant source of the savings. So there are a number of network savings we get as a result of using each other's facilities, including the Sprint local facilities.

Second is advertising. And I doubt anyone will miss a few advertisements from TV at night. And that is—I do not want to get into exactly how much that is—we have some internal debates about this, as you might imagine—but that is a very significant amount of money. It costs a lot to put Michael Jordan on television regularly.

And then, finally, there will be savings from projections of personnel growth over the next few years. And I want to be careful on this, because I just want to make the statement that of all the mergers we have done, we have always had, a year after the merger, more employees in total than the individual companies had combined before the merger. So while there may be some dislocations in certain areas and in certain functions, in our judgment, this merger is about growth. We fully expect to have more people a year after the merger, in the combined company, than we had before.

Senator BROWNBACK. If I could take you right down to that point, how many, though, do you anticipate jobs will be eliminated initially because of duplicative jobs with the proposed, if the merger is approved, on the Sprint with the MCI/WorldCom?

Mr. SIDGMORE. We do not actually have that number today. We have numbers that are based on sort of longer-term projections. But we have not gotten down into the bowels of each operating unit and sorted through which unit does what, how much overlap there is, et cetera. We know there will be some. I am not saying there will not be any. There will be certainly in accounting and functions like that. There will be some. But we do not have a detailed road map yet that would project that out.

Senator BROWNBACK. I thank you. I am sorry to be so detailed and focused in on you, but it is not only the broader, bigger concern, but it is also a narrow concern for a number of constituents and so on to have a chance to be able to ask you those questions. And I hope we have the chance to have your chairman, Mr. Ebbers, in some time, as well, to visit more thoroughly about this.

Thank you all, panelists, for being here today. We appreciate it. I think it was a very illuminating testimony.

The hearing is adjourned.

[Whereupon, at 11:55 a.m., the hearing was adjourned.]

APPENDIX

PREPARED STATEMENT OF LOWRY MAYS, CLEAR CHANNEL COMMUNICATIONS, INC.

I would like to thank the Committee for inviting me to submit written testimony concerning the major mergers taking place in telecommunications industry and the proposed implementation of a small business tax incentive program. The heightened merger activity in the radio industry is the result of years of pent up demand, frustrated by the artificial constraints placed on radio operators by an outmoded, outdated, and counter productive regulatory atmosphere which existed until the Telecommunications Act of 1996.

As competition was increasing for all forms of advertising, and as every other form of communication grew stronger; as newspapers consolidated to the point where most cities had only one major daily newspaper, where most cities were served by very few major cable television providers, where the magazine industry had been consolidating to a few group owners, and even the television programming industry had been consolidating, radio groups could not grow with these competitive threats. By the late 1980's and into the early 1990's, radio had been strangled by a regulatory framework which allowed only 12 AMS and 12 FMs to be owned nationwide by a single entity. Radio values were down, innovation was rare and radio was in danger of being left behind in the growth the rest of the communications world was enjoying. Then, as Congress and the FCC began to loosen its regulatory grip, vitality began to move back into the Industry. In the early and mid 1990's, the FCC relaxed the ownership restrictions to allow up to 20 AM's and 20 FM's nationwide and finally in 1996, Congress removed the national limit and increased the number of stations we could own in individual markets. With these changes, the industry has rebounded and is financially vibrant again.

Curbing the trend towards consolidation which has brought the radio industry back to financial life, will not result in an increase in diversity of owriership or diversity of programming. In fact, it may well hamper these efforts. A consolidated company will have the financial wherewithal to take programming risks and try different formats, as it knows that a failure will not destroy the company's balance sheet. The smaller companies of the late 80's and early 90's had to be programmed in well established formats, as experimental programming that went awry could devastate a smaller company. Bigger companies can afford to take more risks. Further as companies own more than two stations in a market, they can look to program in more specialized formats with their additional signals. In fact, studies by both the FCC and NAB have confirmed that format diversity in most markets has steadily increased since consolidation began in 1996. Also, larger companies can afford to pay for better quality programming up to date equipment, and provide more community service. For instance, in Memphis our stations employees and their families worked together with Habitat For Humanity to build a house for a family in need. In San Antonio our radio stations responded to the community needy children and families through the Elf Louise Project, which helps 35,000 people annually, by sponsoring a radiothon and silent auction which raised over a quarter of a million dollars in the last few years.

Also, consolidation, due to the safeguards that surround all media mergers from the twin government watchdogs of the FCC and the DOJ, has resulted in a multitude of stations that must be sold that otherwise would not ever have become available. Some of these stations will likely be purchased by minority-controlled companies or new entrants into the industry. These purchasers will bring more diversity of ownership. Without consolidation, this diversity most likely would not have been possible. The stations now being sold simply would never have been put up for sale, and would have remained in their current, non diverse ownership structure.

It is important to understand the role current regulations play in preventing a company from dominating a radio market or the radio industry in general. Radio is principally a local medium, and ownership in a station in one city will not effect an advertiser out of listening range of that city. The rules governing ownership are therefore rightfully based on a local area, on the coverage of each radio station's signal. Currently, the FCC limits the number of stations each company can own on an absolute basis, to a maximum of 8 stations in a market, and the Justice Department limits the amount of revenue a new combination may extract from the total revenue of that market. This duality of concerns will result in the divestiture of roughly 100 radio stations from the Clear Channel merger with AMFM. Clearly, the safeguards that exist currently are more than adequate to assure continued competition.

Once any stations are put up for sale, public companies have a fiduciary duty to their shareholders to maximize the return on their investments. While it is in the public interest to sell to diverse voices, each company must balance this interest with its fiduciary obligations. In the past, these competing obligations have often made it difficult to sell to minority companies that have historically been underfunded. The tax initiative program may solve this dilemma. Senator McCain's tax initiative program is therefore both worthwhile, as the number of new entrants has dwindled over the years since the repeal of the old tax certificate law, and timely, as the number of stations about to be available for sale, as a result divestitures related to the merger of Clear Channel Communications, Inc. with AMFM, Inc. will be abnormally high. An underfunded company that provides a diverse new voice might provide a seller with an acceptable offer even though the offer cannot hope to match, dollar for dollar, that of a better funded competitor. The underfunded but diverse company's bid can be equal to or perhaps more attractive than its competitor, if accompanied by a tax incentive. The seller can then meet its fiduciary obligations, the sellers' shareholders will have had its fiduciary obligations met, and the public's interest will also have been served.

The tax incentive program also has the potential to solve the other regulatory issues presented by the Department of Justice and the FCC. The Department of Justice has had a policy against Seller Financing of stations and the FCC has recently added a new "equity debt plus" rule making it difficult from the FCC side as well to find creative ways to help finance the acquisition of stations by historically underfunded companies. Clear Channel has taken the lead in helping establish a fund to finance minority and female broadcasters. Here Congress can take another, well needed step with the tax incentive program.

Clear Channel supports Senator McCain's tax incentive program, and applauds the Committee for having the courage to review the policy in this overtly political time.

PREPARED STATEMENT OF MCHENRY TICHENOR, PRESIDENT AND CHIEF EXECUTIVE OFFICER, HISPANIC BROADCASTING CORPORATION (HBC)

Mr. Chairman and members of the Committee, I am pleased to offer you my written comments pertaining to the recent hearing on mergers in the telecommunications industry. As you know, I am the President and Chief Executive Officer of the Hispanic Broadcasting Corporation (HBC). We are leading Spanish language radio broadcaster in the United States. Specifically, the HBC owns or programs 42 radio stations in 13 markets. In early 1999, we launched the HBC Radio Network. Through the combination of our owned stations and affiliate agreements with other Spanish radio broadcasters, our network reaches approximately 75 percent of Hispanics in the United States. As the largest Spanish language radio broadcasting company in the United States we have a definitive interest in seeing that mergers, which the Federal Communications Commission approves, now and in the future continue to promote the needs of underserved and underrepresented segments of the population.

Today, I will briefly review the status of broadcast mergers in the radio industry, discuss the positive implications of these mergers and offer my support for the Telecommunications Ownership Diversification Act of 1999.

In the last five years the number of mergers in the telecommunications industry has sky rocketed. In 1995, we saw the joining of Disney and Capital Cities/ABC, Turner and Time Warner, and Westinghouse and CBS. In 1997, we saw the proposed merger of US West and Continental Cablevision, Pacific Telesis and SBC, and Nynex and Bell Atlantic. In 1999, we have been witnesses to proposed joint ventures that further consolidate parts of the industry like those between MCI and Sprint, CBS and Viacom, and most recently, in the radio industry, Clear Channel and AM/FM, Inc. These mergers, far from being anti-competitive, are just the beginning of a new era of economic growth that will allow for additional capital investment, the emergence of new entrants into the telecommunications industry and greater benefits to the consumer.

The imposition of mergers, resulting in a more competitive marketplace, creates a scenario for individual station owners and ownership groups to re-evaluate how they do business while focusing programming more specific to the needs of the targeted audience. Those stations with a small audience basis will not be pushed out of the market but will be strengthened by quality programming and further enhance advanced technological services to the consumer.

While some may argue that fewer owners in a market results in consolidation of choices available to consumers, the public in the case of telecommunications mergers is destined to realize all of the advantages that accompany heightened competition and a greater diversity of voices in the marketplace.

When consolidation in radio occurs the variety of programming available to the public begins to diversify because new stations emerge which are attempting to find a unique segment of the listening audience. Then greater variety of programming evolves because the format for each station in a group's lineup within a market is usually clearly differentiated from its co-owned stations. In many markets, this has resulted in the introduction of innovative or "fringe taste" formats that were not previously viable because single-station owners could not absorb the startup costs, and often went after a small piece of a "mainstream" format because they could not afford to experiment and fail with their only property.

Similarly, minority targeted station groups also provide an economic advantage to advertisers and result in better technological service to the consumer. Given the wider range of options presented by a portfolio of formats and their respective demographics, advertisers are able to more precisely target their advertising messages to a specific audience. Many of the stations acquired by group owners, which previously suffered from inattention to their technical facilities, have been upgraded to provide a better class of service to the public. Group owners have used their centralized engineering expertise and greater financial resources to refurbish transmitting and antenna facilities and replace aging audio equipment with state-of-the-art digital facilities. This has resulted in expanded coverage areas and better signal quality.

The primary rationale for regulation has been the need to compensate for the imbalance of power between monopoly suppliers and small users. However, in an environment where full choice is available, the imbalance will change and the problems of price, quality, security, privacy and content diversity will disappear.

Why do we need to look at these consolidations as a prime opportunity to promote the entrance of new diverse ownership? Quite simply, because the demographic make-up of the audience is changing.

For HBC, our goal has always been to provide the most effective programming to educate, enlighten and entertain our listening audiences. As several recent studies indicate the Hispanic population in this country is expected to grow from an estimated 27.2 million people (approximately 10.4 percent of the total US population) from the end of 1995 to an estimated 30.4 million (approximately 11.2 percent of the total US population) by the end of 2000. These estimates imply a growth rate of approximately three times the total US population during the same period.

From a broadcasting perspective this translates into approximately 71.0 percent, or 21.6 million people, of all US Hispanics, live in areas reached by only fifteen markets. The US Hispanic population in these top fifteen markets, as a percentage of the total population in such markets, has increased from approximately 17.0 percent in 1980 to approximately 27.0 percent in 1999.

Even more striking than the increase in the U.S. Hispanic population, however, is that the increase in the top 15 U.S. Hispanic markets grew 29 percent. During that same period, in those same markets, Spanish—language radio listening has grown an astounding 83 percent, with most of that increase coming during the consolidation phase of the industry. So, the facts demonstrate that consolidation has in fact improved the product available to our audience.

Still, we at HBC believe that diversity of broadcast ownership, particularly small business and minority ownership is in the best interests of our country.

Beginning in 1943, with the help of the U.S. Supreme Court, the Federal Communications Commission initiated the first attempt to control radio industry consolidation. The court ruled that consolidation of the Radio Corporation of America (RCA) was monopolistic in nature and thus must be split into two distinct radio networks. The court was attempting to prevent the over monopolization of the industry and promote fair competition. In response to the Court's decision, Congress implemented the first tax certificate program allowing the owners of the RCA to divest and defer any capital gain tax realized from the "involuntary" sale of their properties. This program promoted increased regulation by the FCC and the establishment of measures to ensure better compliance with mandated regulations.

Historically, the impact of tax certificate programs has brought about several economic advantages to private parties and the government. In 1978, a new and revised tax certificate program was initiated to promote minority ownership of a variety of communications properties. Unfortunately, due to several large loopholes in the law, many media sales previously approved by the FCC were in reality part of a shell game by a few owners to assist in realizing a tax advantage. However, these types of programs—when accurately monitored and implemented—are very successful as regulatory tools that spur definite economic benefits. From a purely statistical perspective the ability of minorities to acquire access to the telecommunications industry has been enhanced by tax incentive programs. For example, in 1978 minorities owned only 40 broadcast holdings. With the imposition of the tax certificate program, this number jumped to 350 by 1995. However, present day marketplace circumstances present challenges. Competing tax-free methods of selling stations detract from the attractiveness of tax certificates as an option for sellers. In addition, increasing station prices makes it economically difficult to own stations in large markets except for well-capitalized broadcasters. If the percentages of small and minority broadcasters are to increase in the present radio marketplace, there must be regulatory intervention that will afford them the ability to acquire additional stations.

Thus, consideration should be given to the concerns that resulted in the repeal of the tax certificate program in 1995. As you are aware, the repeal of the tax certificate program was linked to a proposed sale by Viacom of a multi-million dollar cable television system to a minority buyer. This particular merger, coupled with declining tax revenues and complaints about the fact that the tax certificate program was an affirmative action program, helped to heighten the arguments for repeal.

The most recent proposal, offered by Chairman McCain, provides a sound starting point for renewing this vital investment incentive program. Under the Chairman's proposal, mechanisms are proposed to safeguard against of the abuses of the earlier program. Specifically, the implementation of the program would be a joint effort between the Secretaries of Commerce and Treasury. Each agency will establish specific limits on net worth; gross revenues, total assets, and personal net worth for eligible purchasers that were absent from the previous program. However, we believe that it would be prudent to give more specific guidance regarding these safeguards.

Finally, the legislation offers a limit upon the amount of gain that can be deferred under the program. Specifically, a three-prong test is established for new buyers that would provide a safeguard against phantom owners seeking only to reap the benefits of the tax advantage.

The former tax certificate programs, whose goals were laudable, did little to establish a concrete safeguard for ensuring that underrepresented parties would engage in long term ownership agreements. The McCain proposal requires that the seller reinvest the proceeds from the sale of the telecommunications business into another telecommunications business within three years of the date of sale. Moreover, the legislation also requires that the new buyer maintain ownership of the property for at least three years in order to be able to be able to defer a future gain from selling the property.

Realizing the impact of long-term mergers within the telecommunications industry requires that we look at who the parties are that will be most affected. Given the large role that the Hispanic community will have in the coming years in effecting public policy, I strongly urge this committee to encourage diversity in broadcast ownership within a framework of safeguards that will avoid the abuses of the past.

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