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Classic conditioning: the FCC's use of merger conditions to advance policy goals

Gwen Lisa Shaffer
University of California, USA

Scott Jordan
University of California, USA

Federal regulators routinely impose conditions on companies seeking to complete a merger or acquisition. Under standard circumstances, the Federal Communications Commission (FCC) must justify significant policy decisions by explaining assumptions underlying the decision; key alternatives; the rationale for that particular policy tactic; and how the new policy dovetails with agency precedent (Yoo, 2007). Critics contend, however, that merger negotiations lack transparency and are too far-reaching. In fact, the FCC may negotiate with companies under review to extract conditions that have minimal connection to actual concerns surrounding the transaction, and that circumvent established policymaking processes (Koutsky and Spiwak, 2010; Noah, 1997; Tramont, 2001; Weiser, 2009). Critics also assert that by engaging in closed-door negotiations and "arm-twisting" (Noah, 1997), the FCC is able to evade judicial scrutiny—partially because companies in regulated industries fear repercussions if they challenge agency demands. For these reasons, members of Congress have sponsored legislation aimed at severely limiting—and even stripping—FCC regulators of their power to review acquisitions (Borland, 1999; Telecommunications Merger Review Act of 2000). Despite their controversial nature, merger negotiations often do result in a set of conditions that benefit the public. While this study focuses on U.S. deals, European merger obligations can also be used to achieve industry-wide policy goals (Voight and Schmidt, 2005).

Corresponding author:
Gwen Lisa Shaffer, University of California, Irvine, Bren School of ICS, 3208 Bren Hall, Irvine, CA 92697-3425, USA.
Email: gwenlisa@gmail.com

This commentary examines the FCC's historical use of "voluntary commitments" when approving telecommunications company mergers. Because complex factors such as market conditions, corporate lobbying, political climate and technological change dictate regulations, this study is grounded in a political economic framework. Using a focused synthesis, the authors examined key policy issues, such as the political climate and power structures in place during various telecommunications company transactions. The study contrasts the FCC's ability to extract commitments from merging companies with unsuccessful attempts to achieve similar goals through the established rulemaking process. While multiple acquisitions are analyzed, the Comcast/NBC-Universal merger serves as a key case study. The newly formed company agreed to a slew of voluntary commitments that advanced policies—related to online video programming, digital inclusion and community journalism—strongly opposed by industry when the FCC attempted to impose them industry-wide.

Current regulatory review process

When reviewing mergers and acquisitions of telecommunications companies, the Department of Justice's (DOJ's) primary objective is ensuring that communications markets perform competitively (Baker, 2010). By contrast, the Communications Act charges the FCC with determining whether proposed transactions meet a "public interest" standard. This broad mandate may encompass protecting service quality for consumers, preserving American jobs, safeguarding localism, or providing opportunities for audiences to hear diverse points of view (FCC, 2004). When a disagreement arises regarding a matter of material fact during an acquisition and license transfer, the FCC may refer the matter to an administrative law judge. Far more commonly, however, key stakeholders "voluntarily" agree to narrowly tailored conditions geared toward mitigating harm and ensuring the transaction under review complies with FCC rules. Together, three general principles drive FCC information policy: civil liberties, economic efficiency, and social fairness and equity (Bushkin and Yurow, 1980). Therefore, the following section briefly reviews key literature examining the political economy of telecommunications and the FCC's public interest mandate.

Political economy and public interest literature

It is impossible to view the telecommunications industry in isolation from regulators and lawmakers, or to view regulators and lawmakers as separate from the market. Each stakeholder is linked to another. Because these relationships have a profound impact on consumers, the Communications Act mandates regulators to consider another key concept—the public interest. Consequentially, political economy provides an explanatory framework for analyzing both policy and practices influencing telecommunications mergers.

Ideally, telecommunication regulations should promote democratic economic, political and social processes—which then enable a democratized society (Lenert, 2006). Although the FCC accepts public comments before signing off on a merger, these comments may not present the type of information the commission relies on to justify its opinions (Blevins and Brown, 2010). Powerful companies and those with the highest financial stakes have, routinely, usurped the debate over telecommunications policy in the United States (Chen, 2007). Certainly, gaining traction in the hegemonic U.S. telecommunications industry, where a handful of companies control wireline and wireless internet access, is proving to be a challenge. Verizon, AT&T, Comcast and Time Warner spent a combined $53.3 million to lobby Washington policymakers in 2010 (Center for Responsive Politics, 2011).

When a small number of elite and politically connected ISPs establish the terms and conditions for access to media content, by default these firms also determine who can operate in the public sphere. The Supreme Court acknowledged the concepts of a free marketplace of ideas and media diversity as far back as 1945. In the landmark case *Associated Press v. United States* (1945), the justices ruled that "the widest possible dissemination of information from diverse and antagonistic sources is essential to the welfare of the public" (1945: 17). Similarly, the Communications Act of 1934 recognizes the importance of fostering competition, on the grounds that it leads to innovation, lower prices and better quality service. Inversely, telecommunications industry consolidation has the potential to undermine quality of service, limit consumer choice, and lead to price spikes. Previous research has found that if the FCC over-emphasizes the free market when crafting policy, it could dampen deliberative discourse and citizen engagement (Blevins and Brown, 2010). However, "free enterprise" economists argue that government intervention harms competitive markets (Koutsky and Spiwak, 2010; White, 2008). Certainly, when regulatory requirements are applied to select companies, a patchwork of inconsistent policies begins to comprise the political economy of telecommunications. The SBC/AT&T and Verizon/MCI mergers, which closed in 2005 and 2006 respectively, serve as examples. These companies agreed to comply with net neutrality principles for two years. Yet regional DSL providers and the national cable industry, which boasted more residential broadband subscribers than AT&T and Verizon combined, were not bound by these same restrictions.

Technology is enabling users to exercise more control over media platforms, from audio file-sharing to video-on-demand. As a result, the political economy of telecommunications is becoming more user-driven, and telephone and cable companies are reconsidering their own business models. It remains to be seen how these changes will impact conditions placed on mergers in the future, or on the FCC's ability to enforce them. However, regulators and policy scholars continue to learn from voluntary commitments agreed to in the past. Three research questions emerged from this review of literature:

RQ1: Do merger conditions appear to be tailored to the material facts of the transaction under review by the FCC?

RQ2: Are merger conditions driven by regulators' broad policy agenda? Specifically, do these "voluntary commitments" move the FCC closer to achieving policies overwhelmed by opposition during the traditional rulemaking process?

RQ3: When crafted appropriately, can merger conditions transform an anti-competitive merger into a transaction that achieves a net gain for the public?

The following section explains the methodology used to explore and, ultimately, answer these questions.

Methodology

This qualitative study uses empirical evidence to shed light on processes and outcomes surrounding telecommunications and media company mergers. The authors conducted a focused synthesis (Majchrzak, 1984) involving the review of regulatory policies, scholarly research findings, white papers and other written materials. Given the vast amount of available information, the researchers selectively chose relevant documents by applying both external and internal criticism to each. External criticism questions whether the document is authentic, and internal criticism questions whether the data are accurate and relevant (Isaac and Michael, 1981). Similarly, we considered whether these original sources were reliable and valid (Cooper and Emory, 1995), and whether biases were evident.

First, we examined dozens of telecommunications company mergers that occurred since passage of the Telecommunications Act of 1996. We then identified the research problem—broadly, what drives specific merger conditions and whether they compensate for a less competitive marketplace. Next, we focused on the policy environment, that is, the political climate and power structures in place during various transactions. Most significantly, we identified pending FCC rulemakings, regulatory proposals and legislation that addressed issues overlapping with merger conditions. Based on this information, we considered the goals of various merger conditions, how they evolved and their effectiveness. We then analyzed the values and assumptions inherent in merger conditions, and whether they ultimately served the public interest. Finally, we synthesized these findings to answer our research questions.

The following section examines a handful of telecommunications and media company transactions, and draws connections between the political agenda, the marketplace and merger conditions.

Historic use of conditions for telecommunications mergers

During the 1990s, America Online (AOL) grew into a preeminent internet company, with 30 million members (Holahan, 2006) accessing its content and community forums. In January 2000, AOL proposed buying Time Warner for $165 billion. As the largest provider of content in the world (MacKie-Mason, 2000), Time Warner operated multiple cable television systems and popular networks including HBO, Cinemax and CNN; sports franchises; magazines; film production and distribution companies; and record labels. Time Warner cable also owned Road Runner internet service. Potentially the largest merger in history (Baldwin, 2000), the proposed transaction exemplified "new" and "old" media convergence. Time Warner recognized that the internet was crucial to the future success of its music, publishing and video businesses. AOL, in turn, hoped to gain access to Time Warner's vast content collection, as well as to Road Runner.

The FCC spent nearly 10 months conducting a public interest analysis. Ultimately, both the FCC and the Federal Trade Commission approved the transaction with about a dozen conditions. Time Warner was required to provide at least three unaffiliated ISPs with access to its cable systems. The order also prohibited AOL Time Warner from discriminating against content delivered to subscribers of competing ISPs but traveling over its cable system. Finally, AOL Time Warner agreed to make future instant messaging (IM) services interoperable. In aggregate, these conditions advanced the FCC's (2000) long-held goal for cable broadband providers to offer "open access" to their infrastructure (RQ2). At the time, the telephone system operated with full common carrier obligations. This meant that competitive ISPs could sell services within a community for minor investment, with the telephone company providing the last-mile connection to its customers. In the absence of common carriage obligations for cable operators, however, a handful of companies controlled broadband access. In response to RQ3, our analysis finds that the FCC (2002, 2003) negated potential benefits of the AOL/Time Warner merger by lifting requirements to offer open access and make IM services interoperable.

The AOL/Time Warner transaction is reminiscent of AT&T's $43.5 billion acquisition of Tele-Communications, Inc. (TCI), approved by the FCC just one year earlier. That 1999 deal allowed AT&T—the nation's largest telephone carrier—to combine its consumer long-distance, wireless and internet services with TCI's cable, telecommunications and high-speed internet business. At the time, TCI was the nation's second-largest cable television operator. However, the FCC did not mandate that the newly formed entity provide competing broadband companies with access to TCI's cable lines. We argue that this contradiction is solely the result of political priorities, as opposed to the material facts surrounding the merger. Specifically, the FCC undertook this merger review before the open access debate gained traction. Instead, cable television and telephone competition, a V-chip order, broadcast ownership rules and the digital television transition dominated the commission's agenda (Kennard, 1998).

In 2006 a horizontal merger allowed AT&T to purchase BellSouth for $86 billion. In order to win approval from federal regulators, the new company signed off on 11 pages of merger commitments. AT&T agreed to adhere to net neutrality principles for two years and to divest BellSouth spectrum holdings (FCC, 2006). These commitments directly address federal regulators' concerns about competitiveness—always the primary issue during a merger. Several stipulations, however, were wholly unrelated to the terms of the deal (RQ1) but address broader federal policy goals (RQ2). For instance, AT&T agreed to make disaster recovery capabilities available in BellSouth's territory and to donate $1 million toward supporting public safety initiatives. Several months earlier, an FCC panel recommended ways in which the telecommunications industry could more effectively respond to disasters (Wiley, Rein and Fielding, 2006). The merger agreement also required AT&T/BellSouth to report to the FCC on its efforts to serve customers with disabilities, an issue the commission had struggled with since passage of the Disabilities Rights Act in 1990. Additionally, AT&T/BellSouth agreed to return outsourced jobs to the United States. This condition is in line with the federal government's general commitment to economic growth. Finally, the FCC required the new entity to slash rates charged to competitors requesting to lease high-speed data lines. This condition allowed the FCC to claim a victory in its effort to reform special access fees, in the wake of failed attempts to do so industry-wide.

AT&T's 2006 acquisition of BellSouth has much in common with the $12.2 billion horizontal merger between CenturyLink and Qwest, which created the nation's third largest telecommunication provider in April 2011 (CenturyLink, 2011). The commission imposed conditions on Qwest and CenturyLink that reflect a series of goals laid out in the FCC's National Broadband Plan (2010). The plan stresses the need for affordable and reliable residential broadband access, with an emphasis on rural, low-income and minority communities. In order to win merger approval, CenturyLink and Qwest agreed to expand broadband access to low-income customers in their territory. They also promised to steeply discount broadband service for qualifying households, and to increase Qwest's network capacity so that faster download speeds would be available to 4 million additional homes and businesses. Each of these merger conditions explicitly addresses proposals laid out in the National Broadband Plan, supporting the study's assertion that a broad regulatory agenda frequently drives merger conditions.

The following section, which focuses exclusively on Comcast's recent acquisition of NBC-Universal, further explores the answer to our research questions.

Comcast/NBC-Universal merger conditions

Motivations for the merger

In January 2011—following six congressional hearings, multiple public forums, and one of the lengthiest comment periods in commission history—the FCC sanctioned Comcast's purchase of NBC-Universal. This $30 billion transaction illustrates the relationship between merger conditions and the FCC's existing policy goals, including many the commission had failed to achieve through administrative rulemakings. In light of the role campaign finance contributions play in determining the political economy of telecommunications, this section also examines lobbying efforts meant to influence the Comcast/NBC-Universal deal.

With more than 24 million video and 15 million broadband subscribers, Comcast is the largest cable operator in the United States. However, its traditional business model is threatened by online video and growing competition from satellite and phone companies that offer subscription video services (i.e. Verizon FiOs). Comcast recognized the necessity to transition from its existence as a subscription-based cable company to a media content provider, and stands to profit dramatically from NBC-Universal's holdings (Associated Press, 2009)—which include the NBC and Telemundo broadcast networks; 26 local TV stations; cable channels including CNBC, Bravo and Oxygen; the Universal Pictures movie studio and theme parks; and a 30 percent stake in online video distributor Hulu.com (Associated Press, 2011).

The political economy of the merger

Following separate reviews, both the DOJ and the FCC approved the Comcast/NBC-Universal merger in January 2011. The final consent decree contains multiple voluntary commitments that, we argue, are meant to advance a policy agenda pushed by public interest groups and FCC leadership (RQ1 and RQ2).

While the FCC makes evidence-based decisions after reviewing public comments and considering the public interest, its decisions are also "politically informed" (Cowhey et al., 2009: 108). Policy outcomes are often the direct result of the clout exhibited by each stakeholder attempting to influence the political process through contributions to political campaigns, mobilizing voters and swaying public opinion (Galperin, 2004). While working to gain approval of the merger, Comcast spent about $100 million to keep more than 30 lobbying firms on its payroll. Nearly 100 House of Representatives members signed onto a letter urging the commission to approve the Comcast/NBC-Universal merger in order to promote "jobs and investment" (U.S. Congress, 2011). According to the Center for Responsive Politics (2011), 84 of the letter's 97 signatories accepted political contributions from Comcast, ranging from about $1,000 to $25,000. All told, the cable company made political contributions to 385 members of Congress—75 percent of the legislative body—serving at the time of the merger negotiations (Free Press, 2011; Nichols and McChesney, 2011).

The large sums of money spent on lobbying help explain why legislators might craft a regulatory framework or sanction a transaction that privileges the interests of corporations over those of consumers (Birdsall, 1996). At the same time, aspects of the Comcast/NBC-Universal merger suggest the political economy is shifting. Public interest groups floated petitions, released fact sheets, posted to blogs, testified on Capitol Hill and placed full-page ads in Beltway publications opposing the merger. They cautioned it would enable Comcast to slow down or block streaming content from competitors such as Netflix and iTunes; allow Comcast to raise programming and service rates; and shrink media diversity. Yet when federal regulators approved the Comcast/NBC-Universal merger on 18 January 2011, even some of the deal's staunchest critics applauded conditions placed on the newly formed company (Consumer Federation of America, 2011; Crawford, 2011; Feld, 2011). In fact, Comcast/NBC-Universal ultimately agreed to a slew of voluntary commitments that advance a policy agenda advocated by public interest groups.

A vehicle for achieving a broad policy agenda

In its analysis of the Comcast/NBC-Universal transaction, the FCC expressed concerns that the joint venture could boost the prices that competing video distributors pay for the right to distribute NBC-Universal programming, or make it possible for the new company to sell only unpopular shows and movies to competitors (Stoltz, 2011). These scenarios would result in customers switching to Comcast in order to gain access to the shows they value, and then getting locked into costly contracts. Therefore, one of the merger conditions allows an online video distributor to pursue commercial arbitration, should it become entangled in a licensing dispute with Comcast (DOJ, 2011).

We speculate that recent clashes between cable operators and programmers inspired this particular condition. In October 2010, News Corp. doubled the annual rate it charged to carry the Fox network on several New York and Philadelphia channels to $150 million. Cablevision refused to pay up and, as a result, 3 million Cablevision customers temporarily lost access to Fox programming. News Corp also blocked Cablevision internet customers from watching Fox content on both the network's website and on Hulu. Fox rejected lawmakers' calls for binding arbitration to end the dispute. In 2011, a similar feud over retransmission fees involved DirecTV customers losing Fox programming. The arbitration clause in the Comcast/NBC-Universal merger consent decree opens the door for the FCC to implement a more sweeping policy, which commissioners were crafting at the time of the merger approval (FCC, 2011).

The FCC imposed another merger condition requiring Comcast to offer a stand-alone broadband service for less than $50 per month for three years. This condition may be an outgrowth of "lessons learned" during previous mergers (RQ2). In approving both the SBC/AT&T and Verizon/MCI mergers in 2005, the FCC mandated these carriers sell a stand-alone DSL service for two years. But, reportedly, the companies priced naked DSL service so high that most customers bundled it with other services (Consumers Union, 2006). By capping the fee Comcast may charge, the FCC is attempting to ensure customers are not forced to subscribe to unwanted video and phone plans.

The "Internet Essentials" program incorporated into the merger agreement ensures that every household in Comcast's footprint with children eligible for the federal free lunch program qualifies for "economy" broadband service for $10 per month, a $150 PC, and access to digital literacy training. This condition does not address antitrust concerns that typically dominate merger reviews, but it directly advances the FCC's digital inclusion goals—answering our first two research questions. Specifically, the FCC's National Broadband Plan (2010) recommends "free or very low-cost wireless broadband" as a means to spur broadband adoption. The plan also cites the need to implement programs that make non-adopters more comfortable with computers. By tacking on these conditions, the FCC also created a public good (RQ3).

As political economists McChesney and Schiller (2003) assert, communication systems serve as crucial forums for deliberative democracy by providing a space for citizens to clarify and mobilize around social priorities. In its agreement with the FCC, Comcast/NBC-Universal pledged to establish three-year partnerships between non-profit news organizations and at least five NBC-owned television affiliates. Similar entities with a focus on "hyperlocal" news have popped up all over the country, typically in response to downsizing at mainstream newspapers. While a dearth of local news coverage is an emerging crisis (Hindman, 2011; Purcell et al., 2010; Waldman, 2011), it is only tangentially relevant to the marriage between Comcast and NBC-Universal. This commitment does, however, reflect a key priority for the FCC and some federal lawmakers. In 2009, the Senate held hearings focused on "the future of journalism" and introduced the Newspaper Revitalization Act. In 2010, the Federal Trade Commission (2010) proposed policies intended to support the "reinvention of journalism," and the FCC Future of Media task force examined local information needs. Clearly, the commitment made by Comcast/NBC-Universal to support non-profit news is meant to advance a broader policy goal articulated by federal policymakers (RQ2) and to sustain outlets for deliberative discourse (RQ3).

At least one other aspect of the consent decree illustrates that some merger conditions are driven by broad policy goals, rather than concerns related to a particular transaction. As part of its agreement with the FCC, Comcast/NBC-Universal promised that 10 NBC-owned and operated stations would produce an additional 1000 hours of original, local news programming, and that Telemundo stations would air a new

Spanish-language multicast channel. In fact, for years the FCC has been sharpening its focus on Spanish-language programming and promoting diversity in the ownership of broadcast outlets. In September 2008, then-FCC Chairman Kevin Martin (2008) told members of the Congressional Hispanic Leadership Institute that the commission had "a special responsibility" to Spanish-speaking viewers. So while the merger condition is appropriate for Telemundo, it also supports the commission's ongoing interest in fostering television content relevant to Latino audiences (RQ1 and RQ2).

Conclusion

Multiple examples demonstrate that voluntary commitments are frequently extracted in an effort to advance regulators' broad policy agenda, rather than tailored to the material facts of the transaction under review. Our analysis also identified numerous instances in which the FCC employed merger conditions in order to achieve policy goals that faced overwhelming opposition when pursued through the traditional rulemaking process. Finally, we find that the potential for public good exists, but the ability to transform a troubling acquisition depends on the FCC's willingness to enforce conditions, as well as on market forces.

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