I. Background

A. Summary of Proceedings

On July 13, 1999, AT&T Corporation ("AT&T") simultaneously filed an application for approval of a change in control (FCC Form 394, with exhibits) with the 175 cities and towns in Massachusetts that have granted cable licenses to MediaOne Group, Inc. ("MediaOne").[1] At the request of MediaOne, the Cable Television Division of the Massachusetts Department of Telecommunications and Energy (the "Division") scheduled eleven regional hearings to be conducted in the months of August and September. Transfer Bulletin 99-4 (June 28, 1999). Absent these regional hearings, AT&T and MediaOne would have had to participate in 175 hearings in a span of only 60 days.[2] *See* 207 CMR 4.03.

The Division appointed Charles J. Beard[3] to serve as a Special Magistrate to conduct the hearings, and to prepare a report for the participating cities and towns which analyzed the record developed at the hearings and which made non binding recommendations as to whether the applications for change of control should be approved. Cities and towns that preferred to hold separate hearings had the right to opt out of the regional hearing process. According to Division records, 165 of the 175 municipalities covered by the Division's order agreed to the proposed plan, and participated in the hearings, which were held in Greenfield (August 3, 1999), Boxford (August 4, 1999), New Bedford (August 5, 1999), Barnstable (August 9, 1999), Newton (August 10, 1999), Springfield (August 11, 1999), Lowell (August 12, 1999), Malden (August 31, 1999), Foxborough (September 2, 1999), Burlington (September 8, 1999), and Weymouth (September 9, 1999).

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[1] A list of the communities is attached as Exhibit A. The list includes communities that, as of July 13, 1999, were in the process of considering transfer applications filed by MediaOne to acquire licenses then held by Time Warner Cable or Cox Communications.

[2] The Commission stated in Transfer Bulletin 99-4, "the regional public hearing process is especially useful during summer months when scheduling conflicts create a more onerous burden on issuing authorities."

[3] Mr. Beard is a partner in the firm of Foley, Hoag & Eliot LLP in Boston. He served as a member of the Cable Television Commission from 1972-1976, and has extensive experience in providing advice to cities and towns respecting cable television matters. In 1996, Mr. Beard served as a Special Magistrate to conduct hearings and make recommendations respecting U.S. West's acquisition of Continental Cablevision, and earlier this year he served as a Special Magistrate to conduct hearings and make recommendations respecting the acquisition of Greater Media by Charter Communications Inc. Wayne Barnett, an associate at Foley, Hoag & Eliot LLP, presided at three hearings that Mr. Beard was unable to attend, and assisted in the preparation of this report.

At each of the hearings, representatives from AT&T and MediaOne made a presentation in support of the transfer application. Representatives of cities and towns then made comments and asked questions, as did members of the general public. This report addresses the issues raised in the eleven regional hearings held to consider the applications for approval of the transfer of control of the cable licenses held by MediaOne to AT&T.

B. Criteria to be Considered

The criteria to be considered by Issuing Authorities in the license transfer process are set out in Mass. Gen. L. c. 166A, § 7, and the regulations promulgated thereunder. The statute states in pertinent part:

> "No license or control thereof shall be transferred or assigned without the prior written consent of the issuing authority, *which consent shall not be arbitrarily or unreasonably withheld"*. Mass. Gen. L. c. 166A, § 7 (emphasis supplied)

The Division's regulations provide the guidance that is lacking in the statute.[4] 207 CMR 4.04 states in pertinent part:

> "[An issuing authority shall consider only the transferee's
> (a) management experience
> (b) technical expertise
> (c) financial capability, and
> (d) legal ability to operate a cable system under the existing license."

This four-pronged analysis was first articulated by the Division when it decided *Bay Shore Cable TV Associates, v. Weymouth*, CATV Docket No. A-55 (November 13, 1985). As the Division stated when it amended the regulations governing the transfer process, the goal of the analysis is "to provide the issuing authority with the opportunity to determine whether the transferee can 'step into the shoes' of the transferor." Report and Order Amending 207 CMR 4.01-4.06 (Docket No. R-24, November 27, 1995), ¶ 58. There is no reported court case interpreting either Mass. Gen. L. c. 166A, § 7 or the regulations promulgated thereunder. Similarly, there is no reported court case reviewing any of the Division's decisions on these issues.

AT&T and MediaOne did not limit themselves to a discussion of the reasons why AT&T met the four criteria. From the outset of the hearings, they made it clear that AT&T had a much broader agenda. AT&T wants to buy MediaOne as part of a strategic initiative to change AT&T from a long distance company into a company that provides a full range of services, including voice, data and entertainment using not just a telephone but also televisions, computers, hand-held

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[4] At the time the regulations were issued, the Division was then an independent Commission.

wireless phones, virtually any form in which one can receive data.[5] AT&T stressed that it was committed to excellent video cable services, citing a letter from Michael Armstrong, AT&T's chairman, to that effect.[6] On the other hand AT&T made it clear again and again during the hearings that the strategic direction was to create a broadband network, one that went far beyond the video cable services typically contemplated by the MediaOne licenses.[7] In this context, AT&T and MediaOne spent some time previewing the full range of services that they hoped to develop and market after the merger, including their high speed Internet product known as "Road Runner."

There was significant public participation in the hearings. Many of the hearings had 40-50 participants, excluding MediaOne employees. Municipal representatives and private citizens raised questions and made comments on the full range of topics raised by AT&T. For example, they raised questions about whether AT&T's strategic plans would hamper its ability to meet its obligations to its cable subscribers. They raised questions about whether MediaOne personnel would keep their jobs. They raised important public policy questions about whether the Road Runner service is being provided in a manner that will stifle competition and limit the growth of broadband services. The discussions were frequently vigorous, sometimes contentious. The questions about the Road Runner service grew to the point that AT&T decided to make a special presentation about its views on the "open access" question.

This report will not address all of the issues raised during the public hearings. Rather it will focus primarily on the narrow question of whether AT&T has made a case that it meets the criteria set out in the Division's regulations which provide a basis for a determination that the proposed transfer applications should be approved. The other issues, while extremely important, are beyond the scope of the Special Magistrate's assignment.

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[5]Greenfield Tr., p. 13, 14; Boxford Tr., p. 6,9

[6]Boxford Tr., p. 11, referencing letter from C. Michael Armstrong dated July 13, 1999 addressed to each of the Issuing Authorities in Massachusetts, a copy of which appears in the Form 394.

[7]*See* statements of David Jefferson, AT&T's Vice President for Local Services: "This is not just a cable play. This is a broadband play which includes, therefore, a number of products and services that will come across broadband when you consider that Internet, for example, is a significant broadband play for which AT&T has enormous experience in that particular area." Malden Tr., p. 62; and "[T]hose are not just cable customers. Those are Internet customers. Those are interactive video customers. Those are customers that will have access to a lot of the stuff that will be coming out." Malden Tr., p. 84.

II. Analysis

A. Legal Ability

The starting point in this analysis is the legal capacity of AT&T to operate the cable systems under the existing licenses. 207 CMR 4.04(1)(d). There are two major issues that must be addressed in evaluating AT&T's legal capacity. First, there must be a determination as to whether AT&T has assumed all of the obligations of each license. Second, in this particular case, cities and towns have sought confirmation that MediaOne's obligations under its Social Contract with the FCC will be met, and that AT&T will assume Social Contract obligations of Time Warner with respect to systems recently acquired by MediaOne from Time Warner (Foxborough Tr., p. 35-37; Malden Tr., p. 50-51). In addition, although not relevant to the transfer criteria under consideration, because the issues were raised a number of times at the hearings, I will also address the FCC's pending proceeding regarding horizontal ownership of cable subscribers and the so called "open or forced access issue."

1. The Merger

A brief discussion of the structure of MediaOne and AT&T, a description of the merger transaction and a brief explanation of the governing law show why AT&T will be as bound by the license agreements and other MediaOne obligations as was MediaOne itself.

a. The Parties

MediaOne is a Delaware corporation that was formed in June 1998 as a spin off from U.S. West, Inc. ("U.S. West").[8] (MediaOne 1999 Form 10-K ("MediaOne 10-K"), p.1). It is the fourth largest provider of cable television services in the United States, with approximately five million subscribers, and is the largest provider in Massachusetts. MediaOne operates cable systems in six large clusters: Atlanta, Massachusetts, California, Florida, Detroit and Minneapolis/St. Paul. (MediaOne 10-K p.2). In addition to its domestic cable television interest, MediaOne has a number of other international communications properties. What is important here is that the cable licenses granted by cities and towns in Massachusetts are held in one of the following nine subsidiaries of MediaOne: MediaOne Enterprises, Inc.; MediaOne of Brockton, Inc.; MediaOne of Massachusetts, Inc.; MediaOne of Milton, Inc.; MediaOne of Needham, Inc.; MediaOne of Ohio, Inc.; MediaOne of Southern New England, Inc.; MediaOne of Virginia, Inc.; or MediaOne of Western New England, Inc. All of these subsidiary corporations are qualified to do business in Massachusetts.

AT&T was incorporated in 1885 under New York law. (AT&T 1999 10-K ("AT&T 10-K"), p.1). AT&T is among the world's communications leaders, providing voice, data and video

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[8]*See* AT&T/MediaOne slide presentation ("Powerpoint Presentation")that was presented in virtually the same form at all eleven hearings.

communications services to large and small businesses, consumers and government entities. (*Id*. pp. 1-2; Form 394, Exhibit 9). AT&T and its subsidiaries provide domestic and international long distance, regional, local and wireless telecommunications services, and cable television and Internet communications transmission services. (AT&T 10-K, pp. 1-2) AT&T also provides billing, directory, and calling card services to support its communications business. (*Ibid*).

b. The Form of the Merger

The merger may be summarized as follows. MediaOne will merge into Meteor Acquisition, Inc. ("Meteor"), a Delaware corporation which is a wholly owned subsidiary of AT&T. Meteor will survive and MediaOne will be dissolved. In the process, all of MediaOne's subsidiaries will become subsidiaries of Meteor and thus subsidiaries of AT&T.

From the vantage point of the Issuing Authorities, this transaction may look more like a change of control than a merger because the existing licenses with the subsidiary corporations will be unaffected by this transaction. To give an example, the Town of Needham granted a license to MediaOne of Needham, currently a subsidiary of MediaOne. Assuming the merger is completed, MediaOne of Needham will then be a subsidiary of AT&T, but it will continue to hold the Needham license.

2. AT&T's Assumption of MediaOne's Cable License Obligations

Apart from the representations made during the regional hearings by AT&T personnel,[9] there are two reasons why I am satisfied that AT&T has assumed all of the obligations of MediaOne under the terms of the cable licenses. First, section 2.1(c) of the Asset Purchase Agreement entered into between MediaOne and AT&T on May 6, 1999, states that:

> From and after the Effective Time, [Meteor Acquisition, Inc.] shall possess all the rights, powers, privileges and franchises and be subject to all of the obligations, liabilities, restrictions and disabilities of MediaOne.

This language may be fairly read to mean that, as a matter of contract, AT&T, through its subsidiary, Meteor, has stepped into the shoes of MediaOne as the parent corporation of the subsidiaries which hold the licenses in Massachusetts.

More importantly, this merger is governed by the laws of the State of Delaware, and it is clear that AT&T will assume all of the obligations of MediaOne in this transaction by operation of

[9] Newton Tr., p. 62 (Franchise obligations "continue to be undisturbed and will continue in full force." Statement of Mr. Scott Morris, AT&T); Foxborough Tr., p. 91 ("If it's a requirement that's part of the current license, then it's something that we will abide by." Statement of Ms. Maria Arias-Chapleau, AT&T.)

law. *See*, Del. Gen. Stat. §259(a) which states in pertinent part:

> When any merger or consolidation shall have become effective under this chapter, for all purposes of the laws of this state the separate existence of all constituent corporations . . . [shall be] merged in one of such corporations . . . possessing all the rights, privileges, powers . . . and being subject to all the restrictions, disabilities and duties of each of such corporations so merged. . . and all debts, liabilities and duties of the respective constituent corporations shall thenceforth attach to said surviving or resulting corporation. . . .

By contract and by operation of law, AT&T will assume all of the cable television license obligations of MediaOne.

3. The Social Contract

MediaOne is the signatory to a Social Contract with the FCC (FCC 95-335, August 1, 1995, a copy of which is included in the Response to Record Requests in this proceeding.) In addition, AT&T is acquiring cable systems in thirty-one Massachusetts communities that are subject to a Social Contract entered into by Time Warner with the FCC. (Foxborough Tr., p. 36; Malden Tr., p. 50-51). For the reasons stated above, AT&T will be fully bound by the terms of both MediaOne's and Time Warner's Social Contracts to the extent they apply to Massachusetts cities and towns. As with MediaOne's license commitments, AT&T has specifically agreed to assume all obligations in the MediaOne Social Contracts and all material terms of the Time Warner Social Contract for cable systems which it will acquire as part of this transaction and which are subject to the Time Warner Social Contract.[10] (*See also* Greenfield Tr., p. 31).

4. Relationship of Ownership Rules to AT&T's Legal Capacity

Several questions were posed to AT&T at the hearings concerning the percentage of the cable market that will be controlled by AT&T if the acquisition is completed. A brief review of the facts underlying those questions is warranted.

Several years ago, the FCC promulgated a rule stipulating that no cable company could pass more than 30 percent of the nation's homes. When the statute on which the regulation was ruled unconstitutional by a federal district court[11], the FCC suspended the rule. It remains suspended to this day.

Presently, the FCC is considering new ownership rules. The definition of ownership that

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[10] The FCC has approved the assumption of the Time Warner Social Contract by MediaOne for the thirty-one Time Warner communities in Massachusetts. (Foxborough Tr., p. 36).

[11] *Daniels Cablevision, Inc. v. U.S.*, 835 F. Supp. 1 (D.D.C. 1993)

the FCC is considering may include minority stakes. If so, AT&T's ownership interest in Cablevision and Time Warner cable systems would be included, and, together with its ownership of MediaOne and TCI, AT&T would likely exceed the 30% cap. Of course, the FCC may increase the cap as part of its current rulemaking.

The key term in the last paragraph is "considering." As of the date of this report, AT&T is not in violation of FCC ownership rules. If, prior to any Issuing Authority's rendering of a decision, the FCC adopts new ownership rules, then I expect that AT&T would contact Issuing Authorities to explain the impact of the new ownership rules on the company's operations. At this time, however, no such restrictions exist on the legal capacity of AT&T to acquire the MediaOne licenses in Massachusetts.

B. Management Experience

The second criterion to be considered is AT&T's managerial experience. AT&T has indicated that MediaOne's management will remain in place and take control of AT&T's operations of the cable systems.[12] Still, MediaOne's team will now be under the control of AT&T's national management. Accordingly, a two-tiered evaluation is required.

1. AT&T's Record

During the hearings, AT&T argued that it had an outstanding customer service record, and that it wanted to extend this tradition of excellent customer service into the MediaOne merger. It pointed repeatedly to the fact that it had won two Malcolm Baldridge Awards from the US Department of Commerce for its outstanding customer service as evidence of its management strength. Further, there were extremely few, if any, complaints about AT&T's customer service record during the hearings.

There are, however, two great problems in relying heavily on AT&T's management record in these proceedings. First, AT&T is not a local services company. It has traditionally provided long distance telephone services to residential customers and a variety of telephone services to business customers. AT&T does not have a fleet of trucks for service calls and it does not come to customers' homes to install its service. By contrast, cable television companies like MediaOne have focused primarily on local services. George Burnett, AT&T Vice President for consumer services in the Northeast Region, commented candidly on this distinction during the Barnstable hearing when he suggested that MediaOne could "teach AT&T how to be a local company again." Barnstable Tr., p. 16.

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[12] "[T]here is a strong management team in the Northeast for MediaOne...AT&T is not interested in disrupting that in any way. We're stressing continuity. This is a strong team. It understands the issues at the local level, it understands the franchise issues and also the community needs, and we want to continue to see that and go on and leave that in place and support it however we can." Burlington Tr., p. 17 (Statement of Mr. Scott Morris, AT&T).

The second problem is directly related. AT&T neither built the systems nor developed the relationships with the subscribers. MediaOne and its predecessors, Continental Cablevision, Time Warner and Cox did that work. The personnel of these cable companies know the vagaries of their systems. AT&T must therefore rely very heavily on the management teams from MediaOne and its predecessors to effectively manage these systems.

The record is full of representations by AT&T personnel that the MediaOne management team will be kept in place. There are two factors which persuade me that these representations are serious. First, though little mention was made of it, Amos Hostetter, former president of Continental Cablevision, has joined AT&T's board of directors as part of this proposed merger, and he has been named the nonexecutive chairman of the AT&T Broadband and Internet Services Group.[13] Second, while AT&T's record on retaining TCI personnel is quite short, it appears that AT&T is keeping the TCI managers in place.

The record included some discussion of MediaOne's management record and quality of customer service. Even excluding the many comments from MediaOne employees, the majority of the comments about MediaOne's performance were favorable. When one excludes the number of complaints about moving a MediaOne customer service center from one town to another, the pattern that emerges suggests that communities have confidence in the MediaOne management team.

I conclude that AT&T has the management capacity to step into the shoes of MediaOne if it keeps its commitment to retain the MediaOne management team. The evidence in the record strongly suggests that it will do so. I am satisfied that this criterion has been met.

C. Technical Expertise

The third criterion to be considered is the "technical expertise" of AT&T to operate a cable system under the existing licenses. 207 CMR 4.04(1)(b). While AT&T and MediaOne touted their ability to deliver local telephony, high speed Internet access, and other services over cable wires, cities and towns are charged with determining the fate of their cable licenses.

1. AT&T's Technical Expertise

AT&T argues that it has the technical ability to step into the shoes of MediaOne with respect to the cable licenses for two reasons. First, it suggests that it has a track record in the development and management of broadband communications that is quite strong. Second, it argues that by retaining the management and engineering teams of MediaOne, it has the technical capacity to address any issues which are solely related to the video cable services. To some extent, AT&T argues that in the broadband world, the AT&T expertise and the MediaOne expertise complement each other; the combined technical teams are by far the strongest.

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[13] Boxford Tr., p. 6; Barnstable Tr., p. 130-131.

AT&T's technical record is certainly an impressive one. Among the inventions of Bell Labs are the transistor and the computer modem. They also were the first to combine lasers with glass fibers to create today's fiber optic technology[14]. These are all essential components in wireline communications, whether it is telephony or video services. Bell Labs, which created these breakthroughs, has been spun off and is now known as Lucent Technologies. But the tradition of cutting edge communications development continues. AT&T Labs still applies for approximately one patent every day.

AT&T also has a well known reputation for technical competence with its products. Its long distance services, wireless services, Internet services and data transmission services are widely perceived as extremely reliable, further evidence of its technical competence. Indeed, one might view the Malcolm Baldridge Awards as evidence of technical competence as well as strong customer service in AT&T's traditional product areas.

The technical expertise which Issuing Authorities are looking for is not the inventive genius of AT&T Labs but the technical expertise to handle the engineering problems in their cable systems. The expertise sought by Issuing Authorities is the expertise to handle failed amplifiers, or to make sure that the signal strength is appropriate at the end of an amplifier cascade, or to design and build the plant upgrade to hybrid fiber cable ("HFC") as contemplated by the Social Contract, or the expertise to manage the dozens of other engineering problems which arise in operating cable systems day in and day out. In this context, some Issuing Authority representatives expressed genuine skepticism about AT&T's reliance during the hearings on MediaOne's technical expertise. As Mr. Hull, Wilmington's Assistant Town Manager, stated:

> "[AT&T] does not apparently need to demonstrate that they themselves meet each of the four evaluation criteria...since, as has been demonstrated this evening, staff from the entity which is being taken over are being referenced as the personnel who possess the expertise...[T]he takeover company can always point to the expertise of the existing company and, one would expect, never have a problem meeting the technical and management criteria." Burlington Tr. at 67.

I have several comments on this issue. First, AT&T really has no choice but to rely on the MediaOne technical organization. The work of the AT&T Labs is wonderful, but it will not address the technical problems in the Massachusetts cable systems as they arise. For that matter, neither will the senior engineers in the Broadband and Internet Services Division ("BIS"), engineers like the Chief Technology Officer and his peers. Likewise, AT&T's claims about the technical expertise of the TCI staff are misplaced. TCI is another subsidiary of AT&T. It is not

[14] Powerpoint Presentation.

the acquiror here. Those personnel are fully utilized managing the newly acquired TCI systems, a point that AT&T conceded during the hearings.[15]

Second, the evidence is quite clear that MediaOne has the technical expertise to operate and upgrade its systems. MediaOne has been upgrading its systems pursuant to the Social Contract, and the testimony is that MediaOne expects that more than 87 percent of its systems in the Northeast will be upgraded before the merger is even finalized.[16] Few questions were raised during the hearings about MediaOne's technical capacity. The complaints which were raised, by contrast, focused on whether MediaOne was doing what it was supposed to do. Mr. Kenney of Yarmouth, for example, complained that MediaOne was behind schedule in upgrading the Yarmouth system. (Barnstable Tr., p. 39-40).

Third, AT&T's representations that MediaOne personnel, in this case the technical personnel, would continue to manage and upgrade the Massachusetts systems after the merger were strong and unequivocal throughout the eleven hearings. *See, e.g.*, fn. 11, *supra*.

Finally, the evidence, though very limited, suggests that AT&T is behaving in a fashion which is consistent with these representations. As AT&T confirmed in response to a question during the Newton hearing, the TCI personnel are virtually the same as they were at the time of the merger.[17] Of course, only six months have passed since TCI was acquired, so Issuing Authorities can only take limited comfort, but the TCI experience does have some value. In addition, there were several press reports on September 15, 1999 to the effect that AT&T had imposed a hiring freeze and had put a number of workers on notice that they might be subject to layoffs. What was significant was that the affected workers are in the long distance and business services units. No layoffs were contemplated in the cable division; indeed there was some suggestion that people might be able to transfer out of long distance or business services into cable services[18].

No one can predict the future, but I am satisfied that AT&T representations that it will rely on MediaOne's technical expertise are substantive. On the evidence presented at the regional hearings, AT&T, if the MediaOne franchises are transferred, will possess the technical expertise to operate the cable systems.

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15 See, e.g., Barnstable Tr., p. 81 (Statement of Mr. Robert Dughi, AT&T).

16 Powerpoint Presentation.

17 Response to Record Request, Vol. I, Exhibit. I (Letter from Mark Reilly to Bill August, August 13, 1999)

18 "AT&T Freezes New Hiring; Layoffs May Follow" *Wall Street Journal*, September 15, 1999, p. 3; "AT&T sets hiring freeze, may cut some workers" *Nasdaq News*, September 15, 1999

D. Financial Ability

The final criterion to be considered is whether AT&T has the financial capability to fulfill its obligations under the existing licenses. In attempting to establish its financial strength at the hearings, AT&T focused primarily on (i) the sheer size of the company, most notably the fact that its revenues for 1999 will total approximately $60 billion, and (ii) its ability to borrow massive amounts of capital quickly and with no adverse effect on the company's credit rating. According to AT&T, it was able to raise $30 billion in six days to finance the MediaOne acquisition without having its bond rating downgraded. *See* Powerpoint Presentation.

Of the many people who spoke at the hearings, not once did anyone suggest that AT&T might lack the financial capability to fulfill its obligations under the MediaOne licenses. The issue on the minds of MediaOne subscribers was whether or not the price of the MediaOne acquisition and the price of the new technologies that AT&T expects to roll out in the coming years would be reflected in ever spiraling cable bills. Several people also asked whether AT&T's emphasis on broadband communications would lead to a reduction in cable revenues and thus a reduction in funds available to support PEG access programming.

The regulations speak of the financial *capability* of the acquiror, not its financial *plans*. AT&T is obviously an acquiror whose financial resources are unparalleled by other companies that have sought permission to operate cable systems in the Commonwealth. Nevertheless, I have analyzed the financial capability of AT&T below, and address, at the close of the analysis, some of the related questions which have been raised.

1. Analysis

While these proceedings are narrowly focused on cable television, the financial data provided by AT&T includes all of its services. I gather AT&T provided financial information this way for two reasons: (i) AT&T will not keep its books that way, and (ii) an AT&T analysis of all of the company's resources and obligations is necessary to fairly assess its capabilities, since capital expenditures, for example, will build plant to provide broadband services, not just cable services. AT&T will have two sources of capital if the MediaOne merger is consummated: (a) cash generated by its operations ("Operating Cash Flow"); and (b) debt. Operating Cash Flow is similar to EBITDA,[19] and is frequently employed as a measure of a company's performance and prospects. Like EBITDA, Operating Cash Flow excludes cash generated or used in financing or investing activities. Thus, it includes the payment of interest but not the repayment of principal on outstanding debt. Similarly, it includes maintenance charges for existing property, but does not include capital expenditures for new or improved equipment.

In a sense, "Operating Cash Flow" is more useful than EBITDA. Interest and taxes, after

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[19] EBITDA represents income (or loss), before interest expense, income taxes, depreciation, amortization, gain (or loss) on sale of assets and other income (or expense).

all, are amounts actually paid. Operating Cash Flow, unlike EBITDA, accounts for these costs. Operating Cash Flow is thus useful in analyzing the financial strength of a company because it measures the amounts of cash that the company has to spend after it has paid all of its bills.

Determining the financial strength of AT&T under this analysis requires two steps. First, one must determine if its Operating Cash Flow, after dividends, is greater than its capital expenditure requirements. If its Operating Cash Flow is less than its capital expenditure requirements, then AT&T may need debt capacity adequate to cover the shortfall, and AT&T's capacity to borrow funds becomes important.

a. AT&T's Projected Capital Expenditures

AT&T has stated that it plans to spend $13.5 billion on capital expenditures each year between 2000 and 2004.[20] Record Request Responses, Vol. I, Exhibit H. This figure is based not on AT&T's obligations under the cable licenses that it hopes to acquire, but on its analysis of what investments will be necessary to compete against other providers of telecommunications services.[21]

b. AT&T's Projected EBITDA, Operating Cash Flow and Dividends

AT&T has provided a projection of its company-wide EBITDA — assuming that the MediaOne merger is consummated — through 2004. AT&T's projected EBITDA for the year ended December 31, 1999 is $19 billion. The company anticipates EBITDA growing steadily over the course of the next five years, when it expects EBITDA to total just under $40 billion. AT&T's specific projections of EBITDA are:

1999	$19.0 billion
2000	$21.9 billion
2001	$25.2 billion
2002	$29.3 billion
2003	$34.1 billion
2004	$39.9 billion

[20] Because the merger will not be finalized until the second quarter of 2000, there is no need to analyze the figures for 1999. At the hearings, however, AT&T did show a slide indicating that capital expenditures in 1999 would total $11.5 billion.

[21] License obligations should not account for a sizeable portion of these projected expenditures. MediaOne had already upgraded 67 percent of its systems in the Northeast Region by the beginning of 1999, and projects that 87 percent of its systems in the Northeast will be upgraded by the close of the year. *See* Powerpoint Presentation.

AT&T has also supplied its Operating Cash Flow figures for 1996-1998. Operating Cash Flow was: $8.087 billion in 1996; $8.501 billion in 1997; and $10.217 billion in 1998. It measured 67%, 75% and 76% of EBITDA, respectively, for each of those three years. Below, I will rely on these historical ratios to estimate the company's operating cash flow through 2004. So that the analysis will be conservative, I will use the figure of 67 percent — which is well below the average for the three year period.

AT&T paid dividends of $2.2 billion in 1998, which reflected a dividend of $1.32 per share. Although AT&T has paid the same dividend of $1.32 per share since 1994, I will assume two percent increase in the company's dividend each year between 1999 and 2004. This, too, should produce a conservative analysis.

c. Combined Projections

The figures listed above are summarized in Table 1 below.

Table 1 (Dollars in Billions)

		1999	2000	2001	2002	2003	2004
1.	**EBITDA**	19.0	21.9	25.2	29.3	34.1	39.9
2.	**Operating Cash Flow**	12.73	14.6	16.8	19.6	22.8	26.7
3.	**Dividends**	2.24	2.28	2.32	2.36	2.40	2.45
4.	**Cash Flow Available to Reinvest**	10.49	12.32	14.48	17.24	20.40	24.25
5.	**Capital Expend.**	11.5	13.5	13.5	13.5	13.5	13.5
6.	**Excess or Deficit**	(1.01)	(1.18)	.98	3.74	6.9	10.75

A brief description of the table is warranted. Line 1 is the EBITDA projections supplied by AT&T. I am satisfied that, though ambitious, the figures are consistent with the company's recent performance. Line 2 represents 67 percent of the EBITDA projections. Line 3 represents dividend growth of two percent per year, above the 1999 level of $2.2 billion. Line 4 is calculated as Line 2 minus Line 3 and represents the pool of money available to AT&T after it has paid dividends. Line 5 is the projected capital expenditures of AT&T, and Line 6 is the difference between those projected capital expenditures and the projected cash available to fund them (Line 4 - Line 5).

As the analysis indicates, only in the year 2000 would AT&T have to resort to its debt capacity in order to meet its capital expenditure goals.[22] Several comments are in order. First, assuming AT&T's actual performance mirrors this *pro forma*, Issuing Authorities should keep in mind that the Social Contract remains in effect until the end of 2000. Thus cities and towns have protection (a) to be sure that upgrades get completed, and (b) to be sure that rates are not increased precipitously to cover the shortfall. Second, this *pro forma* has several very conservative assumptions. It is certainly possible that AT&T's performance will be better than these projections, in which case there will be no need to borrow funds even in 2000.

In each of the remaining four years, AT&T should be able to finance its capital expenditures out of Operating Cash Flow. This is a fact that should give comfort to Issuing Authorities.

d. Debt Capacity

Should the company need to borrow money to meet its capital expenditure goals in 2000, or in future years, it will almost certainly be able to do so. As discussed above, AT&T has represented that it had the ability to secure commitments to borrow approximately $30 billion in less than six days to finance the MediaOne acquisition. According to the company, this commitment did not compel Standard & Poor's to downgrade its short term debt rating of the company from AA-. That rating is higher than the rating for most cable companies, including Time Warner, Cox, Comcast and Cablevision.

Accordingly, and based on the information available to me, I have little doubt that AT&T is capable of meeting all of its financial obligations under its Massachusetts cable licenses.

e. The Merger and Cable Rates

Saying that AT&T has the financial capability to meet its license obligations, and saying that it will do so without raising cable rates, are two different things. The former issue is the relevant one under the regulations, the latter issue is the one on the minds of Issuing Authorities and cable subscribers.

In the current regulatory environment, rates for basic services are the only rates which are subject to regulation, and these rates are deregulated if the FCC issues an order which finds "effective competition." Issuing Authorities thus have little control over rates. Further, in spite of assurances from time to time during the hearings about rate stability, nobody can be sure what

[22] The projected figures for 1999 are included for context. The merger, however, will not be finalized until 2000.

AT&T will do.

There are several factors which create incentives for AT&T not to raise rates. As to any proposed rate increases before the end of 2000, cities and towns will have whatever protection they have had in recent years from the Social Contract. That remains in place until December 31, 2000. As to the cost of the merger, AT&T has indicated that the $20 billion that will be paid in cash to MediaOne shareholders will be recouped through the sale of non-strategic overseas assets, and not through rate increases. Assuming these assets are sold at the expected prices, much of the pressure to raise rates because of the cost of the acquisition will be relieved.

Consumers will have the ability to "punish" AT&T for rate hikes in a way that has never been possible with MediaOne. If a consumer calls AT&T and cancels cable service, the company loses the ability to market not only cable to that individual, but local telephone service, Internet service, e-commerce service and whatever other new services are developed as well. A truly disgruntled customer can even go so far as to switch long-distance carriers or wireless telephone companies. More so than ever, Massachusetts cable customers will have a company with very good reasons to keep them happy.

There were several questions about whether AT&T's broadband strategy really meant that cable revenues will be diminished as revenues from other services increase. AT&T answered in each case that it expected cable revenues to actually increase (*See*, e.g. Boxford Tr., p. 34-39). Again, nobody can predict the future, but it does appear that AT&T views cable service as an integral part of the broadband service, one which should grow along with the other services.

AT&T has the financial capacity to operate the MediaOne systems whether or not it will raise rates is a separate question and anybody's guess. I am satisfied it has met the criterion.

III. The Open Access Issue

There was considerable discussion during the hearings about the issue of "open access."[23] At its core, the issue is whether a cable operator can require that subscribers who purchase high speed Internet via cable take service only from the Internet service provider ("ISP") affiliated with the cable company, or whether the cable operator will permit unaffiliated ISPs to provide high speed Internet services (a) directly to subscribers without their having to pay the fees of the ISP affiliated with the operator and (b) in a business arrangement with the cable operator which has the same terms and conditions as those which the ISP affiliated with the operator has.

Some people wanted to know what the issue was about. Some municipal representatives and private individuals wanted to press AT&T for a commitment that it would adopt a policy of open access, a commitment that AT&T would not give. At the Malden hearing, representatives

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[23] Opponents use the term "forced access," but the debate is almost always referred to as the "open access" debate; a convention that I will observe.

of GTE, Bell Atlantic and AOL made presentations in favor of a policy of open access, along with Professor Charles Nesson, Director of the Berkman Center for Internet & Society at Harvard Law School. AT&T then announced that it wanted to bring in a panel of experts to put its views on the record. At the Burlington hearing, AT&T had Scott Morris of AT&T; former FCC Commissioner Rachelle Chong; James Starr, director of MediaOne labs; and Robert Scott of Cole, Raywid and Braverman conduct a panel discussion. Others spoke on both sides of the issue at the Burlington hearings, and at the hearings in Foxborough and Weymouth.

At the Barnstable hearing, I suggested that the open access issue, while both important and interesting, was not relevant to the four criteria which appear in 207 CMR 4.00 as the basis on which Issuing Authorities should base their decisions.[24] The reasoning was, and is, simple. While the issue has enormous importance as a public policy issue, it does not on its face relate to whether AT&T has the legal, financial, technical or management ability to step into the shoes of MediaOne, and to operate the MediaOne cable systems in accordance with the current licenses. No one has suggested that any of the current MediaOne licenses in Massachusetts contain any representations or covenants with respect to the open access issue, for example.

Significantly, there were extremely few persons who disagreed with my position. The only two were Mr. Howard Horton, indirectly, and Mr. Howard Green. The public interest in this issue was obviously quite intense, however, since so many people returned to the issue during the hearings. Professor Nesson, in many ways, confirmed my analysis by filing a petition with the DTE asking them to waive 207 CMR 4.00 so that issuing authorities could consider this issue as part of their deliberations on the transfer of control.[25] Subsequent to the hearings, the Town of North Andover also filed a petition with the Cable Division seeking a waiver of those regulations.

As of this date, the Division has not yet responded to the two petitions. Without suggesting in any way that Issuing Authorities should consider this issue in determining whether to approve the proposed transfer, I think it would be useful to include in this report a very brief summary of the viewpoints of the two sides. If for some reason more detail is needed, one can always review the transcripts in detail for more information.

The position of the proponents of open access may be summarized as follows: They want AT&T to permit other ISPs to be able to provide high speed Internet access on the same terms and conditions as Road Runner does. Road Runner is an independent company, and the fact that

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[24]Barnstable Tr., p. 70.

[25]See Weymouth Hearing, Exhibit 7; I should note that Mr. Nesson also suggested that the DTE's regulations went beyond the scope of the statute, and infringed on the jurisdiction of Issuing Authorities.

it is affiliated with MediaOne[26] should not be a reason for it to enjoy a competitive advantage. The Internet has grown and prospered because of competition. By giving Road Runner the exclusive access to the AT&T/MediaOne cable systems, AT&T is stifling the very competition which nurtured the explosive growth of the Internet over the last few years. When one considers that AT&T has Road Runner on its MediaOne systems and @Home on its TCI systems, the anti-competitive behavior covers a very large portion of the country.

Further, the technology that exists today would allow AT&T to adopt an open access policy. Some additional engineering design work would need to be done, but the problems are solvable in the near term if AT&T wished to do so.

AT&T's arguments that open access is technically infeasible should be taken with a grain of salt. The Company argued against regulation in the public interest in at least one instance in the past that is telling today: AT&T argued that the creation of the Bell Operating Companies in the early 1980s was unworkable. People also have to remember that cable companies have traditionally operated as natural monopolies, that cable rates have increased two to three times more rapidly than the CPI and that Congress has already stepped in once to regulate cable rates to slow down the increases. Open access will bring the competition needed to keep rates from rising.

Finally, consumers would benefit from open access in two respects from an open access policy. First, consumers could have a choice among ISPs without having to pay both the Road Runner fee and the fee of their ISP of choice. Second, with more than one choice of ISPs competition between these ISPs may lead to lower prices and improved services.

The argument of those who oppose open access may be summarized as follows: First, people need to keep in perspective that fact that high speed Internet services is a small portion of the Internet market. There are 33 million Internet users today, and AOL alone has 18 million subscribers. By contrast, Road Runner and @Home combined have 1.5 to 2 million subscribers. The other 10 million Internet users are serviced by hundreds of ISPs. There is enormous competition. It is not yet clear that high speed Internet, or that AT&T's products, will be the ultimate winners in the marketplace.

The competition exists at every level. AOL, for example, has developed an alliance with Bell Atlantic to develop efforts to compete with cable modem delivery of the Internet digital subscriber line ("DSL") technology. DSL can provide Internet access at speeds that are comparable to the cable modem service, at competitive prices, only using telephone lines instead of coaxial cable and fiber. This is a high profile effort to develop DSL, but it is only one of many efforts to compete with cable modem delivery of the Internet.

Apart from these considerations, the engineering issues in getting a cable system to

[26] Investors in Road Runner include MediaOne, Time Warner, Compaq and Advanced Newhouse.

support more than one ISP are not so easily resolved.[27]

The better course is the course espoused by the FCC under the leadership of its chairman, William Kennard. The FCC has urged that there be no mandate for open access. It will not issue such a mandate because the evidence does not yet warrant any government competition. The FCC urges cities and towns not to issue open competition mandates as well. It fears there will be no uniformity in the mandates. The result will be unworkable and will stifle the competition that both sides want to foster.

Again, I do not take a position with regard to which of the above two series of arguments is more persuasive. To do so would be to far exceed the scope of my mandate from the Division. These are the arguments in their broadest contours. More in depth discussions are available in several of the hearing transcripts available from the Division.

IV. Conclusion

It is clear from the record[28] in this proceeding that the transfer of MediaOne's licenses to AT&T is an event far different from the hundreds, if not thousands, of license transfers that have taken place to date in the Commonwealth. Never before has a company as large and as diversified as AT&T, and with so many plans for transforming the delivery of cable services, sought to enter the Massachusetts cable market.

The transfer obviously raises a host of public policy questions. I was charged with the duty of helping cities and towns to assess whether AT&T has the legal ability, the management experience, the technical expertise, and the financial capability to fulfill all of the obligations under the MediaOne licenses. As the discussion above indicates, I believe that all of these questions should be answered in the affirmative. Therefore, I make the non-binding recommendation to the cities and towns that participated in the regional hearing process that they approve AT&T's transfer application. I leave the public policy issues to be resolved on another day in another forum.

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[27] Perhaps they can be resolved over time, but they have not been resolved yet. People do not realize that the Road Runner service requires support both from the cable operator and from the Road Runner company. That relationship is not so easy to duplicate for several high speed ISPs, and it is quite a burden to place on AT&T in this competitive environment.

[28] A stenographic transcript of each hearing, as well as exhibits and a variety of materials that were requested of AT&T and MediaOne during the hearings, are available for inspection at the Division's offices during normal business hours. AT&T and MediaOne also submitted affidavits respecting newspaper publication and cablecasting publication of notices of each hearing. Those too are available for inspection at the Division's offices at One South Station in Boston.