HEINONLINE

Citation: 20 Bernard D. Reams Jr. & William H. Manz Federal Law A Legislative History of the Telecommunications of 1996 Pub. L. No. 104-104 110 Stat. 56 1996 the Communications Decency Act i 1997

Content downloaded/printed from HeinOnline (http://heinonline.org) Thu Mar 21 22:07:34 2013

-- Your use of this HeinOnline PDF indicates your acceptance of HeinOnline's Terms and Conditions of the license agreement available at http://heinonline.org/HOL/License

-- The search text of this PDF is generated from uncorrected OCR text.

FEDERAL TELECOMMUNICATIONS LAW:

A LEGISLATIVE HISTORY OF

THE TELECOMMUNICATIONS ACT OF 1996

PUB. L. NO. 104-104, 110 STAT. 56 (1996)

INCLUDING

THE COMMUNICATIONS DECENCY ACT

Volume 20
Document Numbers
190 - 191

BY

BERNARD D. REAMS, JR.
ASSOCIATE DEAN AND PROFESSOR OF LAW
ST. JOHN'S UNIVERSITY IN NEW YORK

AND

WILLIAM H. MANZ
EXECUTIVE LAW LIBRARIAN
ST. JOHN'S UNIVERSITY IN NEW YORK

William S. Hein & Co., Inc.
Buffalo, N.Y.
1997

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act i 1997

Library of Congress Catalog Number 97-70098
ISBN 1-57588-279-5 (SET)

This book has been digitally archived to maintain
the quality of the original work for future generations
of legal researchers by William S. Hein & Co., Inc.

This volume printed on acid-free paper
by William S. Hein & Co., Inc.



Printed in the United States of America.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act ii 1997

SUMMARY TABLE OF CONTENTS

Master Table of Documents . . . . . Vol. 1

Selected Bibliography . . . . . Vol. 1

Section I: Law as Enacted . . . . . Vol. 1 (Doc. No. 1)

Section II: Reports on the Law . . . . . Vol. 1 (Doc. Nos. 2 - 6)

Section III: Hearings on the Law . . . . Vol. 2 (Doc. Nos. 7 - 9)

Section IV: Congressional Record . . Vol. 3 (Doc. Nos. 10 - 87)

Section V: Presidential and Vice Presidential Statements . . . . . Vol. 3 (Doc. Nos. 88 - 95)

Section VI: Past Bill Versions . . . Vol. 4 (Doc. Nos. 96 - 101)

Section VII: Related Bills . . . . . Vol. 5 (Doc. Nos. 102 - 115)
Vol. 6 (Doc. Nos. 116 - 120)

Section VIII: Congressional Record - Related Bills . . . . . Vol. 6 (Doc. Nos. 121 - 162)

Section IX: Past Reports . . . . . Vol. 7 (Doc. Nos. 163 - 170)

Section X: Past Hearings . . . . . Vol. 8 (Doc. Nos. 171 - 172)
Vol. 9 (Doc. No. 173)
Vol. 10 (Doc. No. 174)
Vol. 11 (Doc. No. 175)
Vol. 12 (Doc. Nos. 176 - 177)
Vol. 13 (Doc. Nos. 178 - 179)
Vol. 14 (Doc. No. 180)
Vol. 15 (Doc. Nos. 181 - 184)
Vol. 16 (Doc. No. 185)
Vol. 17 (Doc. No. 186)
Vol. 18 (Doc. Nos. 187 - 188(A&B))
Vol. 19 (Doc. Nos. 188(C) - 189)
Vol. 20 (Doc. Nos. 190 - 191)
Vol. 21 (Doc. Nos. 192 - 201)

Section XI: Final Report . . . . . Vol. 21 (Doc. No. 202)

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act iii 1997

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act iv 1997

INTRODUCTION

AN OVERVIEW OF THE TELECOMMUNICATIONS ACT OF 1996

The "Telecommunications Act of 1996," signed into law on February 8, 1996, opens up competition between local telephone companies, long-distance providers, and cable companies; expands the reach of advanced telecommunications services to schools, libraries, and hospitals; and requires the use of the new V-chip technology to enable families to exercise greater control over the television programming that comes into their homes. This Act lays the foundation for the investment and development that will ultimately create a national information superhighway to serve both the private sector and the public interest.

President Clinton noted that the Act will continue the efforts of his administration in ensuring that the American public has access to many different sources of news and information in their communities. The Act increases, from 25 to 35 percent, the cap on the national audience that television stations owned by one person or entity can reach. This cap will prevent a single broadcast group owner from dominating the national media market.

Rates for cable programming services and equipment used solely to receive such services will, in general, be deregulated in about three years. Cable rates will be deregulated more quickly in communities where a phone company offers programming to a comparable number of households, providing effective competition to the cable operator. In such circumstances, consumers will be protected from price hikes because the cable system faces real competition.

This Act also makes it possible for the regional Bell companies to offer long-distance service, provided that, in the judgment of the Federal Communications Commission (FCC), they have opened up their local networks to competitors such as long-distance companies, cable operators, and others. In order to protect the public, the FCC must evaluate any application for entry into the long-distance business in light of its public interest test, which gives the FCC discretion to consider a broad range of issues, such as the adequacy of interconnection arrangements to

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act v 1997

permit vigorous competition. Furthermore, in deciding whether to grant the application of a regional Bell company to offer long-distance service, the FCC must accord "substantial weight" to the views of the Attorney General. This special legal standard ensures that the FCC and the courts will accord full weight to the special competition expertise of the Justice Department's Antitrust Division--especially its expertise in making predictive judgments about the effect that entry by a bell company into long-distance may have on competition in local and long-distance markets.

Title V of the Act is entitled the "Communications Decency Act of 1996." This section is specifically aimed at curtailing the communication of violent and indecent material. The Act requires new televisions to be outfitted with the V-chip, a measure which President Clinton said, "will empower families to choose the kind of programming suitable for their children." The V-chip provision relies on the broadcast networks to produce a rating system and to implement the system in a manner compatible with V-chip technology. By relying on the television industry to establish and implement the ratings, the Act serves the interest of the families without infringing upon the First Amendment rights of the television programmers and producers.

President Clinton signed this Act into law in an effort to strengthen the economy, society, families, and democracy. It promotes competition as the key to opening new markets and new opportunities. This Act will enable us to ride safely into the twenty-first century on the information superhighway.

We wish to acknowledge the contribution of Loris Zeppieri, a third year law student, who helped in gathering these materials.

Bernard D. Reams, Jr.
William H. Manz

St. John's University
School of Law
Jamaica, New York
April 1997

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act vi 1997

TABLE OF DOCUMENTS

VOLUME 20

Section X: Past Hearings (Continued from Volume 19)

Doc. No. 190 - Examining the Effects of Megamergers in the Telecommunications Industry - Hearings before the Subcommittee on Antitrust, Monopolies, and Business Rights of the Committee on the Judiciary, United States Senate, 103d Congress, 1st Session, Serial No. J-103-33 (October 27, November 16, and December 16, 1993).

Doc. No. 191 - Antitrust and Communications Reform Act of 1993 (Parts 1, 2, and 3) -Hearings on H.R.3626 before the Subcommittee on Economic and Commercial Law of the Committee on the Judiciary, House of Representatives, 103d Congress, 2d Session, Serial No. 40, (January 26, February 2 and 10, 1994).

For ***Master Table of Documents*** of this set, please refer to ***Volume 1.***

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act vii 1997

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act viii 1997

Document No. 190

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act [i] 1997

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act [ii] 1997

S. HRG. 103–850

EXAMINING THE EFFECTS OF MEGAMERGERS IN THE TELECOMMUNICATIONS INDUSTRY

HEARINGS

BEFORE THE

SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS

OF THE

COMMITTEE ON THE JUDICIARY UNITED STATES SENATE

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

ON

EXAMINING THE EFFECTS OF CERTAIN MERGERS IN THE TELECOMMUNICATIONS INDUSTRY ON COMPETITION AND INFLATION, FOCUSING ON THE MERGER OF QVC NETWORK, INC., AND VIACOM, INC., FOR PARAMOUNT COMMUNICATIONS, INC., AND THE MERGER OF TELE-COMMUNICATIONS, INC., AND LIBERTY MEDIA CORP. INTO BELL ATLANTIC CORP.

OCTOBER 27, NOVEMBER 16, AND DECEMBER 16, 1993

Serial No. J–103–33

Printed for the use of the Committee on the Judiciary



U.S. GOVERNMENT PRINTING OFFICE

84–880 CC WASHINGTON : 1995

Superintendent of Documents, Congressional Sales Office, Washington, DC 20402

ISBN 0-16-046464-1

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act i 1997

COMMITTEE ON THE JUDICIARY

JOSEPH R. BIDEN, JR., Delaware, *Chairman*

EDWARD M. KENNEDY, Massachusetts
HOWARD M. METZENBAUM, Ohio
DENNIS DECONCINI, Arizona
PATRICK J. LEAHY, Vermont
HOWELL HEFLIN, Alabama
PAUL SIMON, Illinois
HERBERT KOHL, Wisconsin
DIANNE FEINSTEIN, California
CAROL MOSELEY-BRAUN, Illinois

ORRIN G. HATCH, Utah
STROM THURMOND, South Carolina
ALAN K. SIMPSON, Wyoming
CHARLES E. GRASSLEY, Iowa
ARLEN SPECTER, Pennsylvania
HANK BROWN, Colorado
WILLIAM S. COHEN, Maine
LARRY PRESSLER, South Dakota

CYNTHIA C. HOGAN, *Chief Counsel*
CATHERINE M. RUSSELL, *Staff Director*
MARK R. DISLER, *Minority Staff Director*
SHARON PROST, *Minority Chief Counsel*

SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS

HOWARD M. METZENBAUM, Illinois, *Chairman*

DENNIS DECONCINI, Arizona
HOWELL HEFLIN, Alabama
PAUL SIMON, Illinois

ORRIN G. HATCH, Utah
STROM THURMOND, South Carolina
ARLEN SPECTER, Pennsylvania

BILL CORR, *Chief Counsel*
THAD STROM, *Minority Chief Counsel and Staff Director*

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act ii 1997

CONTENTS

Hearings held on: Page
Wednesday, October 27, 1993 1
Tuesday, November 16, 1993 85
Thursday, December 16, 1993 177

STATEMENTS OF COMMITTEE MEMBERS

Metzenbaum, Hon. Howard M., U.S. Senator from the State of Ohio 1, 85, 177
Specter, Hon. Arlen, U.S. Senator from the State of Pennsylvania 24
Hatch, Hon. Orrin G., U.S. Senator from the State of Utah 26
Simon, Hon. Paul, U.S. Senator from the State of Illinois 35, 88,
Thurmond, Hon. Strom, U.S. Senator from the State of South Carolina 41, 105, 180
Leahy, Hon. Patrick J., U.S. Senator from the State of Vermont 219

CHRONOLOGICAL LIST OF WITNESSES

WEDNESDAY, OCTOBER 27, 1993

Panel consisting of Raymond W. Smith, chairman and chief executive officer, Bell Atlantic Corp.; Sumner M. Redstone, chairman, Viacom International, Inc.; and Martin S. Davis, chairman and chief executive officer, Paramount Communications, Inc 5
Panel consisting of Dale N. Hatfield, president, Hatfield Associates, Inc., Boulder, CO; Kevin J. Arquit, Rogers & Wells, New York, NY; and Peter Huber, senior fellow, Manhattan Institute for Policy Research, New York, NY 50

TUESDAY, NOVEMBER 16, 1993

Mary Lou Steptoe, Acting Director, Bureau of Competition, Federal Trade Commission 89
Robert E. Allen, chairman of the board and chief executive officer, AT&T 107
Panel consisting of Dr. Mark N. Cooper, director of research, Consumer Federation of America; and Andrew Jay Schwartzman, executive director, Media Access Project 159

THURSDAY, DECEMBER 16, 1993

Hon. J. Robert Kerrey, U.S. Senator from the State of Nebraska 181
John C. Malone, president and chief executive officer, Tele-Communications, Inc. 193
Barry Diller, chairman and chief executive officer, QVC Network, Inc 232
Panel consisting of Robert Pitofsky, professor of law, Georgetown University Law Center, Washington, DC; and Henry Geller, communications fellow, The Markle Foundation, Washington, DC 241

ALPHABETICAL LIST AND MATERIAL SUBMITTED

Allen, Robert E.:
Testimony 107
Prepared statement 110
Illustration of a local telephone network 116
Article, "Competition in the Long Distance Industry" 116

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act iii 1997

	Page
Allen, Robert E.—Continued	
Biography of Prof. Michael E. Porter	117
Article, "Competition in the Long Distance Telecommunications Market," by Prof. Michael E. Porter	118
Index to exhibits	126
Exhibits 1 through 28	127–154
Arquit, Kevin J.:	
Testimony	56
Prepared statement	58
Cooper, Dr. Mark N.:	
Testimony	159
Prepared statement	161
Davis, Martin S.: Testimony	20
Diller, Barry: Testimony	232
Geller, Henry:	
Testimony	248
Prepared statement	249
Hatfield, Dale N.:	
Testimony	50
Prepared statement	52
Huber, Peter:	
Testimony	64
Prepared statement	65
Kerrey, Hon. J. Robert:	
Testimony	181
Prepared statement	186
Malone, John C.:	
Testimony	193
Prepared statement	198
Metzenbaum, Hon. Howard M.:	
Prepared statement of Anne K. Bingaman, Assistant Attorney General, Department of Justice, Antitrust Division	5
Letter from:	
Patricia M. Eckert, Commissioner, Public Utilities Commission, San Francisco, CA, Oct. 25, 1993	73
Edward O. Fritts, National Association of Broadcasters, Washinton, DC, Oct. 26, 1993	74
Consumer Federation of America, Center for Study of Responsive Law, Oct. 26, 1993	75
Letter to:	
Melinda R. Hatton, Esq., from Kevin J. Arquit, Rogers & Wells, New York, NY, Nov. 15, 1993	76
Hon. Anne K. Bingaman, from Henry Geller, communications fellow, The Markle Foundation, Washington, DC, Oct. 26, 1993	76
Map of the United States of America showing TCI and Bell Atlantic service areas	79
Pitofsky, Prof. Robert:	
Testimony	241
Prepared statement	243
Redstone, Sumner M.:	
Testimony	9
Prepared statement	13
Schwartzman, Andrew Jay:	
Testimony	166
Prepared statement	168
Smith, Raymond W.:	
Testimony	5
Letter to Hon. Howard M. Metzenbaum, Oct. 26, 1993	8
Steptoe, Mary Lou:	
Testimony	89
Prepared statement	91

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act iv 1997

APPENDIX

ADDITIONAL SUBMISSIONS FOR THE RECORD

NOVEMBER 16, 1993, HEARING

Page

Article, "Divestiture Plus Eight: The Record of Bell Company Abuses Since the Break-Up of AT&T," by Dr. Mark N. Cooper, Director of Research, Consumer Federation of America 257

Comments of the Consumer Federation of America, "In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation—MM Docket No. 92–266" 282

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act v 1997

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act vi 1997

WILL TELECOMMUNICATIONS MEGAMERGERS CHILL COMPETITION AND INFLATE PRICES?

WEDNESDAY, OCTOBER 27, 1993

U.S. SENATE,
SUBCOMMITTEE ON ANTITRUST, MONOPOLIES
AND BUSINESS RIGHTS,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:54 a.m., in room SD–226, Dirksen Senate Office Building, Hon. Howard M. Metzenbaum (chairman of the subcommittee) presiding.

Also present: Senators Simon, Hatch, Thurmond, and Specter.

OPENING STATEMENT OF HON. HOWARD M. METZENBAUM, A U.S. SENATOR FROM THE STATE OF OHIO

Senator METZENBAUM. We will start this hearing a little early because there are two votes on the floor of the Senate. I will ask the first panel of witnesses to take their seats.

We are here today to begin a series of hearings on the wave of megamergers that are sweeping the telecommunications industry. Before any of these mergers are allowed to go forward, there is one overriding question that we must answer for the American consumer; that is, will this unprecedented convergence of telecommunications giants create a swarm of cost-cutting entrepreneurs or a handful of price-gouging monopolists. Before any telecommunications deal is approved by the antitrust authorities or the Federal Communications Commission, we in Congress must be able to assure the American people that we know the answer.

I have not made up my mind about any particular merger. However, I do have serious reservations about many of them, including Bell Atlantic's merger with Tele-Communications, Inc., QVC's merger with the Home Shopping Network, AT&T's acquisition of McCaw Cellular Communications, and the contest between QVC and Viacom to acquire Paramount. The subcommittee will hear more about these deals from Bell Atlantic, Viacom, and Paramount today. We have been in contact with TCI, QVC, and AT&T, and expect them to appear before the subcommittee at a future date.

I believe that some press accounts have oversimplified and even distorted my position on the complex issues involved in these mergers. Let me make my position clear today. I do not believe that a deal is necessarily good or bad because it is big. The concerns I have expressed about certain mergers are based on my reasoned judgment that consumers can be exploited by conglomerates that wield too much market power. The elimination of competition and

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 1 1997

the potential to compete is, in most instances, harmful to consumers. The key is excessive market power, not size alone.

To that end, I am frank to say that the deal that concerns me the most is the merger of Bell Atlantic with TCI. Together, these monopolists will form a colossus which will have a telephone or a cable wire connecting approximately 40 percent of the homes in America. As you can see by the chart to my right, this deal will also give the new conglomerate control of the lion's share of America's most popular cable programming. Frankly, I had planned to recite the entire list of TCI-controlled programming until I realized that it would add 5 to 10 minutes to this opening statement. Moreover, TCI can make a sizable addition to its stable of programming if QVC—in which TCI already owns a 28-percent stake—acquires the Home Shopping Network and Paramount.

Given the size and scope of Bell Atlantic's and TCI's holdings, the merger could create a megamonster. It would have formidable power to dominate the cable market and to freeze competition which would otherwise occur between local phone companies and cable television systems. Such a concentration of power cannot be dismissed lightly by the Congress, the antitrust authorities, or the Federal Communications Commission.

To my mind, the Bell Atlantic deal raises four fundamental questions. First, can the merger of two huge monopolies that would otherwise be fearsome rivals usher in greater competition? Second, should any restrictions be imposed on the new conglomerate's ability to leverage its power in the cable programming and distribution markets? Third, can FCC and State regulatory authorities governing phone and cable companies adequately protect consumers? Finally, is there anything unique about this combination of monopolists that cautions against the merger?

First, it is no secret on Wall Street that local telephone and cable monopolies were positioning themselves to compete against one another. Both Bell Atlantic and TCI have made public statements to that effect. At a March 1990 hearing before a House Energy and Commerce Subcommittee, one of Bell Atlantic's vice presidents stated that "Bell Atlantic wants to be a full-service cable company and was capable of competing with entrenched cable companies." Likewise, at a cable television public affairs forum in March 1992, John Malone of TCI stated that TCI would "look at new revenue opportunities such as * * * residential phone service."

Now, the merger will put an end to any possibility of competition between Bell Atlantic and TCI, which is an issue that the antitrust authorities will have to consider. Gauging the anticompetitive effects of a merger that eliminates a potential rival is an issue that the antitrust laws have wrestled with for at least three decades. The Supreme Court clearly articulated this concern in its 1964 *Penn-Olin* decision stating that "The existence of an aggressive, well-equipped and well-financed corporation * * * waiting anxiously to enter [a] market would be a substantial incentive to competition which cannot be underestimated."

Another antitrust issue is whether approving this deal could lead to an industry dominated by a handful of telecommunications conglomerates that have powerful incentives to coexist instead of compete. In antitrust terms, this is called mutual forbearance. The the-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 2 1997

ory is that a conglomerate which is relatively strong in a particular market may refrain from competing aggressively with a conglomerate in another market out of fear of retaliation. Clearly, such a tacit agreement not to compete would harm consumers by inflating prices and limiting choices.

My second major concern about the deal is how much Bell Atlantic's financial deep pockets will entrench TCI's market power in the cable industry. That could raise new entry barriers against other phone companies or small entrepreneurs experimenting with new technologies. As it stands now, TCI has dominated the cable market by shrewdly positioning itself as the industry's gatekeeper. It has done so by amassing an extensive array of cable programming and building a vast set of cable systems.

Let me explain. First, a cable system can't be successful if it doesn't have the programs that viewers demand, such as news shows, movies, sporting events, and shopping channels. Currently, most of these programs are owned by the cable companies themselves. However, TCI owns or controls more programming than any of its competitors. That gives TCI the power to cripple its rivals and to keep new competitors out of the market by refusing to sell programming to them on reasonable terms.

I might add that Bell Atlantic is well aware of the barriers to entry that allowing one company to own so much programming creates. In a January 1993 filing with the FCC, Bell Atlantic stated that "Cable has used its control of programming to impede the development of competing distribution systems by denying access to cable-owned programming or by providing access on unfavorable, discriminatory terms."

Second, the reach of TCI's cable network allows it to control a rival programmer's access to the entire cable market. TCI has the Nation's largest cable television system. It reaches about 25 percent of all cable subscribers. The conventional wisdom in the industry is that a new cable program cannot break even unless it reaches the critical mass of viewers that subscribe to TCI's cable system. That means TCI's decision not to carry a program, for whatever reason, can doom it.

Bell Atlantic itself has acknowledged that cable systems have abused their power to control which programming gets to market. In a January 1993 filing with the FCC, Bell Atlantic complained that "Cable operators have also impeded the development of independent programming sources by denying them access to their monopoly cable systems."

I expect the antitrust authorities to take a hard look at whether the new conglomerate has too much power to chill competition because of its market penetration and its control over so much cable programming.

My third major concern about the merger is whether regulatory measures are sufficient to control anticompetitive conduct in this industry. As we will hear from several of today's witnesses, Federal regulations have not prevented Bell Atlantic and TCI from using anticompetitive business tactics against their rivals in the past. I believe that is significant and should also be considered by the antitrust agencies.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 3 1997

I am aware that the Cable Act passed by the Congress last year prohibits a great deal of anticompetitive conduct. However, the new law has not been tested and may not be sufficient to curb all possible abuses of the new conglomerate's market power.

Bell Atlantic seems to share my general skepticism. It recently sued to have the FCC's decision on cable rates overturned in favor of regulations that would reduce cable rates by 28 percent. In its pleading, Bell Atlantic described the FCC's decision as "arbitrary and capricious." It also claimed that the FCC rules left cable rates "inflated" and permitted "monopoly operators to continue exercising market power control contrary to the congressional purpose."

I also have doubts about whether the new FCC rules can prevent cable and telephone conglomerates from making monopoly profits at the expense of consumers. Prior to the merger, Bell Atlantic expressed similar doubts. In a January 1993 FCC filing, it urged the FCC to regulate the cable industry to "ensure that cable operators do not evade the Commission's rate regulations by recovering monopoly profits through inflated prices."

In summary, it would be a mistake for the antitrust authorities to rely on untested administrative remedies to protect consumers from telecommunications conglomerates. Finally, I believe that we must be especially careful to scrutinize a merger that involves the medium through which our society communicates the basic values of our democratic society. The exchange of views on television, over the phone, and through computer networking would be influenced by a merger of this breadth.

Therefore, I want to be certain that our antitrust authorities scrutinize the broad political and social ramifications of this merger. As John Shenefield, the Carter administration's antitrust chief, stated almost 15 years ago in testimony before the subcommittee:

> The relationship between economic size and political influence * * * is a fairly direct one. People across this country * * * [grow] quite concerned when they see a limited number of corporate decisionmakers, in effect, governing their lives without direct responsibility, with no public mandate, and without any accountability."

It is altogether appropriate for the antitrust authorities to consider the pervasive power that a telecommunications conglomerate would have to influence our democratic institutions. I would also expect the antitrust authorities to take appropriate steps to block or modify this merger if, after careful scrutiny, the concerns that I and others, including State regulators, consumer groups, and the National Association of Broadcasters have raised, persist. However, I am confident that the Department of Justice will pursue this merger with the vigor it deserves. Their statement indicates that "The proposed telecommunications acquisitions will be analyzed under all plausible theories of competitive harm."

At the conclusion of my statement, I will include in the record a statement submitted to us by Ms. Anne Bingaman, head of the Antitrust Division of the Department of Justice.

I intend to stay involved in this matter and to look carefully at other proposed mergers in this industry, and if I believe that it is necessary, I will propose legislation to adjust our communications policies in the phone and cable industries. I plan to work closely with my colleagues to review the 1992 Cable Act and the 1934 Communications Act to ensure that our antitrust and communica-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 4 1997

tions policies work in tandem to protect consumers from being victimized by telecommunications conglomerates.

[The prepared statement of Ms. Bingaman follows:]

PREPARED STATEMENT OF ANNE K. BINGAMAN, ASSISTANT ATTORNEY GENERAL, DEPARTMENT OF JUSTICE, ANTITRUST DIVISION

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to submit this statement for the record of your hearing on mergers in the telecommunications industry. The announcement of two significant acquisitions in the telecommunications industry has focused attention again on this critical area of the economy. The Department of Justice's Antitrust Division closely monitors transactions in this area since developments in the communication of information will likely be the catalyst for innovation and productivity growth in the economy well into the next century. Telecommunications developments also will have profound and immediate impact on virtually all consumers.

A restructuring of the telecommunications industry requires sound and reasoned antitrust enforcement. Sound enforcement is necessary to assure continuing competition in telecommunications markets. The maintenance of competitive markets is crucially important in maximizing the development of innovative technologies and services, and providing consumers with the widest possible range of choices at the lowest possible prices. Antitrust enforcement also consists of preventing transactions that result in limited access for competitors to telecommunications markets.

Department of Justice merger policy also recognizes that telecommunications mergers may have the potential to create innovative and efficient companies and promote the development of new technologies. For example, there has been some suggestion that these mergers may advance the creation of the long-promised "information superhighway." The Department will closely scrutinize such claims in the course of its merger investigations.

The Department of Justice subjects mergers and acquisitions in the telecommunications industry to rigorous scrutiny as required by law. The Department takes action to oppose transactions after careful review and investigation, typically under the procedures mandated by the Hart-Scott-Rodino Antitrust Improvements Act of 1976. Under the HSR Act, the merging parties are prohibited from consummating a proposed transaction while we conduct a formal investigation.

Proposed telecommunications acquisitions will be analyzed under all plausible theories of competitive harm. Investigations will not be limited to those markets in which the merging parties are direct competitors. The Department of Justice will oppose any transaction if there is significant evidence that the transaction is likely to result in competitive harm. Intervention, if any, will be structured to ensure the prevention of the possible competitive harm caused by the transaction.

Senator METZENBAUM. We will have to take a recess. I see there are five lights on. I will be back just as soon as I can. My guess is it will take me 10 or 15 minutes.

[Recess.]

Senator METZENBAUM. The subcommittee will come to order. I welcome our witnesses this morning. I think you have all been advised that we have a 10-minute time limit, and we will try not to be too rough on that score, but at least try to keep it within the 10 minutes.

Mr. Smith, we have you as our first witness. Please proceed.

PANEL CONSISTING OF RAYMOND W. SMITH, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, BELL ATLANTIC CORP.; SUMNER M. REDSTONE, CHAIRMAN, VIACOM INTERNATIONAL, INC.; AND MARTIN S. DAVIS, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, PARAMOUNT COMMUNICATIONS, INC.

STATEMENT OF RAYMOND W. SMITH

Mr. SMITH. Thank you very much. Good morning, Mr. Chairman and members of the subcommittee. My name is Ray Smith and I am the chairman and chief executive officer of the Bell Atlantic

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 5 1997

Corp. I am pleased to have the opportunity to testify on the merger of the Bell Atlantic Corp., TCI, and Liberty Media. I also want to thank Chairman Metzenbaum for holding hearings on this merger so promptly. I welcome the opportunity to explain to Congress and the American people why this merger is in the public interest.

On October 13, 1993, Bell Atlantic, TCI, and Liberty Media announced our intent to merge in order to create a new kind of company, combining Bell Atlantic's telecommunications skills with TCI's and Liberty's abilities in the creation and the delivery of programming. The net result is a new Bell Atlantic that will cut through the hassle, giving our customers a whole new level of choice and control and convenience in the multimedia marketplace.

Today, consumers are putting up with a tremendous amount of confusion and expense just to get a sampling of the choice and control and convenience that they badly want—VCR's that they can't program, cable channels they can't keep track of, computers and fax machines and telephones that they can't integrate. Consumers want and deserve to have a simple, straightforward way of using the technology to get precisely the information that they want when they want it and how they want it.

It is also clear that neither today's telephone network nor today's cable network alone can meet every one of these customer requirements. Both industries will have to transform their embedded technology base into full-service networks with the power of broadband, the flexibility of switched capabilities, and the freedom of mobile telephone services. These full-service networks will tap the pent-up demand for choice and control and convenience in the communications marketplace.

Our consumers will be the early beneficiaries of such services, such as video on demand that will allow consumers to select the program they prefer from a library containing thousands of titles; interactive distance learning that will allow adults and school-age children to not only watch, but to participate interactively with classes across the city or across the country, or even across the world. Interactive distance medicine will allow patients and doctors to consult a range of specialists without leaving their home or their office, and telecommuting will allow millions to work at or near home, thereby reducing the traffic on our Nation's highways.

The early introduction of these new services will promote the development of the information superhighway, will increase competition for both video and telephone services, and will allow America to be a global competitor with technologies, products, and services to export.

A key vision of the Clinton administration is the establishment of a national information infrastructure, an information superhighway. Our merger supports that vision. The new Bell Atlantic will spend over $15 billion during the next 5 years to create a national network of distribution systems that will transform the way we work and play and learn.

This accelerated investment in the new information technologies that make up the electronic superhighway will make the interactive, multimedia vision a reality much sooner than expected and without the use of any government money. This commitment to the information superhighway means more jobs not just in companies

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 6 1997

like Bell Atlantic, but also in U.S. companies that are developing the equipment and the software that will be used in and with the new full-service networks. Also, by bringing video services to our telephone customers and telephone services to our new video customers, we will stimulate competition where none existed before and bring more customer choice on the markets served by new Bell Atlantic.

Senator, if you look at the map that you referred to in your introductory remarks, you will see red areas all over the country. Those areas mean more competition, not less. A second telephone company is coming soon in those areas to provide more choice and more opportunities and more competition. If you look at the yellow areas, the old Bell Atlantic area, that is where a second cable company is going to be built, providing competition to the existing cable operators.

Outside Bell Atlantic's current telephone service areas, in effect, we will upgrade TCI's cable networks to compete with all comers, including the incumbent local telephone companies. In Bell Atlantic's current telephone service areas, we will upgrade our telephone networks to compete with all other providers, including incumbent cable companies.

We cannot forget in this changing world of technology that in all of these areas you will find well-financed companies, wireless companies, providing competition for both cable and telephone, well-financed companies like AT&T and Bell South and Ameritech, and direct broadcast satellite companies providing competition to the cable companies.

To eliminate any concern about competition in the Bell Atlantic region, we will spin off or sell all TCI and Liberty Cable systems operating there. This means that these cable companies will be completely separate from the new Bell Atlantic—separate companies, no common officers, no common directors, no common employees, no connection; in effect, competitors.

Bell Atlantic has stated to the Department of Justice and the FCC that we will not retain TCI's in-region cable properties. Attached to my prepared remarks today is a letter that I sent yesterday to key Members of the House and Senate Committees on the Judiciary, as well as Commerce, reaffirming that commitment.

Finally, by creating a company that will be one of the world's premier providers of communications services, we will help secure America's preeminence in the global information marketplace. Instead of watching from the sidelines while foreign companies acquire our studios, our long-distance companies, and other programming assets, the new Bell Atlantic will be developing new networks and new services right here in the United States that can be exported around the world. In sum, we think this is a perfect information age marriage, right for our customers, right for our investors, and right for the American public.

At the same time that many are cheering this idea of a new Bell Atlantic and the principles of this merger, some have claimed that the merger might result in a company that is too large. We should put such claims in perspective. Despite the merger, Bell Atlantic will still be one-fourth the size of AT&T, the Nation's largest communications company, and even before its planned merger with

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 7 1997

McCaw. After the merger, Bell Atlantic's video programming revenues will only be 5 or 6 percent of the total video programming revenues generated in the United States. The notion, therefore, that Bell Atlantic by sheer size alone will dominate the marketplace for interactive, multimedia services is without foundation. There are many capable competitors, as the world will see as it evolves.

The proposed merger has other benefits as well. First, because the merger is primarily a stock-for-stock transaction, the merger is being funded by Bell Atlantic's shareholders and not Bell Atlantic's telephone ratepayers. Second, within our region we plan to build video dial tone networks according to the rules set by the FCC. Under those rules, all video programmers will have access to that network on the same terms and conditions as Bell Atlantic or any other company. This means that the networks in our region will be open to all providers of video programming. We cannot and we will not dictate what cable companies, TV companies, or movie studios will put over our network.

Third, although we believe that existing State and Federal regulations are adequate to protect telephone ratepayers, Bell Atlantic will offer all in-region video programming through a subsidiary that is separate from the local telephone company. That separate subsidiary will have access to the video dial tone network only on the same terms and conditions as any other video programmer.

Bell Atlantic is determined that this is one industry in which America will not lose its preeminence. This is one merger that we believe deserves the support of Congress. It is procompetitive and it will cut through the hassles, giving American consumers more choice, more control, and more convenience. Finally, this merger will create jobs and that will be good for the American economy.

Thank you again, Senator, for this opportunity to appear here today. I am happy to answer any questions anyone might have.

[Mr. Smith submitted the following:]

BELL ATLANTIC CORPORATION,
Arlington, VA, October 26, 1993.

The Honorable HOWARD M. METZENBAUM,
Chairman, Subcommittee on Antitrust, Monopolies and Business Rights, Senate Judiciary Committee, Washington, DC.

DEAR MR. CHAIRMAN: As you know, earlier this month, Bell Atlantic, TCI, and Liberty Media announced our intent to merge in order to create a new kind of company, combining Bell Atlantic's telecommunications skills with TCI's and Liberty's abilities in the creation and delivery of programming.

I am enclosing for your review our October 12, 1993 letter of intent setting forth the principal terms and conditions pursuant to which Bell Atlantic proposes to negotiate a merger with TCI and Liberty Media Corporation.

In my testimony before the Senate Antitrust Subcommittee today I will restate my commitment that at the end of this process Bell Atlantic will spin off or sell all TCI and Liberty cable systems in the Bell Atlantic region. These cable companies will be completely separate from the new Bell Atlantic Company—no common officers, no common directors, and no common employees. These cable systems will be managed separately and that no officer, director or other employee of one will serve as an officer, director, or employee of the other. Because both companies will be publicly traded, their ownership will change over time.

I would like to achieve this result immediately, but there is one thing stopping us from creating these two separate companies at the closing of our transaction and that is the Modified Final Judgment. Let me explain.

Under that consent decree, Regional Bell Operating Companies were prohibited from entering the interexchange telecommunications services market now served by AT&T, MCI, Sprint, several domestic satellite fleets and literally hundreds of other

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 8 1997

companies. Unfortunately this apparently clear prohibition on RBOC entry into AT&T's business has been interpreted to prevent us from owning TCI's 26 percent of Turner Broadcasting System or its 18 percent stake in Black Entertainment Television.

Even worse, some of TCI's cable systems straddle LATA borders (which limit the area within which the MFJ permits RBOC's to offer service). The MFJ treats distributing cable programming—even one way movie channels—as the equivalent of RBOC's going into AT&T's interLATA business. Thus, we'll have to hold these systems outside of our new company until the waiver is obtained.

These rules have taken an awful life of their own and they need to be changed. But until the policy is changed and new rules are in place, Bell Atlantic must comply with the ones that exist today. Our Letter of Intent with TCI, therefore, contains an alternative structure—a back-up plan—in case we do not have the waiver of the MFJ that we need by the closing date of this transaction.

Under this scenario, Bell Atlantic will be temporarily prohibited from acquiring an interest in potentially billions of dollars of TCI's assets. These assets include all of TCI and Liberty's interests in other companies that they do not control. These companies include TBS (CNN, CNN Headline News, WTBS, TNT, Cartoon Network) BET, Inc. (Black Entertainment Television), QVC, Home Shopping Network, Family Channel, Court TV, various regional sports networks and cable systems serving over 3 million subscribers. Added to these properties are the cable systems inadvertently built across LATA borders.

This prohibition and awkward structure will only exist for the few months between the closing and when an MFJ Waiver is obtained. Nevertheless, during that time it will contain a substantial amount of TCI's very valuable assets. Therefore, during the temporary period in which it exists, TCI and Liberty's existing shareholders will continue to own it. Once the MFJ waiver is obtained, this "temporary company" will be merged into the new Bell Atlantic and the in-region cable system will be spun back out to the new combined company's shareholders.

We hope this temporary company never exists in the form I have described here. We designed the merger so that the new Bell Atlantic can offer the public all of the benefits from the combined skills, resources and assets of Bell Atlantic, TCI, and Liberty (except in-region cable systems). Only the MFJ prevents us from doing so immediately. We encourage Congress to take whatever measures are appropriate to assure that the MFJ does not—even temporarily—obstruct a transaction so far removed from the concerns it was created to resolve.

Let me underscore that my preference is we go to the final structure immediately and avoid an interim holding company. You have my personal commitment as to what that final structure will be. This is not a mere promise. This is the binding commitment Bell Atlantic has made to the Federal Communications Commission, the Department of Justice, and now to Congress.

There is no compelling reason for the interim holding company that would be required by the MFJ. I have to believe this is one of those unintended effects created by an antiquated MFJ. We can avoid concerns that would be raised by an interim structure if the necessary waivers are acted on in a timely fashion by the Justice Department and the Court, or if the MFJ is modified.

I enjoyed spending time with you this afternoon and discussing the Bell Atlantic/TCI/Liberty Media merger. Should you have any additional questions or concerns, please feel free to contact me directly.

Sincerely,

(Signed) Ray Smith.

Senator METZENBAUM. Thank you very much, Mr. Smith, and I am impressed with the fact that you finished just about exactly within the 10 minutes. Thank you very much.

Mr. Redstone, we are delighted to have you with us this morning.

STATEMENT OF SUMNER M. REDSTONE

Mr. REDSTONE. Thank you. Good morning, Mr. Chairman and members of the subcommittee. My name is Sumner Redstone and I am chairman of Viacom International, Inc. I really wish to thank the members of the subcommittee for this opportunity to testify and humbly to commend the chairman and the members of the subcommittee for their consideration of issues now which will affect

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 9 1997

the telecommunications industry for decades to come, and possibly to avoid a catastrophe.

While the subcommittee has a variety of issues to consider, I will speak to three areas of particular concern to Viacom, and more importantly to the American public. First, I will discuss the structural problems in the cable industry today caused by the extraordinary and abusive monopoly power wielded by TCI.

Second, I will describe why any enhancement of that market power will further choke competition, specifically why TCI's bid through QVC Network for Paramount Communications, as well as the proposed merger of Bell Atlantic and TCI/Liberty, will have cumulative, significant anticompetitive effects.

Third, I will outline the basic elements of Viacom's strategic vision for the communications industry and explain the procompetitive effects and consumer benefits of the Viacom/Paramount merger.

Over the last several years, TCI—and this is no overstatement—has been the bane of the American cable industry and the American cable consumer. Through a complex web of TCI companies, TCI has systematically attempted to exert monopoly power over almost every aspect of the cable industry. Today, TCI-controlled cable systems control exclusive access to well over 20 percent of American cable homes, and together with its partners and would-be partners in QVC, Comcast, Cox, and Newhouse, TCI controls access to one in every three such homes.

TCI's exclusive access gives it the power to make or break independent programming services—and it does—because given the need to reach a critical mass of cable subscribers, a programming service that is not carried by TCI-controlled cable systems has little or no chance to survive. As a result, TCI can and does extract onerous conditions to carriage, often obtaining an equity interest in otherwise independent programming services.

In our particular case, TCI and Liberty have threatened to deny carriage of our premium services, Showtime and The Movie Channel, and have refused to renew affiliation agreements for that carriage. TCI has also threatened, and I quote, to "crucify" The Movie Channel by dropping it from TCI's systems in favor of Liberty's own Encore service. These threats were designed to force Showtime Networks into a low-ball merger with Encore and to weaken or eliminate Showtime Networks' competitive position.

There are many examples of this kind of activity that do not involve our company. In other examples of TCI's predatory conduct, which may be found in my written statement, TCI/Liberty, one, insisted that NBC change the focus of its cable network, CNBC, in order to prevent competition with TCI-controlled Turner Broadcasting's CNN, prompting then Senator Gore, now Vice President Gore, to call the incident, and I quote, a "shakedown by TCI."

TCI and Liberty extracted an equity interest in Court TV by threatening to create a cloned service and refusing to carry Court TV on TCI's cable system. TCI chilled the bidding for The Learning Channel. All it did was say, you can buy it, but if you do, it is off TCI's system. The result was that TCI ultimately purchased The Learning Channel for $20 million less than the original bidder, Lifetime, in which we have an interest, offered to pay.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 10 1997

Significantly, in addition to its dominance in cable distribution, TCI and Liberty now own all or part of at least 25 cable programming services in the United States. TCI has also set out to control various technological developments, from encryption, compression, and transmission of signals, to set-top boxes and delivery of programming to homes, again leveraging its market power over access to American cable subscribers for its own benefit.

This, together with the TCI authorization center, a facility that will employ proprietary technology to encrypt, digitally compress, transmit, and control signals from individual programming services—in effect, TCI seeks control not only over content, but over carriage. This will enable TCI to use new technology to create new bottlenecks in the distribution of cable programming services.

The net result of TCI's predatory practices is that TCI typically demands lower license fees from unaffiliated programmers and extracts monopoly rents in the form of higher prices from consumers. As TCI drives down the wholesale price it pays unaffiliated programmers, such programmers will cut back on what they spend on programming. Program diversity, so essential to the principles of our Constitution and quality, are sacrificed.

Our dealings with TCI, our personal dealings in which I have been personally involved, have proven one economic fact of life. TCI's dominant position in cable distribution nationwide, when coupled with its vertical integration into programming, creates intolerable monopoly power. I don't know of a single industry in the United States today where that kind of power exists or is exercised.

Several weeks ago after suffering, along with other cable programmers, at the hands of TCI for years, we took TCI to court, seeking substantial damages for their monopolistic and predatory practices, and we are also challenging TCI's latest attempt to injure our business, a merger that was worked on for 4 years, a consensual merger, through its bid through QVC to upset the strategic merger with Paramount.

TCI's acquisition through QVC of Paramount can only aggravate the serious structural problems I have described. To understand the very real danger of a Paramount acquisition by TCI/QVC, one must understand the level of vertical integration and program protection that TCI has already achieved.

Turner Broadcasting, which is substantially controlled by TCI, has acquired, or will soon acquire, control of independent studios New Line and Castle Rock. TCI has also entered into agreements providing for a substantial equity interest in Carolco Pictures, and according to published reports TCI is looking at deals with MCA's Universal Studios and Sony's Columbia and Tri-Star Pictures.

Should TCI/QVC acquire Paramount, TCI will have significantly enhanced power to dictate terms to programmers, threatening that, unless such programmers accept TCI's terms, TCI will replace their programming with programming produced by its captive studios. By depressing to below-market levels the rate of return of unaffiliated programmers, program diversity, and quality will suffer. TCI now pays us nothing to carry VH–1. We could complain. They could drop VH–1 and VH–1 is out of business.

TCI and its partners' market power is dangerous enough, but when coupled with the publishing, television, and motion picture

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 11 1997

production and other interests of Paramount, the dangers to fundamental first amendment principles designed to further diversity of voices, multiplicity of viewpoints, and freedom of access to the marketplace of ideas, are sobering. This is especially significant in the light of the threatened combination of two of the largest publishers, something that hasn't been focused on, in the world, Paramount and Newhouse, another partner of TCI. This combination would create the single largest and most powerful publisher, presenting in and of itself serious antitrust questions.

As I said, this combination would create the single largest and most powerful publisher, presenting in and of itself substantial antitrust questions with respect to our control of communications in a household. Its superhighway is really an exclusive toll road which we believe will impose content-based charges on those who wish to communicate through it.

Unlike TCI and Bell Atlantic, Viacom favors a truly open telecommunications superhighway, ensuring everyone an equal chance to step up to the microphone. That superhighway should be content- and identity-neutral, and Congress should require that superhighway to be a two-way operating system that is entirely open.

What we have here is a combination of two great monopolists. We have all heard for years how monopoly will lower prices and advantage the consumer, but this has never happened. What we have here is the elimination of two potential competitors.

In contrast to the acquisition by TCI/QVC of Paramount and the proposed Bell Atlantic/TCI merger, Paramount Viacom will combine two companies with different yet complementary strengths. Rather than entrenching an abusive monopolist, Paramount Viacom will create a new, strong competitor, in which each partner can build on each other's programming expertise and talent.

The emergence of Paramount Viacom is particularly important to assure America's traditional worldwide leadership in the creation of programming. Viacom is already an international leader in marketing its programming services all over the world. It has, in effect, created through MTV the first international global network.

Paramount Viacom will have an even greater ability to create and export programming with broad international appeal and enhance American competition worldwide. Paramount Viacom will also provide direct and almost immediate benefits to American consumers, such as the creation of America's first true interactive educational television network for kids, drawing on Simon & Schuster for its educational publishing expertise and on Viacom and its Nickelodeon unit for their expertise in children's programming and interactive media.

In conclusion, the situation facing us today is not at all unlike that of the old Bell System. The difference here is that the anticompetitive effects can be avoided in the first instance without waiting for the disaster to assume full form before remedial measures are taken.

TCI has monopoly power now and exploits it. Think about this. TCI right now reaches 20 percent of cable subscribers in the United States. With its partners, it reaches one in every three homes in the United States. With Bell Atlantic, it will reach approximately 50 percent of consumers in the United States. Leaving aside all is-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 12 1997

sues of abuse of power, that kind of power should not be lodged in any one company or in any one man.

[The prepared statement of Mr. Redstone follows:]

PREPARED STATEMENT OF SUMNER M. REDSTONE ON BEHALF OF VIACOM INTERNATIONAL, INC.

SUMMARY

1) Today, TCI-controlled cable systems are gatekeepers, controlling exclusive access to well over 20 percent of American cable homes. That exclusive access gives TCI monopsony power to "make or break" independent programming services, because given the need to reach a critical mass of cable subscribers, a programming service that is not carried by TCI-controlled cable systems has little or no chance of commercial success. If the Bell Atlantic/TCI/Liberty deal is completed, TCI will have access to one in every two American homes, enhancing TCI's already prodigious "make or break" power.

2) TCI has been able to leverage its dominant access to American cable homes into cable programming. As a result, TCI and Liberty now own all or part of at least 25 cable programming services in the United States. TCI thus has the power (through its dominant access to cable homes) and the incentive (through its ownership of programming services) to discriminate—and sometimes destroy—independent programming services. And, if TCI acquires Paramount (through QVC), TCI will have even less need for independent programming. As a result, creativity will be stifled, program quality will be diminished and cable service prices to consumers will rise.

3) TCI has also leveraged its market power to obtain control over critical technological developments, including encryption, digital compression, transmission and set-top box access to the home. Given the bottlenecks that TCI has already created in the delivery of cable services, we fear letting the same people build and control the coming communications "superhighway."

4) The TCI/QVC/Paramount transaction, by virtue of TCI's market power and the market power of TCI's partners and would-be partners in QVC, raises serious antitrust questions in itself. The Bell Atlantic/TCI/Liberty combination will only make a bad situation worse. If either proposed combination is allowed to proceed, the American consumer will be forced to *pay more* for *lower quality programming* and *less diversity in programming*. We urge the government to take the time to understand and deal thoroughly with these issues before allowing either combination to proceed. Without government intervention now, it will be much harder to fix the structural problems later—and it may well be impossible to compensate consumers for the harm they will suffer in the interim.

Good morning, Mr. Chairman and Members of the Subcommittee. My name is Sumner Redstone and I am the Chairman of Viacom International Inc. I wish to thank the members of the Subcommittee for the opportunity to appear at today's hearing.

As I am sure you know, Viacom International Inc. is a diversified entertainment and communications company, which employs approximately 5,000 people worldwide. At the core of our company is Viacom Networks, which consists of MTV Networks and Showtime Networks Inc. MTV Networks includes three advertiser-supported, basic cable television networks: MTV: Music Television; VH-1/Video Hits One and Nickelodeon/Nick at Nite. Showtime Networks Inc. operates three premium television networks: Showtime, The Movie Channel and FLIX. We are also joint owners of Comedy Central, Lifetime and All News Channel—three additional advertiser-supported, basic cable networks. Our cable division owns and operates cable television systems that serve approximately 1.1 million customers. Our broadcast division owns five television and fourteen radio stations. Through our entertainment division, we produce programs for the broadcast networks and for first-run syndication. Our new media group is working to develop, produce, distribute and market interactive programming for the stand-alone multimedia and interactive marketplace, which is fast emerging.

In light of recent developments in the communications industry, the work of this Subcommittee, as well as that of federal, state and local regulators and others charged with shaping and enforcing communications policy, is immensely important. We are witnessing the dawn of a new age of communications, a revolution every bit as profound as Bell's invention of the telephone.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 13 1997

As with the development of our nation's telephone system, we should expect enormous technological advances in this communications revolution. But, also as with the development of the telephone system, the future communications system is susceptible to the leveraging of market power and other anticompetitive practices by those who dominate the nation's local delivery systems. The time for decisive action to ensure free competition and the full benefits of the communications revolution is now, and not, as with the old Bell system, years from now when the anticompetitive effects are manifest. Without the vigilance of Congress, the Federal Communications Commission and the antitrust enforcement agencies, the American public will be denied many of the advantages the communications revolution otherwise would bring.

This revolution is happening at a breakneck pace. If these changes hurtle past policymakers without appreciation of their potential anticompetitive implications, it will take at least a decade of reform—regulation, public enforcement and private litigation—to remedy the situation and, in the meantime, American consumers will be the victims, rather than the beneficiaries, of technological innovation. If allowed to proceed unchecked, the risk is that consumers will suffer as creativity is stifled, program quality is diminished and cable service prices rise. What is at stake is nothing less than the way that Americans will receive information, communicate with one another, and interact—well into the next century.

While the Subcommittee has much work and a variety of issues to consider, I will confine my remarks to three areas of particular concern to Viacom and, I believe, to the American public. First, I will discuss certain structural problems in the cable industry today, caused by the extraordinary—and abusive—monopoly power wielded by Tele-Communications Inc. ("TCI") and the companies it controls. Second, based on our experience in the cable industry, I will describe why *any* enhancement of that market power, indeed TCI's stranglehold, in the communications industry—specifically, the proposed merger of Bell Atlantic and TCI and TCI's affiliated company, Liberty Media Corp. ("Liberty") and TCI's bid, through QVC Network, Inc. ("QVC"), for Paramount Communications Inc. ("Paramount")—will further choke competition and lead to a closed communications "superhighway" built and ultimately controlled by TCI and those affiliated with it. Third, and finally, I will outline the basic elements of Viacom's strategic vision for the communications industry, and explain the procompetitive effects and benefits to consumers of the proposed merger of Viacom and Paramount.

I. TCI'S MONOPOLISTIC AND PREDATORY POWER IN THE AMERICAN CABLE INDUSTRY

Over the last several years, TCI has been the bane of the cable industry and the American cable consumer. Through a complex web of companies it controls or influences, TCI has systematically attempted to exert monopoly power over almost every aspect of the cable industry and, most recently, the technological developments that are the key to the future of our industry.

Today, TCI-controlled cable systems are gatekeepers, controlling access to well over 20 percent of American cable homes. No other cable operator comes close to that size. Even Time Warner (the second largest cable operator in the United States) controls access to only half that number of homes, and the next group of cable operators are one-fourth TCI's size. And together with its partners and would-be partners in QVC—Comcast, Cox Enterprises and Newhouse—TCI controls access to one in every three American cable households. With the addition of the Bell Atlantic service base, TCI and those affiliated with it will have access to one in every two households—creating overwhelming power. By contrast, Viacom's cable system holdings are *de minimis* (about one-twelfth the size of TCI), and provide service to less than two percent of all cable subscribers in the United States.

To understand the source and extent of TCI's dominance, one must understand the unique characteristics of the cable industry. TCI's level of exclusive access gives it the power to make or break cable programming services, among other things, as it sees fit. Unlike any other industry that comes to mind, the cable industry is unique in that even a 20 percent market share could result in such monopoly power.

TCI's "make or break" power derives from the fact that to successfully launch and operate a national cable programming service, that service must reach a sufficient base or "critical mass" of subscribers in order to generate sufficient advertising revenues or subscriber fees. In the case of a nationwide advertiser-supported basic cable programming service, such as Viacom's MTV and Nickelodeon, the "critical mass" of subscribers required to succeed is roughly 40 million of the current 57 million available subscribers. Premium television services, such as Viacom's Showtime and The Movie Channel, have extraordinarily high fixed costs, and therefore are also heavily dependent on wide distribution by cable operators in order to amortize those fixed costs. Further, in the case of premium services, wide distribution by cable op-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 14 1997

erators is not enough. Premium services, where carried, also need to be favorably marketed by cable operators (including favorable positioning, packaging and retail pricing) in order to encourage consumer subscriptions to individual services. Due to TCI's control of well over 20 percent of cable homes nationwide, a decision by TCI not to carry or favorably market a programming service on its exclusive-access cable systems would require that that service, at a minimum, be carried by nearly every other cable system in the United States for it to succeed commercially—an impossible hurdle to overcome.

TCI also wields its market power in subtle—but no less anticompetitive—ways. Our experience has shown that TCI attempts to leverage its market power over access to American cable subscribers in order to tighten its grip on programming services and other aspects of the cable industry. TCI often dictates grossly unfair terms as a condition to carriage of programming services. As to existing programming services, TCI often threatens to deny carriage, refuses to renew affiliation agreements and threatens to drop programming services entirely, knowing that without access to TCI's systems, programming services cannot succeed.

In our case, TCI and Liberty have threatened to deny carriage on their cable systems of our premium television services—Showtime and The Movie Channel—and have refused to renew affiliation agreements with Showtime Networks for carriage of those premium services. TCI has also threatened to "crucify" The Movie Channel by dropping it from TCI's cable systems in favor of Liberty's own Encore service.

These threats were designed to force Showtime Networks into a low-ball merger with Liberty-owned Encore Media and to weaken or eliminate Showtime Networks' competitive position. These tactics are part of a pattern by TCI to extract an equity interest in third-party programming services. For example, TCI used its monopoly muscle to buy The Learning Channel when it was put up for sale. Lifetime (a joint venture of ABC/Capital Cities, Hearst and Viacom) submitted a bid for The Learning Channel of $50 million, while TCI offered only $30 million. TCI then used the threat to eliminate The Learning Channel from TCI's cable systems—if the service were sold to anyone other than TCI—to chill the bidding for The Learning Channel. As a result of TCI's predatory actions, Lifetime's competing bid for The Learning Channel was reduced to approximately $39 million and ultimately withdrawn. TCI then purchased The Learning Channel for $30 million.

In another example of TCI's power to eliminate programming competition, when NBC began to develop its own all news cable network, the Consumer News and Business Channel, CNBC, TCI pressured NBC into changing the focus of CNBC in order to prevent competition with TCI controlled-Turner Broadcasting's Cable News Network. According to then Senator, and now Vice President, Gore, TCI kept CNBC off the air until TCI was assured that CNBC would not compete with CNN. Vice President Gore called the CNBC situation a "shakedown by TCI."

In the case of start-up programming services launched by third parties, TCI uses a similar tactic—threatening to create a clone of the new programming service, which TCI threatens will be carried on TCI's cable systems in lieu of the third party's new service, if TCI's demands for an equity interest in that service are not met. Because carriage on TCI's systems is essential for a new service to succeed, TCI's demands for equity tend to be met. For example, we understand that Liberty extracted an equity interest in Court TV in just that way—threatening to create a clone service and refusing to carry Court TV on TCI's cable systems. Afraid of losing its sunk costs, Court TV gave in to TCI and today, Liberty owns thirty-three percent of Court TV.

TCI (and Liberty) now own all or part of at least 25 cable programming services in the United States (including Encore, QVC Network, Home Shopping Network, Superstation WTBS, CNN, Headline News, TNT, The Cartoon Channel, The Family Channel, The Discovery Channel, The Learning Channel, Black Entertainment Television, Court TV, Prime Network, Sportschannel America, X*Press Executive and The Box).

TCI has also set out to control various technological developments—from encryption, compression and transmission of signals to set-top boxes and delivery of programming to the home—again leveraging its market power over access to American cable subscribers for its own benefit. TCI has created bottlenecks which give it control of the delivery of programming by cable and satellite, including control of encryption and compression technology. This, together with the construction of the TCI Authorization Center—a facility that will employ proprietary technology, as TCI sees fit, to encrypt, digitally compress, transmit and control signals from individual program services—will enable TCI to use new technology to create new bottlenecks in the distribution of cable programming services. TCI thus will be able to further leverage its existing monopoly power by refusing to distribute any programming not transmitted through the TCI Authorization Center.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 15 1997

The net result of TCI's predatory practices is borne by cable programmers and the American consumer alike: TCI typically demands lower license fees from programmers in which TCI has no equity interest and extracts monopoly rents (in the form of higher prices) from consumers that will sacrifice diversity, choice, quality and creativity in cable programming. Why? As TCI drives down the wholesale price it pays to such unaffiliated programmers, those programmers will have to cut back on what they spend to create programming. As TCI knows, those programmers have no other viable way to get their programming to cable consumers in TCI's franchise areas except through TCI, so they must accept TCI's terms. Because TCI attempts to—and often does—deny unaffiliated programmers a fair return on their investment, those programmers will spend less, program quality will deteriorate and—most importantly—viewers will suffer. Thus, TCI will continue to rob the marketplace of the incentive to create better television, and consumers will be the losers.

In contrast to TCI's typical practice of paying unaffiliated programmers license fees which are substantially below market rates, we believe that TCI frequently pays programming services in which it or Liberty has an equity interest full license fees. In these cases, TCI creates not only artificially low license fees payable to its competition, but creates artificially high license fees for its own affiliated programming services. The benefit to TCI of this is twofold, *first*, TCI is able to leverage non-TCI cable systems into paying those high license fees for its own affiliated programming services by demanding the same license fees that TCI itself pays, and *second*, TCI is able to depress the license fees payable to its competition because non-TCI cable systems frequently refuse to pay license fees for non-TCI programming which are higher than the license fees paid by TCI for such non-TCI programming. The effect overall is an increase in consumer prices for cable services and a diminution in program quality and choice.

Because of our success in creating programming with broad consumer appeal, Viacom has been a thorn in TCI's side. Perhaps because we have attempted to resist its efforts to leverage its existing market power, TCI has targeted us for its most egregious forms of conduct. Among other things, TCI has tried to acquire Showtime Networks on unfair terms; attempted to destroy The Movie Channel for the benefit of TCI/Liberty's own premium movie services; and acquired studio production capabilities through TCI-related companies and entered into exclusive motion picture output agreements, at predatory prices, for TCI/Liberty's own premium movie services, in order to deny Showtime Networks access to that motion picture output. TCI is willing to overpay for the right to this output since TCI will be recompensed through the monopoly tax TCI will then charge American consumers in the form of higher prices for cable television.

Several weeks ago, after taking TCI on for years in the marketplace, we took TCI to court. We have sued a number of TCI-controlled companies, including Liberty and QVC, in New York federal court seeking substantial damages for their monopolistic and predatory practices. We are also challenging TCI's latest attempt to injure our business—its bid, through QVC, to upset our strategic merger with Paramount. At bottom, our dealings with TCI have proven one economic fact of life: a dominant position in cable distribution nationwide, when coupled with vertical integration into programming, creates intolerable monopoly power; TCI has it, and it uses it. I therefore believe that TCI's market power must be addressed immediately; I also believe that, if the past is prologue, TCI's latest attempt to control the coming communications "superhighway" must be stopped. We simply cannot afford to wait until TCI's closed superhighway is in place, and then spend the next ten or more years trying to open it.

II. A. BELL ATLANTIC WILL ONLY MAKE A BAD SITUATION WORSE

The combination of Bell Atlantic and TCI can only aggravate the serious structural problems that are the source of the anticompetitive power that TCI so brazenly abuses. The primary reason—and primary danger—is that when TCI's, its partners' and would-be partners' share of U.S. cable homes are combined with Bell Atlantic's share of the local telephone service business, estimated to be in excess of 17 percent, the combined entity will be able to reach into virtually 50 percent of American homes. TCI already abuses its control of its local cable franchises, and if allowed to merge with Bell Atlantic, the new combination will possess overwhelming power which can only exacerbate the kind of anticompetitive conduct in which the current TCI already engages. There is simply no question that that kind of power should not be concentrated in one company.

If completed, the proposed merger between Bell Atlantic and TCI will give Bell Atlantic/TCI/Liberty an entrenched dominant presence in 48 of the 50 states and in 59 of the top 100 U.S. local markets. This massive combination will control access

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 16 1997

to 22 million telephone and cable customers—without taking into account the market power and reach of TCI's partners and would-be partners in QVC. If TCI sought to acquire each of the cable systems it does not already own located in the Bell Atlantic service areas, antitrust enforcers would surely view the attempted acquisition as having grave anticompetitive consequences, and the FCC would prohibit that acquisition as a blatant violation of the FCC's horizontal ownership rules (which are far too lenient in any case). Yet, this is essentially what TCI is accomplishing through the "back door" by the Bell Atlantic transaction—horizontal ownership well in excess of the FCC's limits—although TCI tries to gloss over it by the use of superhighway rhetoric.

TCI has already engaged in a series of corporate shell games, essentially shuffling assets in order to avoid the strictures of federal regulation. One need look no further than the history of TCI and Liberty to predict the future. When threatened by restrictions on vertical integration and horizontal concentration, TCI "spun off" Liberty, with majority voting control ending up in the hands of John Malone. And now that the danger from those regulations has apparently been avoided, Liberty and TCI have announced that they will recombine, with the financial benefits of that recombination flowing to TCI/Liberty's controlling shareholder, John Malone.

This makes one suspicious that the same pattern will undoubtedly be followed in the Bell Atlantic/TCI deal. The companies have announced that if they fail to obtain regulatory approval allowing TCI's cable franchises and Bell Atlantic's local telephone service to operate in the same geographical areas, those cable assets will be "spun off" in order to "solve" the problem. However, as in the TCI/Liberty spin-off, the assets will go to none other than the stockholders of TCI/Liberty and their controlling shareholder, John Malone. The regulations will be satisfied on their face while their underlying purpose will be subverted. Control will still lie with TCI through common ownership and interlocking directorates.

TCI has also long used hardball tactics with local governments to get its way. When the small town of Morganton, North Carolina, concluded that TCI's service was "atrocious" and decided not to renew TCI's cable franchise, the Mayor, Mel Cohen, began to explore building a municipal cable system. In response, TCI declared war on the project and on Mayor Cohen. TCI sued the town for $35 million, hired a lobbying firm to propose a referendum giving TCI a lifetime franchise, and ran negative ads to defeat Mayor Cohen's reelection. TCI spent upwards of $140,000 on the campaign, in contrast to the $600 spent by the incumbent. The town fought the lawsuit and won, and the Mayor was reelected, but TCI has continued to appeal the ruling. While the case is on appeal, TCI retains the cable franchise and its $1.3 million annual proceeds. Indeed, in a familiar tactic, TCI offered to sell the system to a consortium of buyers, but the town refused to approve the sale when it discovered that one of the purchasers was owned and controlled by TCI. In a similar, and no less telling story, when a dispute arose between the town of Vail, Colorado and TCI over rising rates and poor service, over one weekend TCI exhibited nothing but the home phone numbers of the mayor and the city manager.

With that history in mind, the new, bigger TCI with its enhanced market power, will be able to step up its destruction of anyone who does not play by TCI's rules. TCI already successfully dictates terms of carriage to almost every programmer, and Showtime Networks, which is fighting for its very survival against TCI's anticompetitive tactics, is living proof of that power. And if past is prologue—and it is—TCI will use this power to favor its own programming as well as to extract ownership interests and unreasonably low license fees from unaffiliated programming services.

TCI proposes illusory cures for these serious concerns. First, publicly TCI promises a better tomorrow with plenty of competition. Meanwhile, privately TCI so thoroughly dictates economic conditions today in the cable industry that competition tomorrow will be far too late to control TCI's abuses. The situation is not unlike that of the old Bell system. The difference here is that the anticompetitive effects can be avoided in the first instance, without waiting for the disaster to assume full form before measures are taken to remedy the situation. TCI has monopoly power now and exploits it now. The acquisition by TCI, through QVC, of Paramount will only further enhance TCI's monopoly power and its ability to abuse it. The Bell Atlantic deal will only make things worse, and no amount of rhetoric from TCI or Bell Atlantic will change that inevitable fact.

II. B. DIFFERENCE IN VISIONS FOR THE DATA SUPERHIGHWAY

How is the Viacom/Paramount merger—with the recently announced investment in Viacom by NYNEX Corporation—different from TCI's proposed Bell Atlantic/TCI/Liberty combination? Aside from very important structural differences (which I will

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 17 1997

get to in a moment), there is a fundamental difference in our vision of the way people will communicate.

TCI has spent a lot of time lately talking about the Bell Atlantic deal as the fulfillment of the long-awaited electronic superhighway. But TCI speaks out of both sides of its mouth. While promising an open highway and free competition—using buzzwords like "connectivity," "system compatibility," and "open architecture"—TCI has also boasted that the Bell Atlantic/TCI combination "will allow us to control all of the communications needs of a household with one device." Similarly, Raymond Smith, Chairman and CEO of Bell Atlantic, has stated:

> Our fundamental strategy is very straightforward. Number one, to develop a full-service network capable of delivering voice and data and image and video using both wired and wireless technologies in high-growth markets, both domestically and internationally. Number two, to develop the information, entertainment, and transactional services that can be offered over that network. And number three, to develop operating systems that allow customers easy access to those services.

Thus, while Bell Atlantic and TCI have promised that the proposed merger will bring "choice, control and convenience in the communications marketplace," what this really means is TCI's choice, TCI's control and TCI's convenience. But, as they say—and as TCI itself recognizes—the devil is in the detail, and TCI and Bell Atlantic are providing no detail. They are saying, in essence, "trust us, we will do the right thing." They cannot be trusted, however, and their vision is not of a truly open, content-neutral, superhighway, where any programmer has unimpeded access to viewers on commercially reasonable terms.

Viacom favors this type of truly open telecommunications superhighway, supporting both competition and First Amendment values, and ensuring everyone an equal chance to step up to the microphone. We believe the superhighway should be content and identity neutral. What that means is that as in an actual highway, a toll is paid to gain access to the highway and that toll is not determined by what a particular vehicle is carrying or the owner of that vehicle. An empty truck owned by company "A" pays the same toll as one owned by company "B" whose truck is loaded with goods worth a million dollars. The toll taker collects tolls based on volume of usage, not the value of goods carried or the owner of the truck. In other words, as with the telephone system today, people should pay based on how much they use the superhighway, not what they say or do on it or who they are.

What TCI has not told you is that *its* superhighway is really an exclusive toll road which detours competition and which we believe will impose content-based charges on those who wish to communicate through it. It is not the road to the future but a path to a past of unchecked monopolies and arbitrary censorship. As both Bell Atlantic and TCI have made clear, their superhighway will give them full control over the programming from its point of origin through its delivery to the home. And they mean to levy tolls on both programmers and consumers at several points along the journey.

The first toll booth on TCI's superhighway will collect a fee imposed on users of the superhighway for initial access, and that fee will not be a flat rate, but rather will be levied on a sliding scale based on TCI's perception of the value of the particular programming. The second toll booth will collect the fee TCI will charge to exit the highway and unlock the key inside the set-top box TCI has placed there, in order to access the viewer. And the third, and most pernicious, toll booth will be the one that collects the charge for obtaining the specifications to the operating system that will control the interactive lanes of the highway, without which programmers will be unable to create software capable of accessing the highway.

By manipulating crucial technologies over which it has the ability to gain control, we believe that TCI will control what the set-top box is allowed to receive or not receive. Already TCI's market power has made its choice of set-top box the *de facto* industry standard. By the same token, Bell Atlantic/TCI will select the proprietary technology and equipment necessary to construct their superhighway, and given the fact that their superhighway will be the first constructed and capable of accessing virtually 50 percent of all American homes, it is safe to assume that the Bell Atlantic/TCI superhighway operating system will also become the *de facto* industry standard. If this occurs, Bell Atlantic/TCI's control over the technology of program delivery, and thus over programming itself, will be almost absolute.

We need to be sure that TCI's superhighway is more than just a means to detour both competition and free speech. To that end, I suggest that you ask TCI a few questions about just what TCI means by an "open" superhighway. Because of TCI's vagueness and its use of politically correct buzzwords, it may be impossible to pin

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 18 1997

TCI down, or ask all the right questions. Nevertheless, we would begin with the following:

(1) *Will TCI charges be based strictly on the amount of usage of the superhighway?* In other words, TCI should charge for the number of trucks on the road, but not for the subjective value it places upon their cargo.

(2) *Will TCI divest its entire interest in programming to a wholly unrelated third party?* Such a sale will help to prevent the threat of discrimination against non-TCI programmers' access to TCI's highway.

(3) *If not, will TCI limit its affiliated programmers' use of its highway to no more than a specific percentage of the highway's total traffic capacity?* TCI has spoken of the virtually unlimited capacity of TCI's highway. But in actuality, capacity can be limited in a manner designed to permit TCI to continue to discriminate against unaffiliated programmers by reserving a large portion of limited highway capacity for its favorite sons. A specific percentage cap on its usage will help ensure that TCI builds the highway as openly as it promised.

(4) *Will TCI subscribe to standardized, non-proprietary data formats (e.g., MPEG II for video and Dolby AC-3 for audio)? And will TCI agree not to place a proprietary transport layer on its data signal?* In other words, will it make the highway usable by all vehicle makes and models?

(5) *Will TCI's highway and set-top boxes support the use of at least two encryption processes?* Such a move will promote both signal security (by offering redundancy in the event that one encryption process is compromised) as well as competition.

(6) *Will TCI permit the set-top boxes to be sold as a commodity (like telephones are now—but were not always), whereby all manufacturers have open access to the necessary technology and specifications to build compatible equipment and which all programmers can access?* Or will it force a household that wants to get other programming services to go to the expense of getting another set-top box? In effect, this would be no different from forcing a family to buy multiple television sets simply to access different channels.

(7) *Will TCI operate its Authorization Center as a non-profit free trade zone?* In other words, will TCI allow programmers to sell their services directly to the viewer (or to other cable systems or other distributors), or will it insist that its Authorization Center serve as a gatekeeper which directly controls whether a consumer receives a given service?

After you pose these questions to TCI, the more vague assurances or "don't know's" you hear, the more worried you should be. All that I ask is that you do not put the highwayman in charge of the highway. Viacom believes that, at a minimum, Congress should require that the superhighway be a full, two-way operating system that is entirely and truly open, and further, that the software specifications for access to the superhighway be made publicly available.

II. C. TCI'S ACQUISITION OF PARAMOUNT WOULD FURTHER STIFLE COMPETITION AND CREATIVITY IN THE CABLE INDUSTRY

If Paramount falls to TCI, through its controlled company, QVC, it will be further able to control not only the method and manner of non-broadcast access to a critical mass of American homes, but it will be further able to exclude from the marketplace or competitively disadvantage any programming provider who will not agree to its terms, and replace that provider's programming with TCI's own program offerings. The result of TCI's exclusionary tactics has been and will be to inflate prices to consumers, reduce quality and deny adequate returns for third-party programming, reducing the supply of innovative television.

To understand the full context and the very real danger of a Paramount acquisition by TCI/QVC, one must understand the vertical integration TCI has already achieved. For example, Turner Broadcasting, which is substantially controlled by TCI, has acquired, or will soon acquire, control of independent studios New Line Cinema and Castle Rock Entertainment. TCI has also entered into agreements providing for a substantial equity interest in Carolco Pictures. And, according to public reports, in addition to its intent to acquire Paramount, TCI is considering deals with both MCA's Universal Studios and Sony's Columbia Pictures and Tri-Star Pictures.

What are the dangers of TCI controlling Paramount? Once TCI has Paramount, TCI will have the enhanced power to dictate terms to Viacom and other programmers by wielding the threat that unless such programmers agree to its terms, TCI

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 19 1997

will replace their programming with that produced by its captive studios. By depressing to below-market levels the rate of return of unaffiliated programmers, diversity, quality and new sources of programming will be thwarted to the detriment of the American viewing public. Indeed, the power that TCI would have to control programming and cable distribution is dangerous enough by itself, but when coupled with the publishing, television and motion picture production and other interests of Paramount, the danger to fundamental First Amendment principles designed to further a diversity of voices, a multiplicity of viewpoints and freedom of access to the marketplace of ideas, is sobering. This is especially significant in light of the threatened combination of two of the largest publishers in the world, Paramount and Newhouse. This combination would create the single largest and most powerful publisher, presenting, in and of itself, substantial antitrust questions. If TCI's plans are fulfilled, it will be TCI which determines which voices, viewpoints and ideas are carried on the nation's superhighway. Indeed, TCI could end up controlling the news we receive and the content of our children's schoolbooks.

DIFFERENCES IN VIACOM'S ACQUISITION OF PARAMOUNT

As I mentioned earlier, there are obvious and meaningful differences between the proposed Bell Atlantic/TCI/Liberty combination and NYNEX's investment in Viacom. Most fundamentally, Bell Atlantic and TCI are merging their entire operations. Two companies which would otherwise compete in an expanded marketplace are becoming one, thereby eliminating the benefits of that competition. In contrast, NYNEX's relationship with Viacom is completely different, since the two companies will remain operationally independent. NYNEX is simply making a passive investment in Viacom and NYNEX will have no right to control Viacom's actions or vice-versa. Any future coordination between NYNEX and Viacom will occur only as a result of arms-length negotiations between independent parties for the benefit of two separate shareholder constituencies. Bell Atlantic/TCI/Liberty will combine to create one gigantic $60 billion company which serves only one shareholder constituency, whose largest shareholder will be John Malone.

In contrast to the proposed Bell Atlantic/TCI merger, which simply makes the nation's biggest cable operator even bigger, the proposed Paramount Viacom International will combine two companies with different—yet complementary—strengths. Rather than entrenching an abusive monopolist, Paramount Viacom will create a new, strong competitor in which each partner has access to and can build on each other's programming, expertise and talent, the very embodiment of First Amendment values.

The emergence of Paramount Viacom International is particularly important to ensure America's traditional worldwide leadership in the creation of programming. Viacom is already an international leader in marketing its programming services to Europe, Latin America and Asia. Paramount Viacom International will be a company with an even greater ability to create and export programming with broad international appeal and thus enhance American competition worldwide.

The proposed Paramount/Viacom merger will do far more than help the U.S. balance of payments. It will provide direct and almost immediate benefits to American consumers. For example, Paramount's Simon & Schuster, the leader in educational publishing, will be able to tap into Viacom's expertise in interactive television technology and together will create many new consumer offerings, such as a new Nickelodeon designed as the first, true interactive educational network for students of all ages and disciplines.

CONCLUSION

In conclusion, I appreciate your commitment to ensuring a fair and competitive environment and to the principles of freedom of expression that you have long labored to guarantee every American. I thank you and will, of course, be happy to answer any questions you may have.

Senator METZENBAUM. Thank you very much, Mr. Redstone.

Mr. Martin Davis, chairman of the board and chief executive officer of Paramount Communications, we are happy to hear from you, sir.

STATEMENT OF MARTIN S. DAVIS

Mr. DAVIS. Thank you. Mr. Chairman and members of the subcommittee, good morning. My purpose today is to tell you why the

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 20 1997

Paramount Communications board voted unanimously to enter into a merger agreement with Viacom, a decision we announced on September 12, 1993.

We are proceeding with this merger agreement on the basis of a revised and enhanced offer to our shareholders just made by Viacom, an offer which, we strongly believe, provides our shareholders with more value, both short and long term, more than the unsolicited hostile takeover bid announced by QVC.

Let me now turn to the basis of our agreement with Viacom. Paramount is a copyright-driven, American-owned enterprise. Our operations are primarily in film and television production, as well as book publishing. Our studio in Los Angeles, I might add, was founded in 1912. Today, we are one of the Nation's leading publishers of educational textbooks and related instructional materials, as well as a premier trade book publisher through Simon & Schuster.

Paramount operates the now completely modernized Madison Square Garden and its popular regional sports cable network, five recently acquired and expanding theme parks, and seven UHF broadcast stations. Paramount also helped to launch USA and Sci-Fi, two successful cable networks jointly owned by MCA.

Over the past decade, the worlds of entertainment and publishing, our two core operations, were forever altered by changes sweeping through our marketplace both here and abroad. These dramatic changes posed formidable challenges to our management and, if I may, let me cite some of them.

First, aided by a weak dollar and by less rigorous foreign accounting practices, European and Japanese companies have entered the U.S. market on a massive scale. Foreign owners are now in control of large Hollywood studios and have gained an enormous beachhead for the production of films, television and cable programming, as well as access to valuable film libraries. They have also acquired a number of major American publishing houses who produce instructional materials for our schools.

Second, our competition overseas has intensified as we pursue new global opportunities in the information and entertainment fields. Our competition now comes in large measure from horizontally and vertically integrated, foreign-owned entities who are protected and shielded by their governments in a trade playing field which is far from level when it comes to American companies. If the United States is to remain a robust competitor in Asia and throughout the Common Market, then only those American companies with strong complementary product franchises and efficient distribution systems will succeed over the long run.

Third, within our own country the media lineup has been radically transformed. Companies that were once independent and limited to a single market have joined forces across the product and service lines, as well as technologies, to create powerful multinational and domestic giants against whom we must also compete.

On that note, what must be of concern to you as members of the Antitrust Subcommittee, as it is to us as independent programmers, is the extraordinary market power amassed by the cable forces who are an integral part of the QVC lineup.

First, we have TCI, which is by far the Nation's largest cable operator, with over 10 million subscribers. Add to that the 3-million-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 21 1997

plus subscribers in Liberty Media, soon to be folded back up again by John Malone into TCI. But it does not stop there. Comcast, part of the original QVC group, has 2.6 million subscribers, making it the fourth largest cable operator. The more recent QVC allies are Cox Cable, with 1.7 million subscribers, and Newhouse Cable, with 1.3 million, the fifth and seventh largest MSO's. This brings the grand total to nearly 19 million subscribers. Effectively, this nationwide cable cartel would give TCI and its partners the ability to control access to one out of every three cable homes in America. When you throw in the Bell Atlantic service area, it is frightening to contemplate that the TCI/QVC group would hold the power to control the cable gateway to one out of every two homes in this country.

This concentration of market power does not even stop there. The TCI/Liberty Malone empire owns all or part of as many as 23 cable networks and 16 regional sports networks. This combination of horizontal and vertical power would have an even greater anticompetitive mass if it were to succeed in acquiring the Paramount Studio, as well as controlling the MSG Cable Network and our 50-percent interest in USA Network.

A QVC-Paramount board consisting of TCI, Liberty Media, Comcast, Newhouse, and Cox nominated directors would exert enormous leverage over the marketplace not only in cable, but in publishing, since Newhouse's Random House competes head to head with Simon & Schuster.

Surely, this aggregation of media power in so few hands must somehow be brought under control if we are to preserve the values of competition, programming diversity, and the best interests of the consumer. Our antitrust agencies must take a long and hard look at the anticompetitive aspects of the QVC hostile takeover bid for Paramount.

May I give you some historical perspective with a direct bearing on the subject before you. During the 1930's and 1940's, companies who owned the movie seats also owned the movies that were being shown. This combination of content and carriage was stifling competition and hurting the consumer.

In 1948, our Government broke up this vertically integrated monopoly in, as it turns out, the Paramount case. Despite the handwringing at the time, the film makers prospered. They were able to increase their production not only to serve their traditional market, the theaters, but the new, free television markets which were then opening up. I submit that we are in the same situation today. Instead of movie seats, there are armchairs in the living room in front of a screen in the form of a television set wired for cable.

Question: By severing the link between the cable program ownership and the control over the means of delivery, could we, by taking a leaf out of the Paramount case book, serve both the consumer and increase competition in this new media age? The new media gateway, I submit, whether it is called the communications superhighway or whatever label one chooses to affix, must be open to all programmers on a fair and equitable basis.

Despite the intent of the 1992 Cable Act, a crucial question you must answer is whether large, integrated cable combines like TCI will be able to continue to discriminate against independent cable

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 22 1997

programmers by denying them fair access to their delivery systems. By so doing, they can block the only currently available cable media path to the consumer. These cable bridge-keepers should no longer be allowed to hold up independent program drivers by charging exorbitant tolls or by keeping them off the cable roadway.

In the face of the structural changes in our business environment that I referred to earlier, it became clear to management that Paramount could not simply stand pat. Since I became chairman of Paramount in 1983—a company that at that time was known as Gulf+Western where I have spent almost all of my working life—my colleagues and I began to explore a number of alternative directions. These strategies were aimed at equipping Paramount to become a first-class competitor in the domestic and international arenas, and thus to build long term rather than short-term shareholder values.

A decade ago, we redefined our businesses by sharpening our focus on entertainment and publishing. We were not afraid to undertake the challenge of deconglomerating and to concentrate on what we considered to be the growth areas of the future as the information age began to dawn. In so doing, we created exciting opportunities for the writers, editors, directors, producers, and performers, the talent that is at the heart of our business. And we did so while strengthening our balance sheet by paying down our once very heavy debt load and increasing our liquidity. In the process, our shareholder values increased ten-fold.

During this restructuring, we also began to explore the possibilities of a business combination to find, if you will, an ideal fit. In pursuing that course, we wanted to avoid the dangers of highly leveraged or bust-up transactions that undermined so many companies in the "go for it" eighties. Our strategy led us to a careful search for an acquisition that could meet these criteria: first, a compatible management culture and business philosophy; a combination that would present no antitrust hurdles—we believe in competition, not in the heavy hand of monopoly; a financially strong association without the need to sell off valuable assets, dislocating employees and their families as well as the communities in which they live; a creative and innovative product mix, proven entertainment franchises, and a motivated talent base together with a global distribution and marketing system, taking full advantage of the latest delivery technologies; and most importantly, a community of interest that would enable us to grow and build our businesses together for the long haul, businesses that would inform, entertain, and educate audiences both here and around the world.

Viacom's chairman, Sumner Redstone, and I have been business associates since the mid-1950's when he built a successful film exhibition circuit throughout New England. Over the past 4 years, Sumner Redstone and I talked about the possibilities of a Paramount-Viacom merger. Last summer, these spirited and arms-length negotiations gained momentum. They culminated in the friendly merger agreement approved by the Paramount board. Clearly, I am convinced our agreement with Viacom meets all of the criteria I outlined. Together, our combined companies can

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 23 1997

achieve more and compete more vigorously than each could have done in its own right.

We saw the unusual benefits that could flow by bringing together the array of creative talent both our companies have assembled in recent years. We looked at the international distribution systems represented by Viacom's MTV Latin America, Europe, and Asia services. Linking these networks to our programming would enhance our ability to reach viewers all over the world.

We visualized the intriguing opportunities in educational publishing. Let me cite Viacom's popular children's cable network, Nickelodeon, and the computer-based interactive learning technology Paramount is bringing into the Nation's classrooms. Uniting these two great franchises would promote educational innovation and literacy training.

We saw the potential of additional free television programming and have just announced the creation of a fifth broadcast network with Chris-Craft, a project we have been working on for more than a year.

We saw a commitment to maintaining the integrity of our assets and a resulting company that would accelerate its growth, expand employment opportunities, and promote the flow of exports—the uniqueness and popularity of American intellectual property that can measurably improve the U.S. trade balance.

Senator METZENBAUM. Mr. Davis, can you wind up, please?

Mr. DAVIS. Pardon?

Senator METZENBAUM. Can you wind up, please?

Mr. DAVIS. I am almost there, sir.

We could not identify any antitrust or regulatory problems. In fact, we are pleased to note that our proposed merger with Viacom last week received the required Hart-Scott-Rodino approval from the U.S. Government.

Finally, we recognize that Paramount Viacom, while still only half the size of Time Warner and smaller than Fox' News Corp. or Sony-Columbia, Matsushita's MCA or the German Bertelsmann Group, could serve as a model for a new form of business alliance, one prepared to meet the global goals of competition, programming diversity, and state-of-the-art product innovation, while at the same time honoring our joint commitment to building long-range shareholder values.

Mr. Chairman, that completes my remarks. I am pleased to respond to your questions.

Senator METZENBAUM. I do have, and my guess is my colleagues have a number of questions, but before doing so some of our members were not here before when we were taking opening statements. Senator Specter, we would be happy to hear from you, sir.

OPENING STATEMENT OF HON. ARLEN SPECTER, A U.S. SENATOR FROM THE STATE OF PENNSYLVANIA

Senator SPECTER. Thank you, Mr. Chairman. In an opening statement, I would like to express some of the concerns which I have, however, I am now very late for an earlier commitment, so I am going to have to excuse myself, but I will try to return to ask questions and have a dialog.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 24 1997

Up until late yesterday afternoon, all I knew about this matter was what I read in the newspapers and heard on the electronic media. As is the custom, I met late, at the request of Mr. Smith and then at the request of Mr. Redstone and Mr. Davis. Although I had earlier appointments scheduled at Mr. Diller's request, he could not complete them, but I talked to him by phone today. What I see unfolding is a very complicated picture, one which is going to require very considerable analysis in a variety of fora.

When Mr. Smith outlines the goals of Bell Atlantic, I am candidly impressed. I have seen Bell Atlantic operate in my hometown over many years, and I would like to see competition in cable and in telephones both in Pennsylvania and in Philadelphia. I would like better cable service also in Washington where they are also present. Bell Atlantic and QVC and Comcast all have very substantial roots in Pennsylvania.

When I take a look at the statements which are made by Mr. Redstone, as I heard them yesterday afternoon and read his statement and hear them this morning, I am very concerned. I have examined in a cursory fashion a very extensive complaint which Viacom has filed against TCI in the Federal court alleging antitrust violations.

I don't know what the facts are, but if TCI is going to have access to 50 percent of American households, then I have grave doubts about the public policy wisdom of such an arrangement; but I repeat, I don't know what the facts are. I have been provided with a chart which talks about vertical integration and horizontal integration, and I think we may soon, if this is all so, have diagonal integration, with as extensive as these issues are.

I am just a little disappointed that Dr. John Malone is not present today, but I understand the problems of scheduling.

Senator METZENBAUM. He has been invited and he was out of the country, but we expect him to be before us at a subsequent hearing.

Senator SPECTER. Well, I would hope that he would be present. When we talk about the kind of allegations—and I emphasize that they are allegations—that Mr. Redstone has made, and I don't know what the facts are, but if these facts are proven, it is a very serious question.

I have been dissatisfied with antitrust enforcement back through many administrations, both Republican and Democratic. I don't think we have had nearly enough vigor in antitrust enforcement. Fortunately, there is a remedy on private right of action, and the Viacom Co. has commenced a complex lawsuit with a big, thick, fat complaint. It would be my hope that Viacom would pursue that in Federal court. There are procedures with the temporary restraining order and preliminary injunction to bring this matter into court promptly and to see what can be proved.

I do not think it is possible for this subcommittee to begin to sort out all these complex factual allegations and potential defenses. When I listened to Mr. Diller on the telephone for a few moments this morning, he had quite a lot to say on the other side. I understand that Mr. Redstone and Viacom have some concerns, motivations perhaps, not to see the QVC merger take place with Paramount. I understand that, but whatever the motivations are, what

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 25 1997

is of concern to this committee and me and others is what the facts are. So I would hope that Viacom would proceed to try to produce a resolution of the facts and put up the evidence to the extent that they have it.

Speaking for myself, and perhaps for others on the committee, we are not going to get involved in whether Viacom or QVC ought to merge with Paramount—that is another question—unless there are antitrust implications in and of itself. But there are very profound public policy interests involved here on the consumers of America in cable television which are enormously, enormously important.

As I say, I will try to return to participate in the questioning, and I think that we are going to have to scrutinize this matter very closely. I hope that the new antitrust chief, Ms. Anne Bingaman, a very competent lawyer who heads that division, will take a close look and that we will be able to find out what the facts are so that we can come to an informed judgment.

Senator METZENBAUM. Thank you very much, Senator Specter.

Senator Hatch, do you have an opening statement?

OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM THE STATE OF UTAH

Senator HATCH. Thank you, Mr. Chairman. This hearing is a very interesting one to me, and the issues surrounding this hearing are very interesting. In my view, the question posed by the title of this hearing, "Will Telecommunications Mega-Mergers Chill Competition and Inflate Prices," manages to be both leading and misleading. The answer to this question is clearly not the reflexive unthinking "yes" that the question invites. This question must instead be examined in light of the revolutionary changes underway in telecommunications.

Until now, the local markets for telephone and cable have developed and have been regulated as separate natural monopolies. Real competition within each market has been viewed as technologically infeasible and regulatory walls designed to prevent the leveraging of market power into other market products have reinforced the local monopolies.

Now, however, technological changes are rapidly rendering obsolete the assumptions that have governed regulation of local telephone and cable markets. Specifically, remarkable advances in wired and wireless communications will soon make vigorous competition possible in both the local telephone and cable markets. The regulatory walls protecting each of these monopolies are rapidly crumbling and the markets themselves are merging.

The collapse of these walls will not only subject the local telephone company and the local cable company to competition; it will also free them to venture out to compete on each other's terrain. The sooner the local monopolies are ended, the more the American consumer will benefit. Promotion of competition in the telephone and cable markets is therefore the surest path to low prices and quality service for the American consumer.

This hearing centers on two prospective mergers, one between a local telephone company, albeit a very large one, and a cable system, the largest; the other a battle within the cable industry for

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 26 1997

control of a movie studio. I hope that this hearing will examine, among other issues, important questions such as: What existing regulatory barriers impede the development of competition in the telephone and cable markets? Do alliances between local telephone companies and out-of-region cable companies offer the best prospect of vigorous competition in the emerging combined market? What threats to long-term competition are posed by acquisitions during this transitional phase that we are now in? These are interesting questions.

I have met with everybody testifying here today on this first panel, and I have to say that I am concerned about some of the problems that have been raised. I do think that it is important, Mr. Chairman, that Mr. Malone testifies before the committee and that he be prepared to answer some of the questions that we have. I think it is critical because this is not some little itty-bitty thing; this is a very, very big set of processes and set of determinations, and I, for one, want to do what is right and proper under the circumstances and under the law in this situation.

Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you very much, Senator Hatch. Let me make it very clear, we had indicated to Mr. Malone that we would like to have him present here. I could not speak with him; he was out of the country. I spoke with his representative. He told me they would consider coming before the committee. I told him we would expect him to come before the committee at a future date, and we will work that out in the not too far distant future.

I also spoke with Mr. Barry Diller and he indicated a complete willingness to be with us, and it is just a matter of scheduling. We also expect to hear from Mr. Allen, chairman of the board of AT&T. So we want to see to it that—and I am sure all of the committee members feel the same way, and that is that all of the parties to these matters be given an opportunity to be heard and that we be given an opportunity to inquire of them.

With that, we will proceed forward with some questions and we will start with you, Mr. Smith. Mr. Smith, until this merger was announced, I had hoped, based on your company's past assertions about competition, that Bell Atlantic would build a video platform which would be the most formidable competitor to TCI's cable monopolies in the Bell Atlantic region.

You claim that you still will move to compete against cable. Frankly, Mr. Smith, I am skeptical. Even if you are not allowed to control both wires into the consumers's homes, you will no longer have strong reason to compete aggressively against cable companies. In fact, there is every reason to believe you will sell the TCI cable systems in your phone region to companies that won't aggressively compete against you. You and I both know you can make sales to people who could be very aggressive competitors and you can make sales to those that would not have sort of an understanding to lay back and not come on too strong as a competitor.

I know there are lots of ways to achieve that kind of an objective, realistically speaking. I believe you will have the power to leverage TCI's vast programming and extensive cable systems to intimidate your competitors and discourage or prevent them from competing with you aggressively.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 27 1997

Isn't it true that if this merger were approved, you could block other phone or cable companies from competing with your phone business because of the control that you have over so much popular programming and the vast number of people that your cable systems would reach?

Mr. SMITH. No, it absolutely is not true, Senator. It is our intention to spin off all of the TCI and Liberty cable systems that are in our territory in a way that will benefit the shareholders of the corporation. We will do that in a way that will be consistent with all of the laws of the land and we will not have any kind of cozy arrangements with anyone at any time. It is the tradition of our company, Bell Atlantic, to remain above reproach when it comes to handling situations of this sort.

Somebody said that it is the definition of intelligence to be able to hold two conflicting ideas in your mind at the same time, and that means that sometimes we are going to have to deal with people as competitors and at the same time they may be suppliers, such as AT&T. We compete vigorously against AT&T. We compete vigorously against Southwestern Bell. We compete vigorously against all sorts of companies that are in our territory. We plan to do exactly that.

We will build the world's best video network in the old Bell Atlantic region. We will compete with the cable companies that are there, whether they were owned by TCI or not in the past. And we have a precedent to this. Back in 1984 when the Bell System was broken into eight parts, AT&T and the seven regional holding companies, there were questions of the sort that you posed. People said, well, these are friends and they are going to have, at least at the very beginning, the same shareholders, and so on; they won't compete against each other. Well, I think that that has proven absolutely not to be true.

We are strategic competitors against virtually every one of the former members of the Bell System, and that is exactly what we will do, and we don't do that just out of an altruism, Senator. We do it because it is good business. The video market is large. The interactive video market is going to be gigantic. It is very much to our advantage to compete very directly against those cable companies.

The cable companies that will be spun off are likely to be spun off to companies like AT&T, Bell South, Ameritech, excellent companies who are going to be doing the same sorts of things as we are out of their region. They are going to be competing against us for telephone and we are going to be competing against them in our territory in video. So I don't see this in any way being advantageous to our shareholders, and it certainly is not something that we would ever consider doing.

Senator METZENBAUM. Well, Mr. Smith, Bell Atlantic is a very well-respected company.

Mr. SMITH. Thank you.

Senator METZENBAUM. And I hold it in the highest regard. You made one statement that caught my attention. You said Bell Atlantic would always want to conduct itself in a manner that would be above reproach.

Mr. SMITH. Yes, sir.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 28 1997

Senator METZENBAUM. But the fact is that I am not sure exactly when you did it, but not too long ago Bell Atlantic was saying that the cable rates should be reduced 28 percent. I came in from New York early this morning and glanced at the Washington Post and saw you had now changed your position on that, you said we will have to reconsider that position. Now, that sort of sounds like, well, I am on a different side of the table now; now, I am in the cable business and I don't think this 28-percent reduction should be the fact.

I have to say to you that we are all realists. You are a business person. I came out of the business world, and if you are going to own the cable companies, you don't want cable rates to be reduced 28 percent. But before when you weren't in that position of owning TCI, you were for it. That is not exactly the kind of image that you tell us Bell Atlantic maintains and wants to continue to maintain. Would you care to address yourself to that?

Mr. SMITH. Yes, certainly. When we were providing testimony concerning the Cable Act, we were concerned about rights and we made statements of that sort. That still is to our advantage. As you know, Senator, we are in a letter of intent stage. We haven't signed a definitive agreement and we certainly haven't closed on these properties, and you should be aware that there is a cash-flow test in these properties which states that we will pay a certain multiple of the cash-flow. So if the cash-flow is slightly lower, we pay a lower price. So I am not retracting that testimony.

We are going to have to review all of our positions so that we represent our shareholders and our customers. All of the positions that we made in the past were made sincerely. We felt that they were appropriate. I am not retracting that, but we will have to consider as circumstances alter cases and we go forward.

I feel that our company has been above reproach. What we have attempted to do was to represent all aspects of our constituency, which is our customers, our shareholders, our employees, and the communities. We try to do it in a balanced and reasonable way so we provide a fair return and we provide good jobs and we provide good value to the customers, and we are good citizens in the community. So, as we make these positions and we change over time, we are doing it as circumstances alter, so I don't think that that is in any way a change in our basic position.

Senator METZENBAUM. Are you saying to me that you need monopoly profits from cable consumers in order to complete this deal?

Mr. SMITH. Monopoly profits, sir?

Senator METZENBAUM. Yes.

Mr. SMITH. Would you explain?

Senator METZENBAUM. Well, if there is no competition—we were looking at a world prior to this deal being made where it was reasonable to assume and everybody in the field felt that the day was coming when the Bell companies would be in a position to compete with the cable companies by having the second wire into the home and providing a similar service to that which cable provides.

Mr. SMITH. Absolutely.

Senator METZENBAUM. Now, the question is, when you eliminate that, when you are in control of both of the wires—and even though you say we will sell off one, the fact is you are saying to

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 29 1997

us now you need the profits that that monopoly gives you, which is what TCI now has. Before, you were telling us there was a 28-percent reduction that should be made, and now I gather from the morning paper you are saying this is something we will have to reconsider.

Mr. SMITH. I will have to read the morning paper, Senator, but the fact is that we made that statement and we still think that that is reasonable. The fact of the matter is, though, we will not own both sides of the wires. Let me see if I can make that clear.

All across in the red parts that you see on your map there, TCI is the cable operator. They will build full-service networks in those areas and they will compete with all comers, not just other cable competitors such as direct broadcast satellite or 28-gigahertz systems that are going to provide sort of short-term wireless cable or any of the others. All comers will be competed with, including the telephone companies.

We fully expect that the telephone companies will do what Bell Atlantic is going to do in the yellow areas, and that is to equip their networks with cable capacities that will deliver the equivalent of video dial tone to all of the customers. It is to our advantage at Bell Atlantic to compete directly with all of the cable companies that are in that yellow territory.

We will never control both sides of the line. I sent a letter just yesterday to yourself and a number of members of the leadership making that very, very clear. We made that statement clear to the Justice Department.

Senator METZENBAUM. Mr. Smith, I am going to have to ask you to make your answers a little shorter because of time constraints.

Mr. SMITH. Yes, sir.

Senator METZENBAUM. But are you saying to me that people in those red areas should be getting 28-percent rate reductions? Is that what you are saying?

Mr. SMITH. No, I am not saying that, Senator.

Senator METZENBAUM. I didn't think so, but that is what you said when you appeared before one of the regulatory bodies.

Mr. SMITH. Senator, I didn't appear before the body.

Senator METZENBAUM. No; I understand.

Mr. SMITH. That was a Bell Atlantic statement that was made.

Senator METZENBAUM. When I say "you," I mean Bell Atlantic.

Mr. SMITH. And under the circumstances at that time, they felt that there should be a reduction in the rates at that level.

Senator METZENBAUM. Mr. Smith, you claim we don't need to worry about the proposed merger because of the nondiscrimination provisions of the 1992 Cable Act.

Mr. SMITH. That is correct.

Senator METZENBAUM. You claim under the act you won't be able to leverage and discriminate, as John Malone did, so there is no problem with your owning all of TCI's programming. However, if you are so confident that the law will work, why did you decide that you needed to pay a hefty price to own all of this programming?

Mr. SMITH. Well, let me say first of all that the accusations made at this table and by others about John Malone are unproven, and America has a long and cherished tradition of unsupported and

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 30 1997

unproven accusations and counteraccusations during acquisition battles. So I am not about to comment on which pot is calling which kettle black, but I cannot sit by and say that John Malone has done these things. These things that are absolutely unproven.

Senator METZENBAUM. I am not sure I would agree with that. From my own personal experience, I remember when a little wireless company in Cleveland was trying to get into the marketplace and just had the squeeze put upon it, and it seems to me that I have some recollection of other instances in which John Malone has indeed wielded his monopoly power.

Mr. SMITH. No offense, but accusations are not proof. But the fact of the matter is I am not prepared to comment on those, and there are accusations made the other way, of course. But the fact of the matter is that the reason for the Bell Atlantic and TCI merger is this, that we felt as we looked ahead that this country was going to move toward interactive video systems that will be delivered to every single home.

As I said in my testimony, this is going to be a very important societal benefit. It is also going to be a very good business. We concluded in Bell Atlantic that we didn't have the programming and cable experience and it would take us an awful long time to develop it. We looked around this country and we said which companies had this kind of experience, and we saw the fine companies of Comcast and Time Warner and TCI and we concluded that the best match for us would be TCI.

We paid the price, or offered the price to TCI and Liberty Media based on the value that we saw in the future. The core competencies of those companies matched ours perfectly. We had a way and means that we felt we would spin out any kind of conflicting assets within our region. We would promote competition outside of our territory and we would bring fierce competition inside the territory by equipping our existing network to become that superhighway. So that was the reason that we wanted to do that. This is a wonderful new business for us and we saw them as the best possible partner.

Senator METZENBAUM. Senator Hatch, I have got another question for Mr. Smith, then I will yield to you and then I will come back to Mr. Smith.

Senator HATCH. I would appreciate it if I could because I do have to leave.

Senator METZENBAUM. I will just ask one more and then yield to you.

Senator HATCH. OK, thank you.

Senator METZENBAUM. Under your merger agreement, I understand that through TCI you would own a large share, 30 percent, of Teleport, a company that has begun to provide direct competition with local phone companies in New York, Boston, Chicago, Dallas, Los Angeles, and is moving into the Bell Atlantic region particularly with respect to New Jersey, Pennsylvania, and the District of Columbia.

If this merger goes through, you would then have a 30-percent share of Teleport. Wouldn't you then be able to stifle telephone competition which would otherwise develop from Teleport?

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 31 1997

Mr. SMITH. We would seek to do exactly the same thing with Teleport as we are doing with the in-region cable. We would think it would be inappropriate to be on both sides of the competitive wire, whether that competitor was a former TCI cable company or a former Teleport company. So we would seek to divest all conflicting assets of that sort.

Senator METZENBAUM. Senator Hatch?

Senator HATCH. Thank you, Mr. Chairman.

Mr. Smith, as you have heard again this morning and as you know, TCI and Mr. Malone have been accused of a broad range of abusive anticompetitive practices. Now, I admit these are accusations and I am eager to hear Mr. Malone's account. I understand why he can't be here, a conflict in scheduling, but I think he is going to have to come. In his absence, though, let me just direct a couple of questions to you.

Mr. SMITH. Surely.

Senator HATCH. First, is Bell Atlantic's acquisition agreement with TCI in any respect contingent upon QVC's successful acquisition of Paramount?

Mr. SMITH. No.

Senator HATCH. What role would Mr. Malone play in the combined Bell Atlantic-TCI merger?

Mr. SMITH. Mr. Malone would be vice chairman and I will be chairman of the board. Mr. Malone will be responsible for the development of new programming, especially in the interactive, multimedia area.

Senator HATCH. One of the basic concerns that Viacom has expressed about TCI is that its size in the cable systems market allegedly gives it monopsony power in acquiring programming, and that it allegedly has leveraged and will continue to leverage that power into monopoly power in the programming market. Now, would you agree that if these allegations are true they would pose a serious threat to competition and to the welfare of American consumers?

Mr. SMITH. I think that the allegations are based on a model of the industry which is rapidly changing.

Senator HATCH. But what if they are true?

Mr. SMITH. The model was that there was one cable operator in each location and there were limited numbers of channels that were available, and this scarce commodity into the living rooms could be controlled by one person or another. Many of those concerns have been addressed by the 1992 Cable Act. It is a good act and it requires that unaffiliated content providers have access to whatever number of channels there are.

But the fact is that the paradigm is changing. With compression technologies and with wireless technologies, the capacity into each city and to each home is increasing almost exponentially. We are not talking about 30 channels that are limited anymore, or even 500 channels. The kind of interactive network that we are building is based on the telephone model; that is, it is switched and any individual who has content will have access to this new network, and we will be able to provide their contact into the home. So the old model, I believe, is no longer operational.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 32 1997

Senator HATCH. But would you agree that these allegations merit careful examination by antitrust enforcement authorities?

Mr. SMITH. I think that all aspects of this deal will require careful consideration, and we expect that and we want that so that we can go forward on an even basis.

Senator HATCH. On pages 16 and 17 of his written testimony—and I have read the testimony—Mr. Redstone poses seven questions to be asked of TCI. Now, may I request that you and Mr. Malone provide answers to those questions to the committee?

Mr. SMITH. Of course.

Senator HATCH. All right, thank you. Now, I have a question regarding the proposed divestment of TCI's cable operations with Bell Atlantic's region. Let me say parenthetically that this divestment eliminates what, from an antitrust perspective, would be the single most potentially troublesome feature of the acquisition.

Mr. SMITH. Yes.

Senator HATCH. Could you explain how the divestment would take place under the acquisition agreement, because as I read the acquisition agreement transfer of in-region cable operations to another company would be contingent on that company agreeing to subscribe to Bell Atlantic's video dial tone network service? I want to know if that is a correct reading, and if so, how would you respond to the concerns that this provision itself might be anticompetitive or might have anticompetitive consequences?

Mr. SMITH. The spin-out of the TCI assets in the Bell Atlantic region is not contingent upon the taking of Bell Atlantic's video dial tone service. This is an offer that we have made to every cable company in our operating territory and a number of them have accepted it. This is an arrangement by which the video dial tone network is built. It is either owned or co-owned by either or both of the parties. It passes all of the scrutiny of the Justice Department to make sure that, although capital may be preserved, which is the idea behind this, competition is also preserved. The approval of those agencies is required before any of these kinds of systems could be put up, but it isn't contingent on that.

Senator HATCH. One last question. Are there any existing regulatory barriers to competition in the cable market that you believe are outdated?

Mr. SMITH. Yes; we went to court, as you may recall, in Alexandria and said that the 1984 Cable Act was unconstitutional on first amendment grounds. Bell Atlantic won that case and it was applied without a stay, pending appeal, to Bell Atlantic only.

We personally feel that there should not be any kind of cross-ownership for cable and that telephone companies all over the countries should be permitted into this field. Free and open competition is really going to be very good. It is going to not only, I believe, provide more choice and convenience, it is also going to provide in the long run lower prices and it will also expand the market. So, yes, I think there is that cross-ownership that is inappropriate even today.

Senator HATCH. Thank you. Mr. Chairman, I just have a couple of questions for Mr. Redstone. I have only taken about 5 or 6 minutes. Could I just finish these?

Senator METZENBAUM. I have no problem, but Senator Simon——

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 33 1997

Senator HATCH. Do you mind, Senator Simon, because this is very important as far as I am concerned?

Senator SIMON. Go ahead.

Senator HATCH. There is a lot riding on it for all sides here. We really do need to go into this in perhaps more detail than what we are doing here today, and I appreciate our distinguished chairman holding these hearings.

Mr. Redstone, as I understand it, your concerns center on TCI's alleged power in the cable systems market. Now, do you agree that technological changes make competition within the local cable market possible, and if so, will these changes suffice to prevent the consolidation or maintenance of abusive market power?

Mr. REDSTONE. No, they won't. If I may suggest——

Senator HATCH. If you will get a little closer to your mike, I think it will help.

Mr. REDSTONE. We have all heard about this 500-channel cable system. Well, I will believe it when I see it. Right now, there is a limited channel capacity throughout the United States. What you have here, however, is control, not only horizontal control of cable, such horizontal control that right now, forgetting the track record of anticompetitive behavior, Mr. Malone decides what people can hear and see in the United States, not only in his cable franchise area but in the United States because if a cable channel cannot succeed, it doesn't succeed anywhere.

That kind of power should not be in the hands of any one person. That kind of power will be enhanced in two ways; first, by an acquisition of Paramount and, second, by this merger. It is not simply the control of the gate; it is the control of the programming services. Mr. Malone, through his own entities and related entities, controls 25 programming services. He controls 16 regional sports channels. Are we to give him Paramount's one regional sports channel?

Right now, he is able to discriminate against every programmer. I assure you, you will not find any programmers here to testify, except those affiliated or particularly friendly with Mr. Malone, because if they do their life is in his hands. If you add the Paramount library to Mr. Malone's enormous program holdings—those aren't disposed of as a result of this merger—he can further discriminate against other programmers and eliminate their necessity on his cable systems.

But, finally, forgetting the track record of anticompetitive behavior—we say it is not proven; it was proven enough for Senator Gore to call it holding ransom, a shakedown, in the words of Senator Gore, and he was right. Forgetting that, nobody should have this kind of power. Nobody should be the gatekeeper to consumers to cable, to access to cable.

Senator HATCH. But doesn't the 1992 Cable Act already proscribe the activities that you allege that TCI has engaged in, and why can't sufficient relief be obtained for these alleged violations either through the courts or through the FCC?

Mr. REDSTONE. Well, I assume they can, and if we could only secure a vigilant look at the antitrust implications of the proposed merger of QVC and Paramount, as well as Bell Atlantic and TCI, that is all we have a right to ask. The hope that these concerns which we express—we do have a private ax to grind, but we believe

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 34 1997

our concerns rise to the dignity of issues of great public concern which will affect the future of the telecommunications industry. We believe that they should be seriously looked at by the antitrust authorities. We have no right to request anything more than that.

Senator HATCH. Do you support or oppose eliminating existing restrictions on the ability of telephone companies to compete in the cable business?

Mr. REDSTONE. I think that telephone companies should be allowed to compete. I think that competition of every kind is good for America, but while we hear about all this potential competition for newcomers, the fact of the matter is that this merger, particularly with TCI, eliminates competition between a proven monopolist and Bell Atlantic. That is the immediate result of this.

We have heard today, if I may just add one thought, that we all want a state-of-the-art superhighway to the American home. We think that is a good idea. We don't think it should be in the control of one man.

Senator HATCH. Well, one last question. Does the Bell Atlantic acquisition exacerbate any of your concerns? If so, how? Let me just add this to it. How does the fact that the combined Bell Atlantic-TCI entity would have access to half of the American homes reflect a threat to competition if other telephone and cable entities would also have access to such homes?

Mr. REDSTONE. I think what you have, sir, is the fact that with just 20 to 25 percent of cable homes in the control of John Malone, reaching just that part of the country, you have clearly anti-competitive behavior. You clearly have serious antitrust issues merely by the existence of the power, getting away from the abusive power.

Remember, these people who have these monopolies are gatekeepers. They decide who can get in and they decide what programmers can get in. When you add just his partners, you now have a reach to one-third of the homes of America. When you add Bell Atlantic, you have a reach by one company into 50 percent of the homes of the United States. That is too much power for anybody.

Senator HATCH. I have used up enough of my time. I am sorry, Mr. Davis, I won't ask you any questions. I am sure you will miss that. [Laughter.]

But I have really enjoyed this and have appreciated all of the testimony here today, both the written and the oral. Thank you.

Senator METZENBAUM. Thank you, Senator Hatch.

Senator Simon?

OPENING STATEMENT OF HON. PAUL SIMON, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Senator SIMON. Thank you, Mr. Chairman. First, I want to commend you for holding this hearing. I think it is important that we look at any concentration of economic resources in our country, and I think the Antitrust Division of the Justice Department also has to look at this very carefully. I confess, as I have told one of you at the table, I probably know less about this whole merger than most members of this subcommittee. But I think whenever you

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 35 1997

have this kind of concentration of economic resources, we have to look at it.

I would say, second, I am concerned not just in this field, but in general, about how we are allocating our capital resources in our country. To the extent that you have a stock-for-stock transaction, that is a healthy thing. We talk a great deal about the Federal Government's deficit, and I have been one of those who has talked a lot about it. But it is really a culture of debt that we have created in our society that applies to corporations, it applies to consumers, as well as to governments.

One of the changes in the tax law that came about the other day that Senator Metzenbaum and I did not vote for was to, for the first time since 1927, permit corporations to write off goodwill when one corporation acquires another corporation. I might add, I am going to be introducing legislation—I would be happy to have you as a cosponsor, Senator Metzenbaum——

Senator METZENBAUM. You got me.

Senator SIMON [continuing]. To rescind that provision as of the effective date that the President signs the legislation.

Third, I am concerned about this—and I mentioned to Mr. Smith the other day when he stopped in the office—I am concerned about telephone companies getting into the cable business and the allocation of costs. A February 1993 GAO report says the FCC simply doesn't have the resources to monitor cross-subsidization adequately. I am also sure the various State regulatory bodies do not have the resources to monitor that adequately, and I fear that the consumer can lose out in the long run in this kind of a situation.

Then, finally, since I have the three of you here—and unfortunately I am just moving from committee meeting to committee meeting this morning and I am going to have to leave in just a few minutes. But since we have all three of you here who represent sizable investments in cable, one of the problems that we are trying to work on is this whole question—and this is not a dollar bottom line, but a cultural bottom line—the whole question of entertainment violence on television that glorifies violence.

The research is just overwhelming. The Surgeon General has twice given us warnings, and the National Institute of Mental Health has as well. No serious researcher questions the reality that entertainment violence is adding to violence in our society. The broadcast networks have moved some. How permanent that move is is a concern of mine. I have to say candidly cable has been much less responsive in terms of where we are going.

If I may just toss this one question at you—and there will probably be another panel on here before I get back, and I will also have some written questions in some other areas. But since we have the three of you here, what is your feeling in this whole area of the glorification of violence? Obviously, if you are going to have a program on the Civil War, it is going to have to have violence in it, but the glorification of violence, what one researcher calls "happy violence," is out there far too much.

Mr. SMITH. I would like to start, Senator. As a father, and soon to be a grandfather twice, I am as concerned about the sex and violence on television as anyone and I really look forward to working

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 36 1997

with this new industry that we are in and also with the Congress to resolve the issue.

I would like to make one comment, though, and it is a question you might want to ask yourself as to why programming is so vulgar and so violent today. One of the reasons is that the programmers are addressing a very large audience through only the number of channels that exist today. They end up programming at the lowest common denominator.

A quote here from George Gilder that struck my eye said that television is not vulgar because people are vulgar; it is vulgar because people are similar in their prurient interests and sharply differentiated in their civilized concerns.

What we are about to do is to create a high-capacity interactive network that will break down that old paradigm. We are going to spend $15 billion upgrading TCI's network and Bell Atlantic's network. It is going to provide a variety of specialized programming, information and services to the public. They will have much more control than they ever had in the old broadcast paradigm. The vulgar will remain, but it will not be broadcast to every single house on the block.

Senator SIMON. Well, if I may just comment, then I want to hear from the two of you. When you say "the vulgar," if something is vulgar, it may offend you and it may offend me.

Mr. SMITH. I was using it as a euphemism for all of that stuff we hate.

Senator SIMON. But the reality is the violence and the glorification of violence is not simply vulgar; it is not simply offensive.

Mr. SMITH. I agree.

Senator SIMON. It does harm.

Mr. SMITH. It creates a pattern in the minds of some people and it becomes the norm, I am afraid.

Senator SIMON. Yes, and what I would like to do is see some cable people step up and say we want to eliminate this. We have one of the best-known children's programs in this Nation that is produced in two versions—one is the violent version for the United States and the other is the nonviolent version for all the other countries in the world. When the Christian Science Monitor asks a spokesperson for the program why, she says in the United States we expect violence and we have no adverse reaction; we can't sell it in other countries. Something is wrong, and I think cable has to join the broadcast industry in doing something about it.

Mr. SMITH. Whether "Beavis and Butt-Head" would sell across this globe the way it sells here in the United States is a real serious question, as someone who is now entering this new industry.

Senator SIMON. Mr. Redstone?

Mr. REDSTONE. In the first place, I can beat the gentleman to my right in one respect. I have five grandchildren and I am very concerned about their viewing habits. In fact, notwithstanding the last comment, I think that Nickelodeon has been generally praised here and throughout the world for the contribution it makes to children's education and programming, and we take that responsibility very seriously.

I think MTV performed a true service in bringing out hundreds of thousands of people who had given up on the system to vote in

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 37 1997

its Choose or Lose campaign last year. As far as the slur on "Beavis and Butt-Head," what took place there was that we developed a program that was basically a satire on the foibles of America. We did not expect young children to be watching it. We learned a hard lesson. The program was immediately moved to late at night and a thorough search of the editorial comments of that "Beavis and Butt-Head" show.

Believe me, we are committed to anything that will eliminate gratuitous violence in programming in the United States. Nor do I believe that the addition of 40 more channels necessarily brings about the result that violence will be diminished. That depends upon the responsibility of the programmer, not the number of channels.

Senator SIMON. Mr. Davis?

Mr. DAVIS. Senator Simon, I am pleased to see this so far has been a nonviolent session. [Laughter.]

We will try and keep it that way.

Senator SIMON. Yes.

Mr. DAVIS. In the 30.5 hours of programming that we at Paramount produce today, perhaps the one show that you have singled out is "The Untouchables" of all the shows that we have, and we are cognizant of the issues that have come up on violence. We are sensitive to it. We are working with you, not only ourselves but through the Motion Picture Association. We are working with the networks. We are working with those cable operators, or programmers I should say, that will function with us, and we intend to do something about it. We are aware of it. We don't necessarily agree on all of the issues, but I think you will find remarkable changes in the future.

Senator SIMON. I thank you, Mr. Chairman.

Senator METZENBAUM. Thank you, Senator Simon.

Senator Specter?

Senator SPECTER. Thank you, Mr. Chairman.

Mr. Smith, when I was reciting in my opening statement some of the allegations of Mr. Redstone, I saw you nodding in the negative. I would be pleased to hear any comment you would care to make on what Mr. Redstone had to say about TCI's alleged monopoly powers.

Mr. SMITH. Well, as Mr. Redstone began to add up all of the areas of TCI's control, I thought for a moment we were approaching 125 percent of the country. I believe that the figures are exaggerated and are incorrect. The fact of the matter is that if you count, as Mr. Redstone did, all of the telephone and all of the cable subscribers in this country, there are 175 million cable and telephone subscribers, and TCI and Bell Atlantic have 22 million of those. So you can take those two numbers and divide them any way you like and add others that may be influenced. But in this world of competition that we are entering, no company is going to have the kind of control that Mr. Redstone suggests or accuses TCI of.

Senator SPECTER. Well, that is a factual question we will have to inquire into further.

Mr. SMITH. Of course.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 38 1997

Senator SPECTER. Permit me to ask you if, in fact, TCI did have a 50-percent market share or access to a market share, would you consider that excessive in the public interest?

Mr. SMITH. If TCI controlled 50 percent of the 175 million telephone and cable subscribers, I would say you would have some real questions there.

Senator SPECTER. You and I talked briefly yesterday about the additional capital and jobs which would be created.

Mr. SMITH. Yes.

Senator SPECTER. That is always a comment of desirability. Would you tell us how much capital would be provided by the proposed Bell Atlantic-TCI merger and how many jobs that would create nationally, with some focus on Pennsylvania? [Laughter.]

Mr. SMITH. I will have to use some Kentucky or Pennsylvania windage here, but basically as we build the business plans for the new interactive networks that we will build in the old TCI and in the new Bell Atlantic territory, we, as I said in my testimony, will be spending something in the neighborhood of at least $15 billion over just the next 5 years.

We expect those investments to accelerate beyond that. There will be two effects of that, one of which will be the actual jobs in our territory and, by the way, in all of the other telephone territories and cable territories in this country that will, I believe, take this merger as the model for the future and they will build their own levels of networks.

But there will be two levels of jobs, first of all those jobs that are involved in the building of the network itself. Those are linemen and splicer jobs, jobs that involve building of the fiber optic highways themselves, the programmers who will program the new systems. This is the computer programmers, not counting all of the others that will be involved in the deployment of the information.

At the end of that 5 years, we are going to be talking about thousands and thousands of jobs in Pennsylvania. I can give you one hint as to the number. I believe in Pennsylvania alone, in our current plans we have something in the neighborhood of $2 billion to spend in just this 5-year period after the merger, so we are talking about substantial investments in this network.

But beyond that, just think about what kinds of services these are going to spawn. QVC, for example, is a very rudimentary—and I am not talking about it in terms of any bid; I am talking about it as a service. QVC is a very rudimentary kind of service. It is on one channel and it is not all that easy to buy the services. Yet, there are 5,000 people who work for that company across the country—by the way, Senator, 2,500 of them in Pennsylvania—who produce this very, very rudimentary shopping service. As it becomes interactive, as it becomes even broader, this and the other kinds of home shopping and home information services are going to create jobs in that magnitude, thousands of jobs, sir.

Senator SPECTER. Thank you, Mr. Smith.

Mr. Redstone, your statement contains some very strong allegations. You have the charge here that TCI was able to pressure CNBC into not going to a news format because it would compete with CNN, which has a significant control factor by TCI and Dr. Malone. You might be interested to know, if you don't know al-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 39 1997

ready, that CNBC covered your full testimony and they cut off when it came to my opening statement. [Laughter.]

Mr. REDSTONE. Believe me, I have no control over CNBC, sir.

Senator SPECTER. You have no control. Perhaps there is coverage by indirection. They want to be sure to not be subject to a charge of unfairness.

You then say in your statement that "Vice President Gore called the CNBC situation a 'shakedown' by TCI." Now, it may be that Vice President Gore is not totally without influence in the Clinton administration. Given his attitude on the subject as you articulate it, why can't you get the Department of Justice to act on your charges?

Mr. REDSTONE. I would like to answer that, but may I, Senator, just refer to one statement that was made by Mr. Smith?

Senator SPECTER. As soon as you have answered my question, you may.

Mr. REDSTONE. Well, we would hope that he would become interested.

Senator THURMOND. If you don't mind, speak in your microphone.

Mr. REDSTONE. We would hope that Vice President Gore would become interested. As a matter of fact, Vice President Gore also said that John Malone was the godfather of the cable industry cosa nostra, so we would think that he should be interested in the public policy issues that we have raised in our complaint. Incidentally, we realize that it is not the function of any government body to deal with a private dispute. What we say is that this private dispute involves issues of great national concern.

Senator SPECTER. Well, have you asked the Justice Department to look into these charges?

Mr. REDSTONE. Our lawyers have been meeting with the Justice Department. I believe at the request of the Justice Department, our technology people have been to the Justice Department to discuss in detail the bottlenecks in the transmission of the signal in the United States. We have met with Mr. Neel, who is the Deputy Chief of Staff at the White House.

What we are really seeking is no more than a good, hard look at what is taking place here. We are satisfied, if that takes place, there will not be a Paramount merger with QVC, which was incidentally just described as a rudimentary shopping channel.

Senator SPECTER. Well, did you take those complaints to the Department of Justice——

Mr. REDSTONE. Yes.

Senator SPECTER. Excuse me. You haven't heard the question yet—before you filed your Federal antitrust suit?

Mr. REDSTONE. No.

Senator SPECTER. Why not?

Mr. REDSTONE. I am not certain. I guess we thought it was our responsibility to file the complaint. It may have been a better procedure to discuss it with them at that time, but we did go to the Department of Justice to express the complaint.

Senator SPECTER. Well, the private right of action is really a supplement to the Department of Justice. I would think that you would look to them. If they file the complaint, you don't have to pay the filing fee.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 40 1997

Mr. REDSTONE. Well, I would agree with that, Senator, but it is not always possible to stimulate a Government agency to utilize the necessary resources to approach abuses of the kind that exist. We are really hoping that we will be successful in having the antitrust agencies take a good, hard look at Paramount-QVC and Bell Atlantic-TCI.

Senator SPECTER. I have many more questions, but I will ask only one in the interests of time because there are so many more witnesses, and that pertains to your statement on page 5 which you made orally that TCI has threatened to "crucify" The Movie Channel by dropping it from TCI's cable system in favor of Liberty's own Encore service.

Now, in a context where TCI has sufficient market power to make that kind of a threat and complete it, what is the quality of your evidence that you have on such a serious charge?

Mr. REDSTONE. We will introduce evidence by employees discussing this matter with employees of TCI who used the phrase—this is not a phrase that we made up—"we will crucify you if there is not a deal done that satisfies John Malone."

Senator SPECTER. Well, a final statement, Mr. Redstone. If you have that quality of proof, I hope you will go into Federal court, seek a temporary restraining order or preliminary injunction, and then we will really know what the facts are if they are submitted to a court and you have an adjudication.

Mr. REDSTONE. We assure you, sir, that the allegations made in our complaint are not frivolous. Every one of them will be proven.

Senator SPECTER. Thank you.

Senator METZENBAUM. Senator Thurmond?

OPENING STATEMENT OF HON. STROM THURMOND, A U.S. SENATOR FROM THE STATE OF SOUTH CAROLINA

Senator THURMOND. Thank you, Mr. Chairman. Mr. Chairman, I want to make a brief statement and then I will have a few questions.

The hearing this morning seeks to address the complex issues involved in the telecommunications industry by looking at consolidation which recently has been proposed. These issues are exciting because traditional telephone, cable television, and wireless technologies are rapidly converging, which may bring new products and strong competition into areas that have not experienced the invigorating effects of competition in the past. We are at the point where cable systems have the ability to begin offering telephone services, while telephone companies may be able to provide video services over their telephone lines.

The role of the Congress should be to encourage competition in these converging technologies so that consumers benefit from better services and lower prices. We should make sure that laws and regulations keep up with technological advances so that we do not unnecessarily restrain competition where it could flourish in the marketplace.

Certainly, this hearing should not be taken as a signal to investors or the antitrust enforcement agencies that the specific transactions being discussed are disfavored or will not survive antitrust

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 41 1997

scrutiny. Our purpose today is not to conduct an antitrust minitrial on the merits of specific transactions.

The Department of Justice and the Federal Trade Commission have been given the responsibility for conducting detailed analyses of mergers under the antitrust laws. In carrying out this responsibility, I expect that the agencies will carefully scrutinize large telecommunications mergers. However, it is neither necessary nor advisable for the Congress to try to micromanage this review process by the antitrust enforcement agencies or to try to influence how transactions are viewed in the financial markets.

Mr. Chairman, the issue should not be whether any particular merger is good or bad, but whether any changes in the applicable laws or regulations may be desirable to achieve strong competition in the telecommunications industry for the benefit of consumers.

I want to thank all these witnesses for their time and effort in appearing before the subcommittee this morning.

Now, Mr. Smith, please make your answers as brief as you can since time is moving on. Does merging with TCI provide any technological help to Bell Atlantic's plans to offer video services over its telephone lines within the Bell Atlantic region, or does the merger simply provide Bell Atlantic with programming in that region?

Mr. SMITH. Senator, it was about a year or two ago that we concluded that in order to get the competencies and the abilities that involved programming and cable operations, it would take us a number of years. We looked at all of the available companies, the companies in this country, concluded that TCI was a very good operator, and that as we combined we would be able to accelerate the deployment of the interactive services in our territory using their skills.

Senator THURMOND. Mr. Davis, in your written testimony you suggest opening the media gateway to all programmers. Does your proposal apply to all companies, including Viacom, or only to telephone companies and the largest cable companies?

Mr. DAVIS. It clearly applies to everyone. Mr. Smith, in his remarks, was referring to choice and control for the consumer. I am as concerned about will the programmers, such as ourselves, have some choice and some small measure of control with who we deal with, or be told who we have to deal with or be told what the price is for our programming. That is our concern, sir.

Senator THURMOND. Under the FCC rules on video dial tone, do all video programmers have equal access to the video delivery systems that will be available over the telephone lines?

Mr. DAVIS. Yes.

Senator THURMOND. Mr. Redstone and Mr. Davis, you both might answer this question. You are focusing on TCI as the party interested in Paramount, but is the ultimate competition for Paramount between Bell Atlantic, through TCI, and NYNEX through its backing of Viacom?

Mr. REDSTONE. I will reply to that, sir. The ultimate competition today involves a true monopolist, TCI. Our position—I tried to bring this in before. Mr. Smith will have no difficulty refuting statements that I didn't make. I didn't make a statement that they would control 125 percent of America, but the statements I made

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 42 1997

were accurate—20 to 25 percent themselves, a third with their partners, access to 50 percent of America with Bell Atlantic.

Coming back to your question, sir, we are concerned both with the implications of Paramount-QVC and Bell Atlantic-TCI. One of our concerns is that you are not only dealing today with a gatekeeper whose gatekeeping will be expanded, you are dealing with a party who combines that with vertical integration, controls 25 programming services, now wants to add to it the Paramount library, which will add several more channels in a world which still has limited channel capacity, increasing the power to diminish the role of the independent programmer like ourselves and the power to discriminate in favor of his own services. Whenever you give anybody control of that much product, you give them control of price.

Senator THURMOND. Mr. Davis, your testimony noted that Paramount chose Viacom in order to enhance your ability to reach viewers. If QVC is ultimately successful in its bid and survives the scrutiny of the antitrust enforcement agencies, would QVC not result in more viewers being reached with Paramount's products?

Mr. DAVIS. It would be virtually impossible, sir, because the reason that we said that we chose to merge with Viacom is looking at the plethora of product that will be available and the opportunities between the two companies. QVC is a shopping network, and having been accused of disparaging it as a shopping network, that is what it is. Viacom is not, Paramount is not.

You are talking about cable networks that exist in Viacom. As we said earlier, we have an interest in the USA and the Sci-Fi cable networks. We have a regional sports network through Madison Square Garden. Putting that together with the creative personnel, with the creative talents that both companies possess, with the huge amount of programming that we have in television, will make this a very successful company that no other company frankly can match in terms of programming only.

Senator THURMOND. Mr. Redstone, in your testimony you seem to consider all of the cable market share of QVC's backers to be controlled by TCI. What is the basis for this?

Mr. REDSTONE. TCI controls QVC in the following way. TCI has something like 22 to 27 percent of control through Liberty Media. Its two partners, Comcast and Diller, each control about 12.5 percent. That comes very close to 50 percent, with the rest widely dispersed. There is a voting trust. Mr. Malone's partners have to vote with Mr. Malone.

Now, coming to some of the other cable programming services, let's come to Turner Broadcasting. Other than Ted Turner, Mr. Malone is the largest stockholder of Turner Broadcasting, but more important than that, he has negative control of everything Turner Broadcasting does. Turner cannot spend more than $1 million unless John Malone says OK.

So when Turner acquired or agreed to acquire New Line and Castle Rock, they could not do so unless John Malone said OK. That has particular significance when you consider the other interests in Carolco, his alleged interest in obtaining equity in Matsushita and Sony, and now you want to add Paramount to that.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 43 1997

Senator THURMOND. I want to ask this question to be answered briefly by all of you. We will start with Mr. Smith. If cable companies are backed by larger telephone companies outside their home regions, will this provide stronger competition in the telecommunications industry? That is, will not Viacom, backed by NYNEX, be a more equal competitor to TCI, backed by Bell Atlantic, compared to the situation before the telephone companies get involved?

Mr. SMITH. Yes, I think that will result in more vigorous competition. It is not only NYNEX and Viacom and Bell Atlantic and TCI, it is also US West and Time Warner and Southwestern Bell and Hauser Cable in our own territory. These are companies that have come to the conclusion that they need both the expertise of cable as well as telephony, and it is going to result in more competition, lower prices, and more choice across this country.

Senator THURMOND. Mr. Redstone?

Mr. REDSTONE. I was just going to say, sir, that the——

Senator THURMOND. Speak in your microphone so we can hear you, please.

Mr. REDSTONE. The premise about NYNEX and Viacom is really, if I may say so, totally off the track. It is not applicable and irrelevant. NYNEX has no interest other than make a financial investment in Viacom. They made an investment in terms of a convertible preferred stock. There are no arrangements for any business transactions between NYNEX and Viacom. None may ever take place. If one does, be assured it will receive the proper scrutiny. That is not at all comparable to a merger, an actual merger, between Bell Atlantic and TCI. There is no merger between us and NYNEX. They made an investment in our company, period, over and out.

Senator THURMOND. Mr. Davis?

Mr. DAVIS. As a programmer, we obviously welcome more competition. As a programmer, we also welcome more channels available to us, not controlled by one single entity. What we would like to see under the new cable law and we would like to see under the new rules applying to telephone companies is more telephone companies coming in with their systems, as opposed to frankly acquiring other existing cable systems, which is only going to stifle competition.

Senator THURMOND. Thank you, gentlemen, for your appearance. Mr. Chairman, thank you.

Senator METZENBAUM. Thank you, Senator Thurmond.

Mr. Smith, it has been a long time. I would like to come to you.

Mr. SMITH. Yes, sir.

Senator METZENBAUM. I am firmly convinced that competition would drive both telephone and cable rates down. In past hearings before this subcommittee and other committees, representatives of consumer and business telephone ratepayers have claimed that Bell Atlantic and other phone companies have charged rates significantly higher than were appropriate for a telephone monopoly. Many of these groups, as well as Bell Atlantic, complained about monopolistic pricing in the cable industry.

It seems to me that this merger will actually make it less likely that consumers will get the rate reductions they deserve. Mr. Hatfield, a communications expert who will testify later this morning,

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 44 1997

claims that you will maximize your profits by not going head-to-head against other competitors to provide the kind of package of cable service or local phone service that consumers receive today.

You have described your cable ventures as a video jukebox that has a server to offer consumers individual shows. I am not sure if you used those phrases today, but I know you did yesterday when we were talking. I don't understand how that would be real competition, with the 40 to 50 channels of diverse programming that cable companies offer today. I wonder if you could explain how you——

Mr. SMITH. Yes; let me start with the local ratepayers in the telephone industry. We are very proud in Bell Atlantic of having probably the very best record over the last 10 years since divestiture of keeping basic rates in line. In some of our jurisdictions, it has been virtually a decade, 10 years, and basic rates have remained at the lowest levels in the country. In the areas where we are beginning our video dial tone experiments, New Jersey, for example, has the lowest rates in the country. So we have a very good track record. We have agreements with the various State regulators to provide incentives to our company and keep basic rates low that will go well into the 21st century. We are very proud of that.

In terms of the video jukebox and why that will increase competition, if I can take just a moment, the notion of channels in the year 2000 will be considered quaint. It will be old-fashioned and people will really chuckle about the fact that there were 30 or 40 or 50.

The video jukebox provides you an infinite number of channels in every single home. As much storage space as there is on these huge new servers that IBM, DEC, Compaq, and other companies will build, that will be the number of "channels" or services that will be available to you, not 30 or 50 or 500, but thousands and thousands to every single home.

The day of limited capacity for video is over. This new technology brought about by digital equipment machines, brought about by fiber optics and by the switching technologies of the telephone companies, will provide an infinite variety and virtually infinite capacity. So the old paradigm, I am afraid, is gone.

Senator METZENBAUM. Mr. Redstone claims that through TCI, you will be able to manipulate the market for communications equipment in a manner that harms competition. When similar concerns were raised in the telephone industry, we opened that market to competition to prevent the AT&T monopoly from thwarting innovation. Your company previously suggested to the FCC that all cable equipment be made available to consumers just as telephones are today. Do you still stand by that position?

Mr. SMITH. Yes; I think that is probably a good idea and I think that that is exactly the way the marketplace will evolve; that is, all aspects of these markets will be competitive. The timing and the exact terms of exactly how that will take place over time remains to be seen. The existing entities, such as cable companies and telephone companies, will be offering competitive services, bundling and unbundling, packaging and unpackaging services in every conceivable way.

The consumer will have the choice, and since they will have not just one cable company or one telephone company in any territory,

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 45 1997

they are the ones who will rule the roost, not an individual, not an individual company, not a producer, not a transport company, but the consumer.

Senator METZENBAUM. You are assuming that there will be competition.

Mr. SMITH. We are going to make sure that there is, sir.

Senator METZENBAUM. One of the concerns of this hearing is whether there indeed will be competition and whether this merger would eliminate that likelihood.

Mr. SMITH. If I may say so, sir, we certainly wouldn't have entered into this merger if we didn't believe that there would be competition and that that competition would be profitable to our shareholders.

Senator METZENBAUM. Wait a minute. I am talking about competition against you. I am not talking about your ability to compete with others. I think there is no question that you will be able to compete.

Mr. SMITH. We will certainly compete in the red areas against the existing cable companies outside of our territory, and already Time Warner and US West have stated that they will compete against Bell Atlantic in our territory, and so has Southwestern Bell when they bought the Hauser cable properties. So there will be competition. They are already building the systems to do so.

Senator METZENBAUM. That is one of the major questions before us, and they are, can you compete without having the programs available and will you have too much control of the programming?

You claim that cable competition in your region will not be harmed by your proposed merger because TCI's properties in your region are not that extensive. My understanding is quite different. Is it not true that TCI owns cable systems—I guess maybe you answered this before—serving about 1.2 million cable subscribers in your cable territory? Isn't that the fact?

Mr. SMITH. Yes, that is correct, sir, and as we have stated in my letter to you yesterday, to the Justice Department and in my testimony, we plan to spin those off to separate corporations which will compete vigorously with us and we with them.

Senator METZENBAUM. But absent the merger, TCI had the potential, or has the potential to be your strongest competitor.

Mr. SMITH. TCI, Comcast, Cox Cable, Jones Intercable—all of these companies in each of the towns are very strong competitors and they plan, each on their own, to go into the telephone business just as we plan to go into the cable business. There is going to be competition on both sides. This merger doesn't affect that in the least. In fact, it increases the possibility of competition in our territory and outside, sir.

Senator METZENBAUM. That is the question that will be before the Antitrust Division and the FCC.

Mr. SMITH. Yes, sir.

Senator METZENBAUM. The 1992 Cable Act was designed to get at the anticompetitive practices of the cable industry. However, Mr. Redstone claims that the untested strength of FCC regulations cannot possibly counter any incentives to engage in anticompetitive conduct that would grow out of this merger.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 46 1997

Bell Atlantic recently challenged the FCC's rules regulating cable rates. In fact, Bell Atlantic filed a Federal lawsuit alleging that the FCC wasn't aggressive enough in bringing down those rates. You obviously recognized that with inflated cable rates, cable companies would have excess cash to invest in equipment that would help them compete with your telephone business.

Given the skepticism that your own company has expressed about the FCC's ability to protect consumers through rulemaking, wouldn't you agree that the antitrust agencies should be even more skeptical of the power of FCC rulemaking to protect consumers when they review this deal?

Mr. SMITH. If there is only one cable company in town, then those statements are reasonable. If there are two cable companies in town, as there is today in the Bell Atlantic region because we tested the 1984 Cable Act under first amendment conditions and found that it was unconstitutional—now that there are two cable companies in town, you will have competition, as well as the FCC and the other regulators that will make sure that competition is fair.

I believe in the market, and the market will tell us who provides the best value, the most reliable service and the most quality, and the customers are the ones that are going to tell us. Bell Atlantic won that case, and so we are entering into the cable business right now. We are building it in New Jersey, we are building it in Virginia, and we will build it all over our territory.

Senator METZENBAUM. Thank you, Mr. Smith.

Mr. Redstone, Viacom has filed an antitrust lawsuit against TCI. It has been mentioned several times today. I want to make it clear that neither I nor this committee take a position on your lawsuit. I do not believe Congress should be trying a lawsuit in a hearing. However, many of your allegations are consistent with the kind of conduct that led the Congress to enact cable legislation last year. Therefore, they raise deeply troubling questions about the proposed merger between Bell Atlantic and TCI.

My first question to you then is, one of the biggest concerns that I have about the Bell Atlantic deal is that it signals an end to competition between cable and telephone companies, or could offer that kind of signal, depending upon your interpretation and the factual basis as determined by the agencies. The way I see it, Bell Atlantic has neutralized its most likely competitor for local phone service by merging with TCI.

Your company, Viacom, operates the 12th largest cable system in the country. Therefore, you must have thought about how competition was most likely to develop in your industry. Were you anticipating that, in the future, local telephone companies would be competing head-to-head with you for the delivery of cable services?

Mr. REDSTONE. It is hard to answer that question, Senator. Mr. Smith describes a rosy new world that is going to take place some time in the future where competition will exist. All I know, sir, is that this particular merger is one of the most obvious and inflammatory examples of the elimination of competition between one man who has excessive control of the cable industry and Bell Atlantic.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 47 1997

Also, if I may, Mr. Smith carefully avoids reference to the control of programming. He says in the year 2000 there will be a million programming services. I don't know about the year 2000. I am concerned about the independent cable programmers who will be put out of business next year because of the influence of Mr. Malone.

It is not so easy to develop a cable programming service, sir. Six years ago when we took over Viacom, MTV was considered a fad. We worked very hard. We were lucky, we were successful, and now we have an international global network. That can't be done just like that. It is easy just to confine your views to access to the consumer. That is bad enough, but what about the control of programming services?

In other words, it takes the two. It is not just the horizontal conspiracy that exists and is being enhanced here, it is the vertical integration and the control of all those programming services which puts TCI in a position that it has today.

Senator METZENBAUM. Let me go to Mr. Davis. Mr. Davis, I get the impression from your statements that you believe it makes business sense for communications network owners like cable companies that want to become more competitive and be part of the so-called information age to invest in programming. Am I correct in that?

Mr. DAVIS. No, sir.

Senator METZENBAUM. No?

Mr. DAVIS. No; actually, when I cited the 1948 consent decree, or the consent decree imposed upon the motion picture in 1948, I am referring to that and I am using that as an analogy to today. We are talking about allowing the programmers or the producers that we were then in 1948 to have access to the theaters then or the distributors today. If we have to deal with one source which has control, we are not going to be able to determine our own destiny.

Senator METZENBAUM. But what I am really asking you is doesn't it make sense, and isn't what we are seeing is the need for communications network owners like cable companies—if they want to become more competitive and be part of the so-called information age, don't they then have to concern themselves more with programming than almost any other aspect of this?

Mr. DAVIS. No; I would think that by doing that, they would only exercise more and more control. They would be able to determine what goes on, who produces what, and who does what.

Mr. REDSTONE. May I help on that, Senator?

Senator METZENBAUM. Surely.

Mr. REDSTONE. The problem is, of course, it would be good to be able to develop more programming, but you can't develop programming in the United States today unless John Malone says OK. That is the problem. He now determines what people can see and hear in the United States. It is not possible. Unless John Malone says Court TV can live, it doesn't live.

Let me give you a quick example, if you like, that we just went through. We developed a shopping channel called the MTV Music Shopping Channel. Mr. Malone was wild for it. Barry Diller called me very upset because it was going to go on HSN, another service controlled by John Malone. I said, why don't you talk to John Ma-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 48 1997

lone. I don't want to, in this hearing, discuss what he said about John Malone; it is in our complaint.

But here is the answer. As soon as the Paramount transaction occurred, all of a sudden this MTV Music Shopping Channel that Barry called me about and wanted and was so upset because it was going to go on HSN—that disappeared. Its life was over, and instead we have a German company, Bertelsmann Music, which was introduced on the scene and our stock was knocked off that day. That is what we live with today.

Mr. SMITH. If I may, we are talking about the merger of TCI and Bell Atlantic, and all roads, all accusations and all logic seems to go back to Viacom and Paramount. These are accusations that are unproven and there are opportunities for Mr. Redstone to find remedies for these in the courts. I would suggest that he does that.

The statement that there is no programming in this country that can ever exist without John Malone is nonsense and, looking forward, the changes in our industry that are underway today—IBM and Digital Equipment and Microsoft are creating this interactive future, a future that isn't 10 years away, but is 1 or 2 years away—will create an open architecture that will not permit anyone, not Mr. Redstone or Mr. Malone or anyone, to control. This is the world that we are creating today.

Mr. Redstone is talking about the past. We have got to look forward to the future. This merger creates an opportunity for competition outside the Bell Atlantic territory in telephony and it creates competition inside our territory for cable. The programming will have all kinds of new paths, not just one lane on the superhighway, but two and three and four lanes through the air and through the terrestrial networks.

Mr. REDSTONE. May I, Senator? We are not talking about yesterday. We are talking about today. Mr. Smith is talking about a rosy contemplated future. We are talking about today. To the extent that we have referred to Paramount, what we have said is that TCI now has monopolistic power in distribution and in the control of programming. What we have said is that becomes enhanced by a merger with Viacom, and it becomes further enhanced by a merger with Bell Atlantic.

Senator METZENBAUM. Gentlemen, we thank you very much for your appearance here today. I think, Mr. Smith, I do hope that you will convey, as well as his representatives in the audience, to Mr. Malone that we do expect him to appear before this committee soon. We will be adjourning some time by Thanksgiving and we expect to hear from him, we expect to hear from Mr. Diller, and we expect to hear from Mr. Allen of AT&T, and so we don't want to wait until the very last minute to do so.

Gentlemen, thank you very much for being here.

Mr. SMITH. Thank you, Senator.

Mr. REDSTONE. Thank you.

Mr. SMITH. Senator Thurmond, thank you.

Senator METZENBAUM. Our next three witnesses are Dale Hatfield, president of Hatfield Associates, of Boulder, CO; Kevin Arquit, of Rogers & Wells, of New York; and Peter W. Huber, Kellogg, Huber & Hansen, of Washington, DC. We will limit each of the witnesses to 5 minutes. At the conclusion of the witnesses' tes-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 49 1997

timony, Senator Thurmond has another engagement and he has asked if he might proceed before the Chair, and I have no objection to that, for a period of 10 minutes.

I will say to each of the witnesses, please indicate whether you currently are or have in the past few years done any work for parties that have an interest in any of these mergers we are discussing. In other words, I know that some of you are professionals in this area. I do not find fault with that. We have called you as witnesses because you are experts and it would only be understandable that you would have some clients in the area.

I would like you each, before Senator Thurmond asks any questions—in fact, Senator Thurmond, I really question the procedure of asking questions before these men have had a chance to testify. You are on live C–SPAN and it just seems as if it is totally out of order. I think the questions could be submitted afterwards, but I think we owe it to them to permit them to offer their 5-minute statements before any questions are asked.

Do you have questions of each of them?

Senator THURMOND. I was just going to base them on their statements they have already submitted.

Senator METZENBAUM. Well, I know, but I think if we do that—we never have done that before and I don't think we should do it today.

Mr. Hatfield, would you proceed and tell us something about your previous or present clients as well? I want to make it clear that in asking that question I am not suggesting any impropriety, nor am I looking askance at the fact that these men who are experts in this area do work for people who have an interest in this issue before us today.

Please proceed.

PANEL CONSISTING OF DALE N. HATFIELD, PRESIDENT, HATFIELD ASSOCIATES, INC., BOULDER, CO; KEVIN J. ARQUIT, ROGERS & WELLS, NEW YORK, NY; AND PETER HUBER, SENIOR FELLOW, MANHATTAN INSTITUTE FOR POLICY RESEARCH, NEW YORK, NY

STATEMENT OF DALE N. HATFIELD

Mr. HATFIELD. Thank you, Mr. Chairman. I very much appreciate the opportunity to appear before the subcommittee today to testify regarding this recent wave of mergers. Let me state, as you have asked, I have been in the consulting business for a little over 11 years, almost 12 years. I have done work for cable television companies, competitive access providers. These are the new companies that are competing with the telephone companies for limited services. I have done some work for the Bell operating companies, and also have worked for a number of the long-distance carriers as well, and then, of course, a lot of other carriers, mobile radio people and things like that, that may have some interest in this proceeding. However, I should say that I am here today strictly on my own.

Senator METZENBAUM. Please proceed, Mr. Hatfield. Thank you.

Mr. HATFIELD. In this testimony, I will focus my attention on potential purchases by the regional Bell operating companies of large

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 50 1997

cable companies, as exemplified by the proposed merger of Bell Atlantic and TCI. Of course, I have prepared——

Senator METZENBAUM. Slow it down a little. You are reading so fast it is going to be hard to follow you.

Mr. HATFIELD. I am trying to get my 5 minutes. Thank you.

Senator METZENBAUM. But I want to be sure we can appreciate what you are saying.

Mr. HATFIELD. I have prepared a full statement which I have given to the subcommittee and, of course, I will summarize it here.

Senator METZENBAUM. All statements will be included in the record.

Mr. HATFIELD. Let me state at the outset that when I first heard the announcement of the proposed merger of a large telephone company and the largest cable company, and when I recognized that this was just probably the first of a series of mergers of the same type to follow, I was really discouraged. I was extremely disappointed because for some 20 years now, I have been a steadfast advocate of the notion that competition, rather than monopoly, is the best way of assuring customers a diversity of affordable communications and information products and services.

My initial reaction was, and still is, that allowing the consolidation of large telephone companies and large cable companies is likely to reduce the prospects for meaningful competition in communications and information services. In the few minutes I have available, I would like to set forth some personal observations as to why the mergers of local telephone companies and cable companies are likely to reduce rather than enhance competition.

First, I would observe that the history of the communications industry in the United States has not been a happy one from an antitrust perspective. From the earliest days of the industry, the Bell System sought to gain and maintain a monopoly by the most nefarious means, including denying access to essential facilities and buying out competition.

I am reminded of this history because the economics of having two networks, a telephone company wire coming into your home and a cable company wire coming into your home—the economics of that are still very uncertain. But if you think for a moment, if the economics do not support two wires and if the telephone companies have come to believe that the cable companies might ultimately have the superior technology or position, then it seems to me it is in their mutual benefit to protect their existing business and investments by acquiring their potential competitors; that is, they have a strong incentive to make sure that the competing technology or system is in friendly telephone company hands, and this is exactly the direction in which I see we are headed.

Second, and related to my first point, I have always been somewhat skeptical of cable companies actually competing successfully for the provision of ordinary local telephone service because of a host of barriers, including State laws and regulations that precede it. In listening to the testimony here today, it sounds like somehow this competition is a foregone conclusion. I have testified through the United States before State regulatory commissions, and by and large they show an extreme degree of skepticism about the benefits

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 51 1997

of ordinary local competition, in part, because of its possible impact on universal service.

However, having participated in the industry for so many years and finally seeing the willingness at least of a few regulators to at least entertain the notion of local competition, I feel that independent cable systems represent the best long-term promise for true local telephone competition. But with cable systems owned by other telephone companies, and despite the arguments of the proponents of the merger to the contrary, I believe that the likelihood of competition will be reduced.

In other words, with such tight control of the industry by a few companies, I doubt if they will really compete. I am afraid they will just pull their punches. Even if the competition does emerge, it is more apt to be at the fringes of the market rather than the traditional core portions of the respective telephone and cable businesses.

Third, I think from what I heard this morning we are missing something here because even if competition develops, we will still be left with a duopoly and the two providers, telephone companies and cable companies owned by telephone companies, would have a strong incentive to limit additional entry using, for example, their control over rights-of-way. In short, a duopoly does not equate to competition, and the duopolists have an incentive to fight additional entry just as a cellular telephone duopoly recently fought so hard to maintain control of their duopoly, their business.

Fourth, over the past few years I have been very gratified to see Bellcore and Cable Labs, the research arms of the telephone industry and the cable industry respectively, compete in terms of designing the best architecture for future broadband networks. I think that rivalry has been very beneficial to the two industries and ultimately to customers. I have to wonder whether that rivalry will continue if the industry is consolidated into telephone company hands. In fact, I doubt if both laboratories will even continue to exist independently if full consolidation of the industry takes place.

Fifth, and finally, if the number of separate paths into the home diminishes or if the number of entities controlling these paths decreases, then I am much more concerned about some of the content control and content ownership issues that have been raised here this morning.

Let me just simply conclude my testimony by stating that based upon my 20-some-odd years of experience in the industry and in dealing with potential competitors, I believe that the proposed merger raises substantial and significant competitive concerns that must be addressed fully by the antitrust enforcement agencies and the communications policymakers.

Again, thank you very much, Mr. Chairman and the subcommittee, for giving me the opportunity to testify today.

[The prepared statement of Mr. Hatfield follows:]

PREPARED STATEMENT OF DALE N. HATFIELD, PRESIDENT OF HATFIELD ASSOCIATES, INC.

INTRODUCTION

Thank you Mr. Chairman. I very much appreciate the opportunity to appear before you today to testify regarding the recent wave of mergers in the telecommuni-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 52 1997

cations industry. I have been involved in the telecommunications policy arena for over twenty years, and I can state without hesitation, or reservation that the issues raised by these mergers are crucial to the development of telecommunications in the United States. They are particularly crucial in determining what role competition—rather than monopoly—will play in the future development of our nation's telecommunications and information infrastructures, and I want to commend you and the Subcommittee for holding these hearings so promptly.

Before I present the substance of my testimony, I thought it might be useful if I briefly summarized my experience in the telecommunications policy field. One of my earliest positions was Deputy Chief of the Office of Studies and Analysis in the Office of Telecommunications Policy, Executive Office of the President. From there, I went to the Federal Communications Commission (FCC) where I became Chief of the Office of Plans and Policy. After serving at the FCC, I went to the National Telecommunications and Information Administration (NTIA) in the U.S. Department of Commerce, where I became Chief of the Office of Policy Analysis and Development. Subsequently, I became Acting Assistant Secretary and then Deputy Assistant Secretary of Commerce for Communications and Information and Deputy Administrator of NTIA. I left government nearly twelve years ago, and established my own consulting firm in Boulder, Colorado. We have grown to six full-time professionals with advanced degrees in engineering, economics, and business. A principal part of our consulting work has been for firms—including cable television companies—who have sought to compete with telephone companies in the provision of local communications services. In addition to serving private sector clients, I have also served as a consultant to the Department of Justice and to foreign governments regarding issues of telecommunications policy.

In my testimony here today, I will focus my attention on potential purchases by the Regional Bell Operating Companies and GTE of large cable television companies (Multiple System Operators or MSO's), as exemplified by the proposed merger of Bell Atlantic and Tele-Communications Inc. (TCI). I will divide the balance of my testimony into three parts. First, I will touch on some of the public policy benefits claimed by proponents of these mergers. Second, I will briefly set forth what I believe are their potential dangers to the public interest. Third, I will offer some personal observations based upon my experience and study of the history of the telecommunications field. I should hasten to add that the views and opinions I am expressing here today are my own, and do not necessary reflect the views of other entities with which I have been, or am affiliated.

Let me also state at the outset that, when I first heard the announcement of the planned merger of a large local telephone company and the largest cable company and recognized that other mergers would surely follow if it was left unchallenged, my heart sank. My heart sank because, for more than twenty years, I have been a steadfast advocate of the notion that competition—rather than monopoly—is the best way of assuring consumers a diversity of affordable telecommunications and information products and services. My initial reaction was, and still is, that allowing the consolidation of large telephone companies and cable companies will greatly diminish the prospects for future competition in telecommunications and information services.

POTENTIAL PUBLIC INTEREST BENEFITS

The proponents of these mergers of large telephone companies and cable television companies have advanced three public interest benefits that could potentially flow from this increased industry concentration. First, they have argued that cable companies lack experience in designing, operating, maintaining, and managing the types of two-way systems necessary to provide ordinary local telephone services and that the mergers would result in the transfer of the necessary experience. Second, they have argued—sometimes unfairly perhaps—that cable television networks have a negative quality and reliability image and that the image would be enhanced by an affiliation with a large telephone company. Third, they argue that because of the debt burdens carried by the cable companies they would be unable to upgrade their networks without the infusion of capital from the telephone companies. Thus, the proponents allege that these mergers would increase the prospects of the cable firms successfully competing in the provision of local telephone services.

POTENTIAL THREAT TO THE PUBLIC INTEREST

In terms of the danger to the public interest presented by the mergers of the large telephone and cable firms, I have identified six potential threats:

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 53 1997

First, if, in their acquisitions of cable television companies, the local telephone companies are allowed to retain control of cable systems lying within their telephone operating areas, the prospects for meaningful competition between the two industry sectors will be reduced and the potential for bottleneck control over video and other forms of programming into the home will be increased.

Second, cable companies (a) have been aggressive investors in companies that have entered the market to carry telephone calls and other forms of communications between large users and the long distance telephone companies such as AT&T, MCI and Sprint, (b) have been experimenting with bypassing the local telephone company to carry telephone calls from smaller customers to those same long distance companies, and (c) have been exploring entry into the ordinary local telephone market itself. Likewise, local telephone companies—especially Bell Atlantic—have been experimenting with technologies that would allow them to deliver television programming in competition with the cable companies. With a highly consolidated, nationwide telephone/cable industry, there would be a much diminished likelihood of these two industries competing head-to-head in the core of each other's businesses.

Third, both the large telephone companies and the large cable companies have been experimenting with wireless pocket-phone systems (Personal Communications Systems or PCS) and those systems may form the technical basis for (a) competition with existing cellular radio companies and (b), potential competition for ordinary local telephone services. Since the FCC has tentatively decided to allow both telephone companies and cable companies (like Bell Atlantic and TCI) to bid for the licenses to provide these pocket-phone systems, potential competition could be reduced since the acquired spectrum would be under common ownership following a merger. Furthermore, cable television systems can be combined with these wireless pocket-phone systems to create networks that can compete with cellular radio systems. But it is unlikely that telephone company owned cable companies would pursue this opportunity aggressively in order to avoid competing with their parent's own, out-of-region cellular affiliates.

Fourth, the fundamental structure of the telecommunications market has an impact on diversity and innovation. Eight large telephone companies (the Bell Operating Companies and GTE) and the large cable companies today provide numerous parallel paths for innovation. A reduction in those parallel paths is likely to lead to less innovation.

Fifth, a key bottleneck for new entrants into broad band communications is the availability of programming. The cable companies already have substantial ownership positions in programming and the large telephone companies have signaled their intent in becoming investors in the programming market as well. With a highly consolidated, nationwide cable/telephone business, there will be fewer independent investors in program production, thus reducing program competition and diversity.

Sixth, if ownership of the facilities for the local distribution of programming is concentrated in fewer firms, and if those firms also have an ownership interest in their own programming (the situation that would exist after these mergers), then those firms would have incentives not to carry independently produced programming thus further reducing program competition and diversity.

PERSONAL OBSERVATIONS

Over the last few minutes I have set forth some of the alleged public interest benefits of mergers between the large telephone companies and described the large cable companies and the associated dangers. In the time I have remaining, I would like to offer some personal observations regarding these issues:

First, and perhaps most importantly, I must observe that the history of the telecommunications industry in the United States has not been a happy one from an antitrust perspective. Going back to the earliest years of the industry, following the expiration of the Bell patents prior to the end of the last century, AT&T tried to stifle emerging independent competition by refusing to interconnect, by refusing to sell equipment to the new entrants, by filing numerous patent suits, by attempting to thwart the development of superior non-Bell equipment, by dominating the conduct of the R&D necessary to advance the industry, and by engaging in a public relations war to destroy public and financial support for the independents. When these attempts failed to stop competitive inroads, the company shifted strategies and began to acquire its competitors. It was these acquisitions, coupled with other actions, that led to the Bell System's monopoly control over the telephone industry and the subsequent abuses that produced the AT&T antitrust suit and the break-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 54 1997

up of the Bell System. Moreover, the anti-competitive and anti-consumer practices of the Bell Operating Companies since the break-up have been well documented.

I am reminded of this history because the economics of having two networks serving the nation's homes is still uncertain. But if the economics do not support two "wires" and if the telephone companies believe that the long term effect of cable-telephone company competition may be that cable companies have the superior technology or position—for example, because they control the existing broad band connection into the home—then it is to the mutual benefit of the telephone companies to protect their existing business and investment by acquiring their potential competitors just as their predecessors did. Moreover, if the mergers are approved, they will have the same incentives (and increased abilities) to maintain that resulting monopoly just as they have in the post-break-up environment.

Second, and related to my first point, I have always been somewhat skeptical of cable companies actually competing successfully for the provision of ordinary telephone services because of host of barriers—such as telephone number portability, difficult and contentious issues surrounding the prices, terms and conditions of interconnection with the incumbent monopolist, and state regulatory barriers to name just a few. However, having watched competition develop successfully in the telephone equipment and long distance portions of the telecommunications market—and the apparent willingness on the part of some regulators to entertain the notion of local competition—I feel that cable systems did present the best long term promise for true local telephone competition.

Thus, as I indicated at the outset of my testimony, I was very disappointed when I learned of the proposed merger because I felt it would be the "straw that breaks the camel's back" in terms of such competition actually developing. In other words, my belief is that when firms face each other on opposite sides of the table in multiple markets, it reduces the likelihood that they will engage in vigorous competition in each other's territory. In other words, if telephone company A owns the cable company in telephone company B's territory and telephone company B owns the cable company in A's territory, they are less likely to use their telephone facilities to compete in the cable business and vice versa. It is less risky for them to confine themselves to their core business and avoid head-to-head competition. On this basis, if competition does still emerge, it is apt to be at the fringes of the market—say in the provision of specialized and/or new services—rather than in the traditional core portions of the their respective telephone and cable businesses.

Third, and related to my first two observations, even if a modicum of competition does develop, there will be strong incentives for a consolidated, nationwide cable-telephone industry to attempt to foreclose entry by additional competitors. Because of their control over critical rights-of-way and bottleneck facilities, they would be in a strong position to limit additional entry. Having two providers in a market—a duopoly—is not enough to produce real competition because the potential price cutter knows that any reduction in price will be immediately met by the other competitor. With multiple providers, there will always be a maverick who will cut prices and thereby protect consumers from the exercise of monopoly power.

The likelihood of concerted action is exacerbated by the fact that the large telephone companies (a) must—by necessity—work together to coordinate the operation of their interconnected land line networks, (b) share in the ownership of a large portion of the cellular radio industry, and (c) typically act in a unified position in the face of threats to their commercial well being. In short, a consolidated industry has the incentive to react to additional competition in a unified way just as the cellular radio carriers (largely owned by the telephone companies) did in opposing a new entrant into their business (FleetCall/NEXTEL).

Fourth, over the past few years I have been gratified to see the rivalry between Bellcore and CableLabs (the research arms of the telephone and cable industries respectively) compete in terms of the best architectures for future broad band networks capable of carrying vast amounts of information. In my opinion, that rivalry has caused the Bell Operating Companies to retreat from what regard as an overly expensive, overly complex, fiber-to-the-home architecture to a more cost-effective architecture based upon a fiber-copper (coaxial cable) hybrid advanced by the cable industry. Even more recently, I read a trade press report that Bellcore researchers had designed a video-on-demand system designed to put interactive multimedia applications, via the telephone network, in the hands of the customer instead of at the telephone company Central Office. The article states specifically that this development "represent(s) a subtle turn in thinking by the telephone industry, patterned after recent architecture developments in the cable TV world." I have to wonder whether such rivalry can, and will exist, if the industry is consolidated. In fact, I

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 55 1997

doubt if both laboratories will continue to exist if full consolidation of the industry takes place.

Fifth, and finally, if the number of independent paths into the home diminishes or, if the number of entities controlling those paths decreases, then I have even stronger concerns about the proposed mergers. Given the telephone industry's increased interest in investing in cable programming and the recent Federal Court decision that would allow Bell Atlantic to provide cable programming within their designated local exchange areas, the potential drawbacks from the merger seem even more severe from a content-control standpoint.

SUMMARY AND CONCLUSIONS

In the interest of time, I will simply summarize my testimony by stating that based upon my twenty-odd years of experience in the industry working with potential competitors, I believe the proposed merger raises substantial and significant competitive concerns that must be addressed fully by antitrust enforcement agencies and communications policymakers.

Senator METZENBAUM. Thank you, Mr. Hatfield. We appreciate your testimony and I will have some questions for you from myself as well as from Senator Thurmond.

Mr. Arquit?

STATEMENT OF KEVIN J. ARQUIT

Mr. ARQUIT. Thank you, Senator. In response to your question, first of all, I am a partner in the law firm of Rogers & Wells. However, neither I nor the firm has a client interest in this matter. This testimony was prepared on my own time. In terms of your request about previous employment, I guess in that sense I was employed by the Federal Trade Commission. In the last 2 years of the Reagan administration, I was its general counsel, and during the Bush administration I was the Director of the Bureau of Competition and in that capacity we investigated and analyzed several cable and programming mergers, but that is the background.

Senator METZENBAUM. Does your firm represent any cable or telephone companies at the present time?

Mr. ARQUIT. Not that I know of, and none has paid for this testimony.

Senator METZENBAUM. I wasn't suggesting they paid for it.

Mr. ARQUIT. OK. Well, I would like to discuss the antitrust implications of recent telecommunications mergers. My comments are set forth in much greater detail in my written statement.

To me, it seems obvious that asking the hard antitrust questions now is the prudent course to take. It will be impossible to remake the competitive landscape 10 years from now if mistakes result from the lack of a thorough analysis. However, we should also recognize that a transaction may speed up the emergence of an interactive, multimedia market. If a merger is necessary to achieve that efficiency, the antitrust laws should not stand in the way.

The motivation for virtually every merger is increased profits, and that fact alone is not troubling. The focus of the antitrust enforcer should be on the expected source of those profits. Will the profits come from leaps in innovation, improved efficiency, or lower costs? If so, the merging parties should be given a hearty round of applause. Or will the profits come from an exercise of market power and the elimination of competition which will benefit the parties, but at the expense of everyone else? Answering these questions is the challenge that confronts the antitrust enforcer.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 56 1997

Let's consider this distinction in the context of a merger between a phone company and a cable company. At first glance, what is the big deal? A telephone company provides telephone service and cable companies provide cable programming. If the two companies were not competing before, how could a merger between them lessen competition?

Well, one answer is that two companies can compete not just in the final service offered to consumers, but across an entire spectrum of activities, including research and development. In the telecommunications industry, for example, the merging parties may not presently have overlapping products or services, but nonetheless be active, competing participants in a research and development race to be a leader in the emerging interactive, multimedia market. A merger puts an effective end to such competition.

There are those who will point out that there are multiple other players that exist, so the loss of R&D competition in any one transaction is no big deal. This may, in fact, be true, but there are also those who will insist that most of the time two well-trained sprinters will run much further and faster than any contestant in a three-legged race. Whatever the truth, the stakes are too high to ignore the question of how a merger will affect competition for competing versions of the future.

There is also the issue of potential competition to consider; that is, that phone companies are poised to enter cable markets, and vice versa. Certainly, cable companies, in recently opposing cable re-regulation, were quick to argue that they faced effective competition from telephone companies about to enter the video market. The obvious antitrust question is whether the marriage of a large cable and telephone company short-circuits that impending competition. If so, consumers are the big losers, as the prospect of competition that would have emerged in both markets is torn from their grasp.

Put another way, there are two lines into most homes that are capable of handling telecommunications, one, the phone line, and the other, the cable line. Placing both in the hands of a single owner deprives consumers of whatever competition may have resulted from the previously separate ownership. It is worth noting that in the United Kingdom cable systems are already competing with British Telecom for local telephone customers.

Potential competition problems are presumably solved if the cable company divests those cable properties located in the telephone company service area. The result is two companies poised to compete in the same manner as were the cable and phone companies premerger. My understanding is that Bell Atlantic is proposing such a fix at first. I simply note that regarding any such spinoff, it is important that the divested cable assets not end up in the same hands as those controlling the merged entity. It is one thing to have separate employees, directors and officers, but what is also needed are separate, unrelated owners. In the final analysis, competitive concerns are alleviated only if the owner of the divested assets has incentives to compete independently without regard for the fortunes of the newly merged entity.

A third competitive issue to consider is the vertical effect of a merger. Certainly, there has been a trend in the cable industry to-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 57 1997

ward vertical integration of suppliers of video programming with distributors of video signals. Vertical integration can raise a number of antitrust issues. For example, if most cable customers end up being served by a very few large companies who control both programming and local cable systems, nonintegrated programmers may be out of luck in finding adequate distribution if the large, integrated companies use only the programming of their own captive sources. I must emphasize, however, that vertical relationships have a capacity to generate efficiencies and that antitrust enforcement in this area should be used sparingly.

In conclusion, the conglomerate mergers underway today present a host of antitrust issues, including vertical foreclosure, potential competition, actual horizontal competition, as well as the promise of significant efficiencies and creation of new markets. Responsible policymakers cannot turn their backs on questions just because they are hard. These mergers will require honest, substantive analysis in order to reach the right results. Mistakes in either direction made in the name of politics could impact virtually every American household.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Arquit follows:]

PREPARED STATEMENT OF KEVIN J. ARQUIT [1]

I. INTRODUCTION

Mr. Chairman, I appreciate the invitation to testify today about the antitrust considerations relevant to the recent groundswell of telecommunications mergers. Most agree that we are witnessing the convergence of two industries (telephony and cable television) into what will ultimately be a seamless communications market. To put it bluntly, the consequences flowing from these deals will be felt by the American public for years, perhaps generations, to come.

To me, it therefore seems obvious that the proposed megadeals should receive very careful scrutiny under the antitrust laws—laws that are focused on enhancing consumer welfare, by encouraging efficiency and protecting competition. Any time a transaction or group of transactions will result in vast economic resources falling into the hands of a few, large players in a vitally important industry, there are critical antitrust questions that need to be asked.

By far the most visible transactions are the competing bids of QVC Network, Inc. and Viacom Inc. for Paramount Communications, Inc., and the proposed conglomerate merger of Tele-Communications, Inc. ("TCI"), and Liberty Media Corporation into Bell Atlantic Corporation. At issue is the ownership of extremely valuable assets in the areas of video signal distribution, telephone service, data transmission, entertainment programming, wireless communication, as well as a host of related and developing technologies. Quite apart from their relevance to antitrust aficionados such as myself, these deals are undoubtedly landmark transactions in the history of American business.

It is also imperative to recognize, however, that there is another side to the equation. The efficiencies that may abound with the emergence of a multimedia, interactive communications market are breathtaking in scope. Such technology combined into the much-mentioned "data superhighway" may end up being the essential life support system for virtually every other American industry. By lowering transaction costs for those other industries, they will be strengthened in the ongoing battle to maximize competitiveness in world markets. To the extent these deals are necessary to achieve such efficiencies, they should be allowed to proceed. Antitrust analysis should fully consider the existence and extent of such efficiencies. Just as lax enforcement can result in irreversible competitive harm, over-enforcement will stunt development of the very technologies that are essential to our future competitiveness.

[1] Mr. Arquit was General Counsel of the Federal Trade Commission from 1988–1989, and Director of the FTC's Bureau of Competition from 1989–1992. He is presently at the law firm of Rogers & Wells. The remarks contained herein represent the personal views of Mr. Arquit.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 58 1997

As a matter of policy, I believe that asking the hard antitrust questions now is the prudent course to take. It will be impossible, or at least impractical, to remake the competitive landscape ten years from now if mistakes result from the lack of a thorough analysis. It so happens that one of the federal antitrust statutes, Section 7 of the Clayton Act (15 U.S.C. Sec. 18), is specifically designed to reach competitive problems in their incipiency, *i.e.*, before their undesirable effects take hold. Section 7, the primary federal statute used to challenge mergers and acquisitions on antitrust grounds, prohibits transactions the effect of which "*may be* substantially to lessen competition, or to tend to create a monopoly" (emphasis added). This stop-it-before-it's-too-late notion seems especially appropriate for this industry.

The main purpose of my remarks today is to identify generally the goals of antitrust enforcement and the antitrust pressure points that could develop as a result of consolidation. As a preliminary matter, let me offer a disclaimer. Antitrust lawyers sometimes engage in a fiction (born of practical necessity) when analyzing the competitive effects of merger transactions or other business practices. To create a meaningful framework for analysis, relevant markets are assumed to exist at some fixed point in time and competitive effects are analyzed within those neatly defined markets. Of course, in reality both competition and the contours of most markets are dynamic: less like a snapshot and more like one of Paramount's full-length feature films with quadraphonic Dolby surround sound.

Particularly with high technology markets such as those involving telecommunications, the effects of present-day transactions on future competition can be difficult to predict and tricky to analyze. Today's state-of-the-art is tomorrow's old hat. Unfortunately for antitrust analysts, the information/technology revolution has not yet developed a crystal ball or a time machine. Indeed, if antitrust practitioners were in fact blessed with any such gift of clairvoyance, I suspect most would be tempted to switch hats and become investment advisors of one sort or another. Instead, as is often the case with important policy decisions, competition policy makers must make their best judgments, given the facts they have and drawing from past experience. But clearly, this exercise is not physics, and absolute answers are elusive.

As a starting point for the antitrust analysis, I would like to emphasize that it is basic market economics and a primary tenet of our free enterprise system that businesses engage in transactions (large or small) in order to increase their profits. Undoubtedly, this is the purpose of the proposed mergers discussed today from the perspective of the parties and their shareholders. But the quest for profits is not itself an antitrust violation, even when those seeking the profits are large and powerful corporations. When markets are functioning properly—that is, when competition is allowed to flourish—the corporate goal of profit maximization is perfectly consonant with the interests of consumers, who benefit from new and better products and lower prices as a result of the incentives that increased profits create. It is therefore important that antitrust enforcement not interfere with a transaction, though pursued for greater profits, that will actually enhance competition. On the other hand, it is imperative especially in an important industry such as telecommunications, for antitrust enforcement to ensure that profit maximization is pursued by companies in a climate of vigorous competition.

Thus, the essential antitrust questions when looking at a merger focus on the way that the parties are likely to achieve the expected increased profits that have motivated the transaction. Will the profits come from improved efficiency and the realization of synergies, which should lower costs, spur innovation, and ultimately benefit consumers as well as the parties? If so, the merging parties should be given a hearty round of applause.

Or, will the profits come from an exercise of market power, the elimination of competition, and the erection of market entry barriers, which will benefit only the parties at the expense of everyone else? Recognizing the difference between these two scenarios is exceedingly difficult, but is the essence of sound antitrust merger policy. Telecommunications mergers, including those that involve cable and telephone companies, can be analyzed in these terms to identify potential antitrust issues.

II. POTENTIAL COMPETITIVE EFFECTS AND EFFICIENCIES

A. Foreclosure of potential competition between cable companies and telephone companies in the distribution of video signals and in the provision of local telephone service

During the debate of the past three or four years over cable re-regulation, the conventional wisdom was that cable companies and telephone companies were on a competitive collision course in the market for the distribution of video signals. Indeed, in seeking to prove that their business faced, or would soon face, "effective

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 59 1997

competition"—and thus that industry re-regulation was unnecessary—the cable companies argued repeatedly that telephone companies were on the verge of competing for video subscribers. On the other side of this coin, it is likely to become technologically feasible for cable companies to provide telephone service over their networks in competition with the local telephone companies. In the United Kingdom, cable systems, some of which are partially owned by the U.S. Baby Bells, are already competing with British Telecom for local telephone customers.

The obvious antitrust question that emerges from these facts is whether the marriage of a large cable company and a large local telephone company might result in the heading off of impending competition in their respective (near-monopoly) primary businesses. If so, such a merger could potentially harm consumers by depriving them of competition both in the market for video signal distribution (if, absent the merger, the phone company would have competed with the cable company for video subscribers) and in the market for the provision of local telephone service (if, likewise, the cable company would have competed with the telephone company for local telephone connections). Of course, this scenario assumes the absence, or at least a lessening, of current regulatory restrictions that forbid some aspects of this competition; as we all know, such proposals are currently being made.

Antitrust experts will recognize this theory of competitive harm as the so-called "potential competition" theory. In practice this theory has been applied sparingly because in many market contexts it is difficult to prove with any reasonable level of certainty how competition will be harmed, when there is no benchmark of actual rivalry between merging parties by which to measure the loss of competition resulting from the transaction. In a nutshell, cases against merging "potential competitors" are often in practice just too speculative to penetrate an able defense by the parties.

The merger of a cable company and a telephone company might, however, present a case where the foreclosure of potential competition is certain enough to raise viable antitrust issues. The fact that these two separate industries have been accelerating toward a head-on competitive battle with one another seems undeniable, based on the industries' own accounts of where they are headed. Moreover, largely because the development of the two industries has been so heavily regulated—with regulatory restrictions discouraging competition in many cases—local monopolies (or virtual monopolies) have become the order of the day for both. Antitrust enforcers will want to examine closely the records of merging cable and telephone companies for documents that recognize that in the absence of regulatory restrictions, the two industries would be a serious competitive threat to one another. Of course, the cable/telephone competition overseas that involves many of these same U.S. companies puts flesh and blood on mere "notions" of competition.

The cable distribution of video signals and the provision of telephone service are essentially confined to discrete geographic areas. Thus, any potential competition problem in these markets created by a merger would presumably be solved if the cable company involved were to divest itself of the properties it owned that were located in the telephone company's local area of operation. Such a divestiture would in effect eliminate the (potential) competitive overlap of the two companies. To the extent that restrictions on telephone companies imposed by the Cable Communications Policy Act of 1984 are either lifted or stricken (as would be the case if a recent federal district court decision stands), the merged company, after appropriate divestitures, could then distribute video signals over its telephone lines in competition with the newly divested (and separately owned) local cable systems. Moreover, in areas not previously served by the telephone company, the merged entity, by upgrading the purchased cable systems could attempt to provide local telephone service in competition with other regional telephone companies. The emergence of either phenomenon would create a new competitor in a previously monopolistic market. Such a potential procompetitive effect should be weighed heavily in the overall assessment of any need for antitrust enforcement.

My current understanding is that such a "fix-it-first" divestiture solution is what Bell Atlantic and TCI have proposed to solve any "potential competition" problem with their transaction. According to news reports, TCI plans to divest all of its cable holdings located in the Bell Atlantic telephone service area, which includes six states and the District of Columbia. Although such divestitures could largely minimize antitrust potential competition concerns with telephone company/cable company mergers, there are a few general caveats to note about the sufficiency of a divestiture solution, whether done voluntarily by the parties or pursuant to a Department of Justice or Federal Trade Commission order.

First, if the spin-off is intended to alleviate anticompetitive concerns, it is important that ultimate control of the divested assets be in different hands from those controlling the merged entity. It is often the case that shares of a widely held, pub-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 60 1997

licly traded company are so dispersed that effective control by any readily definable group of shareholders is not possible. However, where effective control of one corporation is exercised by a limited group, the efficacy of any divestiture is undermined if that same group is also a large shareholder, or is in a position to exercise control, with respect to the divested assets, because the common shareholders of the divested cable systems and the new entity could serve to facilitate competitive coordination between the two purported "competitors." At the very least, the group controlling the divested assets might not operate those assets with the same competitive vigor that a truly independent operator would.

Second, from a competitive effects standpoint, it would be important that those acquiring the divested cable assets have the expertise to operate them as competently as the previous owners and with the same competitive potential in both video signal distribution and telephone service. For example, a large cable company with substantial financial wherewithal might well have engaged in substantial research and development in support of turning its cable systems into a viable competitor in the telephone service market. If the new owner of the divested cable assets located in the telephone company's service area were to be, for example, a company with little or no technological research capability and no chance of using those cable systems for telephone service, then the divestiture may not solve the potential competition problem in the telephone service market (assuming regulatory barriers come down). With their R&D and technical support lifeline having been severed, the divested assets might be a greatly diminished source of competition. This is not to say such a result is inevitable, but simply to point out that the identity of the new owner is a fact relevant to the antitrust analysis.

In sum, divestiture remedies can offer a meaningful solution. However, care must be taken to make sure that the company or individuals who buy the divested assets will be able to compete effectively in all of the relevant markets in which potential competition might be foreclosed, and without regard for the fortunes of the newly merged entity.

B. Foreclosure of actual competition in the "innovation market" for telecommunications technology

When experts examine the competitive effects of mergers, they usually focus primarily on competition between the parties in production and marketing of the ultimate product or service offered for sale. This is because competition at these levels is easier to observe and measure. But companies that compete with one another often do so across the entire spectrum of activities, including research and development. What one usually hears from the parties about R&D when a merger is under review is that the transaction will create great synergies. In many circumstances, this result is undoubtedly true, and great significance should attach to such a fact. There is a flip side, however, and that is that the elimination of R&D rivalry may also eliminate competition for visions of the technological future. Once again, the antitrust enforcer is called upon to make fine distinctions, a job made harder here by the difficulties inherent in defining a meaningful relevant market for "innovation." Nonetheless R&D competition among both telephone and cable companies to emerge as a leader in the evolving interactive multimedia market, where there may soon be little functional distinction between computers, TV's, or telephones, could be foreclosed by mergers among leading firms in these industries. Innovation appears to be the lifeblood of high tech companies, and antitrust must ensure that mergers between them do not chill this important aspect of rivalry in industries such as telecommunications.

Indeed, in telecommunications markets, competition in innovation can be particularly significant. Quite often an entire generation of improvements in telecommunications depends on one company reaching an important technological threshold, which establishes certain standards in a particular area. Once the standard is established, others adapt applications and equipment to take advantage of the standard. This can be very procompetitive by lowering transactions costs through uniform adaptability. In this sense, telecommunications innovation can be more of a step function than a straight line or even a smooth curve. However, if a merger, by reducing R&D rivalry, were to retard the development or lower the quality of a "threshold" standard, it could affect a whole generation of innovations derived from that breakthrough.

However, the competition in R&D for the still emerging communications services market undoubtedly extends beyond the telephone company and cable company that have chosen to be partners in any particular transaction. The list of possible other contestants in the R&D race may include the other Baby Bells, the communication equipment manufacturers, and providers of long distance service. To the extent there are multiple players that are involved in a mad dash to the finish line to de-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 61 1997

velop workable technologies, there is less concern that a particular transaction carries any meaningful risk of competitive harm for R&D.

But resolution of this issue requires a hard look by government enforcers. There are those who will say large telephone and cable companies need each other's R&D help in order to make the future happen, and this may in fact be true. But there are also those who will insist that most of the time, two, well-trained sprinters will run much further and faster than any contestant in a three-legged race. A thorough antitrust investigation of industry merger transactions would at least enable enforcement officials to see what the parties' documents, and their scientists, have to say about their respective independent research efforts. Perhaps consumers would be best served by marrying two complementary technologies now; perhaps they would be best served by forcing the best company to win in a competition to shape the future of telecommunications markets, rather than by allowing two of the strongest competitors to join their efforts. Whatever the truth, the stakes are too high to fail to consider closely this question.

C. Vertical foreclosure in the markets for video programming and video signal delivery

Part of the trend in the telecommunications consolidation that is currently underway is toward vertical integration of suppliers of video programming with distributors of video signals. For example, TCI currently has substantial interests in many cable programming networks, and, an affiliated entity, QVC, is actively involved in a high-profile battle to acquire Paramount Communications Inc., which owns a large movie studio, a publishing company, and other valuable programming assets, including a film library.

Vertical integration can raise a number of antitrust issues. Under certain limited market conditions, a vertically integrated company can potentially harm competition by foreclosing existing, non-integrated rivals from segments of the market that would otherwise be open to them. For example, if, as a result of a series of mergers, most of the video subscribers in the U.S. were served by a very few large, vertically integrated distributors, smaller, non-integrated programmers might be closed out of the market, as the large distributors used only programming produced by their own captive sources. If the net effect of such foreclosure were that consumers were denied a sufficiently broad array of programming, there would be an antitrust problem. To the extent that there exist in a practical sense, either now, or in the near future, alternative methods of signal delivery (e.g., direct broadcast satellite), such entry reduces the likelihood of foreclosure thereby lessening competitive concerns. This assumes, of course, that the technology critical to signal transport and delivery, such as encryption and compression, is made available on competitive terms to those attempting such entry.

In addition to possible foreclosure in the video programming market, under certain circumstances, foreclosure could occur of smaller cable operators attempting video signal delivery. They might not be able to compete with the larger, integrated companies for subscribers, if they were unable to obtain quality programming from the sources tied up by the larger companies. If consumers pay higher prices as a result, there are antitrust implications. Again, the existence or absence of entry barriers is crucial to the antitrust analysis. If there are no significant barriers to entry in the production and supply of video programming, foreclosure of the type just described is unlikely. But if subscribers demand well-recognized, high-quality material of a type not easily duplicated, foreclosure is more plausible.

As for the latter concern, major provisions of the 1992 Cable Act require that vertically integrated cable companies make their programming available to other cable operators on non-discriminatory terms. It is too early to tell whether Cable Act regulations will be effective in guaranteeing high quality programming for independent operators or whether instead we find ourselves in the land of unintended consequences, which so often is the result of regulation.

The federal government's antitrust merger guidelines express two explicit concerns about the effects of vertical integration (at least when it results from a merger). First, according to the guidelines, vertical integration can increase barriers to entry by making it necessary for a potential new entrant to enter both markets in order to enter either. For example, there are a number of upstart technologies that hold at least the potential of providing serious competition to the cable and telephone companies in the distribution of video signal. These include direct broadcast satellite and microwave technologies, both of which can circumvent cable and telephone wires. If the owners of one of these alternative delivery systems were unable to purchase desirable programming, and were therefore forced to enter the programming market in order to enter the video signal distribution market, vertical integration could be seen as raising entry barriers. Similarly, if the technology for a nec-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 62 1997

essary input, such as scrambling or digital compression, were subject to incumbent control, the result could be the foreclosure of alternative delivery systems.

The second issue that the merger guidelines raise is that vertical integration could facilitate collusion. The concern here would be that by owning an upstream entity that sells to downstream rivals, a company can more easily monitor prices in the downstream market. Thus, for example, if a cable/telephone company were to own a large library of programming, and was a large supplier of programming to competitive video signal distributors, the cable/telephone company would possess competitively significant cost information about its downstream competitor. This information could facilitate competitive coordination.

would like to emphasize that whatever antitrust problems may exist as a result of vertical integration in telecommunications markets (and to the extent that the Cable Act and other regulations do not already solve some of them), the Bell Atlantic/TCI merger only lends itself to such an analysis if the transaction creates any additional vertical linkages. Moreover, because vertical relationships have an enormous capacity to generate efficiencies and to remedy sources of market failure, such as free riding, it is only in special circumstances that vertical integration will, on balance, actually harm competition. I flag the vertical integration issue merely because there are many instances of vertical integration in the telecommunications industry. Still, very careful thought would be required before one could conclude that it makes sense to challenge any of these transactions on a vertical theory.

D. Reduction in competition in other relevant markets such as advertising

An issue that merits antitrust attention is whether relevant product markets other than video signal distribution and telephone service might also be adversely affected by mergers between telephone and cable companies. One possibility, which I offer merely hypothetically, is the market for the delivery of audiences to video programming advertisers. I am assuming, of course, that such a relevant product market would be found to exist after a proper analysis. For example, it is possible that other forms of advertising such as that in newspapers and on the radio are in the same relevant product market with video advertising.

If a large telephone company and a large cable company were each capable of distributing video signals to the home (this assumes application of the potential competition theory), then each could presumably sell advertising time on their respective programming lineups, based on their arrangements with program suppliers. If this were the case, the two companies could compete for advertising dollars. A merger between the two companies would eliminate that competition between them.

Again, the advertising "market" is merely an example of how a telephone company and a cable company could theoretically compete with one another in a market separate from services provided to consumers over cable or telephone wire. The important point here is the generic one, that actual or potential competition could be affected by large transactions in relevant markets that are not immediately apparent on the surface. Although divestiture solutions might solve many such competitive problems, always keep in mind that divestitures must be coextensive with the competitive problem in order to be effective.

III. CONCLUSION

As modern commercial markets become more complex, antitrust analysis gets more difficult. And there may be no set of markets that is more difficult to parse from a competitive standpoint than those related to telecommunications, particularly given the rapidly changing nature of such markets. The conglomerate mergers underway today present a host of antitrust issues including vertical foreclosure, potential competition, actual horizontal competition as well as the promise of significant efficiencies and creation of new markets. Sorting out these issues in the context of a particular merger transaction is not an easy task. Nonetheless, responsible policy makers cannot turn their backs on questions just because they are hard. In my opinion, they must embrace the challenges that hard questions pose and seek to enact correct policies that will serve the public interest. Those who contend that large corporate transactions are bad, just because they are "big," are just as irresponsible as those who turn a blind eye to blatantly anticompetitive, anticonsumer transactions just because they benefit a high-profile industry. These telecommunications industry mergers will require honest, substantive analysis in order to reach the right result. Mistakes, in either direction, made in the name of politics could affect literally every American household.

Thank you again, Mr. Chairman, for this opportunity to testify, and I shall be pleased to answer any questions that you or others on the committee may have for me.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 63 1997

Senator METZENBAUM. Thank you very much, Mr. Arquit.
Mr. Peter Huber, we are happy to have you with us, sir.

STATEMENT OF PETER HUBER

Mr. HUBER. Good afternoon, Mr. Chairman. In response to your question, I have a great deal to confess. I was retained by the Department of Justice as an expert witness some years ago. I was of counsel to Mayer, Brown & Platt, and I am now of counsel to a small law firm in town that did represent and may still represent—I would have to check with my partners there—NYNEX, which has a $1 billion stake in Viacom, and has represented Bell Atlantic in its first amendment challenge across the river. We have worked with Southwestern Bell that competes in Bell Atlantic's territory, and for US West that, of course, has a stake in Time Warner that competes against Bell Atlantic. I could go on, but you have limited me to 5 minutes.

I should add perhaps that the person who gave me my first job as a lawyer after I finished my clerkships was a lady by the name of Anne Bingaman, but that is history now.

Mr. Chairman, there are really two essential facts in antitrust law, and they apply here more than anywhere, and two essential inquiries. One is what is the product or service, and the second is where is it sold. What is the product or service, the relevant question here? You have already provided the answer, and correctly. Cable and telephony are converging. We are going into a digital broadband world.

In the digital world, a bite is a bite, whether it is carrying video or voice or data. The technology is here today for telephone companies to provide video services over their networks and for cable companies to provide telephone services, so the product and service markets—clearly, we are talking here about what very soon will be one industry, a single product.

The second inquiry, however, cannot be forgotten and seems to be overlooked, or seems to have been overlooked in much of our discussion. Antitrust analysis is conducted in the scope of geographic markets, and the local distribution market in telecommunications is, by definition, local. It makes no sense to talk about a national market for local distribution. That is an oxymoron.

The content in these markets may be sold nationwide or indeed internationally, but if you are talking about the distribution markets themselves, those are local markets and they must be analyzed as such. Discussion of market shares of a local distribution market simply doesn't make very much sense, and I might also add at this point, and perhaps you would care to follow up on this, a discussion of access to customers is not terminology known to the antitrust law. Both Safeway and Giant have access to me in my neighborhood, but that doesn't mean they own me. Access is not the measure. Market shares are the measure.

These two facts have, I think, two consequences, and they are not very complicated. First of all, we do not want cable and telephone companies to be merging in-region. Very soon, they will be in the same business. Of course, they should not be merging horizontally within relevant geographic markets. As I understand it, not much of that is proposed. If it is proposed, it should be resisted.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 64 1997

But the correlative proposition is that if we see a cable company attempting to compete out-of-region or a telephone company competing out-of-region, we should applaud that. This is an attempt to create new competition, not to eliminate old competition. I feel jealous of British consumers today who have a second telephone company called NYNEX that has been investing in cable properties in Britain. According to the Wall Street Journal last week, NYNEX, through cable properties in Britain, is now British Telecom's "most formidable rival for local telephone service." That is in England. I wish NYNEX would come to Bethesda, too, and perhaps they will once cable properties are spun off.

We see this now across the country. Southwestern Bell is poised to compete head-to-head in Bell Atlantic territory through Hauser. US West, of course, has a major stake in Time Warner, which operates cable systems outside US West's region. NYNEX, of course, has a stake in Viacom. I know this is Washington, but I was amused to hear this characterized as a trivial investment. It is $1.2 billion, which I would have thought gives them a reasonably pressing interest. Bell South has an investment in Prime.

These are all large transactions. Of course, they deserve your scrutiny. Of course, they deserve the scrutiny of the Justice Department and the FCC. They will get that scrutiny. They should, but I think if you examine them in very basic, traditional antitrust terms—what is the product market and where is it really being sold—maps are pretty; I have drawn my share of them in my life, but you have to come down to reality. We are talking about local distribution networks and, examined in those terms, there is all the difference in the world between horizontal overlaps and out-of-region ventures.

There is a great irony for somebody like me who has been in this business for a while—23 years since 1970 when the FCC first acted and then 1984 when the Congress acted. The theory was that cable companies were horribly vulnerable; that if we let telephone companies into any aspect of video business, cable companies would be killed. The John Malones back then were the tiny, vulnerable infants. That was argued as recently as 3 months ago across the river.

Now, when we find telephone companies willing to invest out-of-region and to shore up and cooperate with out-of-region cable companies, which can only increase competition, suddenly the theory is that they are too strong. I think we have to get away from this Goldilocks soup, you know, too hot or too cold approach to antitrust law and do some hard-headed analysis here in terms of the basic products and services at issue and the geographic market.

Thank you very much.

[The prepared statement of Mr. Huber follows:]

PREPARED STATEMENT OF PETER HUBER

My name is Peter Huber. I am a Fellow of the Manhattan Institute for Policy Research, a think tank based in New York, and I serve Of Counsel to the Washington, D.C. law firm of Kellogg, Huber & Hansen. I am a co-author of the treatise *Federal Telecommunications Law* (Little Brown 1992). I was also the author of *The Geodesic Network: 1987 Report on Competition in the Telephone Industry*, the report submitted to federal Judge Harold Greene on the occasion of the first triennial review of the Bell breakup, and an update to that report (privately undertaken), *The Geodesic Network II: 1993 Report on Competition in the Telephone Industry*. I have written

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 65 1997

numerous other articles and commentaries on the technology and economics of the telecommunications industry. Through my current law firm, and through prior affiliation with the Chicago firm of Mayer, Brown & Platt, I have also conducted numerous other studies of the telecommunications industry on behalf of the Regional Bell Companies and other clients. My testimony here today, however, represents my own views.

The recent spate of mergers in the telecommunications industry must be assessed in light of two market realities.

The first is technological. From an engineering perspective, telephone and cable service are fast becoming one and the same. In the digital world, a byte is a byte—whether it represents a hiccup on a telephone call, or a decimal point in a spreadsheet, or one tiny fragment of a picture in a re-run of "I Love Lucy." Voice, video, and data are, or soon will be, indistinguishable. The same networks can and do carry everything. Telephone companies have at hand the capability to transport color television over their existing networks. Cable companies have at hand the technology needed to provide full, two-way telephone service over a combination of existing cable plant and wireless add-ons.

Transport media are merging as well. Television used to travel by air, telephone by wire. Today, cable is the dominant medium for transporting television signals over the last mile to the home. Cable passes over 95 percent of American homes; over 60 percent actually subscribe. Meanwhile, the fastest growth in telephony is wireless. The FCC recently cited studies projecting 60 million users of wireless services within the decade. Congress itself recently designated a very large block of spectrum (200 MHz) for allocation to new "personal communications services." Cable companies have been among the most aggressive and ambitious developers of these wireless services. The first PCS call in the U.S. to use cable plant for a portion of the transport was placed on February 12, 1932, from the President of Cox Enterprises to then-FCC Chairman Al Sikes.

The second basic determinant of market boundaries in the telecommunications industry is geographical. Consumers still buy "last mile" transport locally. A consumer in Denver buys service from cable and telephone companies in Denver, not Des Moines. This fact may seem obvious, but it is overlooked surprisingly often. From an antitrust perspective, however, it is critical. Local telecommunications—whether cable or telephone—are just that—*local*.

These two fundamental facts of the telecommunications industry suggest, in turn, two important antitrust conclusions.

First, phone companies and cable companies should be permitted to compete against each other head to head, in the same service areas. They are in the same business—or they will be as soon as regulators allow. We should welcome the competition that engineering now makes both possible and inevitable. Maintaining regulatory walls between them will only suppress competition. At the same time, we don't want cable and telephone companies to combine competing facilities within the same geographic service areas. As Congress itself has recognized, a single provider of both cable and telephone service may be all that is economically possible in rural areas. But in big cities, cable and telephone companies should go at each other as independent entities.

The best way to encourage that is to permit *out of region* alliances—precisely the same alliances that should be forbidden within the same service areas. Such alliances present the most certain road to head-to-head competition among the seven Regional Bell Companies, GTE, Sprint, Time Warner, Cox, and other providers of both cable and telephone service, whose operations are currently confined to more limited geographic markets.

The potential benefits of such competition have already been tested overseas; British consumers have been the first beneficiaries. As *The Wall Street Journal* reported just a few days ago (October 21, 1993), a New York based Regional Bell Company—NYNEX—is now battling for market share with British Telecom, having entered the British market through a U.K. cable-television affiliate. NYNEX is preparing to offer British customers various discount-calling plans over its British cable network—including free night-time calls or special promotions for phoning friends and relatives. NYNEX's long-distance tariffs currently undercut BT's by as much as 13 percent. As the *Journal* reported, NYNEX "has emerged in the past two years as the biggest cable-TV operator in Britain and BT's most formidable rival for local telephone service." The *Journal* went on to note that cable-TV companies in Britain are already offering 226,871 telephone lines to British subscribers. By some estimates cable-TV operators will capture as much as 20 percent of Britain's telephone market within a decade.

It now seems likely that U.S. consumers will soon realize similar benefits. What NYNEX is doing overseas, Southwestern Bell, US West, BellSouth, NYNEX itself,

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 66 1997

and most recently, Bell Atlantic, are preparing to do within the United States, outside their existing service areas.

Last February, Southwestern Bell announced its intention to purchase two existing cable systems. One is in Arlington County, Virginia and the other is in Montgomery County, Maryland—both are in Bell Atlantic's telephone service area.

In May, US West invested $2.5 billion in Time Warner, the nation's second largest cable operator. Time Warner runs 13 of the nation's top 50 cable systems including New York City (NYNEX), Orlando FL (BellSouth), Houston TX (Southwestern Bell), Honolulu HI (GTE), Rochester NY (NYNEX), Cincinnati OH (Ameritech), Kansas City MO (Southwestern Bell), Memphis TN (BellSouth), Austin TX (Southwestern Bell), San Diego CA (PacTel), Charlotte and Raleigh/Durham NC (BellSouth), and Malden MA (NYNEX). Time Warner also operates a total of 30 cable networks in Bell Atlantic's region. US West/Time Warner is now in a much stronger position to compete against NYNEX, GTE, Ameritech, Bell Atlantic, and others, than they were before that alliance was formed. There has been no offsetting loss to competition in US West's region; the company's alliance with Time Warner was structured to eliminate all possible horizontal aspects of the alliance within US West's home territory.

More recently still, NYNEX announced plans to invest $1.2 billion in Viacom International, the nation's thirteenth largest cable operator. One of Viacom's cable systems runs through the heart of San Francisco—PacTel's telephone territory. Viacom also serves Salem WA (US West), Milwaukee WI (Ameritech), and Nashville TN (BellSouth). Here again, it is almost impossible to imagine how such an alliance could have any effect other than to increase head-to-head competition between NYNEX and the other Regional Bells. Within a few years, NYNEX/Viacom will almost certainly be offering phone service in direct competition with NYNEX's former siblings in the Bell family, just as NYNEX is already doing in Britain, through its alliances with cable entities there. Already today, through different allies, NYNEX and Bell Atlantic are in effect bidding against each other to create a further alliance with Paramount.

In October, BellSouth likewise announced the acquisition of a 22.5 percent stake in Prime Management. Prime's Austin-based cable system subsidiary, Prime Cable, is the nation's 24th-largest cable operator. One of its systems operates in Las Vegas NV, side by side with a telephone network operated by PacTel. This surely means more competition, not less. Recent press reports also suggest that BellSouth may become a third bidder for Paramount.

Competition is of course unfolding in the other direction too—from the telephone network into the cable business. The FCC has led the way with its "video dialtone," which encourages telco provision of video transport in-region, and Bell Atlantic recently prevailed in federal district court on a first amendment challenge to a related provision of the 1984 Cable Act. Telephone companies have the technology to carry video over their existing networks; they are now being granted the legal authority to do so. Thus, as telcos prepare to offer cable services out of region, they must also prepare to square off against other telcos who will offer video dialtone on their home turf. Such developments should warm the hearts of antitrust enforcers.

In my view, the specter of some "Big Brother" monopoly developing in this kind of environment is highly implausible. GTE is the largest local telephone company in this country, followed by the seven Regional Bell Companies. Their counterparts in the cable industry—companies like TCI, Time Warner, Cox, and Viacom—are substantial entities too. As cable companies enter wireless telephony they will find themselves competing not only with local telcos but with AT&T/McCaw—a company with revenues over four times those of Bell Atlantic and TCI combined. It seems wholly implausible to suggest that Bell Atlantic/TCI will soon knock AT&T/McCaw out of wireless telephony, or US West/Time Warner out of video transport, either in Bell Atlantic's region or in areas currently served by TCI.

Defenders of the 1984 Cable Act have long argued that cable companies could *not* survive competition by telcos. No one would dare compete against a telco within its own service area, the argument ran. No cable company had the financial resources, the technical expertise, or the raw staying power, to do anything so risky. Thus, competition itself had to be forbidden, so that competition would be preserved. As recently as last summer, for example, various groups were still arguing before a federal district judge that telco entry into the video programming business would quickly annihilate established cable carriers; all the customers would end up migrating on to telephone company facilities instead.

That prediction is not going to be vindicated. Backed by NYNEX, cable concerns in Britain have proved they can compete head to head against the massive British Telecom. Backed by out-of-region telcos in the United States, cable companies now have abundant resources and technical capabilities to compete against in-region telcos. American consumers will benefit.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 67 1997

Senator METZENBAUM. Thank you very much. I have a few questions and then Senator Thurmond has asked me to make inquiry on his behalf. I would appreciate your answers being rather short.

Mr. Hatfield, I understand you have done extensive work for the cable television industry, as you already indicated, and the long-distance phone companies and the local telephone companies. As I sit here, I must confess I am somewhat astonished that the people you usually represent have been virtually silent about the Bell Atlantic merger since it was announced.

I suppose other cable companies hope to be swallowed by other capital-rich local phone companies and that long-distance companies are looking to get in on the merger action as well, and the marketplace stocks seem to be reflecting that anticipated action in both areas. But the silence frightens me because my experience tells me that when companies are afraid to take on corporate giants in the political arena, they are also afraid to compete aggressively against corporate giants in the marketplace.

Do you share any of my concerns, or would most of your clients support the testimony you presented today?

Mr. HATFIELD. Let me start with the first part of your question and say, yes, I am concerned. Second, I doubt very seriously if many of my clients would support what I had to say here today, but let me reinforce the sort of premise of your question that this silence does indicate something that does very much concern me because before we had industries that were really clashing against each other and now there is this silence. It was my hope, as I indicated, that that rivalry would produce real competitive benefits for consumers.

Senator METZENBAUM. I must confess that it concerns me because those who would normally be heard from aren't being heard from, and you get the feeling that there is some fear psychosis out there that they don't want to step on anybody's toes. I don't have any proof of that.

Mr. HATFIELD. I should say that I have not talked to any of my clients regarding my testimony here today.

Senator METZENBAUM. Mr. Hatfield, my impression from your testimony is that you believe the kind of competition most likely to develop as a result of the merger will be on the margins of telephone and video services rather than head-to-head competition for the core telephone and cable services that most consumers use. Is that your position, and if so, why do you believe the merger won't yield more robust competition?

Mr. HATFIELD. Yes, I believe that that is a likely outcome. There will be some sparring, maybe, at the edges of the market, but the competition won't be head-on and direct into the basic core businesses, and the reason that I say that is that these companies—Mr. Huber said these are just local operations, but telephone networks by their very nature require coordination. In other words, these companies must work together to make sure that we have a seamless network that a call can go across the country. So by their very nature, they are working together every day.

Second, all these companies share in the ownership of cellular. Each of the local telephone companies was awarded a wire line cellular license, so there again they have a natural coordination or a

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 68 1997

natural function together there. Of course, remembering my days from here in Washington many years ago, they always seem to lobby in a very unified sort of fashion. So I don't see this sort of separation of entities here. I see something that is much closer and, as I indicated in my testimony, my fear is that this potential competitor will fall into the hands of an industry that, as I said before, has had a history of trying to preclude competition and maintain their monopoly.

Senator METZENBAUM. My greatest concern about this deal really relates to the fact that—well, I guess it is reinforced when I hear a communications expert like you who seems so committed to full competition in all communications markets expressing disappointment about the Bell Atlantic merger.

Do you believe that if this merger were not completed, it is likely that cable and telephone companies would compete more aggressively, and most importantly from my perspective, would these companies be more inclined to challenge each other's popular core cable TV and telephone services?

Mr. HATFIELD. Yes, I believe, on balance, that the likelihood of competition would be more likely under the conditions where the merger did not take place. But more fundamentally than that, I think what I am trying to say is that the issues are so important here that, you know, I could be wrong, but what we need to do so clearly is to look at it very, very, very carefully.

Senator METZENBAUM. Mr. Arquit, as you know, the cable legislation that we enacted last year was designed to cure anticompetitive abuses of the cable industry's market power. However, those rules, which will be administered by the FCC, have not been tested. I know that some antitrust authorities will claim the FCC's power to regulate the cable industry reduces the need for close antitrust scrutiny. I, frankly, do not share that view.

However, do you believe the antitrust authorities can or should rely on an untested regulatory regime to prevent consumers from being exploited by new telephone and cable conglomerates?

Mr. ARQUIT. I guess, Senator, asking someone like myself who served in the Reagan administration to talk about the problems with regulation is like putting red meat in front of a hungry dog. You know, I think regulation does leave a lot to be desired and all regulation can ever really do is to approximate the results of vigorous competition. Very often, it is a very poor surrogate and what you find yourself in, instead, is the land of unintended consequences, and also regulatory evasion.

I don't claim to be an expert on what has happened with the 1992 cable bill, but there is certainly a vociferous and identifiable crowd of consumers out there whose cable bills went up. I suspect that was not the result intended by Congress when it passed the legislation.

As far as regulatory evasion, there are, as I understand it, provisions in that statute which prevent discriminatory pricing, except when there are differences in cost. Well, when you have got someone owning all the inputs that form the basis of cost, it seems to me there are all kinds of opportunities to free-wheel in terms of what is meant by cost, allocation of overhead, and other things that

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 69 1997

are somewhat intangible, and therefore an ability to affect the price.

I raise these things just to make the point that I don't think regulation is a panacea, and certainly not a substitute for antitrust enforcement.

Senator METZENBAUM. I might say to you on the cable bill that we passed, frankly, I think Congress has an obligation to revisit that issue. I don't think we did the kind of job we should have done, and I expect to talk to some other Members of Congress about doing just that.

In the last 12 years, the antitrust agencies have brought virtually no challenges against mergers that threatened to eliminate a potential competitor. However, while you were at the FTC, that agency brought three such cases. Two of them were against drug company monopolists that were each other's most likely competitors for a particular kind of pharmaceutical product. At the time the FTC challenge was brought, neither of those companies had invaded each other's markets, although they were clearly planning to do so. What kind of anticompetitive effects was the FTC concerned about when it moved to block those mergers?

Mr. ARQUIT. The issue in any potential competition case is whether or not there would have been competition from someone who would have engaged in freestanding entry, someone who no longer does that because they merge instead. The problem with these kinds of cases always has been, whether it is in the pharmaceutical industry or other places, finding proof that, in fact, they had the capability and the intention to enter.

In those cases, one involving the AIDS/HIV virus, it is a fact that neither party was yet a player in the market concerned. However, they were both seen to be the furthest along in terms of research and development and other types of investment that were necessary to enter the market, so the case was brought and settled by a consent agreement.

Basically, what you want to look for is the likelihood that one of the merging parties would have entered independently on its own, that entry conditions are difficult, that the market is concentrated, and that there are not that many other firms capable of entry.

Senator METZENBAUM. Thank you very much, Mr. Arquit.

Mr. Huber, one of the major dilemmas we face as lawmakers evaluating significant mergers is whether we should urge our antitrust officials to engage in a meticulous review of the potential ramifications of the merger before it is completed or just sit back and wait and see what happens in the marketplace.

I know you don't agree with many of my concerns about this merger, but don't you agree that if there are significant problems which can be remedied by antitrust review before the fact, our society is better off with early intervention as opposed to experiencing anticompetitive behavior and massive, costly antitrust litigation down the road?

Mr. HUBER. Yes.

Senator METZENBAUM. Mr. Huber, your testimony states that cable and telephone networks "can and do carry everything." You conclude by stating that "cable companies have abundant resources and technical capabilities to compete against in-region telephone

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 70 1997

companies." Do you agree that we should do everything necessary to promote competition between cable and telephone companies?

Mr. HUBER. Yes, I am a hundred percent in favor.

Senator METZENBAUM. Thank you very much. Now, I have some questions here that Senator Thurmond wanted asked and I will ask them on his behalf. I did ask his staff to cut them down so that I might leave here at a reasonable time.

Mr. Hatfield, do you believe that all of the efficiencies and benefits asserted in defense of the Bell Atlantic-TCI merger would occur just as readily in the absence of the merger?

Mr. HATFIELD. Yes.

Senator METZENBAUM. The answer is yes?

Mr. HATFIELD. I was following the lead of my——

Senator METZENBAUM. OK, fine. Then I want to ask this question on Senator Thurmond's behalf to each of you. Would you please address, in the long run, what is the minimum optimal number of telecommunications competitors that you would hope to see?

Mr. HUBER. I will be happy to start if nobody else wants to. I would like to see more than one, for sure. Obviously, it depends on what scope you are discussing this. At a local level, I think two is a lot better than one. I think we will probably have three or four in the delivery of video if we get DBS and the other oxymoron, wireless cable.

Obviously, at the programming level we will have far more than that, and we already do. Sixty percent of current viewership is not owned by Mr. Malone—incidentally, I have never worked for him so far as I know—but it is over-the-air television in which he has no interest. I have a home satellite dish and I know there are about 150 channels being uplinked at the moment to that dish, so there is a lot of programming up there.

Programming volume has gone up steadily over the last 15 years, which is generally a good sign. That rather suggests that Mr. Malone has not been entirely successful in monopolizing that market yet anyway. But how many providers we get depends in large part on exactly how you are defining your market.

Senator METZENBAUM. Again on behalf of Senator Thurmond, do any of you have any concerns that the antitrust enforcement agencies will not adequately analyze and review these proposed transactions?

Mr. HUBER. To the contrary, I am dead sure they are looking at them with great care.

Senator METZENBAUM. I will just go back for 1 minute. The other two did not answer that question, which was would each of you please address, in the long run, what is the minimum optimal number of telecommunications competitors you would hope to see.

Mr. ARQUIT. Well, I don't know that I have that much to add to it. I think in any particular industry it varies. It depends on the extent to which there will be an ability to engage in coordinated interaction among the players in an industry. When you have an industry where the terms are such that there is instant information that is conveyed if there is standardized product and the like, that suggests that coordinated interaction is somewhat easier, so you would require more firms in such an industry for competition

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 71 1997

to result. Where there are heterogenous products, it is the opposite, but I can't give you an absolute number.

Mr. HATFIELD. I couldn't give you an absolute number either, but obviously I have expressed a concern with just a duopoly. Because, as I have indicated in my full testimony, there are a number of other barriers that prevent additional competition in ordinary local telephone service, I am concerned about whether we can get beyond one, let alone get to two.

Senator METZENBAUM. Again, on behalf of Senator Thurmond, do any of you have any concerns that the antitrust enforcement agencies will not adequately analyze and review these proposed transactions? Mr. Hatfield?

Mr. HATFIELD. Being outside of Washington, and so forth, I have not followed exactly what the new administration has been doing regarding antitrust enforcement, so I am afraid I would have to beg off answering that question.

Senator METZENBAUM. Mr. Arquit?

Mr. ARQUIT. Well, as more than a casual observer to that scene, I have no reason to think that there is any problem there. My impression is that both agencies are committed to vigorous enforcement of the antitrust laws.

Senator METZENBAUM. Mr. Huber?

Mr. HUBER. Mr. Chairman, if I may paraphrase somebody or other, I know Anne Bingaman; Anne Bingaman is my friend. I think you should rest easy. There are many other important matters. She is going to give a very close to these transactions.

Senator METZENBAUM. Does that mean that you know Anne Bingaman and you're no Anne Bingaman? [Laughter.]

Mr. HUBER. That, too, Senator, I confess.

Senator METZENBAUM. Again on behalf of Senator Thurmond, do any of you have comments on the assertion that TCI can make or break cable programming with its 20-percent market share because of the large market share necessary for a program to be successful? Does this amount of market necessary for the success of a program depend on the cost of that program? Do any of you care to answer that?

Mr. HUBER. I would be delighted to. We do know that 60 percent of the viewership in this country is watching programs that are created or distributed initially by the over-the-air broadcasters. Under the must-carry rules, those get on to the cable systems. They get on for free; there is no transport cost. So we do have a large chunk of this market that is pretty well insulated.

Second, one should note that TCI is getting smaller in this transaction. With all of those overlaps, they are losing a base of 1 million, so whatever problems may exist from TCI alone are going to be reduced. If you want to add in all the telephone industry, which is a fair enough addition given the convergence of these technologies, then, of course, you have to add in all the other telephone companies, too. Any way you slice it, I think monopsony power of the traditional cable carriers and TCI, in particular, is declining, not increasing.

Senator METZENBAUM. Mr. Arquit?

Mr. ARQUIT. I presume that is the question that legions of Government antitrust lawyers will be investigating over the next few

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 72 1997

weeks or months, and I don't claim to have the clairvoyant powers to come up with a conclusion before they reach their result. I don't want to make a factual assessment. I don't have the basis for doing it.

Senator METZENBAUM. Mr. Hatfield?

Mr. HATFIELD. I would say that I don't consider myself to have expertise in the programming side of the business to be able to offer an informed opinion.

Senator METZENBAUM. The Chair has had somebody waiting in his office for about 45 minutes. I am going to have to leave, but I am leaving you in very good hands. Senator Specter is with us and, Senator Specter, if you would be good enough to ask such questions as you have and then—just a second, please.

We have received a number of letters from regulators, consumers, and broadcasters that we will put in the hearing record.

[The letters referred to follow:]

PUBLIC UTILITIES COMMISSION,
STATE OF CALIFORNIA,
San Francisco, CA, October 25, 1993.

The Honorable HOWARD M. METZENBAUM,
U.S. Senate, Washington, DC.

DEAR SENATOR METZENBAUM: I am writing to you in connection with the hearings you have scheduled before the Senate Antitrust Subcommittee to explore the implications for consumers of the proposed merger of Tele-Communications, Inc. (TCI) and Bell Atlantic. In announcing the hearings, you warned that this megamerger could have a chilling effect on competition in both the cable and telephone industries and could artificially inflate prices. There are issues which are of significant importance not only to consumers, but also to state regulators, such as the California Public Utilities Commission which is charged with, among other things, the duty of assuring the continued availability and affordability of high quality telephone service and encouraging the development and deployment of new technologies.

The Commission has a long history of supporting the development of competition where feasible as a way of ensuring maximum consumer choice and rates most reflective of costs. The Commission continues to grapple with the introduction of competition into regulated markets which were traditional monopoly markets and which retain bottleneck elements. In addition, we struggle with the involvement of regulated utilities in both regulated and unregulated businesses. Our experience demonstrates the great difficulty and complexity in balancing the various interests involved in such transitional markets. The Commission also is heavily involved in efforts to develop the infrastructure in California to position our citizens to benefit from the essential information superhighway.

From the perspective of a state public utility regulator, the announced merger of TCI and Bell Atlantic, coupled with TCI's involvement in the acquisition of Paramount, raises extremely difficult issues relating to the ability of regulators to effectively regulate the combined entity, particularly since various parts of the new entity are currently regulated by multiple federal, state, and local agencies. For example, to the extent the combined entity will have shared costs, how will the proper allocation of those costs between different regulated entities (cable vs. telephone) as well as with unregulated entities (Paramount) be determined? Given the vertical combination of telephone/cable distribution systems with programming entities, how will regulators effectively review the transactions between the affiliated entities? Important public policy concerns with cross-subsidization and denials of access to "common carrier" and distribution facilities are also implicated in this megamerger.

The information superhighway as presently envisioned is intended to provide vast new horizons and opportunities to businesses and consumers. What will be the effect on that vision if one company, whose interests include both the highway and what is carried on the highway, is positioned to deny entry to others on that highway?

The California Public Utilities Commission has been engaged for the past decade in efforts to both introduce competition into monopoly utility markets and to deregulate utilities as the markets become competitive. This has proven to be an extremely complex effort. The TCI/Bell Atlantic/Paramount may create a new form of access-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 73 1997

controlling monopoly. If that is the case, our Commission may well be called upon to regulate this new entity because of its potential to deny consumers maximum choice and benefits from the information superhighway. At the very time that competition is emerging in many previously regulated monopoly markets, regulators must carefully review a merger of this size and character to assure that it will not eliminate the possibility of some forms of competition and of consumer choice and to ensure nondiscriminatory access to the cable/telco supersystem that could reach forty percent of the homes in the country.

As a member of the California Public Utilities Commission, these issues are of great concern to me. It is crucial that, once the full details of this extraordinary combination are known to the fullest extent possible, these issues be addressed prior to the merger so that armies of lawyers and regulators do not spend decades pursuing answers to issues of access and consumer choice that would not need to be addressed if confronted at this time.

Because of these concerns, I welcome your Committee's careful and thorough deliberation of these issues. Given TCI's interests in California, which include both cable systems and telephone utilities, I intend to explore with our staff at the Commission the appropriate response to this proposed merger. I note that the Pennsylvania Public Utility Commission has expressed similar concerns and has indicated its intention to investigate the impact of this combination on ratepayers and consumers.

Sincerely,

(Signed) Patricia Eckert
(Typed) PATRICIA M. ECKERT,
Commissioner.

NATIONAL ASSOCIATION OF BROADCASTERS,
Washington, DC, October 26, 1993.

The Honorable HOWARD METZENBAUM,
Chairman, Subcommittee on Antitrust, Monopolies and Business Rights,
Hart Senate Office Building, Washington, DC.

DEAR MR. CHAIRMAN: On behalf of the National Association of Broadcasters, I want to applaud your decision to hold a hearing on the proposed merger between Bell Atlantic and TCI in the Senate Antitrust, Monopolies and Business Rights Subcommittee. A number of bills are pending in Congress that would establish much-needed federal policies to regulate operations by telephone companies and other competitors in the modern telecommunications era. Until Congress acts definitively, however, a merger of this magnitude clearly requires stringent oversight by Congress and other appropriate government agencies to protect the interests of the consumers and businesses.

I understand that you may schedule additional hearings on this proposed merger. I strongly encourage you to do so, and I hope that the perspectives of the broadcasting industry can be presented at that time. Clearly, the interests of our industry and the public we serve could be irrevocably harmed by a $30 billion-plus merger between the nation's largest cable company and a regional Bell operating company, which together would control information delivery to approximately one quarter of the nation's homes.

Let me state for the record that NAB is not opposed to the entry of telephone companies into the provision of video services. NAB recently revised its formal Board policy statement on these matters to make our position clear—we support "telco entry" into video services, so long as this entry promotes competition in the local marketplace. We strongly oppose any telco entry into video services that reduces competition or that results in the substitution of one monopoly for another. For example, telephone companies should not be permitted to buy out or obtain control of existing cable television systems within their service area.

NAB urges your Subcommittee to view this proposed merger in light of its potential effects upon competition. I hope that you will explore in detail with the witnesses at this first hearing many of the troubling questions it raises, including the following:

- What will happen to the cable systems in which TCI has an attributable ownership interest that are located within Bell Atlantic's service area? Will Bell Atlantic/TCI be permitted to retain these systems, thereby combining two large monopolies into an even larger monopoly? If these systems are divested, will they be sold to true third parties, or to those in which Bell Atlantic/TCI maintains an ownership interest or other relationship?

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 74 1997

- Will potential competitors have the ability to gain non-discriminatory access to Bell Atlantic/TCI networks or other facilities? Will Bell Atlantic/TCI be permitted to become a super gatekeeper to the homes and businesses in its region?
- What will be the impact of the proposed merger on programming availability and pricing? Will Bell Atlantic/TCI be able to acquire exclusive rights to the most popular programs and services in its region, or to bid up the price of such programs and services to the point that they effectively are denied to potential competitors? Alternatively, will Bell Atlantic be able to exercise monopsony powers to demand unfairly low prices or favorable terms from those who seek to sell programming or services within its market area?
- Who will pay the costs of upgrading Bell Atlantic/TCI facilities to transmit video and other broadband forms of information? Will Bell Atlantic/TCI be able to cross-subsidize its video operations through its telephone services ratepayers?

Until these and other issues are resolved to the satisfaction of your Subcommittee, I strongly urge you to take all appropriate steps to delay the consummation of this merger.

Again, let me express our thanks for the rapid response of your Subcommittee to these fast-moving events. I appreciate your consideration of our views and concerns. Please do not hesitate to contact me if I can be of assistance to you in this important issue.

Warmest regards,

(Signed) Edward O. Fritts.

CONSUMER FEDERATION OF AMERICA,
CENTER FOR STUDY OF RESPONSIVE LAW,
October 26, 1993.

The Honorable HOWARD METZENBAUM,
Chairman, Subcommittee on Antitrust, Monopolies and Business Rights,
Senate Judiciary Committee, Washington, DC.

DEAR SENATOR METZENBAUM: The parties listed below write to voice our serious concerns about the increasing concentration of the telecommunications industry, typified by the recent announcement that Bell Atlantic seeks to purchase Tele-communications, Inc. In addition to this most recent megamerger announcement, major concerns are also raised by the bidding war which has developed for Paramount, the merger of the two major shopping channels and other rumored telco-cable deals.

The Bell Atlantic deal—and others like it—raise the most troubling anti-trust issues this nation has faced since the creation of the Standard Oil trust. It is not just that fully one in four U.S. households will be dependent on this one company for TV programming, telephone service, or both. Even more ominously, the acquisition of TCI constitutes an unprecedented move towards vertical integration, the common ownership of both information and the means of distribution. TCI has already parlayed its control of almost one quarter of the nation's cable TV hookups to obtain ownership interests in most of the major cable networks, including CNN, TNT, The Discovery Channel, Court TV, Encore and many regional sports channels. If TCI's entry in the Paramount bidding war should succeed, Bell Atlantic would be adding programming from the USA Network and the all-important Paramount film and television library to this already imposing stockpile.

We cannot imagine a more arrogant challenge to Congress than this new effort to merge content and conduit, coming as it does, almost exactly a year to the day after Congress attempted to restrain such abuses in the cable industry by enacting the 1992 Cable Act. The promise of the information age has been that an infinite number of separate editorial voices could have equal access to the means of communication, but this merger threatens to give a company the power to block those with viewpoints which are not congenial. Unless Congress takes affirmative steps to block, or at the very least, to require substantial refinements, we can expect a stampede of similar anti-competitive telco-cable deals.

Concentration in the telecommunications marketplace has constitutional as well as economic consequences. The issue of who will own and control access to the information superhighway of the next decade will literally determine the future of democracy. This technology can empower and unite Americans, but if it is abused, it quite literally threatens to divide us into information "haves" and "have nots."

Control of the infrastructure also brings with it the ability to set rates. Unless government steps in, the American public will be gouged twice as a precondition to accessing the information superhighway. First, through cross-subsidization, local ratepayer dollars of Bell Atlantic (and other RBOC's that get involved) are used to

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 75 1997

finance the purchase of competing distribution systems and to finance the company's foray into new ventures.

Second, instead of receiving the benefits of the information superhighway after the forced investments are made, ratepayers will be forced to pay for access at rates set by the monopoly company. History shows us that the rates charged by the monopolist will not be at competitive levels. Customers of both Bell Atlantic and TCI can expect to see their bills continue to go up.

Unless our information superhighway includes common carrier obligations, including open platform architecture, there is no way to guarantee that both users and unaffiliated producers of information will have access to the networks. Universal availability is meaningless for many consumers and producers if the owner of the wire has the ability and incentive to keep competing information providers off of the network. One need only look to the record of abuses toward voice messaging services and alarm services by the RBOC's, and to the artificial restrictions on the availability of cable television programming by TCI and other vertically integrated cable companies for recent examples of these dangers.

ROGERS & WELLS,
New York, NY, November 15, 1993.

MELINDA R. HATTON, Esq.,
U.S. Senate, Subcommittee on Antitrust, Monopolies and Business Rights,
Senate Hart Building, Washington, DC.

DEAR MINDY: As I told you in our recent telephone conversation, I wanted to clarify my response to one of Chairman Metzenbaum's questions at the outset of my recent testimony on telecommunications mergers. Chairman Metzenbaum asked about clients that have retained me or Rogers & Wells to represent them, and I understood him to be asking the other panelists and me: (1) whether the time that I spent in preparing my testimony and appearing before the Subcommittee on Antitrust would be charged to a client of the law firm; and (2) more broadly, whether at the time of the hearing the firm had been retained by a client in connection with the mergers in the telecommunications industry that were the subject of the Subcommittee's hearings. As I stated at the hearing, my answer to both those questions is no. However, the Washington office of Rogers & Wells does have a Regulated Industries practice group which represents telephone companies and utilities in regulatory proceedings before the Federal Communications Commission and other federal and state agencies, as well as in judicial proceedings. None of these clients was consulted, nor did any participate, in the preparation of the testimony.

I appreciate the opportunity to appear before the Subcommittee, and I hope that my testimony will assist you in your review of conglomerate mergers in the telecommunications industry.

Sincerely,

(Signed) Kevin J. Arquit
(Typed) KEVIN J. ARQUIT.

HENRY GELLER,
COMMUNICATIONS FELLOW, THE MARKLE FOUNDATION,
Washington, DC, October 26, 1993.

The Honorable ANNE K. BINGAMAN,
Assistant Attorney General, Antitrust Division,
Department of Justice, Washington, DC.

DEAR ASSISTANT ATTORNEY GENERAL BINGAMAN: On September 15, 1993, the Clinton/Gore Administration released its vision paper entitled, *"National information infrastructure: An Agenda for Action."* The Administration noted that, *"[a]ll Americans have a stake in the construction of an advanced National Information Infrastructure (NII),"* and that *"[d]evelopment of the NII can help unleash an information revolution that will change forever the way people live, work, and interact with each other[.]"*

We agree, and we believe that developments like the proposed Bell Atlantic-TCI merger can serve as catalysts in achieving this goal.

The *Agenda for Action* outlined nine important principles and objectives that the Administration will use in developing specific NII policy initiatives, including:

- promote private sector investment,
- expand "universal service",

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 76 1997

- promote technological innovation and new applications,
- promote seamless, interactive, user-driven operation,
- ensure information security and network reliability,
- improve management of the radio frequency spectrum,
- protect intellectual property rights,
- intergovernmental cooperation, and
- provide access to government information and improve government procurement.

We are writing to urge you to consider these principles and objectives when reviewing mergers and acquisitions in the telecommunications arena, including the proposed Bell Atlantic-TCI merger.

The proposed Bell Atlantic-TCI merger has garnered significant attention and public comment already. Congressional oversight hearings have been scheduled, and you have been asked to scuttle the merger on antitrust grounds by a number of public interest advocates who argue, in essence, that big is bad.

We believe that such an analysis is flawed. The critical issue is not whether the merger results in "bigness" but whether, on balance, it promotes competition and the public interest. We think that it clearly does.

First, Bell Atlantic, using the base of the TCI systems, will be able to provide much needed competition to the local exchange carrier (LEC) in the six regions outside its own home territory. TCI is now engaged in modernizing its systems (largely through conversion to fiber optic) and is interested in provision of access and new digital radio services (PCS). But clearly, a Bell Atlantic-TCI company will be able to compete with the LEC much more effectively in light of Bell Atlantic's deep expertise in local telecommunications and the resources it can bring to bear. Indeed, this development, along with other activities by companies such as US WEST and Southwestern Bell, would seem to indicate a pattern of Regional Bell Holding companies making use of cable television networks in each other's territories. Such strong competition at the local loop to the entrenched LEC is a trend to be welcomed, not blocked.

The merger could be the most important step possible to breakup the local exchange "bottleneck." That brings us to the question of the other large "bottleneck" problem in local telecommunications—cable television. In the Cable Television Consumer Protection and Competition Act of 1992, Congress acknowledged that rate regulation of cable was a stopgap—that what is needed, above all, is effective competition. In entering into the merger agreement, Bell Atlantic has pledged to continue its leadership role in providing such competition. Specifically, it has stated that it will continue its common carriage, video dial tone efforts, with their gateways and open-platforms available to all providers, including the small, innovative companies. We believe that this common carriage approach stands in sharp contrast to the traditional cable model. It will be a marked contribution to the First Amendment goal of insuring that information can come to the American people from as many diverse sources as possible.

In this respect, to assure that Bell Atlantic must go all-out within its region to provide such an open platform and, equally important, to afford the opportunity of all-out telecommunications competition from the TCI-owned cable systems within that region, we urge that there be full divestiture of such systems rather than a spin-off to TCI stockholders. We would hope that the new owners would then engage in the same kind of telecommunications efforts as Bell Atlantic-TCI will do out-of-region.

In short, we perceive no detriments in proceeding in this fashion. Rather, we perceive the opportunity for great gain to the public interest, including the critical competitive aspect. Should problems arise, we believe the existing regulatory structure is sufficient to deal with them.

Finally, this merger, along with other developments including those mentioned above, clearly calls for the development of new policies designed both to foster competition through effective interconnection and open network architecture strategies and to permit the incumbents to operate effectively in the changed environment. We

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 77 1997

hope that the Clinton Administration takes the lead in urging constructive policies upon the Congress in this field. Such policies are vital in light of the significant contribution telecommunications can make to increased productivity in the face of emerging global competition and to the quality of life in the information age.

Thank you for your attention to our concerns.

Sincerely,

(Signed) Henry Geller

(Typed) HENRY GELLER,
Communications Fellow, The Markle Foundation.

(Signed) Barbara O'Connor

(Typed) BARBARA O'CONNOR,
Chairperson, Alliance for Public Technology, Professor of Communications and Director of the Institute for the Study of Politics and Media, California State University, Sacramento.

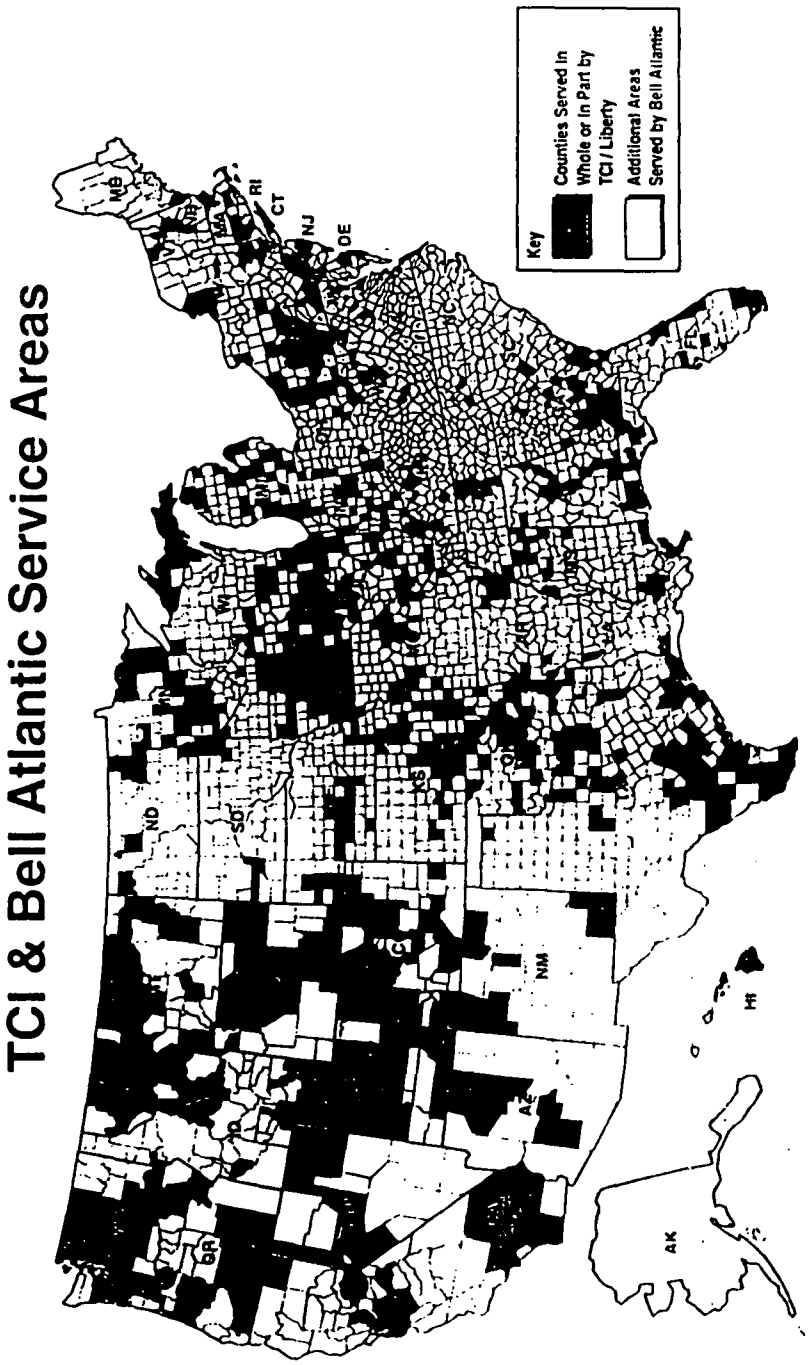
(Signed) Henry Rivera

(Typed) HENRY RIVERA,
Ginsburg, Feldman & Bress.

(Signed) Andrew P. Miller

(Typed) ANDREW P. MILLER,
Dickstein, Shapiro & Morin.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 78 1997



HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 79 1997

Senator METZENBAUM. We will also conduct additional hearings in the future on these important proposed mergers. As I indicated earlier, we do expect to hear from Mr. Diller, Mr. Malone, and Mr. Allen.

Senator Specter, if you would be good enough to carry on as long as you would care to and then conclude the hearing.

Senator SPECTER [presiding]. Thank you, Mr. Chairman.

Mr. Hatfield, I note your statement at page 3 that your reaction is that the consolidation of the large telephone companies and cable companies will greatly diminish the prospects for future competition in telecommunications and information services. The program, as outlined earlier today by Mr. Smith, was to the effect that where you have TCI with telecommunications cable networking in all of the areas of the country where Bell Atlantic doesn't function and you have Bell Atlantic in its own six States and the District of Columbia, they will come in and will provide competition to existing cable systems.

I live in Pennsylvania, in Philadelphia, and there is only one cable company which services my home area. If you do not have an alternative, say, through the telephone company, what are the prospects of having someone provide cable to give some competition to the cable company which now services homes like mine?

Mr. HATFIELD. I am not sure I understand the thrust of your question, but you would benefit if an additional competitor came in the market to compete with the existing cable company. My concern, though, is that in most States, you can't have the reverse. In other words, if the cable company wants to go in to provide telephone service, quite often that is prohibited by State law or by State regulation.

So, if there are economies of scope here, if it is cheaper somehow to provide both telephone and cable over the same facility, but the cable company can't provide telephone, but the telephone company can provide cable services, then it seems to me that the outcome is foregone. I mean, it is a foregone conclusion what the outcome would be.

Senator SPECTER. Well, Mr. Smith talks about having competition in Chicago, for example, through the cable company; that is, competition with the telephone company. If the cable companies were permitted by law to provide competition with the telephone companies, then would that be a desirable competitive effect?

Mr. HATFIELD. Then I would be much more comfortable if Congress would preempt the States' ability to foreclose the entry of additional telephone companies. But I have testified literally throughout the United States, and generally speaking the telephone companies, despite what they are saying here in Washington, still fight local competition. Generally speaking, local regulators are very skeptical of the benefits of local competition. So we don't get the sort of competitive model that we have heard talked about today because of those barriers, and that is the reason I would urge Congress to correct that.

Senator SPECTER. Well, the local telephone companies obviously fight competition. That is what would be expected, but Congress does have the authority to act in the field to preempt local regulation and to say that there will be competition between two prospec-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 80 1997

tive telephone companies. If Congress did act in that way, would you then think that this kind of a merger would be in the public interest?

Mr. HATFIELD. Well, let me say that I would feel much more comfortable because that would get rid of a very real barrier in my mind, but I would still be concerned that if all the cable companies end up being owned by a handful of telephone companies, for all the reasons that I said before. Because of the way they have to operate networks, and so forth, my fear is that they still would not engage in head-to-head competition.

Senator SPECTER. Well, in the absence of a merger such as the one proposed between TCI and Bell, and in the absence of, say, Bell Atlantic being able to provide cable services to homes like mine in Pennsylvania, do you think it is likely that some competitive cable company will enter the field and provide an alternative service of cable for situations like mine?

Mr. HATFIELD. I am sorry, Senator. I don't know whether I am losing my concentration here or not, but the model that I had in mind before I became, as I expressed it, disappointed was that we would have a cable company with the ability to provide telephone service and a telephone company with the ability to provide cable service. My concern is that that won't be the reality, given these mergers.

Senator SPECTER. Well, that can be corrected if Congress acts in a way which we have already discussed. But as I have read your testimony, you are opposed to these kinds of mergers. My question is, is it likely that if we do not have somebody like Bell Atlantic come in to provide cable in a city like Philadelphia that a second cable company will come and wire the city and provide competition for the current cable carrier?

Mr. HATFIELD. As has been mentioned here, there are opportunities for wireless cable at 28 gigahertz, and so forth, that are being explored, and there are DBS, direct broadcast satellite, systems that are coming on line very shortly. Unfortunately, of course, those are one-way type services, so they have a limited ability to be able to compete in the provision, let's say, of ordinary telephone services. That only solves part of the problem.

Senator SPECTER. Let me move to you, Mr. Arquit, with a question concerning your evaluation of the testimony which was heard earlier today. Did you hear Mr. Redstone testify?

Mr. ARQUIT. Yes, I did.

Senator SPECTER. He made the point that TCI now has 20 percent of the cable market and that, including its partners, it goes up to about a third, or 33 percent, and given Bell Atlantic, they would be able to access 50 percent of the houses. He then talks about what he alleges to be predatory practices by TCI and Dr. John Malone.

What is your evaluation of the impact that TCI and Mr. Malone could have, the additional impact, if they did have access to additional homes through the merger with Bell Telephone Co.?

Mr. ARQUIT. Well, I think the issue is one of foreclosure. Again, numbers are elusive, but the point would be are enough homes, or I guess it is called eyeballs, within the control of one group of cable companies, one group of owners that it is no longer efficient for

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 81 1997

independent operators to engage in programming, and there are all kinds of questions there.

How hard is it for one to enter the programming market? What is the minimum efficient scale? What is the amount of revenue that one needs to have in order to justify the programming? The revenues presumably are based on the number of subscribers that can be reached, and so obviously to the extent that certain subscribers are—and I am taking his theory as true here—that certain subscribers are locked up with captive programming with an integrated entity, under his argument they are no longer available to the person who wants to engage in independent programming.

But the question to be asked is what is the size of minimum efficient scale, and are there enough noncaptive or nonintegrated homes left or customers of nonintegrated companies that the revenues can be achieved to justify the investment.

Senator SPECTER. When Mr. Redstone testifies that the pervasive influence of TCI and Dr. John Malone creates a situation where CNBC alters its planning to go into news with CNN because of the kind of coercive conduct described by Mr. Redstone, in your judgment, is the kind of influence or control which TCI and Dr. Malone have sufficient to have that kind of influence in the market?

Mr. ARQUIT. I don't have the factual basis to answer that question, Senator. I think that, again, what the antitrust laws are worried about is competition, and the fact that any one competitor makes it or doesn't make it isn't necessarily an antitrust violation. But the question is, are consumers able to receive the quality of programming they would get without that conduct. That is the question to be asked, but I don't have the answer here today.

Senator SPECTER. Well, we do not know what the parties did and we are looking for Dr. Malone to come in and testify and to see what is happening. A concern that I have or a question in my mind is this: if someone has 20 percent of the market and has the kind of vertical and horizontal integration, which TCI and its affiliates have, is that sufficient market power to drive a company like CNBC out of the intended plan to put an all-news format on to compete with CNN, where Dr. Malone has a substantial interest?

Mr. ARQUIT. First of all, I think the question for Dr. Malone would be, in terms of any of these practices, whether they had a legitimate business purpose for doing it. I think that is a very instructive way to reach the result. But, again, the answer to the question is it depends on what the cost is to engage in the programming of CNBC and can one justify the investment in that cost, knowing that a certain subscriber base is not available to it because it is tied up in the hands of an integrated entity, if the accusations are true. It is a comparing of that cost versus revenue and asking whether a rational investment would be made that is the relevant question. But, again, without having those numbers, I can't give you that answer.

Senator SPECTER. OK. Well, if you can't give us the answer, perhaps you have at least given us the question to ask Dr. Malone.

Mr. Huber, a question or two for you and then we will wrap up the hearings. You say that the matter ought to be referred to the Department of Justice and I quite agree with you. The preliminary

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 82 1997

contacts I have had with Ms. Anne Bingaman suggest to me that she is a first-rate lawyer and will run a first-rate Department.

You seem to express confidence that the Department of Justice has the facilities to really dig into issues of this sort. As I said earlier, I have not been satisfied with the antitrust enforcement, and it is not a matter of Democrat administrations or Republican administrations. These questions seem to me to be so complex and there are so many of them that I have my own private doubts.

You obviously have substantial knowledge in the field. Is it your view that there are sufficient personnel and resources within the Antitrust Division of the Department of Justice to take on the myriad of antitrust issues which that Department has to confront?

Mr. HUBER. I guess I would have to say as compared to whom? I have worked for them in my day and I have also had many occasions to suggest that they didn't dig as deeply as they should or move things as quickly as they should. With all that said, it is the best game we have got in town and I think that they will be giving these mergers a good look.

If I may, Senator, as to your question about the monopsony power of TCI, I do think you have to keep a careful focus on which number you should be looking at. Homes isn't what watches a program. You need actual viewers. Most homes don't watch CBS or NBC or ABC; each of them only captures a very small minority. You can have a viable video program service with much, much less than 80 percent of the homes in this country, which is the homes not currently wired by TCI. I mean, the Super Bowl doesn't get that many of the homes. Certainly, other viable programs need a much smaller fraction than that.

I mean, Jane Fonda videos sell in video stores and they don't need John Malone to have a market. Particularly this word "access," you know, access to 50 percent of the homes—access does not give market power. To repeat, Safeway and Giant both have access to me. That doesn't give them market power. What gives you market power is exclusive access, being the only one in town, and that is a very different problem.

Senator SPECTER. Well, when Mr. Redstone complains that if Mr. Malone cuts out his programming it is going to have a very serious impact on his business, this is a hard question for you to answer, but let me ask your own view as to whether that is a serious charge.

Mr. HUBER. I think there is no question that if you are a distributor of programming, you want as many people to carry your wares as possible, and I am quite sure Mr. Redstone is seriously concerned about local transport capacity. The fact of the matter is today we have a lot more video programming going up, 120 to 150 channels, depending on how you count the marginal ones, than most local cable carriers can carry. There is more going up than can be distributed through that cable pipe. The pipe has been growing year by year; it has been growing rapidly. It is going to grow a lot faster the next few years. I hope and I believe that will take care of a lot of Mr. Redstone's problem.

Senator SPECTER. Well, when you say "compared to what," you are right. We don't have sufficient resources of U.S. assistant attorneys around the country to handle the drug cases, and the question

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 83 1997

is how many you put in the Justice Department to handle the antitrust cases. As I expressed earlier, it is my hope that having filed a private action, that is what the private antitrust remedies are for to provide an avenue of redress without going to the Government because of their limited resources. Let the court decide the case.

Mr. HUBER. And that suit has been filed.

Senator SPECTER. That suit has been filed. My own assessment is that they could get a fairly prompt determination within the course of several weeks or several months on an effort for a temporary restraining order or a preliminary injunction if they have the evidence for it. Would you have any view as to how long that would take?

Mr. HUBER. I don't even know which——

Senator SPECTER. I have read the complaint, or scanned the complaint. You haven't had a chance to do that?

Mr. HUBER. Oh, yes, I have scanned the complaint. I can't, off the cuff, recall which docket they are on, which jurisdiction.

Senator SPECTER. Southern District of New York.

Mr. HUBER. I wouldn't be too sanguine about getting an instant hearing there, but once again I think you have to say compared with what. I mean, that is the traditional forum for a very purely private dispute of this kind and that is where it should be resolved.

Senator SPECTER. Well, thank you very much, gentlemen, for coming early and staying late. We appreciate your testimony.

[Whereupon, at 1:40 p.m., the subcommittee was adjourned.]

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 84 1997

THE FUTURE OF FAIR COMPETITION IN THE TELECOMMUNICATIONS INDUSTRY

TUESDAY, NOVEMBER 16, 1993

U.S. SENATE,
SUBCOMMITTEE ON ANTITRUST, MONOPOLIES
AND BUSINESS RIGHTS,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room SD–226, Dirksen Senate Office Building, Hon. Howard M. Metzenbaum (chairman of the subcommittee) presiding.

Also present: Senators Simon, Thurmond, and Specter.

OPENING STATEMENT OF HON. HOWARD M. METZENBAUM, A U.S. SENATOR FROM THE STATE OF OHIO

Senator METZENBAUM. The hearing will come to order. This hearing has to do with the future of fair competition in the telecommunications industry. However, there is a new development this morning that I would like to address myself to just for a few minutes.

Many of us saw in the morning paper a reference to a TCI memo that was sent to its various cable operators, and I think it is important that we know exactly what the memo said. It went to all system managers, State managers, and division vice presidents from Barry Marshall. Let me read it:

> As we move into the regulatory environment, it is important to remember something vital. Under regulation, we can't simply adjust our economics anymore. We have to take the revenue from the sources that we can when we can. To that end, I want to remind each of you that the transaction charges for upgrades, downgrades, customer service calls, VCR hook-ups, etc., are vital *new* revenue sources to us. We estimate that by charging for these functions, we can recover almost half of what we are losing from rate adjustments.
>
> We have to have discipline. Such like the install fee problem, we cannot be dissuaded from these charges simply because customers object. It will take a while, but they will get used to it. They pay it to other service providers all the time and it isn't free with the phone company. Please hang in on this and installs and we can still have a great fourth quarter when we have our heaviest volume. The best news of all is we can blame it on re-regulation and the government. Now, let's take advantage of it.

Well, I guess he laid it on the line. Blame it on reregulation and on the Government. This Senator believes that we did not do a sufficiently adequate job as far as the cable bill was concerned, and I am not blaming that on anyone because I accept some share of that responsibility, although I was not a major player. I am determined that we revisit this issue in the early months ahead of us. I think that cable users are getting short-changed and I think that

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 85 1997

cable operators in some instances are trying to take advantage of the situation.

Having said that, let me proceed to the direct portion of this hearing. This is the subcommittee's second hearing on the wave of megamergers sweeping the telecommunications industry. Today, we will examine one of the most significant antitrust actions in the last 15 years, the FTC settlement with TCI. It requires TCI and John Malone to shed their relationship with QVC. We will also look closely at other mergers and whether they will cause major misery for consumers.

At our hearing in October, the subcommittee was warned by industry captains and independent experts alike that some telecommunications deals pose serious competitive risks. We were told that consumers could be faced with higher prices and fewer choices if a handful of communications conglomerates dominate the market. In addition, those deals could stem the free flow of competing ideas if a few media moguls were allowed to dictate the content of our news programming.

The proposed deals could also jeopardize future competition between telephone and cable monopolies. The fact is that these monopolists have been positioning themselves to compete against one another for years. This wave of mergers could put an end to any hope of competition between them and create a cartel of telecommunications conglomerates.

These mergers could also allow a handful of telecommunication giants to control the programming that is shown on cable TV, such as HBO, CNN, and Discovery. TCI already controls the lion's share of popular cable programming. Any further concentration of programming in TCI's hands or among its business partners could strangle new competition for cable programming.

To put it bluntly, the anticompetitive risks posed by these new conglomerates should make them unacceptable to Congress and to the antitrust agencies. I am pleased, very pleased, that the Federal Trade Commission, the FTC, shares Congress' skepticism about these telecommunications megamergers.

Yesterday, the FTC voted to block QVC from acquiring Paramount, the last independent movie studio, unless TCI and its soon to be reacquired affiliate, Liberty Media, permanently withdraw from the deal. Last month, an intensive FTC investigation led QVC to break off its merger talks with the Home Shopping Network, in which TCI has a 40-percent stake. Last July, I urged the FTC to investigate the proposed merger of the only two cable shopping networks and who would control them. I am pleased that the FTC took its job seriously and that the deal folded under the pressure of its investigation.

With respect to shopping networks, today what we see on the shopping networks are mostly advertisements having to do with jewelry and some products of that kind. This Senator firmly believes that the future will hold a much more active competition on the shopping networks for more consumer goods, not just in the jewelry area but in many other areas as well, and that is the reason I think it is particularly important that we in government see to it that competition is maintained in this area.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 86 1997

I am frank to say that the FTC's challenge to TCI's acquisition of Paramount confirms my belief that there is already too much concentration in the cable industry. There is no disputing that TCI is the industry giant. It is the monopoly provider of cable to 25 percent of all television viewers and it owns or controls more popular cable programming than any of its competitors. Consequently, TCI's attempt to add Paramount's movies and sports programming to its cable empire by teaming up with QVC should have been blocked by the FTC.

I commend the FTC for taking such swift and decisive action against TCI. If the Government agencies charged with overseeing the cable industry had shown similar resolve in the 1980's, TCI might not have been able to gain such a stranglehold on this industry.

The FTC's challenge to TCI also demonstrates that tough antitrust review is needed for every telecommunications deal. We simply can't rely on FCC or State regulation to protect consumers or promote competition in this industry. Although the FCC and the State regulators have some authority, the fact is they can't be relied upon to protect the American consumer.

The FTC's challenge to TCI's market power also reinforces my fear that the proposed merger between Bell Atlantic and TCI will diminish rather than promote competition. If there are competitive risks associated with TCI acquiring more programming, there must be even greater competitive risks in allowing Bell Atlantic to add its vast financial resources and monopoly local telephone holdings to TCI's cable empire. It is essential that this merger not be approved before the antitrust authorities assure consumers that more, not less, telephone and cable competition will result from this colossal combination.

I also expect the antitrust agencies to closely scrutinize the new deal that QVC has put together for Paramount. Frankly, I have some concerns about BellSouth's taking TCI's place in the bidding war for Paramount. As the map to my right shows, BellSouth's partners in the QVC deal include Comcast, Cox, and Newhouse, which own numerous cable systems in BellSouth's territory. Having those cable systems in its own backyard could diminish BellSouth's incentive to compete with them. You have an overlap. It is not reasonable to think that two companies that have merged are suddenly going to be competing when they both are owned by the same parent.

Consumers are much more likely to benefit if local telephone companies are encouraged to compete instead of converge or coexist with cable systems. To that end, Pacific Bell's recent announcement that it is upgrading its telephone system to compete with the cable systems in its territory instead of simply buying a cable system sets a good model for competition in this industry that others should follow. Of course, it is absolutely essential that ratepayers be protected from unwittingly financing any of these new business ventures.

Consumers repeatedly have been promised benefits from telecommunications restructuring. Few of those benefits have ever materialized. In the early 1980's, the industry claimed that cable deregulation was not a threat to consumers because competition was

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 87 1997

right around the corner. No such competition ever existed and as a result prices skyrocketed. This time, I want to be sure that consumers get the competition they are being promised.

The representatives of major consumer organizations who will appear this morning will talk about the anticompetitive dangers of the pending mergers and how we can avoid them. In addition, AT&T will testify this morning about potential dangers that could result from the Bell Atlantic-TCI merger. The subcommittee will also examine AT&T's proposed merger with McCaw Cellular. Questions have been raised about whether it could block the development of mobile communications or long-distance competition. Moreover, as Bell Atlantic stated at our last hearing, the AT&T-McCaw merger is actually larger in size than the combination of Bell Atlantic and TCI. Both of these issues are appropriate for us to examine today.

However, let me state once again that it is not the size of a merger that determines whether it is anticompetitive. Rather, it is the market power wielded by the parties to any deal. By holding these hearings, we intend to ensure that vigorous antitrust enforcement protects consumers from the kind of excessive market power that could deny them the benefits of robust competition and low prices.

One final note. The subcommittee invited John Malone of TCI and Barry Diller of QVC to testify at our hearing today. They were unable to be here, but we have been assured that they will appear at a future date and we look forward to having them with us. I look forward to hearing their views on telecommunications mergers.

I look forward particularly to hearing from my colleague from Illinois, Senator Simon, whom I am so pleased to see with us this morning.

OPENING STATEMENT OF HON. PAUL SIMON, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Senator SIMON. I thank you, Mr. Chairman. I am not only a junior in terms of seniority on this subcommittee, I am very junior to Senator Howard Metzenbaum in terms of——

Senator METZENBAUM. Age, age. [Laughter.]

Senator SIMON. That is what I was going to say, but very junior in terms of knowledge on this issue. What I do know is that I want to have competition out here, and it is important for the FTC and the Antitrust Division of the Justice Department to do that.

I instinctively have some fears about telephone companies getting into the cable business for a great variety of reasons, but there are a lot of other little things. A New York Times article points out if QVC and its bidding partners win the battle for Paramount, they will—and I speak with some conflict of interest because I write books occasionally, but they will consolidate Simon & Schuster, which is now owned by Paramount, Random House, which is now owned by a bidding partner, Advanced Publications, and McMillian, which was purchased by Paramount last week.

I think one of the great strengths of America is the proliferation of ideas, and publishing houses play a great role in that and if, through this process of consolidation and mergers, we end up with fewer opportunities for people to express their viewpoints, clearly the Nation is diminished in the process.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 88 1997

I look forward to the hearing, and I am going to have to leave here in about 45 minutes, but let me just add I appreciate the effort of my colleague in this field. Howard Metzenbaum has been a giant and a bulldog, if I can mix metaphors here, at the same time. He has done a tremendous job in protecting the consumer in the United States Senate and he is going to be missed when he retires after next year.

Senator METZENBAUM. Thank you very much, Senator Simon. I am very pleased that you are with us this morning and very grateful to you for your comments.

Ms. Mary Lou Steptoe, we are particularly pleased to have you with us as the Acting Director of the Bureau of Competition of the FTC. You have been with us on previous occasions and it is always pleasant to have you here. We look forward to hearing your views.

STATEMENT OF MARY LOU STEPTOE, ACTING DIRECTOR, BUREAU OF COMPETITION, FEDERAL TRADE COMMISSION

Ms. STEPTOE. Thank you, sir. I am very happy to be here today to discuss with you all the Federal Trade Commission's enforcement activities with regard to nonhorizontal and potential competition mergers. I know what you most want to hear about is the consent announced yesterday with TCI which puts an end to the antitrust problems connected with QVC's proposed takeover of Paramount, which is a nonhorizontal merger with both vertical and potential competition aspects.

But if you will bear with me for just a few minutes, I think that consent will make more sense if I put it in the context of the Federal Trade Commission's overall enforcement program because this is not our first experience with these issues, and one of the reasons we could react to this situation so quickly and be confident that we have achieved the correct resolution is because we have this background.

You know, sir, that most of our enforcement work is in the area of horizontal mergers. That is mergers between direct, current competitors. The Commission has investigated a large number of those in all aspects of American industrial life that affect consumers, from defense to health care, and we have struck a careful and correct balance, I think, between letting procompetitive mergers proceed and challenging mergers that would raise prices or reduce output for consumers.

But the fact that we have been so busy on the horizontal side, and I would add quite successful, doesn't mean that we have neglected nonhorizontal theory or failed to correct nonhorizontal problems when we come across them. Several of our recent consents have dealt with these and I thought I would bring up two by way of illustrating the analysis that we brought to the QVC-Paramount matter.

Just by quick analytical background, potential competition theory assumes that a merger removes from the market a company that was otherwise likely to enter independently, and this can have two bad effects. First, if firms already in the market were behaving competitively as a way of discouraging that entry, that constraint is removed and they no longer have to act competitively. Second, if the potential entrant actually would have come in on its own ab-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 89 1997

sent the merger, well, then the merger means that the market is less one competitor than it otherwise was going to have.

We reached a consent agreement a few years ago with Roche-Genentech that is a good example of the Commission working to preserve potential competition for consumers. We took corrective action in three pharmaceutical markets. In one, Roche had an established product, but Genentech was closing in fast with a patented but not yet commercial alternative. In the second market, the situation was just the opposite. Genentech had a commercial product, but Roche was conducting advanced clinical trials for a competitive drug.

In each case, what the Commission did was require divestiture, which has since taken place, of one of the two paired products, so that instead of the market going down to one competitor in the future, there are going to be two. In the third market, which was CD4 therapeutics for the treatment of AIDS, a very important issue, the Commission's focus was even more on competition in the development of new and innovative products that could benefit consumers. Neither Roche nor Genentech had at the time of our consent a commercial product, but both were well along in the research and development stages and very likely to have something to bring to the market in the foreseeable future. The consent here preserves that future competition by requiring Roche to grant nonexclusive licenses of its CD4 patent portfolio to anybody who wants it.

We also deal with vertical issues, and potential competition arises in the vertical context, too, because obviously a firm that is up or downstream in the production and distribution chain is very likely to be a potential competitor. It is very likely to take as its logical move to move down into distribution or up into production. When a vertical acquisition makes it harder for a potential competitor to enter on any level of that production or distribution chain, we would have great concerns.

For example, a few years back ARCO proposed to buy certain chemical businesses of one major customer, Union Carbide, and we were worried there that ARCO's capture of such a large amount of the demand market would make it unattractive or virtually impossible for any company to enter upstream and offer competition to ARCO. So the consent degree there that the Commission entered into freed up demand and upstream entry has actually occurred. Again, there is more competition than there was had we let the merger go through.

So, with all that in mind, let me turn now to QVC-Paramount. The concern here is not with QVC, a programming network, as such. Our concern is with the entity that controls QVC, TCI, the Nation's largest cable company. TCI already owns many popular cable television programming networks, and among them premium movie channels. Our complaint charges that the vertical acquisition of Paramount by, in effect, TCI would lessen competition in two markets—television premium movie channels and distribution of television programming to consumers.

The way it works is this: the acquisition of a major movie company by the owner of a premium movie channel that already has access to a substantial portion of quality movies would reduce the

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 90 1997

products available to competing movie channels. Without the opportunity to buy those movies, other movie channels may not have sufficient offerings to compete for viewers and will simply go out of business.

Now, once that happens, the remaining movie channels are likely to do one or both of two things, neither of which is good for consumers. First, they will be able to charge higher prices or offer fewer movies because they face less competition. Second, they can pay studios less for the rights to movies. The studio, in turn, will have less capital to invest in future movies, and once again you see the reduction in the number and quality of output of movies and consumers are once again cheated of the benefits of full competition.

The second allegation that the consent settles involves the whole spectrum of cable programming. As you yourself mentioned, Senator Metzenbaum, we are on the verge of technological breakthroughs to provide a variety of new opportunities for bringing programming into the house, and you mentioned potential competitors in wireless cable systems, the telephone companies, direct broadcast satellite systems, and probably several others.

In order for these potential competitors to compete with the cable companies, they are going to need not only a method of bringing programming into your house, but also programming to bring. If significant types and amounts of programming are locked exclusively into TCI's system, it could frustrate or delay entry by these alternative technologies. They will have to enter two markets at once, and that is programming and the delivery system, and that is going to take time. It is going to be expensive and it is going to cut into their ability to compete.

Our proposed consent eliminates these concerns by severing the links between TCI and QVC so that Paramount's ultimate owner, whoever else it may be, will not be the Nation's largest cable operator.

I am happy to answer any questions you may have about the details of the consent or anything else in this area that I can. Thank you, sir.

[The prepared statement of Ms. Steptoe follows:]

PREPARED STATEMENT OF MARY LOU STEPTOE, ACTING DIRECTOR, BUREAU OF COMPETITION, FEDERAL TRADE COMMISSION

Mr. Chairman and members of the Committee: I am pleased to appear before you today to present the testimony of the Federal Trade Commission concerning its merger enforcement activities in the area of non-horizontal mergers, including conglomerate and vertical mergers.[1] The Commission is aware that a number of vertical or otherwise non-horizontal mergers—that is, mergers involving firms that may not be direct competitors—have been announced recently. The Committee has asked the Commission to discuss in particular its enforcement activities in two areas: communications and related industries, and potential competition mergers. The Commission is happy to do so, to the extent it is able within its constraints regarding the non-disclosure of non-public information. Thus, although the Commission cannot discuss specific transactions except to the extent that information regarding Commission actions has been made public, the Commission is pleased to describe its general approach to analyzing such mergers.

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

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 91 1997

The Commission is committed to vigorous merger enforcement against all transactions that threaten substantial competitive harm to consumers. Although most of the Commission's enforcement activity has been in the area of horizontal mergers—where consumer harm generally is more likely—the Commission actively examines non-horizontal mergers for potential competitive harm and challenges them when appropriate. At the same time, the Commission is attentive to the potential procompetitive benefits of many mergers. Thus, the Commission's merger enforcement program is carefully focused to identify the competitively harmful mergers.

The following discusses a very recent Commission action in the subscription television industry.

QVC/PARAMOUNT COMMUNICATIONS

On November 15, 1993, the Commission announced its acceptance, subject to final approval, of a consent agreement with Tele-Communications, Inc. ("TCI") and Liberty Media Corporation ("LMC") in connection with the proposed acquisition of Paramount Communications, Inc. by a group composed of QVC Network, Inc. ("QVC"), LMC and others (collectively, the "QVC group").[2]

TCI is by far the largest cable television multiple system operator ("MSO") in the United States. LMC, its programming affiliate, also owns cable television systems and provides satellite-delivered programming services to various distribution media including cable television. TCI's and LMC's affiliated cable systems control distribution of cable programming to about 25 percent of all cable television subscribers in the United States. TCI and LMC also hold substantial stock ownership in many popular cable television programming networks, including The Discovery Channel, The Learning Channel, Turner Broadcasting (producer of CNN and TNT), Request Television, Inc., Black Entertainment Television, The Box, Courtroom TV, Encore, Starz, The Family Channel, Home Shopping Networks, and QVC.

Paramount is a major Hollywood studio. Its businesses include the production and the licensing of new theatrically released movies for transmission on cable television channels, as well as a 50 percent ownership interest in USA Networks.

The complaint accompanying the consent agreement alleges that the acquisition of Paramount by QVC may substantially lessen competition and tend to create a monopoly in two relevant product markets: subscription television program distribution to consumers, and cable television premium movie channels. The subscription program distribution market includes cable TV systems as well as other distribution alternatives that deliver multi-channel television signals to consumers for a subscription fee. The cable television premium movie channel market includes such cable movie channels as HBO, Showtime and Encore.

To put these charges in some perspective, it is necessary to describe in some detail the subscription television industry, and the merging parties' role in that industry. The industry involves at least three levels of vertical relationships.[3] At one level are the programming producers, such as Paramount. These are the businesses that produce the materials such as movies and other programs that are packaged for viewing on a cable television channel as well as on other media. Examples of program producers include movie studios, TV producers and syndicators.

At another level are the programming packagers—the businesses that package programming inputs and prepare them for sale and distribution to cable operators. For example, Liberty Media, currently a member of the QVC group, buys movie rights from movie studios and packages and distributes movies to cable operators through its Encore premium movie channel, for ultimate subscription sale to viewers.[4] Liberty Media has interests in other cable channels as well, as does QVC.[5] USA Network, 50 percent owned by Paramount, is another cable program packager.

The third level of the subscription television industry is composed of the distributors of programming to viewers, currently comprised primarily of cable system oper-

---

[2] *Tele-Communications, Inc. and Liberty Media Corp.*, Agreement Containing Consent Order, FTC File No. 941-0008 (accepted for public comment on November 15, 1993) (Commissioners Azcuenaga and Owen dissenting).

[3] *See generally*, L. White, "Antitrust and Video Markets: The Merger of Showtime and the Movie Channel as a Case Study," in E. Noam, ed., *Video Media Competition: Regulation, Economics, and Technology* (1985).

[4] Encore's principal competitors are Home Box Office ("HBO") and Showtime. TCI and LMC also control Starz, a new premium movie channel.

[5] QVC owns two home shopping television channels—QVC and The Fashion Channel. It has been widely reported in the media that QVC was seeking to merge with Home Shopping Network Inc. ("HSN"), another home shopping channel. According to more recent media reports, however, QVC has stated that it is dropping its bid for HSN. *See* Washington Post, November 6, 1993, at C1.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 92 1997

ators.[6] This level of the industry is involved in the QVC/Paramount transaction as well. The largest shareholder in QVC is Liberty Media, which in turn is controlled by two individuals who also control TCI.[7] Liberty Media has a 21.5 percent interest in QVC and has entered into an agreement with Comcast (a 12.5 percent owner of QVC) and the CEO of QVC to vote their shares as a block. QVC is also partly owned by Time-Warner and other, smaller MSO's.

The Commission's complaint alleges competitive concerns at two levels. First, at the programming packaging level, TCI/LMC's influence over Paramount allegedly may tend to lessen competition or tend to create a monopoly in the market for cable television premium movie channels. Second, the complaint allegation regarding the distribution market reflects a concern that the proposed acquisition could make it necessary for entrants into the distribution market to enter the programming level as well. Thus, the complaint alleges overall that the purpose, capacity, tendency, or effect of the acquisition may be to:

1) Reduce the output and quality of premium movie channels;

2) raise programming fees to cable operators;

3) raise cable television subscriber fees to consumers;

4) enhance dominant firm behavior;

5) enhance coordinated interaction among vertically integrated multiple system cable operators; and

6) increase the difficulty of entry into the provision of subscription television programming distribution.

Since the alleged competitive problems stem from the vertical link between TCI/LMC and QVC, the FTC's consent order addresses them by severing that link. A variety of interrelated provisions in the order assure that TCI's control of QVC is eliminated completely and immediately. The consent order requires TCI and LMC, among other things, to divest all ownership interest in QVC and to divest or terminate all their interest in all existing agreements concerning voting of any shares of stock of QVC. Both the divestiture of ownership interests and the divestiture or termination of voting interests are to be made within 18 months from the date the order becomes final.

To preserve competition during the period prior to final acceptance of the consent order as well as until final divestitures are completed, the consent order is accompanied by an interim agreement which prohibits TCI and LMC, among other things, from exercising any direction of or control over the operations or management of QVC or Paramount, exercising any voting rights or agreements in connection with LMC's ownership in QVC, or participating in any change in the management of QVC or Paramount.

In addition, the interim agreement provides that within five days of the date the agreement containing the consent order is placed on the public record, any officers, directors, or employees of TCI or LMC who are present members of the board of directors of QVC or Paramount will resign as members of such boards. No officer, director, or employee of TCI or LMC will serve on the board of directors of either QVC or Paramount.

Further, until the divestiture of ownership interests and the divestiture or termination of voting interests are completed, the consent order prohibits TCI and LMC from entering into any agreements with QVC or Paramount that grant TCI or LMC exclusive exhibition rights to recently released theatrical motion pictures after Paramount's current contract with certain other parties terminates.

The consent order provides that TCI and LMC shall not be obligated to comply with the order if:

1) QVC terminates or abandons its attempted acquisition of Paramount; or

2) QVC does not acquire more then 10 percent of the common stock of Paramount within twelve months of the date the order becomes final.

The next section discusses in more detail the analytical framework the Commission uses in analyzing non-horizontal mergers.

---

[6] Direct broadcast satellites and wireless cable systems currently have a limited presence in the market for the distribution of in-home programming. A new development at this level of the industry is the emergence of telephone companies that reportedly are planning to develop and install technology that will enable them to distribute TV programming over optical fiber telephone lines.

[7] Liberty Media is a spin-off of TCI.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 93 1997

The Commission's merger enforcement activity demonstrates the carefully focused approach it applies to all mergers. For example, the Commission has investigated a large number of horizontal mergers in a variety of industries, ranging from health care[8] to defense,[9] and challenged only those that it had reason to believe threatened substantial harm to competition. Most recently, the Commission authorized the staff to seek in federal district court a preliminary injunction against the proposed acquisition of Chrysler Corporation's rail boxcar fleet by General Electric Company, the dominant rail boxcar operating lessor. The acquisition would have combined the number-one and number two firms in the industry. The parties withdrew from the transaction after the Commission announced that it would challenge the acquisition.

The Commission approaches non-horizontal mergers with the same recognition that many such mergers are competitively beneficial or neutral, but it looks carefully for those transactions that may be harmful to consumers. The following discusses some of the competitive theories and efficiency considerations that may be relevant in particular circumstances.

A. Vertical mergers

A vertical merger or acquisition involves firms that operate at different but complementary levels in the chain of production and/or distribution. The defining characteristic of a vertical merger is that the product or service produced by one firm can be used as an input to the product or service produced by the other firm.[10] Common examples include a merger between a manufacturer and a distributor, and a merger between two manufacturers, one of which produces an end product and the other a component of the end product.[11]

Since, by definition, the parties to a vertical merger do not operate in the same relevant market, the merger does not lessen actual competition between the two firms. However, competitive harm can result from vertical mergers in certain situations, as both the courts and the Commission have recognized. In examining particular vertical mergers for possible anticompetitive effects, the Commission looks to case precedent in this area and at all the relevant facts and circumstances.

There are several theories of possible competitive harm from a vertical merger.[12] One common thread that runs through them is that the analysis looks to the potential effects on *horizontal* competition at one or more of the levels of production or service at which the merging firms operate. Thus, these situations may be referred to as vertical mergers that have horizontal consequences.

1. A vertical merger may have anticompetitive effects if it forecloses new entry at one level of production by reducing the size of the market available to the entrant

---

[8] *E.g., FTC* v. *Columbia Hospital Corp.*, Civ. No. 93-30-CIV-FTM-23D (M.D. Fla. May 5, 1993) (preliminary injunction issued). The relief obtained prevented the merger of two of the three hospitals in Charlotte County, Florida.

[9] *E.g., FTC* v. *Alliant Techsystems Inc.*, 808 F. Supp. 9 (D.D.C. 1992) (preliminary injunction issued to block proposed acquisition by Alliant Techsystems of Olin Corporation's Ordnance Division). The court found that the merger could increase prices to the U.S. Army, and ultimately to taxpayers by as much as $115 million. Before the merger was announced, the Army had decided that it would select a single supplier for 120 millimeter tank ammunition through competitive bidding. The two firms then agreed to a merger that would eliminate competition on this and other bids. The court rejected the claims of the merging firms that competitive bidding would increase the Army's costs and that the Army could protect itself from monopolistic price increases.

[10] *See generally* ABA Antitrust Section: Monograph No. 14, *Non-Horizontal Mergers: Law and Policy* 5 (1988).

[11] Vertical mergers are a subset of a broader category called non-horizontal mergers, which also includes mergers between firms that do not have a vertical relationship. These other non-horizontal mergers are sometimes referred to as "conglomerate" mergers. The competitive analyses in these sub-categories overlap to some extent because, as discussed later in this Statement in connection with potential competition theories, both vertical and conglomerate mergers can present potential competition issues.

[12] For example, the 1984 Merger Guidelines issued by the Department of Justice [Department of Justice, *Merger Guidelines* (1984), *reprinted in* 4 Trade Reg. Rep. (CCH) par. 13,103 (hereinafter "1984 Merger Guidelines")] contain sections that identify possible anticompetitive effects from vertical and other non-horizontal mergers. Although the 1992 Horizontal Merger Guidelines [Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* (1992), *reprinted in* 4 Trade Reg. Rep. (CCH) par. 13,104], jointly issued by the Commission and the Department of Justice, supersede the prior Guidelines with respect to horizontal mergers, the provisions in the 1984 Merger Guidelines regarding non-horizontal mergers [secs. 4.1, 4.2] have not been modified. The 1984 Merger Guidelines provide a convenient starting point for analysis.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 94 1997

at another level.[13] For example, if the downstream division of the merged entity will only buy from its upstream division, the downstream division's portion of purchases from the input market is not open to competitors. A would-be entrant into the upstream market may find the remaining portion of the market too small to support efficient-scale entry.[14]

2. Under a similar foreclosure theory, a vertical merger could require a would-be entrant to enter the upstream and downstream markets simultaneously in order to be successful. For example, in an industry with a high degree of vertical integration and a limited independent supply of product in the upstream market, an entrant into the downstream market may find it necessary to enter the upstream market as well. If such "two-level" entry is more risky, more difficult, or more time-consuming than entry into the primary market alone, a merger that increases vertical integration could create competitively objectionable barriers to entry.[15]

3. A vertical merger could facilitate collusion. The 1984 Merger Guidelines posit two ways in which this could happen. First, vertical integration by an upstream firm into the retail level may facilitate collusion in the upstream market by making it easier to monitor downstream prices.[16] The ability to monitor downstream prices may make it easier to determine whether upstream firms are cheating on a collusive scheme.

Second, the acquisition of a particularly disruptive buyer in a downstream market may facilitate collusion in the upstream market by eliminating an incentive to cheat on a collusive scheme in order to gain the buyer's business.[17] Before the merger, the disruptive buyer may have been playing one firm against another to obtain the best price. With the disruptive buyer no longer independent of the upstream firms, collusion may be easier to maintain.[18]

4. Anticompetitive effects may occur if a vertical merger enables a regulated firm to evade rate regulation.[19] For example, a vertically integrated utility could inflate the price of inputs that it buys from itself, thereby inflating its rate base and enabling it to pass on those higher costs as higher prices and showing the resulting

---

[13] This was one of the theories of the complaint in Atlantic Richfield Co., C-3314, 55 Fed. Reg. 51,963 (1990) (consent order). Earlier cases sometimes found vertical mergers to be anticompetitive under a broader foreclosure theory that was not limited to an entry barrier effect. A vertical merger was sometimes held unlawful if the acquisition of a supplier or customer would foreclose a competitor from a substantial part of an input or output market. *E.g., Ford Motor Co.* v. *United States*, 405 U.S. 562, 568 (1972); *United States* v. *E.I. du Pont de Nemours & Co*, 353 U.S. 586 (1967); *Brown Shoe* v. *United States*, 370 U.S. 294, 323–24 (1962).

[14] Whether such a foreclosure strategy is economically rational depends, in part, on the demand characteristics and competitive structure of the downstream market. To the extent that the downstream market is competitive before the merger, and the merger is purely vertical, economic theory predicts that an anticompetitive price increase will result in lost sales for the merged entity, reducing the market share of the downstream division, and increasing the portion of the downstream market open to competition. In that situation, an attempt to exercise market power through a vertical merger may be self-defeating. In examining such issues, the Commission will consider the conclusions suggested by facts of the case before it, in light of relevant economic theory and case precedent.

[15] *E.g., United States Steel Corp.* v. *FTC*, 426 F.2d 592, 605 (6th Cir. 1970); Atlantic Richfield Co., C-3314, 55 Fed. Reg. 51,963 (1990) (consent order); *see also* 1984 Merger Guidelines sec. 4.21. On the other hand, entry into both markets may in some circumstances be less risky than entry into a single market precisely because of the foreclosure issue described above. If an entrant into the upstream market is assured of demand for its product from its downstream division, the upstream division may be more likely to be profitable than an entrant into only the upstream market.

Some cases found a vertical merger to be illegal if the merged firm could use its position as a supplier to disadvantage competitors, either by restricting supplies or imposing a price squeeze. *See, e.g., United States Steel Corp.* v. *FTC*, 426 F.2d at 605. Analogously, the 1984 Merger Guidelines state that in considering the feasibility of one-level entry, the Department "will consider the likelihood of predatory price or supply 'squeezes' by the integrated firms against their unintegrated rivals." 1984 Merger Guidelines sec. 4.212 n.31.

[16] 1984 Merger Guidelines sec. 4.221.

[17] 1984 Merger Guidelines sec. 4.222.

[18] Two countervailing considerations may be relevant. First, the merged entity has incurred the costs of merging with the disruptive downstream firm, yet all firms engaged in the collusive agreement benefit from the merger. This free-riding on the anticompetitive efforts of a competitor puts the merged entity at a disadvantage relative to the others, and thus may reduce any incentives to merge vertically to facilitate collusion. However, in a particular case, the significance of this factor may not be clear, since there may also be other motivations underlying the merger. Second, unless the disruptive downstream firm was uniquely able to undermine the collusive agreement, other downstream firms may be able to perform the same role after the merger.

[19] 1984 Merger Guidelines sec. 4.23.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 95 1997

higher profits in its unregulated business.[20] A regulated utility may also be able to allocate non-utility costs to utility customers, thereby causing a distortion in both markets.[21]

5. A vertical merger may allow a firm with market power in one market to extend its market power to a different market. For example, if the firm has market power in the upstream market, and if the downstream market can vary the proportion of the monopolized input used, a vertical merger can increase overall profits by shifting the mix of inputs. Economic theory suggests that, before such a merger, an attempt by the upstream monopolist to raise prices likely would induce firms in the competitive downstream market to substitute away from the monopolized input and toward the alternate inputs.[22] By integrating downstream, however, the monopolist can control the substitution and produce the downstream product with the optimum mix of inputs. It can then charge the monopoly price to consumers of the downstream products, earning higher profits than were possible before the merger.[23]

B. Potential competition

A non-horizontal merger may have anticompetitive effects if it eliminates a potential entrant. Firms in vertically related markets are often likely entrants.[24] Potential competition theories are equally applicable to non-horizontal mergers that do not involve a vertical relationship between the firms.[25] This is the area of non-horizontal merger theory with which the Commission has the most extensive and recent enforcement experience.

The possibility (either real or perceived) that new competitors might enter concentrated markets if they remain independent may induce existing competitors to behave competitively. If the threat of entry is eliminated through mergers between likely potential entrants and market participants, higher prices or reduced output may result or continue unabated in certain circumstances. Because of the pro-competitive benefits of potential entrants poised on the edges of markets, the Commission has recognized and sought to preserve competition under theories of "potential competition."

The possible harm resulting from the loss of potential competition generally is analyzed under two theories: "perceived potential competition" and "actual potential competition."[26] These potential competition theories were discussed by the Supreme

---

[20] In 1986, the Commission challenged an acquisition by Occidental Petroleum Corp., a supplier of unregulated natural gas, of MidCon Corp., an interstate natural gas pipeline company. The Commission had reason to believe that the $3 billion acquisition could substantially lessen competition in the pipeline transportation and sale of natural gas in the St. Louis area by enabling MidCon—the sole supplier of natural gas transportation to the St. Louis area—to transfer natural gas from Occidental at inflated prices and to pass those inflated prices on to consumers. The case was settled by a consent order that required MidCon to divest one of its two pipeline systems in the region, so that it was no longer the sole supplier. Occidental Petroleum Corp., 109 F.T.C. 167 (1986).

[21] The utility need not be vertically integrated in order for this effect to occur.

[22] There would still be a deadweight loss to society, however, because the downstream firms would use an inefficient mix of inputs.

[23] Economic theory predicts that if the downstream market cannot vary the proportions used of the upstream product—*i.e.*, it cannot substitute away from the upstream product to other inputs—vertical integration can have no effect on profits. According to economic theory, in that situation the upstream monopolist likely would have already extracted the maximum level of monopoly profits at the upstream level; any further increase in price at either level would result in lower sales and less profit.

[24] *See, e.g., Ford Motor Co.* v. *United States*, 405 U.S. at 570–71.

[25] The 1984 Merger Guidelines discuss the potential competition theory under the general category of horizontal effects from non-horizontal mergers, which includes vertical mergers. 1984 Merger Guidelines sec. 4.1.

[26] *See* 1984 Merger Guidelines sec. 4.1. The perceived potential competition theory maintains that competitors in concentrated markets may be constrained from engaging in anticompetitive behavior solely by the perceived *threat* of entry by a non-participant, which would dissipate any gains from anticompetitive behavior. The removal of the threat, through merger, may eliminate that constraint and ease pricing pressure on existing competitors. As a result, the market may become less competitive.

In contrast, the actual potential competition theory posits that markets that may not be behaving in a competitive manner at present would become more competitive and less concentrated through the impending entry of a new firm—and, in fact, that the acquired (or acquiring) firm was one of the most likely entrants. The injury to competition, therefore, is the loss of the procompetitive influence that the potential entrant would have had on the market had the entry not been preempted by the acquisition.

The Commission's standards in potential competition cases were most recently stated in B.A.T. Industries, Ltd., 104 F.T.C. 852 (1984). *See 1984 Merger Guidelines* secs. 4.131–4.134.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 96 1997

Court in *U.S. v. Marine Bancorporation*.[27] Similarly, in *B.A.T. Industries, Ltd.*,[28] the Commission analyzed a merger affecting the chemical carbonless paper market under the actual potential competition doctrine.[29]

The Commission recently has challenged several proposed mergers on potential competition-grounds. These matters include *Roche Holding, Ltd.*[30] (actual potential competition in the pharmaceutical industry), *Atlantic Richfield Co.*[31] (actual potential and perceived potential competition in the chemical industry), and *Institut Merieux*[32] (actual potential competition in the vaccines industry).[33]

Roche Holding, Ltd., is a good example of the kinds of competitive concerns that may be present in potential competition cases. In 1990, the Commission accepted a consent order with Roche Holding Ltd. relating to that Swiss pharmaceutical company's acquisition of a controlling interest in Genentech Inc.[34] The complaint alleged that the acquisition would have eliminated actual and potential competition and enhanced the likelihood of collusion in three pharmaceutical markets for which entry was difficult: the worldwide market for vitamin C; the U.S. market for therapeutic drugs for the treatment of human growth deficiency; and the U.S. market for CD4-based therapeutics for the treatment of AIDS/HIV infection.

In the first market, the complaint alleged that Roche, a major international pharmaceutical firm, had a dominant share of both the U.S and world markets for vitamin C. Genentech, a leading U.S. biotechnology company, had developed a new patented process for producing vitamin C, although its technology was not yet commercial. To preserve innovation and future competition in sales of vitamin C, the consent order required divestiture of Genentech's technology. In the second market—therapeutics for human growth hormone deficiency—it was Genentech's drug that allegedly had a near-monopoly share, but Roche was conducting advanced clinical trials with a product that allegedly would compete in this market. The consent order required divestiture of Roche's human growth hormone releasing factor business to ensure continued development of that product. Both of the mandated divestitures were completed in 1992.

In the third market—CD4-based therapeutics for the treatment of AIDS/HIV infection—the Commission's focus was even more directly on competition in the development of new and innovative pharmaceuticals. There, Genentech was allegedly the most advanced of a number of companies developing CD4, and Roche had also engaged in research and development and had patent applications pending on its products. Although CD4 was not yet an approved drug, the consent order required Roche, for a period of 10 years, to grant non-exclusive licenses of CD4-based therapeutics based on Roche's patent portfolio to any entity that was willing to pay certain royalties and stated an intention to sell such a therapeutic drug in the United States.

C. Potential benefits of non-horizontal mergers

A non-horizontal merger can be motivated by a variety of pro-competitive or efficiency-enhancing objectives. For example, a company with expertise in one relevant product market may acquire a firm selling into another relevant market because there are opportunities for adapting or modifying its current technology for use in the second market. In addition, a merger may provide advantages through the pooling of information and sales forces, the ability to offer distributors a broader line, or more general managerial efficiencies, that may take longer or be more costly to attain if the firms remained independent. Any or all of these efficiencies may be present in a merger that is analyzed under the potential competition theory.

---

[27] 418 U.S. 602 (1974).

[28] 104 F.T.C. 852 (1984).

[29] The Commission has recognized both potential competition theories. *See, e.g.*, Tenneco, Inc., 98 F.T.C. 464, 577 (1981), *rev'd on other grounds*, 689 F.2d 346 (2d Cir. 1982). *See also* Grand Union Co., 102 F.T.C. 812, 1050–51 (1983); Hueblein, Inc., 96 F.T.C. 385, 583 (1980); Brunswick Corp, 94 F.T.C. 1174, 1267, *aff'd sub nom. Yamaha Motor Co. v. FTC*, 657 F.2d 971 (8th Cir. 1981), *cert. denied*, 456 U.S. 915 (1982).

[30] C–3315, 55 Fed. Reg. 53,191 (1990) (consent order).

[31] C–3314, 55 Fed. Reg. 51,963 (1990) (consent order).

[32] C–3301, 55 Fed. Reg. 38,854 (1990) (consent order).

[33] In a merger case involving two oil refineries in Hawaii, the Commission alleged both a potential competition count and a horizontal count. *See FTC v. Pacific Resources, Inc.*, Civ. No. C87–1390, slip op. at 3, 5 (W.D. Wash. Nov. 6, 1987) (preliminary injunction issued). Both counts were also alleged in an administrative complaint, which was resolved with a consent order, requiring prior approval for future acquisitions, after the parties withdrew from the transaction. Pacific Resources, Inc., Dkt. No. 9211, 111 F.T.C. 322 (1988).

[34] *Roche Holding, Ltd.*, C–3315 (1990).

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 97 1997

Vertical mergers can likewise have pro-competitive effects.[35] Three of the most common benefits that may result are reduction of transaction costs, technological economies, and assurance of an adequate supply of an input product. A fourth benefit, which may become increasingly significant, is the advancement of technology.

1. *Reduction of transaction costs.* A vertical merger can reduce transaction costs in a number of ways. For example, a vertical merger can reduce the costs of negotiating a myriad of transactional details between the two firms (*e.g.*, delivery, contingencies, etc.) and may provide planning efficiencies. A vertical merger can also increase the firms flexibility to deal with unforeseen changes[36] and reduce the need for the parties at different stages of production to negotiate large risk premiums to protect themselves against the risk of failure.[37] Vertical integration similarly can reduce the chance for opportunistic behavior by a firm that may attempt to profit from the unforeseen success of the other party by threatening to hold up cooperation.

2. *Technological economies.* Physical proximity (or organizational control) may allow joint production of two stages at lower cost than if they were separated. A commonly cited example is steel manufacturing, where vertical integration of the basic steel making and intermediate fabrication operations can reduce the energy cost of reheating the product for further processing.

3. *Technological advances.* Vertical integration of related technologies may promote the more rapid development of new products where the joint or coordinated development of inputs is more efficient than separate development. This kind of efficiency may become increasingly important in new technological fields.

4. *Assuring an adequate supply of inputs.* Historically, a common reason advanced for many vertical mergers is that firms may integrate backward into the production of an important input product in order to assure an adequate supply of the input.

This discussion of possible efficiencies is not exhaustive by any means, but it gives some indication of the various possible motivations behind many non-horizontal mergers.

CONCLUSION

The Commission already has conducted investigations involving several different aspects of the communications industry. Non-horizontal mergers in these industries, and others, are evaluated in light of the applicable facts, law, and economic analysis. The Commission has actively investigated non-horizontal mergers in order to determine whether there are anticompetitive problems, as well as pro-competitive benefits, and will continue to do so.

Thank you for giving me the opportunity to appear before you today to present the Commission's testimony. I would be happy to answer any questions.

Senator METZENBAUM. Thank you very much for being with us, and thank you very much for the prompt action with which the FTC acted in this matter. I think it was in the public's interest.

Ms. Steptoe, it has been at least 15 years since the antitrust authorities moved to block a vertical merger. However, this action of yours yesterday confirms my strong belief that vigorous antitrust scrutiny is the best protection that consumers can have from anticompetitive telecommunications deals. I would like to ask you a few questions about the FTC's consent decree against TCI.

Ms. STEPTOE. Yes, sir.

---

[35] *See, e.g.*, W. Kip Viscusi, John M. Vernon, and Joseph E. Harrington, Jr., *Economics of Regulation and Antitrust* 221–24 (1992).

[36] For example, a vertically integrated firm might be able to adjust to unexpected changes by making internal adjustments in its upstream or downstream operations. This may be less costly than contractual adjustments by independent firms.

[37] For example, consider a research and development firm that negotiates a contract that provides for compensation based on performance in accordance with specifications set by the buyer, a manufacturing firm. Such a contractor may build in a risk premium to adjust for the possibility that on some contracts of that nature, it will not be able to meet the buyer's specifications and its compensation will be less than expected. If the manufacturing firm and the R&D firm were vertically integrated, the risks could be internalized and the transaction costs (of contracting) would be reduced or eliminated.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 98 1997

Senator METZENBAUM. As I read it, in order to clear QVC to bid for Paramount, you are requiring TCI, its former partner, to sever its ties to QVC. TCI must divest its ownership or voting interest in QVC within 18 months. However, all of its officers, directors, or employees must resign immediately from the boards of QVC and Paramount. In addition, you prohibit TCI from directing or controlling QVC or Paramount in any manner and from entering into any exclusive agreements for Paramount's movies.

I must say the terms of the consent decree seem pretty airtight to me and are impressive. Are there any other significant safeguards in the consent decree that I did not mention?

Ms. STEPTOE. There is one, sir, and that is after TCI has finally divested itself its stock and voting interests in QVC, it is prohibited for 3 years from reacquiring those interests. It cannot do so unless it has submitted itself to Commission review and approval.

Senator METZENBAUM. Thank you. In 1992, the Wall Street Journal reported that TCI has a history of structuring its business dealings so it can evade regulatory review. Likewise, as the TCI memo that I read this morning shows, TCI will use any loophole it can to undermine Federal laws and mandates in order to take advantage of the American consumer.

Therefore, it is not surprising that concerns have been raised that TCI might attempt to circumvent either the letter or the spirit of the consent decree to gain control over Paramount's programming in a way that could escape antitrust review. In your opinion, is that possible, and what could the FTC do to prevent it from happening?

Ms. STEPTOE. Well, I think we have a number of ways to prevent somebody trying to evade our orders. In the first instance, anyone who violates an FTC order is subject to fines. It is $10,000 a day. Now, I realize that may not sound like a lot, given the size of this company.

Senator METZENBAUM. Not much money.

Ms. STEPTOE. So let me continue. It is $10,000 a day per violation, so conceivably it could be more than $10,000 a day if you had a number of violations. But even so, if that did not seem to us a sufficient deterrence, we can go to court under our enabling statute and ask for any relief that is necessary to stop what is going on. That could include restitution, and there the amounts of money would be much greater, and an injunction saying stop doing whatever it is immediately. Of course, anyone who violated that would face criminal contempt charges. So, I think we have a pretty good arsenal of weapons at our disposal, and I can assure you that we would use them.

Senator METZENBAUM. The FTC's consent decree confirms my view that TCI already has too much market power over cable systems and programming, and therefore it shouldn't be allowed to acquire any more. I realize you are not the antitrust agency charged with reviewing the TCI-Bell Atlantic merger. However, it seems to me that your concerns about the harm to consumers that could have resulted if TCI gained control over Paramount apply with equal force to the TCI-Bell Atlantic deal. In fact, wouldn't you agree that the anticompetitive effects of that deal could be even more serious for consumers?

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 99 1997

Ms. STEPTOE. Well, when you consider the number of consumers affected by Bell-TCI, obviously the potential, if there is an antitrust problem there, is enormous. I can't comment on that deal. The Department of Justice, of course, has announced that it is reviewing it, but they have also announced that they are going to scrutinize it down a laundry list of every available antitrust theory. That, to me, sounds like the exact sort of hard, careful, close look that we gave QVC-Paramount.

Senator METZENBAUM. As you know, I had serious concerns about the proposed merger between the only two cable shopping channels, QVC and the Home Shopping Network. Last July, I wrote detailed letters to both you and the Antitrust Division outlining my objections and asking for strict review of the merger. I might say that I was impressed with the seriousness with which the FTC pursued that investigation.

As you may recall, one of my major concerns with the shopping channel deal was that TCI had a large stake in QVC and therefore the merger would have given it control of both shopping channels. I asked the FTC to investigate whether allowing TCI to acquire a controlling interest in both QVC and the Home Shopping Network could have increased its leverage in the cable programming and cable systems markets. If so, TCI could have kept new shopping channel competitors out of the market and charged high prices for its shopping channels.

Fortunately for consumers, that merger has been called off, at least for now. However, there have been some suggestions that if QVC wins the bidding war for Paramount, it may reopen merger talks with HSN. According to my information, TCI owns 40 percent of the Home Shopping Network. Therefore, wouldn't you agree that any attempt on the part of QVC to reopen its merger discussions with Home Shopping Network would raise many of the same anticompetitive concerns that led you to block TCI from acquiring Paramount?

Ms. STEPTOE. I would certainly agree with that, but what I would like to point out is the consent that we have right now between TCI and ourselves with regard to Paramount is going to solve those problems. Under the consent, QVC cannot go and acquire HSN, or vice versa, because that would intrude TCI back into ownership of QVC, which is precisely what this consent forbids. So for the next 4½ years, I don't think that is likely to happen.

Senator METZENBAUM. According to the consent decree against TCI, the FTC has to approve the buyer. As you know, BellSouth has taken TCI's place in the Paramount bid by investing $1.5 billion in QVC. However, as I understand it, because BellSouth is not buying TCI's interest in QVC directly, it would not be subject to the FTC's prior approval requirements. Could you explain to us briefly how and when BellSouth's investment in QVC will be reviewed by the antitrust authorities?

Ms. STEPTOE. It will come up in one of two ways. If BellSouth invests in QVC by buying the stock that Liberty or TCI must divest under the order, then it would come under review under the Commission's prior approval requirements of this consent order. There is a lot of other QVC stock out there other than that about a quarter of the company owned by TCI and Liberty.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 100 1997

If BellSouth becomes a backer with regard to that other chunk of stock, at the time where it acquires voting rights or gets control over QVC, that would be a reportable transaction under Hart-Scott-Rodino and would be subject to all the governmental review that that connotes.

Senator METZENBAUM. Concerns have been raised about BellSouth buying into the QVC deal for Paramount. That is because BellSouth's partners in the Paramount deal would be three cable systems—Cox, Comcast, and Newhouse. As the map to my right shows, those companies own quite a few cable systems in BellSouth's service area. In my view, that could destroy head-to-head competition between BellSouth and its partner cable companies.

Your testimony states that the FTC can and has blocked mergers when they eliminated the two most likely competitors in a market. In one case, neither company had actually entered the other's market, but both were strategically positioned to do so. I think that is precisely the situation we are facing in the Bell Atlantic-TCI merger, and perhaps with BellSouth's partnership with Cox, Comcast, and Newhouse to acquire Paramount.

As both you and AT&T acknowledge in your testimony, local telephone companies and cable companies have until recently been gearing up to compete with one another. In fact, the evidence is quite clear that cable and local telephone companies are each other's most likely and most formidable potential competitors. I am not asking to judge either the Bell Atlantic-TCI or the BellSouth-QVC deal. However, wouldn't you agree that those deals could raise significant antitrust concerns if they were, in fact, eliminating the most likely potential competitors to the current cable and local telephone monopolies?

Ms. STEPTOE. Yes; again, thank you for asking me not to prejudge, particularly Bell Atlantic where we are not the reviewing agency. But, obviously, as you are going down the list of antitrust concerns, as I hope I made clear in my earlier testimony, potential competition is a major one and you would want to ask whether the two media are indeed potential competitors, how soon they are likely to mature this potential competition into real competition, and what it is going to do to their incentives to do that, to compete, as, in the meantime, they have become partners in owning a very important piece of programming.

Senator METZENBAUM. Thank you.

Senator Simon?

Senator SIMON. Thank you, Mr. Chairman.

How do Justice and FTC determine who handles what?

Ms. STEPTOE. We always get asked that. We have started a clearance procedure, and any time one agency wants to open an investigation it informs the other agency and says, have you any objections. Most of the time, there is enough antitrust work out there for us both to be busy and there is no objection.

Sometimes, the other agency says, well, I was thinking of that myself, and at that point we sit down and discuss which of us can do the investigation best, most efficiently, who can hit the ground running because we know the industry better or we know the par-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 101 1997

ties better or we have had more—it is a theory that one has had more recent experience working out in a real-world context.

Senator SIMON. And do you share information?

Ms. STEPTOE. Yes, we do. We don't necessarily on a daily basis on any investigation. That would be duplicative and we don't do that, but we certainly are very open to sharing our thoughts and any background information we have because we are on the same team.

Senator SIMON. You mentioned in response to a question from Senator Metzenbaum a $10,000-a-day fine. When was that initiated?

Ms. STEPTOE. I really don't know. For as long as I can remember, that has been the upper limit of the fine.

Senator SIMON. So that if, in fact, we wanted to keep up with inflation, we might go back and take another look at that $10,000-a-day fine which, in this kind of an operation, is not that significant a fine.

Ms. STEPTOE. Certainly, it has been criticized and I personally feel that it is not always a significant deterrent. It depends on the company that you are dealing with.

Senator SIMON. In my opening remarks, I mentioned the three publishing giants. Have you or Justice looked at that aspect of this at all?

Ms. STEPTOE. The announcement by Paramount that it wants to acquire McMillian is a new transaction. The mergers never stop coming at you. It will be one that will be reviewed. At this time, I don't know whether it would be us or Justice looking at it.

Senator SIMON. Thank you, Mr. Chairman.

Senator METZENBAUM. I think Senator Specter was the next to arrive. Senator Specter?

Senator SPECTER. Thank you, Mr. Chairman.

Ms. Steptoe, have you noted the article in the Washington Post regarding the TCI memo calling for price hikes?

Ms. STEPTOE. Yes, sir, I read that.

Senator SPECTER. The story relates that Mr. Barry Marshall, chief operating officer of TCI, sent out a memorandum on August 20, 11 days before the new cable rules took effect, asking systems managers and division vice presidents to raise rates for various transaction services such as customer hookups and VCR hookups which TCI had provided at free or nominal cost.

The thrust, according to the Washington Post story, was that these charges should be made even though they hadn't been made in the past to put the blame on the Congress for passing the Cable Act and then the consumers would find that the prices are really increased. When questioned about this, Mr. Marshall, according to the news accounts, did not back away from his memo, but says that these are items which they are going to press on. The story contains a notation that the FCC will investigate to determine whether the cable rate increases represent "culpable evasions."

Now, what action can the FCC take in the face of this kind of conduct?

Ms. STEPTOE. I am not really sure of everything that the FCC can do. It is a sister agency that I don't feel comfortable speaking for. From my perspective as an antitrust enforcer, I think this let-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 102 1997

ter highlights something, which is that you can regulate all you want, but people will always try to find ways around it and competition is far more likely to impose some restraints. That letter was saying the customers will get used to it. It was, in essence, saying they have nowhere else to turn. If they had somewhere else to turn, then maybe this company wouldn't be able to get away with tricks like that.

Senator SPECTER. Well, in a context where the FTC has very substantial regulatory authority over TCI, does this kind of conduct have any bearing at all on motive or intent, or any relevance to evaluating their good-faith operation on any of the other Federal laws which your Agency enforces?

The point that I am looking for is here you have the FTC taking a close look at TCI. TCI is coming before the FTC in a very complex transaction. It is true that the FCC is different, but where you have these kinds of calculated practices, the thought crosses my mind that that might be probative or relevant on some of the things which your agency is doing.

Ms. STEPTOE. Yes, I think it is on a couple of points. One that I made is it confirms my feeling that the problem we saw with their takeover of Paramount is there, that they shouldn't get so much programming and that they can exercise unchallenged control over what the consumers are seeing. Second, going back to Senator Metzenbaum's question about are you going to be vigilant to make sure they don't evade your order, I think this adds reason to double our vigilance.

Senator SPECTER. Do you think that there is some inference on predatory practices or bad faith which moves from one situation to the other?

Ms. STEPTOE. I would have to know what the other situation is. I think we want to be a little wary of just branding a company or a person as a bad actor and taking off from that point of view. I would examine each series of problems that was presented to me with a company on its own.

Senator SPECTER. Well, that is a generous attitude and perhaps it is the correct attitude, but it is certainly——

Ms. STEPTOE. Well, I hope it doesn't mean a lenient attitude.

Senator SPECTER. Well, it may be. The difficulties of the regulatory practices are extreme, because no matter how tightly a law is drafted or how tightly regulations are drafted, it is not possible to contemplate every single circumstance, and there has to be in the industry some degree of good-faith compliance with what is done. Where you have this kind of conduct by TCI, it seems to me that it does have some bearing, or at least raises a question as to whether that kind of a practice ought to be scrutinized by an agency which contemporaneously has a very major matter under analysis by TCI.

Let me move to another subject briefly, Ms. Steptoe, and that is the enormous complexity of issues which are coming before your Agency and the Justice Department. The Antitrust Subcommittee is able to deal with these subjects only to a limited extent because of the very heavy press of business which this committee and the Senate has generally.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 103 1997

But I note that at a time when you are making a determination as to TCI and Liberty and Paramount that Viacom, QVC's key rival, is dealing with another major cable system owner and programmer backed by NYNEX, and it has somewhat similar overtones as the QVC-BellSouth arrangement. Would you be in a position to comment about what the implications of Viacom's operation and joinder activities are with respect to the issue of lessening competition and posing another antitrust problem?

Ms. STEPTOE. I am really constrained from getting very specific on matters that haven't been voted on by the Commission. I think, sir, some of my previous answers go to that to the extent that in all of these connections I think both antitrust agencies are looking not only in the traditional horizontal merger mode, but we are considering questions of potential competition. In what you have just outlined there, and you could probably give three or four other examples out of the newspaper pages in the last couple of weeks, there are a lot of vertical alliances going on in the telecommunications or communications industry and I think all of them potentially raise these questions. I am sure, whichever agency ends up reviewing them, the whole, as I called it, laundry list of questions will be asked.

Senator SPECTER. Well, the second panel is going to be Mr. Robert Allen, CEO of AT&T, who will testify regarding AT&T's acquisition of McCaw Cellular Communications, Inc., which is the Nation's largest cellular provider with regional operations serving over 30 percent of the cellular subscriber market, according to information which is provided to me. Here again, without dealing with the specifics, don't we have the same sort of a concern about antitrust issues and the lessening of competition?

Ms. STEPTOE. I think the concerns certainly have to be addressed, yes.

Senator SPECTER. In the context of so many of these activities, are the FTC and the Justice Department really—I will conclude within 2 minutes, Mr. Chairman—are the FTC and the Justice Department adequate staffed to undertake the kinds of searching inquiries and legal analysis and factual analysis which are called for by these kinds of transactions, with so many of them coming to the fore at the same time?

Ms. STEPTOE. Well, I could always use some more resources. I think we are managing, but obviously these are, as you say, resource-intensive inquiries. To the extent we are doing them, we may have to put some other matters on the back burner. I don't think, to date, we have failed to give the problems the consideration they need, but if you would love to give us some more money to get some more lawyers in, I could certainly use it.

Senator SPECTER. Well, I would love to, if we could. Just one final comment, and that is I note that there is a major decision which gives the networks now the opportunity to control their programming. Here we have this major fight over Paramount which has to involve the Paramount movie rights and the enormous treasures which are in Paramount. I thank the chairman for scheduling these hearings. I just wish we did not have so many conflicting responsibilities. We have got the crime bill on the floor. I have an

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 104 1997

amendment coming up. I know Senator Metzenbaum and Senator Thurmond do, too.

But we wish you well, and if you can give some specifics on what you need, we would like to help you have sufficient resources to deal with these complex issues. This is the kind of a matter that a major law firm would put a phalanx of partners and associates and paralegals on for months. Do you do that?

Ms. STEPTOE. I think our phalanxes are much smaller.

Senator SPECTER. Thank you.

Senator METZENBAUM. Thank you very much, Senator Specter. Senator Specter, I am not sure if you were here earlier, but I had indicated that I was going to explore whether or not we don't have to revisit the whole question of cable regulation. I am going to ask my staff to speak with yours concerning the possibility of your interest in that subject because I think it is pretty obvious from this memo that we haven't done all that we should have done and could have done.

Senator SPECTER. I take it that is an announcement of your candidacy for reelection, Senator Metzenbaum. [Laughter.]

Senator THURMOND. His reelection or his son-in-law's election?

Senator METZENBAUM. Well, I guess that is another subject.

OPENING STATEMENT OF HON. STROM THURMOND, A U.S. SENATOR FROM THE STATE OF SOUTH CAROLINA

Senator THURMOND. Mr. Chairman, I am going to make my opening statement and then I will ask a few questions.

This morning, we hold our second hearing on recent proposed transactions in the telecommunications industry. In the short time since our last hearing, the complexion of two of these transactions has changed significantly. Yesterday, the Federal Trade Commission announced a consent decree which will sever the relationship between TCI and QVC in its bid for Paramount. This eliminates the connection between the Bell Atlantic-TCI merger and the QVC-Paramount tender offer, and resolves many of the competitive concerns that were expressed at our last hearing.

At the last hearing, I stated that I was confident that the antitrust enforcement agencies would carefully scrutinize large telecommunications mergers so that the Congress did not need to micromanage the antitrust review of these transactions. I am pleased that the Federal Trade Commission was able to provide rapid analysis and action in their decision to block the participation of TCI in the proposed acquisition of Paramount.

While the Congress must determine whether any changes in law are necessary, and may hold appropriate oversight hearings, the signing of this consent decree confirms that the antitrust enforcement agencies are where the full competitive analysis and any necessary antitrust challenges should take place.

The recent changes in the transactions also give some indication of the fragility of these unconsummated proposals and reinforce my concerns that these congressional hearings not be taken as any determination that the mergers will not or should not survive thorough antitrust analysis by the antitrust enforcement agencies. The role of the Congress should be to maximize the benefits to consumers by ensuring that laws and regulations keep up with the conver-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 105 1997

gence of telephone, cable, and wireless technologies so that competition can flourish wherever possible in the marketplace.

Mr. Chairman, I want to thank all these witnesses who are here today for appearing before the subcommittee.

Now, Ms. Steptoe, I welcome you to the subcommittee. How long have you been with the FTC?

Ms. STEPTOE. Virtually all of my working life. Are you going to make me say when I started?

Senator THURMOND. Administrations change, but you stay on forever.

Ms. Steptoe, I want to commend you and the Federal Trade Commission for rapidly analyzing and acting on the TCI-QVC-Paramount proposed merger. Would you say that this is an example of antitrust scrutiny by the antitrust enforcement agencies working as it is supposed to in order to protect American consumers from potentially anticompetitive transactions?

Ms. STEPTOE. Yes, sir, I would, and if I could take a minute I would like to say that the reason we were able to act so fast is that we had attorneys who worked virtually night and day and slept in their offices and didn't stop until they had gotten the answers that they needed to get. I think the staff of the Bureau of Competition deserves great commendation.

Senator THURMOND. Ms. Steptoe, do you have any concern that the antitrust enforcement agencies will not be able to properly analyze the competitive effects and determine whether it is necessary to oppose on antitrust grounds the Bell Atlantic-TCI merger, the AT&T-McCaw merger, or BellSouth's possible participation in QVC?

Ms. STEPTOE. I think speaking especially for my agency, I have no concerns. As I was saying earlier, I think we have been thinking through the issues for a long time. We are well up on the theory. We have extensive experience in this industry, in the information delivery industry. I don't think it has yet evolved to knowing what its future name is going to be. So I think we are poised to be able to deal with whatever comes down the pike next and analyze it appropriately.

Senator THURMOND. Ms. Steptoe, in a thorough antitrust agency review of a large merger such as the Bell Atlantic-TCI transaction, assuming that a second request for information is issued, can you give us a general idea of the magnitude of the investigation in terms of how many documents the agency could receive from the parties, how many interviews will be conducted by the agency of employees of the parties and third parties, and how many agency attorneys and economists might be involved in conducting the investigation and deciding whether to challenge the merger on antitrust grounds?

Ms. STEPTOE. The documentary returns can vary, sir. It depends on how much paper a company generates and what the industry is like. There is a core series of questions we ask in virtually every second request. Sometimes, that generates a response of, you know, 10 cartons of documents; sometimes it can be several hundred. It depends really on the industry.

We do interview numerous employees of the parties. We also interview customers. We interview competitors. We deal with, if we

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 106 1997

can find them, experts on the industry. It is quite a thoroughgoing investigation. Our staffing of mergers usually starts off with one or two attorneys and as we approach a situation where we think we might have to challenge it in court, we may staff it up to, say, about 10 attorneys, probably, no more than that. The earlier remark about phalanxes—that is the size of my phalanx, 10.

Senator THURMOND. Ms. Steptoe, from your perspective at the Federal Trade Commission, what can the Congress do to encourage competition in the telecommunications industry? Do you have any recommendations about laws or regulations that should be changed by the Congress to foster competition in this evolving industry?

Ms. STEPTOE. Sir, I don't feel competent to recommend legislation to you, but I would ask for the continued support that you and all the members of this subcommittee have shown to the antitrust agencies because I think whatever else happens in the area of legislation, having vigorous antitrust enforcement is going to contribute to keeping competition alive in this industry as it develops.

Senator THURMOND. Thank you, Mr. Chairman. Thank you, Ms. Steptoe.

Senator METZENBAUM. Thank you, Senator Thurmond.

Ms. Steptoe, thank you very much. You are indeed one of the unsung heroes of government.

Ms. STEPTOE. Thank you.

Senator METZENBAUM. People oftentimes talk about government not doing a job, people not caring. I don't have much doubt in my mind that with your experience you could have gone out and made a lot more money than you are making working for the Government. But I just want to say as chairman of this subcommittee, and I think I speak for all of the members of the subcommittee, we are really very grateful to you for the public service that you have devoted yourself to, I guess, ever since you came out of law school. The people are lucky to have you in that position, and I hope nobody comes along with such a substantial offer that they will take you away to some private law office or some private corporation.

Thank you very much on behalf not only of this subcommittee, but the people of the country. Thanks a lot.

Ms. STEPTOE. Thank you, sir.

Senator METZENBAUM. Our next witness is Robert E. Allen, chairman of the board and chief executive officer of AT&T. We are happy to have you return to be with us, Mr. Allen. Please proceed.

STATEMENT OF ROBERT E. ALLEN, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, AT&T

Mr. ALLEN. Thank you, Mr. Chairman. Mr. Chairman and members of the subcommittee, as you noted, I am Robert E. Allen. I am chairman and chief executive officer of AT&T, and I welcome this opportunity to discuss the issues being raised by the winds of change that are swirling through our industry today.

Specifically, I will address the questions that arise from AT&T's proposed merger with McCaw and the very different issues that surround the proposed Bell Atlantic-TCI merger and similar transactions between other regional Bell operating companies, the so-called RBOC's, and cable companies.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 107 1997

I want to make three principal points this morning. First, in evaluating any of these transactions, I think the critical question for the Government and for this distinguished subcommittee is whether they will strengthen or retard competition. Second, AT&T's proposed merger with McCaw is manifestly procompetitive. Third, while we believe that the proposed Bell Atlantic-TCI merger includes many positive aspects, that transaction presents very different competitive issues than does the AT&T-McCaw proposed merger.

Mr. Chairman, telecommunications is an area in which national policy should be very clear and very simple, and that is to create conditions that allow vigorous competition to develop in each potentially competitive segment of the market. Our own experience since divestiture offers a powerful lesson. Competition has spurred the delivery of the most advanced, most cost-efficient, most widely available service to Americans in the shortest possible time.

Robust, often fierce competition in the long-distance communications equipment, and in the enhanced services market has delivered exactly the consumer benefits that we expected from a competitive market, a dazzling array of new services and features, and prices have dropped dramatically. AT&T believes competition would produce similar benefits in the one area of telecommunications that remains a rock-solid monopoly, and that is the basic local exchange service. That is why we have urged State and Federal regulatory authorities and the Congress to adopt policies that eliminate barriers to entry into these markets and otherwise permit competition to develop whenever it is economically and technically feasible.

To the degree that the proposed Bell Atlantic-TCI merger fostered this competition, AT&T believes it would be a positive development. But it is critically important that this transaction and others like it be structured in a way that promotes potential future competition between cable and local exchange service rather than retard it.

AT&T's proposed merger with McCaw does not raise any of these concerns. On the contrary, this merger would have only one competitive consequence, and that is to promote competition in the wireless service market. McCaw today provides cellular service to about 17 percent of the Nation's cellular customers, but McCaw operates under the handicap of competing with affiliates of the RBOC's who have both the incentive and the ability to use their bottlenecks to impede competition.

Like all long-distance carriers, including AT&T, McCaw is dependent on the RBOC's and other local exchange providers. The fact is that some 99 percent of all calls made by cellular customers are placed to landline phones and require local exchange facilities to complete the call or to be connected to the long-distance carrier of their choice.

The chart that you see, Mr. Chairman, on your right, on my left, illustrates the point. Here is the concrete example. If you make a cellular telephone call from your car to your A.A. in the Senate, that call begins over the cellular network and it almost simultaneously is handed off, however, in this case to C&P's local monopoly network for completion.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 108 1997

Similarly, in the case of the 3 to 5 percent of all cellular calls that are long distance, C&P delivers that call from the cellular network to an interexchange carrier's network over its local bottleneck facilities. In spite of the fact that the proposed AT&T-McCaw merger is manifestly procompetitive, the RBOC's have argued that it would require removing or modifying the MFJ's long-distance or manufacturing restriction. Their arguments are completely without merit.

They say, for example, that this merger represents AT&T entering the local telephone business, that it permits us to bypass the local monopoly that you see illustrated there. They are wrong. These claims are not true today and they will not be true for the foreseeable future. Cellular radio is simply not basic local phone service. It extends that service, but does not and cannot displace local service.

More to the point, as the chart shows, we do not bypass the local networks. Today, 99 percent of the time the connection between a cellular system and AT&T's long-distance network is provided by an RBOC or another franchise local exchange monopoly. The RBOC's talk about competing on equal terms, but there is nothing equal when they control the local monopoly facilities on which all long-distance carriers depend to reach their customers and on which all cellular carriers similarly depend. That bottleneck will not disappear until local exchange competition becomes a reality. AT&T's merger with McCaw will not affect the monopoly nature of the local exchange one bit.

Finally, Mr. Chairman, I want to briefly outline why the Bell Atlantic-TCI merger is substantially different than that between AT&T and McCaw. First, AT&T and McCaw are each participants in a highly competitive business, or businesses, I should say. By contrast, Bell Atlantic and TCI are monopoly service providers today and represent the most likely potential future competitors in each other's businesses. Their merger would be a very positive development if it would spur competition between cable and local telephone companies.

Second, AT&T and McCaw each operate as common carriers. Neither owns or controls the content of the information that they transmit. By contrast, Bell Atlantic-TCI would obviously control both programming and distribution facilities. This is why we believe the merger should be conditioned on Bell Atlantic spinning off the in-region cable properties.

Third, AT&T has committed to provide full choice of long-distance carriers to McCaw's customers, strengthening the procompetitive nature of this merger. By contrast, at least to my knowledge, neither Bell Atlantic nor TCI has indicated that their TCI cable systems will offer equal access to providers of video programming, long-distance services, or customer equipment. We believe this is an important procompetitive requirement.

These differences do not mean that the Bell Atlantic-TCI deal should not go forward. Again, we believe it has positive potential, given the conditions that eliminate substantial anticompetitive concerns. But these differences do mean that regardless of the disposition of the Bell Atlantic-TCI merger, AT&T's proposed merger with McCaw is entirely procompetitive. It raises no substantial competi-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 109 1997

tive concerns and provides absolutely no reasons to modify the MFJ.

Thank you, Mr. Chairman. I will be glad to stand for your questions.

[The prepared statement of Mr. Allen follows:]

PREPARED STATEMENT OF ROBERT E. ALLEN

SUMMARY

The critical question for government in assessing the AT&T-McCaw merger, the Bell Atlantic-TCI merger and similar transactions between Regional Bell Operating Companies (RBOCs) and cable companies should create conditions that will allow competition to develop in the only remaining monopoly segments of telecommunications—local exchange and cable—whenever that competition becomes technologically and economically feasible.

AT&T's proposed merger with McCaw is manifestly pro-competitive. AT&T and McCaw each compete in separate and distinct competitive markets that depend on access to RBOC local telephone monopolies: AT&T in the manufacture of telecommunications and computer equipment and the provision of long-distance services; McCaw in the provision of two-way cellular radio, one-way paging and other "mobile radio" services. AT&T's participation in the mobile services market through McCaw is no more a threat to competition than is its provision of CPE, PBXs, long distance services or other services that also depend on nondiscriminatory access to local telephone facilities.

The merger will promote competition in mobile services markets by ameliorating some of the artificial advantages the RBOCs have enjoyed and by making McCaw a more effective wireless competitor. AT&T has committed that McCaw will offer equal access to long-distance carriers for McCaw customers if the merger is consummated, thereby fostering additional interexchange competition, rather than reducing it.

The attempts of the RBOCs to use the merger to obtain MFJ relief or conditions on competitive businesses are spurious. An analysis of the facts shows that these claims are false and misleading. The MFJ already provides in Section VIII(C) for the removal or modification of the restrictions when the RBOCs can no longer exercise monopoly power.

Although the proposed TCI-Bell Atlantic merger has positive aspects to it, these transactions present very different competitive issues than does the AT&T-McCaw merger. It is critical that telephone/cable transactions be structured so that they foster potential future competition between today's cable and exchange monopolies, rather than inhibit it. And, more importantly, that the issues surrounding the Bell Atlantic-TCI deal and others like it, not be allowed to cloud discussion about the AT&T-McCaw deal.

Mr. Chairman and members of the Subcommittee. My name is Robert E. Allen. I am Chairman of the Board and Chief Executive Officer of AT&T. I appreciate the invitation to appear today to discuss the questions that have been raised by AT&T's proposed merger with McCaw and the quite different issues raised by the proposed TCI-Bell Atlantic merger, and the similar transactions between other Regional Bell Operating Companies ("RBOCs") and cable systems.

My testimony makes three principal points. First, in assessing all these transactions, the critical question for the government should be whether they will foster or retard competition. The provisions of the Modification of Final Judgment ("MFJ") and other such fundamental changes in the structure of the telecom industry measures have created extraordinary benefits for consumers and entrepreneurs in long distance, equipment manufacturing and customer premises equipment ("CPE"). Government's principal objective should be to create conditions that could allow comparable competition to develop in the only remaining monopoly segments of telecommunications—local exchange and cable—if and when that competition becomes technologically and economically feasible. In this regard, the Bell Atlantic-TCI merger would be a positive development to the extent it fostered this competition.

Second, AT&T's proposed merger with McCaw is manifestly pro-competitive. Its primary effect would be to offset some of the artificial advantages that the RBOCs have had in providing paging, cellular radio, and other mobile radio services and to make McCaw a more effective competitor in these markets. Conversely, the merger could not lessen competition in any market, and it patently could afford no basis

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 110 1997

for modification of the MFJ unless and until local exchange competition develops. Nor should the merger be an occasion for imposing conditions on AT&T's competitive long distance and manufacturing businesses.

Third, although the proposed TCI-Bell Atlantic merger has positive aspects to it, these transactions present very different competitive issues than does the AT&T-McCaw merger. It is critical that these transactions be structured so that they foster potential future competition between today's cable and telephone monopolies, rather than inhibit it.

BEST COPY AVAILABLE

I.

Telecommunications is an area in which national policy should be very clear: to foster the structural and other conditions that allow competition to develop in each potentially competitive segment of the nation's and the world's telecommunications markets. Competition will spur the delivery of the most advanced, and most cost-effective, voice, data, video, and multi-media services to America's citizens in the shortest time—without burdening citizens and taxpayers with unnecessary costs. Competitively structured markets will attract private investment and entrepreneurial activity at the pace and degree that the marketplace sets and demands.

The nation's experience in long distance, telecommunications equipment, and other competitive telecommunications markets is vivid testimony to these facts. Long distance and telecommunications equipment manufacturing markets were potentially competitive in the decades that preceded the entry of the 1982 Modification of Final Judgment ("MFJ"). But competition did not fully develop. However, competition flourished once the MFJ established that the divested RBOCs would be barred from providing long distance service or manufacturing equipment for as long as they had the ability to use bottleneck local monopolies to impede competition in these markets. By assuring participants that all would have non-discriminatory access to RBOC monopolies and to information about them—and that none would be victimized by access discrimination or cross-subsidization—the Decree created the structural conditions that allowed competition to develop.

One result has been extraordinary growth and consumer benefits in the long distance market. Hundreds of new carriers have begun providing competing long distance services at lower prices. Whereas there were no national alternatives to AT&T's long distance network in 1982, today there are four national long distance networks, dozens of regional networks, and several hundred resellers. Indeed, whereas AT&T's 1982 network was analog, thousands of miles of fiber optic cable have been strung across and up and down the country by numerous different carriers. Long distance service is now all digital. Other new, advanced technologies have been deployed in the long distance networks with greater speed and urgency. The net effect is that consumers have benefited from dizzying arrays of new services and features and that prices have dropped dramatically. As the attached paper by Michael Porter demonstrates, any contention that the long distance market is not competitive is erroneous.

The telecommunications equipment manufacturing business has also become fully competitive. Before divestiture, the RBOCs had potent incentives to discriminate in favor of an affiliate and to use monopoly revenues to cross-subsidize its affiliate's operations, and the RBOCs purchased virtually all their network equipment from their captive Bell System manufacturing affiliate (Western Electric). But once the Decree severed that captive relationship and barred the RBOCs from otherwise affiliating with manufacturers, the RBOCs' sole incentive has been to buy from whichever supplier offered the equipment with the best combination of features and price. The RBOCs thus structured their engineering and procurement operations to assure that interested manufacturers would have access to information required to design equipment and could compete on the basis of the price and quality of their products. New suppliers with fresh ideas have entered the marketplace; innovation has accelerated; and prices have dropped for both the customers premises equipment and network equipment.

AT&T believes competition would produce these same benefits in the one area of telecommunications that has remained a bottleneck: basic local exchange, exchange access and switching facilities that connect customers' premises to local networks and to long distance networks. Although these facilities have historically been found to be natural monopolies, technological developments that are now underway hold out the promise that cable television systems, or other systems, could soon [illegible] of [illegible] alternatives to these monopoly services. For this reason, AT&T has urged state and federal regulatory authorities and the Congress to adopt regulations that terminate all government-imposed barriers to entry in these markets and otherwise allow

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 111 1997

competition to develop in local exchange telecommunications if, when, and to whatever extent it is economically and technologically feasible.

As explained below, the proposed TCI-Bell Atlantic merger (and other telephone company investments in cable television systems such as US West's investment in Time Warner) represent positive developments to the extent they would accelerate the development of competing cable television systems that would provide two-way, interactive broadband services and test whether the systems can provide cost-effective basic (narrowband voice) telephone service as well. That is why it is critically important that these transactions be structured in ways that promote the potential future competition between cable and local exchange, rather than retard it.

II.

By contrast, AT&T's proposed merger with McCaw does not raise any such concerns. Once the relevant markets are understood, it is very clear that the merger could have a major positive competitive consequence: to promote competition in separate mobile services markets by ameliorating some of the artificial advantages created for the RBOCs by the FCC and by making McCaw a more effective competitor. Conversely, there is no possibility that a merger of AT&T and McCaw would lessen actual or potential future competition in any market, and there is no basis for the attempts to condition approval of the merger on MFJ relief for the RBOCs or on anticompetitive conditions on AT&T's long distance or manufacturing businesses.

AT&T and McCaw are not competitors in any market. All businesses in which AT&T participates which are fully competitive. Most depend on access to RBOCs' local bottleneck monopolies: the manufacture of telecommunications equipment; the provision of long distance service; and the provision of customer premises equipment, office telephone systems (PBXs), and related local installation and maintenance services. McCaw, by contrast, participates in a separate competitive market which equally depends on interconnections with the local exchange monopolies: the provision of two-way cellular radio, one-way paging, and other "mobile radio" services.

As the RBOCs themselves have elsewhere demonstrated in detail,[1] these mobile radio services are provided in a separate market from local telephone services and are in no way substitutes for local telephone services. Rather, mobile radio services *complement* local telephone service by allowing mobile customers to *access* the local monopolies of the RBOCs without being physically connected to a telephone line.

A cellular system provides this capability through a separate network of low-powered radio transmitters (called cell sites) and of mobile switching offices (called MTSOs). As the attached chart shows, these separate cellular systems are interconnected to the local telephone monopoly in much the way a business telephone system (PBX) is, and are equally dependent on local exchange bottlenecks. For example, a call from a cellular phone in Washington, D.C. to the Senate Office Building will begin over a cellular system, but will be handed off to C&P's local monopoly network and delivered by C&P to the Senate Office Building. Similarly, in the case of the small fraction (3 to 5 percent) of cellular calls that are long distance calls, C&P delivers the calls from the cellular network to the interexchange carriers' networks over C&P's bottleneck facilities.

The nearly complete dependence of all cellular carriers (including McCaw) on the RBOCs and other local exchange carriers is illustrated by the fact that some 99 percent of calls made by cellular customers are placed to "landline" telephones and require use of local exchange facilities to terminate the call (or to provide connections to a long distance carrier like AT&T or MCI).

THE MERGER WILL MANIFESTLY PROMOTE COMPETITION BETWEEN MCCAW AND RBOC'S

McCaw today provides cellular service to about 17 percent of the nation's cellular subscribers, but McCaw has been seriously handicapped in doing so. These handicaps derive from the fact that McCaw has had to compete with affiliates of the RBOC (or other local monopolies). The RBOC affiliates are well-known and well-fi-

[1] The RBOCs themselves have advised the Justice Department, that competition between cellular and local exchange service is "nowhere near imminent:"

> It has been suggested, however, that mobile services are converging with landline services. * * * Given the vast discrepancy in both price and present levels of penetrations, direct competition [with landline services] is nowhere near imminent.

Report of the Bell Companies on Competition in Wireless Telecommunications (p. 185), dated October 31, 1991, and filed with the Department of Justice December 13, 1991, in support of the RBOCs' wireless waiver request.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 112 1997

nanced. They have substantial technological and other resources. As the FCC has further found, they have the ability and the incentive to use their bottleneck monopolies to impede competition by McCaw and others. Finally, the FCC gave the RBOCs additional artificial advantages in providing these services.

For example, whereas McCaw had to make substantial investments, and incur huge amounts of debt, to acquire its cellular licenses, the RBOCs were automatically allocated most of their licenses by the FCC at no cost. The FCC procedure further allowed the RBOCs to receive substantial "headstarts" in commencing cellular service. The net effect of these artificial preferences is that while each RBOC is financially strong, McCaw had to take on large debt burdens in order to acquire licenses. Today McCaw is a highly leveraged firm with a net book debt ratio of over 70 percent and correspondingly constrained financing capabilities.

The effect of the merger is that it would enable McCaw to offset some of these disadvantages and be a more effective competitor to the RBOCs. The merger would give McCaw access to a strong brand name (AT&T) so as to better compete with the well-known RBOCs. The merger would give McCaw access to more advantageous financing, which would be more comparable to what RBOCs enjoy. The merger would give McCaw access to AT&T's marketing and technological capabilities and its traditions of customer service. Finally, because AT&T believes that all wireless customers should have a choice of long distance carriers (as cellular customers now do only on RBOC systems), AT&T has committed that McCaw, too, will offer equal access after the merger is consummated. All these features of the merger are pro-competitive.

A MERGER OF AT&T AND MCCAW WILL NOT LESSEN COMPETITION IN ANY MARKET

A merger of AT&T and McCaw could not substantially lessen competition in any relevant market. There is no substantial competition between AT&T and McCaw today and a merger could not substantially lessen future competition in any market.

First, AT&T's participation in McCaw would not adversely effect competition in mobile radio services. These are wireless telecommunications markets in which two cellular licensees, SMR licensees, and others compete today, and in which Congress and the FCC have provided for the future entry of numerous PCS and other wireless carriers. Indeed, four times more spectrum has been allocated to these new wireless carriers (200 MHz) than to cellular carriers (50 MHz) (*see* Pub. L. No. 103–66, 107 Stat. 312, sec. 6001), and the FCC has announced it will issue seven new wireless service licenses in each geographic area of the country beginning next Spring.

The only entities that could conceivably exercise market power in mobile radio service markets are the RBOCs and other LECs. For it is the LECs that control the local monopoly facilities that cellular and mobile systems must use to provide local calling and that provide access to interexchange carriers. Indeed, AT&T's participation in the mobile services markets through McCaw is no more a threat to competition than is its provision of CPE, PBXs, long distance services or other services that also depend on non-discriminatory access to local bottleneck facilities.

Second, AT&T's participation in McCaw would not adversely affect competition in the provision of interexchange services. Today, domestic service is a highly competitive $50–55 billion market in which comparable interexchange services are provided to mobile and landline customers alike by dozens of facilities-based carriers and hundreds of resale carriers. The long distance usage of McCaw's cellular subscribers today represents a minute fraction of that market (less than two one hundredths of one percent). Further, McCaw and AT&T generally do not compete for any of this business today, for McCaw customers can now receive only a McCaw long distance service (which McCaw provides by buying services of facilities-based carriers and reselling it). By contrast, because AT&T has committed to provide equal access, the merger will not reduce but will foster *additional* long distance competition by providing more choice for customers.

Finally, the transaction would have no adverse impact on competition in the manufacture of telecommunications equipment. This is a highly competitive worldwide market in which AT&T competes with Motorola, Ericsson, Northern Telecom, Siemens, NEC, and others for the business of LECs, wireline and nonwireline cellular carries, and others. Because McCaw's cellular competitors have a choice of numerous vendors, AT&T's incentive would continue to be to assure non-discriminatory treatment of all its cellular equipment customers. Similarly, because McCaw is not rate regulated, because it faces competition from cellular carriers today, and because it will face enhanced competition from SMR licensees shortly and PCN licensees in the future, McCaw's sole incentive would continue to be to purchase the equipment in order to provide the most cost effective and rapid access to services and features.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 113 1997

THE ATTEMPTS TO USE THE MERGER TO OBTAIN MFJ RELIEF OR CONDITIONS ON COMPETITIVE BUSINESSES ARE SPURIOUS

The Regional Bell Operating Companies have nonetheless argued that this merger, if consummated, would require removal or modification of the MFJ's long distance and manufacturing line of business restriction on the RBOCs. Further, the RBOCs (and MCI) have sought to use the merger to impose various conditions on AT&T's competitive long distance or manufacturing businesses. These arguments are spurious.

First, the RBOCs claim that they are entitled to MFJ relief because they allege that AT&T is entering the local telephone business, and that AT&T can, or will hereafter, "bypass" the RBOCs' local telephone access services by building AT&T facilities to connect McCaw's cellular systems to AT&T's long distance network. The RBOCs are confused on several scores.

Cellular radio simply is not basic local telephone business. As I explained above, it is offered over separate systems of radio transmitters and switches which (like "PBXs") depend on interconnections with the local telephone networks of the RBOCs. More to the point, AT&T does not "bypass" these local networks. Today, it is the case 99 percent of the time that the access facilities that connect cellular systems to AT&T's long distance network are provided by an RBOC or some other franchised local exchange company. Moreover, under today's economics, bypass is not cost-effective. AT&T's studies show that the economies of scale mean that these access facilities remain natural monopolies today.

That is, of course, not to say that things could not change in the future. There is much speculation that radio or other technologies could someday create alternatives to today's local exchange monopolies. Such competition would be beneficial. We hope alternatives will develop. Although we do not believe that this could happen in the near or foreseeable future, it is important to understand that the MFJ *already* provides a remedy for this contingency. If future technological changes end the monopoly character of the exchange, then Section VIII(C) of the MFJ will require removal or modification of the restrictions. *See United States* v. *AT&T*, 552 F. Supp. 131, 184–85 (D.D.C. 1982), *aff'd*, 460 U.S. 1001 (1983).

Second, the RBOCs also have sought removal of the MFJ's long distance and manufacturing restrictions on the ground that that would allegedly allow them to compete on "equal terms" with AT&T-McCaw. What this ignores is that AT&T-McCaw and the RBOCs aren't equal. The RBOCs control the local bottleneck monopolies on which all long distance carriers depend to reach all their customers (cellular and otherwise) and on which all cellular carriers depend to provide their service—and which have led to numerous other advantages for RBOCs. Because the control of this bottleneck would allow the RBOCs to stifle interexchange and manufacturing competition, the MFJ requires that the RBOCs be excluded from long distance and manufacturing markets so long as they have this substantial ability to use local monopolies to impede competition.

Indeed, if the RBOCs were interested in true "equality," each would do what one RBOC (Pacific Telesis) is doing: divesting its cellular businesses from its bottleneck monopolies. That will free Pacific's cellular operation from the MFJ and it will compete with McCaw "equally".

Beyond that, the MFJ would not give AT&T any substantial advantages over the RBOCs in providing cellular service. The MFJ and the orders that have been entered under it *allow* the RBOCs to offer "seamless" service in which their cellular customers can place, and receive, calls wherever they are located, in which RBOCs may "cluster" "local" calling areas that conform to natural mobile markets, and in which RBOCs may hand off long distance calls to the carriers of the customer's choice. AT&T has committed to operate McCaw in the same way, with local calling areas of comparable size and "equal access" to each customer's chosen interexchange carrier. Further, as AT&T and MCI have argued to the FCC, the same equal access requirements should be imposed on all wireless carriers now.

Third, there is not the slightest substance to the RBOCs' claims that AT&T could use its long distance or manufacturing businesses to harm the RBOCs' cellular businesses—or to the RBOCs' attempts to impose "conditions" on these AT&T businesses. What the RBOCs ignore is that AT&T's long distance and manufacturing businesses are *competitive*. If AT&T were to attempt to discriminate against RBOC cellular systems (or their customers), the sole consequence would be that AT&T would lose the RBOCs' cellular customers' long distance business to MCI, Sprint, or others and lose the RBOCs' cellular equipment business to Motorola, Ericsson, Northern Telecom, or others. AT&T's long distance and manufacturing businesses have overwhelming incentives to treat the RBOC's cellular system and their customers no differently than McCaw and its customers.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 114 1997

Finally, these same facts dispose of the objections that MCI and a second long distance carrier (Allnet) have made in the pending FCC proceedings. Because AT&T will offer "equal access", MCI and Allnet have no basis for complaining that customers will be unable to select MCI, Allnet, or any other long distance carriers. MCI also objects to the fact that AT&T will be able to "bundle" cellular service with long distance service or with cellular CPE. This is not only unobjectionable; it is pro-competitive. The simple reality is that cellular service, cellular CPE, and long distance are each competitive, and the FCC has found that bundling of cellular CPE and cellular service is in the public interest and "may be benefiting" consumers so long as there is no mandatory tie-in and so long as customers have the option of taking one without the other[2]—as AT&T's customers will be able to do. Indeed, because MCI can resell cellular service, it already has the ability to offer "bundles" of long distance service, cellular service, and/or cellular CPE to AT&T customers. It is difficult to understand MCI's complaint.

III.

Finally, the TCI/Bell Atlantic merger (and the other RBOCs' investments in other cable television such as the Time Warner/US West venture) present very different competitive issues and considerations than does the AT&T-McCaw merger. In particular, although the RBOC transactions could have positive aspects to them, they are different from the AT&T-McCaw merger in three fundamental respects.

First, AT&T and McCaw are each participants in competitive businesses in which there are numerous other participants today and numerous potential future entrants. AT&T competes in the long distance market where there are several national facilities-based carriers, numerous regional facilities-based carriers, and literally hundreds of resellers. McCaw competes in mobile radio service markets in which these are two facilities-based cellular carriers, SMR licensees, and resellers that provide service today—and scores of firms poised to bid for seven PCS licenses when licensing commences next Spring.

By contrast, cable system operators (like TCI) and RBOCs (like Bell Atlantic) not only are each monopoly service providers today, but also represent the most likely potential future competitors in each other's businesses. Local exchange monopolies (like Bell Atlantic's) today represent the most likely future alternatives to the cable television system's broadband local distribution monopolies. Conversely, cable television systems today represent the most likely future alternatives to the RBOCs' exchanges in residential and other lower density areas. Indeed, as reflected in TCI's investment in Teleport, cable systems further are likely partners in the now-fledgling efforts to compete with local exchange carriers in serving large business customers in downtown areas of major cities.

In this regard, the TCI-Bell Atlantic merger and the other transactions are assuredly positive developments to the extent that they would result in acceleration of the much-discussed efforts to create competing local networks by upgrading cable television systems to enable them to provide two-way interactive broadband services and test whether cable systems can be cost-effective alternatives for basic exchange and exchange access telephone service (*i.e.*, narrowband voice). However, it is critical that any such transactions be allowed to go forward only if they will have the effect of enhancing the incentives to make these investments, rather than inhibiting them. At a minimum, this means that, prior to any consummation of the merger, TCI should spin off all of its interests in businesses or systems that could potentially compete with Bell Atlantic's local telephone monopolies.

Second, AT&T and McCaw each operate as common carriers, and neither owns or controls the content of information transmitted over its network. By contrast, Bell Atlantic-TCI would control both programming and distribution facilities, and the programming that they would control would be provided to nonaffiliated Cable MSOs as well as to TCI-Bell Atlantic. These factors not only raise issues of their own, but also complicate predictions about future telephone company-cable system competition.

Third, whereas McCaw had not given its customers a choice of long distance carriers today, AT&T has committed that it will offer McCaw cellular subscribers equal access to other long distance carriers. The AT&T-McCaw merger thus gives customers pro-competitive choices that they do not have today. By contrast, neither TCI nor Bell Atlantic has indicated that their cable systems will offer equal access for multimedia or other broadband services of competing providers of video programming, long distance services, or CPE. TCI and other cable systems should develop

[2] *See* In the Matter of Bundling of Cellular Customer Premises Equipment and Cellular Service (CC Docket No. 91–34), par. 23 (June 10, 1992).

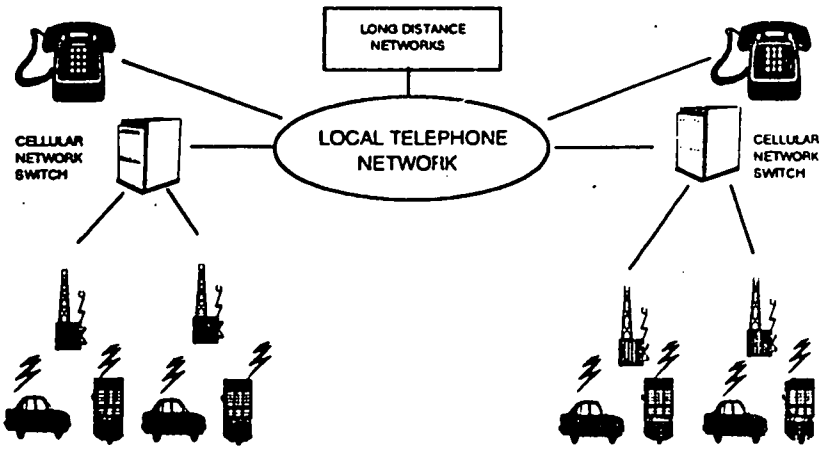
HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 115 1997

a scheme that assures open, non-discriminatory access to their facilities at prices that are generally available and that are imputed to the cable systems operations.

These differences do *not* mean that the Bell Atlantic-TCI merger should be found to be anticompetitive as it has been proposed. Nor does it mean that the merger cannot be conditioned in ways that eliminate any substantial anticompetitive concerns. As I have stated, this merger and the other RBOC-Cable MSO transactions have positive potential. But the differences do mean that, whatever one thinks about the TCI-Bell Atlantic merger, AT&T's proposed merger with McCaw neither raises any substantial competitive concerns nor affords any grounds for modification of the NFJ.

I thank the Committee for inviting me to testify. I would be pleased to answer any questions you may have now or for the record.

99% OF ALL CELLULAR CALLS USE
THE LOCAL TELEPHONE NETWORK



COMPETITION IN THE LONG DISTANCE INDUSTRY

Claims have been made on Capitol Hill and to the media that the long distance industry is not truly competitive. This claim is untrue and distracts from the important goal of opening the local telephone exchanges to effective competition.

Professor Michael Porter of Harvard Business School has just concluded a study on long distance competition. Dr. Porter is the nation's leading expert on what makes an industry and a nation competitive. He has written extensively on competitiveness, including a 1990 book, *The Competitive Advantage of Nations.*

This is Dr. Porter's third study of the long distance industry. All three studies (1987, 1990 and 1993), unequivocally have found that the long distance industry is highly competitive. To quote from the September, 1993, report:

> *[In 1987 and 1990], I found the structure was so tilted toward competition that the intensity of competition was likely to increase. I recently reviewed the record of the intervening years, and events have strongly validated these past conclusions. There are no data to suggest that recent events have undermined the fundamental underpinnings of competition.*

Among the important indicia of competitiveness considered in the attached report are:

- Nine long distance carriers are truly national in scope, offering long distance service in 45 or more states—up from three carriers in 1986.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 116 1997

- Four carriers own fully digital nationwide networks: AT&T, MCI, Sprint and WilTel.
- The basic rate of a 5 minute call (New York to Chicago) is 56 percent lower than in 1984 on an inflation adjusted basis.
- Lower long distance prices are not just attributable to lower access rates. Net of access, AT&T's revenues per minute are down 7.2 percent since 1990.
- Carriers also compete by offering steeply discounted optional calling plans, thus reducing tariffed prices even further.
- Major long distance carriers' employment GREW a *net* 18 percent from 1988–92, even accounting for AT&T's slight job loss and increased industry productivity.

BIOGRAPHY OF PROF. MICHAEL E. PORTER

Michael E. Porter is the C. Roland Christensen Professor of Business Administration at the Harvard Business School, and a leading authority on competitive strategy. He received a B.S.E. with high honors in aerospace and mechanical engineering from Princeton University in 1969, where he was a member of Phi Beta Kappa and Tau Beta Pi. He also received an M.B.A. with high distinction in 1971 from Harvard Business School, where he was a George F. Baker Scholar, and a Ph.D. in Business Economics from Harvard University in 1973.

Professor Porter joined the Harvard Business School faculty in 1973 and become one of the youngest tenured professors in the School's history. His ideas have now become the basis for one of the required courses at the School. One of Harvard Business School's most popular teachers, Professor Porter also lectures in the School's programs for senior executives, and speaks widely on competitive strategy to business and government audiences throughout the world.

Professor Porter is the author of 14 books and over 45 articles. His book, *Competitive Strategy Techniques for Analyzing Industries and Competitors*, published in 1980, is widely recognized as the leading work in its field. In its 45th printing, it has been translated into fifteen languages. A companion book, *Competitive Advantage: Creating and Sustaining Superior Performance*, was published in 1984 and is in its 19th printing. His 1990 book, *The Competitive Advantage of Nations*, develops a theory of how nations compete and their sources of economic prosperity. The book was chosen as one of the top ten business books in 1990 by Business Week magazine and by the Financial Times newspapers in both London and Toronto. Professor Porter's *Capital Choices, Changing the Way America Invests in Industry* (1993) is the result of a two-year research project directed by Professor Porter, which examined how America invests in industry.

Professor Porter has served as a counselor on competitive strategy to many leading U.S. and international companies, among them AT&T, Campbell's Soup, Credit Suisse First Boston, Montedison, Procter and Gamble, and Royal Dutch Shell. He also serves on the boards of directors of Lotus Development Corporation, Alpha-Beta Technologies, and Hyatt Legal Plans. He is active in public service work, having served as a strategy advisor to Brigham & Women's Hospital, the Institute of Contemporary Art, WGBH public television, and other community organizations.

Professor Porter also serves as a counselor to government. He was appointed by President Ronald Reagan in 1983 to the President's Commission on Industrial Competitiveness, which made its report in February, 1984. He was the chairman of the Commission's strategy committee. Professor Porter continues to play an active role in economic policy with Congress, business groups, and as an advisor to foreign governments. He has led major studies of the economy for the governments of such countries as New Zealand, Canada, and Portugal. Professor Porter has also assisted state and local governments both in the United States and abroad in enhancing competitiveness. His *pro bono* work in Massachusetts, beginning with the report *The Competitive Advantage of Massachusetts* (1991) has resulted in new legislation and numerous other state initiatives. His most recent initiative is a study of economic development in America's inner cities.

The awards and honors won by Professor Porter include the David A. Wells Prize in Economics for his research in industrial organization, two McKinsey Awards for the best Harvard Business Review article of the year, and the 1980 Graham and Dodd Award of the Financial Analysis Federation. His book *Competitive Advantage* won the George R. Terry Book Award of the Academy of Management in 1985 as the outstanding contribution to management thought. Professor Porter was honored by the Massachusetts State Legislature for his work on Massachusetts competitive-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 117 1997

ness in 1991. In 1993 Professor Porter was named the "Irwin Outstanding Educator in Business Policy and Strategy" by the Academy of Management.

Professor Porter was named a Fellow of the International Academy of Management in 1984, the Academy of Management in 1988, and the Royal Swedish Academy of Engineering Sciences in 1991. Professor Porter has also been awarded honorary doctorates from the Stockholm School of Economics, the Universidade Tecnica de Lisboa, and Johnson and Wales University.

COMPETITION IN THE LONG DISTANCE TELECOMMUNICATIONS MARKET, BY PROF. MICHAEL E. PORTER

I. INTRODUCTION

This report addresses a set of issues that are important to any discussion of the regulatory structure of the interLATA interexchange industry. In specific, is the industry competitive? Is it growing more competitive, or less so? Is that competitiveness self-sustaining? I have examined these questions twice previously, in 1987 and 1990, and both times I presented analyses showing that the industry was highly competitive and structured so as to make this competitiveness self-sustaining. Indeed, I found the structure was so tilted toward competition that the intensity of competition was likely to increase.

I recently reviewed the record of the intervening years, and events have strongly validated these past conclusions. There are no data to suggest that recent events have undermined the fundamental underpinnings of competition. Quite the contrary. Competition is evident in dramatic price reductions which have continued through the early 1990s; in higher service levels and new features that create higher value for customers; in the steadily growing sophistication of both consumers and business buyers; in major structural changes such as the advent of portable 800 numbers; in the broad expansion of marketing, advertising and promotional programs aimed at customers by numerous competitors; in the ever growing number of financially strong companies that compete using their own facilities; and in cross-border alliances, such as MCI's arrangements with Stentor in Canada and British Telecom in Britain, that create partnerships with scale approaching that of AT&T.

Rather than attempt an entirely new analysis, this report will update my previous efforts by examining the most salient recent developments in the interLATA interexchange (hereafter referred to as IX) industry. It will begin by reviewing outcomes—pricing, service quality and profitability, among others—to assess whether they are consistent with outcomes in competitive industries. It will then examine the actions of competitors and customers to assess what those actions tell us about the current level of competition. Finally, this study will review the industry's competitiveness using the five forces model of industry structure. Taken as a whole, the evidence says clearly that the industry remains competitive, indeed is more competitive than it was three years ago. This competitiveness appears to be securely self-sustaining, and every indication points to the conclusion that competition in the industry will continue to intensify.

II. COMPETITIVE OUTCOMES IN THE INTERLATA INTEREXCHANGE INDUSTRY

Competitive industries are characterized by competitive outcomes. Firms in those industries face incessant pressures to win customers from competitors by cutting prices, providing better service and adding new features. They face equally great pressures to make the investments and cost reductions that make possible these offers to customers. Their profitability, while sufficient to attract capital needed for growth, is restrained at reasonable levels by competitive forces. And their superior performance in lowering cost and improving quality makes them successful in the international economy, allowing them to generate export revenue and forestall inroads by importers.

InterLATA interexchange carriers (or IXCs) show competitive outcomes in all these areas. They have cut prices vigorously, and they continue to adjust pricing frequently to win customers. They have offered consumers significantly higher levels of service, as measured by clarity of transmission, reduced call blockage, innovations in features and services, and even improvements in the accuracy and comprehensibility of bills. They have invested heavily to create the efficiencies and skills underlying these gains. Their profits are no higher than those of firms in many other industries that are generally considered to be competitive. And they have been successful versus foreign competitors.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 118 1997

Pricing and market share

As the first three charts indicate, the IXCs' inflation-adjusted prices have fallen rapidly. Since 1984, the three largest carriers' basic-schedule consumer prices have fallen by 56 percent on average for a five-minute evening call (see Exhibit 1). The price cutting has not abated in recent years. AT&T's average revenue per minute[1] across all services has dropped 11.9 percent since early 1991, as Exhibit 2 shows (figures for AT&T alone are used because similar figures are not available for competitors). Prices have fallen in recent years even after we remove the impact of falling access prices; as Exhibit 2 indicates, AT&T revenue per minute net of access charges has fallen 7.2 percent since 1990. This is not merely a phenomenon of market averages that has left islands of secure customers. Exhibit 3 indicates that AT&T's inflation-adjusted prices to business customers for 800 services have dropped 67.9 percent since 1984 (including access), while AT&T's price for outbound business services has fallen 10.1 percent since 1990. AT&T's pricing for residential services has continued falling in recent years, with a 17.1 percent drop in average revenue per minute (including access) since early 1990.

It is important to realize, however, that competitive industries need not always be characterized by falling prices. Price reductions tend to be associated with changes in not only the level of competition but also technology, costs of inputs and regulation. Competition helps ensure that such changes benefit an industry's customers. But over the short term, or even during longer periods where cost savings are not available, it is entirely possible even in the most competitive industries that prices will go up instead of down. Moreover, it is quite normal—and consistent with a high level of competition—that prices for some services might move up even as prices for others trend down. This outcome can result from an array of factors affecting specific services such as supply/demand imbalances or rapid feature innovation.

Another development in the industry's pricing has been the near elimination of the gap between the basic-schedule prices of AT&T and its principal competitors (see Exhibit 4). This development provides strong evidence of competition rather than the easing of competition that some commentators have suggested. In a highly competitive market, firms that maintain higher prices are penalized by the rapid loss of market share. Indeed, as Exhibit 5 indicates, market share has shifted profoundly toward new competitors, indicating that the dynamic in the IX industry has been fundamentally competitive. Customers have in large numbers exercised their ability to change suppliers to obtain lower prices. AT&T as the higher-priced firm faced the choice of continuing to lose share or lowering its prices to approximate those of competitors. It took the latter course, with results that correspond exactly with those we would expect in a competitive market: Prices came together and share erosion was reduced.

It is worth noting that consumer prices after discounts such as those provided by optional calling plans maintained a larger gap than that between competitors' basic-schedule rates, mainly because MCI and Sprint have had larger discounts which were adopted by more of their customers. AT&T's *i* Plan discounts, introduced earlier this year, represent AT&T's attempt to close the remaining gap.

Like lower pricing, the market share shift is a broad phenomenon that is reflected in virtually all services. Exhibit 5 indicates the scale of the overall change, which has taken nearly 30 share points away from AT&T in less than 10 years. The sheer scale of this shift indicates that competitors have been courting customers very effectively, and that customers are quite willing to change carriers for lower cost or higher value.

Quality and customer satisfaction

Firms in competitive markets do not compete only through price. They also compete by raising the quality, functionality and variety of their products and the attentiveness of their service, thereby increasing customers' welfare.

Again, the outcome in the interexchange industry is what we would expect in a competitive marketplace: Service has been getting better over time. Underlying these improvements have been substantial and continuing investments. IXCs have made broad and basic changes to their networks, replacing copper and microwave facilities with fiber, installing several generations of new switching equipment and reconfiguring their networks' structure and operating software to minimize downtime, as evidenced by AT&T's FASTAR approach.

---

[1] Average revenue per minute is a measure of what customers actually pay after choosing among all the services and pricing plans available. This is different from price indices calculated using a constant market basket (such as the FCC utilizes for price cap regulation), which does not automatically account for changes in the mix of services customers purchase, and may as a result show different changes in average prices.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 119 1997

These performance enhancements have not occurred in a vacuum: Customers have noticed the difference and are more satisfied with IXCs' offerings. An independent survey of business customers' satisfaction with data communications service shows that over the past three years, customers' average level of satisfaction (with each carrier's performance weighted by revenue) has risen from 3.8 on a five-point scale to 3.85 (see Exhibit 6). This performance improvement has been accompanied by an increase in the competitiveness of newer carriers' offerings. AT&T's lead in overall satisfaction, compared with a weighted average of other carriers' ratings, has shrunk from 0.26 on a five-point scale to 0.14.

The IXCs compete not only by cutting price and improving service levels on existing products, but also by rapidly introducing new functionality and wholly new services (see Exhibit 7). In data communications, IXCs have leapfrogged each other in expanding the type of service offered. Since the mid-1980s, they have moved from analog to digital, to larger capacities, and then to services that provide more flexibility in the increments of capacity purchased and the speed with which they can be made available. The results have been bandwidth on demand and, in 1991, frame relay services that offer variable and almost instantly available capacity.

In 800 services, a range of competitors have steadily introduced new capabilities to transform 800 from a set of relatively costly services requiring their own equipment and lines to flexible services that are a seamless part of even small companies' telecom networks. The process of evolution has been a competitive tit-for-tat. AT&T innovated in early 1990, for instance, with a service that terminated interstate, intrastate and Canadian traffic on a single line. Then, later in the year, MCI announced a service to let customers dictate routing of calls. AT&T came back early the next year with enhancements to its Megacom service, and then MCI responded with more network management features.

IXCs have also moved into completely new service areas, such as two types of videoconferencing. And consumers have seen the introduction of new ways to communicate while away from home, including multipurpose credit/calling cards, debit cards, personal 800 services and low-cost ways to call home from abroad such as AT&T's USADirect and MCI's Call USA service. Overall, the pattern of feature and product introductions shows that IXCs respond to each other's innovations in a competitive fashion, and they are doing so more and more quickly across a broader range of services.

Investment and jobs

Industries without competition tend to see low investment and job growth; without the incentive to compete on cost, service quality and new features, firms avoid the expense of creating new capabilities and harvest their existing business. Competitive industries are often characterized by the reverse, with significant investment and job growth, as they create new and better products that serve a broadening range of customer needs.

The record of the past six years shows that IXCs have been major investors in new facilities, services and R&D. Moreover, their intense rivalry has led to such substantial investments that they have been net creators of jobs despite their significant productivity improvements. Exhibit 8 tracks both measures. Despite the winding down of the massive expenditures needed to create nationwide fiber networks, investment remains at very high levels to fund improvements in efficiency, new services and still more capacity expansion. As for jobs, AT&T's slight job loss over the past five years was more than made up by employment gains at other carriers, with the major carriers as a group showing 18 percent higher employment in 1992 than in 1988. These numbers understate the employment impact of the industry's investment activities, since they do not include jobs created at supplier industries, such as makers of fiber optic cable and network equipment, or at smaller IXCs and resellers.

Profitability

IXCs are profitable, but no more so on average than firms in other competitive industries. Exhibit 9 shows the after-tax return on assets for IXCs, which averaged 6.5 percent over the past five years. This level of return has been adequate to attract the capital the firms have needed to fund service improvements, but IXC profitability appears moderate compared to that of a range of other industries shown in Exhibit 9.

Exports

Another measure of an industry's level of competition is its success in the international economy. Less competitive industries tend to be assaulted successfully by their foreign counterparts, who sell imports to the industry's U.S. customers and take away share in export markets. Competitive industries keep imports at bay

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 120 1997

while selling aggressively and successfully in foreign markets. U.S. IXCs clearly have been highly successful relative to their foreign counterparts. The best single measure is the enormous imbalance of international traffic, with minutes outbound from the U.S.—that is, originated by callers in the U.S.—exceeding the number of inbound minutes originated by foreign carriers by 180 percent (see Exhibit 10). The gap has grown steadily since 1984, when outbound minutes exceeded inbound by only 60 percent. U.S. carriers have fought fiercely for outbound minutes by aggressively cutting prices, which has spurred demand. Meanwhile the foreign PTTs, who originate and price inbound minutes and who generally lack domestic competition, have reduced prices far less aggressively in most cases and now generally have significantly higher rates than U.S. carriers on equivalent routes.

Summary

Judged by the results, the interLATA IX industry is keenly competitive. Prices have fallen substantially, and attempts to charge higher prices than competitors are met with pronounced customer defections. Service levels are higher, features are more varied and useful and customers have grown progressively more pleased. Rather than harvest their businesses, firms throughout the industry have invested heavily and created jobs. Profitability has been moderate, and U.S. carriers have been successful in the international economy. It is difficult to find examples of even one of these outcomes occurring over a sustained period in an industry where competition is impaired. The presence of so many competitive outcomes is powerful evidence that the IXCs are competing fiercely.

III. COMPETITIVE BEHAVIOR IN THE INTERLATA INTEREXCHANGE INDUSTRY

The intensity of competition in the interLATA IX industry is visible through more than outcomes. It can be seen through the actions of the competitors and their customers. Firms in competitive industries make visibly competitive moves: They cut prices to steal the march on competitors; they advertise ever more heavily; they expand their sales forces and/or reach out to place their services before the customers through new distribution channels and marketing partners; they launch aggressive promotions to win share; and they introduce new services and features. For their part, customers in a competitive market regularly re-evaluate their decisions to buy from a particular vendor and act by shifting their purchases.

Examination of the actions of IXCs and their customers shows the interexchange industry to be vigorously competitive. Moreover, a look at another visible element of industry structure—the growing number and financial strength of competitor firms—illustrates that competition among IXCs is not a precarious or transient phenomenon. Established competitors have staying power, and newer competitors arrive regularly to bid for their customers.

Competitors' behavior

Four developments powerfully illustrate the intense rivalry among IXCs in recent years:

1) The proliferation of features and services;

2) a sharp increase in promotions;

3) heavy advertising and marketing competition; and

4) the expansion of selling capacity.

Service and feature proliferation

IXCs have competed vigorously by developing and pushing new services and functions. Examples can be found in virtually any interexchange service. In data communications, for example, innovations have come rapidly since the mid-1980s (see Exhibit 11). In the mid-1980s, competitors worked simply to match AT&T's offerings. By the late 1980s, however, major new product introductions began coming at a one-a-year clip, including fractional T1, bandwidth on demand products and high-speed packet services such as frame relay.

Not only did the pace of innovation increase, but the identity of the innovators changed. Where AT&T once led with new services, competitors—often relatively small ones such as WilTel and Cable & Wireless—began in the late 1980s to lead the market with new products such as fractional T1 and frame relay and have been rewarded with high market shares in those areas.

As described earlier, IXCs dramatically raised the rate of new feature introduction in 800 services during the late 1980s (Exhibit 12). The marketing battle sparked by 800 portability has intensified this phenomenon; all major carriers have added features to enhance network management and reliability, along with service-ori-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 121 1997

ented changes such as technical representatives to ensure quick responses to network problems.

The development of videoconferencing provides a third example of the rapid "leapfrogging" that has come to characterize innovation among IXCs. Sprint had the first commercial success with a reserved public room offer. As shown in Exhibit 13, AT&T responded with a switched service with new features, but Sprint parried by adding features and lowering price on its public room offer and introducing its own switched service. MCI is now entering with a switched service.

Nor have consumer services been left out of the features race. Sprint has attempted to differentiate with billing options such as account code billing; MCI and AT&T have rolled out speed-dial features and conference services for calling card users (see Exhibit 14). Voice messaging and voice mail are some of the other features recently introduced.

Promotions

IXCs have dramatically increased their promotional activity across most services over the past three years. Consumer and 800 services provide cogent illustrations. In the late 1980s, Sprint and MCI played follow-the-leader in consumer services, generally matching the structure of AT&T's promotions while cutting price under AT&T's price "umbrella" (see Exhibit 15). As AT&T's own pricing has become more competitive, however, Sprint and MCI have aggressively launched their own optional calling plans, including MCI's Friends & Family, with steep discounts off calls within a calling circle, and Sprint's The Most. Each was launched with a special offer, generally aimed at groups with specific calling patterns, and each has been refreshed and enhanced with new pricing and loyalty programs. They have also been extended to include more customer groups, such as Sprint's The Most for international calling and versions of MCI's Friends & Family for small business customers and 800 customers.

In 800 services, the advent of telephone number portability has brought an unprecedented level of marketing and promotional activity (see Exhibit 16). Even before the "fresh look" period allowing mid-term revisions to 800 contracts, MCI began offering customers who switched to its service 100 days free. IXC competitors matched those terms, and some customers have reportedly received steep negotiated price cuts of 10 percent to 25 percent. The major carriers have beefed up service guarantees, often offering partial refunds if performance targets are not met.

Advertising and marketing effort

IXCs have increased their advertising sharply since the late 1980s. In 1989, U.S. advertising by all carriers totaled $848 million, according to estimates by outside research firms. Only three years later, it had risen 85 percent to $1.6 billion. This has taken the industry's advertising intensity, as measured by the ratio of advertising expenses to sales, from 1.7 percent to 2.7 percent, a level seen in highly competitive retailing industries but not equaled by many providers of business or consumer products (see Exhibit 17). Most of this advertising effort, it appears, is aimed at increasing the information available to customers, which clearly increases the level of competition by lowering customers' costs of evaluating alternatives. As for other marketing methods, it is clear even to casual observers that the major carriers also spend huge amounts on telemarketing and direct mail.

Investment in selling channels

IXCs have invested heavily in expanding the scope and intensity of their selling efforts. Just as excess carrying capacity gives competitors incentives to compete for share to raise utilization levels, adding distribution capacity helps ignite and sustain the competitiveness inherent in production overcapacity. All carriers have added to their sales forces, with AT&T, for instance, nearly doubling the size of its sales force for small business customers in 1991. The industry's distribution is being revolutionized by the explosion in the use of outside distribution partners, especially by MCI and Sprint in consumer services. MCI, for instance, has arranged partnerships with American Express as well as GM and several airlines, among others (see Exhibit 18). These new channels are adding tremendously to the competitiveness of the industry by increasing the ease of customer contact with carriers (thereby lowering the cost of switching) and raising the number of potential selling opportunities.

Customer behavior: churn and market share

Advertising gives customers information and encourages them to use it to switch carriers. Promotions make the economics of switching more attractive to customers, and broader selling channels make the switch easier to execute. Yet one must examine the daily tug-of-war for market share to determine the degree to which cus-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 122 1997

tomers are persuaded by these efforts, and indeed a look at the data confirms that customers are switching among carriers at a very high rate.

Overall, customer churn and market share fluctuation illustrate three aspects of a competitive market: First, that customers feel free to change and are not impeded either by ignorance or switching costs; second, that changing improves customers' welfare, meaning that a competitor has made them an offer that is superior in price or value; and third, that firms are indeed competing for customers' dollars rather than resting contentedly with their lot. As Exhibit 19 shows, market share actually fluctuates substantially on a quarter-by-quarter basis, indicating that the marginal customer is hotly contested. Between the third quarter of 1992 and the first quarter of 1993, for instance, nearly two percentage points of share moved into AT&T's competitors and then back out again, the summed effect of millions of individual customer decisions. Residential consumers can be particularly fickle, especially the higher-spending consumers that account for a disproportionate part of the IXCs' residential revenue. During 1992, AT&T's churn in consumer services—measured as the percentage of revenue that changed from another carrier to AT&T or vice versa—was 19 percent, high by the standards of any industry and indicating that consumers have the information and disposition to shop aggressively for the best offers. Nor has the churn been limited to consumer services. Each year a significant number of large business customers shifts the bulk of their long distance purchases from one carrier to another. Exhibit 20 shows a sampling of those who have left AT&T in recent years; the number of changes is still higher if we include the significant number who left competitors for AT&T.

The partial information available to date on 800 portability indicates that it has enormously increased customer mobility. AT&T has won 10,000 new accounts to date, but those gains must be weighed against losses to MCI, which says it has won $170 million in additional annual revenue;[2] and Sprint, which had won 15,000 new accounts at most recent count.

Finally, complicating the picture and raising the level of competition across all services is the entry of new players, who ensure that share is not simply traded by incumbents but is taken by new entrants who need it to grow. WilTel, for example, has built an estimated 6 percent share in private line services since its entry in 1985.[3]

Number and strength of competitors

A third and related symptom of competitiveness is a large and increasing number of financially strong competitors. In 1987 and again in 1990, I concluded that the economics of the industry will continue to attract potential entrants, that these entrants will be able to fund and execute network construction and that, once having entered the market with particular services, they will seek to use their spare capacity by expanding into other services. Events have continued to show the validity of these predictions. Competitors are stronger and more numerous than ever, and they are likely to become even more so.

When I examined this issue in 1987, many observers viewed the financial health of Sprint and MCI as questionable and their futures as precarious. I argued that both were in fundamentally sound financial health. At the time, both companies were in the midst of major, one-time cash outlays for network construction, but I argued that once these projects were complete, their networks would be able to generate ample cash flow to pay back the investment and fund future growth. This has proven to be the case. Both MCI and Sprint have strong profit and cash flow, as shown in Exhibit 21. The range of financial measures included in Exhibits 21 and 22 indicate that newer entrants' sales, profits and, most notably, cash flow have grown at a faster rate than AT&T's. Their long-term bonds are rated as investment grade, giving them wide access to debt financing, and the stock markets have shown faith in their future by rewarding them with higher stock price appreciation than AT&T (Exhibit 23).

MCI, moreover, has access to resources on a global scale through alliances with foreign carriers, especially the dominant British carrier, British Telecom. The BT arrangement, announced in June, dearly enhances MCI's strategic flexibility in the U.S. as well as abroad. Among other provisions, it includes a $4.3 billion investment by BT for 20 percent of MCI equity; a joint venture capitalized at $1 billion to provide enhanced services to international companies; and possible collaboration in

[2] Shearson Lehman Brothers Inc., "U.S. Telecommunication Services—Industry Report," June 17, 1993, p. 8.

[3] Northern Business Information, *Dossier, U.S. Telecommunications Service Markets/Long Distance Markets*, June 1993.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 123 1997

international calling cards and multimedia services. The BT agreement alone should erase any doubts about MCI's seriousness as a competitive force.

In my earlier reports I also challenged the notion, then given wide currency, that the high capital cost of new networks would prohibit the entry and growth of additional competitors. I argued that new competitors could enter as resellers, construct regional facilities and then either build or merge them into national players. Again, events have shown that entry barriers were not insurmountable. Exhibit 24 shows the growth in the number of firms with truly national scope, measured by their purchase of equal access in 45 or more states. In 1992 alone, the number of such firms rose by 50 percent, to nine. ALC/Allnet, to cite one example, followed the reseller to regional to national approach by merging with other regional operators. At the international level, Sprint and MCI have attained parity with AT&T in the scope of their international presence, as Exhibit 25 shows.

Moreover, no evidence proposes that these entry paths have closed in the intervening years and abundant evidence suggests they have not. LDDS Communications—which had only $110 million in revenues in 1989—obtained capacity and scale by merging with smaller regional resellers and facilities-based carriers. Last year its revenues exceeded $800 million, and this year, with the proposed merger with Metromedia and Resurgens, it is poised to create another national carrier (see Exhibit 26).

WilTel showed there is another approach to surmounting entry barriers, combining a reseller strategy with construction of fiber links along right-of-way already owned by its pipeline affiliate (see Exhibit 27). Despite its initially small scale, it quickly established itself as the low-cost competitor in its initial product area, private line. WilTel also demonstrates the power of another dynamic: While firms may enter the industry with a narrow product focus—like WilTel in private line—they show strong tendencies to broaden their scope of products, thereby increasing competition throughout the industry. WilTel added switched services and frame relay. Sprint and MCI started as voice providers but rapidly moved into data.

IV. INDUSTRY STRUCTURE

The intense competitiveness of the interLATA interexchange industry over most of the past decade is the direct result of an underlying structure. This structure not only makes its competitiveness self-sustaining but suggests that it is likely to continue to increase over time. An industry's competitiveness is determined by the intensity and interaction of five forces. Direct rivalry among competitors is only one of those sources. Low *barriers to entry* allow new firms to enter an industry and stimulate incumbents to respond vigorously to avoid loss of share. The development of *substitute products* encourages firms to lower prices and/or improve product offerings. Powerful *buyers* create the same effect by playing competitors off of each other. And powerful *suppliers* force firms to bid vigorously for inputs they control.

As I described and documented in detail in my first study, and reconfirmed in 1990, the most important factors determining the interexchange industry's self-sustaining competition are the factors accounting for high degrees of rivalry and buyer power, along with serious threats of new entry and, in some portions of the market, a significant threat of substitutes. The data outlined above clearly show that these same forces are even more actively at work in 1993 than in 1990.

The FCC's reviews of the industry's competitiveness have focused on a somewhat narrower subset of these factors: the supply capabilities of participants, demand elasticity, buyers' negotiating power and barriers to entry. Even judged against this narrower set of factors, the industry remains and will continue to be highly competitive.

Supply capabilities

The industry is characterized by even more capacity and lower utilization than in 1987 or 1990. This would be true even without any new entrants, since the major firms have continued to invest (see Exhibit 8). Yet new players have continued to enter and to build new facilities to reduce their dependence on capacity purchased from their larger competitors. WilTel, for instance, has kept its capital spending at high levels; LDDS, in addition to buying existing capacity through its mergers, is investing at its highest rate ever.

Nor is the capacity overhang likely to recede in the foreseeable future. Advances in the electronic equipment that generates the light signals carried by fiber are expected to double signal capacity at yearly intervals without new cable. Moreover, as explained earlier, there is no evidence that the entry of new firms—and their capacity—will slacken in the future.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 124 1997

Demand elasticity

Anecdotal evidence as well as econometric studies suggest that the industry's demand remains highly elastic. Unit growth has continued at high levels as prices have fallen over the past few years. A broad crossection of analysts has attempted to measure the industry's elasticity (see Exhibit 28). Their efforts have produced estimates ranging from —0.72 to —0.35. This indicates that, generally speaking, customers will respond to a 10 percent price reduction by raising their unit demand by 3.5 percent to 7.2 percent. More important, however, is the elasticity of demand faced by each firm in the industry. Given buyers' high levels of information, and their eagerness to evaluate and change carriers, the elasticity facing an individual firm is several times that facing the industry as a whole, giving carriers a powerful incentive to continue to lower prices.

Negotiating power of buyers

Buyers' negotiating power is compellingly confirmed by the high level of customer switching described earlier. Clearly, buyers in 1993 have at least as much negotiating power as they did in 1990, and they are considerably more likely to exercise it. Business buyers grow ever more sophisticated with the appointment of technically proficient, professionally trained telecom managers with a charter to reduce transmission expense. An increasing share of the market is controlled by network outsourcers who resell capacity and network management services, gaining tremendous volume and knowledge and an incentive to use it to bargain down their telecommunications costs. Private construction and operation of networks remains a viable option even for many medium-sized business customers, and portability of 800 numbers have opened a floodgate of carrier changes among business customers. Meanwhile, consumers have become more powerful, too. Carriers have spent billions educating consumers to compare prices and switch carriers to save. Through promotions—payment of switching fees and free credits—the carriers help erase switching costs. Consumers today are more price-sensitive, less brand-loyal and more likely to change carriers than ever before.

Barriers to entry

I noted earlier in this report the continuing ability of firms to enter the interexchange industry and grow into major players within a brief period. The entry barriers to the interexchange business are no higher than they were in 1987 or 1990. It remains possible to enter as a reseller with ease; capital requirements are minimal, access to distribution can be simplified with a tight market focus, technical skills are widespread and technology is available off the shelf. Once inside the market as a reseller, a firm can invest in owned facilities and expand into other areas and services. Sometimes this involves organic growth (as with WilTel through much of its brief history), but it need not; regional carriers can link up with their brethren elsewhere, creating, through mergers, multiregional and national players. Either way, the inflow of new firms suggests that more major players will emerge over time, reinforcing the industry's structural tendency toward high rivalry.

V. CONCLUSION

The interLATA interexchange industry remains highly competitive. This competitiveness is not restricted to certain services, such as outbound calling, or certain customer groups, such as large businesses. It cuts across services and customers, a tendency dictated by the fundamental economics and technology of interexchange telecommunications: Networks can be adapted to multiple uses, so that if one carrier finds it profitable to provide certain customers with certain services, others can and will follow. These network economics would be enough by themselves to create a competitive market, but they are reinforced by the tendency of increasingly educated buyers to shop aggressively and play carriers off against each other. Finally, the continued entry of new firms provides more opportunities for buyers and creates incentives for competitors to vie even more fiercely for share. These characteristics of the market were apparent even six years ago and are even more salient today. Nor does the future promise any slackening of competition. Capacity additions continue despite unparalleled overcapacity. Buyers grow ever more eager and effective in shopping for price and service quality, abetted by carriers' huge expenditures on advertising and promotion. Looking at the record of recent years, I feel confident in concluding that this highly competitive market is structurally inclined to become even more so.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 125 1997

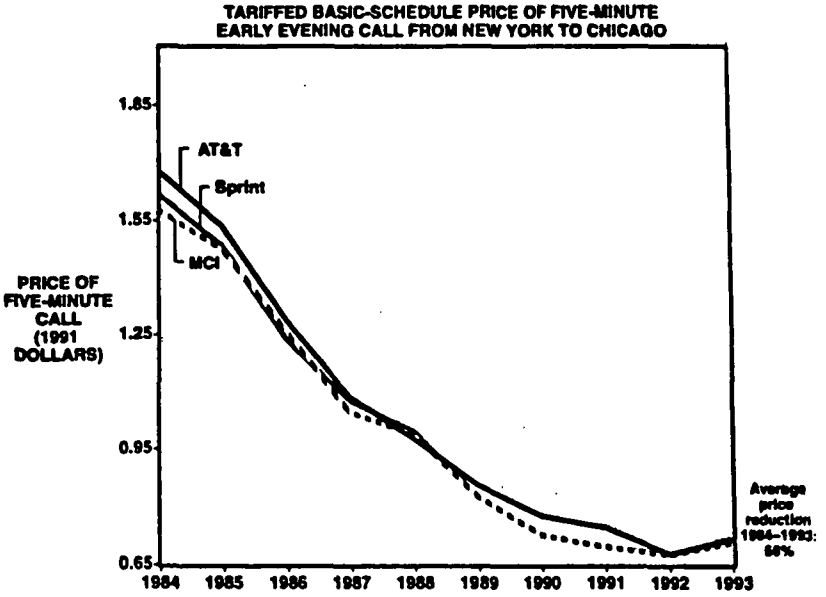
INDEX TO EXHIBITS

EXHIBIT 1.—INTERLATA INTEREXCHANGE CARRIER PRICING HISTORY
EXHIBIT 2.—AT&T PRICING HISTORY
EXHIBIT 3.—AT&T PRICING FOR SELECTED SERVICES
EXHIBIT 4.—DIFFERENCES BETWEEN INTEREXCHANGE CARRIER PRICES
EXHIBIT 5.—OVERALL MARKET SHARE
EXHIBIT 6.—CUSTOMER SATISFACTION
EXHIBIT 7.—INNOVATION
EXHIBIT 8.—CAPITAL INVESTMENT AND EMPLOYMENT
EXHIBIT 9.—AVERAGE PROFITABILITY OF IXC'S
EXHIBIT 10.—EXPORT PERFORMANCE
EXHIBIT 11.—EVOLUTION OF DATA COMMUNICATIONS PRODUCTS
EXHIBIT 12.—EVOLUTION OF 800 SERVICES THROUGH 1991
EXHIBIT 13.—EVOLUTION OF MULTIPOINT VIDEOCONFERENCING SERVICES
EXHIBIT 14.—EVOLUTION OF CONSUMER CALLING CARD PRODUCTS
EXHIBIT 15.—INTEREXCHANGE CARRIER CONSUMER PROMOTIONS
EXHIBIT 16.—CARRIER RESPONSES TO 800 PORTABILITY
EXHIBIT 17.—INTEREXCHANGE CARRIER ADVERTISING EXPENDITURES
EXHIBIT 18.—NEW DISTRIBUTION CHANNELS
EXHIBIT 19.—MARKET SHARE SHIFTS
EXHIBIT 20.—SWITCHING FROM AT&T BY SELECTED BUSINESS CUSTOMERS
EXHIBIT 21.—FINANCIAL PERFORMANCE OF IXC'S
EXHIBIT 22.—FINANCIAL PERFORMANCE OF IXC'S
EXHIBIT 23.—STOCK PRICE PERFORMANCE AND BOND RATINGS OF INTEREXCHANGE CARRIERS
EXHIBIT 24.—DOMESTIC GEOGRAPHIC SCOPE OF INTEREXCHANGE CARRIERS
EXHIBIT 25.—INTERNATIONAL SCOPE OF INTEREXCHANGE CARRIERS
EXHIBIT 26.—LDDS EXPANSION, 1989–1993
EXHIBIT 27.—WILLIAMS TELECOMMUNICATIONS GROUP EXPANSION, 1985–1992
EXHIBIT 28.—ELASTICITY OF DEMAND FOR INTERLATA IX SERVICES

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 126 1997

EXHIBIT 1

INTERLATA INTEREXCHANGE CARRIER PRICING HISTORY



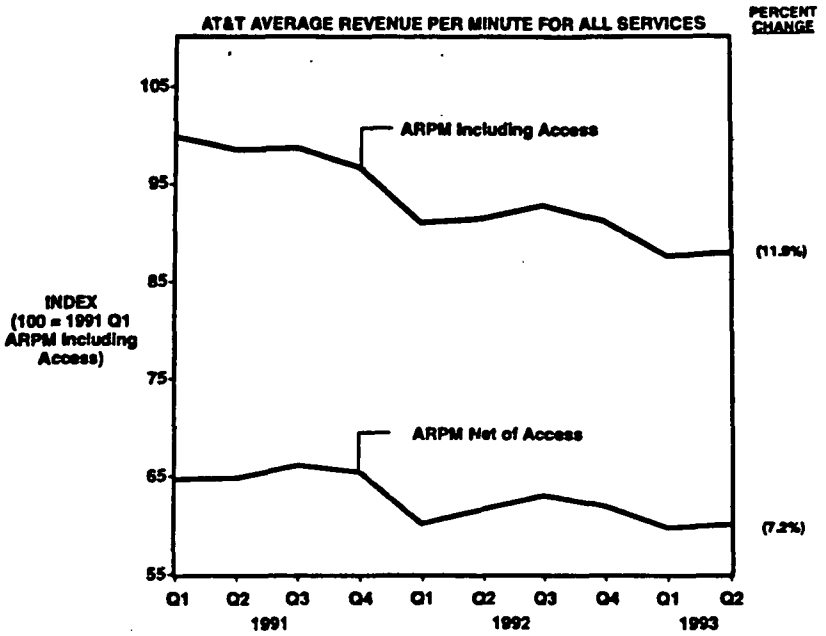
Note: 1984–1992 figures reflect prices as of December 31 of each year. 1993 figure reflects prices as of September 1.

SOURCE: FCC, STATISTICS OF COMMUNICATIONS COMMON CARRIERS, 1991/1992; AT&T, MCI AND SPRINT 1992 AND 1993 TARIFF FILINGS

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 127 1997

EXHIBIT 2

AT&T PRICING HISTORY

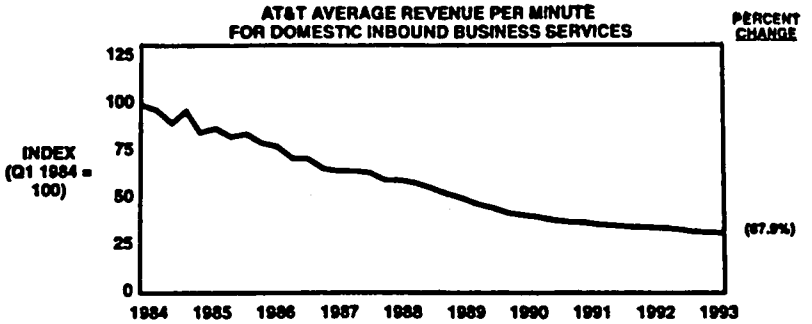


SOURCE: AT&T

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 128 1997

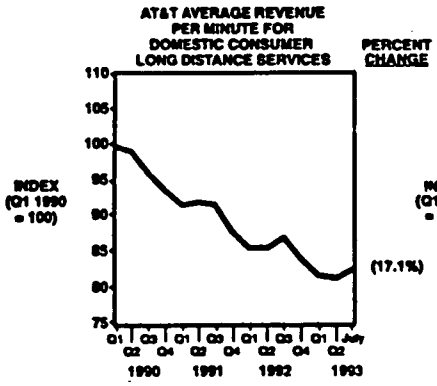
EXHIBIT 3

AT&T PRICING FOR SELECTED SERVICES



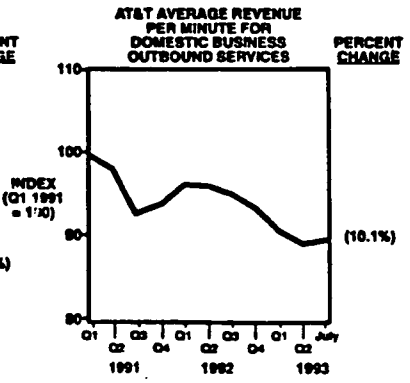
Note: Based on average revenue per minute in 1992 dollars; access charges included.

SOURCE: AT&T



Note: Based on average revenue per minute in 1992 dollars; access charges included.

SOURCE: AT&T



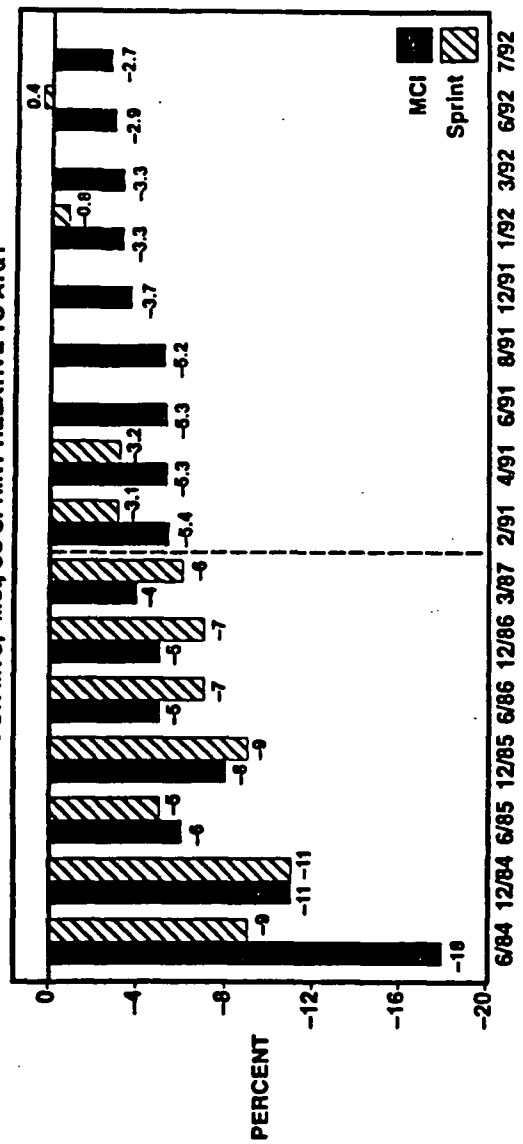
Note: Based on average revenue per minute in 1992 dollars; access charges included.

SOURCE: AT&T

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 129 1997

EXHIBIT 4

DIFFERENCES BETWEEN INTEREXCHANGE CARRIER PRICES

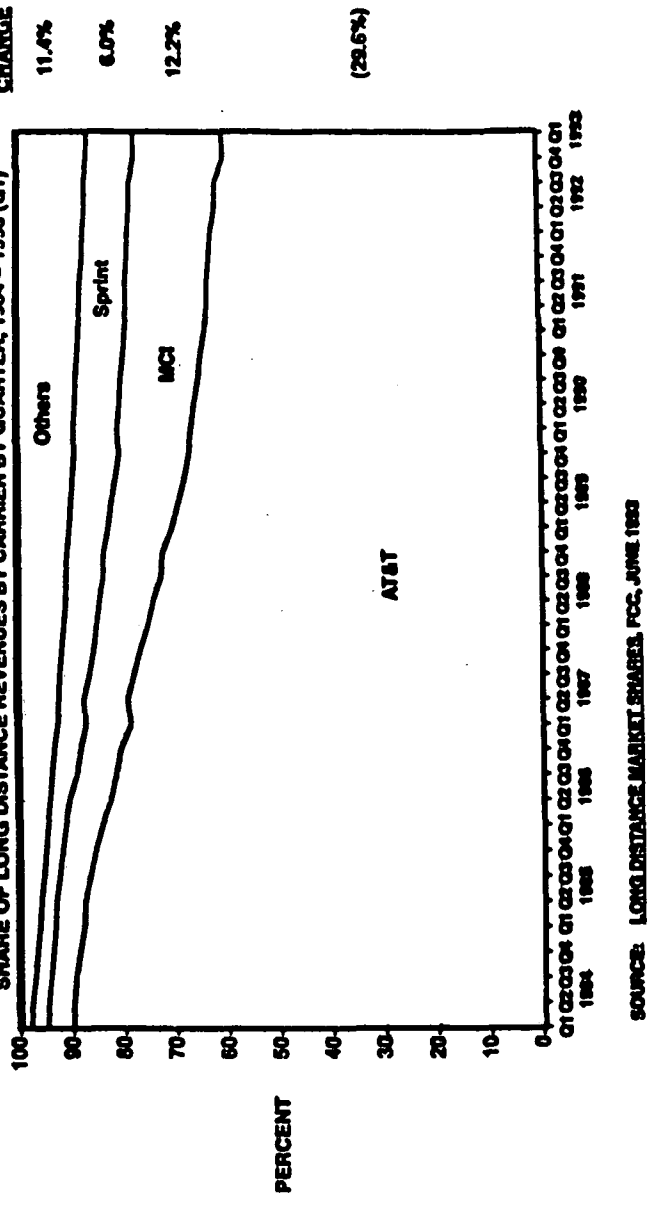


* Average of day, evening, and night differentials; impact of calling plans excluded
SOURCE: AT&T, MCI, US SPRINT TARIFFS

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 130 1997

EXHIBIT 5

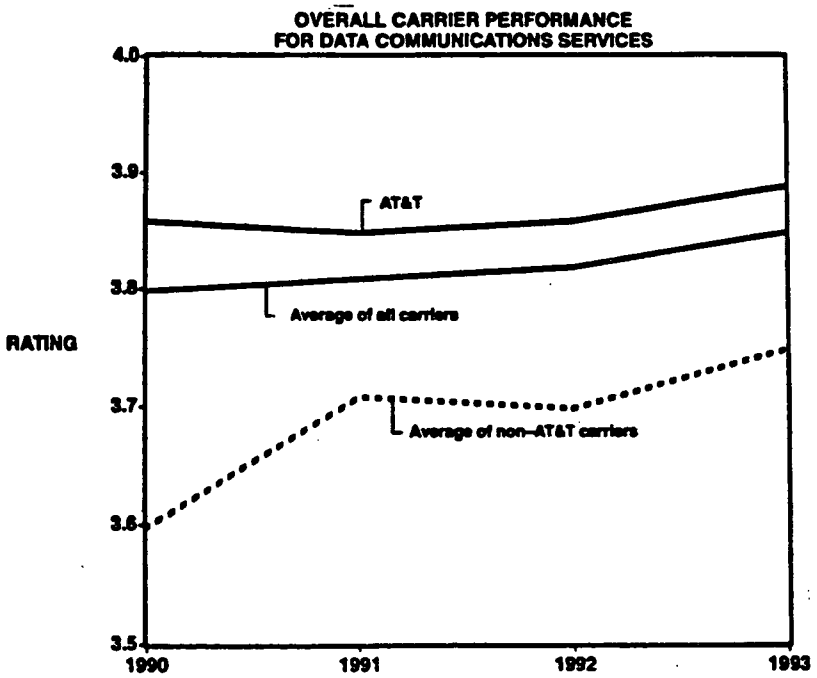
OVERALL MARKET SHARE



HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 131 1997

EXHIBIT 6

CUSTOMER SATISFACTION



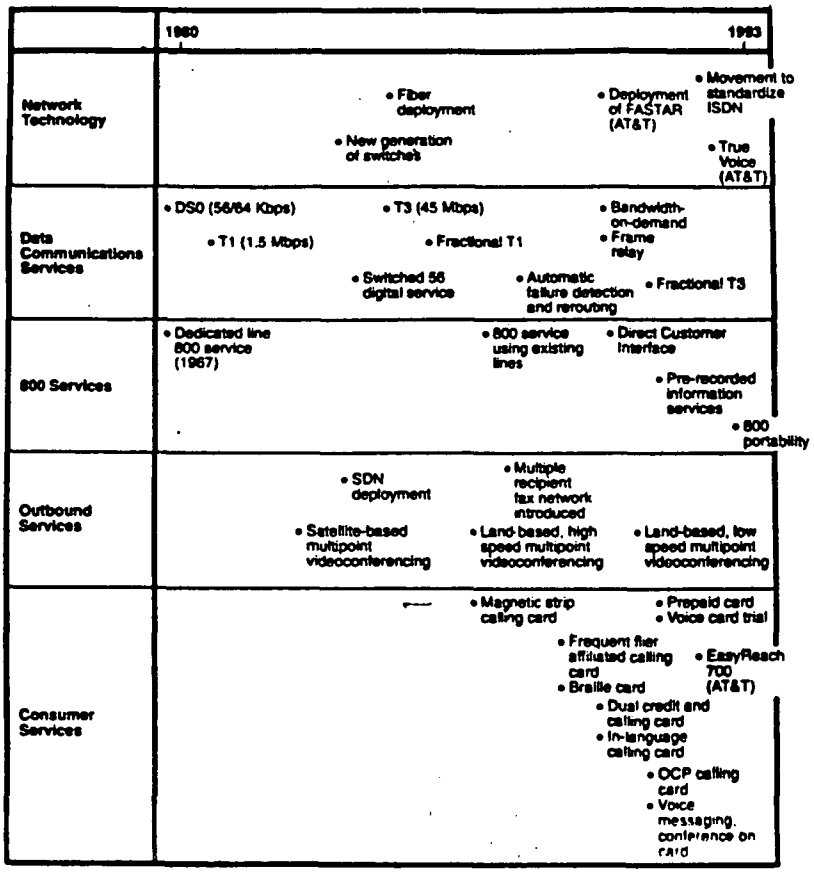
Note: Respondents were asked to rank on a scale of 1 to 5 (1 = Poor, 5 = Excellent) their satisfaction with carrier services. Averages are weighted by overall revenue from telecommunications services. Average number of respondents is 587.

SOURCE: DATA COMMUNICATIONS MAGAZINE ANNUAL SUBSCRIBER SURVEY

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 132 1997

EXHIBIT 7

INNOVATION

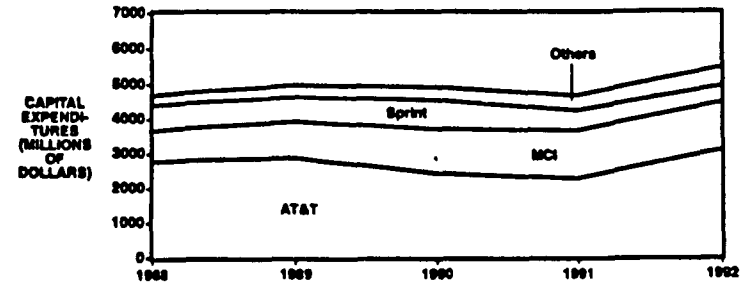


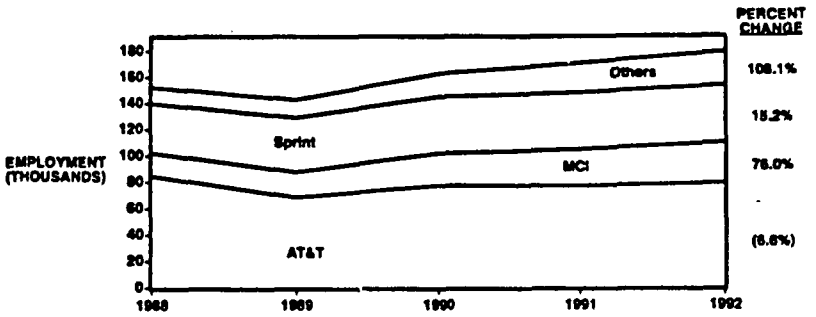
SOURCE: YANKEE GROUP; DATAPRO INFORMATION SERVICES

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 133 1997

EXHIBIT 8

CAPITAL INVESTMENT AND EMPLOYMENT





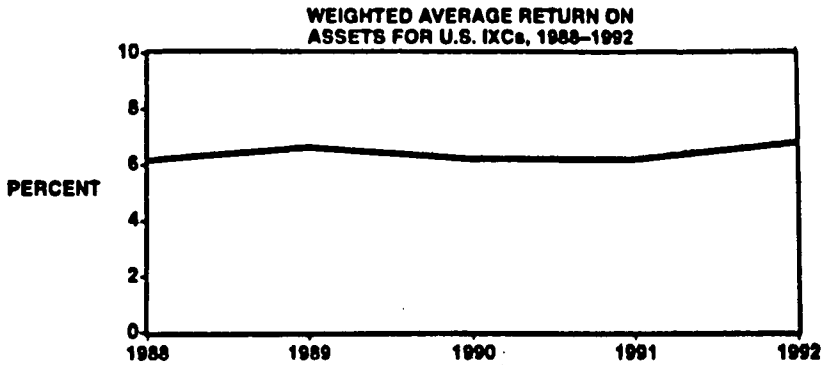
Note: AT&T figures are for Communications Services only; Sprint figures include long distance only for capital expenditures, but corporate total for employment !

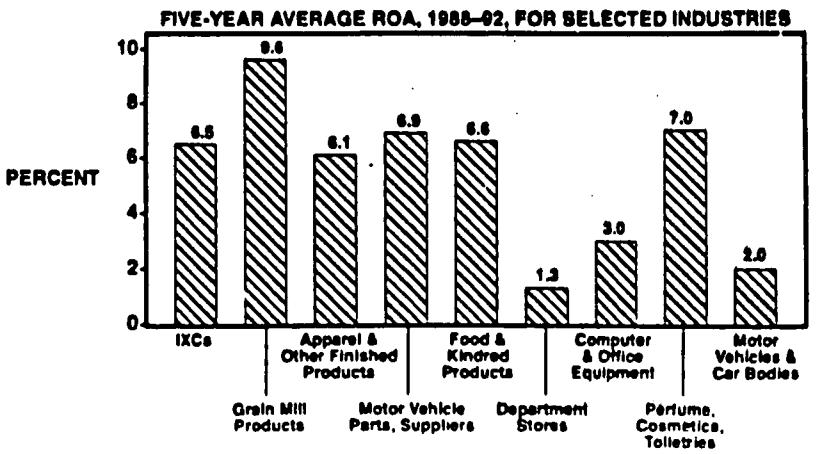
SOURCE: ANNUAL REPORTS; STANDARD & POOR'S COMPUSTAT SERVICES; AT&T FORM M

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 134 1997

EXHIBIT 9

AVERAGE PROFITABILITY OF IXCs



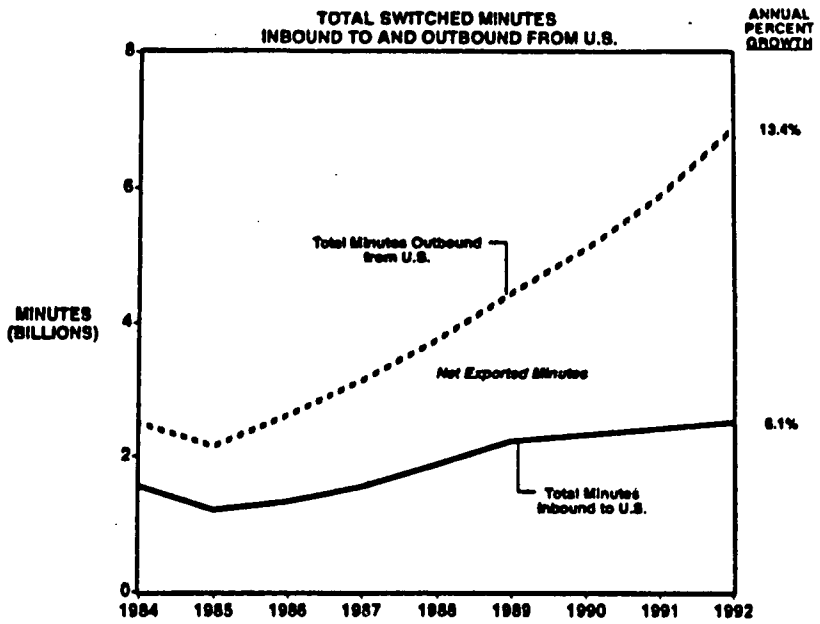


SOURCE: STANDARD & POOR'S COMPUSTAT SERVICES; AT&T FORM M

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 135 1997

EXHIBIT 10

EXPORT PERFORMANCE

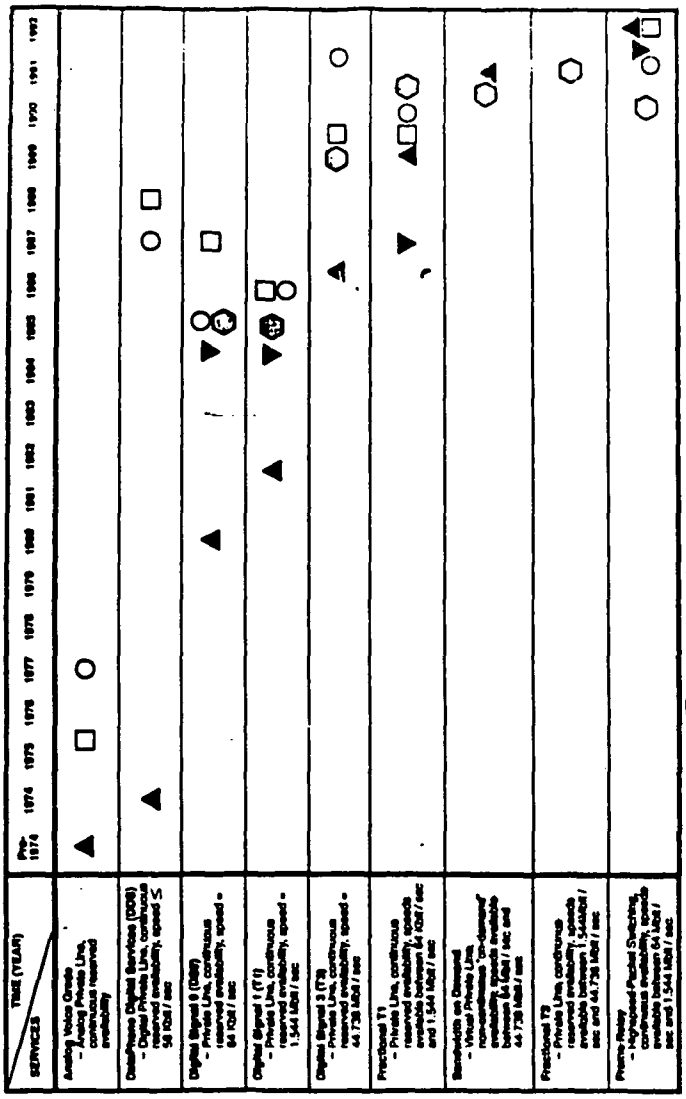


SOURCE: FCC, STATISTICS OF COMMUNICATIONS COMMON CARRIERS

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 136 1997

EXHIBIT 11

EVOLUTION OF DATA COMMUNICATIONS PRODUCTS



SOURCE: ANALYSIS OF YANKEE GROUP DATA; CARRIER PRODUCT ANNOUNCEMENTS

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 137 1997

EXHIBIT 12

EVOLUTION OF 800 SERVICES THROUGH 1991

DATE OF INTRODUCTION	SERVICE	DESCRIPTION
January 1967	• AT&T 800 Service	• Original 800 service – Can be accessed from other countries via USADirect Service
1967	• MCI 800 Service	• Toll-free, inbound service – 800 Switched WATS Termination (WAL) – 800 Dedicated Termination (DAL) – 800 Common Business Line (CBL)
December 1987	• AT&T 800 Readyline	• Uses existing local lines – Handles up to 500 hours of inbound calling per month
April 1990	• AT&T 800 Masterline Service	• Terminates interstate, intrastate, and Canadian 800 traffic on a single dedicate 800 line – Eliminates need for three dedicated lines
August 1990	• MCI 800 Configuration Management	• Direct customer interface for routing
February 1991	• AT&T Megacom 800 Service	• For customers with 10 or more lines and over 450 hours of usage per month. Optional enhancements: – Split access flexible egress routing – Alternate destination call redirection – Automatic number identification
February 1991	• AT&T 800 INformation FOrwarding–1	• Order-taking service for businesses
March 1991	• MCI Enhanced Call Router Feature	• Network-based call router
1991	• AT&T CustomNet Service	• Designed for customers with multiple locations – Usage is combined for volume discounts
March 1991	• AT&T Advanced 800 Service	• Enhanced features for use with basic AT&T 800 Service, 800 Masterline, Megacom 800 Service, and 800 Readyline – Versatility in numbering and routing schemes
September 1991	• AT&T Starterline	• Targets companies with less than three hours of toll-free calls per month – Routed over regular phone lines
December 1991	• MCI Survey	• Capability to set up pre-recorded questions that callers access using an 800 number

SOURCE: DATAPRO INFORMATION SERVICES

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 138 1997

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 139 1997

EXHIBIT 13

EVOLUTION OF MULTIPOINT VIDEOCONFERENCING SERVICES

MAJOR TECHNOLOGY	Satellite-based Service	Land-based, High Speed Service	Land-based, Low Speed Service
MARKET LEADER	• Isacomm (Sprint) • AT&T	• *Sprint*	• AT&T
TRANSMISSION SPEEDS	• Satellite DS1 • Dual T1s (1.544 Mbps)	• 1.544 Mbps • 768 Kbps • 384 Kbps	• 112 Kbps
TYPES OF CONFERENCING UNITS	First Generation Group Systems	High End Codecs / Permanent Videoconferencing Rooms	Low End Codecs / Portable Modular System

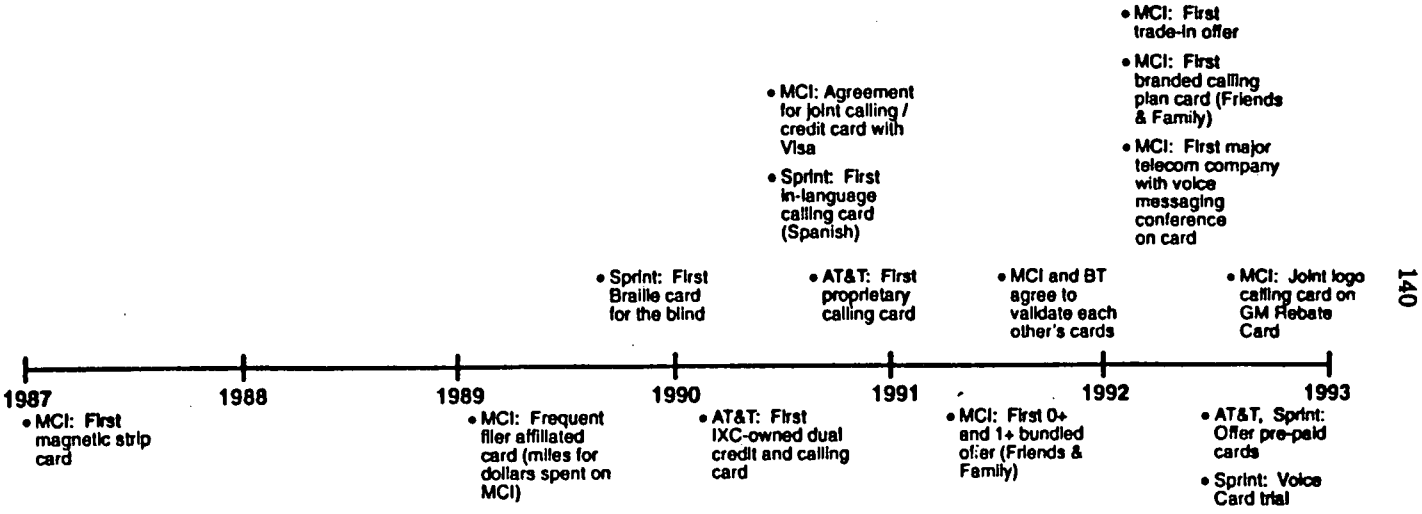
1981 — Phase 1 — 1985 — Phase 2 — 1989 — Phase 3 — 1993

SOURCE: ANALYSIS OF YANKEE GROUP DATA; INTERVIEWS WITH INDUSTRY EXPERTS

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 140 1997

EXHIBIT 14

EVOLUTION OF CONSUMER CALLING CARD PRODUCTS

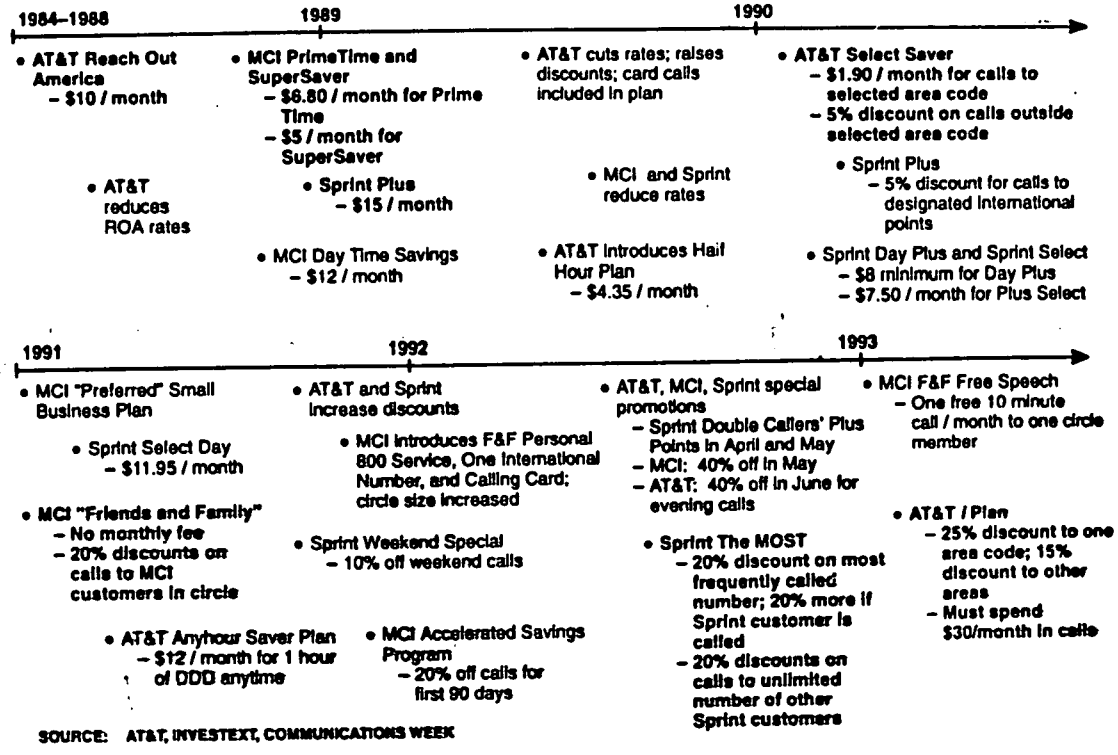


SOURCE: CARRIER PRODUCT ANNOUNCEMENTS

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 141 1997

EXHIBIT 15

INTEREXCHANGE CARRIER CONSUMER PROMOTIONS



SOURCE: AT&T, INVESTEXT, COMMUNICATIONS WEEK

EXHIBIT 16

CARRIER RESPONSES TO 800 PORTABILITY

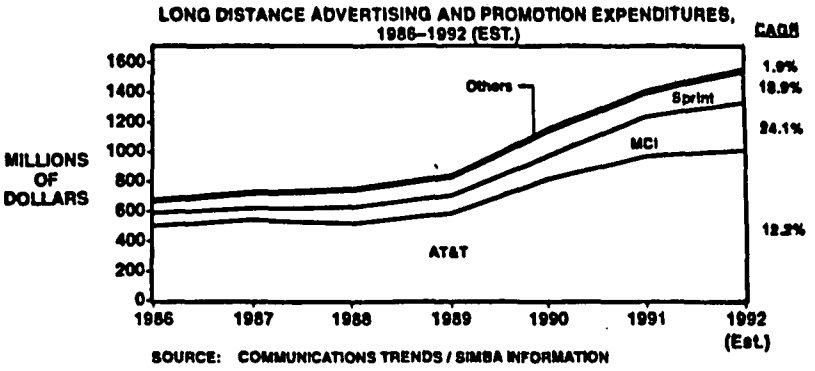
CARRIER	FEATURE / SERVICE INNOVATION	MARKETING RESPONSES
AT&T	• 800 Never Miss a Call Guarantee • Custom Traffic Manager • On-line Call Detail Manager • Signature 800 • 800 Readyline Plus • 800 Masterline Plus • Megacom 800 Plus • 800 CustomNet	• Spent reported $75MM on marketing campaign to retain current accounts
MCI	• Fresh Look Guarantee • 800 MultiManager • MCI Traffic View • 800 Guarantee Plan • Friends & Family 800	• Launched $10MM 100-day T.V. campaign reported • Spent reported $45MM total in 800 campaign to gain customers from AT&T
Sprint	• Secure Carrier Diversity • Secure Satisfaction Guarantee • Site-RP (Sprint Interface to an External Routing Processor) • Clarity Call Center • 800 Call Director	• 40 seminars held for users, analysts and clients through summer of 1992 • Deployed team of 50–60 people in 800 sales effort
Other	• Cable & Wireless, Metromedia and WilTel began offering nation-wide service • Enhanced features included Westinghouse Communications billing, call accountability and call management • PacBell became first RBOC to offer long distance toll-free	• Allnet successful at gaining new customer data bases – Won Call Home America customer base from MCI

Note: Advertising expenditures from Report on AT&T May 10, 1993 and Washington Post November 5, 1992

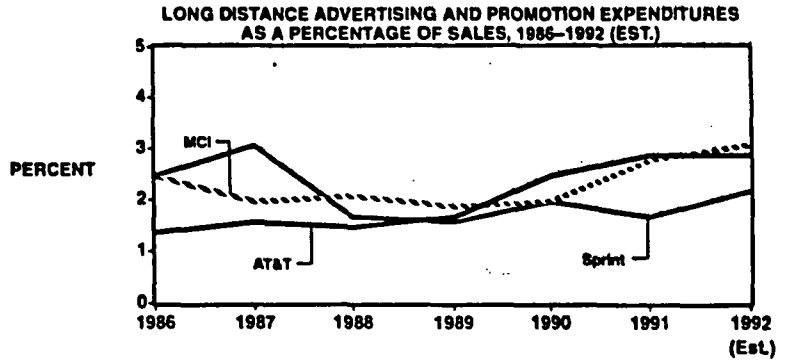
HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 142 1997

EXHIBIT 17

INTEREXCHANGE CARRIER ADVERTISING EXPENDITURES



SOURCE: COMMUNICATIONS TRENDS / SIMBA INFORMATION



SOURCE: COMMUNICATIONS TRENDS / SIMBA INFORMATION; AT&T FORM M; STANDARD & POOR'S COMPUSTAT SERVICES

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 143 1997

EXHIBIT 18

NEW DISTRIBUTION CHANNELS

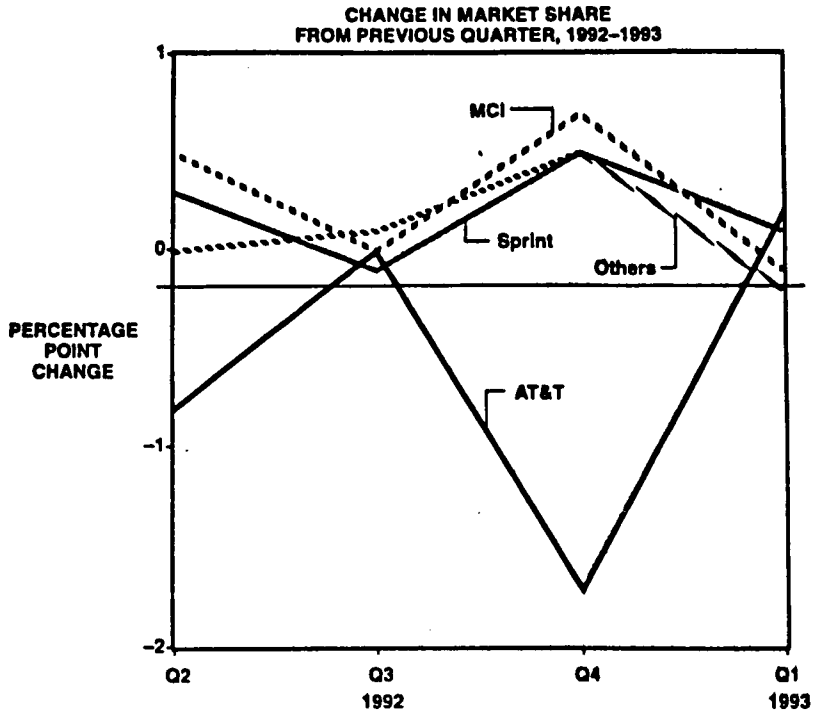
CARRIER	PARTNER	PROGRAM	PRODUCTS	DATE BEGUN
MCI	• General Motors	• 5% of all calling applied towards purchase of GM vehicle • Extra 5% off MCI charges billed to credit card	• Dial-1 • 0+ • 800	9/92
	• Citibank	• 15 minutes of free long distance every month in which use Citibank Visa • Annual fee waived if customer remains presubscribed with MCI	• Dial-1 • 0+	11/92
	• American Airlines	• All MCI telecom usage applied towards free mileage • 5 miles for every dollar spent • Extra mile if charged through Citibank	• All MCI usage	1/89
	• Northwest Airlines	• All MCI telecom usage applied towards free mileage • One WorldPerks mile plus 4 bonus miles for every dollar spent	• All MCI usage	6/89
	• American Express	• College students enrolled in Connect Plus receive 30 minutes of long distance free for one year and $3 of credit on each of 12 bills after enrollment	• Calling card	1991
	• Celutel	• Discounts on MCI's service available to Celutel customers • Celutel assists MCI in marketing directly to Celutel's business customers	• All MCI usage	2/93
Sprint	• Visa	• Visa cardholders from three Korean banks can use Visa cards to charge international long distance calls from the U.S.	• Visa Phone service	9/92
	• American Express	• Connect Plus, as detailed above	• Calling card	1991
	• Asian American investors	• An Asian American Association will market Sprint products and services to Asian communities in nine U.S. cities	• The Most • Sprint World • Sprint FONCARD	2/93
	• Celutel	• Discounts on Sprint service available to Celutel customers • Sprint and Celutel assist in each other's sales efforts	• All Sprint usage	5/93

SOURCE: AT&T; PR NEWSWIRE; LONG DISTANCE LETTER

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 144 1997

EXHIBIT 19

MARKET SHARE SHIFTS



SOURCE: LONG DISTANCE MARKET SHARE, FCC, JUNE 1993

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 145 1997

EXHIBIT 20

SWITCHING FROM AT&T BY SELECTED BUSINESS CUSTOMERS

YEAR	SAMPLE ACCOUNTS SWITCHING FROM AT&T TO COMPETITOR	COMPETITOR
1989	• Apple Computer	• Sprint
	• Greyhound Lines, Inc.	• Sprint
	• Grubb & Ellis	• Sprint
	• Merrill Lynch	• MCI
	• PepsiCo	• Sprint
	• Sears, Roebuck	• Sprint
1990	• CBS	• MCI
	• Chrysler	• MCI
	• Citicorp	• MCI
	• General Electric	• Sprint
	• Household International	• MCI
	• Mobil Oil	• MCI
	• Neiman Marcus	• MCI
	• Reynolds & Reynolds	• Sprint
	• Rockwell	• Sprint
	• Shawmut	• MCI
1991	• Aetna	• MCI
	• Circuit City Stores	• MCI
	• General Electric	• MCI
	• Silicon Graphics	• Sprint
	• United Stationers	• Sprint
	• Unocal	• MCI
	• Zale Corp.	• MCI
1992	• American Greetings	• MCI
	• Challet Susse	• MCI
	• Holiday Inn	• MCI
	• Kroger Co.	• MCI
	• Maytag Corp.	• MCI
	• McDonnell Douglas	• MCI
	• North American Philips	• MCI

SOURCE: PRESS REPORTS

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 146 1997

EXHIBIT 21

FINANCIAL PERFORMANCE OF IXCs

SALES OF SELECTED TELECOMMUNICATIONS COMPANIES
DOLLARS (MILLIONS)

COMPANY	1988	1989	1990	1991	1992	CAGR
AT&T	35,276	34,277	33,534	33,926	34,992	0.0%
MCI	5,137	6,471	7,680	9,491	10,562	19.8%
Sprint	3,405	4,324	5,065	5,388	5,658	13.5%
ALC / Allnet	394	334	326	347	376	(1.2%)
LDDS	20	109	154	263	800	151.5%

NET INCOME OF SELECTED TELECOMMUNICATIONS COMPANIES
DOLLARS (MILLIONS)

COMPANY	1988	1989	1990	1991	1992	CAGR
AT&T	1,689	1,947	2,197	1,906	2,116	5.8%
MCI	346	558	299	551	60[illegible]	15.2%
Sprint	(386)	156	99	195	198	N / A
ALC / Allnet	(29.9)	(21.3)	(19.6)	5.3	20.8	N / A
LDDS	(1.7)	0.8	9.7	17.7	(5.9)	N / A

CASH FLOW* OF SELECTED TELECOMMUNICATIONS COMPANIES
DOLLARS (MILLIONS)

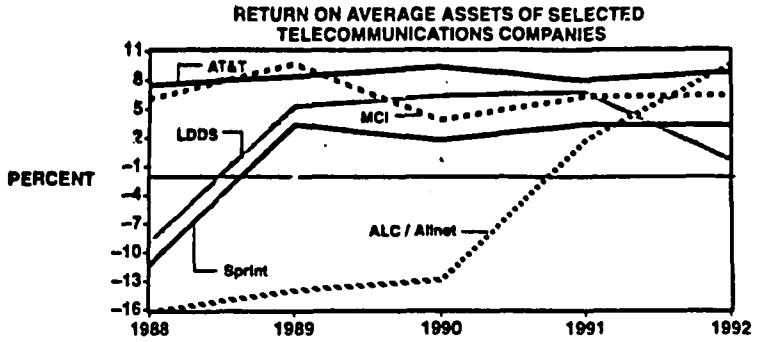
COMPANY	1988	1989	1990	1991	1992	CAGR
AT&T	4,005	5,124	5,067	4,970	4,318	1.9%
MCI	905	1,258	1,042	1,297	1,452	12.6%
Sprint	(41)	650	693	879	898	N / A
ALC / Allnet	(11.9)	(8.7)	(7.8)	13.6	24.8	N / A
LDDS	(0.6)	10.7	19.2	33.1	53.7	N / A

* Cash flow defined as Net Income and Depreciation
Note: AT&T figures include Communications Services only; Sprint includes long distance only
SOURCE: AT&T FORM M; STANDARD & POOR'S COMPUSTAT SERVICES; ANNUAL REPORTS

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 147 1997

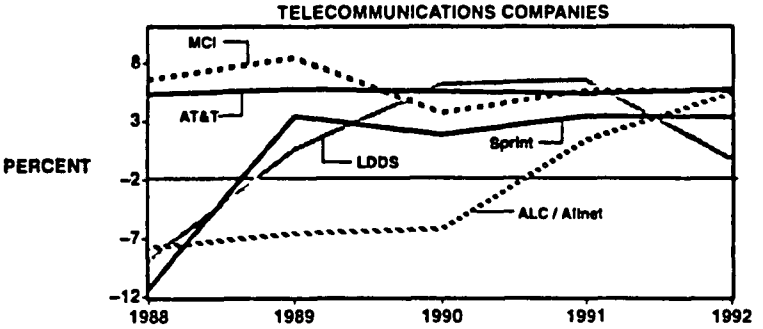
EXHIBIT 22

FINANCIAL PERFORMANCE OF IXCs



Note: AT&T figures include Communications Services only; Sprint includes long distance only

SOURCE: AT&T FORM M; STANDARD & POOR'S COMPUSTAT SERVICES; ANNUAL REPORTS



Note: AT&T figures include Communications Services only; Sprint includes long distance only; ROS is net income / sales.

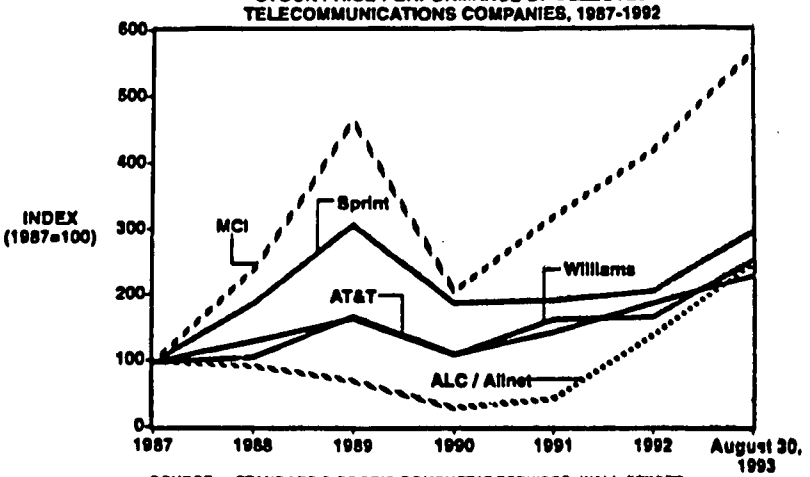
SOURCE: AT&T FORM M; STANDARD & POOR'S COMPUSTAT SERVICES; ANNUAL REPORTS

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 148 1997

EXHIBIT 23

STOCK PRICE PERFORMANCE AND BOND RATINGS OF INTEREXCHANGE CARRIERS

STOCK PRICE PERFORMANCE OF SELECTED TELECOMMUNICATIONS COMPANIES, 1987-1992



SOURCE: STANDARD & POOR'S COMPUSTAT SERVICES; WALL STREET JOURNAL

STANDARD & POOR'S BOND RATINGS OF SELECTED TELECOMMUNICATION COMPANIES, JULY 1993

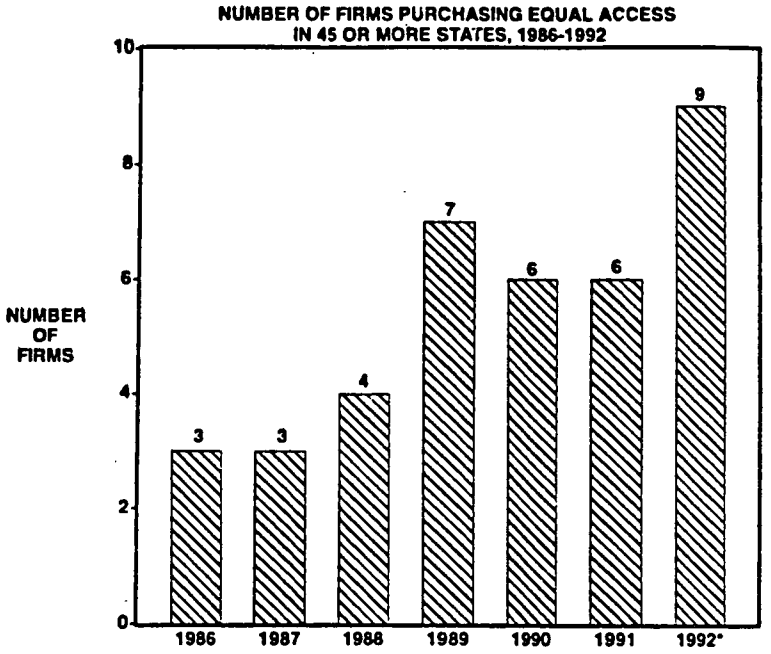
COMPANY	BOND RATING
AT&T	AA
MCI	BBB–, BBB
Sprint	BBB–, A–
ALC / Allnet	B–
The Williams Companies	BBB–

Note: The Williams Companies includes WilTel, Williams Western Group, Williams Natural Gas Company, Williams Energy Company, and Williams Pipe Line Company
SOURCE: STANDARD & POOR'S COMPUSTAT SERVICES

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 149 1997

EXHIBIT 24

DOMESTIC GEOGRAPHIC SCOPE OF INTEREXCHANGE CARRIERS



* Carriers and number of states in which purchase equal access: Allnet (49), AT&T (50), Cable & Wireless (46), LDDS (48), MCI (50), Metromedia (50), Oncor Communications (48), Sprint (49), and WilTel (49)

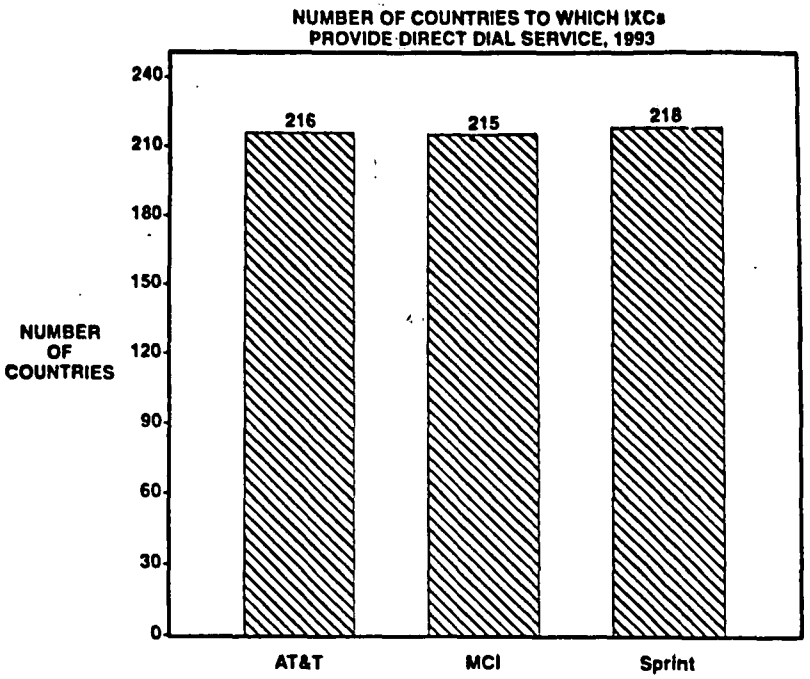
Note: As of December of each year

SOURCE: SUMMARY OF LONG DISTANCE CARRIERS, FCC, MARCH 1993

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 150 1997

EXHIBIT 25

INTERNATIONAL SCOPE OF INTEREXCHANGE CARRIERS



SOURCE: AT&T COMMENTS FILED IN FCC DOCKET 92-134

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 151 1997

EXHIBIT 26

LDDS EXPANSION, 1989-1993

FISCAL YEAR	CAPITAL EXPENDITURES (MILLIONS)	ACQUISITIONS: COMPANY	ACQUISITIONS: REVENUES (YR PRIOR)	NEW PRODUCT INTRODUCTIONS	NETWORK COMPOSITION	FINANCIAL POSITION
-1988	N/A	Inter-Comm Telephone (ICT)		• Total offering includes: – 1+ dialing – Outbound WATs – Inbound 800 – 800 travel service – Private line network	• Completed installations of COTT Signaling System 7 • More than 250 points of interconnection with LECs	• $100 SMM revenues • 8.7% ROS
		Advantage Companies	$20 SMM			
		Convirik				
1989	$15.8	Mercury, Inc.	$15MM	• Preferred 800 • Operator service		• $154.4MM revenues • 6.5% ROS
		Telecommunications Corp of Louisiana (TMCL)	$22MM			
		Southtel				
1991	$29.4	National Telecommunications of Austin	$30MM		• Minimized capital outlay by leasing private line circuits – 90% of transmission facilities leased	• $263.4MM revenues • 6.7% ROS
		Phone America of Carolina	$15MM			
		Mid American	$7MM			
1992	$39.1	Amerkall / Pinphone	$90MM	• Online – Away-from-home global access to LDDS network, 24 hour operator, dual-armed 6 language armed	• 45 switch sites in operation • Interstate operations in 44 states • Intrastate operations in 45 states	• $500 SMM revenues • 1.0% ROS
		Prime Telecommunications				
		TFN				
		TMI				
		Sharp Use Network Systems		• Acclaim! – Feature-rich product platform for multilocation businesses		
		Advanced Communications				
		ATC	$300MM			
1993	$50 (E)	Dial-Net	$80MM	• The Answer – Discounted price plan for small to medium sized companies	• Consolidation of traffic from acquisitions and network will improve scale economies • Switch locations to be eliminated in overlap areas	
		Touch 1 Long Distance	$24MM			
		Memorade & Resurgens	$47MM			

Note: Capital expenditures for transmission and communication equipment only. Financial position as stated in financial reports, not restated for subsequent acquisitions.
SOURCE: COMPANY REPORTS

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 152 1997

EXHIBIT 27

WILLIAMS TELECOMMUNICATIONS GROUP EXPANSION, 1985–1992

FISCAL YEAR	CAPITAL EXPENDITURES (MILLIONS)	MEANS OF CAPACITY ADDITIONS	NETWORK COMPOSITION	TOTAL BILLABLE CIRCUITS	REVENUE (MILLIONS)
1985	$28	• Built fiber optic line from scratch	• 1,000 miles fiber optic cable		
1986	$141	• Built 2,000 mile fiber optic and 800 mile digital microwave network	• 3,000 miles fiber optic cable • 800-mile digital microwave system		
1987	$41	• Merged with LDX NET – 1,000 mile fiber optic cable • Expanded voice grade circuit miles – 42 miles	• 4,600 miles fiber optic cable • 800-mile digital microwave system	6,606	$64.9
1988	$83	• Built line from Cleveland to New York • Purchased Chicago-Cleveland portion of RCI Corp.'s fiber optic network – 400 miles • Implemented fiber optic cutover to new control center	• 5,600 miles fiber optic cable • 800-mile digital microwave system	8,700	$174.6
1989	$51	• Purchased Houston Network, Inc. (Wynn) – Interchange carrier • Acquired Lightnet – Added 4,500 miles of fiber optic network on East Coast • Built 430 mile route between Los Angeles and San Francisco	• 8,070-mile fiber optic network • 800-mile digital microwave system	11,341	$299.7
1990	$65	• Acquired Resolve Systems, Inc. – Tulsa-based regional network service integrator	• Nationwide 11,000-mile digital fiber optic network • 800-mile digital microwave system	12,531	$378.2
1991	$73	• Acquired WilTel Communications Systems – Sells, installs and maintains telephone systems and related equipment • Rolled out frame relay service • Acquired Telesphere – Enabled nationwide switched network	• Nationwide 11,000-mile fiber optic network • Direct access to additional 20,000 miles of digital network	15,040	$523.1
1992	$68	• WilTel Communications expanded into complete network operations management – outsourcing	• Nationwide 11,000-mile fiber optic network • Direct access to additional 20,000 miles of digital network	18,045	$757.6

SOURCE: THE WILLIAMS COMPANY REPORTS, WILLIAMS TELECOMMUNICATIONS GROUP

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 153 1997

EXHIBIT 28

ELASTICITY OF DEMAND FOR INTERLATA IX SERVICES

ANALYST	SOURCE	SEGMENT	ELASTICITY ESTIMATE
Alexander Belifante, Jerry Hausman and Timothy Tardiff	FCC Industry Analysis, May 1993 (p. 182)	Industry	–0.55
Larson and John S. Watters, Southwestern Bell Telephone	Cited by Jain–Shing A. Chen and John S. Watters in "Estimating Telephone Usage Elasticities: A Shares Equation System Approach" Applied Economics, 1992 (p. 1219)	IntraLATA	–0.44
Jack C. Lee, Member of Technical Staff, Statistics Research Group at Bell Communications Research	Nested Rotterdam Model Applications to Marketing Research with Special Reference to Telecommunications Demand (p. 205, Table 2)	InterLATA	–0.353
William E. Taylor and Lester D. Taylor, National Economic Research Associates, Inc. and Department of Economics, University of Arizona.	Post-Divestiture Long Distance Competition in the United States, May 1993 (p. 188)	InterLATA	–0.63
Joseph Gatto, AT&T	"Interstate Switched Access Demand Analysis" Information Economics and Policy Journal, 1988	InterLATA	–0.72

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 154 1997

Senator METZENBAUM. Thank you, Mr. Allen.

Senator Thurmond, do I understand that you had one question?

Senator THURMOND. Thank you very much. I have another engagement, and I appreciate your courtesy.

Mr. Allen, welcome.

Mr. ALLEN. Thank you.

Senator THURMOND. The written testimony of Ms. Steptoe of the Federal Trade Commission points out that nonhorizontal mergers may be anticompetitive by eliminating potential competition. Could you please address this issue by discussing whether AT&T could have directly entered the cellular market without acquiring the largest cellular company?

Mr. ALLEN. Yes; we looked at a number of different ways that we could enter the cellular market and we made the business judgment that this was the quickest and the most efficient way and, most importantly, it was the manner in which we could stimulate competition in this marketplace the fastest. There will be additional competition in the future as other spectrum allocations are made and have been made to other potential competitors, but in terms of real-time, early competition we felt that this was the best avenue for us.

Senator THURMOND. Mr. Allen, please explain your plan to bundle cellular and long-distance services, and discuss whether you expect this bundling to put pressure on other cellular or long-distance companies to offer comparable services.

Mr. ALLEN. Well, we have not made market judgments. We are not even absolutely certain the merger will be approved and we are in the very early stages of discussing relationships between the company and getting through the premerger hurdles with the various regulatory bodies.

Having said that, it would be my opinion, without being expert in the marketing area, that one of the very stimulating competitive approaches for businesses which are separately competitive is to bundle offers that are appealing to customers. Customers are not required to accept bundled offers and to the extent that, if this merger is approved, AT&T and McCaw make bundled offerings in the marketplace, that would not be the only way customers could purchase those services. They could purchase them separately and independently and, of course, if they don't like our bundles or our separate offerings, they can always go somewhere else.

Senator THURMOND. Mr. Allen, what degree of competition with the local access carriers do you believe should occur before it would be appropriate to lift the Modification of Final Judgment restrictions on the regional Bell operating companies, and do you see this level of competition with the local exchange eventually being provided by cellular service or by cable companies offering telephone service or in some other way?

Mr. ALLEN. Well, the great hope for AT&T, and I think for consumers in this country has been and would be that the cable companies would be the most likely competitors to the local exchange companies for local exchange service, and we continue to hope and believe that will be the case.

In a separate hearing before another Senate committee, we were asked if we would provide criteria for determining when competi-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 155 1997

tion exists in the local exchange. It is a challenging task to do so, but let me, if I may, just quote the metrics that we submitted in that context. First, there would be no application for elimination from the restrictions or for petition into the interLATA business for 7 years, which would permit the RBOC's sufficient time for upgrading and opening their networks to competition.

Second, 100-percent implementation of open network and number portability specifications would be made; that is, the entire network of a local exchange company would—or all of their customers would have open network and number portability.

Third, 75 percent of the subscribers in a particular telephone company's territory would be able to obtain local exchange and exchange access service from two or more providers at cost and quality comparable to the telephone company; that is to say you would have at least a choice of one other.

Finally, the real test of competition is not just whether choices are available, but whether customers make those choices. At least 30 percent of those subscribers must actually rely on alternative providers. We believe that those are criteria which would demonstrate that competition does exist.

Senator THURMOND. Mr. Allen, you emphasized in your written testimony that long-distance services are highly competitive, and submitted a study showing that long-distance companies are making only average profits. If this is true, why are the regional Bell companies so eager to compete in long distance?

Mr. ALLEN. Well, Senator, with all due respect, I think you would have to ask them because they are full participants—some would say more than full participants today in the long-distance market; that is to say that 40 cents of every dollar we collect from our long-distance customers we pay to the local telephone companies for access. Not only are they full participants in that sense; we are their largest customer in that regard, represent something on the order of 20 percent, on the average, I believe, of their total revenues. In many cases, our studies indicate that those access costs produce up to and as much as 110 percent of their total profits for the whole enterprise. That differs from place to place.

So I find it as puzzling as your question seems to suggest as to why they would want to enter the long-distance market in any other fashion. I would love to have that kind of business and those kinds of margins.

Senator THURMOND. Mr. Chairman, thank you very much. Thank you, Mr. Allen, for your appearance.

Mr. ALLEN. Thank you, Senator.

Senator THURMOND. I have another engagement, Mr. Chairman, that I have to go to, but I have a few questions for Mr. Cooper and Mr. Schwartzman, that I would like them to answer for the record.

Senator METZENBAUM. Thank you very much. We will provide for that. Thank you for being with us.

Mr. Allen, I think you have covered this, but I want to just go back to it for a moment. One aspect of your proposed merger with McCaw Cellular is particularly troubling to me. As the Nation's largest long-distance phone company, this merger would put you in the position of potentially reducing long-distance competition by connecting McCaw's mobile car phone calls automatically into your

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 156 1997

long-distance company. Would you accept free choice of phone carriers, nondiscrimination and equal access as appropriate conditions of your merger and as ongoing regulatory policy?

Mr. ALLEN. Mr. Chairman, we believe that choice and competition should be the guidelines and the rules in this business, and as I think we have stated publicly before, but I want to make very clear here today, we have volunteered the fact that we would accept those conditions, and wholeheartedly so.

Senator METZENBAUM. You state in your testimony that AT&T does not intend to become a local telephone company. However, by attempting to merge with McCaw, which provides mobile car phone service in local markets, you will certainly be positioned to provide local phone service. If you begin to compete for local phone service, would you be willing to abide by all the open network nondiscrimination rules that you suggest the Bell companies follow?

Mr. ALLEN. We have no intention of doing so, but I can't speak for all time and I certainly can't speak for my successor. But if that were the situation, we would accept all of those conditions that you cite.

Senator METZENBAUM. In your testimony, you support the development of competition of local telephone monopolies, and I am frank to say to you that I share your goals. However, I am concerned that the proposed merger of Bell Atlantic and TCI will reduce the incentives for cable companies in Bell Atlantic's region to move aggressively into the telephone business. Do you share those concerns?

Mr. ALLEN. Well, I do share those concerns not because I particularly question the intent of either party in that case, but because the history does not demonstrate that there has been much propensity for one to compete with the other in any territory.

Senator METZENBAUM. And isn't it the fact that even if the telephone company sells off its cable operations——

Mr. ALLEN. In its own territory?

Senator METZENBAUM. In its own territory. Isn't it reasonable to assume as a practical business matter that that kind of sale will be made in such a way without any specific understanding or any language in the agreement that the purchaser will not, at least for a reasonable period of time, become an aggressive competitor?

Mr. ALLEN. Well, I wouldn't want to attribute motives, Senator, that may not be there.

Senator METZENBAUM. I am just talking about the realism of the business world.

Mr. ALLEN. I think if you are talking about relationships that have existed for a long time and tend to cause people to lean one way or the other, I would have to assume that if they erred on any side, it would be on the side you suggest.

Senator METZENBAUM. Were there requirements imposed by the Department of Justice in the breakup of the old Bell System that have resulted in increased competition which might be useful to apply to the proposed Bell Atlantic-TCI merger?

Mr. ALLEN. I certainly think that the equal access provisions—and I don't know precisely what that means in this new context, but I certainly believe that equal access is a very important issue. I think providers of information and receivers of information which

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 157 1997

are on either end of that distribution capability that exists in the telephone companies will have a high level of interest in having choice; that is to say the consumers at the end would want to have choice about content and content providers would want to be sure that their potential customers can get access to their services. I certainly think that would be an important provision, probably the most important.

Senator METZENBAUM. A witness at our last hearing, Dale Hatfield, expressed strong concern that if the Bell Atlantic-TCI merger were approved, Bell Atlantic would not be likely to compete aggressively for the core cable or local phone business of the incumbent phone or cable companies in its territories. Instead, Bell Atlantic would be likely to expand its phone and cable businesses to compete on the margins for new combinations of telephone and video services.

It seems to me if Mr. Hatfield is correct, we wouldn't really have the kind of local phone or cable competition that would connect the most commonly used long-distance services your company provides. Is that a potential problem with the Bell Atlantic-TCI merger, and should antitrust officials be concerned about it?

Mr. ALLEN. Well, I think it could be. Again, I don't want to attribute motives or behavior with respect to people who are good customers of ours and people with whom we have dealt successfully over a number of years. I would again recite the history in the 10 years since the breakup of the Bell System. I have not seen a single RBOC compete in another's territory, with the exception of cellular franchises that they have bought in some of those areas, and I certainly have never seen a cable company compete against another cable company or a telephone company. So, I think with no record of competition or incentive to compete, I would have to be concerned about those issues.

Senator METZENBAUM. Our Nation has a long history of preventing companies that control the transmission of communications from interfering with the content or the speech that is being communicated. I fear this principle is jeopardized when more and more cable or telephone companies own or control the programming they deliver to television viewers.

As telephone and television technologies merge, don't you believe we should impose strict limits on any transmission company, whether it be a telephone company, a cable company, wireless, whatever, that would prevent it from controlling or manipulating the message being communicated?

Mr. ALLEN. Well, manipulating might be one concern I would have. I have mixed emotions about that issue. If customers can make choices at the local exchange level and real competition does exist, then I believe that the people who control the transmission to the customers will ultimately be incented to obtain content that their consumers want. Therefore, I would have a natural concern about the vertical integration of content and deliverers of content, but I think if we have the discipline at the consumer end—that is to say, competition—I think that market can get sorted out reasonably well, it would be my personal opinion.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 158 1997

Senator METZENBAUM. Thank you very much, Mr. Allen. Each time you come before us to testify, you are always a very cooperative witness and we are happy to have you with us, sir. Thank you.

Mr. ALLEN. Thank you for the opportunity.

Senator METZENBAUM. Our next two witnesses are Mark Cooper of the Consumer Federation of America, and Andrew Schwartzman of the Media Access Project. I think each of these witnesses has been told to have 5 minutes for presentation.

Mark, are you ready to go forward?

PANEL CONSISTING OF DR. MARK N. COOPER, DIRECTOR OF RESEARCH, CONSUMER FEDERATION OF AMERICA; AND ANDREW JAY SCHWARTZMAN, EXECUTIVE DIRECTOR, MEDIA ACCESS PROJECT

STATEMENT OF DR. MARK N. COOPER

Mr. COOPER. Thank you, Mr. Chairman. The information industries affected by the TCI-Bell Atlantic merger may well be the highways of economic commerce in the 21st century and the marketplace of political ideas. The decisions we make today about the concentration in these industries could go a long way toward determining the nature of our economic well-being and political freedom.

In the decade since divestiture of local telephone service and deregulation of cable TV service, these two firms have defended their monopoly power and their core businesses, extended their market power to related activities, and never tried to break the core business monopoly of others. They have achieved these objectives by denial of access and manipulation of access to bottleneck facilities, abusive marketing of consumer services, funding acquisitions with excessive rates on monopoly services, extending market power through acquisition, expanding market power by leveraging their monopoly base, and mutual forbearance from competing in other markets. I prepared documents which I have submitted with my testimony that look at a variety of these practices.

To believe that these two companies would suddenly become vigorous competitors requires a leap of faith that responsible public policymakers cannot make. In truth, the merger can only make matters worse. Marrying TCI's market power over programming and cable distribution with Bell Atlantic's financial resources will only enhance TCI's efforts to dominate the programming sector.

Combining the massive potential for cross-subsidy possessed by the telephone company with ownership of programming in the cable company would be an added weapon for an integrated telco cable company to prevent entry into the telephone business. Creating a company that owns both a ubiquitous, closely regulated common carrier and a ubiquitous, lightly regulated private carrier will simply stimulate the migration of services to the private network, enabling the merged entity to increase profits without going into the telephone business in any competing area. Where the two companies do decide to enter the cable business, the combination of massive resources, control over programming and access to a telephone cross-subsidy will quickly overwhelm the competition.

Theories of technological convergence or economic synergies just do not justify this merger. As technologies converge and become ho-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 159 1997

mogeneous, we should have decentralization—anybody can buy it—not concentration. If economies of scale require one firm to cover half the country and own three-quarters of the most popular programming, then the possibility of a competitive market is dubious at best.

Nor can we rely on regulators. The Federal Communications Commission could not prevent anticompetitive abuses in the 1960's and 1970's in a fairly simple industry like telecommunications. That was the basis for the antitrust breakup of the telephone company. They have not been able to do it in the 1980's as the local exchange companies moved into information services. The problem of regulating anticompetitive behavior in a mixed telco cable company in the 1990's would be even farther beyond their capabilities.

Therefore, to ensure an open and competitive information age, to prevent anticompetitive cross-subsidies and further abuse of consumers and competitors, any merger of the two industries through acquisition must meet a series of conditions. It must extend the principles of common carriage to the cable network. It must be contingent upon the prior existence of effective competition to the public switched telephone network. It must require that services provided over either network pay for all facilities utilized in proportion to the demand placed on the network to prevent cross-subsidy. It must require that all telephone and cable operations be completely separate and subject to full, direct oversight by Federal and State regulators. None of these protections exist today.

With respect to this specific merger, we must go even farther because of its massive nature. Divestiture of programming from TCI and distribution must take place. That is the only cure to prevent TCI from its continued anticompetitive pattern of amassing market power in programming. Divestiture of the telephone lines in areas of overlap is the preferable cure for anticompetitive problems, since the telephone monopoly is stronger than the cable monopoly.

The future of any acquisition of programming must be precluded, since the massive presence of TCI and Bell Atlantic in distribution creates an immediate competitive problem with respect to potential demand, denial of access to demand. These are theories that were articulated by the first witness and we think they are very real in this merger.

A century ago, we fought a similar battle in this country when the robber barons in the railroad industry sought to seize the levers of economic power through anticompetitive practices and manipulation of pricing and access. The battle to preserve our political and economic freedom started on the highways of commerce of that age, the railroads, and it was won by aggressive regulation and the creation of the very antitrust laws that this committee oversees.

With the information age reaching into the home of every citizen in the country, the stakes are certainly as large today as they were then. Our economic analysis leads to a similar conclusion. In excessive economic concentration, there is neither economic prosperity nor political freedom.

Thank you.

[The prepared statement of Mr. Cooper follows:]

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 160 1997

PREPARED STATEMENT OF DR. MARK N. COOPER

Mr. Chairman and members of the Committee, I am Dr. Mark N. Cooper, Director of Research at the Consumer Federation of America (CFA). CFA is the nation's largest consumer advocacy organization, composed of over 250 state and local groups with some 50 million members. CFA has participated in virtually every federal regulatory and legislative proceeding dealing with the telephone industry since divestiture and the cable industry since deregulation. We have also testified and provided extensive support to local groups in telecommunications matters in states as diverse as Arkansas, Missouri, California, Vermont, Colorado, Texas and Maryland.

I. OVERVIEW

A. The importance of merger

The merger of Bell Atlantic and TCI causes us a great deal of concern because the information industries, particularly their distribution networks, may be both the highways of economic commerce in the twenty first century and the marketplace of political ideas. The decisions we make today about how much economic and political power we allow to be concentrated in the hands of specific companies in these industries may go a long way toward determining the nature of our economic well-being and political freedom in the information age.

B. The track record of anti-competitive behavior

The firms proposing to merge are two of the largest entities in the telephone and cable TV industries. At the time of deregulation and divestiture both local telephone service and cable television service were local franchise monopolies. Since that time the industries in general, and these two firms in particular, have successfully defended their monopoly power in their core businesses, extended their market power to related activities, and never tried to break the core-business monopoly held by others. They have achieved these objectives by a variety of anti-competitive practices including:

1) Denial and manipulation of access to bottleneck facilities and functionalities;
2) Abusive marketing of consumer services;
3) Charging excessive rates on monopoly services to fund acquisitions;
4) Extending market power through acquisition;
5) Expanding market power through leveraging their monopoly base; and
6) Mutual forbearance from competing in other markets.

C. The impact of the merger

To believe that these two companies with such a poor track record of anti-competitive behavior, marrying these two industries, with an even more worse record of anti-competitive behavior, would suddenly be converted into vigorous competitors requires a leap of faith that responsible public policy makers simply cannot make. In truth, the merger can only make matters worse.

1) Marrying TCI's market power over programming and cable distribution with the Bell Atlantic's financial resources generated by excess telephone company profits will only enhance TCI'S effort to dominate the programming sector.
2) Combining the massive potential for cross-subsidy possessed by the telephone company with ownership of programming in the Cable company will be a powerful, added weapon for an integrated telco/cable company to prevent entry by cable companies into the telephone business in its service territory.
3) Creating a company that owns both a ubiquitous, closely regulated common carrier and a ubiquitous, lightly regulated private carrier will stimulate the migration of services to the private network. This will enable the merged entity to increase revenues without going into the telephone business in competition with local telephone companies outside of its service territory.
4) Where the merged entity does chose to enter the cable business, the combination of its massive resources, control over programming, access to cross-subsidies, and extensive practice at anti-competitive tactics will quickly overwhelm the competition.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 161 1997

II. THE TRACK RECORD OF ABUSE

A. Preserving monopoly power through denial of access to bottleneck facilities and functionalities

The local telephone companies hold a hard and fast monopoly over basic telephone service. Approximately 98 percent of all calls placed in this country still go through the local switch and over the telephone distribution plant.

While there has been a great deal of talk about who might come down my street to compete for my telephone business, in ten years no one has and there is no clear picture of when, if ever, anyone will. Efforts by local telephone companies to frustrate local competition have been prodigious, proceeding primarily through denial of access to the local network. Bell Atlantic was a leader in attempting to disadvantage cellular providers and faces less intralata long distance competition than any of the Baby Bells.

Local franchise cable companies hold a hard and fast monopoly over the distribution of non-broadcast television. Approximately 98 percent of all cable television subscribers have one and only one non-broadcast television supplier.

In virtually no instance has there been a competitive alternative offered. TCI's efforts to frustrate local competition have been prodigious, proceeding through challenges to potential competitors who would seek to deploy a similar technology (overbuild) and denial of access to programming for all competitors.

B. Abusive marketing of consumer services

The Regional Bell Operating Companies repeatedly have been found to engage in fraudulent and abusive marketing practices. These abuses have ranged from simple deception in the presentation of bundles of service, to negative checkoffs in the billing of services, to outright fraud in assigning services to subscribers without their knowledge or consent.

On a per subscriber basis, Bell Atlantic paid the highest fine in the country for customer abuse. Even after that case was settled, it continued to manipulate and misrepresent the nature and availability of its services to consumers.

Prior to the passage of the Cable Act, cable companies constantly shifted their packaging of services to force consumer bills higher. With the passage of the cable act, they have again restructured their offerings in an effort to avoid the rate reductions mandated by Congress.

TCI's most notorious attempt to abuse consumers involved a negative check-off for the purchase of a premium pay channel, which was piggy-backed on an existing free channel.

C. Excessive rates for monopoly services to fund acquisitions

The Regional Bell Operating Companies have funded their forays into other businesses with excess earnings from monopoly operations. Competitors, lacking a similar source of funding, are at a huge disadvantage.

Over the decade since divestiture, Bell Atlantic has used excess earnings from its telephone operations to acquire over six billion dollars in non-telephone company assets. Those assets have lost a cumulative total of approximately $700 million. Yet, it continues to acquire more assets, insulated from the consequences of its actions by the continually mounting flow of funds from its telephone subscribers.

The Cable industry generated cash flow through the blatant exercise of market power in constantly raising rates and manipulating offerings. Rates increased three times faster than general inflation in the decade after deregulation and cable systems were sold and resold to capitalize the stream of monopoly rents.

D. Extending market power through acquisitions

Telephone companies, who have never tried to compete head-to-head with telephone companies outside their service areas, have only recently been allowed to provide cable service. Yet, at the very moment that Bell Atlantic seemed to be exercising the right to do so, it has chosen to buy the biggest cable company instead of going against it. For almost twenty percent of its telephone subscribers, the buy out involves the direct elimination of potential competition.

This pattern of expansion through acquisition has pervaded the period since divestiture. Bell Atlantic now has over 100 subsidiary companies in the holding company. The list of acquisitions amassed by Bell Atlantic includes foreign cable, telephone and cellular companies, domestic cellular companies, domestic computer hardware and software firms, and beeper companies, in addition to a wide range of other companies not related to information industries.

Cable companies, who have never tried to compete head-to-head with other cable companies outside their franchise areas have never tried to compete with telephone companies inside or outside of their franchise areas. TCI, which has engaged in the

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 162 1997

most aggressive expansion of its cable TV market power, does so by buying up other cable companies, not competing with them.

TCI used its stream of excess cash flow to make over 400 deals. It has amassed a market share in distribution of almost 25 percent combined with a stake in three quarters of the most popular programming, when all of its affiliations are included.

E. Expanding market power through leveraging the monopoly base

The monopoly power of these distribution companies has also been extended to nearby market segments. Wherever these industries have been allowed to extend their economic activity, they have leveraged their local distribution monopolies into market power in other economic activities.

Leveraging its control over the local switch, telephone subscriber lists and the preferred customer contacts granted to it as the local franchise monopoly, the local telephone companies have completely dominated the Yellow Pages directory and inside wire maintenance markets, the first two markets into which local Bell exchange companies were allowed to go. They have begun to exert domination over the market for information services, such as voice messaging, into which they were recently allowed to expand, through their monopoly control over the both the functionalities of the network (such as call forwarding) and their preferred access to customers.

TCI has pursued an aggressive policy of acquiring local monopoly franchises in an effort to put together a national market presence that yields immense market power. Leveraging this dominant position in the local distribution markets, the programming segment of the cable industry has become highly concentrated under the aggressive expansion policies of TCI. By purchasing programming and alternative distribution technologies and with-holding access to its subscribers, TCI has gained a dominant position in the programming marketplace. It is presently seeking to extend it economic power into the production segment through the acquisition of Paramount, which owns not only a production studio, but additional popular programming.

F. Mutual forbearance from competing in other markets

Neither of these two companies has ever sustained economic activities in competitive environments.

In spite of a 97 percent market share in the Yellow Pages directory market in its own service territory and levels of profits of over 50 percent on those activities, Bell Atlantic has never even tried to offer Yellow Pages services outside of its franchise monopoly area. Nor has it done so with inside wire maintenance, an area where it has a similar market share and profitability. It simply does not go where the competition cannot be overwhelmed by the exercise of its market power, leveraged on the local monopoly franchise.

As previously noted, it has never competed with other local telephone companies. When it has entered truly competitive non-telephone businesses where it could not leverage its monopoly power, such as computer services, it has failed badly. The cellular business, in which it participates, is extremely limited in the extent of competition and still relies on the local net-work to complete its calls.

TCI never enters markets as an over builder and sustains competition in those markets, in spite of its great success as a cable operator. It forebears from entering markets where a strong competitor exists and buys out the potential competitor where it seeks to expand. As previously noted, it has not offered telephone service in competition with the local telephone company anywhere in the country.

III. THE ANTI-COMPETITIVE IMPACT OF THE MERGER

Having observed their previous patterns of behavior, it is quite clear that their profits are maximized by milking the local monopoly, extending its coverage geographically, and leveraging the monopoly core to gain market power in related lines of business. From this perspective, the merger presents a massive, anti-competitive problem.

A. Marrying market power over programming and cable distribution with financial resources of excess telephone company profits will only enhance TCI's effort to monopolize the cable industry

Bell Atlantic's franchise monopoly telephone rate payers are a source of potential financing that would increase the leverage of the merged entity dramatically. The threat to withhold programming or access to subscribers, which is TCI's primary means of extracting concessions from other entities in the cable TV industry, would now be backed up with a source of funding that insulates the merged entity from severe economic harm for sustained periods of time.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 163 1997

Unfortunately, there is little likelihood that this flow of excess earnings will be stemmed at any time in the near future. Profits from telephone operations have been deregulated completely in some places and subject to increasingly regulation in others. Costs are declining and revenue streams are growing, so much so that the debt taken over by Bell Atlantic in the merger, which appears to be the only transfer of assets that has a claim on cash flow, will be absorbed by Bell Atlantic with little difficulty.

B. Cross-subsidy as an added weapon for an integrated telco/cable company to prevent entry into the telephone business

The resources available to Bell Atlantic/TCI can be mobilized in a more directly anti-competitive fashion. Telephone companies have repeatedly engaged in the cross-subsidization of their non-telephone businesses. Bell Atlantic has explicitly adopted a cross-subsidization strategy in its video dial tone proposal. It has refused to allocate any of the costs of the backbone network that will be used to support video dial tone to its tariffs for video dial tone. In essence telephone rate payers have paid for facilities that will be utilized to provide video dial tone.

This strategy of building excess capacity and functionality into the network at the expense of rate payers in order to destroy competition has been a long standing strategy of telephone companies. The capacity for an integrated telco/cable company to implement this strategy will be greatly increased.

Consider the plight of the cable companies in the Bell Atlantic service territory. They face a local telephone monopolist with a massive source of funds, an overbuilt local network as a source of cross subsidy, and ownership of the largest programmer. Not only will local cable operators be dissuaded from going into the telephone business, but they are very likely to make significant concessions to prevent Bell Atlantic from going into the cable business.

From Bell Atlantic's point of view, profits will be increased much more easily and quickly by:

1) Using its leverage to prevent telephone competition;

2) avoiding a fight for cable subscribers; and

3) extracting profits from programming or even the terms and conditions of use of video dial tone by others.

C. Remonopolization over the telephone network

Should the strategy of extracting concessions be resisted, the prospects for cable operators who choose to fight the merged telco/cable company are bleak. The combination of massive resources with control over programming and access to cross-subsidies will quickly overwhelm the competition. Under current law, the local telephone company can exert this pressure through its video dial tone, which we believe is wholly inadequate to protect consumers and competitors. If they succeed in their litigation, they will be able to do it without even the toothless protections of video dial tone.

At best, the local cable company would be forced onto the telephone company wire, being forced to rely on a bottleneck facility controlled by the telephone company. At worst, the losses imposed on independent cable companies will put them out of business. In either case, the result will be one network instead of two.

D. Migration of services to the private network will enable the merged entity to increase revenues without going into the telephone business in competition with local companies

Avoiding competition will also be the preferred strategy in the areas where Bell Atlantic/TCI is a cable operator. The marriage of Bell Atlantic and TCI weds two networks which are governed by fundamentally different principles. It will be in the merged entity's interest to maximize its revenue stream on the cable side and stay out of the telephone side.

The cable TV network is a private carrier subject to very light regulation at the federal level and virtually no regulation at the state or local level. The telephone network is a common carrier subject to light regulation at the federal level and much more rigorous (albeit increasingly relaxed) regulation at the state level.

Rather than compete for telephone service in TCI territories, which would subject those services to local regulation, Bell Atlantic/TCI, would serve its own interests much better by delivering as many service as possible over the private network. Rather than invite the local telephone company to retaliate by entering the cable business, mutual forbearance on the core businesses would be much more profitable.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 164 1997

IV. PUBLIC POLICY TO ENSURE A COMPETITIVE INFORMATION AGE

A. The inadequacy of the current policy to protect the public from the abusive effects of the merger

These examples of the anti-competitive intentions and practices of these two companies are only the tip of the iceberg in the industries that they seek to dominate. I have attached two studies of the anti-competitive practices that pervade these two industries. While TCI and Bell Atlantic have heretofore shown proclivities for specific subsets of the abusive practices, the entire range of strategies so frequently applied in these industries will be available to them. Indeed, from a position of such immense market power as this merger will confer, they could raise these practices to new heights. History has shown that these companies prefer to behave in an anti-competitive manner; the clear economic incentives of this huge vertically integrated and horizontally concentrated entity dictate that it will behave in that manner in the future.

Theories of technological "convergence" or economic synergies simply do not justify this mergers. As technologies converge, as they become homogeneous and appropriable, they should engender decentralization. The increasing concentration we are observing in the information industries is contrary to that economic expectation. If economies of scale and scope require one firm to cover half the country and own three-quarters of the most popular program to achieve the necessary synergies, than the possibility of sustained competition in the industry is dubious at best. These mergers have very little to do with the imperatives of technological convergence or economic synergies and very much to do with the effort to obtain and expand market power through horizontal concentration and vertical integration.

Nor can we rely on regulation to protect the public. As this committee well knows, the Federal Communications Commission could not prevent abuse in a simple industry like the telecommunications industry of the 1960s and 1970s; that was the anti-trust reason for divestiture. The FCC was not able to prevent abuse in the 1980s after divestiture, as local exchange companies have moved into information services. The problem of preventing anti-competitive behavior in a merged telco/cable industry will be vastly greater and even farther beyond the abilities of regulators in the 1990s.

B. General policy to promote an open, competitive information age

Only by removing the structural incentives for anti- competitive behavior can the public interest be served. The cure for the competitive problems posed by this merger is to send a strong signal to all that there is a genuine commitment to competition in our public policy.

With respect to the ongoing problem of concentration in the information age, policy makers should insist on what I call the four "C"'s, common carriage, competition, cost allocation and consumer protection. The general principles are as follows:

- To ensure an open information age, any merging of the two industries through acquisition must extend principles of common carriage to both networks.
- To ensure the sustainability of competition, any merging of the two industries through acquisition must be contingent upon the prior existence of effective competition for the public switched network.
- To prevent anti-competitive cross-subsidies, services provided over either network must pay for all facilities used and the charges must be in proportion to the functionalities and capacities used.
- To prevent abuses of consumers and competitors through leveraging of monopoly facilities, complete separation of telephone, information and video services must be maintained and regulatory oversight over transactions with both the public and competitors must be exercised.

C. Curing the unique problems of the TCI/Bell Atlantic merger

With respect to the merger at hand more vigorous steps are necessary, since it poses such an immediate and direct threat to competition.

Divestiture of the programming from the distribution businesses is the only cure that will prevent the anti-competitive pattern from being reinforced. Without this step, TCI will continue to use its market power over distribution to extend its market power over programming.

In areas of overlap between TCI and Bell Atlantic, divestiture of the telephone lines would be the preferable cure for the direct harm to competition, since this separates the stronger monopoly from the massive whole.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 165 1997

The acquisition of programming networks or production studios should be precluded, since the massive presence of TCI/Bell Atlantic in the distribution phase (with 25 percent of all households today and potentially 50 percent tomorrow) creates an immediate competitive problem should it reenter the other phases of the industry (production and programming).

V. CONCLUSION

This is a key moment in the struggle to create a competitive, open information age. A similar battle was fought just a century ago, when the robber barons in the railroad industry sought to gain control over the levers of economic power in this country through concentration and all forms of anti-competitive manipulation of price and access. The battle to preserve economic freedom started on the highway of commerce of that age, the railroad industry, and it was won through aggressive regulation and the creation of the very anti-trust laws that this Committee oversees.

With the information age reaching into the home of every citizen in the country, the stakes are certainly as large as they were a century ago. In excessive economic concentration and vertical integration, there is neither economic prosperity nor political freedom.

Senator METZENBAUM. Thank you very much.

Mr. Schwartzman?

STATEMENT OF ANDREW JAY SCHWARTZMAN

Mr. SCHWARTZMAN. Thank you, Mr. Chairman. I have a lot of questions for you today and very few answers.

Senator METZENBAUM. I thought we gave the questions and you gave the answers.

Mr. SCHWARTZMAN. I am going to ask some questions because I don't have answers.

The telecommunications mergers now being proposed have constitutional as well as commercial dimensions. The very premise of the first amendment is that democracy depends on maintaining a well-informed electorate. That means citizens, all citizens, must have the right to receive information on matters of public concern, to speak and to be heard. But to achieve the democratic ideal, all Americans must be interconnected so they can communicate as equals.

My view that it is up to government to make sure that we follow the right course has not been fashionable of late. For more than a decade, the executive branch and the independent agencies have lacked regulatory self-esteem, wrongly condemning government as being an obstacle to competition. We deserve better and we may now be getting it. I am especially heartened that the FTC has determined, I believe quite correctly, that TCI's involvement in the proposed Paramount acquisition would be antithetical to the public interest.

I hope that this is the beginning and not the end of the exercise. Some parts of the FTC's proposed consent decree may need to be tightened up, and I certainly hope that the FTC will not rubberstamp the substitution of BellSouth for TCI without the same kind of careful scrutiny.

But now here are some questions. First, just what is a common carrier and why do we need one, or two or many? In other words, do we all mean the same thing when we use terms like "common carrier" or like "universal access" or "interactive" or "nondiscrimination?" Common carriage does seem to be the best way to go, but this and other terms do not have universally understood

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 166 1997

definitions when they are applied to technologies which sometimes haven't even been invented.

Here is what I mean by common carriage: a system in which the carrier would have no editorial control or ownership of the information transmitted over its lines. Every customer should be able to obtain the same two-way connection under the same terms and conditions as everyone else, and the carrier must offer reciprocal access to its competitors.

Second, why shouldn't we let telcos be telcos? In other words, what benefits are to be gained by transforming telephone companies from passive transporters of data into TV networks and motion picture studios? Consider, for example, BellSouth's proposed acquisition of a major interest in QVC. It may not be irrelevant that just last week BellSouth announced a major downsizing, presumably to permit it to deploy its assets more efficiently. But is this an efficient purchase? Will BellSouth help Paramount make better movies or publish more books?

Third, if you have got the conduit, why do you need the content? In other words, is it necessary or desirable for telephone companies to have unlimited rights to control both the content of programming and the means used to transport it?

Fourth, why let telcos do what cable had to be stopped from doing? Having first let the cable industry achieve control of virtually all of the popular program sources and then finding it necessary to pass a law forcing cable operators to share them with competitors, is it possible to erect adequate safeguards to ensure that new telecommunications technologies, especially wireless technologies, will be able to get off the ground?

Fifth, will we all be permitted to be programmers and merchants on the superhighway or will the link to the home be a one-way street? In other words, if telephone companies buy up the Nation's cable industry rather than build competitive systems, will Americans receive universal access to a fully interactive two-way digital hookup or will residential and small business customers be relegated to second-class status under the first amendment?

The buzz word is "interoperability." We need it, but we may not get it if transporters want to make all their money from home shopping and by selling programming and information services rather than from carrying back-and-forth data transmissions.

Sixth, do we want peace among enemies? Do the giant regional telephone companies, with their superior technology and vast resources, need to buy existing cable systems?

Finally, what is the rush? Do we really need fiber for the on-and-off ramps to the digital superhighway? Is it necessary to make the massive investment needed to accelerate development of fiber all the way to the home or will we be able to get data to and from the local central office with copper wire and new wireless technologies, at least in the early years?

We may not need to lay fiber optic cable all the way to the home right away, or perhaps ever, to deliver the fruits of the technological revolution. This so-called "last mile" will be very expensive and we may be able to do the job much more cheaply with an upgraded version of old-fashioned copper wire or with modern wireless technologies.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 167 1997

Mr. Chairman, my questions are not rhetorical. They are real. In voicing skepticism, I am not insisting that I know the right answers. In particular, I am not opposed, in principle, to all mergers, nor do I oppose passive but strategic investments by telecommunications providers.

There are, of course, many more questions in search of answers. In particular, I worry about what happens while we are building the new networks. What may be perceived as efficient and cost-effective in the short run could well prove to be disastrous over time if the cost will be measured in ignorance, innumerability, illiteracy, and divisiveness.

[The prepared statement of Mr. Schwartzman follows:]

PREPARED STATEMENT OF ANDREW JAY SCHWARTZMAN

I am Executive Director of the Media Access Project ("MAP"). MAP is a 20-year old non-profit public interest telecommunications law firm which represents the interests of the listening and viewing public on mass media policy issues. In its appearances before the FCC and the courts, MAP rarely speaks in its own name, but acts on behalf of its clients, which typically are civil rights, civil liberties, consumer, environmental and other organizations. Thus, the views I am presenting today are my own.

Mr. Chairman, I have a lot of questions for you today, and very few answers.

The sudden rush of telecommunications mergers poses a compelling challenge for Congress, for the Administration, and for the regulatory bodies. I welcome the Subcommittee's announced intention to explore the economic implications of these developments and to take strong action if necessary to preserve competition.

IMPLICATIONS FOR THE ECONOMIC MARKETPLACE

If we do things right, the telecommunications revolution can propel this nation towards international technological and economic leadership in the 21st century, while at the same time restoring the prosperity and upward mobility which has eluded too many of us in the last decade.

If we do things wrong, we can destroy the competitive structure which has been the driving force of our nation's economic engine. Small entrepreneurs have been the primary source of innovation in the development of the computer and telecommunications industries. These small and often powerless entities cannot participate in the information society if they are unable to obtain access to huge data and distribution networks of the future. Their ability to do so is not preordained.

IMPLICATIONS FOR THE MARKETPLACE OF IDEAS

But there is more, because this task has constitutional as well as commercial dimensions. The very premise of the First Amendment is that democracy depends on maintaining a well-informed electorate. That means that citizens, *all* citizens, have the right to receive information on matters of public concern, to speak and to be heard. The digital revolution offers the opportunity to maximize these democratic values, but not all of the companies seeking to be part of the future are willing to acknowledge any obligation to fulfill that objective. Small and independent journals and video programmers have been the primary source of the ever broadening diversity of information available to the marketplace of ideas. But all Americans must be interconnected if we expect our data networks to promote democracy and economic opportunity for each of us.

WE NEED GREATER LEVELS OF REGULATORY SELF-ESTEEM

For more than a decade, the Federal Trade Commission, the Federal Communications Commission and the Justice Department's Anti-trust Division have lacked regulatory self-esteem. All too often, they have pronounced themselves to be part of the problem, and not part of the solution.

We deserve better, and we may now be getting it. I'm especially heartened that the Federal Trade Commission appears to have taken a close look at the QVC's original proposal for the Paramount acquisition and determined, I believe quite correctly, that TCI's involvement in the deal would be antithetical to the public interest. I hope that this is the beginning, and not the end, of the exercise. I've seen TCI

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 168 1997

wiggle out of too many anti-trust jams to be comfortable until I see the details; for example, will TCI be such a large creditor of QVC that it will be able to retain some control of QVC's actions? And I certainly hope that the new consent decree does not mean that the FTC will bless the substitution of BellSouth for TCI without the same kind of careful scrutiny which was given to TCI. These are not the last major mergers that will be proposed, and each one should receive equally close attention.

THE AT&T EXPERIENCE: ANTI-TRUST ENFORCEMENT CAN BE EFFECTIVE

Mr. Allen's appearance here today as the CEO of an increasingly competitive AT&T is the best evidence I can offer to show the value of vigorous anti-trust enforcement. By contrast, I would remind you of what we have experienced in dealing with the cable television industry. A decade ago, we were told that government only gets in the way of progress, and that if we simply deregulate cable, competition would inevitably develop and flourish. But after Congress enacted the 1984 Cable Act, competition died.

THE 1984 CABLE ACT: DEREGULATION, BUT NO NEW COMPETITION

It's not just that prices soared under deregulation. Led by TCI, the cable industry bought the programmers, and used this ownership to deny products (that is, programming) to new wireless technologies that have thus far been unable to enter the market. As Viacom has attempted to demonstrate in its recently filed anti-trust complaint against TCI, the cable industry has used its control over the technology of program distribution to erect additional obstacles. Among many other anti-competitive misdeeds too numerous to mention here, cable operators successfully killed off the access channel mechanisms inserted in the 1984 Act to permit a few channels in each system to be outside the editorial control of cable operators.

If government abdicates its supervisory role in making sure that competition will be there as new technologies evolve, competition will *not* be there. As we have learned from the regulatory battles arising from efforts to implement the Cable Act, it is far easier to protect competition as it develops than to restore it after it is lost.

SEVEN QUESTIONS IN SEARCH OF ANSWERS

With those preliminary thoughts in mind, here are a few of the most important questions on my mind. Here is what I would ask:

1. Just what is a "common carrier" and why do we need one? Or two? Or many?

In other words, do we all mean the same thing when we use terms like "common" "universal access," "interactive" and "non-discrimination?"

Understandably, perhaps inevitably, there are plenty of assurances that there will be non-discriminatory access to the gateways of the information superhighway. But these terms do not have universally understood definitions. For example, will a telephone company operating a switched multichannel video "gateway" share its customer lists with competing programmers seeking to use these transmission services. Will it provide access to its data base which shows customers' demographic attributes and billing history? (And if it does, who is going to protect customers' privacy?) Or will the telco be able to emulate the airlines' abuse of their computerized reservations systems and misuse its on-line menus to promote its own services at the expense of others'?

The newly-developing interactive digital technologies are ideally suited for a far more perfect system of common carriage than we have ever had before in any line of commerce. Digital interactive networks of the future will be available to everyone under the same terms and conditions. The technology appears to offer the opportunity to eliminate virtually all of the distributional bottlenecks that have permitted owners of information to use their power to control other parts of the commercial market, as well as the marketplace of ideas.

Under common carriage, the network provider would have no editorial control or ownership of the information transported on its lines. It would make money selling transport, not the data. There would be no incentive to discriminate in providing hook ups; the more hook-ups and the more information it carries, the greater the revenues it will generate.

Common carriage is an especially worthwhile model for information services. Not only is common carnage economically efficient, but it is particularly conducive to advancing First Amendment values. Common carriage could provide an electronic soap

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 169 1997

box that would better fulfill the democratic ideal than anything that Jefferson and Madison could have ever imagined.

The same confusion surrounds other important terms. For example, does "universal service" mean that every customer will receive the same quality hook up? While every phone and cable company wants to deliver video signals to every home, they do not all wish to invest in two-way systems that will return video as well as voice and simple data transmissions. If "universal service" means the right to buy video on demand and to be a home shopper, but not the right to be a programmer and a video speaker, democracy will suffer.

So, it is not enough to say we need common carriage, or universal service. We need to ask what each speaker means when it uses these terms.

2. Why shouldn't we let telcos be telcos?

In other words, what benefits are to be gained by transforming telephone companies from passive transporters of data into electronic newspaper editors and TV producers?

It is unclear whether there is any advantage to having telephone companies attempt to learn new tricks. MIT's Michael Schrage has wisely warned in his syndicated column that Bell Atlantic's acquisition of TCI may lead to a disastrous corporate cultural mismatch.

Consider, for example, BellSouth's proposed acquisition of a major interest in QVC as part of QVC's own proposed takeover of Paramount. It may not be irrelevant that just last week BellSouth announced a major downsizing, presumably to improve its efficiency and permit it to better deploy its assets. But will BellSouth help Paramount make better movies, or publish more books? On the other hand, if we have open access, BellSouth doesn't need to own QVC or Paramount in order to carry its programming.

3. If you've got the conduit, why do you need the content?

In other words, is it necessary, or desirable, for telephone companies to have unlimited rights to control both the content of programming and the means used to transport it?

Perhaps the most significant question posed by the recent activities of the regional Bell companies is the sudden move towards vertical integration, that is, acquisition of ownership and control of the content of programming.

What benefits derive from telco ownership of the means of programming? Certainly the telephone companies bring little programming expertise into this new line of business. While telcos' financial clout is considerable, cable has not had difficulty obtaining willing investors.

On the other hand, the dangers posed by telcos' program ownership are tremendous. The opportunities for cost subsidization are evident. Even more ominously is the possibility for abuse of this journalistic and programming power. For example, Bell Atlantic—a company which seeks to please every state legislator and public service commissioner in the middle Atlantic states—seeks in its proposed purchase of TCI to acquire a major stake in Cable News Network. I have no reason to expect that Bell Atlantic, or TCI for that matter, would ever knowingly seek to abuse this power by killing or carrying stories that would help or hurt politicians. But why create the problem, and then worry about how to deal with it, if you don't have to do it in the first place?

4. Why let telcos do what cable had to be stopped from doing?

In other words, having first let the cable industry achieve control of virtually all of the popular program sources, and then finding it necessary to pass a law forcing cable operators to share them with competitors, is it possible to erect adequate safeguards to insure that new telecommunications technologies, especially wireless technologies, will be able to get off the ground?

The rate regulation adopted in the 1992 Cable Act is simply an interim measure designed to permit competition to develop under the much more important anti-competitive provisions also contained in that law.

In the Cable Act, Congress made what are among the most specific statutory findings in history detailing how the cable television industry leveraged its control of programming into an unregulated monopoly, stifling introduction of new technologies and making giant companies like General Electric/NBC beg for access.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 170 1997

Given this recent exposure to the dangers of vertical integration, why repeat the mistake, especially if it may not be necessary to rapid development of a digital superhighway?

5. Will we all be permitted to be programmers and merchants on the superhighway, or will the link to the home be a one way street?

In other words, if telephone companies buy up the nation's cable industry rather than build competitive systems, will all Americans receive universal access to a fully interactive two-way digital hookup, or will residential and small business customers be relegated to second class status under the First Amendment?

You don't need full two-way capabilities to order groceries and movies. If a transporter's real profits come from selling programming and information services and from home shopping, it will have little incentive to develop full two-way interoperability.

Much of the talk in recent weeks has characterized the public as "consumers." The consumer metaphor is a dangerous one, because it connotes a passive role for a public which will be merchandised to, programmed to and otherwise exploited. The technology now under development will be capable of sending just as much information in the other direction, and the future of the democracy may depend on making sure that is what we get.

6. Do we want peace among enemies?

In other words, do the giant regional telephone companies, with their superior technology and vast resources, need to buy existing cable systems?

Cable and telephone have thus far viewed themselves as natural predators in the communications wilderness. The prospect of direct competition between them is something that many of us have long awaited. Ironically, Bell Atlantic has thus far led the way in fashioning a model for effective competition between the cable and telephone industries.

It may not be a good idea for telcos to end the competition by acquiring the nation's cable TV systems.

Telephony and cable have offered two very different models. Under cable's system, the operator owns much or most of the programming, and delivery is a relatively minor part of the business, as is exemplified by cable's studied indifference to customer service. Cable's relatively archaic trunk and tree architecture has many shortcomings; like old fashioned Christmas tree lights, one break in the system can knock out service to hundreds of subscribers.

Telephone companies have been proposing to offer non-discriminatory transport services to all comers, using an advanced version of the switched technology that has brought us reliable voice and data service for decades.

A few years ago, when the Federal Communications Commission adopted its so-called video dial tone rules, telephone companies (including Bell Atlantic) said they had no interest in, knowledge about, or desire to become programmers. Rather, they argued that they simply needed a purely passive financial interest in programming in order to prime the pump and create the additional revenues necessary for reinvestment. When the FCC adopted rules permitting telcos to have a 5 percent passive ownership interest in their programming, most telcos expressed pleasure. Bell Atlantic, in particular, not only said they could live with those rules, but they started to build systems which would operate under them.

Why then did Bell Atlantic wish to buy TCI? Did it seek to acquire TCI's superior consumer services capabilities? Surely not. Did it seek to acquire a superior technology and switching capability? Surely not.

What, then, is Bell Atlantic acquiring? Well, first it is acquiring a lot of debt. TCI's proprietors, Dr. Malone and Mr. Magness, are cashing out, getting Bell Atlantic's cash in exchange for a company loaded down with debt. This part of the investment will not be used to hire new Bell Atlantic employees. It will not help lay a foot of fiber cable, develop a single line of new software or otherwise advance the infrastructure.

What else is Bell Atlantic acquiring? Little that it can not construct on its own, except programming it may not need and existing cable systems outside of its service area which rely on an inferior cable television technology.

7. What's the rush? Do we really need fiber for the on and off ramps to the digital superhighway?

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 171 1997

In other words, is it necessary to make the massive investment needed to accelerate development of fiber all the way to the home, or will we be able to get data to and from the local central office with copper wire and new wireless technologies, at least in the early years?

This matters, because someone has to pay for all this investment, and it is likely to be the residential ratepayer who will wind up with a large part of the bill.

We may not need to lay fiber optic cable all the way to the home right away, or perhaps ever, to deliver the fruits of the technological revolution. This so-called "last mile" will be very expensive, and we may be able to do the job much more cheaply with an upgraded version of old fashioned copper wire, or with modern wireless technologies.

Indeed, in announcing its own plan to develop a high speed data network last week, PacTel indicated that it thinks it can deliver video services to the home, without bringing fiber all the way to the home. The experimental joint venture of Time-Warner and US West in Orlando would also employ a mix of copper and fiber.

Bell Atlantic used to say the same thing. Now, however, it seems to be thinking just about fiber, not copper. One of the great disappointments of the Bell Atlantic-TCI acquisition is that Bell Atlantic was leading the way in developing technology to use its preexisting plant of copper wire and telephone switching to deliver digital services to homes and businesses. This is at least potentially a much cheaper and smarter way to begin the development of a superhighway. It will be a long time, if ever, when we actually need fiber into the home; depending on how wireless technologies emerge, fiber into the home may prove to be an expensive mistake.

I would also caution about the seeming urgency to decide these issues immediately; it may be an artificial crisis. High definition TV is an instructive example. Indeed, we are lucky that policymakers did not succumb to similar demands in the mid-1980's for immediate construction of a high definition TV system. As it has turned out, the Japanese moved too quickly to develop an inferior analog technology. We have waited for digital technologies to catch up, and we're much better off for it.

* * * * *

Mr. Chairman I wish to be clear: my questions are not rhetorical, they are real. In voicing my skepticism, I am not insisting that I know the right answers. In particular, I am not opposed in principle to mergers of the telecommunications giants. Indeed, in light of AT&T's declared interest in open network access, the proposed merger of AT&T and McCaw could prove quite beneficial, so long as certain necessary safeguards are instituted. Nor do I oppose strategic investments by telecommunications providers. For example, NYNEX's passive investment in Viacom's proposed merger with Paramount is far less troublesome to me than BellSouth's evident interest in being an active operator of Paramount.

There are of course many, many more questions in search of answers. I hope this Subcommittee and others which share jurisdiction with you will keep seeking answers. In particular, I am concerned about preserving "free" over-the-air TV as a unifying force in our culture. The right to speak and to receive access to information is meaningless if it is reserved only for those with deep pockets.

I am worried about what happens while we are building the new networks. Telecommunications can and should promote inclusion, linking each of us to each other and the world, enabling us to share common cultures and differing traditions. If telephone companies busy themselves building new information superhighways while ignoring their current services, the installed base of residential telephone installations will continue to erode. This could leave millions more Americans left unable to speak to friends, family, and employers by this medium. What may be perceived as efficient and cost-effective in the short run could well prove to be disastrous over time, if the cost will be measured in ignorance, illiteracy, innumeracy, and divisiveness.

Senator METZENBAUM. Thank you very much, Mr. Schwartzman.

I do have a few questions for both of you. Mr. Cooper, at our last hearing on communications mergers, experts expressed concerns that TCI's vast network of cable systems and programming added to Bell Atlantic's local telephone monopoly would diminish incentives for head-to-head cable and telephone company competition. Since I share those concerns, I am extremely troubled that your

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 172 1997

testimony describes a history of abusive, anticompetitive practices engaged in by TCI, Bell Atlantic, and similar companies.

Would you comment on the kinds of behaviors that are relevant to antitrust review of the proposed Bell Atlantic-TCI merger?

Mr. COOPER. I think the crucial behaviors are denial of access. The telephone companies have consistently fought access to their network, have thrown up conditions, have made it difficult for competitors to get access to their networks. I was just reading Judge Green's first triennial review and he cited Bell Atlantic as creating problems for their cellular competitor because, as you saw today, they still rely on the local switch network. So they deny access to the technology and therefore disadvantage their competitors. TCI, of course, has had a similar pattern by withholding access to their subscribers and withholding access to their programming.

The first antitrust theory you heard this morning had to do—or one of the theories—had to do with a denial of access to potential markets. So if you take this massive market of 22 or 24 million subscribers, depending on how you count them, and you combine that with companies who have consistently denied access, you have a terrible vertical problem with respect to competition in the industry.

TCI can make its own market in programming and can destroy alternative programmers from achieving a market. That is the central complaint. TCI alone could do that. Add to that the additional subscribers of Bell Atlantic and you have a monumental problem in terms of denial of demand.

Senator METZENBAUM. Mr. Cooper, as we heard from the FTC this morning, TCI's power in the cable and programming markets is so great that the Commission found significant competitive problems with TCI gaining an ownership stake in Paramount. From a consumer perspective, should the FTC's analysis and concerns be relevant to an antitrust review of the proposed Bell Atlantic-TCI merger?

Mr. COOPER. Absolutely. The vertical problems—there were three theories: loss of a potential competitor, and that is absolutely the case. The cable and telephone companies looked like the most likely competitors. That is the first theory you heard this morning. A second theory was the loss of demand. Those are absolutely crucial theories. They are clearly at issue in this merger and they just get bigger when you take two of the largest entities and put them togetner. So those vertical theories have direct and immediate relevance to the Bell Atlantic-TCI merger and any merger involving one of the Baby Bells because of the massive potential in terms of access to consumers.

Senator METZENBAUM. You state very forcefully in your testimony that regulation, including the 1992 Cable Act, cannot prevent the anticompetitive practices that you believe are associated with proposed mergers like the Bell Atlantic-TCI deal. Would you care to elaborate on that point?

Mr. COOPER. Well, the history is clear. There are not enough regulators and auditors in the world to follow all of these transactions. I have testified in about 70 State cases on various and sundry abuses, and the most dramatic one is in Georgia in which the voice messaging market had been opened up to the Baby Bells and com-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 173 1997

petitors are simply completely dependent upon the transactions that take place between the local monopoly switch and the telephone company.

In every transaction, when someone would call and say I want to sign up for this voice messaging service, they would have to order something from the local company. They would cross-sell. Why do you want to buy from them? We offer the same service. Of course, they have effectively and systematically destroyed that competition. How can you police those transactions?

I have been an expert witness in two fraudulent marketing cases in which, when people call up for local service, they get sold other things fraudulently. How can regulators police those private transactions? The record is clear, the tendency is clear, and the impossibility of regulators policing all that is just as clear as well.

Senator METZENBAUM. QVC's partners in the Paramount bidding war include cable companies Cox, Comcast and Newhouse that own cable systems in the territory of BellSouth, the newest partner in QVC's tender offer. Similarly, Viacom has enlisted NYNEX as a major financial partner in its bid for Paramount.

Do you believe that antitrust authorities should require that either local telephone or cable operations be divested where financial partners could end up owning both communications wires into the home?

Mr. COOPER. I absolutely think there should be divestiture, but I think that divestiture should be of the telephone lines, if that is technologically feasible, rather than the cable lines. Because the telephone line is the stronger monopoly, the potential threat to competition comes from the potential subsidy of those telephone subscribers. So while you have frequently heard people say we will divest the cable company, I suggest that maybe we should look at them divesting the telephone lines, since that is the greater threat to competition.

Senator METZENBAUM. If the proposed Bell Atlantic-TCI merger were not approved by antitrust authorities, some industry observers claim that the convergence of communications technologies will lead to similar large corporate combinations and consolidations. Do you agree with that assessment, and if not, please explain how competition for local phone and cable service would be more likely to develop without megamergers?

Mr. COOPER. I think the key barrier, as mentioned by Andy, is there is no clear reason why we have to have convergence of the content and the conduit. There is a difference between the pipe and what you put in the pipe, and that is the crucial link that has to be broken. We need to have divestiture and separation of the programming of the product from the pipes.

We may have three or four pipes coming into every house, but if you can tie up the product, then you will ultimately shrink the number of potential competitors. So the convergence of technology just doesn't ring true in terms of the potential for programming compared to the potential for delivering it. There is no clear relationship between making movies and then turning them into bits, a data stream, because that is all you are doing on the network. They are completely separate technological tasks. Once you have

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 174 1997

the movie, you can turn it into a data stream of ones and zeroes, and anyone can deliver that and unscramble it.

The linkage between ownership and concentration of programming and ownership and concentration of the pipes is not technologically necessary or, in fact, in the public interest.

Senator METZENBAUM. Thank you. Mr. Schwartzman, I am going to have to be rather brief with you because I have just been advised that a vote has just commenced on the floor.

At our last communications merger hearing, Mr. Smith from Bell Atlantic stated that even with all of TCI's programming, Bell Atlantic would only own a small percentage of all television programming and therefore could not impede competition in the programming market. Do you agree with Mr. Smith's analysis?

Mr. SCHWARTZMAN. No; I will try to be brief for a very complicated question, Mr. Chairman. There is programming and there is programming. These are not widgets. They are not fungible items any more than the Washington Post is comparable to the monthly newsletter of a community association or homeowners group. Different channels of media have different power and preestablished power.

As Ms. Steptoe said this morning, much of the entertainment production of this country is already tied up on contracts and goes to particular entertainment channels. These have marquis value. Even though there may be several hundred supposed channel offerings, when you eliminate the repetition there are many fewer. But even of those channel offerings, most people watch just a few of them. Those dominant channels are the ones that are necessary in order to maintain control, and of those dominant channels, TCI controls most of them or many of them. So, the degree of clout that TCI has when combined with Bell Atlantic's financial clout is not simply measured in some sort of small percentage calculation of the number of channels.

Senator METZENBAUM. I agree with many of the concerns you raised in your testimony about the proposed mergers in the communications industry. However, some industry observers claim these fears should disappear when cable and other communications systems expand to offer 500 channels of programming. Do you agree with that assessment? What about all this talk of 500 different channels of programming and you don't need to worry about who has got control of what programming?

Mr. SCHWARTZMAN. Well, 500 channels may be controlled by as few as one company, and that is the problem. How many companies have editorial control? That is the core assumption of the 1992 Cable Act, which is that when you have 50, 60, or 70 channels all controlled by one cable operator, you have a bottleneck. Experience since 1984 in deregulation has proven that that bottleneck can be abused.

I am not sure we are going to have 500 channels, as most people seem to think. A lot of these are going to be data and information services, but video on demand means that they are going to use 100 channels by having 10 movies being shown 10 times a day at staggered intervals. If those 10 movies are all controlled by one company, that doesn't bring any diversity. The real key is whether competitors are going to be able to gain access, and if we look to

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 175 1997

TCI as the model on how to use control over the gateway in order to keep access out, it is not a very optimistic situation that we face. That is what is so troubling.

Bell Atlantic, a company that I greatly respect, had been leading the way in setting up competition with the cable industry. Bell Atlantic was moving toward a model of a truly open gateway in which everyone would be able to hook up on a nondiscriminatory basis and Bell Atlantic was going to be offering transport. So when Bell Atlantic buys TIC, it is buying the company with the experience to abuse its control over the access to the home. That is what troubles me.

Senator METZENBAUM. I am troubled, also. I am troubled that not only competition, but political debate may be stifled when large communications companies combine. For example, Hollywood used to defend the rights of the creators of programming against cable's monopolistic practices. However, industry critics claim that since Time, Inc., merged its cable operations with Warner Brothers Studios, Hollywood lost its zeal for fighting the cable industry. Similarly, at our last hearing we heard how TCI allegedly pressured NBC to alter the format and focus of its cable news network.

How do you respond to these claims, and what are the broader implications for the free flow of information in our society?

Mr. SCHWARTZMAN. These are very troublesome concerns, and the G.E. example that you described is a very potent one that the supposedly all-powerful network, backed by General Electric, had to agree in writing that it would not compete with TCI's own Cable News Network. Well, let us talk about Cable News Network, which has been run, I think, in a very fair and even-handed way, but the potential for abuse is tremendous.

Now, you have Bell Atlantic acquiring TCI and, through TCI, acquiring what is in many ways an effective control of CNN. Bell Atlantic is a company which is accountable right now to State legislators and State regulators throughout the entire Middle Atlantic States. Supposing, in theory, CNN were doing an investigation of political practices or regulatory practices, the concern, whether it is real or not, whether it is fanciful, might be that, gee, they are going to come after us, maybe we ought to be nice to them.

When you combine the kind of power that comes with being a regulated monopoly, a company that is accountable for providing common carrier service, with the control over dissemination of news and information, you are creating a scenario that offers opportunity for great abuse. As with all that we have been talking about this morning, Mr. Chairman, the solution is to look ahead, to act prophylactically to avoid creating combinations that can cause problems and then trying to fix them up after the fact.

Senator METZENBAUM. Thank you very much, Mr. Schwartzman. Thank you, Mr. Cooper.

The hearing stands adjourned.

[Whereupon, at 11:47 a.m., the subcommittee was adjourned.]

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 176 1997

MEGAMERGERS: EXPRESS LANE OR ROADBLOCK TO THE INFORMATION SUPERHIGHWAY?

THURSDAY, DECEMBER 16, 1993

U.S. SENATE,
SUBCOMMITTEE ON ANTITRUST, MONOPOLIES
AND BUSINESS RIGHTS,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:05 a.m., in room SD–226, Dirksen Senate Office Building, Hon. Howard Metzenbaum (chairman of the subcommittee), presiding.

Also present: Senators Thurmond and Leahy (ex officio).

OPENING STATEMENT OF HON. HOWARD M. METZENBAUM, A U.S. SENATOR FROM THE STATE OF OHIO

Senator METZENBAUM. Good morning. This is the third and, barring some new development, final Antitrust Subcommittee hearing on the wave of mergers that is sweeping through the telecommunications industry.

Since we began these hearings in October, there have been almost daily press accounts of some new deal among powerful telephone, cable, and video programming companies. To date, US West has formed a joint venture with Time Warner. BellSouth has teamed up with QVC and three cable companies, Cox, Comcast, and Newhouse, to bid for Paramount. Southwestern Bell has announced a joint venture with Cox. NYNEX has invested in Viacom's bid for Paramount. AT&T has reached out to acquire McCaw Cellular. The five largest cable companies—TCI, Comcast, Time Warner, Continental, and Cox—have formed a joint venture to develop new telecommunications services, and Bell Atlantic has proposed a megamerger with cable giant TCI.

We are witnessing a feeding frenzy that threatens to consolidate the telecommunications industry into a handful of giant conglomerates. Some have welcomed this, claiming that it will speed development of the so-called information superhighway. I have my doubts. It appears to me that these megamergers are less likely to advance developments in communications than they are to suppress competition and force new monopolies.

To my mind, the single most important issue is whether these deals will give consumers more choices for telephone and cable services at lower prices, or allow them to be victimized by a handful of telecommunications giants.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 177 1997

The fact is that no one in this room or in any corner of industry or academia has the definitive answer to that question. However, industry captains, Federal trustbusters, independent experts and consumer representatives have warned us that we must proceed with extreme caution if we want competitive market forces to build this information superhighway. The fact is that the deals that are allowed to pass antitrust scrutiny in the next 3 to 5 years can control the growth and direction of this industry for the next 50 to 100 years. If Government does not provide the proper direction or insist on safeguards to protect the public, we may miss an important opportunity.

As Prof. Robert Pitofsky, who is heading an administration defense antitrust panel, will testify, growth and innovation in an industry can be retarded for decades if the antitrust authorities turn a blind eye to anticompetitive strategies to dominate the market. If America hopes to be competitive in the 21st century, we cannot allow that to happen in the telecommunications industry.

Until a few months ago, telephone and cable companies had been positioning themselves for head-to-head competition. However, they now seem intent on combining rather than competing. Unless we are vigilant, a future telecommunications industry could be dominated by a colossus like TCI-Bell Atlantic and a handful of less competitors. Under those circumstances, there could be more incentive for telecommunications companies which have no history of or experience with competition to simply coexist.

As Robert Allen, the head of AT&T, observed at our last hearing:

> I have never seen a single [regional Bell company] compete in another's territory, with the exception of cellular franchises * * * and I have never seen a cable company compete against another cable company or a telephone company * * * [They have] no record of competition or incentive to compete.

There is another reason to be concerned about consolidation in the telecommunications industry. Telephone and cable monopolies have an established track record of anticompetitive conduct. Last month, consumer witnesses testified that the regional Bell companies have repeatedly been guilty of deceptive marketing practices and outright consumer fraud. Likewise, the cable industry has been disciplined for forcing consumers to buy expensive packages of cable programs and for other abuses.

At our last hearing, I read an astonishing memo from an employee of TCI who urged his system managers to undermine cable rate restrictions by charging consumers for established services and then "blame it on re-regulation and the Government." We will certainly give Mr. John Malone, the head of TCI, an opportunity to defend that memo when he testifies later this morning.

However, the megamerger that concerns me the most is Bell Atlantic and TCI. That is because TCI has been allowed to acquire so much market power over cable systems and programming. In 1984, the Baltimore Sun reported that Mr. Malone compared his industry to "a game of monopoly" and stated that "TCI's primary goal was to * * * buy more property." TCI has certainly realized that goal. It is the Nation's largest cable system. It reaches about 25 percent of all cable subscribers. In March of 1993, Fortune Magazine reported that TCI's John Malone "has the power of gate-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 178 1997

keeper in this highly competitive industry. No cable channel can thrive without access to his customers."

TCI's market power will become even more formidable if it is allowed to merge with Bell Atlantic. That new colossus would have a telephone or cable wire connecting approximately 40 percent of the homes in America. The head of the FTC's Bureau of Competition testified before this subcommittee "When you consider the number of consumers affected by Bell Atlantic-TCI, obviously the potential, if there is an antitrust problem, is enormous."

Moreover, TCI and Bell Atlantic would control a vast stable of cable programming, including 9 of the 20 most popular cable networks. The very large chart to my right lists TCI-controlled programming. It is a very formidable list.

It was TCI's excessive power over cable programming that led the FTC to challenge its back-door acquisition of Paramount. Incidentally, TCI argues that, well, we don't have a 51-percent position in this company or that company, and therefore we don't have control. Don't you believe it. Mr. Malone and TCI are in a position to exercise control with far less than a 51-percent position.

Technically, in the previous matter before the FTC, it was QVC and not TCI that was buying Paramount. However, TCI has a 22-percent stake in QVC which the FTC concluded could give it the power to control Paramount's cable programming. Consequently, in a November 15 consent decree against TCI, the FTC charged that giving TCI control over Paramount's cable programming could permit it to raise prices to subscribers and other cable operators, to collude with other cable operators to raise prices or to deny competitors access to desirable programming, and to keep new competitors out of the market.

The fact is that TCI already has the power to raise prices and block new competitors with or without acquiring Paramount's cable programming. In my view, the real importance of the FTC's challenge is that it marked the first time in recent memory that a Federal agency was willing to say no to TCI. For that, the American people owe the FTC a debt of gratitude.

However, none of the charts displayed in this room or the FTC's consent decree against TCI tell the complete story of its dominance in the cable industry. The fact is that TCI has found other even more clever ways to expand its power and intimidate would-be rivals.

For example, TCI controls a programming buying agent for cable systems which purchases cable programming at a deep discount. That TCI subsidiary wields enormous power. It can refuse to buy programming at a competitive price, which easily could put a programmer out of business, or it can expel a renegade cable system from the group, denying them the financial benefits of TCI's buying clout and putting their systems at risk.

The Congress must ensure that there is robust competition in telecommunications markets. To that end, yesterday I sent a letter to Anne Bingaman, the Department of Justice's Antitrust Chief, and Janet Steiger, the Chairman of the Federal Trade Commission, calling upon them to create elite units of experienced antitrust lawyers to review telecommunications deals. My reasons for making this recommendation are three-fold.

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 179 1997

First, some of the most important deals, such as Time Warner's joint venture with US West, were never formally reviewed. I believe that the antitrust agencies should go back and look at those deals in light of recent mergers that involve Time Warner's other programming investments.

Second, I am concerned that if telecommunications deals are reviewed in isolation from one another, their anticompetitive consequences may be understated. However, if those deals are examined in light of the consolidation and the web of interlocking arrangements that are developing in the industry, their anticompetitive dangers will be more apparent.

Third, a December 9 Wall Street Journal article suggested that the Clinton administration might challenge some communications deals and not others "to show that it intends to live by its aggressive antitrust rhetoric." I do not believe that either DOJ or FTC would do such a thing. That statement implies political gamesmanship on the part of DOJ and FTC. Frankly, I have more faith in the integrity of those agencies than in the Wall Street Journal report.

The fact is that the decisions that the antitrust agencies make to approve, to condition, or to challenge a telecommunications deal will affect consumers and the vitality of the industry for decades and the free flow of ideas to all Americans. The Department of Justice and the FTC could demonstrate their enforcement resolve and bolster their resources by forming special units to scrutinize every telecommunications deal. Doing so would also protect American consumers from decades of anticompetitive abuses at the hands of a few ruthless telecommunications giants. I intend to make sure that the President is fully aware of my antitrust concerns, as well as other members of his administration.

We are delighted to have with us today the ranking member of this subcommittee, Senator Strom Thurmond. Senator, do you have an opening statement?

OPENING STATEMENT OF HON. STROM THURMOND, A U.S. SENATOR FROM THE STATE OF SOUTH CAROLINA

Senator THURMOND. Thank you, Mr. Chairman. This morning, we hold our third hearing on recent large transactions in the telecommunications industry. Telecommunications businesses continue to evolve rapidly, as shown by the partnership between Cox Enterprises and Southwestern Bell and Bell Canada's investment in Jones Intercable, both of which have been announced since our last hearing.

The speed at which this industry is changing raises the need for congressional review of the appropriateness of relevant laws and regulations. Additionally, it raises concerns that excessive Government review and regulation will unnecessarily impede private initiative and competition in this vital sector of our economy.

At our previous two hearings, I discussed the proper role for the Congress in considering the proposed mergers. Determining the purpose and proper scope of this hearing is even more important due to the large number of allegations that have been made against Tele-Communications, Inc. The purpose today should not be to attempt to adjudicate the specific allegations against TCI, for

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 180 1997

we are neither judge nor jury. Detailed consideration by this subcommittee of improper conduct or market imperfections is necessary only where existing antitrust laws or enforcement are inadequate or under review.

TCI's actions are now being challenged under the antitrust laws in Federal court where the issues can be fully and fairly litigated and adjudicated. In fact, Mr. Malone may be unable to address certain issues in any detail today because of the pendency of this private antitrust litigation in New York.

Finally, as I have stated at our previous hearings, the antitrust enforcement agencies are entrusted with conducting a competitive analysis of the proposed mergers and bringing any necessary antitrust challenge. The role of the Congress should be to ensure that laws and regulations keep up with the convergence of telephone, cable, and wireless technologies so that competition can flourish wherever possible in the marketplace for the benefit of consumers.

Mr. Chairman, I wish to thank each of the witnesses for their time and effort in appearing before the subcommittee this morning because I know it was difficult for several of them to arrange a time to do so. I look forward to hearing their testimony.

Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you very much.

We are very, very pleased that Senator Bob Kerrey of Nebraska is with us this morning. Senator Kerrey has been a leader in studying the importance of communications policy since he was Governor of Nebraska, and so this is not a new area for him and we are pleased that in this area, as in so many others, he is willing to speak out and share with us the benefit of his thinking.

We are delighted that you are here with us this morning, Bob.

STATEMENT OF HON. J. ROBERT KERREY, A U.S. SENATOR FROM THE STATE OF NEBRASKA

Senator KERREY. Thank you, Mr. Chairman. Since you asked me to keep my testimony to 10 minutes, I will do two things; first, ask unanimous consent that the entire testimony be included in the record, and then, second, I will drop the first 10 pages which are essentially complimenting you on holding these hearings, and reduce that to a single paragraph to say that American consumers really have benefited from your tireless and truly fearless vigilance on their behalf. You have not only saved taxpayers an awful lot of money, Senator Metzenbaum, you have saved an awful lot of lives.

Senator METZENBAUM. Thank you very much.

Senator KERREY. I know there are going to be a number of people who like to buy silence around here with campaign contributions who won't regret your passing in 1995, but I, for one, will miss you terribly and I can't imagine how it is going to be possible to fill your shoes.

Senator METZENBAUM. Your friendship means much to me and I appreciate your comments.

Senator KERREY. Mr. Chairman, I have made an effort to come here and ask to testify on this proposed merger because I would like to suggest how I think we should regulate these new communications industries, but I am also here because I believe that some of the most important concerns, at least as I see them being ex-

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 181 1997

pressed by the American people, as well as their aspirations, hang in the balance of what we do.

The revolutionary changes—and indeed they are revolutionary changes—in the technologies that enable these industries to grow and to form present the American people and the world, I believe, with a series of good news/bad news events.

The good news is these technologies are going to create millions of new jobs for the American people who have acquired the skills in the new media. The bad news is that millions of jobs will be lost as software replaces workers and as obsolete products disappear with startling speed.

The good news is that we are going to be given a tool which will enable us to communicate with one another more quickly, more cheaply, and in ways which could enrich our culture and deepen our respect for the powers of the Almighty to create and destroy. The bad news is the potential for the invasion of privacy and the trivialization or vulgarization of our culture, politics, and humanity.

The good news, Mr. Chairman, is that democratic power and business politics and our social life could become more distributed to the people, but the bad news comes in the form of monopolies, either imposed by the Government, Mr. Chairman, or allowed by neglect, which could strangle the individual impulse to create and express.

The good news is that these technologies could change our lives for the better, but the bad news is that they could, if we do not apply values that satisfy our highest aspirations, add fuel to the fire of violence that is threatening the American family and the American way of life.

Borrowing, Mr. Chairman, from an observation made by Mr. Neil Postman, when I look at America and make a list of good news and bad news, the good news is seldom a consequence of technology alone, and the bad news is never a result of a shortage of technology. If there is something missing today in America, it is not a new generation of whiz-bang toys, personal data systems, modems or fiber optics. The missing ingredient is the need to belong, to feel some dignity, to feel some purpose of life, and to feel that our individual power to do something good is alive and well.

One of the most important conditions that adds to an individual's sense of dignity, Mr. Chairman, and to that individual's respect is having a job. A job, Mr. Chairman, can cure a lot of ills. It can change a life from desperation to optimism, and jobs are clearly at stake, Mr. Chairman. Our regulatory response to this proposed merger will have a profound impact on the lives of our youth who are searching for work and our middle-age workers who may be among the 2 million Americans a year who receive a pink slip.

Jobs must be issue number one. Millions of new American jobs will be created as new products and services are sold to American and world consumers. We must take care not to allow the headline stories that describe telephone companies downsizing their workforce to prevent us from seeing the news of rapid growth of jobs in the hardware, software, and infrastructure industries.

Mr. Chairman, to summarize a few pages here, it has been estimated that the telecommunications industry, and the telephone

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 182 1997

companies specifically, will invest $150 billion over the next 5 years; that the marginal increase in investment will total $50 billion in 1993 money. Mr. Chairman, that $50 billion over 5 years compares, in 1993 dollars, to $37 billion that was invested in the interstate highway system from 1957 to 1963.

Mr. Chairman, these investments that are being made by private capital are going to create an awful lot of jobs here in the United States of America, and my hope, Mr. Chairman, is that you will follow your quite persuasive and quite impressive consumer nose to allow you to determine how it is that we ought to regulate. I would like to suggest, Mr. Chairman, that if you do follow that consumer nose and say, what is it the consumer wants, what is it that I want, what is it that you want as a consumer, it is much more likely that our regulatory response will be appropriate.

Let me give you an example. I have got a number of consumer needs that I have in my own household, and I would like to describe those consumer needs, and I would like to describe as well how I currently satisfy those needs.

First of all, I want a phone that works. To satisfy that need, I make sure I elect regulators who promise to keep my rates as low as possible. I want my television to be as clear as it can be, and again to get that done, I elect regulators who promise to keep my cable service as cheap as possible. I want a mix of news and entertainment on my radio and TV, and so I ask Federal regulators to monitor the hourly content of the broadcasts.

I want my newspaper delivered before I eat breakfast, so I pray, Mr. Chairman, every day that the newsprint monopoly is concerned enough about seeing print ads to get that done. I want my mail waiting home at night, and that is why I buy a Christmas present for my postman every single year. I like to read, Mr. Chairman, so I shop at stores that I like; I shop at stores that allow me to have a cup of coffee and read at my leisure.

I have eclectic tastes in music, Mr. Chairman, so I go to stores where the other shoppers are approximately the same age as my children. Though I do not, Mr. Chairman, buy and watch videotapes, I do have an account at Blockbuster because my children, like many children in America, currently today check out more videotapes at video stores than they do from the public library.

Mr. Chairman, what I suggest to you is that it is possible if we regulate properly to go from an old world where I said I want telephone service and television service and other information services and I have got to seek the opportunity to get that through regulatory effort. I believe in the new world it is possible merely to say I as a consumer should have options; I as a consumer should have choice. I should not face any business that says to me, Mr. Chairman, that I have to take that service on a take-it-or-leave-it basis. That business should understand that if I don't like the service that they provide me, I will take my business elsewhere; I will move it down the road.

Mr. Chairman, I know it is difficult for all of us to understand, but today all of this information—the dial tone, the video service, the newspaper, the music, the images and the information that I buy—all of this can be converted into an indistinguishable pile of ones and zeros. Mr. Chairman, my hope is that we regulate to

HeinOnline -- 20 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 183 1997