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DEUTSCHE TELEKOM AND VOICESTREAM MERGER: CHARTING A NEW REGULATORY COURSE

¶ 1 On July 24, 2000, the German telecommunications giant Deutsche Telekom AG (Deutche Telekom) agreed to purchase the Bellvue, Washington based VoiceStream Wireless Corporation (VoiceStream) for over $50 billion.[1] Although the merger may ultimately fall through, the response generated by the proposed merger indicates the future for deals between US and foreign-owned telecommunications companies. With the increasing globalization of the world's telecommunications markets, the Deutche Telekom deal represents the first time that a company dominated by a foreign government has attempted to purchase an American corporation. The signatories of the Basic Telecommunications Agreement, an agreement among World Trade Organization (WTO) members to open their telecom markets to foreign competition, are closely watching the US response. The stance that the US government takes in reviewing this merger can be seen as a sign of things to come as the world's single largest telecommunications market opens up to the world.

Background of the Proposed Merger

¶ 2 Deutsche Telekom considered VoiceStream an attractive property to acquire despite the fact that the one-year-old company had been previously unprofitable.[2] VoiceStream, which spun off from Western Wireless Corp. last year, is one of the nation's last independent nationwide wireless carriers and owns wireless phone operating licenses nationwide. In addition, it is one of the few major US carriers that operates on the GSM standard for wireless communication, the dominant standard outside North America. Deutsche Telekom and VoiceStream had hoped to make a strong play for business travelers and create a comprehensive service network that reached across Europe, Asia and the Americas. VoiceStream has 8,200 employees and completed several acquisitions of its own earlier this year, including Aeriel Communications Inc. for $5.6 billion and Omnipoint for $7.2 billion.[3] Although VoiceStream was an attractive target for technical reasons, its relatively small customer base, currently around 2.3 million users, meant that Deutsche Telekom would have paid more than $20,000 per customer.[4] This raised questions about the financial viablity of the merger within the industry. These questions, however, paled in comparison to the questions raised in Washington about the politics of the acquisition of a US company by German government-owned Deutche Telekom.

Controversy Over the Merger

¶ 3 The dispute over the acquisition in Washington grew most heated when the two companies approached the Federal Communications Commission (FCC) for permission to proceed.[5] In response, thirty senators urged the FCC to consider the national security implications of any foreign acquisition of a US telecommunications firm.

¶ 4 The strong concern in Congress was illustrated by the numerous Senators who joined Senator Ernest Hollings when he introduced legislation to amend the Communications Act of 1934. Senator Holling's amendment proposed to strengthen the limitation on the holding or transfer of licenses to foreign government-held companies when merging with domestic companies.[6] The bill, titled the Foreign Government Investment in Telecommunications bill, would have absolutely baned the granting of licenses to companies with more than 25% foreign government ownership. The bill removed the FCC's discretion to grant a license, which the FCC normally has if it feels a merger will not affect its three concerns (national security, public interest and competition in the marketplace). In June, the bill was sent to the Senate Committee on Commerce, Science, and Transportation and has not been addressed again as of this writing.[7]

¶ 5 In addition to the direct attack on the FCC's discretion, opponents also attempted to attack the deal through a rider added to the appropriations bill for the fiscal year 2001. The rider proposed a removal of all funding from the FCC for a year to review mergers involving foreign governments.[8] The appropriations bill read as follows:

> Provided further, that no amount appropriated under this Act may be obligated or expended by the Federal Communications Commission to grant or transfer a license or authorization under §310(b)(4) of the Communications Act of 1934 (47 U.S.C. 310 (b)(4)) or §90.115 of the Commission regulations (47 C.F.R. 90.115) to a corporation of which more than 25 percent of the stock is directly or indirectly owned or voted by a foreign government or its representative.[9]

¶ 6 The Republican leadership in Congress later removed the rider from the spending bill in order to streamline the appropriations bill during their recent budget battles with the White House. They made it clear that the rider was not removed due to a lack of support.[10]

¶ 7 While the merger debate raged on, Senator Hollings also voiced staunch opposition to VoiceStream's efforts to take part in an FCC wireless license auction.[11] The Senator's objections were due in large part to an infusion of $5 billion from Deutsche Telekom to VoiceStream. The

Senator claimed that the new investment brought Deutsche Telekom's level of ownership in VoiceStream to 39%, greater than the 25% allowable without explicit FCC approval. A spokesman for VoiceStream insisted that the level of Deutsche Telekom's investment would actually be closer to 11.5%. The auction, which was scheduled to take place on December 12, was for PCS licenses in the C and F blocks. These licenses could have brought in as much as $25 billion in revenues; however, VoiceStream's original application to participate in the auction was denied while the merger was still pending.

¶ 8 Despite the strong opposition that developed among some lawmakers, the President and several influential members of Congress came out in favor of the merger and urged the FCC to give its permission. This group noted that the deal was still subject to review by the Committee on Foreign Investment and by the President, both of whom could have blocked the merger if it was found to violate national security interests.[12]

Legal Analysis

¶ 9 As the above controversy indicates, it is the deliberations of the FCC that have drawn the most attention and illustrate where the real battle is being waged. The FCC currently grants, transfers, or authorizes licenses to telecommunications companies.[13] As part of this function, the FCC reviews the merger of any telecommunications company to determine whether the new entity will comply with licensing requirements. When companies merge they must apply to the FCC for a transfer of licenses or new licenses. If the new entity created by the merger has any element of foreign ownership, the provisions of 47 U.S.C. §310 of the Federal Telecommunications Act of 1996 apply.

¶ 10 The current FCC regulations evaluate the effect of a merger on national security, public interest, and the competition in the marketplace.[14] The national security concern requires the FCC to determine that mergers with government interests do not allow foreign governments access to American military or technological secrets. When examining the public good, the FCC balances national security concerns against the advantages to consumers that the additional competitor could provide. Finally, the FCC determines whether the merger would benefit the marketplace by adding competition and lowering prices, or harm the market by eliminating American companies.

¶ 11 In addition, all companies with foreign government ownership face three statutory obstacles: the company must gain the right to provide international services under §214 of the Communications Act of 1934; it must obtain permission to exceed the 25% foreign ownership cap for spectrum licenses under §310(b)(4) of the Act; and finally, it should secure approval for taking over the majority of stock in an American company under §310(c)(4).[15] The FCC will approve a merger that involves a foreign government-owned company, even if the company violates one of the three statutory obstacles, if the merger is conditioned to address the FCC's concerns.[16] For example, the FCC could grant a license to a company that is more than 25% owned by a foreign government if the company signs a competition agreement that protects other American companies.

¶ 12 Through most of the history of §310, the FCC has taken a dim view of foreign ownership in telecommunications licensees.[17] This view has generally been upheld by the D.C. Court of Appeals. Both the FCC and the courts take seriously the national security policy rationale behind the exclusion of foreign ownership in the US telecommunications infrastructure.[18] In addition to national security concerns, many of the major telecommunications companies in other countries are government-controlled monopolies, which makes it difficult to approve foreign ownership on competitive grounds.

¶ 13 However, in the last five years there has been an abrupt shift in policy. Senator Hollings stated in his testimony before the House subcommittee that the FCC has never previously waived the foreign ownership restrictions on public interest grounds. The FCC, however, has made several rulings in the past decade that relax the §310(b) restrictions.[19]

¶ 14 The highest profile example of this relaxation occurred in the 1994 ruling that allowed British Telecom to acquire a large minority interest in MCI.[20] A major factor the FCC took into account in this ruling was that MCI is a common carrier, rather than a broadcaster that exercises control over the content of radio transmissions.[21] In the FCC's ruling on the MCI matter, the FCC rejected AT&T and Sprint's request that a standard of comparable market access be adopted.[22] Such a standard would have required that the FCC consider the barriers to market entry in the home country of the foreign carrier wishing to acquire an interest in a US common carrier. The FCC ruled that the formulation of such a standard went beyond the scope of MCI and British Telecom's application. One year later, however, in a 1995 Report and Order, the FCC stated its position that the restrictions in §310(b) could be relaxed if the proposed deal promoted the interests of fair competition in the international telecommunications market.[23] The Order adopted an economic competitive opportunities (ECO) test to determine whether or not a foreign carrier could be granted a license in the US.

¶ 15 After the adoption of the World Trade Organization's Basic Telecommunications Agreement, however, the need for this test when dealing with WTO member nations was eliminated in the FCC's view. The ECO test was replaced with an open entry standard in 1997.[24] This new standard presumes that the entry of a foreign competitor in the US telecommunications market is in the public interest, absent evidence than an application "poses a very high risk to competition."[25]

¶ 16 While this new position does not reflect a change in the underlying statute, it does indicate a significant change in the way the FCC will exercise its broad discretion in interpreting §310. To highlight this change in attitude at the FCC, Chairman William Kennard delivered a report to Congress on his vision of the future.[26] At the end of the report, in a list of proposed changes to implement that vision, is a recommendation to amend §310(d) to authorize *pro forma* transfers of licenses. According to the language of the report, "this will streamline the FCC's administrative process with regard to the processing of assignment and transfer applications." Effectively, it will also mean that future mergers involving foreign entities will be given much less scrutiny and will normally be approved, whereas for most of the last 65 years, they were generally denied.

¶ 17 As mentioned above, the new regulatory climate at the FCC is, in large part, a result of the WTO's Basic Telecommunications Agreement. The Basic Telecommunications Agreement is the result of negotiations between member nations of the WTO to open the world telecommunications market to greater competition. The Agreement, which went into effect in February 1998, pledges signatory nations to open their markets to foreign ownership of all telecommunications services and facilities.[27] According to the Office of the US Trade Representative, prior to the agreement, only 17% of the global telecommunications market was open to competition by US businesses. With full implementation of the agreement by the signatories, over 95% of the market would be open.[28] This new, more open, global telecommunications market creates pressure on the federal government to reduce many of the restrictions that close our market to foreign investors. The Office of the US Trade Representative (and, through that office, the President) now have the daunting task of convincing Congress that a more open domestic telecommunications market will ultimately lead to greater benefits for American companies doing business abroad.

¶ 18 FCC Chairman Kennard supported the FCC's current regulatory stance on foreign government ownership in a speech addressed to the United States House of Representatives Subcommittee on Telecommunications, Trade and Consumers Protection on September 7, 2000.[29] Chairman Kennard told the Subcommittee that the current regulations were adequate. He characterized the current regulations as comprehensive, flexible, and above all effective. Chairman Kennard's arguments, however, may not be persuasive enough to convince a Congress considering a bill that would absolutely ban foreign government licenses. Furthermore, an expected slowdown in the recent booming economy can only increase Congress' desire to keep foreign entities out of the domestic marketplace.

¶ 19 Some observers have suggested that if the US takes a stand against telecom mergers that involve foreign governments, other signatories of the WTO Basic Telecommunications Agreement will feel that we have withdrawn our commitment to open our markets to foreign competition. European Union spokesman Michael Curtis issued a stern warning regarding the WTO implications of a bill being adopted that would restrict foreign ownership of US telecommunications firms.[30] The European Union would like to argue that such a bill would be contrary to current commitments given in the WTO. This argument is largely belied, however, by the recent decisions of several other WTO signatories, including Italy, Spain, and Hong Kong, not to allow foreign government-controlled companies to gain footholds in their domestic telecommunications markets.[31] Each of these nations is open to foreign investment but draw the line when the acquiring companies are controlled by foreign governments.

Conclusion

¶ 20 Despite the recent push in Congress towards absolute prohibition of telecommunications mergers with foreign government-owned companies, both sides of the debate are likely to get what they want. The FCC, along with the President and the Office of the US Trade Representative, will probably continue to argue for the desirability of having a domestic telecommunications market that is open to foreign competition. The momentum towards open markets is unlikely to be reversed in the short term, particularly as US companies enjoy greater access to lucrative overseas markets. In future merger situations, the players will have learned from the experience of the attempted VoiceStream/Deutsche Telekom merger and will be more ready to comply with the realities of the new regulatory environment.

¶ 21 At the same time, opponents of these mergers may have their concerns addressed in the form of concessions. Over the last decade, the trend towards allowing foreign investment in the US telecommunications market has grown unabated. The catalyst that brought together the coalition led by Senator Hollings was the large interest that the German government holds in Deutsche Telekom. In response to this concern, Berlin indicated that, in order to secure approval of the merger, it might be induced into reducing its stake in Deutsche Telekom.[32] Although legislators may not like foreign ownership in American telecommunications companies for political reasons, they will probably not be able to stop these mergers once the specter of "foreign government" has been removed from the deal.

¶ 22 In the past five years, the FCC, along with the Office of the US Trade Representative, has consistently pushed for a more open global telecommunications market. Overall, the FCC maintains that it is essential to have foreign ownership to establish an open, competitive global infrastructure. This stance indicates that in order for American companies to succeed in the global telecommunications market, we must also let in foreign ownership. According to this view, if we want to play in their backyard, we have to open the gate to our own.

By: Aaron Futch
Yemi Giwa
Andrew Grimmig
Kisa Mlela
Amy Richardson
Yelena Simonyuk

Footnotes

1. *See* The Associated Press, *Deutsche Telekom to Buy U.S. Firm VoiceStream in $46 Billion Deal*, ABCNEWS.com, *at* http://more.abcnews.go.com/ sections/business/dailynews/wireless000724.html (July 24, 2000).

2. *See id*.

3. *See id*.

4. *See id*.

5. *See* David Lawsky, *Deutsche Telekom, VoiceStream Seek FCC Merger Approval*, Reuters Wire Service, Sept. 18, 2000.

6. *See* Foreign Government Investment Act of 2000, S. 2793, 106th Cong. (2000), *available at* http://www.wow-com.com/lawpol/congress//journals/dltr/articles/pdf/fcc_062700a.pdf (last

visited Feb. 6, 2001).

7. *See id*.

8. *See* Making Appropriations for the Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies for the Fiscal Year Ending September 30, 2001, and for Other Purposes, H.R. 4690, 106th Cong. (2000), *available at* http://thomas.loc.gov/cgi-bin/bdquery/z?d106:H.R.4690:|TOM:/bss/d106query.html (last visited Feb. 6, 2001).

9. *Id.*

10. *See* Patrick Ross, *Deutsche Telekom Clears Hurdle for VoiceStream Buy*, CNET News.com, *at* http://yahoo.cnet.com/news/0-1004-200-3302756.html?pt.yfin.cat_fin.txt.net (Oct. 26, 2000).

11. *See* Jeremy Pelofsky, *U.S. Lawmaker Seeks to Bar VoiceStream from Wireless Auction*, Yahoo! News, *at* http://biz.yahoo.com/rf/001201/n01540277_2.html (Dec. 1, 2000).

12. *See* Lawsky, *supra* note 5.

13. *See* Communications Act of 1934, 47 U.S.C. §151 (1934), *available at* http://www4.law.cornell.edu/uscode/47/ch5.html (last visited Feb. 6, 2001).

14. *See* 47 C.F.R. §43.51(a)-(e) (1999), *available at* http://www.access.gpo.gov/nara/cfr/cfr-retrieve.html (last visited Feb. 6, 2001).

15. *See* 47 U.S.C. ■ 214, 310 (1934), *available at* http://www4.law.cornell.edu/uscode/47/214.html ; http://www4.law.cornell.edu/uscode/47/310.html (last visited Feb. 6, 2001).

16. *See* 47 C.F.R. §90.115 (1999), *available at* http://www.access.gpo.gov/nara/cfr/cfr-retrieve.html (last visited Feb. 6, 2001).

17. *See* Moving Phones Pshp. L.P. v. FCC, 998 F.2d 1051 (D.C. Cir. 1993), *cert. denied*, 511 U.S. 1004, 128 L. Ed. 2d 46, 114 S. Ct. 1369 (1994); Cellwave Tel. Servs. L.P. v. FCC, 30 F.3d

1533 (D.C. Cir. 1994); Kansas City Broadcasting Co., 5 Rad. Reg. 1057 (1952).

18. *Moving Phones*, 998 F.2d at 1055-56.

19. *See* In re Cable & Wireless, Inc., FCC 95-422 (1995), *available at* http://www.fcc.gov/Bureaus/Wireless/Orders/1995/fcc95422.txt (last visited Feb. 6, 2001); Fox Television Stations, Inc., FCC 95-313 at 21 (1995), *available at* http://www.fcc.gov/Bureaus/Mass_Media/News_Releases/nrmm5086.txt (last visited Feb. 6, 2001); Teleport Transmission Holdings, 8 F.C.C.R. 3063 (1993); GCI Liquidating Trust, 7 F.C.C.R. 7641 (1992); IDB Communications Group, Inc, 6 F.C.C.R. 4652 (1991); MMM Holdings, Inc., 4 F.C.C.R. 8243 (1989); GRC Cablevision, 47 F.C.C.2d 467, 467-68.

20. *See* In re Request of MCI Communications Corporation British Telecommunications, P.L.C., 9 F.C.C.R. 3960 (1994); *see also FCC Approves MCI/British Telecom Merger Subject to Certain Conditions*, *at* http://www.fcc.gov/Bureaus/International/News_Releases/1997/nrin7033.html (last modified Aug. 21, 1997).

21. *See* In re Request of Millicom Inc., 4 F.C.C.R. 4846.

22. *See In re MCI*, 9 F.C.C.R. at 3965.

23. *See* In re Market Entry and Regulation of Foreign-affiliated Entities, 11 F.C.C.R. 3873, 3941 (1995), *available at* http://www.fcc.gov/Bureaus/International/Notices/1995/ntin5002.html (last visited Feb. 6, 2001).

24. *See* In re Rules and Policies on Foreign Participation in the U.S. Telecommunications Market; Market Entry and Regulation of Foreign-Affiliated Entities, 12 F.C.C.R. 23891 (1997).

25. In re Rules and Policies on Foreign Participation in the U.S. Telecommunications Market, FCC 97-142 (1997), *available at* http://www.fcc.gov/Bureaus/International/Orders/1997/fcc97398.txt (last visited Feb. 6, 2001).

26. *See Strategic Plan: A New FCC for the 21st Century*, 1999 FCC LEXIS 3874 (Aug. 1999), *available at* http://www.fcc.gov/21st_century/draft_strategic_plan.txt (last visited Feb. 6, 2001); *see also Chairman Kennard Calls For Implementation of Five Year Plan to Build an Agency That Serves All in the Coming Century*, *at* http://www.fcc.gov/21st_century / (last visited Feb. 6,

2001).

27. *See President's 1999 Annual Report on the Trade Agreements Program, Office of the United States Trade Representative*, *at* http://www.ustr.gov/html/2000tpa_index.html (last modified Dec. 21, 2000).

28. *See id.*

29. *See Testimony of the Honorable William E. Kennard, Chairman Federal Communications Commission Before the Subcommittee on Telecommunications, Trade and Consumer Protection*, Federal News Service, Sept. 7, 2000 [hereinafter *Testimony*], available at http://www.fcc.gov/Speeches/Kennard/Statements/2000/stwek071.html (last visited Feb. 6, 2001).

30. *See* The Associated Press, *supra* note 1.

31. *See Testimony*, *supra* note 29.

32. *See* Pelofsky, *supra* note 11.