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November 28, 2000

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 Twelfth Street, SW, Room TWB-204
Washington, D.C. 20554

RE: Notice of Oral Ex Parte
In the Matter of Applications for Transfer of Control to America Online, Inc. ("AOL") of Licenses and Authorizations Held by Time Warner Inc. ("Time Warner")
CS Docket No. 00-30

Dear Ms. Salas:

On November 28, 2000, Mark Rosenblum and the undersigned, representing AT&T Corp. ("AT&T"), and David Lawson of Sidley & Austin, counsel for AT&T, met with Deborah Lathen, Sherille Ismail, Darryl Cooper, Royce Dickens, and Peter Friedman of the Cable Services Bureau, and Jim Bird and Joel Rabinovitz of the Office of General Counsel, to discuss the substantial competition and consumer interest issues that would be raised by AOL's acquisition of Time Warner's controlling interest in Time Warner Entertainment Company, L.P. ("TWE") and the Commission's jurisdiction to address those issues in this proceeding. The discussion focused on the attached document that AT&T provided to those attending the meeting.

We also discussed the limits on AT&T's "registration" rights under the TWE partnership agreement that are summarized in the November 8, 2000, ex parte from James Cicconi to Kathryn Brown. Finally, we noted that the Commission cannot simply rely on the antitrust laws to discourage any future conduct that would be contrary to the public interest. If AOL and AT&T were to become partners in TWE, their shared ownership and incentives could, for example, lead to unilateral conduct that would produce the same outcomes that consumer advocates have suggested would result from joint action *See* Letter from Andrew Jay Schwartzman, Attorneys for CU, et al., to Deborah Lathen, dated November 13, 2000.

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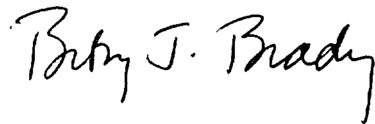
In accordance with Section 1.1206 of the Commissions rules, I have submitted two copies of this Notice for filing in the referenced proceeding.

Sincerely,



Attachment

cc: Deborah Lathen
Sherille Ismail
Darryl Cooper
Royce Dickens
Peter Friedman
Jim Bird
Joel Rabinovitz

The Commission Should Exercise Its Authority To Condition The AOL-Time Warner Merger On Procedures Designed To Ensure AT&T's Timely Withdrawal From Time Warner's TWE Partnership

The merger of America Online Inc. ("AOL") and Time Warner Inc. ("Time Warner") would, if approved, make AOL and AT&T partners in Time Warner Entertainment Company, L.P. ("TWE"), the entity that controls's Time Warner's cable systems and a vast programming library. Consumer advocates have cautioned that adding AOL to the TWE mix in the present circumstances – *i.e.*, with Time Warner effectively holding AT&T's multi-billion dollar passive interest in TWE hostage – could only harm competition and consumers. As explained below, the Commission has ample authority to address those potential public interest harms and to impose conditions that would encourage AOL and Time Warner to allow AT&T's timely withdrawal from TWE.

AOL Would Have the Ability and Incentive to Use its Ownership Interest in TWE to Impede Competition from AT&T. TWE was formed by Time Warner in 1992 to own and operate Time Warner's entertainment assets.[1] Although AT&T has a substantial economic interest in TWE, it has virtually no management rights – Time Warner terminated MediaOne's position on the Management Committee that actually manages TWE when AT&T acquired the MediaOne interest in TWE.

At the same time, Time Warner's cooperation is required for AT&T to withdraw from TWE. The TWE partnership agreement provides AT&T with only very limited "registration"

[1] In addition to Time Warner cable systems, TWE owns a vast library of cable television programming and filmed entertainment. TWE's cable television programming assets include Home Box Office ("HBO"), Cinemax, HBO Independent Pictures and other assets amounting to approximately 60% of all pay television subscriptions in the United States. TWE's filmed entertainment assets include Warner Brothers Studios, the Warner Brothers Network, Warner (continued . . .)

rights. As AT&T has previously explained, Time Warner has, to date, been unwilling to provide the cooperation necessary to ensure AT&T withdrawal from TWE in a timely manner and at a fair price. *See* AT&T October 4, 2000 *Ex Parte* Letter; AT&T November 8, 2000 *Ex Parte* Letter. Thus, although AT&T would prefer to meet the AT&T-MediaOne merger conditions by divesting its TWE interest, it appears increasingly unlikely that this will occur without Commission action in the AOL-Time Warner proceeding to encourage AOL and Time Warner to facilitate AT&T's withdrawal.

There can be little doubt that, because of its control of TWE, Time Warner enjoys substantial leverage over AT&T. Time Warner holds captive billions of dollars of capital that earns no return for AT&T or its shareholders and that AT&T would like to use to finance the substantial capital and operating investments it must make to bring additional choice to consumers nationwide.

There can likewise be little doubt that this leverage could be used by AOL to impede competition from AT&T and thereby harm consumers. Consumers Union in its recent *ex parte* letter posts several anticompetitive scenarios. *See* Consumers Union November 13, 2000 *Ex Parte* Letter at 2-4.

First, Consumers Union observed that AOL would have the incentive to use its influence to affect AT&T purchasing/partnering decisions to maintain or gain monopoly power in Internet-related applications markets. For example, "AOL would clearly have the incentive to use its leverage to induce AT&T to drop its efforts to push for compatibility/interoperability/access to AOL's IM customers." *Id.* at 3. Consumers Union also explained that AOL could use the TWE

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Home Video and other assets amounting to one of the world's largest distributors of
(continued . . .)

leverage to foreclose rival portals like Yahoo. Thus, AOL might "encourage" AT&T to "favor AOL (as a portal) over rival portals such as Yahoo or give preferential treatment to AOL/Time Warner music distribution services." *Id.*

Second, Consumers Union noted that AOL could use the TWE leverage to impede competition where AOL and AT&T compete "head-to-head" or plan to do so. *Id.* For example, AOL would clearly prefer it if AT&T would drop its planned interactive TV offering. Post-merger AOL could let AT&T know that a condition for agreeing to restructure TWE would be for AT&T to drop its rival interactive TV platform. *Id.* Similarly, Consumers Union showed that AOL would clearly prefer less rather than more broadband competition from AT&T and, as a consequence of the merger with Time Warner, could gain the means to achieve that goal. *Id.* at 2-3.

Consumers Union concludes that: "it is inconceivable that the Commission would approve the formation of TWE if TWE did not exist today, and AOL-Time Warner and AT&T were hereafter to propose its formation. *A fortiori,* it cannot be in the public interest to permit the continued interrelationship between AT&T, Time Warner and AOL in TWE after AOL owns Time Warner." *Id.* at 3-4.

As currently structured, the AOL-Time Warner merger disserves the public interest and should not be approved. The competition issues raised by the TWE partnership can, however, be addressed with a simple, targeted condition. Time Warner has indicated a willingness to purchase AT&T's TWE interest,[2] and AT&T is willing to sell its TWE interest to Time Warner.[3]

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programming, movies, and television programs.

[2] *See* Time Warner October 13, 2000 *Ex Parte* Letter.

However, to date, Time Warner has not made a serious offer for AT&T's TWE interest. The Commission should therefore condition its approval of the AOL-Time Warner merger on agreement by AOL and Time Warner that "in the event AT&T and AOL/Time Warner fail to reach agreement on the price of Time Warner will pay for AT&T's interest by a date certain, the matter will be submitted to binding arbitration pursuant to a customary appraisal process. *See* AT&T November 8, 2000 *Ex Parte* Letter at 3.[4]

The Commission Has Ample Authority to Impose Conditions on the AOL-Time Warner Merger Necessary to Protect the Public Interest. There can be no claim that the Commission lacks authority to impose tailored conditions necessary to ensure that the AOL-Time Warner transaction enhances, rather than harms, competition. Sections 214(a) and 310(d) of the Communications Act of 1934 ("Act"), 47 U.S.C. §§ 214(a), 310(d), grant the Commission broad authority to ensure that license transfers in connection with mergers serve the "public interest, convenience, and necessity." The Commission has consistently held that it can approve the license transfers associated with a merger only when it is persuaded that, on balance, the transaction serves the "public interest."[5] And "[w]hen necessary, the Commission can attach

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[3] *See* AT&T November 8, 2000 *Ex Parte* Letter.

[4] The Commission would also need to ensure that AT&T and the investment banker-arbitrator receive the type of due diligence information that one would ordinarily expect to receive in such a transaction.

[5] Memorandum Op. and Order, *Application of NYNEX Corp. and Bell Atlantic Corp. For Consent to Transfer Control of NYNEX Corp. and its Subsidiaries*, 12 FCC Rcd. 19985, ¶ 2 (1997) ("*Bell Atlantic-NYNEX Merger Order*").

conditions to a transfer of lines and licenses to ensure that the public interest is served by the transaction."[6]

In the *Bell Atlantic-NYNEX Merger Order*, the Commission observed that "[t]he public interest standard is a broad, flexible standard, encompassing the 'broad aims of the Communications Act.'" *Bell Atlantic-NYNEX Merger Order* ¶ 2 (quoting *Western Union Division, Commercial Telegrapher's Union, A.F. of L. v. United States*, 87 F. Supp. 324, 335 (D.D.C. 1949), *aff'd*, 338 U.S. 864 (1949)).[7] The Commission has subsequently confirmed on several occasions that its merger review authority that goes well beyond simply determining whether a merger would violate a provision of the Communications Act or the Commission's rules.[8]

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[6] Memorandum Op. and Order, *Application of GTE Corp. and Bell Atlantic Corp. for Consent to Transfer Control of Domestic and International Section 214 and 310 Authorizations and Application to Transfer Control of a Submarine Cable Landing License*, CC Docket No. 98-184, ¶ 24 (June 16, 2000) (citing 47 U.S.C. §§ 214(c), 303(r)) ("*Bell Atlantic-GTE Merger Order*").

[7] *See also FCC v. RCA Communications, Inc.*, 346 U.S. 86, 93-95 (1953); *Washington Utils. and Trans. Comm'n v. FCC*, 513 F.2d 1142, 1147 (9th Cir. 1976). Among the "broad aims" the Commission has found to be included in the Communications Act are "the implementation of Congress' pro-competitive, de-regulatory national policy framework for telecommunications, preserving and advancing universal service, and accelerating rapidly private sector deployment of advanced telecommunications and information and services." *Bell Atlantic-NYNEX Merger Order* ¶ 2 (citations omitted). "[T]he public interest analysis may also include an assessment of whether the merger will affect the quality of telecommunications services to consumers or will result in the provision of new or additional services to consumers." Memorandum Op. and Order, *In the Matter of Application of WorldCom, Inc. and MCI Communications Corp. for Transfer of Control of MCI Communications Corp. to WorldCom, Inc.*, 13 FCC Rcd. 18025, ¶ 9 (1998) ("*MCI-WorldCom Merger Order*") (citing Commission precedent).

[8] *See* Memorandum Report & Order, *Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from MediaOne Group, Inc., Transferor, to AT&T Corp., Transferee*, CS Docket No. 99-251, FCC 00-202, ¶ 10 (June 6, 2000) ("*AT&T-MediaOne Merger Order*"); *Bell Atlantic-GTE Merger Order* ¶ 22; Memorandum Op. and Order, *Applications of Ameritech Corp. and SBC Communications Inc. For Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of*

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The Commission has repeatedly observed, for example, that that a merger does not satisfy the public interest standard if it, on balance, "eliminate[s] or retard[s] competition." *Bell Atlantic-NYNEX Merger Order* ¶ 3. *See also AT&T-MediaOne Merger* ¶ 10; *Bell Atlantic-GTE Merger Order* ¶ 23. In assessing the competitive impact of a merger, the Commission has stressed that its "public interest evaluation is distinct from, and broader than, the competitive analyses conducted by antitrust authorities." *MCI-WorldCom Merger Order* ¶ 12. "[T]herefore, it is possible for the Commission to arrive at a different assessment of the size or nature of the likely competitive harms under its public interest standard than the antitrust agencies arrive at based on antitrust law." *Id.* ¶ 13. *See also United States v. FCC*, 652 F.2d 72, 81-82 (D.C. Cir. 1980) (en banc) (the Commission's "determinations about the proper role of competitive forces in an industry must therefore be based, not exclusively on the letter of the antitrust laws, but also on special considerations of the particular industry").

The Commission has also consistently held that its competition analysis under the "public interest" standard extends beyond immediate competitive harms and encompasses potential, future markets that may develop.[9] In this regard, the Commission has stated that it will not approve a merger that "impede[s] the development of future competition" even if it "does not decrease the current level of competition." *MCI-WorldCom Merger Order* ¶ 14.

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the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission's Rules, 14 FCC Rcd. 14712, ¶ 48 (1999) ("*SBC-Ameritech Merger Order*").

[9] For example, in the Bell Atlantic-NYNEX merger the Commission evaluated the merger's effect "in a market for bundled local and long distance telecommunications." *Bell Atlantic-NYNEX Merger Order* ¶ 114. While no such "market" yet existed, the Commission found that "[t]he evidence of record demonstrates that many of these mass market customers would be likely to purchase both local and long distance services as part of a single bundled service." *Id.*

Where the Commission has determined that a merger, as proposed, falls short of satisfying the public interest standard, courts have held that the Commission has broad remedial authority. "[T]he Commission may impose conditions whenever in the absence of such conditions the transfer would not be in the public interest." *GTE Services Corp. v. FCC*, 782 F.2d 263, 268 (D.C. Cir. 1986). Indeed, courts have even held that the Commission may use its public interest merger review authority to accomplish "indirectly" that which it cannot do "directly." *Western Union Tel. C. v. FCC*, 541 F.2d 346, 355 (3d Cir. 1976). *See also id.* at 355 ("the Commission is expressly authorized by statute to attach to the issuance of [a] certificate such terms and conditions as in its judgment the public convenience and necessity may require.") (citing 47 U.S.C. § 214(c)).

Consistent with the Commission's broad reading of its public interest authority, it has often approved mergers only with conditions that it believes necessary to ensure that the merger serves "the broad aims of the Communications Act." For example, in transactions that would enhance the merging parties' incentives to discriminate or foreclose rivals, the Commission has required applicants to provide certain services through structurally separate affiliates.[10] Similarly, where the Commission believes that applicants do not have incentives to deal fairly in commercial negotiations, the Commission has conditioned its approval of a license transfer upon requirements that applicants agree to mediation. *See Bell Atlantic-GTE Merger Order* ¶ 317; *SBC-Ameritech Order* ¶ 395.[11]

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[10] *See Bell Atlantic-GTE Merger Order* ¶¶ 260-72; *SBC-Ameritech Merger Order* ¶¶ 363-68; Memorandum Opinion and Order, *Application for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Southern New England Telecommunications Corp. to SBC Communications, Inc.*, 13 FCC Rcd. 2129, ¶ 51 (1998).

[11] Other remedies that have been imposed by the Commission include requirements that the merging parties: 1) adopt uniform OSS and prepare and provide performance monitoring reports

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Where these more targeted remedies are insufficient, the Commission has endorsed much broader divestiture requirements. For example, in the MCI-WorldCom merger, the Commission approved the transaction only after the MCI agreed to divest its Internet backbone business. *MCI-WorldCom Merger Order* ¶ 142 ("we must independently determine that this sale addresses the concerns raised regarding the Internet. As discussed below, we find that all MCI Internet assets are being divested to C&W, and therefore the merger will not have any anticompetitive effects on any Internet services, as long as the proposed divestiture is in fact carried out."). In so holding, the Commission expressly rejected MCI's and WorldCom's claims that they did not need Commission approval for this aspect of the transaction. *Id.* ¶ 142 n.381.[12]

Under these precedents, the Commission has clear authority to condition its approval of the AOL-Time Warner merger to address the enormous leverage AOL would gain over AT&T as a result of the merger and the potentially anticompetitive uses to which that leverage could be used. As explained above, the Commission has broad authority to impose tailored conditions necessary to ensure that a proposed transaction enhances, rather than harms, competition, including divestitures, *see MCI-WorldCom Merger Order* ¶ 142 & n.381, and corporate

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for their OSS, *see Bell Atlantic-NYNEX Merger Order* ¶¶ 181-84, 193-196; 2) compete in out-of-region territories, *see Bell Atlantic-GTE Merger Order* ¶¶ 319-23; *SBC-Ameritech Merger Order* ¶¶ 398-99; 3) deploy xDSL services to low-income groups in rural and urban areas, *see Bell Atlantic-GTE Merger Order* ¶ 278; *SBC-Ameritech Order* ¶ 376; and 4) reduce the rates charged for certain services even where the present rates being charged were not considered unlawful, *see Bell Atlantic-GTE Merger Order* ¶¶ 307-15; *SBC-Ameritech Order* ¶¶ 390-93.

[12] The fact that most of these remedies were initially proposed by the applicants themselves does not change this analysis. The Commission made clear that it must evaluate whether the proffered conditions are sufficient to ensure that the merger serves the public interest. *MCI-WorldCom Merger Order* ¶ n.381. *See also Bell Atlantic-NYNEX Merger Order* ¶¶ 146, 178. Further, where conditions proposed by applicants are not adequate to ensure that the merger serves the public interest, the Commission has modified those conditions in its approval order. *See SBC-Ameritech Merger Order* ¶ 354.

restructuring, *see Bell Atlantic-GTE Merger Order* ¶¶ 260-72; *SBC-Ameritech Merger Order* ¶¶ 363-68; *SBC-SNET Merger Order* ¶ 51. Indeed, there is considerable precedent upholding the ability of federal antitrust authorities, acting under statutory authority that is narrower than the Commission's public interest mandate, to dissolve joint ventures that, while raising no concern when they were created, raised competitive concerns because of subsequent interventions by third parties.[13] *A fortiori*, the Commission has authority to require AOL-Time Warner to cooperate in good faith in the restructuring of TWE to eliminate those links between AT&T and AOL-Time Warner.

Although AT&T Agrees with the End Result Sought by Consumer Union's Consolidation Request, Consolidation of the AOL-Time Warner Merger Proceeding with the AT&T-MediaOne Merger Proceeding Is Not Necessary to Achieve that Goal. On July 6, 2000, Consumers Union petitioned for reconsideration of the *AT&T-MediaOne Merger Order* arguing, *inter alia*, the Commission should revisit its refusal to consolidate the AT&T-MediaOne merger proceeding with the AOL-Time Warner proceeding.[14] AT&T opposed that request on the ground that the decision of whether to consolidate the two proceedings was within the Commission's discretion and the Commission provided a non-arbitrary explanation as to why it would consider the mergers separately.[15] On November 9, 2000, Consumers Union "supplemented" its petition.[16] Consumers Union now argues that in light of a fuller examination

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[13] *See* Consumers Union November 13, 2000 *Ex Parte* Letter at 4 n. 9 (citing cases).

[14] *See* Petition for Reconsideration of Consumers Union *et al.*, CS Docket No. 99-231, at 15-16 (filed July 6, 2000).

[15] Opposition of AT&T Corp., CS Docket No. 99-231, at 11-12 (filed July 17, 2000).

[16] *See* Supplement to Petition for Reconsideration of Consumers Union *et al.*, CS Docket No. 99-251 (filed Nov. 9, 2000) ("Consumers Union Supp. Pet.").

of the ways in which AOL could use its TWE control anticompetitively, consolidation of the AOL-Time Warner and AT&T-MediaOne merger proceedings is necessary so that "the Commission [can] assert authority over all the merger parties and direct severance of the common ownership of TWE." Consumers Union Supp. Pet. at 10.

Although AT&T agrees with Consumers Union's ultimate argument that it makes sense for the Commission to "sever" the TWE "relationship "without dictating a business 'winner'" and "ensur[ing] that no 'fire sale' occurs," *id.* at 15, the fact that Time Warner will not negotiate in good faith to buy AT&T's TWE interest does not require consolidating the AOL-Time Warner and AT&T-MediaOne merger proceedings. As explained above, the goal Consumers Union seeks can be achieved by way of a condition imposed upon AOL and Time Warner in that merger proceeding – *i.e.*, conditioning Commission approval of the merger on agreement by AOL and Time Warner that in the event AT&T and AOL/Time Warner fail to reach agreement on the price of Time Warner will pay for AT&T's interest by a date certain, the matter will be submitted to binding arbitration pursuant to a customary appraisal process. *See* AT&T November 8, 2000 *Ex Parte* Letter at 3.

However, AT&T strongly takes issue with Consumers Union's other arguments in the supplemental filing. Consumers Union contends that it is no longer the case that AT&T requires the 12-month waiver of the horizontal ownership rules the Commission granted in the *AT&T-MediaOne Merger Order*. This is so, according to Consumers Union, because "AOL and Time Warner have reassured the Commission that AT&T is capable of divesting this interest at any time by selling its interest to a third party, negotiating a fair price with Time Warner, or by activating its rights under the partnership agreement." Consumers Union Supp. Pet. at 14.

As AT&T has explained in its prior filings, Time Warner's actions belie its "assurances." *See* AT&T October 4, 2000 *Ex Parte* Letter; AT&T November 8, 2000 *Ex Parte* Letter. Further, the Commission granted the 12-month waiver because all three options available to Applicants involve complex business transactions. That remains true today, as confirmed by AT&T's subsequent efforts to negotiate a withdrawal from TWE.

Consumers Union also makes the odd claim that AT&T has "accepted" the so-called "end-to-end principle" and therefore the Commission is obligated to impose open access on AT&T. *See* Consumers Union Supp. Pet. at 17-18. In support of this position, Consumers Union points to filings AT&T has made in which it has argued that the Commission should impose conditions on the AOL-Time Warner merger that would ensure that AOL's instant messaging ("IM") service will interoperate with other IM services. According to Consumers Union, "[i]t makes no sense to accept the logic of open access and interconnection for Instant Messaging without accepting the same open access principles for cable Internet access generally." *Id.* at 18.

The attempted analogy clearly fails. AT&T is not advocating that AOL should be required to "unbundle" the component facilities it uses to provide the IM service so that AOL's rivals can offer competing IM services over AOL's facilities. Rather, AT&T has argued simply that customers of other IM services should be allowed to communicate with AOL's IM customers. This type of "interoperability" already exists for AT&T's cable modem services. AT&T's cable modem subscribers can reach any public Internet content cite, can select any portal that they want as their home page, and can e-mail any customer of any other service.

Moreover, the essential precondition for "access" regulation – the existence of market power – does not exist for cable modem services but does for AOL's IM service. As explained

by members of the IM Unified Coalition in their October 24, 2000 *ex parte*, AOL's overwhelming market share, its unprecedented anticompetitive behavior, and its demonstrated ability to foist its IM platform on competitors and providers of next-generation IM-enabled devices demonstrate that AOL has already achieved IM dominance and that the merger threatens irreversibly to tip the IM market in AOL's favor. In contrast, as the Commission has repeatedly found, AT&T's cable modem services are not poised to gain a monopoly but instead face effective competition from numerous high speed Internet providers.[17]

[17] *See generally* Report, *Inquiry Concerning the Deployment of Advanced Telecomm. Capability to All Americans in a Reasonable and Timely Fashion and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, 14 FCC Rcd. 2398 (1999); Memorandum Report & Order, *Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Tele-Communications, Inc., Transferor, to AT&T Corp., Transferee*, 14 FCC Rcd. 3160 (1999); *AT&T-MediaOne Merger Order*; Report, *Inquiry Concerning the Deployment of Advanced Telecomm. Capability to All Americans in a Reasonable and Timely Fashion and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, CC Docket No. 98-146, FCC 00-290 (Aug. 21, 2000).