

1 to leverage content distribution systems, not to favor your  
2 own content through caching and primary screens, no attempt  
3 to leverage the AOL-AT&T linkage -- often conclude with,  
4 "Trust me, we won't."

5           And one of the central criticisms of the opponents  
6 is that, why should you? And I would concede that in a  
7 market in which we don't necessarily know how things will  
8 evolve, there may be room for "trusting you," but I thought  
9 I would represent some things that concern me. One of the  
10 best indicators of that is historical performance.

11           And it seems to me that -- I look at things like  
12 the high-profile case in which Time Warner was stripping the  
13 vertical blinking interval for an EPG. I look at the fact  
14 that some fairly heavy-handed tactics by local franchising  
15 authorities of Time Warner's and SBC's region on DSL. I  
16 look at over a year ago some of AOL's public promises on  
17 open Internet messaging services that have still yet to be  
18 fulfilled. I'm not personally criticizing those choices.  
19 There may be rationales for them, and they both all may be  
20 things not even within the scope of our authority but,  
21 nonetheless, they are historical backgrounds of credibility  
22 on the trust point.

23           And what I would like to emphasize is that I think  
24 it's very, very important that the companies, in proving  
25 their case, show why there are very powerful economic

1 reasons, not just behavioral reasons, to pursue open models  
2 and not leverage content. And Mr. Case, I think you made a  
3 good point about, you have to get on systems elsewhere, and  
4 I think that's the kind of argument we need to hear. But I  
5 would add one refinement. The key is, at what terms and  
6 conditions and prices?

7           And I think one of the concerns, or the anxieties  
8 raised are that the extreme ability you will have as a  
9 content provider may be able to allow you to trade off and  
10 dictate terms and conditions that are more favorable to you  
11 than others. And I don't need a voluminous response to  
12 that. But I just wanted to guide responses to the idea of  
13 demonstrating why, as a business matter and economic matter,  
14 these are the things we can expect to happen, as opposed to  
15 trust.

16           MR. LEVIN: Well, the short answer is really that  
17 the, it's the consumer who makes these choices, and if we  
18 were ever to exclude, you know, whether it relates to EPG  
19 which is a subject that the Commission has under advisement,  
20 and we will carry -- whatever line the Commission draws,  
21 that's exactly what we will do. But we'll carry anything  
22 and everything, because it's the consumer that is making the  
23 choice for navigation.

24           And the same thing applies to programming. And  
25 that's really the history. If you're not providing the

1 programming or the material or the convenience that the  
2 consumer wants, it's very clear that the consumer can go  
3 elsewhere and, in fact, now that we're talking about the  
4 opportunity to go elsewhere on the Internet, there are all  
5 these distribution systems. So the economic compulsion is  
6 really overwhelming to service the consumer.

7           Having said that, I have to also comment that I  
8 think that this company, these two companies and this new  
9 company is distinctive, not only because of its history, but  
10 the desire to want to serve the consumer, the public  
11 interest with a set of values that really count. I think  
12 that's very important to us. So that, yes, we are  
13 responsive to shareholders, but we're also responsive to the  
14 public interest. Indeed, it's built into our charter. That  
15 was the charter at Time, Inc., and it is at AOL, and it will  
16 be at the new company.

17           So, we have the best of all possible worlds. We  
18 have the recognition that the consumer is making a choice,  
19 and you have a company that values its social commitment.

20           MR. CASE: Let me just add that as I said in my  
21 opening remarks, there's a lot of misinformation flying  
22 around, and I think some of it was embedded in one of your  
23 premises regarding instant messaging in particular. And I  
24 certainly take issue with that characterization. I actually  
25 think our company has been a model for how to take a

1 technology and open it up.

2 But as I said in my opening remarks, we invented  
3 this, actually 15 years ago. Three years ago, we made it  
4 free so anybody could download the software for free or use  
5 it for free. And then in the past year we've licensed it to  
6 more than a dozen companies on a royalty-free basis. That's  
7 not something that Microsoft, for example, has done with  
8 Windows.

9 If the Justice Department, as their remedy in  
10 this, suggested that Windows should be put on the Web so  
11 anybody could download and use for free and license on a  
12 royalty-free basis to a dozen other companies, they would  
13 have been laughed out of Washington as a much too stringent  
14 remedy. We did both of those things voluntarily and,  
15 additionally, have indicated our commitment to  
16 interoperability proposed to the IETF in architecture for  
17 server-to-server interoperability.

18 So I think we've done a lot to make sure that  
19 anybody can talk to anybody, nobody has to subscribe to AOL,  
20 you can use it for free if they want, if companies want to  
21 create their own interface, they're free to do that. And if  
22 we can get agreement with these companies about server-to-  
23 server interoperability, we're ready, willing and able to do  
24 that.

25 CHAIRMAN KENNARD: Commissioner Ness and then

Heritage Reporting Corporation  
(202) 628-4888

1 Commissioner Tristani.

2 COMMISSIONER NESS: A number of commenters have  
3 been very concerned about your ability, not just to  
4 discriminate in favor of your own product but, rather,  
5 potentially, to discriminate in favor of the product of  
6 other major players in exchange for benefits that you might  
7 receive from such relationships. And it's been described as  
8 a colony of two 800-pound gorillas dancing, and thereby  
9 stomping a number of other smaller players who might want to  
10 be able to play in the marketplace. Can you comment a  
11 little bit about these concerns that have been raised? And  
12 I'm sure we'll be hearing them as the panels proceed.

13 MR. CASE: Want me to start on that one? I think  
14 people who make that claim do not understand what's happened  
15 on the Internet. What's happened on the Internet is the  
16 blowing up of traditional barriers to entry, which is  
17 resulting in an unprecedented flood of competition and  
18 choice. When I was growing up, the only thing I could watch  
19 on television and ABC, CBC, NBC and PBS. Now, you've got  
20 dozens of stations in some markets, hundreds of stations in  
21 other markets, and millions of Web sites to choose from.

22 So this notion that people are constrained in  
23 choice is a little silly. What's happening is unprecedented  
24 choice, and we're trying to stimulate more choice on  
25 television. We, you know, some say, well, you should worry

1 about these guys because they're potential monopolists.

2           Actually, if those companies are worried about us,  
3 it's because we're populists, trying to take the Internet  
4 model to television, and instead of consumers going home and  
5 turning on the television and watching what the networks  
6 want when they want, they want to work like the Internet  
7 where they choose to go where they want, do what they want,  
8 when they want. So we want to take that Internet model,  
9 which is a model of competition and choice, and bring it to  
10 television. It's not surprising to me that some companies  
11 would rather protect the status quo. Consumers want the  
12 Internet model on top of television.

13           COMMISSIONER NESS: The expectation, however, is,  
14 for example, you'd have major cable companies exchanging  
15 benefits with each other to the detriment of others who do  
16 not have cable facilities. Cable still remains, in most  
17 areas of the country, as a major bottleneck provider. Can  
18 you comment further on that?

19           MR. LEVIN: I don't think that the cable companies  
20 are working together with other cable companies in any way.  
21 As a matter of fact, I think the history of the cable  
22 industry is in fact what Steve Case has just indicated is  
23 now being carried out on the Internet. And that's  
24 deconstructing the establishment. That's really always been  
25 the history, providing more services that were not otherwise

1 available.

2           We used to have this very narrow aperture through  
3 which programming can pass. And in fact, each, as each day  
4 goes by, there are more services that are being created.  
5 And frankly, when we, when I look at the conventions coming  
6 up, the political conventions, I think it's time to  
7 recognize that the public interest, convenience and  
8 necessity has now shifted from broadcast licensees to the  
9 cable industry and the Internet industry, because who's  
10 going to carry, on a 24-hour basis, everything that's  
11 happening in, you know, two of the most important political  
12 events so it's available on an interactive basis to all  
13 Americans? It's coming from all the cable networks, it's  
14 coming from CSPAN, it's coming from local cable news  
15 services, it's coming from all the Internet services. It's  
16 the most exciting thing to happen. It's not coming from the  
17 broadcast licensees.

18           So in fact, I think it's time to recognize that in  
19 fact the net effect of creating more capacity, which is what  
20 cable has done and what the Internet now explodes on an  
21 infinite basis, is providing more choice and more  
22 opportunity for independent programmers. The last thing I  
23 would say is a lot of the comments we're hearing seem to  
24 belie the other proceeding that we're involved in, which is  
25 at the FTC, examining the antitrust issues. The issue here

1 is not to protect competitors but to stimulate competition.  
2 And I think that's what all this technology is designed to  
3 do.

4 MR. CASE: I also would add that there's a big  
5 distinction between television of the past and how you think  
6 about it and limited channel capacity and whose gets  
7 carriage, essentially, and the Internet model, which,  
8 essentially, everybody gets access, everybody gets carriage.  
9 And certainly on AOL, people can go wherever they want  
10 whenever they want, and this notion that we would somehow  
11 block the Yahoo domain or somehow slow it down is  
12 ridiculous. We, we've never done that, we never would do  
13 that.

14 The reason is if we did that, our members would  
15 quit, because they don't want a constrained Internet. They  
16 want an open Internet, and that's what they get from AOL.  
17 If we tried to do some of the things that some of the people  
18 are suggesting, it would be harmful to our business.

19 MR. LEVIN: If I could just go back to, again, the  
20 difference between the marketplace and a regulatory  
21 requirement. The concept of high-definition television,  
22 which we've been working on for many, many years. There's  
23 more activity taking place by Home Box Office, which is not  
24 a regulated licensee in that sense, than by any broadcaster.  
25 And the reason for that is the picture quality is exquisite,



1 and it makes a lot of sense from a kind of a competitive  
2 advantage.

3 So that's a marketplace desire. It's part of the  
4 history of innovation, and I think that needs to be  
5 acknowledged, because that's what's driving so much of all  
6 of these new services.

7 CHAIRMAN KENNARD: Commissioner Tristani, and then  
8 we're going to have to wrap up this first panel.

9 COMMISSIONER TRISTANI: I have here a four-page e-  
10 mail that I received from a Joel Payne from Massachusetts.  
11 And I told you I got lots of e-mails about this merger, and  
12 most of them are, like, two paragraphs, garden variety, deny  
13 the merger, they're too big, danger to democracy. Mr. Payne  
14 goes into a bit more detail, but his main concern is instant  
15 messaging, and you must love the service, and I commend you.  
16 If you invented it, it sounds marvelous, and I'm going to  
17 check it out.

18 But his concern -- well, first of all, he wants,  
19 wants us to deny the merger, but he said, if you do allow  
20 it, make sure instant messaging is interoperable and that  
21 everybody can have it. I hear you saying that you're  
22 already taking a lot of steps to do that but, aside from Mr.  
23 Payne's e-mail, a lot of our commenters have said that for  
24 about 18 months, AOL has said a lot but done too little in  
25 this area.

1           And I hear that you're committed to doing this,  
2           but how strong can your commitment be? I mean, can you say  
3           this is something that absolutely must be done? And I'll  
4           tell you what drives his concern. I didn't know much about  
5           instant messaging until I got this e-mail and started  
6           thinking about it, but if it's as good as it sounds, I can  
7           see a lot of people who are going to say, I'm not going to  
8           get any other system that can't use it, and we may end with  
9           the one system that has it, and --

10           MR. CASE: Well, I understand the concern. Again,  
11           I'll just try to reiterate some of the facts, that we did  
12           open it up and make it freely available, that issue three  
13           years ago.

14           COMMISSIONER TRISTANI: Well, but let me ask you,  
15           does that mean that everybody that's on the Internet can  
16           have it?

17           MR. CASE: Yes. Yes. For free. That three years  
18           -- up until three years ago --

19           COMMISSIONER TRISTANI: So I can have it?

20           MR. CASE: The only way to get instant messaging  
21           was to pay us a monthly fee, because it was part of our  
22           service. And we said, well, that's a benefit and, indeed,  
23           may attract and keep members. Wouldn't it be better for us  
24           to open it up for anybody --

25           COMMISSIONER TRISTANI: So how would I go about

1 getting it for my provider?

2 MR. CASE: Go to AOL.com and you can download AOL  
3 instant messenger for free, whether you're using Mindspring  
4 or Earthlink or the Microsoft Network or any provider. It  
5 doesn't cost you anything to download. It doesn't cost you  
6 anything to use it.

7 COMMISSIONER TRISTANI: And I can, I can put it in  
8 my system?

9 MR. CASE: Yeah, absolutely. Or you can download  
10 it from many other companies like Lycos and Apple and Novel  
11 and Lotus, their own customized versions using the same  
12 technology.

13 COMMISSIONER TRISTANI: So how come there's been  
14 so much e-mail like this?

15 MR. CASE: Because there's a merger pending and  
16 there's an opportunity, and people like to focus on issues.

17 COMMISSIONER TRISTANI: It is as easy and simple  
18 as doing that? You know, I don't really know --

19 MR. CASE: Well, I welcome you to download it  
20 tonight and see it for yourself. I would also add, I would  
21 also add that what's happened in instant messaging is  
22 competition. There are some pretty big companies, including  
23 Microsoft, who have entered the market. Microsoft launched  
24 their messenger services less than a year ago. Last week,  
25 announced they 18 million users of it. So this is a market

1 that we're hardly monopolizing. There are many, many,  
2 companies --

3 COMMISSIONER TRISTANI: But let me ask you  
4 something. If, let me get back, because you've gone into  
5 another issue. But if I don't want to go through the  
6 trouble -- and you say it's real easy, but I'm not  
7 technology-savvy, and I'd suspect a lot of Americans my age  
8 are not either -- if I don't want to go through the trouble  
9 of having to do that, what's wrong with there being an open  
10 system, where I don't have to do that?

11 MR. CASE: There is nothing wrong with it. That's  
12 what we're working toward.

13 COMMISSIONER TRISTANI: Particularly when there  
14 are 23 million subscribers who, you know, who are probably  
15 my buddies.

16 MR. CASE: The issue right now is anybody can use  
17 our instant messaging system for free. Nobody has to pay us  
18 anything.

19 COMMISSIONER TRISTANI: But you're not answering  
20 my question. Why couldn't there be an --

21 MR. CASE: No. I'm about to answer your question.  
22 Anybody can use any of the messaging systems of any of the  
23 dozens of companies, pretty significant companies, Lotus and  
24 Apple and Lycos, and so forth, that have their own  
25 customized versions of this. What we're trying to now do is

1 server-to-server interoperability so you can download some  
2 other system and the servers talk to each other in a way  
3 that protects the privacy and security and prevents spam and  
4 pornography and things like that.

5 COMMISSIONER TRISTANI: Which is back to --

6 MR. CASE: That requires a technical architecture,  
7 which we have submitted to the IETF, which companies are now  
8 able to comment on.

9 COMMISSIONER TRISTANI: When did you submit that?

10 MR. CASE: About a month ago.

11 COMMISSIONER TRISTANI: About a month ago?

12 Because I think we got into another issue. Yeah, you can do  
13 it eventually, but the idea is since this is such a  
14 wonderful --

15 MR. CASE: Well, to be honest, this is an issue  
16 which troubles me, because I think if today we were sitting  
17 here with a huge market share in instant messaging and the  
18 only way to get instant messaging was to pay AOL a monthly  
19 fee, and people said, you know, maybe, because instant  
20 messaging is becoming more important, maybe this company  
21 should actually make it available to other companies on some  
22 kind of license basis, I think nobody would have  
23 hypothesized that an appropriate, fair thing to do would be  
24 require us to give it away free to consumers and license it  
25 on a royalty-free basis to companies. I think that would be

1 viewed as overreaching, just as I think that would be viewed  
2 as overreaching if the government thought that, you know,  
3 the way to deal with the Microsoft issue was to basically  
4 put the Windows on the Web -- anybody could download it for  
5 free and any company could modify it and use it for free.

6 But we did both of those things voluntarily, and  
7 now we're going an extra step and trying to work with the  
8 Internet standards body, IETF, to promote server-to-server  
9 interoperability that will allow anybody to talk to anybody  
10 using any system in a way that protects privacy and avoids  
11 spam and a lot of other problems that could emerge. I think  
12 we should be applauded for what we've done.

13 CHAIRMAN KENNARD: We'll have some more discussion  
14 on instant messages. Commissioner Powell, you'll have to  
15 have the last comment, because we --

16 COMMISSIONER POWELL: I just want to, again, try  
17 to make sure we sharpen these concerns. I applaud and am  
18 more impressed by the second half of your answer, but I want  
19 to say something about the first. It is classic information  
20 industry network effect to give product away in order to  
21 build and install base to substantial levels, and only then,  
22 when you have substantial customer bases, to then  
23 potentially try to develop new and more value-added services  
24 from which the revenue comes.

25 I'm sure I wouldn't ask you nor would you want to

1 commit that any and all services that would be generally  
2 categorized as instant messaging will stay free forever.  
3 For example --

4 MR. CASE: I think it's highly likely they will  
5 stay free forever. It hasn't in industry, but we have no  
6 plans to change that. We believe instant messaging is a  
7 feature, not a business, and we want to make that feature  
8 broadly available.

9 COMMISSIONER POWELL: Well, it would be one thing  
10 if it's, if you're going to make some representation it will  
11 stay free forever, but we expect, and I think that we would  
12 applaud, that there'll be development of innovations using  
13 that technology, for example, net-to-phone functionality for  
14 voice services will then offer, I think as it is on AOL, for  
15 a cent a minute or two cents a minute, there are service  
16 relationships and fees associated with those services. And  
17 I think those are good things, but those are not free  
18 things, and a free thing can be a leverage to things that  
19 ultimately produce revenue.

20 And I just want to emphasize that that's part of  
21 the concern, and I don't, again, I don't think that it means  
22 it's wrong, but it, but it means that I think it's important  
23 in the responses to be focused on to what degree --

24 MR. CASE: Well, if I could just quickly respond.  
25 I understand the network dynamic, and I would just add that,

1 as I said before, Microsoft launched a messaging service 10  
2 months ago and now has 18 million users, so it hardly  
3 suggests that somehow the network effects in this particular  
4 feature are such that it's somehow impeding competition. I  
5 think competition is robust. I think Microsoft is going to  
6 integrate, unless the government doesn't allow them to, that  
7 messaging service in the operating system and will have far  
8 more than 18 million customers a year from now. So it's a  
9 vibrant, competitive market.

10 CHAIRMAN KENNARD: Thank you very much for your  
11 testimony, and we'll invite the next panel to come up, which  
12 is Esther Dyson and Barry Nalebuff. Thank you. While  
13 people are coming up for this next panel, I'd like to ask  
14 everyone here to please turn their cell phones off. This is  
15 the FCC. We love cell phones but not in our open meetings,  
16 so please turn them off. We're very pleased to have our  
17 next two panelists, Esther Dyson and Barry Nalebuff, and  
18 I'll remind you to please confine your presentation to five  
19 minutes so we can have some time for a free interchange with  
20 you. Esther?

21 MS. DYSON: Thank you very much, Chairman and  
22 Commissioners. I'm glad to be here. I'm neither an  
23 economist nor a lawyer, so I am generally going to try and  
24 set some perspective from the viewpoint of a longtime  
25 industry observer, a venture capitalist and someone who's



1 intimately involved with some of the policy issues for the  
2 Internet's infrastructure.

3 I'd like to start out by saying that I think these  
4 hearings are tremendously important and useful. The Federal  
5 Communications Commission may have some very specific things  
6 it can and cannot do, but the role of government is not  
7 simply to either interfere or let things move forward  
8 without interfering. It is to educate the citizenry  
9 broadly, to educate the press, the consumers. I think what  
10 we want here is neither federal regulation nor is it  
11 self-regulation. It is regulation by the marketplace.

12 And in order for that to happen, the marketplace  
13 has to be informed. Consumers may have a lot of choice, but  
14 if they don't know what those choices are, if they aren't  
15 aware of them, they won't be able to exercise them. So I  
16 want to say from the start, even though I do believe this  
17 merger should go forward, I think these hearings are an  
18 important part of the process of what the government should  
19 be doing. And with that, I'd like to talk in my remaining  
20 three minutes about the marketplace and a little bit about  
21 the government's role.

22 This market is changing incredibly rapidly, and I  
23 don't think the Federal Communications Commission or Time  
24 Warner or AOL or I or anybody here could really figure out  
25 what is going to happen, but it's clear to me that the way

1 people are looking at this market now seems to be missing a  
2 number of very interesting phenomena. Nobody here today has  
3 mentioned Napster or Gnutella.

4 This whole -- we're talking about the content  
5 business as if the business of eating were entirely Lutes  
6 and perhaps McDonald's. But there's a huge amount of home  
7 cooking going on. And AOL built its business by providing  
8 its users access to each other more than it did by providing  
9 content. It is now heavily reliant on commerce. Content is  
10 almost -- it's like the beer you serve in a bar, but what  
11 you're really selling is the ambience -- the bartender, the  
12 other people in the bar. And to look only at content is to  
13 miss the point.

14 We're looking today also at access. We're, again  
15 there's going to be huge amounts of competition from various  
16 other players. This has been gone into at length. But  
17 another part to mention is the whole billing relationship  
18 with the customer. That's, that's what AOL has now, to some  
19 extent. It sells access to these consumers for purposes of  
20 e-commerce. And in that way, it's going to be competing  
21 with banks, with utilities, with Amazon.com.

22 The real key is to have that customer  
23 relationship, and here I would like to disagree or at least  
24 point out something that I think was missed. Through AOL  
25 you can indeed get to all these other Internet sites, and

1 they would be incredibly stupid to try and block access.  
2 But they do provide links. They have favored marketing  
3 partners, for which they are paid. And that's part of what  
4 the issue is here today.

5 How much choice does the consumer have and know  
6 about? How easy is it? At what point does making things  
7 incredibly convenient for the consumer limit the consumer's  
8 choice because he doesn't know about what else is out there?  
9 And that's why I think consumer education is tremendously  
10 important. In that context, then, the role of the  
11 government, I think, should be to let this go forward but to  
12 raise concerns -- to say this is what we're going to be  
13 watching for.

14 Some people will say, well, that's unpredictable  
15 and arbitrary and the government should stick to its  
16 knitting and simply implement the laws, but this is a  
17 fast-changing market. There are concerns. There are  
18 concerns about things like instant messaging and, yes, AOL  
19 is starting to do the right thing, but I would hardly say  
20 it's voluntary. I would say it's in response to consumer  
21 and political pressure. And God bless it. I like to see  
22 that happen. And I see hearings like this as part of that  
23 whole process.

24 Finally, there is indeed all the issues of open  
25 access, and Barry's going to talk about this, but let me

1 just end by saying open access is not just a matter of  
2 principle, it's a matter of pricing. And so, watching those  
3 contracts and the terms of those contracts is indeed an  
4 important function. Thank you very much.

5 CHAIRMAN KENNARD: Thank you very much. Dr.  
6 Nalebuff.

7 MR. NALEBUFF: Chairman, Commissioners, many  
8 people here, myself included, are trying to understand the  
9 future of the Internet, its impact on our lives and the  
10 economy and how this proposed merger will change the course  
11 of history. Yes, actually I think the stakes are that big.  
12 And at the same time, I think that predicting the future of  
13 the digital economy is actually hopeless. In fact, given  
14 the flux of the environment today, I would be more than  
15 content to predict where we are today.

16 So that leaves us in a predicament. The stakes  
17 are high and our knowledge is low. In this type of an  
18 environment, how do we best set policy? My answer here is  
19 simple. Keep a level playing field so that the best man,  
20 woman, technology company may win. This one single rule  
21 should be what guides any policy prescription.

22 Now, of course that's easier said than done. What  
23 is the field? Is it home? Work? Mobile? What is level?  
24 Do we want to emphasize levelness within a technology, and  
25 thereby promote intersystem competition? Or emphasize

1 levelness across technologies, and thereby promote  
2 intersystem competition? We certainly don't want to create  
3 equality by bringing everyone to the lowest level. And the  
4 current environment is decidedly unlevel.

5           While phone and cable technologies are converging,  
6 the regulatory environments have not. There are open access  
7 requirements on DSL that do not exist for cable. Do we  
8 relax requirements on DSL? Create requirements for cable?  
9 Try to find some middle ground? Or simply rely on  
10 competition to sort things out?

11           I think that creating a level playing field for  
12 open access will be your most challenging problem, and that  
13 is where I will focus my remarks. I believe that it is in  
14 the self-interest of Time Warner AOL to provide access to  
15 their system and that this is in line with their public  
16 statements. The question is at what price and with what  
17 terms?

18           The bundling of a cable modem pipe and an ISP is  
19 not all that different than bundling an operating system and  
20 a network browser. The ability to sell a package of  
21 complementary goods and services as a bundle offers the  
22 bundler a tremendous advantage in the marketplace. By  
23 "complementary," I mean goods that enhance each other's  
24 values, as in hardware and software, hamburgers and french  
25 fries or, in this case, broadband cable pipes, ISPs and

1 content.

2           What's interesting here is that the advantage of  
3 the bundler comes from being able to offer a lower -- not  
4 higher, but lower price. And this is now where you see my  
5 role as a theorist come into play. When two separate firms  
6 get together to coordinate their pricing of complementary  
7 products, such as A and B, the monopoly price is lower than  
8 the result with uncoordinated pricing. The intuition is  
9 that when the price of A falls, that helps expand the market  
10 and part of those gains go to B. Unless the sellers of A  
11 and B work together, they won't fully recognize those gains,  
12 and thus the price will be too high.

13           This is in direct contrast to when firms  
14 coordinate the price of substitutes or competing products,  
15 and thereby raise the price. When firms coordinate the  
16 price of complements, the price goes down. Thus, at first  
17 glance both the firms and the consumers are better off. The  
18 only reason that you may wish to be concerned is that  
19 those who don't or who can't bundle are left at a big  
20 disadvantage and over time that may change the nature of  
21 competition.

22           Bundling is neither win-win nor win-lose. It's  
23 win-win-lose. A win for the bundler, a win for consumers  
24 today, and a lose for those who are excluded from the  
25 bundle. This brings us back to the issue of a level playing

1 field. Do you want to help keep the level field -- the  
2 playing field level for players who are left out of the  
3 bundle? What does the FCC want to do for players who, like  
4 AOL just a few months ago, are worried they'll have no one  
5 to dance with?

6 If all consumers could choose between competing  
7 bundles for broadband, this wouldn't be a concern. In many  
8 places, competition does exist, from DSL bundles, from RCN  
9 second cable line, from wireless, cable and satellites. I  
10 expect that third generation mobile wireless technology will  
11 really solve this issue, but we are not there yet.  
12 Therefore, the question is whether or not to level the  
13 playing field by giving other ISP and content providers  
14 access to the Time Warner AOL bundle.

15 I don't wish to regulate how the elements of a  
16 bundle should be priced when broken up into its components.  
17 The resulting arguments over setting those prices would be a  
18 lose-lose game. But we do have the advantage of AOL selling  
19 dial-up service and content as an add-on to those with  
20 Internet access.

21 That leads me to ask whether the price they set  
22 for those two services, whatever they choose, might be a  
23 useful proxy for how much to discount the cable bundle when  
24 offering their cable pipeline services to other players. In  
25 particular, I think the discount should be at least the

1 bring-your-own-access price, currently \$9.95, plus some  
2 fraction of the extra price for dial-up service, currently  
3 \$12.00 -- to get to the \$21.95 price -- reflecting the basic  
4 ISP services.

5 My final point is that there's another subtle  
6 example where the playing field today seems tilted. And  
7 it's a problem I think you should be concerned about, and  
8 it's something, actually, we heard again and again in Mr.  
9 Levin's testimony. This proposed merger is what has caught  
10 your eye, but practically every single issue that you will  
11 talk about today could also arise as a result of contracts,  
12 typically exclusive contracts. And you've heard about the  
13 problems that have been created by the Road Runner contracts  
14 and the @Home contracts, many of which are trying to be  
15 undone today. I believe that the FCC and other government  
16 agencies should be paying as close attention to these  
17 contracts as they do to merger agreements. Thank you.

18 CHAIRMAN KENNARD: Thank you. Thank you both for  
19 that testimony. It was wonderful testimony. Let me follow  
20 up with a couple of questions, first for Dr. Nalebuff. Is  
21 there a role in this future of telecommunications as you see  
22 it for anyone who doesn't or can't bundle? Will we lose the  
23 unbundlers, if you will? Or the unbundled companies.

24 MR. NALEBUFF: If, in the end, there is enough  
25 competition in different types of platforms, the advantages



1 of opening up those platforms to, if you'd like, single  
2 providers, I think will allow them to exist. On the other  
3 hand, whether or not venture capitalists and the market will  
4 fund those companies in a world where they're not sure to  
5 get access is a question. The fact that they do have access  
6 now on dial-up or in the case of DSL certainly is helpful.

7 I'm less worried, I guess, in a world in which you  
8 could have bundle against bundle competition. But I think  
9 it is inevitable that people who are -- who don't have a  
10 bundle to offer will be at a disadvantage in the  
11 marketplace.

12 CHAIRMAN KENNARD: Okay. And let me -- I don't  
13 mean to characterize your testimony. I'm really just trying  
14 to understand here. Are you saying that in order to create  
15 that environment where someone who is not able to bundle its  
16 access to the platform, if you will, are you suggesting that  
17 requires some government intervention to make that happen?

18 MR. NALEBUFF: I believe that they will certainly  
19 have access. The question is at what terms and what price.  
20 And moreover, I believe that if you required everything to  
21 be unbundled, actually prices would be higher, and adoption  
22 would be slowed down and consumers would be worse off. And  
23 so there is this tradeoff, if you'd like, between success  
24 today, penetration today and serving consumers today, and  
25 the ability of people to play going forward. I don't have