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# LOCAL TELEPHONE COMPETITION

## HEARING

BEFORE THE

## COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

JUNE 19, 2001

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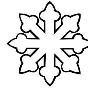

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ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION


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# LOCAL TELEPHONE COMPETITION

**TUESDAY, JUNE 19, 2001**

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
*Washington, DC.*

The Committee met, pursuant to notice, at 9:30 a.m. in room SR–253, Russell Senate Office Building, Hon. Ernest F. Hollings, Chairman of the Committee, presiding.

## OPENING STATEMENT OF HON. ERNEST F. HOLLINGS, U.S. SENATOR FROM SOUTH CAROLINA

The CHAIRMAN. Good morning. The hearing will come to order. We very much appreciate our distinguished colleague on the House side, Mr. Markey, for coming and obliging the Committee. As I understand, there is a very important hearing over on the House side concerning the Firestone case.

I first invited Chairman Bliley and he had a conflict, and then Chairman Tauzin and Congressman Dingell, but they told me of the conflict and we will have them at another time. Otherwise, Senator McCain and others—who started this change in seating, anyway?

Senator MCCAIN. We were told that, Mr. Chairman.

The CHAIRMAN. Well, we will return to the way it was before. We will not do it this way just for TV, Sam. Do not worry about it.

The truth of the matter is, with 23 Members, we always have to yield to the Chairman and the Ranking Member for their opening statements, but we are going to hold opening statements to a minute in length, not necessarily this morning, because we are not crowded, but when we get 23 Members. Otherwise, I will try to set an example by putting my full statement in the record.

I would simply say that the 1996 Telecommunications Act was a very deliberate, studied deregulation. I have heard about being so-called anti-Bell companies. The truth of the matter is, I started deregulating the Bell companies myself back in 1991 as Chairman when I put in the bill to allow them into manufacturing. I worked on the bill—1822—for a little over 2 years and then, when the Republicans took over the Congress in 1995, of course, we had 652 and we amended the two bills and passed it finally in February, 1996.

But everyone should understand and the record should show that we had meetings with the Bell companies' representatives, their attorneys, and their K Street counsel. They came in every Friday—and the competition for long distance, they came in every Tuesday morning over a 2-year period, hammering out the so-called 14-point

list. In other words, when you deregulate and allow the Bell companies into long distance, we told the Bell companies that they could get into long distance anywhere they wanted to in the country except where they had a monopoly.

The whole idea of those meetings on Friday and Monday with all the parties were so there would be no hidden ball tricks or anything of that kind, that they would hammer out what would be reasonable and acceptable, and because I had already experienced deregulation in the airlines and it had not worked. We still have the best telecommunications system in the entire world and the idea at that time was to bring about this deregulation in a studied fashion so that we did not mess up America's telecommunications.

It was the Bell companies who were begging for the deregulation to get into long distance to compete. So we provided that the local exchange networks be made available under Section 251. Then in Section 271, they wrote up the 14-point checklist. I would like to go back home when I am a politician and say I wrote it and everything like that, but the truth of the matter is, the Bells and the long distance companies hammered this out. That is why when we passed it we had 95 votes in favor of it in the U.S. Senate.

So what we are really looking at in this hearing—what we are looking at with Chairman McCain on local competition, is how do we get compliance with the deregulation of the 1996 Act. Simply put, we know that instead of competing, the Bells questioned the constitutionality of it immediately. It was a shock to me because I had checked with my Chairman, John Clendennon with BellSouth, in December before we had the final conference and I read to him the language that he was asking for. He was down in Florida and had already left for the Christmas holidays, and I said: "John, does this suit you?" He said: "That is fine; pass the bill; we are ready to compete."

Instead, they questioned the constitutionality. They took us through every court and every public service commission, the Federal Communications Commission, all the way up to the Supreme Court, and have even the Chairman of the present Federal Communications Commission saying the only way we are going to get compliance is to double or increase the fines.

Let me yield to Senator McCain.

[The prepared statement of Senator Hollings follows:]

PREPARED STATEMENT OF HON. ERNEST F. HOLLINGS, U.S. SENATOR FROM SOUTH CAROLINA

Today, the Committee will examine the state of competition in the local telephone market. Specifically, the Committee will address the question as to why competition has not arisen in the local telephone markets as had been planned for by the passage of the 1996 Telecommunications Act. Some have questioned whether there are problems with the Act. What we will find as we explore the record today, however, is that the problems arise, not from the Act, but from the efforts by the Bells to avoid the requirements of the Act, and enter the long distance and broadband markets while simultaneously preserving their local monopolies.

Today, we will hear from the competitive companies that are trying to bring competition to the local markets. These companies together have already invested over $150 billion in their efforts to compete in the local market place. We will hear from State officials who have attempted to enforce and follow guidelines of the Act, as well as from public interest groups.

Finally, let me make it known that I extended invitations to every Bell company to testify. I am glad that my friends from BellSouth have agreed to attend. And let

me make it clear for the record that anytime the Bell companies—particularly their CEOs—would like to speak on the record on this issue before this Committee, they are welcomed. But the one thing that this Committee will not do is function at the dictates of Bell companies. This is what is happening in the marketplace and is the crux of the difficulties we are experiencing today in the telecommunications industry.

I have heard that the Bells would like to make this a debate solely about broadband, but the fact of the matter is that this is not a debate about broadband. This is a debate about how to ensure competition in local telephone markets—whether it is the provision of local or broadband service. In other words, broadband, like all the other service issues, is merely a subset of the larger issue—which is market structure and competition. So let's begin this debate by doing away with the subterfuge and obfuscation.

So, why is today's hearing important? The answer is simple, because of the importance of the telecommunications industry to the whole infrastructure of our Nation's economy. According to the Department of Commerce, telecommunications currently accounts for nearly 10 percent of our Nations's total economic output. All of America's industries—and American consumers in general—have a crucial stake in the structure of our telecommunications industry: if it is competitive, our costs are cheaper, and services better: if it is not competitive, cost will be higher, and quality of service will suffer. We often hear much talk today about the internet and e-commerce. I, for one, am proud of these new technological advancements and on this note, was honored to work with my friends Tom Bliley and Senator McCain in passing the Digital Signature bill last year, which has opened the door to massive growth in e-commerce. But though these industries are great, it all begins with telecommunications. Who owns the lines, and those that compete in the telephone business may very well determine the fate of those industries.

But we didn't get to where we are on a whim. For more than two decades, the courts, Congress, State legislatures, and regulators have been working to bring competition to the telephone marketplace. This is no easy feat since Congress gave Ma Bell a monopoly in the local and long distance phone markets, protected Ma Bell from competition, and guaranteed Ma Bell a profit. In that environment, Ma Bell fulfilled its mission of building a nationwide network and connecting the vast majority of residents to that network.

Over time however, other companies attempted to compete, but their efforts were thwarted by Ma Bell which used its power to lock its competitors out of the marketplace. Judge Greene stepped in and in the early 1980s, broke Ma Bell into AT&T and 7 regional Bell operating companies. This allowed competitors to enter the long distance market, and since then, consumers have had a choice of service providers and have generally benefited from lower long distance rates.

When Judge Greene broke up Ma Bell, he recognized the significant market power of the local Bell companies, and the fact that they had no competitors in their local markets. Clearly, under such conditions, if the Bells were allowed to enter new markets, they could quickly destroy their competitors by using their monopoly revenues to subsidize their entry into these markets. Consequently, in an effort to protect competition in other markets, Judge Greene restricted Bell companies from entering markets such as the long distance and manufacturing markets.

The next step for Congress then was to open the local phone markets to competition. After many years of hard work, numerous hearings, and tons of analyses, Congress in an agreement signed on to by all the relevant parties—including the Bells, long distance service providers, and cable companies—passed the telecommunications Act of 1996. The 1996 Act is a landmark bill, representing the most significant restructuring of the 1934 Communications Act. The bill met the needs and requests of each of the important parties and most critically, gave the Bells what they most coveted, entry into all markets. In doing so however, Congress put in place provisions to ensure competition. This was to be accomplished by preventing Bell companies from extending their monopolies to new markets until they allowed competitors to interconnect with their networks.

I am proud to have been one of the principal members involved in drafting the 1996 Act. I am proud to have worked with my good friends Larry Pressler and Tom Bliley. We all had high hopes, particularly given that all the major companies were at the table and signed onto the Act. We knew we had overcome an enormous hurdle—bringing together some of the most powerful warring industries in the country—and passing one of the most significant industrial bills ever enacted by Congress.

As noted, the essence of the Act was to restructure and make competitive one of the most monopolistically controlled industries in the country—the local telephone market. If everyone played by the rules and kept their promises, the goal would be

accomplished. But unfortunately, the Bells have not played by the rules and have not kept their promises.

Almost as soon as the ink was dry on the Act, the Bells were in court seeking a short cut to extend their monopoly into new markets. They have bullied competitors and refused to provide real access to their monopolistic networks. In essence, they have sought to use the Act to get what they didn't have, but coveted—entry into the long distance and other markets—and preserve through circumvention what they had, and still have—their local telephone monopolies.

Having not been as successful as they would have liked before the courts and Federal and State regulators, they have now returned to Congress seeking legislative help to extend their monopolies. They claim that no one contemplated the development of data service when the 1996 Act was passed. Well, we all knew about the potential of data service when the 1996 Act was passed. We included Section 706 in the 1996 Act which requires the FCC to take action to encourage the deployment of broadband service, and as early as 1984 Richard McCormick, then CEO and Chairman of USWest, in 1994 testifying before the Senate Commerce Committee stated the following: "We have embarked on an aggressive program both within our 14-State region and outside to deploy broadband. We want to be the leader in providing interactive—that is, two-way multimedia services, voice, data, video."

At the time the Act passed, Members of Congress even made similar statements. Representative Tauzin stated: "Today, in a bipartisan way, we unleash the spirit of competition in all forms of telecommunications services, from telephones to computers, to services dealing with video programming, and data services to interexchange services that are going to link us as Americans together as one like never before and give us access to the world and the world access to us as never before." [February 1, 1996, page H1151 of the Congressional Record.]

Furthermore, many Wall Street analysts have noted that competition has been a driving factor in Bell deployment of broadband service. A Wall Street analyst with Montgomery Securities stated that "RBOCs have finally begun to feel the competitive pressure from both CLECs and cable modem providers and are now planning to . . . accelerate/expand deployment of ADSL in order to counter the threat."

Another Wall Street analyst with Prudential Securities noted that with respect to RBOC deployment of broadband service an "important motivating factor is the threat of competition [and] [o]ther players are taking dead aim at the high-speed internet access market."

The fact is that Congress should not help the Bells extend their monopolies. It is clear that under the 1996 Act, Bells can enter the long distance or the broadband market or any other market they choose, but just not by extending their monopoly and harming competition. Today, Bells continue to hold 92 percent or all phone lines. Cable companies do not compete with the Bells for business customers. Therefore, Bell companies are the predominant providers of broadband service in the business market where they compete primarily with CLECs. In Addition, Morgan Stanley and others predict that by 2004, Bell companies will catch up to the cable companies in the residential broadband market.

The reality is that Congress gave the Bells a monopoly in the local telephone market. Congress certainly should not now grant them a monopoly in the long distance and broadband services markets. The Bells must compete like everyone else to get customers in these markets and not look for a government handout. Given the potential benefits of competition, the answer must be "yes" to competition in the long distance and broadband markets and "no" to monopoly dominated markets.

Congress has a responsibility to consumers to promote an open competitive local telephone market and must Act to ensure Bell compliance with the 1996 Act.

I thank the witnesses for joining us today and look forward to their testimony on this vital issue.

## STATEMENT OF HON. JOHN McCAIN, U.S. SENATOR FROM ARIZONA

Senator McCAIN. Thank you very much, Mr. Chairman. Thank you for holding this hearing on this important topic, and we welcome our colleague from the House, Congressman Markey.

When the Telecommunications Act of 1996 was passed, its supporters hoped that its passage would let communications companies from various sectors enter into each other's markets, thereby stimulating an explosion of new competition in all sectors of the telecommunications market. This hoped-for explosion was in turn

expected to produce an abundance of consumer choice and lower consumer prices for telecommunications services.

Unfortunately, we have not seen the lower prices promised by the Telecommunications Act. We have consistently seen prices rise since the Act's passage. Local phone prices are up more than 12 percent. Take out long distance prices and consumers are paying almost 20 percent more than in 1996. Cable rates are up almost 33 percent, which is almost three times the rate of inflation.

Moreover, I note that AT&T has recently raised its basic long distance rates 11 percent, its third increase in basic long distance prices since October 1999.

These price increases are caused by several factors, but the most important of these is doubtless a lack of competition between various types of service providers. Nowhere is this lack of competition more apparent than in the provision of local phone service. In fact, according to the FCC's recent report on local competition today, more than 5 years after the Act's passage, CLECs are only providing service on a little more than 8 percent of local telephone lines, meaning that the Bell operating companies still control about 92 percent of the local phone market.

Of course, the CLECs and the Bell companies have diametrically opposed views about the causes of this lack of competition. The Bell companies claim excessive subsidies and regulations make the local consumer market unattractive to potential competitors, so they encourage further deregulation.

Some CLECs allege anti-competitive conduct by Bell companies and urge further regulation as a means of shoring up their market capitalization.

This Committee needs to probe behind the rhetoric of the parties to discover a solution designed not to favor or punish particular industry sectors, but to create competition and true competition that will reduce prices for consumers. That has to be our goal, a pro-competitive solution that will lower consumer prices.

Mr. Chairman, I thank you again for holding this hearing and congratulate you on your assumption of the chairmanship of this Committee. As always, I look forward to working together as we have for many, many years. I thank you.

The CHAIRMAN. Very definitely we will continue to work together. Do you want to yield to Senator Lott? He might have to get to the floor.

## STATEMENT OF HON. TRENT LOTT, U.S. SENATOR FROM MISSISSIPPI

Senator LOTT. I will be very brief. Thank you, Mr. Chairman Thank you for having this hearing and thank you to our colleague from the House and to the other witnesses who are here today. I am glad we are having this hearing and I assume that there will be additional hearings on this important subject.

I will be brief this morning because you have already asked whether we all need to have opening statements before we get to our panel. So I will be very brief. I just want to say that you and I obviously have worked together on the Telecommunications Act of 1996 and were able to, I think, have a breakthrough that has been positive. Our goals were more competition and better access.

In some respects and in some areas these goals have been achieved, and in others there has not been as much success.

I think it is incumbent upon us to see if we need to take a look at the Act and see if it needs to be tweaked in some way and make sure that what we tried to accomplish in the Telecommunications Act actually is occurring. So, since there is legislation that has been introduced and has been moving some in the House, I think we need to learn more about what it does and decide how we are going to proceed.

So this hearing is the beginning of a process that will allow us to do that. I thank you for that.

The CHAIRMAN. Very good.

Senator BROWNBACK.

**STATEMENT OF HON. SAM BROWNBACK, U.S. SENATOR FROM KANSAS**

Senator BROWNBACK. Thank you, Mr. Chairman. I too want to congratulate you for holding this hearing. This is your first one as Chairman in this iteration this time around on telecommunications and competition, and I think that is an important topic. I am glad you are doing it, and I would ask that my full opening statement be included in the record as if read.*

The CHAIRMAN. It will be.

Senator BROWNBACK. The one point I would like to make is I would like to use this hearing to examine something that has been a great deficiency, and that is the deployment of broadband or high-speed Internet, particularly into rural areas and into a number of urban areas as well. That is a great shortage that we have in my State of Kansas. It has been in most rural areas across the country that we simply are not getting the high-speed Internet access, and I would like to see why and hear from the individuals that are here to testify today why we are not getting this broadband deployment out into many areas across the country, and what needs to take place for us to get this.

There are different approaches for coming forward. Some Members are putting forward subsidy approaches. Others are putting forward tax credits.

What I would hope we could do is seriously address this topic because it is becoming a business of competitiveness or lack of it, in rural areas in particular and some urban areas as well. So I would hope that we can look at that issue, which is one that is front and center and a difficult one for people in my State.

I will be looking forward to putting forth legislative vehicles to try to deal with this need for broadband deployment, particularly in a deregulatory framework. With that, I look forward to the testimony, Mr. Chairman.

The CHAIRMAN. Very good, thank you.

Mr. Markey. We appreciate your appearance.

*The information referred to was not available at the time this hearing went to press.

**STATEMENT OF HON. EDWARD MARKEY U.S. REPRESENTATIVE FROM MASSACHUSETTS**

Mr. MARKEY. Thank you, Mr. Chairman. I appreciate the invitation to appear before you today.

This is one of the longest-standing discussions that we have had in the Congress. When I was first elected in 1976 I arrived, I think, in the same way that most of us arrived, with the notion that the telephone company was a natural monopoly, that is that there could only be one telephone company. It took me a while and many meetings with Bill McGowan, the Chairman of MCI, sitting in my office in 1977 and 1978 trying to explain to me that there could be competitive telephone companies.

I will be honest with you. For the first several meetings I had visions of like 4-foot telephone poles going down the street as we had a startup telephone company that would compete against AT&T. I could not figure out how they would do it. How can a company compete against AT&T?

Then after a while it became clear that if you allowed MCI, if you allowed Sprint, if you allowed dozens of other companies to have access to the wires of AT&T and to the switches and to the homes that they served, that they could provide a competing long distance telephone service.

But AT&T, a company with over one million employees, the largest company in the United States, a monopoly, really refused to allow any competitors any realistic access to consumers. So as a result the Federal Government, the Justice Department, beginning with Gerald Ford, through Jimmy Carter and then through Ronald Reagan, ultimately on January 1, 1984, Judge Harold Greene's decision went into effect which called for the breakup of AT&T, so that the regional Bell operating companies that still controlled the local loop—that is, the seven Bells from BellSouth to Nynex and Pac Bell and SBC—would be broken off and AT&T would be left with its manufacturing and with its information services and long distance.

So now the local Bells had no additional reason to discriminate against MCI and Sprint since they no longer were in the long distance business. What happened? Almost immediately, rates started to plummet. Choices started to be made available to consumers all across the United States.

Instead of the long distance call being something special, as it was in my home, where your mother would say to you: "You are on the phone with long distance; you cannot talk for long." Now it is no big deal. Now long distance is just another service.

That is what happened because we ensured that MCI and Sprint could create the competition which collapsed the rates that long distance had always presented to the ordinary American family.

What else happened? Well, because the local Bells no longer controlled the manufacturing, they no longer had a monopsony as well. That is, the Bells used to be the only purchaser of equipment. So if you made competing telephones, if you made competing telephone equipment, well, why would the Bells buy from you if they made their own equipment? My father used to say to me: "Eddy, every cook loves the smell of his own food," although he did not quite use that phrase, a similar phrase to that.

The reality is that the Bells did not buy from anybody else. So as a result, by 1977 when I arrived in Congress, 1980, I still had a black rotary dial phone in my house and just about every one of us did as well. Notwithstanding the fact that the Bell Labs had been winning Nobel Prizes in basic telecommunications research, but because they had a monopsony they did not have a stake in developing new technologies for consumers.

But once the monopoly was broken up, once the monopsony was broken up, as of January 1, 1984, all of a sudden each of us in our own homes could purchase any equipment that we wanted to. There was no longer this control over the development of these technologies.

However, there was one thing that was remaining. Each of us still thought that the provision of local telephone service was a monopoly. How are you going to break that up? We just could not figure that out. So we kind of allowed them to stay there under rate of service, cost of service controls, with universal service built in to reach the rural parts of any State. But we just could not figure out how to do that.

But the Bells almost immediately sought to get out from underneath the restrictions. Let us into long distance, they said. Let us into manufacturing, let us into information services. We had many hearings in the 1980s and in the early 1990s.

Finally, we cut a deal with them at their request, and the deal was this. If we allowed them into long distance, which they had been prohibited from getting into since January 1 of 1984, they would open up their local phone markets to competition, because it turned out that there were companies like McLeod and RCN and Covad and scores of other companies that said if you could just guarantee that we had access to the local phone business in the same way that you guarantee to MCI and Sprint that they could gain access to those customers for long distance, we will provide local competition. Just to sweeten the pot, we actually threw in free, no extra charge, the lifting of the restriction that the Bells were under that prohibited them from getting into cable service. They promised that if we lifted the restriction on them getting into cable that they would go out and deliver cable competition all across the United States.

We passed that Act in 1996. Senator Lott and Senator Hollings and I and Tom Bliley, Democrats and Republicans, liberals and conservatives, we came together on that legislation.

Now, as you pointed out, Senator, the first act of the Bells was not to comply with the Act. It was to take the Act to court. SBC actually brought a case saying that the bill was a bill of attainder, that is, it targeted a specific company or set of companies, and that the bill was illegal.

Now, my memory is the same as yours. I remember the CEOs coming in and begging us to pass the bill. It was just the opposite of being a bill of attainder. It was their request that we grant them this relief and in turn they would accept the restrictions that were placed upon them that forced them to open up their local loop.

As a result of all the court cases, however, they delayed opening their local loop. 1996, 1997, 1998, 1999, they still have not opened up a single State because they are in court. Only in December

1999, almost January of the year 2000, do they finally accede, after having lost the court cases, to opening up New York.

Now, that is only a year-and-a-half ago. An Act 5 years old and people say, why is it not working? Well, they went to court first, and they also wanted to consolidate. So the first thing they tried to do was to, in addition to the court cases, was to move from seven companies down to four, which is where they are now. Economies of scale, they say, synergies.

Monopoly is another word for it. But that is where we were.

So only a year-and-a-half has transpired. Since that time we have had Massachusetts, we have had Texas, we have had Kansas, and we have had Oklahoma, that is it. Now, they have applications in in other States now as the local regulators and the FCC has increasingly begun the process of ensuring that there is proper and timely review of the applications which they are finally making in these States.

So what has happened, though, since the 1996 Act has passed? $60 billion worth of new investment by new companies in broadband deployment all across this country. Hundreds of competitors. ISPs by the thousands which now have access to millions of homes. They are innovating, they are driving prices and service. If the Bells had had their way, there would have been no access which they would have granted as of yet to any of these homes for any of the competitors.

The bottom line on this is that what finally is driving innovation and deployment of technology in this country is paranoia. It is the paranoia of a competitive marketplace, Darwin-like competition, Adam Smith smiling in his grave competition looking up at this marketplace that has finally unfolded after 100 years.

So we are at this critical point right now where we have proven that you can provide local phone service, local telecommunications competition. Now, we are only up to 7 percent of all of the lines in the United States being controlled by the competitors, but it is as a result of the 1996 Act.

So in the same way that in long distance we saw a revolution, we are at the dawn of this local phone competition. Now, the good news is that 52 percent of all American homes now have access to broadband technology. That is only since the 1996 Act passed, 52 percent. So it is moving fast, very fast, as fast or faster than the long distance revolution.

Remembering, however, that long distance was already available, so there was a flick of a switch quality to that. But the reality is that the Act is working, not perfectly, but in a way that ultimately has given this incredible incentive to hundreds of companies to make investments.

We have a word for this phenomenon. We call it the NASDAQ. So many of us look at the NASDAQ and say: What are the names of all those companies? I never heard of them before. There is a good reason, because in the 1996 Act they did not have access to the capital markets. There was no incentive to deploy new technologies.

Now, there is a little bit of irrational pessimism which has hit the NASDAQ over the last year. But without question it has been

for the last 5 years and it will be for the rest of our lives the single most important revolution that affects our society.

So thank you, Mr. Chairman, for the opportunity to testify before you today. All I say to you is the bottom line on the competitive local exchange carriers is that they lead to more job growth, more innovation, lower prices, and ultimately more choices for consumers across this country. It is something that I think that we should stay the course with because it is a success, not a success without some deficiencies, but a success of historic proportions.

Thank you, Mr. Chairman.

The CHAIRMAN. Well, Mr. Markey, that is an outstanding statement. Let the record show that you were in the room at the conference committee when we finalized the 1996 Act. It might be well to remember at that particular time it was a pretty well designed Act.

I will never forget that the Vice President came on that evening right in the middle of Tom Brokaw. I thought maybe the President had gotten shot, because Brokaw said: “Wait a minute, folks; we have got a highly important announcement; here is the Vice President of the United States.”

So he came on and he said: “We have gotten together on the telecommunications highway and I got everything I wanted.”

When he said “I got everything I wanted,” Bob Dole said “that bill will never pass,” and Newt Gingrich said “that thing is deader than Elvis.” That was in the first part of December, and I had to hold the hands of all the members of the conference until February without a change of a word.

I mean, he did not get everything he wanted and that kind of a thing. It was just a political thing to put us all off.

The record ought to show that you are exactly right. You just made an outstanding statement and jogged my memory. You helped me recall Bill McGowan. I will never forget, he got a Farmers Home Loan in order to finance two little things, a two-story one-room proposition down here in Georgetown with a couple of aerials up on top. That is how he started the competition.

As to the equipment, I competed with the Bell Labs trying to get that telephone manufacturer in South Carolina. They got it in Raleigh, North Carolina, but it is now out in Singapore and maybe it has moved to China. I have not checked in a few years. But we are losing all of that.

But in any event, what you point out is the dynamism of the market and the great success. However, there is weeping and wailing on the House side about, “oh, this thing is a disaster, we do not have any competition, we have got to change the law.” All we have got to do is enforce the law.

Our problem was that we did not make mandatory Section 271. In fact, when I saw the movement on the House side in the last Congress, I put in a bill, a drop-dead date for the Bells to comply with their own 14-point checklist that they wrote themselves. If they did not do so for half of their States by 2001, they would have a certain fine of $100,000 every day for non-compliance. But if we ever got compliance there and real opening up, we would have the competition.

So what has occurred? In Illinois they have tried to beef up and make more mandatory the different voluntary provisions. Otherwise, in Pennsylvania they say, well, we have got to have a structural separation where you can more easily audit wholesale and retail service, to make the Bells sell to their competitors on a retail basis the same as they are selling to their in-house retail company.

But those are the real needs right now as seen by NARUC. All the State commissioners have come in and begged us: Do not mess up the Act itself; it is working, except for the fact that they are not complying. The ones who begged for this thing are putting on a Broadway act up here in Washington to the effect that, oh no, this thing has not worked and what we need is data, and we never considered data and those kinds of things. It is all out of the whole cloth, the biggest bunch of nonsense I have ever heard of.

Senator Brownback or Senator Lott.

Senator LOTT. I will pass.

Senator BROWNBACK. On that note, Congressman Markey, you noted on the broadband deployment issue that there had been, I think your figure was, 52 percent penetration. In the rural areas of the country it is under 20 percent. It is about 19 percent, and that is with one broadband provider. It is not competition in high speed. There are not two people competing. That is one out there.

So it has been slow going into rural areas. That is an area that you may not have as many in your district of, rural areas. But a lot of us have large patches or large swaths across the country. I would hope you could work with us on that particular issue because that is one where I want to make sure that we have the rural areas in North Dakota or Mississippi or South Carolina or Georgia or across the country, that high-speed Internet access and deployment on an increasing and a more rapid basis.

So I would hope you could work with us on that particular issue.

Mr. MARKEY. I note, Senator, on the next panel you will have, amongst others, Mark McLeod, who is the CEO of McLeod Communications, which is an Iowa company which focuses upon rural America as part of its business plan.

One of the things that I remember most vividly about the 1996 Act was the amount of time that Senator Hollings and I spent in Senator Lott's office, and I would say the single most discussed subject was how to maintain universal service to rural America. Senator Stevens was interested in it, Senator Lott, Senator Hollings, just about every Member of the Senate who talked about this issue.

I guess what I would say to you is this. For good parts of rural America, competition is going to work. There is an incentive. It is again they are moving slow because the Bells started slow. They decided not to move in the competitive direction first, but rather to consolidate and then to challenge in courts, whereas, however, in most parts of rural America there may be a solution which is necessary. I think we can discuss that in the context of some universal service-like provision, some tax incentive, some solution.

It would be a big mistake in my opinion to remove the incentives which have been built in that are driving the Bells to deploy in urban and suburban and in good chunks of rural America already and to replace that with something that would allow the Bells to

remonopolize in terms of their giving access to the competitive local exchange carriers and all of the ISPs that are out there now able to survive and potentially thrive because of this 1996 Act.

So I think there is a solution, Senator. But I think it should be done in the context of our historic understanding that universal service is especially appropriate for the most rural parts of the country.

Senator BROWNBACK. I hope you would recognize that very point, because we have not left rural areas behind before, whether it's on electrification or telephones. Now people need access, high-speed access to the Internet, and this is not an area we should leave the rural areas behind. So I would hope that we could intensively focus in that area.

You present a universal service approach. I put forward a deregulatory approach. Others have put forward tax credits. But we need to do something, because the longer it languishes the longer that rural areas are left vulnerable to business moves or lacking of information or lacking access to the very means they need to have to be able to produce commerce and to have competitive goods and services out there.

I would hope you would continue to work with us on these sorts of topics, as I would hope the Chairman would as well.

Mr. MARKEY. By definition, Senator, the reason that the telephone companies or electric companies do not go to the most rural parts of America is that it is uneconomical. So in my opinion it is unrealistic to think that just because we allow them to wall out the CLECs and the ISPs that they now are going to go to this uneconomical part of the country. I do not think that is going to happen.

I think what we should do is keep in place this paranoia-based competition policy which drives them to serve every street in urban and suburban and rural America they can reach economically and then to construct a policy that deals as we have historically done with the most rural parts of the country. I think we can do it, but I think it would be a big mistake to take off the books that thing which has essentially created the NASDAQ, these hundreds and thousands of companies that have changed the face of this information age and made us the leader in the world, looking over our shoulders at number two and three in the world over the last 5 years.

Senator BROWNBACK. I do not know that this needs to be constructed such that what you are saying, that a certain group is walled off from the marketplace in order to try to get at the problem that I think you would agree is there and that exists, and that I think the Chairman agreed exists in his State, it certainly is in mine, and that we can maybe knock the straw man down and say: OK, here is the serious business about what we need to deal with, it is a problem that exists and we want to get at it and we want to focus on that.

Thank you very much, Mr. Chairman.

Mr. MARKEY. In Boston, my father and I, we have been subsidizing the most rural parts of New England forever, and we accept that. I mean, we do believe in notions of universal service. But it should not be done at the expense of policies which also work for

urban, suburban, and the most densely populated parts of rural America.

The CHAIRMAN. There are no restrictions at this minute to go into the rural areas, none whatsoever. They can go in right this minute. In the real world, that is why you have got the co-ops. I mean, it was not economically profitable and so they just avoided and neglected it and that is why we have got the strong co-ops.

I am, like you say, from a rural State. Senator Lott is as well. Senator Cleland.

**STATEMENT OF HON. MAX CLELAND, U.S. SENATOR FROM GEORGIA**

Senator CLELAND. Thank you very much, Mr. Chairman. Let me just say it is a pleasure to welcome some dear friends: Margaret Greene of BellSouth, based in Atlanta, and my dear friend, Mike Armstrong, with AT&T.

Just on a philosophical note, Mr. Markey, I wonder. I have always had some reservations about total deregulation or the wisdom of deregulation. It does seem to me that when you deregulate, whether it is airlines, trucking, telecommunications, or whatever, it is the rural areas of our country that suffer, because there is no real economic incentive to go there any more, so to speak.

Under a regulated environment, airlines went there under a certain tariff, trucking went there under a certain tariff, and telecommunications went there, such as it was, based upon a regulatory environment. I wonder if we are not reaching the outer banks of the effects, the positive effects of deregulation and running up against the negative effects of deregulation.

I have often thought that in the telecommunications world that we had sewn to the wind and are now reaping the whirlwind, that we have reaped, in effect, the benefits of deregulation for 20 years, now we are running up against the hard part of it.

In my State the hard part of a deregulated telecommunications environment is that the people most in need of the new telecommunications services are the ones most denied, for several reasons. First of all, expense; second of all, distance. Third, basically there is no economic viability there. There is no "there" there.

I think back, and the distinguished Chairman mentioned the co-ops. I think back to my State and the whole question of electricity, how were we connected first of all in electricity. Now we seek connectivity with the Internet and the World Wide Web and connectivity with the telecommunications assets. But how was my State connected first of all in electricity?

First of all, it was Franklin Roosevelt that came in 1936 and threw a switch in Barnesville, Georgia, that created the REA, which was a government program, a regulatory environment, and that has, in effect, created the co-ops that now serve rural Georgia. It is now Georgia Power. It is Oglethorpe Power, it is a bunch of co-ops out there, and TVA, all of which were basically started as governmental programs under a regulatory environment. That is how we get electricity first of all in the rural environment.

Now, I guess my question to you is where do we go from here? I mean, how are we going to—it is one thing to have competition in Buckhead, which is where I have an apartment, and I have all

those assets. What is the Billy Joel song, “50 Channels and Nothing On.” But anyway, the point being I have a suburban friend who has access to 500 channels. It takes him an hour-and-a-half to surf the Net.

The point is, we are overwhelmed with choices in metropolitan Atlanta, but in Umadilla and parts like it, basically two-thirds of my State area-wise, they are still struggling just to get fiber optic cable. They are struggling just to get hooked up to the Internet.

So how do we get, in this deregulated environment, how do we get “there” there? How do we put the “there” there? How do we connect rural America? Because there are so many disincentives to go there.

Now, I do not see the CLECs in my State just all of a sudden popping up in Umadilla, either. I mean, they are in metropolitan Atlanta as well. So do you have any guidance here for us as we consider some of these great challenges? I think the big challenge here we all face is how do we provide incentives to get out there and connect all of our people.

Mr. MARKEY. You raise a very good point. First of all, it should be understood that DSL was invented by the Bells, but until 1996 they did not have any incentive to deploy it because there was no competition in the marketplace. So it was no different really than the black rotary dial phone. It could sit there forever.

Only at the point at which competition was introduced did the Bells begin to deploy DSL. Again, as I pointed out earlier in the testimony, they took all of 1996, 1997, 1998, and 1999 to bring the 1996 Act to court rather than to the marketplace. So they are a little bit behind, there is no question about that. We really only have seen this in full deployment since the beginning of the year 2000.

What the key insight of the 1996 included was that the word should not be “deregulated,” Senator. That is really a misnomer for what we did. What we did was demonopolize. Deregulation is a concept which is possible to be implemented at a point at which there are multiple competitors in the marketplace. Here we were faced with a situation where there was one competitor and so we had to demonopolize and, paradoxically, we then had to put regulations on the books that would make it possible for these dozens, these hundreds of competitors, to get into the market and to serve all of these consumers.

So at this point, pretty impressive: 52 percent of all Americans have access to the technology, to DSL, to broadband, to high-speed Internet. That is very impressive. By the way, 8 percent of all Americans have access to the Internet itself, I mean narrowband. By the way, most Americans are never going to subscribe to broadband because they do not need it, because most Americans use the Internet for email.

Only at the point at which there is this ability to download massive amounts of video in an economically viable way are we ever going to see the average consumer even using broadband in their home. Right now it is mostly businesses. When people get home, even though they have had it at work, they still only really subscribe to narrowband. That is where most Americans get it and have it today, as a matter of fact.

Senator CLELAND. Mr. Markey, my time is up. May I just say that in order to enhance incentives to go to rural areas, Governor Roy Barnes and the State enacted the business expansion and support tax, which BellSouth quite frankly, is taking advantage of to upgrade their switches to accommodate high-speed services.

So there are actions that government can take, which is one of the reasons I am fascinated by our panelists today. What actions can we take to provide greater incentives to get into rural areas. But I might say, it does seem to me that deregulation ultimately tends toward monopoly, because what I see in the airlines and the trucking and to a certain extent in telecommunications, the greater the deregulation, after a period of time the ultimate result of that is that you wind up with two or three dominant players, whether it is airlines, trucking or telecommunications.

I just thought that it does seem to me that the more you deregulate, the more you ultimately tend in the private sector to end up with a monopolistic situation.

Anyway, Mr. Chairman, it is a fascinating hearing. Thank you.

Mr. MARKEY. Can I just briefly respond. First point: In the most rural parts of America it is possible to construct at a statewide level or a national level a set of policies—tax incentives, universal service—that ensures that there is deployment of any technology out into those parts of the country. The analog is electricity, the analog is telephone. We can do it as well for broadband if that is our decision.

The second point is that in 1996, for all intents and purposes, the telephone industry had a 100 percent control of the local marketplace. Today, after the passage and this brief implementation period of the Telecom Act, the competitors now control 7 to 8 percent of all the lines in the United States. So we are heading in just the opposite direction of some of these other deregulation analogies which you used.

The protection which the consumer and competitors have is that there is an Act on the books, there is a 14-point checklist, there is a carrot which is held out there, which is that they cannot get into the long distance business, a $100 billion business, until they open up their local loop, and then it is up to the FCC and the State regulators to make that determination.

Although they have only now complied in five States, we already see 7 percent of all the lines in the United States controlled by competitors. When we hit the 50-State level, if we hold onto this Act, if we ensure that the State and Federal regulators implement it and we do not repeal it, which is what many people are proposing, then we will see a dramatic increase in the total lines that are controlled by competitors. We will see just the opposite of what happened in the trucking or in the airline business.

So we have just the opposite situation. We actually put the law on the books to break it up. We have not done that yet in airlines. We have not done that in other industries. We have done it here, and I would just say that our best course is stay the course.

Senator CLELAND. Thank you very much.

The CHAIRMAN. Senator Dorgan.

## STATEMENT OF HON. BYRON L. DORGAN, U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. Mr. Chairman, thank you very much.

Mr. Markey, this must be therapeutic for you, to come over and be able to say in front of the Senate what I have heard you say so often.

Mr. MARKEY. Well, as you know, my wife is a psychiatrist, so I say it to her at night. So this is great.

[Laughter.]

Mr. MARKEY. It is great to have others.

Senator DORGAN. Like I say, it is actually therapeutic for us to just have you sit there so we can talk about these issues.

Let me just follow my colleagues' lead on that and make a couple of remarks and then ask you a question. I am actually pretty tired in the morning, getting up and shaving, and I have a television set on, and hearing advertisement after advertisement after advertisement about Dingell-Tauzin, selling it kind of like a foot powder, something that will cure everything from hiccups to the gout. But Dingell-Tauzin, every morning, Dingell-Tauzin.

Well, let me try to describe where I think we are. We passed the Telecommunications Act. I thought it was a pretty good bill. I do not think we ought to take it apart at this point. I think a couple things have intervened. I think, one, we have had an FCC that made some bad turns, some wrong turns, and probably drug their feet for some while in terms of the implementation of it. The FCC must be a referee in a circumstance like this and I think in some respects has not done as good a job as we would like.

Second, some companies took this to court, delayed its full implementation.

But as I see it there are two issues. One is the ability for consumers around this country to have competition in the local exchanges. While I think that there has been some small amount of progress, it is infinitesimal and we need to get at the business of giving people around this country the opportunity to see competition in local exchanges.

If you take away the business lines, in terms of residential I think you are talking only 3 or 4 percent of the people in this country that have that choice. The incumbents control about 96 percent or so. So we have not made great progress there.

Second, the buildout of advanced services all across the country, that is going to happen in rural areas only when you have universal service support. The investment stream necessary to support the buildout of that infrastructure for advanced services will occur only to the extent that the FCC understands that universal service was intended by us not to be capped, it was intended by us to be a mechanism by which all Americans would have universal access to all of the technologies and the services.

So I think that we are in a situation at the moment where things have not gone as well as we had hoped. The solution is not to take apart the 1996 Act. The solution is to make sure that the 1996 Act works as we intended it to work. We intended it to work in a manner that allows a checklist for the incumbent local exchange carriers to meet the checklist, after which they are free to go into long distance inter-LATA, but when they meet the checklist it means

the competitive local exchange carriers will be able to come in and compete.

Competition is when you have a number of firms competing over price and service and you have robust competition. But we have a market system that is clogged at this point. The arteries of that system are clogged and it does not work right. So some say, well, let us just pass Dingell-Tauzin.

In my judgment, Dingell-Tauzin is going to get slowed way, way down when it gets here to the U.S. Senate and should get slowed down. I do not think the Senate is prepared to pass the Dingell-Tauzin Act. But what we should do, it seems to me, is try and evaluate what has not worked and how do we put it on a track to make it work?

Now, Congressman Markey, with those comments, very briefly, tell me the two things you think we can do in dealing with establishing once again the need for competitive local service in the local exchanges and, second, the buildout of advanced services to rural areas?

Senator LOTT. Senator, would you yield?

Senator DORGAN. Of course.

Senator LOTT. I am concerned because I fear that those who have been running these ads may double their buy, because apparently they have not gotten through to you. It is Tauzin-Dingell.

[Laughter.]

Senator DORGAN. Is it?

Senator LOTT. It is Tauzin-Dingell.

The CHAIRMAN. Instead of Dingell-Tauzin.

Senator DORGAN. That is why I thought it had something to do with foot powder, "Tauzin-Dingell."

[Laughter.]

Senator DORGAN. Well, it goes to show my attention deficit in the mornings. But I have just enough attention to it is annoying.

Congressman Markey, I have asked you a question.

Mr. MARKEY. I think saying it Dingell-Tauzin is anticipating, Senator, a five-seat switch in the House. You know, it is anticipatory.

Senator DORGAN. Something we have experience with in the Senate.

Mr. MARKEY. So again, the Act is working. As each Bell in each State applies to the Federal Government, the Federal Government at the FCC then relies upon the State public utility commission to determine whether or not the checklist has been met.

I think that if the message is sent from the Senate that the Act is not going to be changed, then the Bells no longer have an incentive in delaying in their applications being sent to the FCC and to the States, because there will not be any relief from the requirements. If, however, there is a sense that the Senate may change the Act, then they do not have an incentive to comply because they will be relieved of their responsibilities.

So there is a regulatory uncertainty which has been introduced into the marketplace by the introduction of this legislation. It hurts these competitive companies in the capital markets and it hurts them in the sense that the four Bells do not have an incentive to fully comply at the State level with the opening of their market.

So I think the first and most important thing that can happen is that a signal be sent that there will be no changes. As a result, the Bells have a higher incentive to more quickly comply with the 14-point checklist and we will see more competition.

With regard to rural America, again they have already been the beneficiaries of this competition policy. It may only be 20 percent of rural America thus far, but again that has happened in a relatively short period of time. To the extent to which all of rural America, that is the parts of it that are very difficult to reach, need a special policy, I think that we can construct one, looking at tax incentives, looking at universal service, looking at a State-Federal co-operation to effectuate that end.

But I do not think that we should tamper with the underlying principles of the Act which have created hundreds, thousands of companies which have revolutionized information services in this country and across the world. I think that that would be the biggest mistake which we could make.

Senator DORGAN. Mr. Markey, my time is expired. Let me just, Mr. Chairman, mention, in Minot, North Dakota, there is a company, it is a rural telephone co-op called Soares River Telephone, which actually bought the exchange from the old Northern States Power. They took Minot, which is about 40,000 or 50,000 people, and all the small towns and the farms in their entire service area, and they have decided as a co-operative, we are going to build out advanced service capability to everybody.

All of Minot is now able to achieve advanced services if they want to do so under this system. Small towns 30 miles away can. In September, using a wireless approach, this company—this rural telephone co-op, has said everybody in our service area is going to have advanced service capability. It is a matter of will for those that want to do it.

I would say the larger carrier in our State that provides the local exchange service has not had that will. In fact, they have wanted to sell some of their exchanges and to not invest in others. I am very concerned about what is happening in larger towns than Minot where people do not have the same capability because the will does not exist by those that are now serving it.

That is why I would like to see a strong, good burst of competition all across this country in these areas.

Mr. Chairman, thank you very much.

The CHAIRMAN. Very good.

Senator Carnahan.

## STATEMENT OF HON. JEAN CARNAHAN, U.S. SENATOR FROM MISSOURI

Senator CARNAHAN. Thank you, Mr. Chairman. I want to thank you for inviting me to participate today. I am very much looking forward to rejoining this Committee at the appropriate time.

I am pleased the Committee has convened this hearing to examine this, what is an extremely important issue of competition in local telephone markets. It seems lately that, as Senator Dorgan pointed out, you cannot turn on your television or open a newspaper without being deluged by messages promoting competing theories about the rollout of high-speed Internet services.

The debate, however, is fundamentally about contrasting views concerning the proper interpretation of the Telecommunications Act of 1996. Although I was not here when that legislation was crafted, I do believe strongly in the importance of its overall goal, to encourage competition in local telephone markets. Robust competition is good for consumers, it is good for the economy. Competition helps to forge breakthroughs in technology as well.

Consumers have already reaped the benefits of competition in long distance services and we need to ensure these same benefits are available in local markets as well. These are certainly extremely complicated issues that have tremendous implications for consumers in Missouri and across the Nation.

Our panelists today, I am sure, will have a diverse set of viewpoints concerning the State of local competition, and I am looking forward to a lively and insightful discussion with them. But I might ask Mr. Markey this question. I have noted that Chairman Powell has said that he thinks the FCC needs to be able to levy larger fines against incumbent carriers when they do not comply with the Act. Do you agree with that assessment and, if so, do you think that larger fines will suffice?

Mr. MARKEY. I do believe that larger fines are necessary, much, much larger fines. But I do not believe that we should have the fine collected any longer go to the Federal Government. I believe that the fine should then be given over to the companies that were harmed, so that there is a jeopardy which is run by the Bells if ultimately a decision is made against them whereby the companies that were harmed actually got the money and not the Federal Government and as a result become more competitive. So it makes it a much more dangerous game for the Bells to engage in if they wind up being the source of funding for their competitors.

If a decision is made that a fine should be levied right now, that is not the case. Otherwise, what we wind up with is kind of a posthumous vindication by the competitors as to fines that are collected by the Federal Government but not handed over to the companies.

So yes, I do believe fines are necessary. I do not believe that in and of themselves they are sufficient because these companies do want to compete and only if there is a full implementation of the 14-point checklist will there be full competition in the marketplace. So stronger fines that go to the competitors, not to the Federal Government, coupled with a full implementation of the 14-point checklist, will be a formula which will guarantee the consumers will get choice in the marketplace.

Senator CARNAHAN. Thank you very much.

The CHAIRMAN. Mr. Markey, my only regret is we did not have all 23 Senators here on the Committee to hear your testimony. You know, when they do not have roll calls then they do not come in, and that is unfortunate and we are going to have to have you back. You are the most informed Member on telecommunications in the Congress and we cannot thank you enough for coming over here. Just tell our friend Billy when you see him—he is having those Firestone hearings—tell him the tread has come off of the monopoly tire over on the Senate side.

[Laughter.]

Mr. MARKEY. Can I say one final word, Senator? I appreciate the honor to have been asked to come and testify before you. In my opinion, in summary, there are three key reasons why we do not need a change of law, especially the proposal which is being touted on television that Senator Dorgan referred to.

First, it is unnecessary. There is competition in the marketplace today. It is very vigorous. It has been hurt by the marketplace. It has been hurt by the potential that new legislation could pass. But there is tremendous competition out in the marketplace, so it is unnecessary in terms of the new legislation.

Second, it is unfair. It is unfair to all these companies, the hundreds, the thousands of them that have gone out into the marketplace and raised all of these tens of billions of dollars to change the rules halfway through the game.

Third, it is undigital. It is undigital to argue that it is possible to separate the zeros and ones of voice and data and video. It cannot be done. The very point of everything that we are trying to accomplish is that there is a convergence. So they are setting up a proposal that is from a regulatory perspective impossible to ever monitor, because you cannot take out the zeros and ones of voice from the zeros and ones of data. That is why we have the restriction on the books.

Once they are allowed into long distance, they are allowed in for voice and data. But you cannot say that they are just in for data but not for voice, because a regulator cannot separate them. So in my opinion the CLEC slump means that prices have started to rise, that the DSL prices are up, cable modem prices are up, cable programming rates are up. If we do not reinvigorate competition by letting the marketplace know that this Act is going to be implemented, then the new economy will suffer.

There is a misunderstanding that I think is sought to be created that it is a battle between the cable guy and the telephone guy for the future. It is not. That is a false choice. It is a choice between the cable guy, the telephone guy, and hundreds of other companies who are now finally allowed in, ISPs and CLECs, that are invigorating competition that both of these monopolies historically have not been subject to.

Those are the primary beneficiaries, that is those companies combined with the consumers that now see deployment of technology that they otherwise would never have seen from either the cable or the telephone guy. So keep those people in mind because those are the real entrepreneurs. Those are the little guys, those are the people taking risks, those are the technologists, those are the people who are changing our country. When you consider this Act, consider the impact which you will have upon them.

Senator Hollings, it is a great honor to have been up first.

The CHAIRMAN. Thank you very, very much.

The next panel will please come forward: Mr. Royce Holland of Allegiance Telecom; Ms. Margaret Greene, Vice President, BellSouth; Mr. Michael Armstrong, Chairman of AT&T; and Mr. Clark McLeod, Chairman of McLeodUSA.

Very good. I am southern enough to start with the lady.

Ms. Greene, we will recognize you and go right across, Mr. McLeod, Mr. Armstrong, and then Mr. Holland.

**STATEMENT OF MARGARET H. GREENE, EXECUTIVE VICE PRESIDENT, REGULATORY AND EXTERNAL AFFAIRS, BELLSOUTH CORPORATION**

Ms. GREENE. Mr. Chairman, it is good to be with you today, and congratulations on your chairmanship.

The CHAIRMAN. Turn on that microphone or let us get a little closer, please, so we can all hear.

Ms. GREENE. I have a prepared summary and I am going to totally abandon it at this point.

The CHAIRMAN. We will include the entire summary of each of the four on the panel. Your full statements will be in the record and we will ask you please to summarize them, because we have another panel following you and we would like you to highlight it and then be subject to questioning. Thank you very much.

Ms. GREENE. What I would like to do, sir, is not to use the prepared summary, but talk about some of the things where I am in agreement with what has been said here this morning and where I have disagreement with what has been said here this morning.

BellSouth agrees totally with you that the Act was carefully crafted. It was a very well balanced Act. It had four major platforms. Those four major platforms would introduce deregulation first, demonopolization and deregulation into the telecommunications marketplace. The feeling of BellSouth, though, is that only one purpose of the Act has been implemented and that is to encourage competition. The other three remaining purposes that were so carefully designed into the Act—ensuring universal service, making sure that alternative networks were incented, and ultimately moving toward deregulation—those purposes have not been accomplished.

We also would agree with what was said here today, that rural service is essential, it is required, and we will have to have economic incentives and strong economic incentives in place to make sure that rural high-speed access is placed and we have appropriate rural investments.

We would also agree regulatory uncertainty exists in the broadband market today and that regulatory uncertainty is what Tauzin-Dingell seeks to address.

But, as you might imagine, the conclusions that I draw from the facts that I agree with are quite different from what has been put forward today. First of all, I strongly disagree that we sought to block implementation of the 1996 Act. In fact, what we sought to do is understand how the 1996 Act was being implemented.

You will recall on August 8, 1996, the FCC put forward implementing regulations and in those regulations the FCC introduced something called TELRIC pricing. What they did was break up our network. They broke it into piece parts and they priced those piece parts looking forward and using technology that does not exist in our network today, but a hypothetical most-efficient network.

I would say probably the single most detrimental thing that has been done to achieve your vision of competition and deregulation in this marketplace is the implementation of TELRIC pricing or breaking our network—not the breaking our network up, but the prices that were put into place. Those prices basically offered our

competitors about a 70 percent discount on accessing our business customers.

The second purpose of the Act, preserving universal service, would have called for either an increase in residential rates and implementation of a universal service fund or some other mechanism that would have put similar economic incentives into the residential marketplace. It was not until late 1999 or 2000 that any attention was paid to the concept of universal service at all.

So as a result, you have exactly the way the Act was implemented has decreed the kind of competition we have. In BellSouth's service territory we have robust increase in our business market. We have some of our central offices where we have less than a 50 percent market share for business customers today. We have 100 percent of the residential rural customers that nobody else wants because our service is priced well below the cost of serving those customers.

In Columbia, South Carolina, we have 45 competitors that are competing in our business market in downtown Columbia. They are able to offer service to our customers at a mere fraction of what our rate, our business rate today, how our business rate is set today. Remember that those rates were set intentionally at a high margin, not being cost-based, to encourage universal service and to incent a broad deployment of network. That universal service piece is what is missing from the economic incentives that we have in place today.

I would also disagree that we have sought to delay the implementation of the 14-point checklist. As you will recall, Senator in 1997 we brought an application up to the FCC out of South Carolina. We twice brought applications up, in 1997, 1987, out of Louisiana. In those applications we interpreted and sought to work with the FCC to implement what we thought was the 14-point checklist.

Today we still do not have a successful application in BellSouth, even though we now have proceedings filed in all of our States. The 14-point checklist has grown in Georgia to be 1800 different performance measures that we are required to report on and to disaggregate and report on a CLEC-specific basis.

By the time this is implemented—what we have been doing since 1996 is first of all, seeking to understand what will be required for us to get into long distance. We have hired hundreds of people to help implement the solution that regulators are outlining for us and we have invested $1.6 billion in equipping our network to deliver that solution that the regulators are outlining.

I would also disagree that we have anything that remotely resembles deregulation. I came into this business from the Federal Government, where I served as a regulator. I have served as a cabinet secretary for the Governor of Kentucky. I have been in government and outside of government.

I entered this business at divestiture and at no time in my career in the telephone company have we been more regulated than we are today. Every aspect of our business is micromanaged. Every price that we charge is examined and judgment substituted for the judgment that we put into our pricing models. Our performance is measured and sliced and diced to the million parts.

So we are as far away from deregulation as you could possibly imagine. The 1996 Act was carefully designed. It was carefully crafted. We have just implemented one piece of the four-part plan that Congress saw fit to send forth. I would say that we need to stay the course. The 1996 Act needs to stay in place. It is working in many respects. But we need to fully implement the vision of the Congress that passed the 1996 Act.

[The prepared statement of Ms. Greene follows:]

PREPARED STATEMENT OF MARGARET H. GREENE, EXECUTIVE VICE PRESIDENT, REGULATORY AND EXTERNAL AFFAIRS, BELLSOUTH CORPORATION

Today's telecommunications headlines lament a "breakdown in competition," and the "remonopolization" of the telecom industry. These reports suggest there are four factors responsible for the lack of competition in the telecommunications market—the financial woes of the competitive local exchange companies' (CLECs), limited competitive alternatives for residential customers, the failed business strategies of the interexchange carriers (IXCs) and the consolidation of the Regional Bell Operating Companies' (RBOCs). The conclusion that should be drawn is in fact quite different. Competition is robust in every sector of the communications market except long distance. The RBOCs are not the dominant players in the data, broadband, Internet and long distance markets and are experiencing significant share loss in the local business voice market. Only in the subsidized residential voice market do the RBOCs remain the dominant provider. Across the country, the competitors share of the local residential market is about 5 percent—it is important to note that they have done this in about half the time it took MCI to gain a similar share from AT&T after deregulation of the long distance industry.

A more complete examination of each of the four factors shows that they have erroneously lead to incorrect conclusions drawn by a backward-looking, voice-centric perspective, and that these conclusions are therefore irrelevant, and in fact are even injurious, to our economic future.

Often cited as evidence that the 1996 Telecommunications Act is not working are the financial woes faced by the competitive local exchange industry. The CLEC industry is indeed undergoing a significant restructure not unlike that which occurs in any industry transitioning to competition. The belief among telecommunications industry analysts is that the recent experiences in the CLEC industry are no different from other evolving industry segments. It can be compared to the railroad, automobile, airline or personal computers. All went through a period of rapid increase in the number of competitors and the subsequent failure or merger of these competitors until the market determined the number of competitors that could succeed. Many CLECs are failing, and the once darlings of the capital markets are having significant problems raising investment capital. Investors are increasingly reluctant to put their money in this and other segments of the telecommunications market, and in the larger technology market without assurances that those they invest in have sound business plans that can generate the earnings growth expected in today's market.

However, while many CLECs have seen their business plans fail, the CLEC industry has seen a growth in revenues of 93 percent year over year. While the recent FCC report shows that CLECs have achieved an 8 percent market share overall nationwide in 2000, up from 4.4 percent in 1999, they have achieved a far higher penetration in the business market. In several wire centers in BellSouth territory, CLECs now enjoy over a 50-percent business-market share, and the number of CLECs operating in our territory, over 300, is increasing. The FCC says that nationwide, business customers make up 60 percent of the CLECs revenues, as contrasted to only 20 percent of the incumbent local exchange carrier (ILEC) revenues. These business customers are high-margin customers, located in highly concentrated business districts.

The CLEC industry sprang up in response to regulatory policy put in place to implement the Telecommunications Act of 1996. The Act has four major purposes:

- To encourage competition;
- To encourage investment in alternative networks;
- To ensure universal service by making subsidies obvious instead of hidden; and
- To increase deregulation.

Regulatory policy to date, however, has focused solely on creating competition by any means possible.

The FCC created a structure whereby the ILECs are required to open their existing networks for wholesale purchase by competitors, either in whole or in pieces. If sold in whole, the network pricing is at a prescribed resale rate (defined as retail less avoided costs such as marketing). If sold in part (unbundled network elements or UNEs), the pricing would be on a cost-plus or rate-of-return basis. The FCC largely ignored the resale pricing provisions, and the UNE prices were set at TELRIC (total element, long-run incremental cost) levels, which were decreed to be forward-looking, most-efficient technology prices—prices that the local exchange companies find hypothetical and inadequate. UNE pricing was designed to jump-start competition by carving up the ILEC revenue stream, and it has worked well in the business market. However, it has not worked in the subsidized residential market. A review of the actual numbers clearly shows why.

Significant competition has developed for the business market in urban locations, like Atlanta, Georgia; Nashville, Tennessee; Miami, Florida; or New Orleans, Louisiana. Examining the difference between the retail business rate and the wholesale-unbundled rate—both products of regulation—is instructive. BellSouth's retail business rate in Columbia, South Carolina, for example, is $42.75. This rate was set by regulators intentionally above cost to subsidize local residential rates. The wholesale rate available to competitors is $18.48, also intentionally set at cost. The $24 difference in these rates is available to the competitor as a margin, thereby providing a clear incentive to concentrate on the business market. The picture changes though when we look at rural South Carolina and the competitors' interest in the residential voice customer. The subsidized residential rate in rural South Carolina is $12.70. The wholesale, cost-based rate is $36.91. Competitors are not flocking to pay $36.91 to access a $12.70 revenue stream.

Working from a regulatory structure that clearly enabled them to compete using a business plan of price arbitrage against the ILEC, hundreds of CLECs have flocked to the same urban areas to compete for the same business customers. The CLECs have not sought to serve the residential market despite the fact that 88 percent of all U.S. households reside in ZIP codes "served" by a CLEC. Not surprisingly, there is not sufficient revenue in the limited targeted-customer terrain to sustain them all.

Today, many business customers enjoy new pricing plans and lower rates. For the most part, however, the CLECs have not built modern alternative networks or introduced new products or services. The ones that have, and thus have an ability to distinguish themselves in the marketplace, are the ones that are expected to survive and prosper.

It is a relevant fact that there has been limited competition for the landline residential voice customer, especially those in rural areas. The actual rates outlined above, while specific for South Carolina, are representative of the economics surrounding the non-urban segment of the market. There are no easy financial incentives for competition in the residential landline voice market. The 1996 Act did not fail in this regard; it just was not fully implemented. The 1996 Act required that implicit subsidies be made explicit. This has been done only to a very limited extent.

If subsidies were removed, residential rates would have to be permitted to rise to cost. Retail rates would have to be deaveraged to accurately reflect costs, historic jurisdictional cost allocations would have to be removed, access charges would have to be uniformly reduced, and class of service distinctions between geographically separate markets would have to be ignored. Artificially low residential rates, coupled with state-regulatory-imposed retail service standards, currently discourage competitors from serving the residential voice market through or with competitive landline services or networks. Perhaps more importantly, however, they also serve to retard competitive technology's ability to take hold in the residential market.

Today there are many alternatives to traditional voice transmission. There is E-mail, wireless voice, wireless E-mail, fixed wireless, paging and voice over Internet Protocol. In fact, only one-in-four new connects for telephone service goes to the landline network. The front page of the New York Times on June 12 reported that Microsoft is ready to supply a phone in every computer for computer-based telephony. Cable modems are the dominant residential high-speed Internet access tool today and increasingly are able to accommodate switched voice as an add-on service. By 2003, it is expected that voice landline traffic will be reduced to approximately 45 percent of the total telecommunications traffic. If even a reasonable residential rate were introduced into this environment, the competitive dynamics would explode. Customers would then choose their technology according to their user needs without the artificial repression of rates or market definition created by regulation.

A third factor cited as evidence that competition is failing is the financial uncertainty of the IXCs. The three key participants in the long-distance market, AT&T, WorldCom and Sprint, are all subject to increasing market pressures despite the

fact that the cost of access has declined by as much as 95 percent over the last several years. The long-distance companies say the ILECs prevent them from entering the local residential market. It is not the ILECs, however. It is the economic reality previously noted that discourages them from leaving the safe haven of regulatory protection for the competitive marketplace. Further, their safe haven is increasingly dwindling because there is no longer a discreet long-distance market. Always a creature of regulation, first expressed through pricing subsidies embedded in long-distance rates, then enforced through judicial decree and later codification, long distance is obsolete as a stand-alone market.

This demise did not come at the hand of the ILEC industry nor did it originate with the approval of Verizon's entry into long distance in New York or SBCs entry in Texas. In fact, the FCC found that the RBOCs entry into long distance stimulated local residential competition dramatically in New York and Texas. Ironically, long distance as a stand-alone market was first attacked by AT&T itself, and then killed by Sprint, as a result of their wireless pricing plans that eliminated roaming charges and moved to flat rate nationwide. Wireless pricing, coupled with the substitution of data or E-mail and Internet traffic for long distance voice traffic, makes their earnings growth potential problematic and finds them actively engaged in businesses like cable television, broadband deployment, Internet transport and nationwide wireless.

These new technologies and efforts are expensive and capital intensive, thus creating intense earnings pressures. But make no mistake; this earnings pressure applies to BellSouth and to any company that undertakes the development of a broadband platform. The broadband platform does not exist in the legacy monopoly plant. It must be built and it is expensive. No one company will have the financial capacity to build it all, and no one technology will have the flexibility to meet all of a user's needs. The IXCs, however, have many digital assets, and they are assisted by their national scope and virtual freedom from regulation at the State and Federal levels.

The final fact purported to show the demise of competition is due to the consolidation which has occurred in the local exchange industry. True, the seven RBOCs are now four. They have arrived at this point by responding to the incentives currently available to them in the marketplace. The RBOCs still are regulated as if they are a monopoly. With traditional profits subject to regulatory redistribution, billions of available investment dollars are being mandated to build an open-access or open-network platform. (This construction has been mandated under the Act's 14-point checklist, which has now grown to be some 1,800 performance metrics. When calculated for each CLEC operating within BellSouth, this expands to a total of some 4.5 million measurements per month.) Additionally, the RBOCs find themselves in a market position where they trail their cable-company competitors by a 3-to-1 margin in customers for data and future growth-oriented technologies. RBOCs have had to turn their attention to maintaining the margins demanded by the capital markets by taking existing technology and applying it across as many customers as possible to achieve decreasing costs. Without progressive policy tools, many of which were outlined in the Act but not implemented, the pressure to consolidate to shed costs in the legacy network will continue.

Telecommunications regulation has reaped what it has sown—limited and tentative investment in only one of the four technology platforms poised to deliver the digital economy. The landline, ILEC, public switched network alone is subject to price, service and investment regulation. Policy, driven as it is today by backward-looking residential voice concepts, will continue to severely limit investment and may ultimately not allow the growth in the domestic economy that was foreseen by Congress when it enacted the Telecommunications Act of 1996.

Tomorrow's telecommunications headlines should read, "robust competition in telecommunications stimulates domestic economy and brings unparalleled benefits of advanced technology to all." In order for this headline to become a reality, we must move forward now with the full implementation of forward looking telecommunications policies.

The CHAIRMAN. Thank you.

Mr. McLeod.

## STATEMENT OF CLARK McLEOD, CHAIRMAN AND CO-CEO, McLEODUSA

Mr. McLEOD. Thank you, Mr. Chairman. My name is Clark McLeod and I am the Chairman and Co-CEO of McLeodUSA. We

are the largest independent CLEC in the country. We provide bundled local, long distance, and high-speed data products in 25 States. We are the company that is truly bringing competition to medium and small businesses, to residences, and to your local communities. We do not just serve large commissions. McLeodUSA has a presence in 2,250 cities.

Today I would like to speak briefly about H.R. 1542 since it has come up earlier. H.R. 1542 has no redeeming qualities. It guts key open access provisions of the 1996 Act and it strengthens the Bells' control over the local network. It moves us toward re-monopolization of service that is presently competitive, and finally it has created incredible uncertainty which has cut off CLEC access to capital.

I urge each of you, as you already have stated, Chairman Hollings, to publicly oppose H.R. 1542. The tread certainly should come off of that tire.

Now let us focus on the key to local competition going forward, and this will go back into the 1980s. I have heard a lot of talk today about long distance. I think it is very important. The key to local competition is equal access to competitors. Today we are beginning to provide consumers with a choice to local service. Five years after the Act, however, all of us together have about 8.5 percent share. If you contrast that to the 5 years following the 1984 divestiture of AT&T, the long distance competitors in the same length of time had gained 30 percent market share, four times the rate that we have gained today.

Why has local competition been slow? The answer is the Bell companies have successfully denied competitors equal access. What is the remedy? Well, let us look again at long distance. During the 1980s, I was a founder of a company that grew to be the fourth largest long distance company in the U.S. Equal access to the AT&T network was mandated and Judge Greene was dedicated to enforcing it. Real competition flourished. In the last 7 years, we have seen about 40 percent reduction in long distance prices.

Second example is wireless. For the first 10 years, the wireless industry was a duopoly and prices remained artificially high. Then the FCC opened up additional spectrum in the mid-1990s, thereby allowing equal access to more competitors. Voila, real competition developed, resulting in a 50 percent reduction in prices to consumers over the last 7 years.

What do these models have in common? Access to consumers. So what is the answer for local competition? As Chairman Hollings pointed out, we need to mandate equal access to that local loop and we need to enforce it. Unfortunately, there is not equal access today, either in economic terms or in functional terms.

Let's start with economic equal access. For the CLECs today, local access is the equivalent of paying the power company, but also having to purchase and operate your own generator to keep and guarantee the lights are on. Competitors pay for 100 percent service from the Bells and receive far less. Accordingly, competitors should be paid damages for the costs they incur as a result of unequal access. Alternately, rates charged competitors should be discounted—like the feature group A discount—was in the long distance industry back in the 1980s.

These remedies will produce results. For example, with QWEST we have seen positive trends in responsiveness, service delivery, creativity, if you will, all of which have contributed to a significant improvement in our relationship. This result is attributable, we think, in part to the fact that QWEST is paying us penalties directly for misperformance.

Second, functional equal access. This means competitors are able to order, provision, and service lines in the exact same way the Bell companies are. It seems like common sense, but we do not have that today. Bell company systems must be blind to who is ordering the service. This eliminates their ability to discriminate.

So to enforce functional equal access, penalties are necessary. Some have suggested fines of $10 million, but that is not enough. Imagine a $10 million fine for a company with a $100 billion market cap. I am afraid it is the equivalent to a parking meter violation.

Last year, the Illinois Commerce Commission fined SBC $60 million. Later, one Illinois legislator was told that paying a $60 million fine was simply "cost of doing business." Progressive penalties must be meaningful. Functional equal access comes from separating network operations from retail operations. This can be done functionally and QWEST is currently working with competitors to implement that.

But if separation is not done, then regulators must have the authority to structurally separate the Bells' retail and network operations.

In conclusion, competitors, after spending billions of dollars, have averaged a little more than 1 percent market share per year, and if you extrapolate that, there will be no one in this room alive by the time we have meaningful competition. In fact, all current competition may die along the way.

We need a mechanism for consumers to receive higher levels of service at lower rates, like they have enjoyed in long distance and wireless service. Congress needs to finish what was started in 1996 by taking action to enforce the Act and provide equal access to the local network.

Thank you, Mr. Chairman.

[The prepared statement of Mr. McLeod follows:]

PREPARED STATEMENT OF CLARK MCLEOD, CHAIRMAN AND CO-CEO, MCLEODUSA

McLeodUSA provides competitive telecommunications services to residential and business customers in 25 States. We also serve rural and urban markets. We currently provide a bundle of local, long distance and high-speed DSL and other data products.

H.R. 1542 has no redeeming qualities. It guts key open access provisions of the 1996 Act and strengthens the Bells' monopoly control over the local network. This bill created uncertainty, which cutoff CLEC access to capital. This bill would move us toward remonopolization of all telecommunications industries by the Bell companies. I urge you to publicly oppose H.R. 1542.

Local competition has developed much slower than long distance competition. The reason is that the Bell companies have successfully denied competitors equal access (both economic and functional) to their local network.

In order to open up the local network to competition, we should review the successful models in the long distance market and the wireless market. Access led to competition, which led to lower prices and higher service quality for customers.

The answer for local competition is to mandate equal access and enforce it. Unfortunately, there is not equal access today, either economic or functional.

Economic equal access does not exist today, because competitors are not getting what they pay for. Competitors pay for 100 percent service from the Bells but receive far less. Consequently, competitors must receive damages to offset the costs they incur as the result of unequal access. Alternatively, the price competitors pay the Bells should be discounted (similar to the long distance feature group A discount).

Functional equal access also does not exist. Competitors must be able to order, provision and service lines in the exact same way the Bell company does. A system is needed within a Bell company that does not reveal who the ordering company is, thus eliminating the ability to discriminate. Until that occurs meaningful and progressive penalties must be assessed when the Bells discriminate.

Separation of retail and network operations is critical to functional equal access. Separation can occur functionally within a company, which is the system Qwest is implementing. But, if meaningful separation does not occur, regulator must have the authority and budget to structurally separate the Bells' retail and network operations and must use it to accomplish functional equal access.

On behalf of McLeodUSA, I would like to thank the Committee for the opportunity to talk with you today. I would like to accomplish three goals: first, highlight McLeodUSA's progress in serving residential and business customers in rural and urban markets; second, briefly summarize our opposition to H.R. 1542, which moves us toward re-monopolization of all telecommunications industries by the Bell companies; and third, highlight the keys to local competition.

## I. McLeodUSA IS EXACTLY WHAT CONGRESS ENVISIONED

### *A. Entrepreneurial*

In the early 1980s, I was CEO of Teleconnect, a company founded to compete in the long distance industry. I started basically out of my garage and began to bring the benefits of competition to my customers. In 1981, the Federal Communications Commission (FCC) mandated AT&T to allow competitors access to its existing network. As public policies continued to encourage and support competition in that industry, several competitors, including Teleconnect, began to have success. Over the course of about 8 years we built Teleconnect into the fourth largest long distance company in the country employing nearly 7,000 employees. So I know entrepreneurial competition can work to bring competition to medium and small businesses and residences in your local communities.

In 1992, I organized McLeodUSA, headquartered in Cedar Rapids, Iowa, began competing in the local and long distance telephone markets. We started slowly. When the Telecommunications Act of 1996 ("the 1996 Act") was passed, we were able to take our company public and accelerate our growth.

McLeodUSA's corporate team is recognized as one of the strongest management groups in the telecom industry: strong because of our breadth, and strong because of our depth.

McLeodUSA Incorporated is a Nasdaq-100 company traded as MCLD. The Company's website is available at *www.mcleodusa.com.*

### *B. Serving a Wide Range of Customers*

We serve both business and residential customers. In fact we serve more residential customers than business customers. Our goal is to be the number 1 and most admired company in the markets we serve. We cannot accomplish that by only serving large business customers in large cities, so we rejected that model. The Bells like to portray competition as competitors who merely "cherry-pick" high-margin large business customers. In our case that portrayal is just not true.

We also serve a wide range of communities ranging from cities as small as a few hundred people up to cities as large as Chicago. In the communities we serve, our focus is primarily on small and medium sized enterprises. While we do serve residential customers and large businesses, we have found that small and medium-sized businesses are largely underserved. We have good success with those customers using our beat-cop sales approach that meets customers face-to-face. Currently our average business customer has 6 telephone lines. So again you can see we are not in this business to only serve the "high revenue" large business customers of the Bell companies. We are committed to taking competition to the small businesses along Main Street as well as to the residences of your constituents.

## II. McLeodUSA IS BRINGING COMPETITION AND ITS BENEFITS

McLeodUSA is the largest independent CLEC in the country. In March 1996 we served approximately 40,000 local access lines. Today, we serve over 1 million lines.

*A. Jobs*

In late 1994 we had approximately 200 employees, primarily in Iowa. Today we have nearly 11,000 employees working in 150 offices located in 25 States.

*B. Technology*

At the end of the first quarter of 2001, we had 50 central office and long distance switches and 396 data switches in operation. In addition we had deployed and begun operating approximately 29,000 route miles of fiber optic cable connecting most of those facilities. By the end of 2002, we will operate a 30,000-mile broadband network connecting 810 cities capable of delivering service to a local telephone connection (the "local loop") for 90 percent of the U.S. population. See Exhibit 1. The one critical missing requirement for meaningful local competition, however, is for competitors to have equal access (functional and economic) to the Bell local network . . . the *entire* local network.

## III. H.R. 1542 MOVES US TOWARD RE-MONOPOLIZATION OF ALL TELECOMMUNICATIONS INDUSTRIES BY THE BELL COMPANIES

Let me get immediately to the point: H.R. 1542 has no redeeming qualities. It guts key equal access provisions of the 1996 Act and strengthens the Bells' monopoly control over the local network.

It does nothing to spur broadband investment in rural America.

It is totally irrelevant to the Bells' ability to provide DSL service. The Bell companies can and do provide broadband DSL service today.

It substantially reduces the Bells' incentive to open their local markets to competitors, by granting immediate authority to provide long-distance "data" services.

This bill created uncertainty, which cutoff CLEC access to capital.

Consequently, I urge each of you to publicly oppose H.R. 1542.

## IV. KEYS TO LOCAL COMPETITION

Today, we are at the beginning of providing consumers a competitive choice for their local telecommunications service. Five years after the 1996 Act, all competitors (independent CLECs, AT&T, Worldcom and Sprint) have gained 8.5 percent share of local access lines. In contrast, competition in the long-distance industry during the 1980s developed much faster. Five years after the 1984 divestiture of AT&T from the Bell companies, all long-distance competitors had gained nearly 4X the marketshare that competitors have gained in local access lines.

Why has local competition been slow to develop? The answer is that the Bell companies have successfully denied competitors equal access (both economic and functional) to their entire local network. [See Exhibit 2.]

How do we open up the local network to competition? Let me describe two successful models used in the long distance market and the wireless market.

First, long distance. The two keys actions that allowed competition to flourish in the long distance industry was that equal access was mandated and enforced. In 1981, the FCC mandated that all competitors have access to the AT&T network. In 1986, equal access from the Bells was mandated, thus allowing 1+ dialing. Additionally, Judge Greene provided strong enforcement, including meaningful penalties, to deter anti-competitive conduct. The result was healthy long distance competition, an approximate 40 percent decrease in prices since 1993 and higher service quality for all customers. I can personally testify to this market opening during the 1980s as the founder of the 4th largest long distance company in the 1980s. [See Exhibit 3.]

Second, wireless. For the first 10 years, the wireless industry was a duopoly. Even though technology made great strides, prices remained artificially high. The FCC then opened up additional spectrum, thereby allowing equal access to more providers. Real competition developed and prices decreased over 50 percent since 1993. [See Exhibit 3.]

What do these two models have in common? Equal access to customers. So what is the answer for local competition? It is very simple. Mandate equal access.

QWEST has shown some positive improvement, but unfortunately, there is not equal access today, either economic or functional.

*A. Economic Equal Access*

First, economic equal access. Competitors are not getting what they pay for. For CLECs, local access today is the equivalent of paying your monthly bill to the local power company but also having to purchase and operate your own power generator to guarantee the lights stay on. Competitors pay for 100 percent service from the Bells but receive far less. Not only do competitors receive less than 100 percent of

what they order from the Bell companies, current local access rules cause competitors to lose money while ensuring the Bells make a profit. [See Exhibit 4.]

So how do we enforce economic equal access? There are two alternatives. Competitors must have the price they pay the Bells discounted like was done successfully with long distance (the feature group A discount). Or, in the alternative, award damages for costs competitors incur when less than 100 percent service by the Bells is provided. We know damages will accomplish our goal. With QWEST, we have seen positive trends in its responsiveness, service delivery and creativity, all of which have contributed to a significantly improved business relationship. This result is attributable in part to the fact that QWEST pays penalties related to performance problems directly to us.

*B. Functional Equal Access*

Functional equal access means competitors are able to order, provision and service lines in the exact same way the Bell company does. This seems like common sense, but we don't have it today. A system is needed within a Bell company that does not reveal who the ordering company is, thus eliminating the ability to discriminate.

So how do we enforce functional equal access? Progressive penalties can be imposed against the Bell companies when they engage in discriminatory conduct. Some have suggested up to $10 million, but $10 million is too low by several orders of magnitude. Imagine a $10 million fine against a company with a $100 billion market cap. It's the equivalent of a parking meter violation.

During last year, the Illinois Commerce Commission fined the incumbent provider $60M. In response to these payments, one Illinois legislator was told that paying the $60 million fine was simply a "cost of doing business." Clearly penalties must be increased substantially in order to be meaningful.

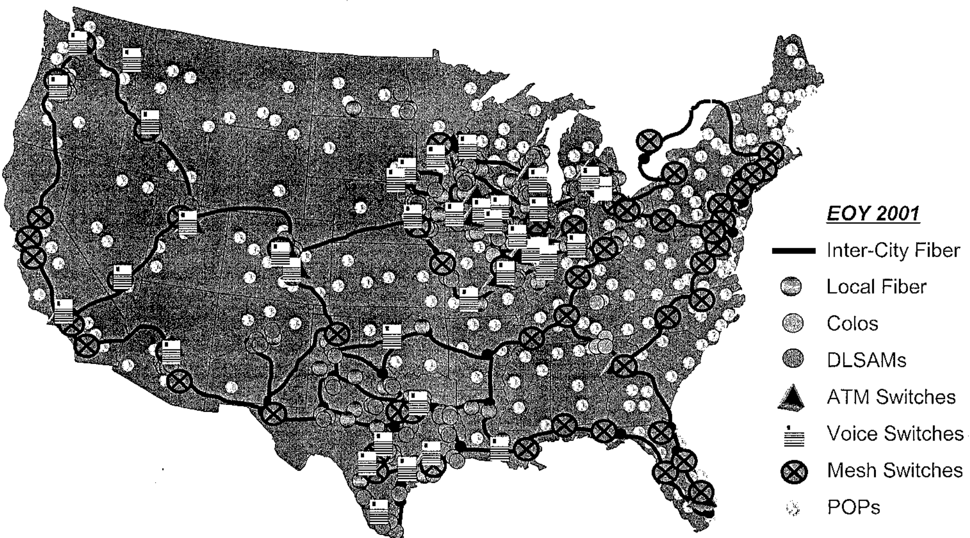
Functional equal access can also be implemented by separation of network and retail operations with the incumbent provider. QWEST is working with competitors to implement adequate functional separation and non-discrimination practices. Other Bell companies are not. If penalties do not result in functional separation, then State and Federal regulators should be authorized to structurally separate the Bell companies. They need the authority and the budget to carry out the separation, and if they do not determine separation has occurred they should use this authority.

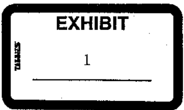
*Conclusion*

Competitors, after spending billions of dollars, have averaged a 1 percent marketshare gain per year. If you extrapolate, there will be no one is this room still alive by the time we have meaningful local competition. And in fact, competition may die enroute. Congress needs to finish what was started in 1996 and take action now to mandate equal access and enforce it.

FLR4/01-14a

# McLeodUSA Broadband Network...




## ...serving rural & urban markets

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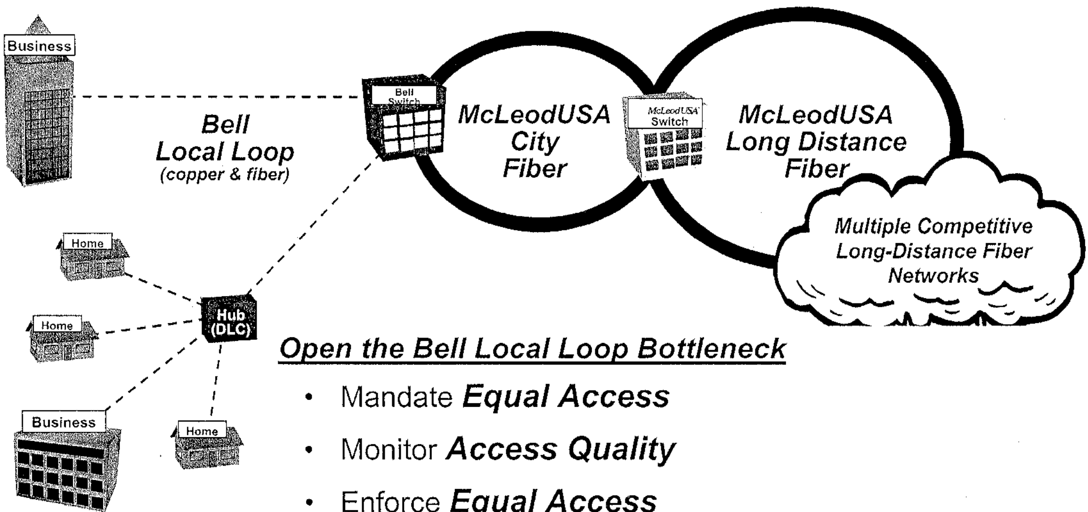
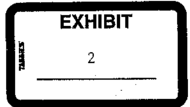
# One Critical Piece Missing...




**_Open the Bell Local Loop Bottleneck_**

- Mandate ***Equal Access***
- Monitor ***Access Quality***
- Enforce ***Equal Access***

***..."last mile" local loop***



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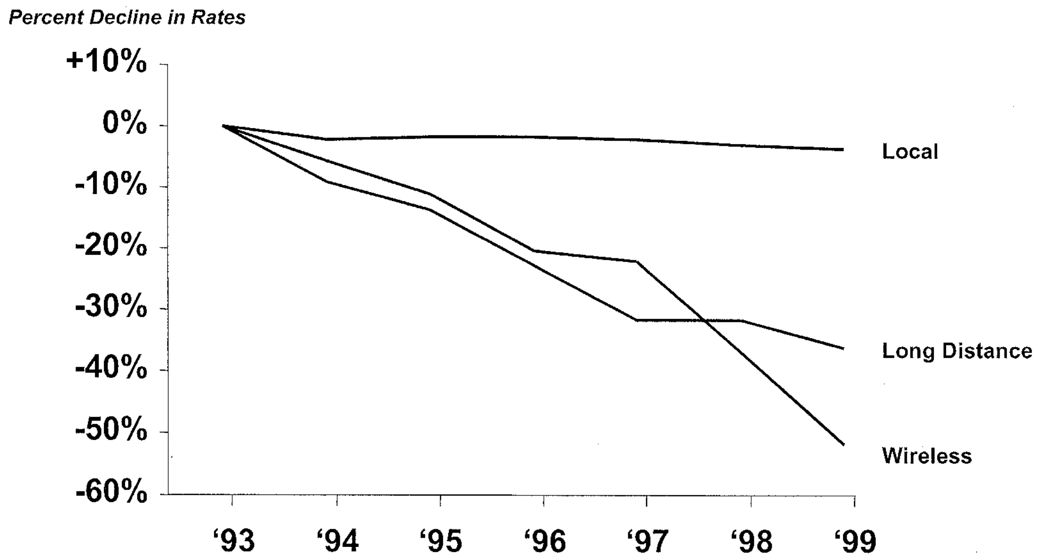
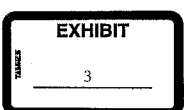
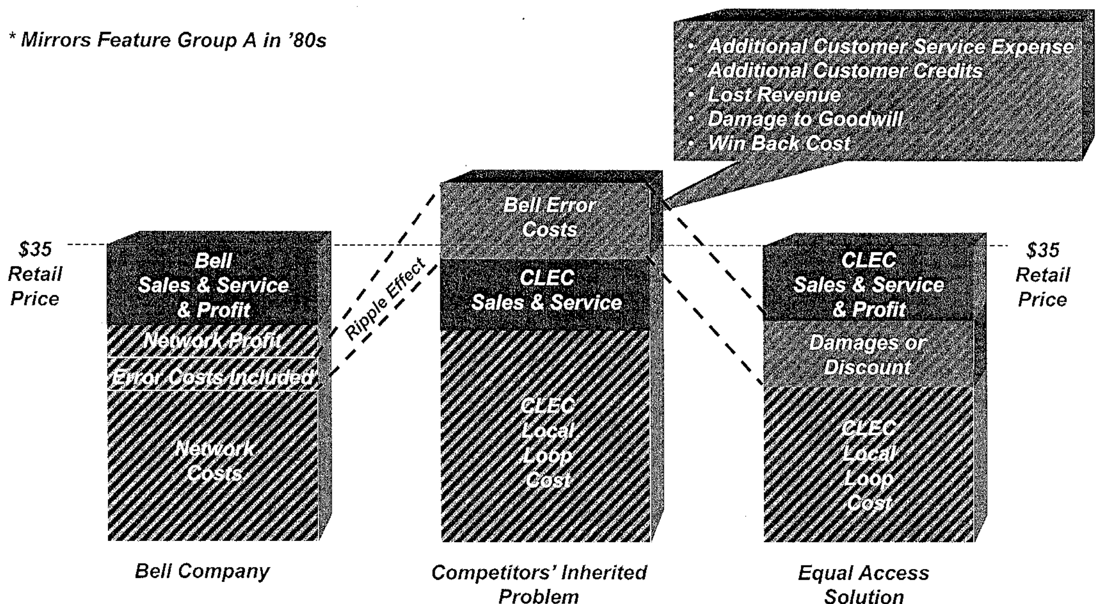



## ...consumers benefit




FLR4/01-17
Unequal Access = Uneconomic Access*
* Mirrors Feature Group A in '80s
Additional Customer Service Expense
Additional Customer Credits
Lost Revenue
Damage to Goodwill
Win Back Cost
$35 Retail Price
Bell Sales & Service & Profit
Network Profit
Error Costs Included
Network Costs
Ripple Effect
Bell Error Costs
CLEC Sales & Service
CLEC Local Loop Cost
CLEC Sales & Service & Profit
Damages or Discount
CLEC Local Loop Cost
$35 Retail Price
Bell Company
Competitors' Inherited Problem
Equal Access Solution

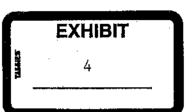


EXHIBIT
4

The CHAIRMAN. Thank you.
Mr. Armstrong.

**STATEMENT OF C. MICHAEL ARMSTRONG, CHAIRMAN AND CEO, AT&T CORPORATION**

Mr. ARMSTRONG. Thank you, Mr. Chairman.

Congratulations. Thank you for holding this hearing and it is an honor to appear. I know time is limited, so I will be brief.

First of all, AT&T is committed to bringing competitive local telephone service to residential and business customers. We have invested over $100 billion in local telecommunications and cable networks and we now serve over two million local telephone customers. We are fulfilling our part of the bargain of the 1996 Telecom Act.

Second, we and other local competitors could be doing even more if the incumbents were living up to their responsibilities under the 1996 Act. Unfortunately, the Bells have spent 5 years, as has been talked about, playing their hole cards, mostly price and process, after the delays and litigation.

Even though the Bells are required to lease parts of their networks to competitors at reasonable wholesale rates and with reasonable processes, we all lose money because the wholesale prices the Bells charge and the processes we are subjected to are not reasonable. Where Federal and State regulators have insisted on compliance with the Act, as appears could be the case in New York now, we have seized the opportunity and entered the local marketplace.

Third, contrary to the incumbent monopoly claims, there is no regulatory barrier to the Bells' deployment of broadband. It is occurring faster today than the deployment of any new technology in memory. The Bells are spending billions now to deploy DSL, but for one reason: competition. As was mentioned, DSL sat on the Bells' shelf for about 10 years. Now the first places they have deployed it is where competitors are most active.

The local monopolies claim that a bill now pending in the House, the Tauzin-Dingell bill, would bring broadband more quickly to rural areas. This is a transparent effort to exploit digital divide concerns. In fact, the deployment provisions of the bill actually mandate less than what the Bells are already doing. At the same time, the Bells are selling off a lot of rural exchanges.

Far from being necessary to promote competition, the Tauzin-Dingell legislation presents a serious threat to local competition. It would deprive competitors of the ability to purchase access to critical parts of the monopoly's network, and it would allow the Bells to enter the long distance market without first opening their local market to competition. Eliminating these provisions of the 1996 Act would preserve monopoly power over local phone service and really allow the Bells to leverage this monopoly into the control of high-speed data services.

Finally, if action is needed to finish the job started in 1996, it is to enforce the law. There must be meaningful penalties and damages available to the competitors where their businesses have been harmed by the incumbent's failure to comply. Most importantly, policymakers should consider compelling the Bell companies to cre-

ate a clear structural separation between their wholesale and retail operations. This will simply help ensure the Bells provide the same price and the same process to their competitors as they do to themselves.

If a monopoly is not de-monopolized before entering a competitive market, it will use its monopoly power to monopolize that competitive market. This is exactly what the Bells are doing in the narrowband arena with price and process and it is exactly what they are up to in the broadband market with the Tauzin-Dingell bill. Separation of the Bells' network and retail operations will enable the market to demonopolize the Bells' local monopoly.

Regulation and enforcement can work, but, as we have seen repeatedly, Bell gamesmanship against competitors and the lack of meaningful penalties are defeating the intentions of the Act. Structural separation coupled with stronger enforcement will let the market do the work.

The hope for competition and local phone service is really at a critical juncture. CLECs and long distance companies have invested billions relying on the 1996 Telecom Act. Due to a lack of compliance by the Bells, it is not working. Not only does simple fairness argue against Congress repudiating the rules it wrote, now in the middle of the road or the game, it also argues to make sure the rules are enforced and that local competition results. If this does not happen, we will surely face the re-monopolization of the consumer-small business communications market in America.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Armstrong follows:]

PREPARED STATEMENT OF C. MICHAEL ARMSTRONG, CHAIRMAN AND CEO, AT&T CORPORATION

Thank you, Mr. Chairman and Members of the Committee, for inviting me here today to share AT&T's views on the status and prospects for local competition. Since 1996, AT&T has been a leader in developing competitive alternatives to the incumbent telephone monopolies for residential and business customers. In reliance upon the promise of the Telecommunications Act, we have invested over a hundred billion dollars in local telecommunications and cable networks and now serve over 2 million local residential customers.

The 1996 Act promised to end almost a century of monopoly control over the local telecommunications market and bring the benefits of competition to consumers. To keep that promise, Congress made a simple deal with the Bell companies: Open your monopolies to competition—real competition—and then you'll be allowed into the long distance market. The incumbents were not given a choice. Congress said in no uncertain terms that monopolies must be opened, and that regulators should make sure that it happened, and that it happened quickly.

In response to the passage of the Act, AT&T and dozens of other companies invested billions of dollars in new telecommunications facilities and services. In addition to spending over $95 billion to acquire and upgrade cable facilities to provide telephone competition, we purchased Teleport for $11 billion to serve business customers. AT&T also supplemented its existing long distance network by bringing more than 70 local switches and hundreds of collocation facilities on line across the country to compete with the incumbents. All new entrants took substantial risks in reliance on the regulatory framework created by the 1996 Act, under which they should have had a fair chance to compete with the established incumbents. And where that framework has been supported and protected by State regulators, it has enabled successful local competition.

Unfortunately, the ILECs have resisted and challenged nearly every attempt to implement the pro-competitive provisions of the Act. They have spent 5 years playing their two hole cards—price and process. And with them, they've largely managed to keep competitors out of their monopoly. Their strategy of resistance, delay, and litigation has enabled the ILECs to maintain their dominance of the local tele-

phone market, while dozens of their competitors are forced to scale back service plans, and many others go out of business entirely. And the incumbents now seek changes in the law that would repeal the rules that are essential to local competition and remove the incentives put in the statute to encourage them to open their local markets. Even considering such legislation creates the kind of market uncertainty that deters new investment and deployment. Enactment of such a bill would repudiate all of the hard work of Congress, and this Committee in particular, to bring consumers the benefits of a competitive marketplace, would jeopardize the significant investments made by AT&T and other new entrants to bring broadband and competitive local service to the American people, and would slow the deployment of advanced services. There is no justification for doing so.

There is no need to abort the promise of competition in exchange for broadband deployment by the incumbents. The market-opening requirements of the 1996 Act have not been an impediment to Bell company investments. In the past 5 years, the Bells have added almost five times the total number of access lines of all the competitive providers combined, and today they provide more than 90 percent of residential DSL services.

We have heard the incumbents complain before that overregulation was deterring them from rolling out advanced services and facilities. In 1998, they demanded that the FCC give them the right to offer advanced services largely free of the market-opening requirements of the 1996 Act. But before they gained the relief they sought, competitors began to deploy broadband services and the incumbents responded with vigorous deployment of their own. Under the spur of competition, regulatory relief proved unnecessary. Now, with the competitors seriously weakened and their deployment plans curtailed, the incumbents are back with the same untenable claims of overregulation. They are as unjustified now as they were two or 3 years ago. Now, as then, the incumbents' threat that they will cancel deployment unless the rules are changed is nothing more than a ploy to retain and strengthen their monopoly position.

Nor is the demand for "regulatory parity" between the ILECs and cable companies a justification for deregulating the local telephone monopolies. There are good reasons why cable companies and telephone companies are regulated differently, starting with the fact that cable companies face substantial competition in their core video business. In any event, it is a myth that cable operates on an unregulated basis. To the contrary, cable companies are subject to significant regulatory obligations, such as local franchising requirements and payment of local franchise fees, that do not apply to ILECs.

Experience shows that the ILECs have deployed advanced services under the existing rules when faced with competition—and absent competition did not deploy them—even when the technology existed and the market-opening requirements of the 1996 Act had not yet been enacted. Remove the possibility of DSL competition and the prospects for ILEC deployment of advanced services will be substantially reduced.

Legislation may be necessary to finish the job started in 1996, but the right tools for that job would ensure a forum for rapid resolution of complaints against ILECs, meaningful penalties for violations of the market-opening provisions of the Act, and structural separation between the wholesale and retail operations of a Bell company. In other words, rather than dismantling the framework of the 1996 Act, Congress must reaffirm its commitment to its competitive principles. Congress must resist efforts by the Bell companies to weaken that commitment through unwarranted legislation that would relieve the incumbents of the very obligations on which local competition depends. And Congress must demonstrate its renewed commitment to the principles of the Act by sending a clear signal that the goals of the Act can only be realized through vigorous enforcement of the provisions designed to end monopoly control over the local telecommunications market.

I will address each of these concerns in turn.

### AT&T IS COMMITTED TO LOCAL COMPETITION

Soon after the enactment of the 1996 Act, AT&T realized that it could not rely solely on the incumbents for the network facilities it needed to offer local service. As a result, we began to acquire our own local networks. In 1998 we purchased Teleport for $11 billion to serve business customers. Then, in 1999 and 2000, we spent nearly $90 billion to buy the cable companies TCI and MediaOne so that we would have a line into the homes of residential customers. We spend billions more each year to upgrade those networks, lay fiber, and create data centers. These investments have paid off: we've gone from about 50,000 cable-telephone customers

a year ago to nearly 825,000 today, and AT&T has local business customers in 71 major markets around the country.

But our own local networks do not reach everywhere. Until recently, for instance, FCC rules limited us to serving only about one-third of all cable subscribers. The incumbents are under no such restriction, as the reduction in the number of Bell companies from 7 to 4 in the last few years dramatically illustrates. To bring competitive choices to more Americans, we must rely on the marketopening requirements of the 1996 Act to lease facilities from the incumbents and resell their services. Even in the face of grudging and spotty compliance with these requirements, the results have been dramatic: over 2 million local residential customers in 16 states have chosen AT&T as their local service provider.

AT&T has also made a substantial commitment to providing competitive DSL service to residential and business customers. Earlier this year, AT&T committed more than $130 million to acquire the assets of the now-defunct NorthPoint Communications. The assets include collocations in 1920 locations, 3000 DSLAMs and other DSL networking equipment, 153 ATM switches, and the associated systems (hardware and software) that support provisioning, engineering, testing and maintenance functions. Those assets will be integrated with AT&T's existing network and allow us to reach more of our customers with a broad mix of services, including DSL broadband, local, and long distance.

### LOCAL COMPETITION IS EMERGING WHERE REGULATORS HAVE UPHELD THE PRINCIPLES OF THE 1996 ACT AGAINST ANTICOMPETITIVE BEHAVIOR BY THE INCUMBENTS

To be able to put our assets to work for consumers, we need to be able to interconnect with the incumbents' networks, and we need to be able to lease use of their network elements at reasonable prices and fair terms. Without these things, AT&T and other competitors will not be able to provide the full range of services on regional and national levels that customers demand.

The history of the telecommunications industry teaches that use of ILEC network elements is an important stepping stone to facilities-based competition. No new entrant—even a facilities-based competitor—can be expected to build out a national or even a regional network before signing up customers. The market-opening requirements of the 1996 Act allow new entrants to enter the marketplace and gain customers while they are building their networks. This is how long distance competition developed. MCI and Sprint began service as resellers of AT&T's service. They would not be in business today if they had to build out their networks before signing up a single customer—or if the pro-competition rules and policies that attracted them to the market were subsequently reinterpreted as favoring or preferring only facilities-based providers.

Back in 1996, the Bell companies pledged to support the Telecom Act. Then they went to court to stop it. They challenged Congress' authority to pass it, the FCC's authority to implement it, and just about every meaningful interpretation of it by the States. Their continued resistance to meeting their obligation to open local markets has caused significant harm to the prospects for successful local competition. Where states have made meaningful strides in insisting on compliance with the Act, we have seized the opportunity and entered the local marketplace. In those states, consumers can buy local service at competitive prices that is better tailored to their needs than what they get from the incumbents. In fact, a recent report found that residential consumers in New York have saved up to $416 million dollars a year by switching to competitors for local telephone service.[1] That is the true accomplishment of the 1996 Act. Without the necessary commitment of resources toward enforcement and implementation, however, the incumbents have deterred competition in a myriad of ways.

For example, competitive local exchange carriers seeking to lease elements of the incumbents' networks to provide competitive service have been frustrated by the incumbents' refusal to provide these elements. At various times since 1996, the Bells have refused to provide elements essential to voice services, elements essential to advanced services, and combinations of elements essential to all services.

Competitors also find that incumbents mishandle or delay their service requests. Last year, Verizon admitted to mishandling *more than a quarter of a million* competitive requests. And an FCC report for Pennsylvania showed that while Verizon always filled orders for its own customers in under 5 days, 80 percent of competitive customers had to wait longer than 5 days.

[1] "TRAC Estimates New York Consumers Save up to $700 Million A Year on Local and Long Distance Calling," [TRAC Press Release May 8, 2001.]

Moreover, the elements that are provided are offered at inflated prices designed to eliminate competitors. As a result of litigation brought by the incumbent monopolists, the FCC lost its authority over wholesale pricing. Although the Supreme Court eventually restored this authority in 1999, the FCC has since been reluctant to override State commissions that have permitted the incumbents to charge anticompetitive rates.

In addition, although CLECs are entitled to obtain dedicated space in an incumbent's central office or at other of its locations (such as remote terminals) and to place equipment there to interconnect with the incumbent's network, the incumbents have taken every possible step to deny CLECs this right, including challenging the FCC's rules implementing these requirements in court. In the meantime, the incumbents have attempted to restrict the type of equipment and facilities that CLECs may collocate at their central offices, and they are refusing to permit CLECs collocated in the same central office to connect to one another.

In some cases, ILECs are prepared even to punish consumers rather than comply with the Act. That happened recently in Illinois, where SBC announced it would halt its digital subscriber line deployment program rather than comply with an Illinois Commerce Commission order allowing competitors access to its fiber optic technology at cost-based rates. There is no better indication of SBC's monopoly power than a unilateral decision to cease providing service. As Illinois Commerce Commissioner Terry Harvill aptly observed in a letter to Speaker Hastert, "if the market were competitive, SBC/Ameritech would not be able to unilaterally halt the deployment of DSL infrastructure and deny these [Illinois] customers advanced telephony services."

AT&T agrees with Commissioner Harvill that "[w]ithout competitive guidelines like those [SBC] objects to, it is unlikely that millions of customers in Illinois will ever see the intended benefits of the Act in the form of lower prices, many choices for broadband services, and better customer service." And if this happened in Illinois, it could happen in Ohio, Wisconsin, or any other state.

In the face of these types of behavior, many competitors have been forced to stop offering local telephone service. And where competitors leave the market, price increases follow. In Texas, SBC has announced a ten to thirty percent price increase for long distance service. The same is true for advanced services, where the incumbent carriers now control approximately 90 percent of all residential DSL lines. Analysts at Legg Mason have noted that "with numerous DSL providers exiting the playing field . . . DSL pricing appears to be on the rise."

The current threat to local competition does not stem from the 1996 Act. When State regulators intervene and protect competition by blocking anticompetitive acts by the incumbent monopolists, local competition can work successfully. For example, we previously had warned that we would have to leave the New York market because we were losing money. But if a recent New York ALJ decision ordering Verizon to lower its network element rates is upheld, we will be able to stay in New York and continue to compete, to invest, and to expand our efforts to provide broad-based local service to consumers. As a result of positive efforts by the Michigan Public Service Commission to set fair, costbased wholesale rates for unbundled network elements, we also plan to begin offering UNE-based local service in Michigan by the end of the year.

### LOCAL COMPETITORS CANNOT SURVIVE THE DOWNTURN IN THE FINANCIAL MARKET IF MORE LOCAL MARKETS ARE NOT TRULY OPEN TO COMPETITION

Competitive LECs are suffering heavily because of the difficulties they have encountered entering local markets and the economic downturn. Over the past year, the CLEC industry has virtually collapsed. Numerous competitors, including Winstar, e.spire, Vectris, Jato, Prism, NETtel and many others, have declared bankruptcy or shut down operations. Even NorthPoint, which was widely considered the type of major competitive player created by the Act, is now defunct. For those that continue to struggle in operation, stock prices have plunged, and the capital market has virtually dried up. While telecommunications companies captured an average of two billion dollars per month in initial public offerings over the last 2 years, they raised only $76 million in IPOs in March of this year, leading numerous companies to withdraw their IPO plans.[2]

The difficulty in entering local markets has also caused nearly all competitors to scale back their plans to offer service. Covad, originally another success story, is closing down over 250 central offices, and will suspend applications for 500 more facilities. Rhythms has canceled plans to expand nationwide. Net2000 has put its

[2] *Telecom Meltdown*, Business Week [April 23, 2001.]

plans for expansion on hold. Numerous other competitors have resolved to focus on a few core markets. Each of these decisions has been accompanied by hundreds of eliminated jobs. CLECs dismissed over 13,000 employees in the last year-and-a-half, attempting to remain in business. While the ILECs conveniently dismiss the massive collapse of the CLEC industry as the result of "bad business plans," this cynical criticism clearly does not explain what has caused the failure of CLECs running the entire gamut of strategies, sizes, financial backing, and geographic location. In fact, what these companies had in common was their reliance on the promise of the 1996 Act for a fair chance to compete and the utter refusal of the incumbents to satisfy their statutory obligations to competitors.

The repercussions of the troubled CLEC industry on consumers are significant. CLECs reinvested most of their 2000 revenues in local network facilities. CLECs declaring bankruptcy in 2000 had planned to spend over $600 million on capital expenditures in 2001. Those competitive networks will not be available to consumers. Further, as CLECs leave the market, the incumbents raise their prices, and lose incentive to deploy advanced services.

REGULATORY RELIEF FOR THE INCUMBENT MONOPOLISTS IS UNWARRANTED

The incumbents argue for changes in the law that would repeal rules essential to local competition and remove the incentives put in the statute to encourage the incumbents to open their local markets. But relieving the ILECs of these obligations—such as unbundling loops—will only delay successful local competition by undermining the ability of competitors to offer DSL and other services.

Legislation pending in the House—H.R. 1542—would create broad exemptions from and limitations on the ILECs' unbundling and resale obligations for high-speed data facilities and services. This type of bill would deny customers the better value, greater innovation, and broader deployment of advanced services that only competition can deliver. In a direct reversal of the requirements of the 1996 Act, it would preserve, exclusively for the incumbent carriers, the economies of scale, scope, and density that they have built on the backs of the ratepayers as the sanctioned monopoly providers of local services for nearly a century.

It is clear that this price need not—and should not—be paid in order to encourage ILEC investment in broadband facilities. After sitting on DSL technology for 10 years, ILECs finally deployed it only in response to competitive offerings of CLECs and cable companies (and specifically AT&T). Verizon, for instance, will spend $18 billion this year on capital investment,[3] and SBC is spending more than $6 billion on its heavily promoted "Project Pronto."[4] Qwest will spend $9.5 billion this year to build out its facilities,[5] including a 1000-mile fiber optic network in the Detroit metro area over which it will offer high-speed service to business customers. BellSouth's Duane Ackerman has stated that BellSouth "invested over $33 billion . . . during the 1990s," and that BellSouth expects "total DSL revenue of approximately $225 million this year and $500 million in 2002."[6] Mr. Ackerman acknowledged that the regulatory challenges BellSouth is facing "are unlikely to slow down the momentum of the marketplace."[7] Contrary to the incumbents' complaints, the facts demonstrate that application of the 1996 Act's unbundling requirements has not been a deterrent to this extraordinary level of investment.

Further, these investments are producing significant revenue for the ILECs. While SBC threatens to cease deployment of advanced facilities in Illinois after a State regulatory decision allowing competitors access to SBC's fiber optic facilities, it simultaneously boasts to investors that "[t]he network efficiency improvements alone pay for this [Project Pronto] initiative, leaving SBC with a data network that will be second to none."[8] Beyond those savings, of course, SBC and the other ILECs will earn substantial revenues from the new services made possible by the deployment of advanced facilities. And when SBC makes advanced facilities available to competitors as unbundled network elements, they earn yet another revenue stream from competitors who must pay the costs of these elements plus a profit.

Nor is there any assurance that the incumbents would use the regulatory relief in H.R. 1542 to deploy broadband facilities any faster or to historically underserved areas like rural communities or inner cities. Their arguments that this bill will give them the incentive to bring high-speed access to rural areas ring particularly hollow

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[3] *Id.* 4. "SBC Communications," *Interactive Week* [June 4, 2001].
[4] "SBC Communications," *Interactive Week* [June 4, 2001.]
[5] "Running on Empty; Industry Trend or Event," *Communications Week International* [Mar. 5, 2001.]
[6] Duane Ackerman, *Talk Notes*, Salomon Smith Barney Conference [Jan. 9, 2001] at 7, 15.
[7] *Id.* At 11.
[8] *Id.* At 2; *see also www.sbc.com/data/network/0,2951,5,00.html.*

when you consider the fact that they are selling off many of their rural exchanges, and there is little evidence that the ILECs have used the last 5 years to extend broadband to unserved communities.

Indeed, the broadband deployment "requirement" added by the Commerce Committee's mark-up mandates *less deployment* than the Bells have already announced. It requires deployment to only 20 percent of incumbents' central offices within 1 year after enactment. By contrast, SBC currently can provide high speed service to more than *50 percent* of its customer base and has announced that it will deploy its "Project Pronto" to *80 percent* of its customers by the end of 2002. Verizon can currently provide high speed service to 47 percent of the company's access lines. *Even if these companies deploy no new facilities until 2003, they would still be in compliance with the bill's "buildout requirement."* Further, there is nothing in the bill that prevents the incumbents from selling exchanges to avoid the buildout requirements.[9] The amendment does not even include a provision, like the duty imposed on the cable industry, prohibiting the BOCs from denying access to their services based on the level of the residents' income.

Without the competitive spur of new entrants, the incumbents will slow the pace of deployment and raise prices for advanced services. Analysts at Yankee Group have observed that: With the majority of ILECs transitioning toward self-install models to improve provisioning time and reduce operating costs, the question that arises is: Why are DSL monthly prices increasing? The answer: The Return of the Monopoly. The downfall of DLECs such as NorthPoint effectively eliminated competition in the DSL market, leaving little motivation for the incumbent providers to maintain existing $40 per month price levels.[10]

Although incumbent local telephone companies argue that they should be relieved of the market-opening requirements of the 1996 Telecommunications Act because cable companies' broadband services are unregulated, that is simply not true. Cable companies face local franchising requirements, the payment of billions of dollars in annual franchise fees, and often must provide free service to local governments and schools. Local telephone companies face nothing similar. Cable companies also face the possibility of limits on the number of subscribers that they can serve, under a statutory scheme not applicable to local telephone companies. As noted above, cable companies also must provide access to their services without regard to the level of the residents' income. The incumbents, by contrast, can and likely will deploy broadband services where they stand to gain the biggest profits and avoid other communities that could greatly benefit from high-speed Internet access.

Congress chose, correctly, to regulate telephone and cable companies *differently* because telephone companies still dominate their core business while cable faces video competition from DBS and other providers. Only a tiny percentage of Americans actually have a choice for local phone service. By contrast, nearly everyone in the Nation has an alternative to cable for multichannel video. Since 1993, the share of the multichannel video programming marketplace held by cable's competitors has increased to 20 percent. The incumbent telephone companies' demand for deregulation in the name of "parity"—while their local markets remain closed—ignores the facts that led Congress to reject a similar proposal prior to the enactment of the 1996 Act.

More fundamentally, the proposed legislation is unnecessary because the BOCs themselves hold the key to obtaining the authority to provide any long distance service by opening their local markets to competitors. Verizon recently was granted permission under Section 271 of the Act to provide interLATA service in Massachusetts, in addition to its existing authority to provide interLATA service in New York. The FCC has also granted SBC approval to provide interLATA service in Texas, Kansas, and Oklahoma. Although AT&T believes that each of these Bell company applications fell short of what the Act requires in particular respects, it is clear that the requirements of Section 271 of the Act are attainable and can be met, if a Bell company takes steps to open its local markets to competition.

This is a particularly significant point because granting the Bell companies interLATA data relief would harm the very competition that Congress is seeking to promote. Congress' incentive-based approach takes full advantage of the long distance restriction to provide the Bell companies with a reason to open their local markets for the benefit of all consumers. And the ability to provide high speed data

[9] The benefits of the "buildout requirement" are illusory for two further reasons. First, the requirement can be met with the same satellite technology that is being used today by satellite providers in their existing offerings of highspeed services. Second, enforcement of the requirement is in all events subject to consideration of technical feasibility.

[10] Imran Khan, "Broadband Price Hike: Whatever Happened to Greater Choices and Lower Prices?," Yankee Group Research [May 22, 2001.]

services across LATA boundaries is a powerful incentive: currently, the majority of traffic traveling over long haul networks is data traffic, not voice, and analysts predict that data traffic will make up 90 percent of all traffic within 4 years.

Too much remains to be done for Congress now to remove or lessen the incentives provided by Section 271. The four Bell companies continue to dominate the local exchange market. CLECs account for less than 9 percent of the total local telecommunications market, and far less of the market for residential local telephone service.[11] By permitting Bell companies to enter the high speed interLATA data market without first opening their local markets, H.R. 1542 would substantially reduce the likelihood that this dominance will end.

VIGOROUS OVERSIGHT AND ENFORCEMENT IS NEEDED TO FINISH THE JOB STARTED IN 1996

What is needed today is not a weakening of the principles embodied in the 1996 Act, but rather vigorous oversight and enforcement of the Act's market-opening requirements. Congress should ensure that competitors have a forum in which complaints against incumbent LECs can be heard and addressed expeditiously. Where an incumbent is found to be in violation with its unbundling or interconnection obligations, there must be meaningful penalties and damages available to the competitor whose business is harmed by the incumbent's failure to comply.

Most importantly, Bell companies should be forced to create a clear structural separation between their wholesale and retail operations. At a minimum, this should be done if they continue to fail to meet their obligations under the 1996 Act. The arm that provides local-service elements for both the Bell company and its competitors needs to be a structurally separate organization. It is the only way to make competitive local service more than simply a vision. Pennsylvania has taken a courageous first step in this direction by ordering Verizon to engage in the "virtual structural separation" of its wholesale and retail local exchange businesses. True separate subsidiaries are a necessary precondition for a competitive local market. They help ensure that the Bells provide the same price and the same service to their competitors as to their colleagues. By improving a Bell company's incentive to act as a neutral wholesaler of services and facilities, and highlighting transactions between the parent and the affiliate, structural separation will require less regulation in the long run. And by putting all local service providers on an equal footing with respect to access to network elements, the success or failure of their business plans will be determined in the marketplace rather than through affiliation with the incumbent.

*Conclusion*

The CLEC industry is at a critical juncture. If we don't succeed now, it will be a long time before others are willing to invest the billions of dollars needed to try again. Rather than eliminate the obligations and most important incentive for the Bell companies to open their local markets, Congress should consider ways to make the process that it established in the 1996 Act more—and not less—effective. We remain optimistic that with the assurance of such dedication to its requirements, the promise of the 1996 Act can become reality. Thank you again for the chance to present our views.

The CHAIRMAN. Thank you.
Mr. Holland.

## STATEMENT OF ROYCE J. HOLLAND, CHAIRMAN AND CEO, ALLEGIANCE TELECOM, INC.

Mr. HOLLAND. Thank you, Mr. Chairman. I am Chairman and CEO of Allegiance Telecom. We are headquartered in Dallas, Texas. We operate in 32 markets across the United States and will be in 36 markets by the end of this year. Before starting Allegiance, I was President and Chief Operating Officer of MFS Communications Company, one of the first competitive access providers, and it was said quite often that we were the poster child for the 1996 Telecom Act.

[11] "Local Telephone Competition: Status as of December 31, 2000," [Federal Communications Commission, May 2001.]

Representing MFS, I testified before both the Senate and the House committees in 1995. I felt that Congress was on the right track in structuring what became the Telecom Act of 1996, and to this day I feel that it is one of the most significant pieces of commercial legislation passed by Congress since the early 1950s.

In 1995, I felt that the weakest part of the bill was its tepid enforcement provisions. This is because an incumbent carrier that merely failed to be responsive to requests of competitors for access to local bottlenecked facilities could kill competition by inaction as readily as by overt competitive practices. I will tell you, 4 years of battle scars out there competing in the market have done nothing to change that opinion.

I could spend the rest of the hearing reciting real world examples of the consequences to customers and competitors of poor enforcement and inadequate penalties. In the interest of time I will just hit two major ones. First, Allegiance's fastest growing product is an integrated voice-high speed Internet and web hosting service provided to small businesses that desire to update from dial-up Internet service and have a presence on the web. The bottleneck in providing these services is attaining the last mile, generally a T-1 tail circuit or DSL-qualified copper loop from the Bell company, which is the only feasible way to serve these small businesses in over 95 percent of the cases.

We have thousands of these small business customers that in many cases have been waiting over 2 months to have service installed due to the inability or unwillingness of the Bell company to provide the bottleneck local loop facility. Now, astoundingly enough, they can usually provide such a facility to their retail customers in a week or two.

We will lose at least half of these customers to our competitor—the Bell company, due to the incompetence or duplicity of our bottleneck supplier, also the Bell company. This is totally absurd.

Another malady that plagues the entire CLEC industry today is the deadbeat dominant carrier syndrome that has infected some of the Bells and their former parent, AT&T. By not paying their bills absent litigation or threat of litigation, these behemoths have used their market power to bully smaller players into untenable financial positions, thus muffling competition.

The FCC needs much more powerful medicines to effectively stamp out dominant deadbeat carrier syndrome. That is why I am so encouraged by Chairman Powell's recent statement that when companies break the law he will hurt them and he will hurt them bad. But the Chairman also said that his current authority is woefully inadequate to deter the frequency of the incumbent's poor performance. The Chairman needs a much bigger stick. I would like to highlight a few suggestions for provisioning the FCC with that bigger stick.

Number one, I would recommend the maximum fine of 1 percent of a company's quarterly revenues. The dominant carriers have quarterly revenues of $10 to $15 billion. A fine of $1 million, even $10 million, literally gets lost in the accounting accruals. A fine or the potential of a fine of $100 to $150 million, 1 percent, would impact quarterly earnings and set off alarm bells in the executive

suites and make obeying the law a much higher priority. I am a CEO; I know what gets my attention.

Number two, direct the FCC to adopt national performance standards, including penalties that are payable to CLECs as liquidated damages, as suggested by Congressman Markey, when the RBOCs fail to meet the standards.

Number three, adopt measures to combat that "deadbeat dad syndrome" from which dominant carriers like AT&T and its offspring seem to suffer.

Number four, significantly accelerate the enforcement cycle by authorizing the FCC to hire 25 special masters to speedily resolve complaints and severely restrict the abilities of the parties to unleash their lawyers to file numerous appeals of the masters.

Number five, as a last resort, if these enforcement initiatives do not get the job done and the anti-competitive abuses continue, Congress should authorize the FCC to require structural, or at least functional, separation of the RBOCs into wholesale and retail divisions.

In closing, I would also like to take a moment to comment on the debate going on in the House that we heard about today. I have listened to a lot of rhetoric about the need to deregulate the Bells so they will deploy broadband. Well, the truth of the matter is that the Telecom Act lets the Bells enter any market they want to out of region. SBC can build in Atlanta and BellSouth can build in Dallas totally free of regulation.

The Tauzin-Dingell legislation is not about encouraging deployment. It is simply about Bell companies wanting to preserve and extend their government-granted legacy monopoly. Nothing could be more anti-competitive or anti-consumer than this.

Stricter enforcement of the Telecom Act is essential if the promise of the Act is to be fulfilled. That requires, one, more enforcement powers for the FCC, but, two, the resources necessary to use those powers effectively.

Thank you, Mr. Chairman, for allowing me to testify.

[The prepared statement of Mr. Holland follows:]

PREPARED STATEMENT OF ROYCE J. HOLLAND, CHAIRMAN AND CEO, ALLEGIANCE TELECOM, INC.

Mr. Chairman and Members of the Committee, I am Royce J. Holland, Chairman and Chief Executive Officer of Allegiance Telecom, Inc. Allegiance is a facilities-based, competitive local exchange carrier (CLEC) headquartered in Dallas, Texas that offers the small and medium sized enterprise (SME) market a complete package of telecommunications services, including local, long distance, international calling, high-speed data transmission and advanced Internet services including high speed dedicated access, web hosting, virtual corporate intranets, and an E-commerce platform.

I appreciate this opportunity to testify before the Committee. I wish to address three of the most important issues facing my industry: fulfillment of the pro-competitive intent of the Telecommunications Act of 1996, effective enforcement of Congress' mandate to open telecommunications markets to competition, and national performance standards for incumbent local exchange carriers (ILECs).

Before I do so, let me provide the Committee with some background about Allegiance. Since its founding in 1997, Allegiance has expanded its operations to serve 32 markets across the country with almost 4,000 employees. We had revenues of $285 million in 2000, an increase of 188 percent over the prior year. And we expect to double that revenue again this year with projected revenue of approximately $550 million.

Allegiance has designed our networks using a “smart build” approach. We use a combination of our own network facilities, unbundled network elements leased from the incumbent telephone companies and, where it is available, fiber leased from third parties to provide service to small and medium sized businesses. To date we have installed more than 730,000 lines, approximately 90 percent of which are “on switch.” We have collocated in 636 incumbent local exchange carrier central offices across the nation, and when we add four more markets this year we will complete our current fully funded 36 market business plan.

Prior to co-founding Allegiance, I was President and co-founder of MFS Communications Co., one of the pioneers in the competitive local telephone industry even before the passage of the Telecommunications Act of 1996. MFS grew from a privately held startup operation to one of the Nasdaq 100 Index companies serving 52 markets in North America, Europe and Asia, with annual revenue of about $1 billion. At the time the Telecom Act was debated and passed, MFS was the leading competitive entrant in the local telecommunications market. MFS was purchased by WorldCom in 1996.

COMPETITION PRE-1996 TELECOM ACT

Six years ago, in my capacity as President and Chief Operating Officer of MFS Communications, I testified before the Senate Judiciary Committee and the House Telecommunications and Finance Subcommittee regarding the bills that were then pending that were ultimately enacted as the Telecommunications Act of 1996. I know what we went through then to get the bill passed, and I know what was at stake. We knew then that the Telecom Act was about transition—transition from regulated telephone monopolies to fullblown competition in the local exchange market. We knew that local competition would not happen overnight, but with the right conditions and legal requirements, market forces would break through the stone walls of the monopolies to allow competition to take root and flourish.

As you know, MFS was providing local exchange services in competition with the ILECs before passage of the Telecom Act. We knew first-hand what it was like to deal with entrenched monopolists that controlled bottleneck facilities. Before the Telecom Act, one of our goals was simply to be able to connect our network facilities with those of the incumbents so that our customers could make calls to their customers. This so-called “interconnection” of competing local networks was a radical departure from the past, and the Bell companies, most notably, were extremely reluctant to concede one inch of ground to upstart competitors like MFS. We knew that the Bell companies would not voluntarily do anything to help their competitors succeed, and they would resist legal requirements for network access every step of the way.

We knew the experiences of the Judge Greene court and the antitrust proceeding that broke up the old Bell System. We knew how hawkish oversight of monopolies in transition to competition was essential if competition in the long-distance market was to take hold. If competitors to AT&T’s monopoly over long distance services were ever to succeed, they needed conditions that would provide them, at a minimum, a level playing field with AT&T.

We knew how the Bell companies, dating back to the first decades of the century, would drive small telephone companies out of business simply by denying them the ability to connect their networks to the Bell network. Once those small companies failed, the Bell companies would seize their customers, seize their markets, and expand the Bell company’s own monopoly power.

More recently, we knew how at least one Bell company would charge MFS more than $100,000 for a 10-foot by 10-foot chain link enclosure to keep our equipment separate from its equipment in the Bell central office. Somehow those same exorbitant real estate rates were never reflected in the rates that the Bell companies charged their own customers. As a result, we knew that network elements and colocation had to be made available to competitors at cost—the Bell companies should have no pricing advantage simply because they were entrenched as incumbent carriers. The most critical element that competitors needed from the incumbent—access to the local loop—had to be provided at cost, on commercially viable terms, and within timeframes that the Bell company provided to itself. Unless competitors had a level playing field, unless we could compete with the Bells on the same terms that the Bell companies provided service to itself, there would be little hope for true competition.

In 1995, we tried to impress upon Congress the need for clear, strong language that would compel the Bell companies to open their markets to competitors. We attempted to impress upon you that the monopolist must be treated differently. With its market power and control over essential facilities, an incumbent that merely

failed to be responsive to the requests of competitors could kill competition as readily as with overt anticompetitive practices. The monopolist must be told in unambiguous language what it must do, when it must do it, and what would happen if it didn't do it. I testified in the Senate and the House that strong and effective follow-up enforcement and compliance provisions were needed in addition to a competitive checklist. As I said then, the competitive checklist approach alone would be like having a law which says that every car must contain an engine, four wheels, a transmission, brakes, and headlights, but does not require that these parts together enable the car to drive off the dealer's lot, let alone for a prescribed warranty period or shakedown cruise. I said we wanted a car that runs!

MFS's success proved that Congress created a car that runs. I left MFS after it was acquired by WorldCom and started up Allegiance with the view that the new markets created by the Telecom Act could support more competitors to the Bell companies. The car that is the competitive market certainly runs, but it could run better. While the Telecom Act began the transition to competitive markets, Congress and the FCC must make sure that the transition process is completed.

COMPETITION AS ENVISIONED BY THE 1996 TELECOM ACT

There has been a lot of frustration expressed over the slow development of local competition since the enactment of the Telecom Act. I share that frustration. But I think the blame is misdirected. It's important to review for a moment the framework of the 1996 Telecom Act in light of the 100-year head start enjoyed by the Bell companies. It is important to also note that the Telecom Act was about bringing competition to two markets that had no competitive choice: the small business market and the residential market. Prior to 1996, companies like MFS, were able to offer some level of competitive choice for the large corporate users. But Congress wisely recognized that facilities-based competition to the RBOCs could not occur overnight. Congress also wisely did not mandate a generic, industrywide business plan. Instead, the Act provided for three methods of competitive entry and relied on market forces to decide where and how that competition would emerge.

In essence, the 1996 Act envisioned competitive entry under three scenarios: (1) resale; (2) a combination of facilities and unbundled network elements; and (3) pure facilities-based entry. The only economically feasible entry method to serve the small business market and residential market is by the first two entry methods. The only long term economically feasible way to serve these markets is by a combination of network facilities and unbundled network elements, most importantly, the local loop. The pure facilities-based entry method is only viable for cable TV companies serving the residential market and for CLECs serving only the large corporate market. Since Allegiance Telecom specializes in serving the small and medium-sized business market, we based our entry on a combination of our own facilities and unbundled network elements that we lease from the ILEC.

Entry to a new market requires extensive planning and can be extremely time consuming. Let me outline the steps that Allegiance takes before it is prepared to begin service to customers in new markets. As you will see, any additional delay imposed by ILEC recalcitrance makes a difficult process even more arduous.

- First, Allegiance must file for and obtain authorization to provide local, intraLATA toll and long distance service from the State Public Utility Commission.
- Second, Allegiance must negotiate interconnection agreements with the incumbent LECs. If negotiations are unsuccessful, Allegiance must file an arbitration petition with the State Public Utility Commission to establish interconnection terms and conditions. An arbitration takes up to 9 months and can easily cost a hundred thousand dollars.
- Third, Allegiance must design the network and order the switch.
- Fourth, Allegiance must secure real estate for its switch site and sales office.
- Fifth, Allegiance must select the ILEC central offices where Allegiance needs to be colocated to serve customers, and then submit applications to the ILEC for colocation space. Colocation is essential because Allegiance uses the local loop unbundled network element provided by the ILEC, and Allegiance must have physical access to the local loop in the ILEC central office.
- Sixth, Allegiance must contact city and county Public Safety Administration Point (PSAP) jurisdictions for purposes of negotiating agreements and completing other tasks necessary to obtain authorization to provide 911 service.
- Seventh, Allegiance must apply to the North American Numbering Plan Administration for blocks of telephone numbers.
- Eighth, Allegiance must place orders with the ILEC for interconnection trunks, 911 trunks and operator services/directory assistance trunks.
- Ninth, Allegiance must order and install colocation equipment.

• Finally, Allegiance must update the Local Exchange Routing Guide (LERG) with our company-specific information. The LERG is an industry data base of carrier codes and routing information so that other carriers know how to route calls to and from Allegiance customers in the new market.

While Allegiance certainly analyzes the market for the likelihood of successful market entry before initiating the process, and solicits customers during the process, we still enter new markets without any guarantees that we will establish a customer base sufficient to justify the significant investment needed to provide service. As the above list illustrates, the risk associated with new market entry strongly depends on ILEC conduct and whether the ILEC provides essential services and facilities that Allegiance needs in a timely manner.

I am proud to say that the success of Allegiance's business model validates the foresight of the 1996 Act every day. And as our performance continues to improve every quarter—which it does—the benefits of the 1996 Act will continue to grow as well. Now is not the time to abandon those principles of competition, or the unbundled loop approach that makes our business possible. Instead, Congress and the FCC should ensure that CLECs can depend on ILEC compliance with the duties placed on them by the 1996 Act.

COMPETITION POST-1996 TELECOM ACT

The Telecom Act was one of the greatest pieces of commercial legislation of the last thirty years. For the first time in any of our lifetimes, it offered consumers the promise of a choice of local telephone service providers. No one expected that competitors would find it easy trying to break the monopoly strongholds controlled by the Regional Bell Operating Companies (RBOCs) and GTE. Nonetheless, 5 years after you so astutely determined that developments in technology and the public interest demanded that the government sanctioned protection for local telephone monopolies should be lifted, competitors have been able to capture a mere 8 percent of local telephone lines. In the residential market and small business market, the disparity is even greater—the RBOCs alone control over 140 million lines while CLECs have 8 million lines.

At the same time, the RBOCs and GTE have joined forces to increase their size and domination of the nation's local telephone market, with the former Bell Atlantic acquiring New York Telephone, New England Telephone and GTE to become the behemoth Verizon; and Southwestern Bell acquiring Pacific Telesis, Nevada Bell, Southern New England Telephone, and Ameritech. While Congress concluded that it would only be fair to open the long distance market to the RBOCs once they had opened their local markets to competitors and for that reason overrode the MFJ and Judge Greene's oversight of the RBOCs, an unfortunate byproduct of life without the MFJ has been the concentration of control of the nation's local telephone market in the hands of 4 megamonopolies, rather than the 8 that dominated the market in 1996. What this means for CLECs is that the Goliaths they must battle for both customers and network access have grown bigger, more powerful and more cocky about using their market power to keep their competitors at bay.

Take Verizon as an example. According to its Year 2000 Annual Report, the Verizon companies are the largest providers of wireline communications in the United States with nearly 109 million access lines in 67 of the top 100 US markets and 9 of the top 10. Verizon serves one-third of the nation's households, more than one-third of Fortune 500 company headquarters and the Federal Government. Verizon has proudly trumpeted to Wall Street that it lost 29 percent fewer lines to competitors in the second half of 2000 than it did in the first half of the year. Statistics like these demonstrate that further deregulation of the RBOCs is not appropriate, and indeed would be extremely detrimental to the struggling competitive industry, at this time. The increase in concentration of control of the nation's local access lines since the passage of the 1996 Act means that more, not less, regulatory enforcement is needed if the pro-competitive goals of the Act are to be realized.

In order to provide service to customers, CLECs need access to the networks and facilities of the incumbents, especially to the unbundled loops connecting customers to the network (also known as the last mile) and colocation space in the incumbents' central offices. In passing the Act, Congress recognized that competitors could not duplicate the ubiquitous facilities of the incumbents overnight and indeed that in most instances, the last mile could never be duplicated for the small business market and residential mass markets. Sections 251 and 252 provide CLECs with access to the interconnection, unbundled network elements, colocation and wholesale pricing that we need to get into the local telephone market, but the rights afforded by the Act are ephemeral unless they can be expeditiously enforced without expensive and drawn out litigation. Although CLECs are big customers of the RBOCs as pur-

chasers of interconnection trunks, colocation and UNEs, CLECs use those tools to compete for the same end users as the RBOCs. This inherent conflict between their roles as suppliers and competitors significantly diminishes the incentive the RBOCs have to open their markets.

To help ensure that local telephone competition becomes a reality for all American consumers, Congress must give the FCC the resources to implement a regulatory scheme that has certainty and an enforcement program that has teeth.

COMPETITION NEEDS STRONGER FCC ENFORCEMENT

The need for stepped-up enforcement is shown by the relative ineffectiveness of the major enforcement actions over the last year that the FCC took against RBOCs for flouting their local competitive obligations. By far the largest of these actions concluded nearly a year ago when GTE agreed to pay $2.7 million for openly flouting the collocation provisioning standards. In another proceeding, the FCC fined BellSouth for refusing to provide Covad with cost justification and other information in an interconnection proceeding. This conduct, the FCC found, constituted a breach of BellSouth's legal obligation under Section 251 to negotiate in good faith with requesting CLECs. The FCC, nonetheless, found that BellSouth's intransigence, which stymied competitive entry into the multi-billion dollar high speed services market, warranted a fine of $750,000, approximately one-half of the amount that the FCC could have assessed.

In December 2000, as finalized this past March, SBC was found to have "willfully" and repeatedly violated the service quality reporting obligations imposed by the FCC as a condition of the SBC-Ameritech merger. Specifically, SBC overstated the quality of service provided to CLECs for such important performance measures as timely Firm Order Confirmations, OSS order flow-through, the number and duration of provisioning delays, and the number of trouble reports. Most troubling, this data was used by the Oklahoma and Kansas Commissions as part of the basis for their respective endorsements of SBC's section 271 applications in those states. The FCC Enforcement Bureau assessed a woefully inadequate fine of only $88,000.

Similarly, this past January, the FCC Enforcement Bureau issued a Notice of Apparent Liability finding that SBC failed to comply with the FCC's collocation notice requirements. The consequences that SBC faces, however, are fairly trivial. Despite the Enforcement Bureau's detection of "numerous" violations—each punishable by a forfeiture of up to $110,000 per day—the Bureau proposed a forfeiture amount of only $94,500.

Although I commend the willingness and the ability of the FCC to identify and sanction the BOCs' actions that threaten competition, the penalties imposed are trivial for these huge companies. These fines are plainly insufficient to deter the BOCs' illegal and anticompetitive conduct. Additional authority and direction from Congress that it intends the FCC to impose greater penalties should serve as encouragement to the FCC to take more aggressive action against future violations. Given the relative laxness of enforcement of violations of the Telecom Act, the RBOCs must view FCC enforcement as the better course than actually complying with their statutory obligations. Paying the fines and continuing to discriminate against competitors remains a smart business decision when one considers the competitive advantages to be gained by the RBOCs as a result. We appreciate Chairman Powell's recognition that CLECs have often "been stymied by practices of incumbent local exchange carriers that appear designed to slow the development of local competition" and applaud his request for increased forfeiture authority.[1] But more is necessary.

The Commission's enforcement authority must be increased significantly to the point where the fine would significantly impact the quarterly financial results of an RBOC or AT&T. The FCC should be specifically directed to assess the fine based on the revenues of the offender. We recommend that the maximum penalty be leveled at 1 percent of a company's quarterly revenues. Such penalties would impact the quarterly financial reports of the offending party. That is the only way to really focus the attention of the RBOC's CEO and senior management to change the culture of the RBOC to abide by the spirit and letter of the law. If the FCC penalties do not impact the financial success of the company, then there will be no change in the company's behavior in its compliance with the law.

The FCC should also be authorized to require that all or a portion of a forfeiture assessed for violations of the Act or the FCC's rules be paid to the carriers injured

[1] May 4, 2001 letter from Chairman Michael K. Powell to the Members of the House and Senate Commerce and Appropriations Committees.

by the violations, rather than to the Treasury, in an amount sufficient to compensate them for the damages caused by the violations.

The FCC should also be encouraged by Congress to exercise its Cease and Desist Authority more readily. We have experienced several issues with RBOCs that we believe warrant Cease and Desist action. The RBOCs have the ability to thwart CLECs' efforts to attract and retain customers in a myriad of ways other than poor provisioning of the facilities needed to provide service. For example, one RBOC appeared to be engaged in a systematic attempt to thwart Allegiance's sales efforts by, among other things, calling our prospective customers after we submit orders to the RBOC to switch the customer's service to Allegiance and offering the customers a better deal if they cancel their orders with Allegiance. This campaign included the following specific actions:

- We learned from a customer who canceled his order with Allegiance before his service had been switched from an RBOC that its representative called him shortly after he signed on with Allegiance and offered to match Allegiance's rates. Section 222(b) of the Act prohibits carriers that receive proprietary information from another carrier from using such information for their own marketing purposes. The only way this RBOC could have learned of the customer's impending cancellation of service was through the order Allegiance submitted to it to convert the customer's service. This was not an isolated incident. During the fourth quarter of 2000 and the first quarter of this year, more than 10 percent of the customers who had signed up for Allegiance service in two large states served by this RBOC canceled their orders before their service was converted.
- We learned from another customer who called his RBOC to lift his PIC freeze so that he could switch his service to Allegiance that the RBOC's representative responded, "Are you sure you know what you are asking me to do? Let me fax you over a list of the problems Allegiance has caused and then you decide if you still want me to remove the freeze." The FCC has specifically determined that Section 222(b) prohibits a carrier executing a customer's request to change carriers from using such information to convince the customer not to make the switch. This has not stopped this particular RBOC.

Competition is clearly harmed where an RBOC exploits the advance notice of a customer's impending cancellation of service that it receives in its position as the underlying network facilities provider to market its own services and win the customer back. Such conduct is clearly prohibited by the Act. It is also not clear that carriers injured by such conduct have a private right of action for damages. To the extent that the FCC finds a carrier guilty of the misuse of carrier to carrier proprietary information and assesses a fine, it should be authorized to share a portion of that fine with the carrier injured by the violations.

Under the FCC's new slamming rules, carriers that receive allegations from customers that they have been slammed are required to notify the unauthorized carrier of the customers' allegations. All carriers are required to file a report with the FCC twice a year stating the number of slamming allegations made against them and whether the allegations were valid, as well as the number of slamming allegations they received against other carriers and the identity of those carriers. Since the notification rules have become effective, Allegiance has received a disproportionate number of slamming notifications from one RBOC in two of its service territory states. For example, during the week of April 23-27, 2001, 66 percent of the slamming notifications Allegiance received were generated by these RBOC subsidiaries. Almost every notification we have received from this RBOC bears the fax line of its General Business Services Win Back Group. The Win Back Group apparently takes a very liberal approach to the definition of a slam as we have learned when we contact the customers to investigate the slamming allegations and discover that a substantial majority are unfounded. This RBOC's Win Back Group seems to categorize any instance where a customer decides to return to it as a slam no matter what the circumstances. We have received slamming notifications on customers who have reported to us that they never told this RBOC they were slammed. We received one slamming notification from the same RBOC on a former customer who had called to complain about its bill *from that RBOC.*

Allegiance takes slamming very seriously and immediately terminates any employee found to have engaged in slamming. Allegiance does not believe, however, that the FCC intended for carriers to classify any instance where a customer elects to go back to its former carrier as a slam. The apparent abuse of the RBOC described above of the FCC's slamming notification rules has caused Allegiance to devote considerable staff time and resources to investigating allegations that have no basis. We have no means to recoup these resources. Again, to the extent that the Commission could assess substantial fines against carriers for such abuses, and

share a portion of those fines with the victimized CLECs, CLECs could be compensated for the damages they incur.

PROVIDE THE FCC WITH ADDITIONAL RESOURCES TO ADJUDICATE COMPLAINTS

Of course, it is easy for me to say that the FCC needs to do more to enforce the Telecom Act, but I know that it cannot do more unless it is given more resources. The threat of enforcement must be constant enough and the penalties for noncompliance must be high enough to effectively deter anticompetitive behavior. Congress should appropriate sufficient funds to enable the FCC to double the size of the Market Disputes Resolution Division of the Enforcement Bureau and to hire 25 special masters with relevant legal and industry experience to hear and adjudicate complaints between incumbents and competing carriers.

FCC MUST ENFORCE SECTION 251

Lax enforcement has encouraged a perception by some of the ILECs that compliance with Section 251 of the Act is somehow voluntary and only to be achieved in order to receive Section 271 authority to enter the inter-LATA market. The FCC has authority pursuant to Section 251 of the Act to resolve inter-carrier disputes and enforce interconnection agreements, statements of generally available terms and State tariff provisions that codify the RBOCs' obligations to provide interconnection, UNEs and colocation. While many State commissions have been vigilant in resolving interconnection disputes, the decisions have no precedential value outside of the State where the dispute was brought and the RBOCs often take the position that the decisions are applicable only to the parties to the dispute. For example, over the past several years, the Texas PUC has issued several decisions directing SBC to pay reciprocal compensation to CLECs. Despite these decisions, another RBOC has continued to resist its obligation to pay reciprocal compensation arguing that the PUC's rulings applied only to SBC. Even after the PUC issued a decision last fall specifically holding that the RBOC was subject to the same reciprocal compensation obligations as SBC, the RBOC has continued to withhold full payment of amounts owed to CLECs on the grounds that the decision applies only to the CLEC that brought the action.

The FCC has the authority to enforce compliance with section 251 and to decide interconnection disputes which would allow for the development of precedent that has nationwide applicability and would relieve CLECs of the financial burden of bringing multiple complaints against every RBOC in every State in which they operate. The substantial financial resources that are currently being diverted to litigating interconnection rights on a State by State basis could be far better spent by the CLECs on developing and expanding their networks.

AUTHORIZE THE FCC TO REQUIRE PAYMENT PENDING THE RESOLUTION OF BILLING DISPUTES AND TO AWARD PUNITIVE DAMAGES

One very effective method RBOCs have employed to harm their competitors is to withhold or delay payments of amounts owed and to resist or delay providing credit for amounts overcharged under interconnection agreements or tariffs. Allegiance has faced this situation time and again with the RBOCs. CLECs do not have the luxury of withholding payment as an offset to amounts owed or delaying payment to the RBOCs because the consequence of doing so is being cutoff and denied access to the essential facilities we need to provide service to our customers.

It is not only the RBOCs that have resorted to self-help to withhold payment to CLECs. CLECs all across the country have been forced to bring lawsuits against AT&T to collect payment of access charges for the use of their networks to originate and terminate the long distance calls of AT&T's customers. AT&T complained for years about the ILECs' access rates, but never withheld payment as it has done with the CLECs. The FCC repeatedly has ruled that carriers are not entitled to engage in self-help to withhold payment, but instead must pay amounts billed pursuant to tariff under protest and then bring an action to challenge the billings. Unfortunately, AT&T has ignored these rulings and continues to use the CLECs' networks to complete their customers' calls without payment, benefiting as it does from the delays involved as the complaint cases wend their way through the courts and the public utility commissions.

If the CLEC industry is to survive, CLECs must have access to a forum that can resolve payment disputes on an accelerated basis and that can provide relief while the actions are pending. Congress should require the FCC to hear complaints arising under interconnection agreements or tariffs on an expedited basis and authorize it to provide interim relief in the nature of "Deadbeat Dad" remedies. If one party to the dispute has failed to pay charges billed by the other party, the FCC should

require payment of the full amount billed within 30 days of the filing of the complaint unless the nonpaying party can show by clear and convincing evidence that the billing is fraudulent or otherwise invalid on its face. Such immediate relief, subject to true-up after a full hearing of the dispute, is necessary to remove the benefits the RBOCs and AT&T currently realize by delaying payment and depriving CLECs of the revenues necessary to fund their operations.

The Commission should also be given the necessary resources to process all such complaints under a revised Accelerated Docket. The FCC should be required to resolve disputes on the merits within 60 days of the filing of the complaints and should have the authority to grant all relief necessary to remedy violations of the agreement or tariff, including, but not limited to, injunctive relief, compensatory damages and punitive damages.

THE FCC SHOULD ADOPT PERFORMANCE STANDARDS AND REGULATIONS TO IMPLEMENT ITS 271 ENFORCEMENT AUTHORITY

For competition to survive, the FCC should adopt a comprehensive set of selfenforcing performance standards governing the provision of interconnection and unbundled network elements. While the carrot of entry into the long distance market provides some incentive for the RBOCs to provision interconnection and unbundled network elements at an acceptable level of performance in the months immediately prior to the filing of their Section 271 applications with the FCC, the performance standards they are required to meet vary State by state. In addition, the RBOCs have shown a proclivity to backslide once 271 relief has been granted and the carrot has been eaten. The penalties currently being assessed against incumbents have not proven sufficient in size to deter discriminatory and anticompetitive behavior as Allegiance can attest.

CLECs cannot succeed in the marketplace unless they can offer their customers a level of service comparable to what those customers can get from the RBOCs. National selfenforcing performance standards would create an invaluable tool for monitoring RBOC compliance with their obligations under the Act and detecting incidences of discriminatory behavior. The FCC should adopt minimum performance benchmarks, which RBOCs must meet in providing service to their CLEC customers with automatic monetary penalties to be paid to CLECs when the RBOCs' performance falls below the benchmarks.[2] To monitor compliance, the FCC should require the RBOCs to publish monthly performance statistics on a state-by-state basis for installation and maintenance of interconnection trunks, UNEs and any other services CLECS purchase. The performance reports should compare the intervals within which the RBOCs actually install and repair similar facilities for themselves, their retail customers and their affiliates and the intervals within which they provide such services for CLECs. The reports should also compare the frequency and duration of service outages suffered by the RBOCs' retail customers and those suffered by CLECs. If, over a 12 month period, the reports reveal a deterioration in service quality in any State in which they operate, the RBOCs should be required to show cause why their rates for interconnection and UNEs should not be reduced on a going forward basis by an amount proportionate to the deterioration in service quality.

In addition, the FCC should adopt rules that require RBOCs to provide automatic discounts on interconnection trunks, UNEs and special access services in any State where the actual installation and repair services they provide to CLECs are inferior to the services they provide to their retail customers and themselves. A sliding scale

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[2] Allegiance proposes, at a minimum, the following national performance standards: Firm Order Commitments (FOCs) and order rejections returned within 48 hours of order submission. FOCs should be complete and accurate when delivered and should identify all Circuit identification numbers, any potential facility issues, and working pair issues. Initial order rejects should also be complete and should identify all issues with the order as opposed to the ILECs' current practice of issuing serial rejects, each identifying only one issue at a time.

On-time delivery of facilities consistent with FOC date.

Where ILEC reports that facilities are unavailable to fill CLEC order, ILEC must provide accurate delivery date within 48 hours after receipt of clean Local Service Request (LSR) or Access Service Request (ASR).

Orders to augment trunk groups fulfilled in 14 days or less.

Mean Time to Repair (MTTR) 24 hours or less for all out of service conditions.

Timely and accurate notification of ILEC completion of CLEC colocation spaces and augments.

Provisioning intervals for unbundled loops and interoffice transport at parity with provisioning intervals for comparable retail products.

Mean Time Between Failure (MTBR) and repeat Trouble Tickets.

Updates to CFA data bases made within 24 hours.

Billing accuracy standards.

of discounts should be established based on frequency and extent of delays. For delays in installation of new services, the discounts would be applied to non-recurring charges. The RBOCs should not be permitted to assess any non-recurring charges for installation if service is not installed within the retail installation interval. For delays in repairing services, the discounts would apply to monthly recurring charges for the affected facilities. Self-enforcing penalties are imperative both because they will provide the right incentive for RBOCs to improve their performance and because CLECs receiving poor performance should not be required to pay full price.

The FCC should also adopt rules to implement the enforcement authority granted in Section 271(d) and to deter backsliding from compliance with the competitive checklist once the RBOCs are allowed into the long distance market. Such regulations should incorporate a range of penalties for violations of 271 and should include mandated rate reductions for wholesale services and network elements, suspension of 271 authority, the imposition of material fines and revocation of 271 authority.

CONGRESS SHOULD CONSIDER A REQUIREMENT FOR STRUCTURAL SEPARATION OF THE RBOCS

As I noted above, the RBOCs have the ability and the incentive to deny their competitors full, fair and nondiscriminatory access to their networks. If the increased penalties do not sufficiently alter their current anticompetitive behavior then I would suggest the only plausible solution at the end of the day would be for Congress to require structural, or at least functional, separation of the RBOCs' retail and wholesale operations. If the retail side of an RBOC's company was forced to purchase service for their customers under the same terms and conditions that CLECs are, the wholesale division would have significantly stronger incentives to improve provisioning and performance standards.

*Conclusion*

I testified in the Senate and the House when the Telecom Act was being considered, and I recall how we all expected the Telecom Act to unleash the power of competitive forces on the local telephone market. With access to the bottleneck facilities of the incumbents, in exchange for regulatory relief once their markets were open to robust competition, competitors would be able to provide new services at lower prices and with better quality. The incumbents would be forced to do likewise by the operation of market forces.

Looking back from 5 years out, the robust competition we expected then has been painstakingly slow to develop on a broad scale in the small business market and residential mass markets. I believe that this is due primarily to the lack of effective enforcement of the Telecom Act, caused by the FCC's limited resources and limited forfeiture authority. Despite good intentions, the FCC's enforcement authority, enforcement resources and cumbersome and bureaucratic processes are not geared to a dynamic competitive environment, and have facilitated the constant delays and violations of the Act by the RBOCs and AT&T.

Instead of invading each other's monopoly service territories and competing for each other's customers, the RBOCs have focused on combining their forces to form even larger monopolies. They have devoted scant effort to complying with Sections 251 and 252 of the Act. They have abused their dominant market power in many ways, including illegally withholding payments for exchange of traffic with CLECs. AT&T has also used its dominant position in the long distance market to favor the ILECs over new entrants in terms of paying its access bills, thereby causing significant financial harm to a number of CLECs.

The bottom line 5 years after passage of the Act is that (1) competitive choices are available to you if you are a large corporation; (2) far more often than not you remain at the whim of the local monopolist if you are a small or medium-sized business; and (3) most residential subscribers are still stuck with the same monopoly providers they had in 1996 for local phone and cable TV service, or the new owners who bought out those providers. There is nothing that Congress can do to make the reluctant monopolists (the RBOCs and AT&T) compete with each other. However, Congress can significantly improve the opportunity for competition to develop in the small business market and residential mass markets by arming the FCC with greatly increased enforcement powers, and by directing it to establish objective performance standards that can be enforced with meaningful penalties. I urge you to strengthen the FCC's enforcement powers to help ensure that as the RBOCs and AT&T get bigger, the strides made by CLECs in providing consumers with competitive choices are not reversed. It is imperative that Congress make the penalties for noncompliance with the Act steep enough to serve as a deterrent, and not just a cost of doing business for the monopoly providers.

The CHAIRMAN. Thank you.

I want to hold my Senators as long as I can. Max, let me yield to Senator Cleland.

Senator CLELAND. Thank you very much. I feel like I am watching live Atlanta wrestling here.

The CHAIRMAN. Yes, deadbeat dads, what is it, dominant deadbeats.

Senator CLELAND. Let me just say, I am an old Army signal officer and one of the things I learned in Vietnam was it did not matter what your obstacle was, the objective was to provide service. I mean, that is really where I come out. It does seem like that we have been focusing on the way to get to service rather than service itself. It does seem like we have been talking about whether we are deregulated or not regulated or whether deregulation is a good idea or a bad idea, whether competition is good or bad, whether people have access the consumers and so forth.

The truth of the matter is that in my State about two-thirds of the State is rural. We have about 100 counties there. There is plenty of access to consumers. Any of you want to come on down, we will be glad to take a tour and I will show you more consumers than you can shake a stick at, even a big stick.

Mr. Holland, we noticed that you are in Georgia, but you are in Atlanta. You are not in Fitzgerald. In Fitzgerald, Georgia, there is a community college there that is anxiously awaiting connectivity of any kind to connect up their little school to the Internet and the World Wide Web, because their goal is to move from a textile-based pine tree economy which is declining to a high tech, Internet global marketplace, and they are training information technology majors there. They just want to connect.

Over in LaGrange, Georgia, in Troop County, the founding fathers there 10 years ago decided to wire the whole town. This means public housing residents and everybody. I have been there. It is an amazing sight. They just want to connect.

So in the world of globalization connectivity is the key, service is the key. That is really what I would like to turn your attention to, not whether so much we are deregulated or whatever or we are competitive or whatever, but how do we get there.

Ms. Greene, I would like for you the tell me what plans you have, particularly in Georgia, that might be worthy of our attention here to overcome the digital divide, to get more people in play here, to get people, particularly in rural America, in the global marketplace.

It is interesting we talked about NASDAQ. NASDAQ just went under 2000 for the first time in a while. CLECs in my State are going broke. I mean, I think we focus on how to get there too much rather than the goal. The goal is service, how are we going to provide service to more people at a reasonable cost, and what is it about this whole question of universal service that we are not able to execute.

Ms. Greene first.

Ms. GREENE. Well, government has two proper roles to play in incenting deployment of technology. They can incent deployment of technology through putting proper economic incentives in place, because competitors—we are all running a business here. Competi-

tors will go where the money is. That is why you do not see competition going into the residential market for the most part. You do not see it going into the rural market for the most part.

A second role that government can play is to create investment incentives through tax credits. What has been done in the implementation of the 1996 Act is the role that government has tried to play is micromanagement and overregulation. What government needs to do is to put the correct incentives in place through proper pricing and then get out of the way or, some combination, government needs to put proper investment incentives through tax credits, as we have done in Georgia.

In Georgia, through a port tax we have been able to use some tax incentives to greatly expand our rollout of DSL. We take our responsibility to our rural areas—BellSouth is a very rural company. We take our responsibility seriously. We have plans right now to roll out DSL to 70 percent of our service territory and we are looking every day to find ways to make the technology more affordable, to find new investment avenues, and also to work with our States to create incentives.

I would like to take your point about service just one step further. BellSouth takes our service responsibility very seriously. Four out of the last 5 years we have gotten the J.D. Power Award for outstanding service. We are number one in customer loyalty from the Yankee Group. This year we were picked by the American Customer Satisfaction Index as the number one provider of telecommunications.

We take service responsibility very seriously. Penalties, we talked about penalties here over—the last three speakers talked about penalties. The biggest penalty—there are two big penalties in place for us today besides the Federal and the State level penalties that we pay both to government and CLECs. The biggest penalty that we have is any time we pay a fine, our customers read a headline that says BellSouth did not give them good service, and that is not in our best interest, it is not in our best competitive interest, and it is not consistent with our heritage, which is to be a premier service provider.

So that, coupled with the fact that we do not have access to a $14.2 billion revenue stream, which is long distance, those are both some pretty big penalties.

Senator CLELAND. Mr. McLeod, what are some of your plans to provide better service at lower cost, in rural areas particularly?

Mr. MCLEOD. We have taken an approach to deploying our network facilities on a regional basis. So as we build network through Iowa or Illinois, we connect up not only first tier markets, but second, third, and fourth tier markets. So that has been our plan, and we have now about 30,000 miles of fiber network that we either own or control in our area.

Now, of course in a marketplace where we have access to capital we can deploy network like that. In today's market we do not have access to capital. Basically, we have stopped the deployment of additional facilities of this type.

Even with those facilities that we have today, once we bring our fiber line into a community—and it might be a community of a thousand people or 5,000 people—we are still dependent on getting

access to that very last mile of connectivity, the copper line, if you will. In some cases it is a combination of fiber and copper.

On that last mile line, we can put high-speed Internet service. So the key to us is getting access to the last mile. So we have already interconnected hundreds of cities with fiber. The key is to get to the consumer, and that is what the 1996 Act was all about, the last mile.

In rural areas where you have small telephone companies now, there are really two areas. There are the areas covered by the Bell companies, 85 percent of the country, and then you have the small telcos, the co-ops, and so on and so forth. We have actually found in our markets a lot of the co-ops have done a very good job of deploying DSL services in their market and are not necessarily behind the rest of the areas. So where you have a monopoly, a local telephone company—and by the way, local small telephone companies are highly profitable. If you have ever looked at a P&L, they have money to invest.

So that smaller company, it is dependent on them to deploy some of those profits that they have. If you want to encourage it through tax incentives, tax incentives would be great for little telephone company monopolies and they would be great for large telephone company monopolies, but for the CLEC industry there is not one CLEC in the United States that is making a profit to offset taxes against, tax credits against. So in our case, incentives of some other sort is needed, at least in the near term, like our rates being too high that we are paying for that last mile connection and areas like this that will cause us to better serve these customers.

Senator CLELAND. Mr. Armstrong, can you tell us a bit about AT&T's plans for interconnectivity in a global marketplace?

Mr. ARMSTRONG. Yes, Senator, I will speak to that from a variety of technologies, since AT&T has been and is investing in several technologies to bring all forms of communications to consumers and business. I think first, of course, enforcing the Telecom Act is going to create the most competition out there across all the technologies.

I think, second, understanding the buildout plan so we do not go solve yesterday's problem when it is not tomorrow's problem. For example, we took a cable system that was analog broadcast video, just doing limited entertainment, and we converted it from low capacity to high capacity. We converted it from analog to digital and we converted it from broadcast to interactive so that it could do all voice, video, and data applications. We spent about $6 billion last year on that capital program to upgrade it across the country where we have the homes passed. We are spending $4.5 billion this year. As I testify this morning, we are about 74 percent of our homes passed complete, which means we can bring digital video and we can bring interactive data. We are going to be spending in 2002 and 2003, capital to complete that, so that in small towns, big towns, every town that we are in, where we can afford that we will be upgrading it to bring those services.

We are doing the same thing with fixed wireless. This is using bandwidth that could have been used for the mobile application, but in this case the fixed application, and we are deploying it in communities for both telephone service and online high-speed data

services as well. That will roll out over the next 4 to 5 years to pass some 11.5 million homes.

Also for the rural area, in my prior career with Hughes in the satellite business, when we implemented the DirecTV, we also implemented something called DirecPC. That enables a geosynchronous satellite with the same KU band transponder capacity to actually beam a broadcast signal down for download of Internet data of about 400 kilobits and using the backhaul of the telephone infrastructure so that they could reach all of rural America with a broadband solution.

But there still, to take your point, may be some who are underserved or not served at all. AT&T has been I think very supportive of universal service. We are, I think, the largest collector of that and pass it on. If the Congress deemed through any of the alternatives, to those that can be untouched in the future by broadband, that a policy change in subsidization, incentives, or tax breaks is necessary, we would support that as well.

Senator CLELAND. Thank you very much, sir.

Mr. Holland.

Mr. HOLLAND. Yes. Let me take a look at my home State of Texas, one that I am familiar with. I grew up in a small town there. In fact, my mother was the office manager for the small independent telco that operated in that town. It is something that I have always been very interested in. Texas is a State—and I know Illinois, where I have also lived, also is typical of this—where the 20/80 rule applies very well. The RBOC, in Texas SBC, serves about 80 percent of the population and about 20 percent of the land area. With the independents, the 80/20 rule works the other way.

In fact, you can get in your car in Austin, Texas, and drive to El Paso, which is 600 miles, and you pass through 10 miles of SBC territory through West Texas. Those are the rural regions that are very tough to serve. The further west you go, the more remote they are. As you get to New Mexico and Arizona, it is even worse.

We serve typically a lot of small schools, churches, barber shops, beauty parlors, retail stores, real estate brokerages, things like that. That is our bread and butter type customer. We do not serve the large customer.

To try to go into the rural areas, though, would be very difficult, not only for us but for SBC. For instance, the Tauzin-Dingell bill says that it is going to provide broadband deployment to rural areas. Well, SBC could go build, except for that one 10 miles around Fort Stockton, 600 miles of facilities where they are not the ILEC and have no regulation at all in the State of Texas in the independents' areas. That is not going to happen.

I agree with Congressman Markey, the only way to make that happen is really through tax credits, subsidies, through leveraging the buying power. I know this Committee was very instrumental in the Telecom Act of 1996. I think they got it right, because to a large extent they set up a system that protected a lot of the small independent telcos, which I fully agreed with. It prevented companies from going in and just taking the big industry or the school in town away from the independent telco and leaving everything else there. I think that was a good system.

But that is a barrier to anyone coming in there because you cannot interconnect. I think the tax credits, the subsidies, financial incentives—I have even suggested in Texas, where I am on the e-government task force, that the State of Texas use its buying power as one of the biggest telecom users in the State to attach conditions on its suppliers to go provide services to rural areas.

I really think the government has to play a big role in that area.

Senator CLELAND. Thank you all very much.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Dorgan.

Senator DORGAN. Mr. Chairman, thank you.

Mr. Holland, does your company market to individual telephone users in the home?

Mr. HOLLAND. To the home, no, sir. We serve small businesses. Over half of our customers are one-, two-, and three-line customers. That is, in fact, the most neglected part of the market today. The dynamics of serving that customer, of execution, are very similar to serving the one- or two- or three-line homeowners.

The problem gets down to the competitive landscape. When we go serve a small business, you know, the barber shop with two lines, we are competing against one monopoly. That is the telco, the ILEC. We have been able to do that successfully and have done quite well, and we have installed over 750,000 lines in the last 3 years.

If we go to the home with the same type of service, we have got to compete with two monopolies, the RBOC and the cable TV company. I will tell you every DSL player out there today has either gone bankrupt or has been given this going-concern tattoo on their forehead by their accountants, which puts you in the Chapter 11 waiting room, because they tried to go in, even in urban areas, and compete with those two behemoths and they got squeezed. It cannot be done without better enforcement. With better enforcement, you can go in and be successful. But it would take a lot better enforcement.

Senator DORGAN. Mr. Holland, I heard you say that and Mr. McLeod and Mr. Armstrong all talked about better enforcement. Let me ask about that for a minute.

Mr. McLeod, you said on page 6: “The Bell companies have successfully denied competitors equal access to their entire local network, both economic and functional.” I assume you take that complaint to the FCC repeatedly; is that correct? I mean, that is the referee here.

Mr. MCLEOD. Sure. I mean, we would take it to the State commissions and then go through a process there, and then eventually we could get to the FCC, where we would wait maybe a couple of years to be heard there. So yes, there is an administrative remedy, but it is very long and very involved. A rocket docket is a 2-year plan and not a 1-month plan.

Senator DORGAN. So back up 24 months from today and you have 24 months ago, you have a vista of new enterprises, new companies out there having access to the capital market with a great deal of new capital. They have got plans, they have got business plans that are exciting. They are going to go compete, right?

Twenty-four months later, to the extent that there are some left, they are hanging on by their financial fingertips. Many have fallen by the wayside. Many are in Chapter 11. Those that are left are hanging on by their fingertips. Mr. McLeod said they are not making profit at all, not a penny of profit. So what happened in the intervening 24 months?

Mr. MCLEOD. Two things happened, and it was not just a 24-month period. We actually began our expansion back in 1996. The two areas are, one, gaining access to that local network in an equal fashion to our competitor—let me give you an example. I have got one here that I want to just run through just to show you, not only functional access, but economic access.

We have a travel agency here last fall that wanted to move eight blocks, about 14 telephone lines, already a customer of ours in Illinois. We sent an order to the local telephone company, in this case SBC, and we get a firm order commitment from them. Now, that sounds like we are going to get something on a specific day. So we go to do the cutover on that specific day. The travel agency, who depends totally on telephone service, moves to the new facility.

On that day we are told by SBC that there are no facilities available. So we start the process of trying to hold onto this customer of ours, and the first thing we do is we go out and buy cell phones for all of the people in this operation and fund that, and we call-forward their old number into a cell phone.

Then we also have a policy of giving refunds to a customer that would be damaged. We paid the neighboring business to use one of their telephone lines in this case. Then we finally had a settlement with the customer—this is a $500-a-month customer—and 8 months later we have service from the local telephone company. We have paid $4,500 out of our own pocket just to keep this one customer.

Now, the problem is that we are supposed to have access to this customer or to this network to service these customers. If we can get access to that network, we can provide great telephone service to the customer. But this kind of access, the competitive industry cannot survive long.

Now, when the financial markets are wild and crazy and saying, 1996 Act, we are going to open up all of this to competition, sure they are going to pour funds into it. But then the footsie bill, the Tauzin-Dingell bill, came in last year and everybody started wondering whether or not the 1996 Act was going to be overturned. That was the start of it. There has been a study done to show the effect on people's stock prices every time the Tauzin-Dingell bill has been talked about.

So you have got inferior access going on through this whole period of time, and then you get the stock market nervous about Congress, and now the stock market is saying: "Make a profit, CLECs." Well, we will not make profits when we are making up $4,500 credits to customers that should be just typical small business barber shop kinds of customers. So we have an economic and a functional unequal access to that local network and we need to get that resolved through enforcement and mandating equal access.

The 1996 Act is just fine.

Senator DORGAN. Mr. Chairman, Mr. McLeod told a fascinating story here. I will follow up with you later about what you did with respect to that specific situation. I understand all of you have talked about the need for enforcement and I think you will find Members of Congress, and perhaps the Chairman and myself and others, sympathetic to wanting to do something that is real with respect to enforcement.

Mr. MCLEOD. Can I just add one thing to that? During that same year, SBC was fined $60 million in this same State for some of these same kinds of occurrences. Of course, we are one of the damaged parties. We got none of it. So there were penalties in this case, but in this case, the Bell companies viewed it as a cost of doing business.

Senator DORGAN. I would like to ask a brief question.

Ms. Greene, you said it was your company's intention to build out advanced services to 70 percent of your territory. I am wondering whether that is like the Blackberry, Palm VII, who say they serve 94 percent of America, but you cannot operate them in North Dakota. They are talking about population versus territory.

A substantial amount of the territory of this country is not territory where you can carry a Blackberry and get that kind of service. But they still advertise that they are somewhere in over 90 percent of the territory. Tell me about the 70 percent?

Ms. GREENE. We have actual plans to equip 70 percent of our lines, so it will be an actual retrofitting of the line to be able to carry DSL. Our goal is, of course, to achieve as close to 100 percent as we can, because we view that as our responsibility and ultimately it lets us build a platform that creates economic growth for everybody.

We do not have the financial wherewithal right now to see our way clear to building out to 100 percent. But something about this Act is working and I think that Mr. McLeod tells an interesting story, but I have got a couple of charts here that, if I could just show you a second. You know, we are hearing a lot about the demise of the CLEC industry and Mr. McLeod said, we will all be dead by the time it really takes off.

To show you these charts, just to really show you the slope of the line, even though we are talking about the CLEC industry being under duress, if you look at the slopes on those lines, which is the number of operational CLECs and also the number of CLEC facility-based lines, those are pretty steep curves.

I think what you are seeing here in this marketplace is you are seeing a huge technology challenge. A lot of the money that we could have spent equipping DSL we have had to spend on retrofitting our network to be able to break our network up into pieces and to do things that it was never designed to do. Our network was built to serve a telephone number that was identified with a specific geography. Now it has to be made available to competitors and the telephone number goes with the specific person and not with the specific geography.

We have had to totally rebuild our systems to do that. What I think you see in the slope of that line is not that we are finally getting around—or we have got the threat of penalties. What you see in the slope of that line is we have done the heavy lifting that

it takes to make our network do something that it was never designed to do.

We look forward to when we have made that investment and we can then turn our attention to deploying DSL lines.

Mr. HOLLAND. Senator Dorgan, could I just add something to what Ms. Greene said? One thing I have heard a lot of the ILECs talk about, especially the RBOCs, was they are going to do this and that and we are going to build this amount of population and that and so forth. What I have never heard them say is: We are going to go out of territory where we cannot leverage the monopoly to do that. Like BellSouth could have been in North Dakota 4 years ago building anywhere it wanted to with absolutely no regulation whatsoever. It could have found out what it was like to be a CLEC.

Despite the number of lines increasing, this time last year there were about 45 publicly held players—CLECs, DLECs, ISPs, that type of thing. Today most of the Wall Street analysts will tell you that Clark, myself, and Time Warner Telecom and a handful of others will probably survive the shakeout, probably less than ten.

In fact, since last July between 15 and 20 emerging telecom providers have gone bankrupt, representing $35 billion of invested capital. That is not market cap. That is actual checks written and put into play.

Now, a lot of these wounds were self-inflicted. There were a lot of bad business plans. There was a lot of poor execution. Some of them tried to bite off more than they could chew financially. But the intransigence of the incumbent telcos in complying with the law and implementing the Telecom Act and the inability, unwillingness and lack of tools of the regulators to act as policemen and make them obey the law and give competitors the same access to the local bottleneck facilities as they provide to themselves, equal parity or equal access, as Clark says, has produced that problem.

The ILECs should walk in our shoes before they start talking about what a bed of roses it is.

Senator DORGAN. Mr. Armstrong, one of the interesting sagas of recent years has been to watch AT&T. You took a big old sleepy company and gave it an industrial strength vitamin B-12 shot, and we are not where all of this takes you and it. But it has been a very interesting thing to watch. The population of companies and entrepreneurs and interests to get into this business and do interesting things goes from the very small to the very large. Mr. Holland, in fact, calls you a behemoth.

So tell me, if you will, from the perspective of a very large company involved in this issue, as opposed to Mr. Holland and Mr. McLeod that are smaller—well, Mr. McLeod is a pretty good-sized operation these days in our part of the country. But give me your perspective from a very large company doing business in the same set of circumstances. You have all of the issues dealing with opening the systems and trying to deal with the FCC and the local regulators and so on. Give me your perspective on what is happening here.

Mr. ARMSTRONG. Senator, I would be happy to. Three-and-a-half years ago when I started this journey with AT&T, we quickly realized that we were left with the remnants of Judge Greene's order, as Congressman Markey was so eloquent in describing. That is, the

middle of the phone call, a thing called long distance. It was never born out of the marketplace, regulation, or legislation. It was born out of Judge Greene's breakup of the Bell System in 1984.

It was not a bad place to be. We got to be kind of a behemoth. But two things happened along the way. The first is that the networks went from analog to digital, and that meant the whole access regime that was really the predicate of the Judge's decision, regulated monopolies originating and terminating and having something in the middle be an industry or a market called long distance.

And of course, the Telecom Act, which then set a 14-point checklist, can a LEC, the originators and terminators, complete the call.

So we set out to do two things. One is to rebuild and transform our company by transforming three networks: a wireless network, a data network that would not only be domestic, but global, and a cable infrastructure that would make a fiber infrastructure. That was the first challenge.

The second challenge is we had 60 million consumer long distance customers, and what they engaged with us was long distance and it was going to go away, because completing the call is the natural act, whether it's a technology statement, a human statement, or a cost statement, connecting the call, completing the call.

So we had to have access to the only thing that connected our 60 million long distance customers, the twisted copper pair local loop. The enforcement and interpretation of the Telecom Act of 1996 was fundamental to AT&T being able to connect the call, to complete the call, because that is all that connected our 60 million ubiquitous customers throughout the United States.

We started it—this is our third foray. We started it back in 1997 with a thing called TSR. That was Total Services Resale, which was taking a platform from the Bells in six States and reselling it. After 6 months, we shut it down because we had gotten 400,000 orders and after 6 months had only been able to provision 200,000 of them. We had to incent the other 200,000 to go back to the Bells because we just could not get them through the Bell systems. We shut down the operation. It cost us $3.2 billion.

Then New York opened and we pleaded with the commission as well as the FCC that it was not operationally ready, nor was it economically viable, for UNEP, Unbundled Network Element Platform or Loop. It still was enacted. We showed up. It was important for three reasons: one, to prove, to demonstrate to this town as well as to this country, that if a market opened AT&T would provide consumer choice and competition in that market for local exchange service.

The second reason is that we could take share, that the choice would not be just showing up, it would also be taking share.

Third, to demonstrate that it was not economically or operationally viable.

Unfortunately, we proved all three. We have about 800,000 customers. We lost several hundred million dollars. We have stopped our marketing activities. No one is showing up of other significance in other markets, however, that are opening.

Mr. Markey's market of Massachusetts, nobody of significance has shown up. In Oklahoma and Kansas, nobody of significance has

shown up. Why? Because we know we will lose lots of money if we go in there under the conditions that are being presented. It is not being interpreted or being enforced to be either operationally or economically viable.

Now we have just bought $135 million worth of Northpoint assets to co-locate in 1900 local service offices for DSL, and Tauzin-Dingell would like to take the loop back so that nobody can provision broadband services competitively.

So our experience, Senator, has been from 1997 attempting with TSR and losing billions of dollars, to the UNI situation today, to the DSL situation tomorrow. This Act can work with the right interpretation and enforcement.

Senator DORGAN. Mr. Chairman, you have been very patient. If I have other questions I will submit them to the panel.

Thank you very much.

The CHAIRMAN. Very good.

Ms. Greene, Mr. Holland says that BellSouth can go to North Dakota without any regulation or restriction whatsoever, a totally open market, no 1996 Act or anything else, no 271.

You are ready, willing and able according to the law. Why have you not gone to North Dakota?

Ms. GREENE. Because we choose to invest our money in our home territory of the nine States that we serve. We had invested——

The CHAIRMAN. Well, wait a minute. Now, you are in some 7 or 11 countries. When I go to Buenos Aires, they congratulate me on my company making a heck of a lot of money down there in Buenos Aires. I get up to Lima, Peru, they congratulate me. You can get down to Peru and Argentina and these other countries, but you cannot get to North Dakota?

Ms. GREENE. Well, why am I not surprised that we have ended up at this point? Let me talk a little bit about the amount of money that we invest in BellSouth. Last year we invested $5.5 billion in our nine States.

The CHAIRMAN. How much money have you invested overseas?

I am paying the rate down in my home, the BellSouth rate. Are my profits that you make from my paying the rate going to Argentina, Mexico, New Zealand?

Ms. GREENE. Actually, we have invested more in South Carolina over the last 4 years than we invested last year in Latin America. That is in South Carolina alone. In addition to that, we have invested 165 percent of the net income of our domestic communications group back in domestic communications.

The CHAIRMAN. But you are regulated in South Carolina, but you are not regulated in North Dakota. Why do you not go to North Dakota?

Ms. GREENE. Because there is not enough money to build out a network everywhere that we go—everywhere in this country.

The CHAIRMAN. But there is enough money to build a network out down in Buenos Aires?

Ms. GREENE. Well, we would like to serve our customers with DSL and we would like to make sure that we are honoring 251 and 271 of the Act, and that is how we have chosen to spend our money.

The CHAIRMAN. Well now, you say regulatory uncertainty. You know, that sort of gets me, because you wrote it. It is just like Plato's famous couplet: "The politician makes his own little laws and sits attentive to his own applause."

Here you write the regulation and then you talk about the uncertainty of it, and that you are trying not to block all these court proceedings and everything else, but trying to understand the checklist. Is it not a fact that Senators McCain and Brownback asked for interpretation and then when they get it out of the FCC you say the 14-point checklist has expanded to 600, 800, 1,000, 1100? It has not been expanded.

Telecommunications is highly technical, very complex, and you can paint any kind of picture you want. But we understand and know, you wrote the 14-point checklist. There was no difficulty understanding at the time that you wrote it and said, "vote on it." You asked me to support it.

Ms. GREENE. I think what we have to do here is to separate the implementation of the Act with the Act itself. The Act was clearly designed and was tightly woven to put forward a balanced platform. When the Act was implemented—I will give you an example of what happened. When the Act was implemented back in 1996, there were at that point about a dozen piece parts of our network. Today we are up over 300 piece parts that our network has been broken into.

The uncertainty that Tauzin-Dingell seeks to clarify is how the FCC's authority about how many piece parts it needs to break the network into is unbridled and unclear. When the FCC itself tried to scale back its breaking up the network, they did so in SBC's merger, the court told them: No, there is no real authority under the Act for you to restrict your actions in this way.

So what Tauzin-Dingell would seek to do is to give clear policy direction to the FCC about what they can and cannot do to facilitate broadband services going forward.

The 14-point checklist—actually, the 1100, 1800, 600, whatever you want to call it, it does not make any difference. Those different categories have come in under four of the points under the checklist. So when we came out of South Carolina, when we came out of Louisiana seeking to provide long distance and felt we had opened up our network, the reaction we got back from the FCC was: No, in these four areas we want to break those down into thousands more subparts.

That is not the fault of the Act. It is the fault of incomplete implementation of the Act.

The CHAIRMAN. Well, the implementation has got to be done by the company itself. It cannot be done by the FCC. In fact, I followed your application. I was interested in BellSouth and, in fact having been one of the principal authors of the Act itself back in 1996, I thought it would be fine if my own RBOC could comply. I learned from the FCC that the public service commission order was 69 pages practically word for word as a typical order, a model order that you submitted at the time, and of course the PSC signed it.

Legally it sounded pretty, but you did not have actual substance. That is why you were refused. It did not have anything about the implementation and the uncertainty.

But let us get to the confiscatory pricing. You took that all the way to the Supreme Court. The *Business Week* schedule showed last year BellSouth increased their profits 22 percent, and the court refused this confiscatory pricing that you are talking about, like you are being penalized or going out of business.

Ms. GREENE. Well, actually it is still pending at the Supreme Court. The whole issue about TELRIC pricing is still pending at the Supreme Court, and we did win that pricing at a lower court on appeal because the court said that the way the FCC implemented the Act, they looked at a hypothetical network and not at an actual network and that that was not appropriate to do.

The CHAIRMAN. Why is it being appealed to the Supreme Court if you have won it?

Ms. GREENE. Well, we are not the only—there are two sides and one side does not like what has happened here.

The point being, I mean if you just step back and look at hypothetical pricing, what happened is that the FCC took our network, which was a legacy network that was designed in a cost-plus environment, and they transformed us on paper into being the most fleet, efficient competitor. How can companies like—one of the big mysteries to me in this whole policy debate is how companies like Mr. Holland's or Mr. McLeod's can view that as being a positive situation for themselves, where our network is priced at a cost that is so low, no matter how modern a network they build, they are not going to be able to effectively compete with us on a price basis.

The CHAIRMAN. It has been now 5 years of courts, appeals, rulings, and yet very little compliance over the entire country. For example, in Pennsylvania they said what we need to do is have some restructuring, operational restructuring, not to have separate subsidiaries. When we wrote the 1996 Act we required a separate subsidiary for manufacture.

Rather than arguing about the price and everything else like that, what is the matter with listing your wholesale price and your resale price separately?

Ms. GREENE. Well, sir, we do list our wholesale price and our retail price separately today. Structural separation——

The CHAIRMAN. Wait a minute. Let me understand that, because I have heard differently. I can come and look at the BellSouth books and find out how much you wholesale to BellSouth and how much you wholesale, let us say, to a CLEC like Mr. McLeod?

Ms. GREENE. Let me give you a couple of examples, because I have some actual pricing. All of our rates are published and all of our rates are set by regulators. Our retail rates are set by regulators, our wholesale rates are set by regulators.

In Columbia, South Carolina, for example, the FCC has determined and the State PSC has determined that the rate that competitors are going to pay in Columbia is $18.48. They have set our retail rate for business customers at $42.75. The $24 difference there is known to our competitors and known to our customers, and that is why all the competitors are flocking to the business market, because they know exactly what their wholesale price is, they know exactly what our retail price is. They also know exactly how close to parity we are giving them in how we are treating them from a service standpoint compared to our retail, because we have to re-

port 1800 measures disaggregated by CLEC, posted to the Internet, fines assessed already by each of our State jurisdictions against our performance.

Structural separation is an answer looking for a problem. There is not a problem today that requires structural separation.

The CHAIRMAN. Therefore you would not object to a functional separation or a requirement thereof?

Ms. GREENE. Sir, we operate under functional separation today. This detailed checklist and report card that we have in each of our States serve as functional separation.

The CHAIRMAN. So you would not object to it, since you are already doing it, I take it?

Ms. GREENE. Structural separation, mandated separate structural separation, does nothing but drive up costs for consumers. So the devil is in the details. Today we functionally offer parity and functionally separate out our networks. To have that structurally mandated or legislatively mandated we would disagree with, because the ultimate person that gets cheated out of that is the consumer.

The CHAIRMAN. Well, I appreciate it. The Committee really is indebted to each of you for your appearance this morning. I am sorry that we have not had more of the Senators present because, as I explained earlier, we do not have roll calls today and so they are doing a lot of work at home.

Thank you all very much. The record will be open for questions and any other comments that you folks might want to add. Thank you a lot.

We will now go to the final panel: Mr. David Rolka of Rhoads & Sinon; Mr. Gene Kimmelman of the Consumers Union; and Senator Dave Sullivan of the State of Illinois.

[Pause.]

The CHAIRMAN. Let us have a little order, please. We will start again from left to right, or your right to left.

Mr. Rolka of Rhoads & Sinon, we are glad to hear from you, sir.

**STATEMENT OF DAVID W. ROLKA, SENIOR VICE PRESIDENT, RHOADS & SINON GROUP LLC**

Mr. ROLKA. Good morning, Mr. Chairman. It is really a privilege and an honor for me to be here this morning, and I commend you for your patience and endurance in weathering through these arguments.

I guess I should introduce myself a little. I am one of those viruses from the Petri dish of State regulation. I was a public utility commissioner for two terms. I was unanimously confirmed by my State Senate to participate in these decisions as they have all evolved. I am now with a consulting firm located in Harrisburg and I continue to enjoy the opportunity to provide services to my former colleagues in the States, advising them on cases and working on such things as universal service administration.

Contrary to some rumors that reach me in Harrisburg, I do not have as a client AT&T. I never have. I have refused some entrees they have made to me to provide services and do some work for them. I am here at my own expense and I have taken three-and-

a-half days out of my otherwise consulting schedule to be here, and I really appreciate the opportunity to be here and to do this.

The CHAIRMAN. Well, that is just to your credit, because he has just been described as a dominant deadbeat dad, so I would not be associated with him either.

[Laughter.]

Mr. ROLKA. I am not here on behalf of NARUC, the organization of commissioners. But having sat here for the morning with you and listened to the things that the other people have testified to before you, I would encourage you—and hopefully the testimony has whetted your appetite—to hear from some of my current colleagues in the field of regulation at the State level, to hear about what is actually going on in at the States in terms of implementing the Telecom Act.

I know I am invited here to talk a little bit about my experience in Pennsylvania that occurred over the last year. As you have mentioned several times during the testimony, Pennsylvania did embark on the exercise of trying to structurally separate Verizon of Pennsylvania. I have submitted for the record a lengthy prepared statement. I encourage your colleagues to——

The CHAIRMAN. I will ask each of the witnesses please—the full statements will be included in the record and I ask each of the three to summarize. Thank you.

Mr. ROLKA. Pennsylvania clearly was frustrated at the lack of progress in opening the local communications markets to competition. The responsibility to open the local markets to competition is an obligation that predates TA-96 and it is not an obligation in Pennsylvania that is conditioned on the success or failure of Verizon to get into the long distance market.

Structural separations for the dominant service provider, with an inherent incentive to discriminate against its competitors in order to preserve or expand its own market share, represented the only rational choice to compel Verizon of Pennsylvania to comply with the nondiscriminatory provisions of the State law and the Federal law in Pennsylvania.

The commission found in the global proceeding that the non-structural remedy proposed by Verizon would be less effective in preventing market power abuses and more costly to enforce. Structural separations provides a bright-line demarcation point between the retail and the wholesale activities of the incumbent. While ongoing oversight of these contractual requirements would be required, the structurally separate relationship of these entities would make it much easier to police and to oversee.

The commission staff is accustomed to and well qualified to monitor the implementation of this contractual arm's length relationship and division of responsibilities between the wholesale and retail operations of the company.

In contrast non-structural separations enables the incumbent to continue to bundle its retail and its wholesale services and functions and makes it much harder to enforce any code of conduct that the commission indisputably must prescribe in either situation.

Inappropriate conduct, should it emerge under the structurally separate relationship, would be easier to detect, sanction, and correct. Nonetheless, the commission decided in March, and issued an

order again in April of this year, to require Verizon to undertake a functional structural separation rather than full structural separation. While, in my opinion, full structural separation represents the best course of action, the commission's decision sets forth a number of measures that it intends to undertake in order to put in place non-structural competitive safeguards and a code of conduct to govern Verizon's wholesale and retail relationships.

The PUC claimed that the expeditious implementation of functional separation would be more worthwhile than compelling structural separation followed by the inevitable litigation and regulatory micromanagement stemming from functional separations. In my view, the commission reinterpreted the concept of regulatory efficiency, failed to appreciate that the implementation of its current plan will not be expeditious, and condemned itself to ongoing regulatory oversight, for which it is poorly equipped, and will inevitably continue to face protracted litigation.

The key to the commission's decision, a stringent code of conduct and competitive safeguards, have not yet been defined and must be addressed in another ongoing rulemaking proceeding. The fact that Verizon continues to argue that forcing its retail operations to function similarly to all other CLECs is inefficient and that it imposes additional costs on its customers demonstrates very clearly that the two functional divisions that it wants to set up, one for itself and another for the competitors, that it proposes to handle its retail competitors, are not equal.

Structural separation is not the wildly expensive, draconian blood-letting of a regulatory agency run amok that Verizon has depicted to the public, to the legislature, and to the courts. Unlike divestiture, which is used to remedy anti-competitive behavior and which requires certain lines of business to be sold, structural separation is a less sweeping vaccination that leaves the company free to engage in the activities at issue.

Structural separation is the best mechanism for ensuring nondiscriminatory access to interconnection, resale, unbundled network elements, and it will reduce the regulatory oversight and the resources needed by the regulator to monitor and enforce the rules that it will have to use to implement the code.

As I sat here, I made a few notes of things other people talked about. The first thing I wanted to point out to you as you are looking for solutions to address the deployment in rural areas. Pennsylvania, several years before the passage of Telecom Act of 1996—and I guess I am guilty, guilty of liking my own cooking here—passed its own law that traded alternative forms of regulation for a network deployment scheme, and in that scheme we mandated as part of our tradeoff that deployment would be balanced across urban and rural and suburban areas of our State.

There were no ceilings, no limitations on the pace. Bell could, if it chose, race ahead in any of those regions to do its deployment, but it was obligated after it specified where it wanted to go to meet the minimum targets of deployment in the rural areas.

They have repetitively, despite things they have said here in Washington, reported to the legislature and to the commission in Pennsylvania that they are on target for meeting those deployment schedules, that they are able to deploy broadband services in Penn-

sylvania without the relief that would be afforded by Tauzin-Dingell. In my opinion, the Tauzin-Dingell bill would not only have the adverse consequences that many of my former colleagues in the States have identified, but it would seriously, very seriously, undermine the ability of universal service programs currently in place to continue in operations and it would seriously jeopardize the ability to roll out provisions of service in high-cost areas of this country.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Rolka follows:]

PREPARED STATEMENT OF DAVID W. ROLKA, SENIOR VICE PRESIDENT, RHOADS & SINON GROUP LLC

Mr. Chairman and Members of the Committee. My name is David W. Rolka, Senior Vice President of Rhoads & Sinon LLC, a consulting firm located in Harrisburg, Pennsylvania. Prior to joining the consulting firm of Rhoads & Sinon LLC, I served as a member of the Pennsylvania Public Utility Commission (December 1989—September 30, 1999). During my tenure at the Commission, I co-sponsored the motion, adopted by the Commission, which among other things, directed Bell Atlantic-Pennsylvania, Inc., (VZ-PA) to file a plan that creates a structurally separate affiliate to supply retail telecommunications services.

It was our conclusion [1] that structural separation of retail and wholesale operations is the most efficient tool to ensure the successful development of fair and nondiscriminatory local telephone competition. Following on our state's successful implementation of electric competition, we found that the division of retail and wholesale operations is particularly necessary where a large incumbent monopoly controls the vast majority—around 90 percent at the time of the vote—of local exchange access lines in its service territory. Equally important, VZ-PA continues to control bottleneck facilities that competitors must have fair and nondiscriminatory access to in order to compete, in virtually all local exchange markets where it currently operates.[2] The overwhelming competitive presence and concomitant ability to exercise market power, including the ability to provide itself with anti-competitive, preferential treatment and cross-subsidies, and the corresponding opportunity and incentive to discriminate against competing telecommunications carriers in the provision of wholesale services, strongly supports the Commission's conclusion in September 1999 that structural separation is necessary to provide the local service competition envisioned under State law (Chapter 30, of the PA Public Utility Code) and TA-96.[3]

It is a privilege and an honor to be invited to present this testimony to the U.S. Senate Committee on Commerce, Science, and Transportation today.

## I. INTRODUCTION: A CHANGED PARADIGM

During most of the 20th century, local telephone service has been treated as a natural monopoly. That paradigm changed in Pennsylvania in 1993, with the enactment of Chapter 30 of the Public Utility Code, *66 Pa.C.S. §§3001-3009.* Pursuant to Chapter 30 of the Code*, 66 PA.C.S. §3009,* the Commission approved four consolidated applications to provide competitive local exchange service *in Application of MFS Intelenet of Pa., et al*., *Docket No. A-310203F002, et al. (October 4, 1995)(MFS-I).* These applications represented the first efforts at competition in the local exchange market for Pennsylvania since the first decades of the 20th century.

The national paradigm changed in 1996 with the enactment of the Federal Telecommunications Act of 1996, *Pub. L. No. 104, 110 Stat. 56, codified at 47 U.S.C. §§151 et seq*. (Hereafter TA-6).

Pursuant to TA-96, Congress mandated the opening of local telecommunications markets to competition. Consequently, many proceedings—over 20—were initiated before the Commission to bring competition to the local telecommunications markets

[1] Opinion and Order, P-00991648 and P-00991649, entered September 30, 1999, Chairman John M. Quain, Commissioners David W. Rolka, Nora Mead Brownell and Aaron Wilson, Jr. in accord. Vice Chairman Robert K. Bloom dissenting (*Global Order*).

[2] As of December 31, 1998, Verizon Pennsylvania (then known as Bell Atlantic Pennsylvania, Inc.) (VZ-PA) controlled a minimum of 90.6 percent of the business access lines and over 99 percent of residential access lines in its service territory. While the percentage of access lines that VZ-PA has declined over the last year, VZ-PA remains the monopoly service provider of all wholesale services that CLECs need in order to serve their customers.

[3] Global Order, P-00991648/P-001649.

in Pennsylvania including proceedings to address access charges, implicit subsidies in local exchange rates, and the maintenance of universal service.[4]

II. REALIZATION THAT AN INTEGRATED RESOLUTION OF LOCAL COMPETITION ISSUES WAS REQUIRED

Due to the complexity of the various subject matters, the Pennsylvania Commission had proceeded to separately adjudicate individual telecommunications cases, with each case focused upon a particular aspect of local competition. This approach was the tried-and-true way that regulatory commissions historically have handled complex proceedings. However, the Commission realized that the telecommunications issues facing it were not only complex; they were inextricably intertwined. Resolution of one issue required consideration of many other local competition issues. The Commission also recognized that the pace of change in the industry and technology would outstrip the slow pace of piecemeal adjudication. The Commission therefore embarked on a comprehensive resolution, commonly known in Pennsylvania as the *Global* proceeding. The approach was not unprecedented in Pennsylvania, and in fact had been used in the discussions that led to the legislation restructuring the electric industry, and in the individual company proceedings that followed.

III. SIX MONTHS OF COMMISSIONER-FACILITATED SETTLEMENT DISCUSSIONS TO REACH A BROAD SCALE SETTLEMENT

In the fall of 1998 Chairman Quain and I issued an invitation to the parties to the numerous pending proceedings to join us in a global settlement conference for the purpose of exploring an integrated resolution of the complex issues presented by those proceedings, in an integrated conclusion. On March 1, 1999, the negotiation expired without resolution, but the negotiations did serve to focus the parties on potential integrated solutions. In addition, the discussions provided a much-needed opportunity to confer with the parties in a less formal atmosphere and served to provide us with a fundamental understanding of their business needs and concerns.[5]

IV. SIX MONTHS OF FOCUSED LITIGATION

Shortly after the *global* negotiations were concluded, two petitions were filed with the Commission proposing comprehensive solutions and recommending the closure of the pending dockets. The petitions were each sponsored by several participants in the prior negotiations and while each proposal addressed the same issues, the proposals clearly were incompatible. One Petition—docketed at P-00991648 and which became known as the 1648 petition was filed by three State senators, interexchange companies (IXCs) and competitive local exchange companies (CLECs). The other Petition—docketed at P-00991649 and which became known as the 1649 petition was filed on behalf of Verizon-Pennsylvania (VZ-PA), the rural telephone company coalition and two CLECs.

[4] *Application of MFS Intelenet of Pennsylvania, Inc. for Approval to Operate as a Local Exchange Telecommunications Company*, A-310203F0002, P-00961137. *Application of MCImetro Access Transmission Services, Inc for a Certificate of Public Convenience and Necessity to Provide and Resell Local Exchange Telecommunications Services in Pennsylvania* , A-310236F0002. *Bell Atlantic-Pennsylvania, Inc. v. MCIMetro Access Transmission Services, Inc.*, C-00967717, R-00973866C0001. *Formal Investigation to Examine and Establish Updated Universal Service Principles and Policies for Telecommunications in the Commonwealth*, I-00940035. *Generic Investigation into Intrastate Access Charge Reform*, I-00960066. *Investigation into Bell Atlantic-Pennsylvania's Entry into In-Region InterLATA Services under Section 271 of the Telecommunications Act of 1996*, I-00980075, M-00960840. *Sen. Vincent J. Fumo Request for Declaratory and Injunctive Relief against Bell Atlantic for Violations of the Pennsylvania Telecommunications Act*, I-0980080. *Formal Investigation to Examine and Establish Updated Universal Service Principles and Policies for Telecommunications Services in the Commonwealth*, L-0950105. *Statement of Policy on Expanded Interconnection for Interstate Special Access*, M-00920376. *Implementation of the Federal Telecommunications Act of 1996*, M-00960799. *Petition of Bell Atlantic-Pennsylvania, Inc. for a Determination of Whether a Telecommunications Service is Competitive under Chapter 30 of the Public Utility Code*, P-00971293. *Petition of Bell Atlantic-Pennsylvania, Inc. for a Generic Proceeding to Investigate Issuance of Local Telephone Numbers to Internet Service Providers by Competitive Local Exchange Carriers*, P-00981404. *Pennsylvania Public Utility Commission* v. *The Bentleyville Telephone Company*, R-00974174, R-00974174C0001, R-00974174C0002. *Pennsylvania Public Utility Commission* v. *Denver and Ephrata Telephone and Telegraph Company*, R-00984315, R-00984315C0001.

[5] Legal waivers of due process concerns arising from the Pennsylvania statute governing *ex parte* communications were provided by the participating parties prior to the commencement of the settlement conferences.

The Commission asked the parties to attempt to reach stipulations regarding issues that might reduce the necessity for prolonged hearings. This effort failed completely. All parties maintained that their competing proposals were indivisible package deals. Consequently, the Commissioners unanimously decided to sit *en banc* during hearings and commenced formal litigation to develop an evidentiary record to enable them to decide the merits of each of the major issues of the numerous proceedings identified by the Commission. One of those issues, structural separation, is the focus of the balance of this testimony.

V. BACKGROUND OF PENNSYLVANIA LOCAL COMPETITION LAWS

In Pennsylvania, VZ-PA was granted an alternative form of regulation pursuant to Chapter 30 in 1994.[6] Chapter 30 expressly anticipated that the alternative regulation of VZ-PA, as the dominant incumbent in the state, would facilitate competition in the local exchange market by requiring Verizon to provide cost-based, nondiscriminatory pricing and access to its network elements. *See* 66 Pa. C.S. § 3009; *MFS-I, et al*. That did not happen, however, because VZ-PA had absolutely no incentives to open up its local exchange market to competitors. Even after the Telecommunications Act of 1996 was passed, the important policy objective in Pennsylvania and Federal law, the promotion of local exchange competition, remained largely unsatisfied. Instead, VZ-PA still maintained a virtual monopoly in the Pennsylvania local exchange market. In addition, the evidence presented by VZ-PA's competitors in the *Global* proceeding, and in earlier proceedings incorporated into the pending docket, contained numerous examples of VZ-PA's abuse of its market power by providing competitors with less than comparable access to its network, or by employing other discriminatory conduct that prevented VZ-PA customers from switching to a competitor.[7]

At the time of the *Global* decision, the Pennsylvania Commission was clearly frustrated, as were the FCC, other State commissions, and State and Federal legislators, at the lack of progress in opening the local telecommunications markets to competition since the passage of TA-96 over three-and-one-half (3½) years before[8] and the issuance of a Competitive (pricing) Safeguards Order[9] shortly thereafter. At the time of our decision, the FCC had rejected five (5) Section 271 applications and approved none. A good argument could be made that we were hardly closer to competition in the local exchange markets than we were in 1996. Some, like myself, had come to believe that the carrot of long distance entry might not have been sufficient inducement to open the local exchange market to competition. However, I also recognized that the responsibility to open the local markets to competition in Pennsylvania was an independent obligation and should not be conditioned on the success or failure of VZ-PA to gain entry into the long distance market.

VI. THE COMMISSION'S DECISION TO REQUIRE SEPARATION OF VZ-PA'S WHOLESALE/ RETAIL OPERATION[10]

The 1648 and 1649 Petitions each acknowledged the serious conflict of interest and opportunity for anti-competitive conduct by an incumbent local exchange carrier that provides both retail services directly to local service customers and wholesale services to other telecommunications carriers competing for those same local service customers. Accordingly, both petitions proposed a "Code of Conduct" setting forth rules to ensure fair and nondiscriminatory treatment of telecommunications carriers when they seek to purchase wholesale services from an ILEC in order to provide retail services to end-users in competition with the ILEC.

A very significant difference between the two proposals was in the type of business unit separation requirement recommended for preventing VZ-PA from receiving

[6] *In re Bell Atlantic—Pennsylvania, Inc.'s Petition and Plan for Alternative Form of Regulation Under Chapter 30* , Docket No. P-00930715 (Order entered June 28, 1994).

[7] See, e.g., MCI WorldCom Statement No. 4.0, at 23-30 (various examples provided); Covad Statement No. 2, at 4-10 (Covad witness describes collocation experience in Pennsylvania with BA-PA); AT&T Statement No. 3.0, at 13-24 (AT&T witness similarly describes collocation experience in Pennsylvania with BA-PA); Petition of Bell Atlantic Pennsylvania, Inc. for a Determination that Provision of Business Telecommunications Services is a Competitive Service under Chapter 30 of the Public Utility Code, Docket No. P-00971307, Recommended Decision of ALJ Michael Schnierle at 46 (July 24, 1998) (litany of CLEC complaints arising from BA-PA's OSS cited to by Judge Schnierle; Docket No. P-00971307).

[8] *Opinion and Order*, of the Pennsylvania Public Utility Commission, P-00991648/P-001649, page 228.

[9] *Opinion and Order*, of the Pennsylvania Public Utility Commission, M-00940587, entered August 6, 1996.

[10] A copy of this section of the Order is appended to the testimony. The text of the full Order can be found on the web site of the Pa PUC at *http:puc.paonline.com.*

any unfair competitive advantage in the marketplace. The 1649 Petition's Code of Conduct proposed a *functionally* separate organization for its wholesale services, such as an operating division within the existing corporate entity that would service the wholesale clients, as adequate protection to ensure nondiscriminatory access to VZ-PA's wholesale services by competing telecommunications carriers. The 1648 Petition, on the other hand advocated a *structural* separation of the wholesale and retail arms of BA-PA into two distinct corporate subsidiaries such that the wholesale subsidiary would service its retail affiliate and competitors alike.

Based on the record, the Commission concluded that structural separation is the most efficient tool to ensure local telephone competition where a large incumbent monopoly controls the market. VZ-PA controlled the vast majority local exchange access lines in its service territory and controlled bottleneck facilities in most, if not virtually all, local exchange markets where it operated. This overwhelming competitive presence, the concomitant ability to exercise market power; the ability to provide itself with anti-competitive cross-subsidies, and the opportunity and incentive to discriminate against competing telecommunications carriers in the provision of wholesale services strongly support the Commission's conclusion, that structural separation is necessary to provide the local service competition envisioned under Pennsylvania law (Chapter 30) and TA-96.

TA-96 and Pennsylvania's own statutory mandate under Chapter 30, have as goals the provision of competitive services by alternative providers on equal and non-discriminatory terms. 47 U.S.C. §§ 251 and 271; 66 Pa.C.S. § 3001. Both legislative mandates envision a telecommunications arena where competition creates savings and technological innovations for our Nation and Pennsylvania. Both statutes recognize and authorize structural separation as a regulatory tool to implement a competitive market where unfair competition may result absent its implementation. 47 U.S.C. § 272; 66 Pa. C.S. § 3005(h).[11]

The Commission found that it could not exercise its duty to enforce, execute, and carry out the pro-competitive mandates of Chapter 30 absent structural separation[12] It also found that given the length of time needed to actually accomplish structural separation for VZ-PA (estimated at the time to require approximately 1 year), it would be inefficient and more burdensome for VZ-PA to require separate retail affiliates on a piecemeal basis as different parts of the local service market are declared competitive. The Commission expected that if it ordered the structural separation planning, hearing, and implementation process to begin, it could be accomplished within the approximate timeframe that VZ-PA was expected to achieve Section 271 approval from the FCC and formal designation of its remaining retail services as competitive from Pennsylvania. A proceeding to implement the details of structural separation was convened following the *Global Order*. I'll address that proceeding later in this Statement.

The Pennsylvania Commission's structural separation decision was a sound exercise of its administrative discretion and application of law, based on the overwhelming record evidence that had been amassed. The decision also built upon its experience in designing and implementing the most successful competitive electric model in the country.[13] Structural separation for the dominant service provider, faced with an inherent incentive to discriminate against its competitors in order to preserve or expand its own market share, represented the only rational choice to compel VZ-PA to comply with the non-discrimination provisions of State law and Federal law in Pennsylvania. The Commission also found in the *Global* Proceeding

[11] Section 3005(h) specifically provides for the use of structural separation as a regulatory tool for LECs serving over one million access lines "if the commission finds that there is a substantial possibility that the [competitive] service on a non-separated basis will result in unfair competition." Section 3005(h) was clearly applicable because the ultimate goal of the proceeding was to open up competition in all telecommunications markets in Pennsylvania, especially local competition. In addition, the proceeding established a process that could lead to a formal declaration that all remaining retail local services are "competitive" under Chapter 30. Moreover, the fact that the Commission addressed this matter in a 1994 proceeding under Chapter 30, well in advance of the enactment of TA-96, did not preclude the Commission from imposing structural separation based on the record of the current proceeding.

[12] ". . . *we cannot fulfill our Section 501 duty* to enforce, execute and carry out our mandate under Chapter 30 to promote and encourage the provision of competitive services on equal terms throughout the Commonwealth" [absent structural separations]. (p. 224)

[13] See, e.g. Application of PECO Energy Company for approval of its restructuring Plan Under Section 2806 of the Public Utility Code and Joint Petition for Partial Settlement, Docket Nos. R-00973953 and P-00971265 (Order entered December 23, 1997) (PECO Restructuring Order). In the PECO Restructuring case the Commission found that: Functional separation of regulated [electric distribution company] functions and competitive generation functions is essential for the development of a vibrant competitive market. Structural separation through the establishment of fully independent entities is preferable whenever possible. Id at 128.

that the non-structural remedy proposed by VZ-PA would be less effective in preventing market power abuses and more costly to enforce. We also took administrative notice that structural separation had been successfully implemented by other states in the telecommunications and gas industries.[14]

Structural separation is not the wildly expensive draconian bloodletting of a regulatory agency run amok that VZ-PA depicted to the Pennsylvania legislature and the courts. Unlike divestiture, which is used to remedy anti-competitive behavior and which requires certain lines of business to be sold, structural separation is a less sweeping vaccination which leaves the company free to engage in the activity at issue.

The structural requirement levels the 'regulatory parity' field. It also changes the regulatory oversight responsibilities, hopefully in ways that better suit regulatory staff skill sets and makes parity of reporting treatment more realistic.

Separate subsidiaries enable regulators to view the terms of affiliate transactions in ways that facilitate detection of an affiliate receiving favored treatment due to the contractual nature of the transactions. Structural separation heightens both the likelihood and perception of fairness and if carried out hopefully will enhance the willingness of potential competitors to make the investment to enter a market in the face of an overwhelming competitor that controls essential bottleneck facilities.

## VII. THE INEVITABLE APPEAL

While the Commission's decision to order structural separations was final, the details remained to be worked out. VZ-PA undertook extraordinary appellate efforts to request the Pennsylvania Supreme Court to immediately assume fast-tracked jurisdiction of the appeal. Its effort proved unsuccessful and typical appellate procedures ensued. VZ-PA filed State and Federal appeals of the Commission's decision. Front and center was the structural separations decision, along with various and sundry challenges to other portions of the *Global Order*.

VZ-PA also initiated appeals of the *Global Order* in the lower appellate court, Pennsylvania Commonwealth Court, as well as in the U.S. District Court, Eastern District of Pennsylvania. The Pennsylvania Commonwealth Court unanimously upheld the PUC's Decision on all issues and in particular the structural separation decision. *Bell Atlantic-Pennsylvania, Inc. v. Pa. PUC* , Nos. 2790 C.D. 1999 *et seq* ., (October 25, 2000). The Court found that the PUC had the authority under Federal and State law to order structural separations (47 U.S.C. Sections 253(b), 272, 261(c)), and that the PUC's evidentiary record constituted "substantial evidence." Subsequent events, which will be explained in Section IX, have mooted further State appeals challenging the PUC's authority to impose structural separations.

I find the similarities between the Pennsylvania Commonwealth Court Opinion and a subsequent Order of the United States Court of Appeals for the Sixth Circuit, to be compelling! The Sixth Circuit focused on the decision of the FCC to impose structural separation on all local telephone companies providing commercial mobile radio service. *GTE Midwest, Inc. et. al. V. Federal Communications Commission,* Nos. 98-3167/3203, 2000 FED App. 0392P (6th Cir.) (November 15, 2000).

The FCC argued: a. The LECs have the incentive and opportunity to engage in anti-competitive practices; b. Increased competition may increase the incentive to discriminate against competitors requesting interconnection; c. The costs of the separate subsidiary implementation do not outweigh the benefits; d. It is not a requirement without precedent.

The Petitioners argued: a. The requirement was contrary to the Congressional intent underlying the Telecommunications Act of 1996; b. Congress had the opportunity to impose structural separation and declined by classifying wireless services as "incidental interLATA' services, which are exempt from the separate affiliate requirement; c. Section 601(a)(3) of the Act released AT&T from the requirement that it provide its cellular service through a separate affiliate; d. Congress sought to promote parity between AT&T and the Bell companies and did not intend for the Commission to have the power to declare a new separate affiliate requirement.

The Court affirmed the FCC decision, as a legitimate exercise of the agency's expertise and as a matter of Federal law, finding: a. That the FCC reasonably concluded that it could not rely exclusively on non-structural safeguards given the mo-

[14] See AT&T Statement No. 1, at 24-26; Senators' Statement No. 1, at 28, 30-32; Main Brief of AT&T at 85-87; Initial Brief of Senators Madigan, Fumo, and White at 53-57. See also Robert E. Burns et al., Market Analysis of Public Utilities: The Now and Future Role of State Commissions at 6 (National Regulatory Research Institute July 1999) (study recommends that State regulatory commissions should consider structural separation as a regulatory tool to offset potential cross-subsidization problems, especially where utility services are being provided in markets that are initially highly concentrated).

nopoly power of the LECs that stems from the bottleneck control over the infrastructure; b. The Court expressly declined to second-guess the expert choice of the FCC on this point, and did not require the FCC to point to specific instances of past abuse to justify its decision; c. The Act does not limit the FCC's authority to adopt separate affiliate requirements, citing Section 601(c)(1); d. There is no explicit indication that the Act is intended to promote regulatory parity between non-dominant carriers such as AT&T and dominant carriers such as the Bell companies; e. If Congress had sought to preclude the FCC's ability to impose separate subsidiary requirements, it could have done so explicitly.

## VIII. STRUCTURAL SEPARATIONS PROVIDES A PREFERRED MEANS OF ENFORCING COMPETITION-OPENING LEGAL REQUIREMENTS

In my opinion, structural separation provides a bright-line demarcation point between the retail and wholesale activities of the incumbent, and coupled with an appropriate code of conduct, prescribes a clear framework for requiring arms length dealings with the incumbent's retail affiliate. The wholesale affiliate must treat its retail affiliate in the same manner that unaffiliated competitors interact with the wholesale company. Under Pennsylvania law, the retail and wholesale affiliate transactions and services would have to be memorialized in a written agreement that would be subject to regulatory scrutiny before the fact under the affiliated interest provisions of the PA Public Utility Code, 66 Pa. C.S.A. § 2100, *et seq.* The Commission has the built-in mechanism for exercising forward-looking regulatory responsibility. While ongoing oversight of these contractual requirements would be required, the structurally separate relationship of these entities would make it much easier to police and oversee. Detection of contract violations and Commission Orders would be more consistent with the training and practice of commission staff. Violations if detected could result in voiding business transactions and could be determined to be unlawful activity.

Structural separation avoids the detailed, ongoing, enforcement responsibilities that functional separations demands. Joel Klein, formerly of the U.S. Department of Justice, captured the assessment of the situation with the following observation: Finally, based on a century of experience, I would further emphasize that the Department [Department of Justice] is also highly skeptical of any relief that requires judges or regulators to take on the role of constantly policing the industry. Relief generally should eliminate the incentive or the opportunity to act anticompetitively rather than attempt to control conduct directly. We are institutionally skeptical about code-of-conduct remedies. The cost of enforcement are high and, in our experience, the regulatory agency often ends up playing catch-up, while the market forces move forward and the underlying competitive problems escape real detection and remediation, ( *Making the Transition form Regulation to Competition*, FERC Distinguished Speaker Series, January 21, 1998, p.12)

## IX. THE STRUCTURAL SEPARATION IMPLEMENTATION PROCEEDING

True to its word, the PUC initiated a separate proceeding to implement the structural separation decisions that it reached as part of the *Global Order*. The parties' arguments were predictable: VZ-PA complained that structural separation was inefficient and costly while CLECs set forth various alternatives to accomplish the PUC's decision. The proceeding turned on whether VZ-PA would be permitted to bundle its retail and wholesale services together and whether the retail and wholesale companies must abide by a true, arms length relationship, to be prescribed in a stringent Code of Conduct. VZ-PA mainly relied on the Verizon Advanced Data Services affiliate that it set up in compliance with one of the merger conditions to which Verizon had agreed as part of obtaining the FCC's approval of the Bell-GTE merger. CLECs objected, contending that wholesale and retail services must be uncoupled from its current intertwined relationship.

The PUC decided in March, and issued an Order in April, to require VZ-PA to undertake a "functional/structural separation" and to agree to other market-opening conditions. If VZ-PA refused the conditions, then the PUC advised that it would issue another order calling for structural separation. VZ-PA did subsequently accept the PUC's conditions. The PUC claimed that the "expeditious implementation" of functional separation would be more worthwhile than compelling structural separation followed by the inevitable litigation and regulatory micro-management stemming from structural separations.

In my view, the Commission has substantially abandoned the concept of regulatory efficiency, failed to appreciate that the implementation of its current plan will not be expeditious, condemned itself to ongoing regulatory oversight for which it is

poorly equipped and will not avoid protracted litigation. In summary the PUC replaced the structural separation directive with the following provisions.

1. VZ-PA is required to establish non-structural safeguards, such as separate accounting for wholesale and retail services and abide by a code of conduct that requires VZ-PA to treat competitors in a nondiscriminatory manner.

2. The separation of wholesale and retail divisions must be accomplished through a new Code of Conduct and competitive safeguards, that will be established in a separate rulemaking proceeding. The New Code of Conduct shall encompass personnel, accounting, record keeping and business practices. In the meantime, VZ-PA is supposed to comply with the Interim Code of Conduct established in the *Global* Order.

3. Although already accomplished, consistent with its commitment to the FCC in the Bell-GTE merger, VZ-PA must establish an advanced services affiliate.

4. Verizon's advanced data services affiliate must comply with the Section 251 unbundling, interconnection and resale obligations.

5. Several industry collaboratives concerning pending technical issues regarding loop provisioning were convened.

a. Industry standards for providing CLECs with access to equipment known as "DSLAMs" in remote terminals that may enable them to provide DSL service over copper lines will be discussed through an industry collaborative.

b. VZ-PA must commence a trial of electronic loop provisioning to determine its feasibility.

c. Next Generation Digital Line Carrier and equal access to DSL over fiber will be discussed through an industry collaborative.

d. A line-splitting collaborative was established.

6. VZ-PA must withdraw all appeals that challenge the PUC's *Global* Order. VZ-PA must agree to increase remedy payments for providing CLECs with discriminatory service. For violations of performance standards up to 30 days, VZ-PA must pay $3,000 to each affected CLEC. For violations that occur from the 31st day to the 90th day, VZ-PA must pay $5,000 to each affected CLEC. The PUC also initiated another new proceeding to determine whether any further adjustments of these payments should be made.

VZ-PA must reduce (by 75 cents) the loop rate in the rural areas of VZ-PA's territory known as Density Cell 4. The PUC convened another separate proceeding to address whether any further UNE rate adjustments should be ordered.

As part of its March 22, 2001, deliberations, two of the Commissioners made clear that they were extremely displeased with the manner in which VZ-PA had conducted its publicity campaign concerning the regulatory issues at stake in the proceeding. Outgoing Chairman Quain requested the PUC prosecutory staff to initiate an Order to Show Cause against VZ-PA for engaging in an "extensive, systematic campaign of misinformation" that was "based on exaggerated fears rather than the facts."

In response to Petitions filed by AT&T and Sprint to clarify the April Order, the PUC issued a subsequent Order in May, 2001. The May 2001 Order referred allegations to the Commission's Law Bureau for review and potential initiation of an action against VZ-PA for failing to comply with the *Global* Order Interim Code of Conduct from September 1999 through April 2001, the period following the *Global* Order through the issuance of the April 2001 Structural Separations Order. As for considering the adoption of an Interim plan for functional/structural separation, the PUC declined to adopt one and instead directed VZ-PA to submit a report by July 23, 2001, detailing the interim compliance with the PUC's April 2001 Order.

## X. A REGULATORY MANDATE RATHER THAN A UTILITY-SPONSORED "VOLUNTARY" INITIATIVE

Structural separation may be painful to implement, at the beginning, but more cost effective and efficient over time. There is no question that structural separation would have imposed additional costs on VZ-PA-Retail; but no one at the Commission has suggested that those costs are not recoverable from the clients of the wholesale subsidiary, competitors and affiliates alike. Those costs are, in my opinion, a reality of the transition to non-discriminatory access to the incumbent network. One of the fundamental tradeoffs in converting from a monopoly to a competitive market is the potential for duplicative capacity and higher operating costs in the immediate term, in exchange for innovation and managerial changes that improve productivity and thus lower costs over the long term.

The fact that VZ-PA continues to argue that forcing its retail operations to function similar to all other CLECs is "inefficient" and "imposes additional costs on its customers", demonstrates very clearly that the two functional divisions (one for

itself and another for competitors) that it proposed to handle wholesale customers, are not equal.

XI. HOW WOULD I DEFINE A SUCCESSFUL STRUCTURAL SEPARATION REGIME?

A successful structural separation would accomplish each of the points that I have identified in my testimony and which were identified by the Commission when it initially directed the structural separation of Verizon-PA. It would:

- Ensure non-discriminatory access to interconnection, resale, UNEs and OSS.
- Benefit ratepayers with lower overall cost of service.
- Result in improved ILEC wholesale performance to CLECs as a general matter (i.e. improved OSS interfaces, arms length transactions).
- Reduce regulatory oversight and the resources needed by the regulator for monitoring and enforcement.

XII. IF STRUCTURAL SEPARATIONS IS SUCH A CRAZY IDEA, THEN WHY HAVE SOME COMPANIES VOLUNTARILY EMBRACED IT AS PART OF THEIR BUSINESS PLANS?

In April, 2000, British Telecom (BT) announced plans to separate its wholesale and retail businesses, creating a new network company, NetCo., which would be both structurally and managerially separate. BT said that the move is pro-competitive and removes any perceived conflicts between NetCo and the rest of BT. The new NetCo will be able to focus solely on meeting the needs of the other licensed operators and service providers including of course, BT-Retail and the retail operators will all benefit from being served by a company that has a clear, separate and exclusive emphasis on their distinct needs. In the view of BT (Nov. 9, 2000), the creation of NetCo (a fully separate company) should reduce the need for those aspects of regulation which derive from its current vertically integrated structure. Sir Ian Vallance, BT's chairman, expected NetCo to be up and running during 2001, assuming shareholder approval and the Annual shareholder General Meeting in July 2001.

Regulation of BT in the UK will have greater clarity and should be concentrated primarily on the wholesale business. An immediate advantage of the restructuring is that in identifying the separate businesses within BT, shareholders and analysts will be able to gain a greater understanding of their intrinsic value and potential. This in turn will facilitate separate stock listings for some of BT's businesses.

The new businesses would trade on an arm's length basis with each other. This would allow regulation to be concentrated primarily on the wholesale business, which will supply services to other operators and service providers as well as the BT retail operation. This change should enable the BT retail operation to be increasingly treated in the same way as other companies in the competitive market by its regulators.

XIII. CONCLUSION

The Pennsylvania Commission found that it could not exercise its duty to enforce, execute, and carry out pro-competitive mandates absent structural separation. It also found that it would be inefficient and more burdensome on VZ-PA to require separate retail affiliates on a piecemeal basis, as different parts of the local service market are declared competitive.

The Commission's decision to require structural separation of wholesale and retail functions was logical, and built on its experience in designing and implementing the most successful competitive electric model in the country. Structural separation, for the dominant service provider, steeped in embedded subsidies and support mechanisms, represented the only rational approach of record for administering the non-discrimination provisions of State law and Federal law in Pennsylvania.

Unlike divestiture, which is used to remedy anti-competitive behavior and which requires certain lines of business to be sold, structural separation is a less sweeping vaccination against anti-competitive and discriminatory behavior. Structural separation is not the wildly expensive, draconian bloodletting, of a regulatory agency run amok, that VZ-PA depicted to the public, the legislature and the courts.

A structural separation requirement changes the regulatory oversight responsibilities, hopefully in ways that better suit regulatory staff skill sets and makes parity of reporting requirements more realistic among competitors.

Separate subsidiaries enable regulators to view the terms of affiliate transactions in ways that can easily discern that an affiliate is not receiving favored treatment. It heightens both the likelihood and perception of fairness and, when implemented, would hopefully enhance the willingness of potential competitors to make the investment to enter a market where a competitor continues to control essential bottleneck facilities.

Thank you very much for the opportunity to present my perspectives on this issue to you.

The CHAIRMAN. Thank you very much.
Mr. KIMMELMAN.

**STATEMENT OF GENE KIMMELMAN, CO-DIRECTOR, WASHINGTON OFFICE, CONSUMERS UNION**

Mr. KIMMELMAN. Thank you, Mr. Chairman. On behalf of Consumers Union, publisher of Consumer Reports, and I am also representing the Consumer Federation of America this morning, I appreciate the opportunity to testify.

I learned something I think very important this morning. If I am ever so honored as to be asked by you to draft legislation, I think I am going to respectfully decline to do so. I think it is a tough standard to live up to, but I think it is the appropriate one to place in front of the companies who did help design the 1996 Act.

What I have heard this morning is to me the really classic story of special interest groups trying to manipulate a law that was very optimistically designed to respond to promises of the potential for competition in telecommunications. It is a classic form of manipulation, focused on extremely appealing concepts and terms—deregulation and competition, which we all are very favorably inclined toward for their potential to provide more choices for consumers, lower prices for consumers.

The manipulation, and we have seen it in other markets as well, takes many forms. First, there is an enormous exaggeration and promises made about what companies will do. Recall the local phone companies all were going to go into cable and long distance. The long distance companies were all going to go into cable and provide local phone service that way. Many of those promises are unfulfilled today.

One of the first things many of these companies did with the relaxed oversight resulting from deregulation was to take advantage of that, to consolidate. We had Bell Atlantic and Nynex getting together and then getting together with GTE, SBC with Pacific Telesis, then Ameritech. We now have two companies expanding their monopolies, each of which controls more than a third of the phone lines in the country, before we have had any meaningful opening up to competition.

It is like taking dominant airport hubs and then just connecting them all together and then saying, well, maybe we will open up after that. It just does not work. We have seen it in other sectors of the industry as well.

Then you have heard stories this morning about slow-rolling of competitors, failure to provision, failure to respond, failure to make the equipment necessary to connect the customers available. Obviously, when you start with a monopoly or close to it, the slower you serve potential companies that need access to your network the longer you hold onto that customer, the more difficult you make competition to develop.

There has certainly been some squeezing of consumers, as Senator McCain pointed out, some local phone fees are up, certainly cable rates way up, high-speed Internet access, whether it is of-

fered by cable or phone companies, all up. More players in the market, but prices up, not down. Basic long distance rates, up.

Then what we see is an effort to look for the high margin customers to serve, the people where you can make the most money. It is no surprise. In deregulated markets, you look for the highest profit margin. But as we heard from many of your colleagues today, there are many, many pockets, particularly rural America, particularly people of modest income, small businesses, who cannot even get the services. They are not being served, they are not being offered the newest telecommunications services.

I think that the bottom line, Mr. Chairman, is that this manipulation of the law and, as you point out, the words actually written by many of the companies involved, is tarnishing an important concept, the concept of competition itself. It is tarnishing the notion of how deregulation can be helpful to the public.

I think what is really most dangerous to the goal of deregulation is the reality that consumers are getting very little competition, we are seeing prices going up. We are appreciative of your effort to revisit this issue and look at what is really happening, because we believe the FCC and the State regulators need to go back to the drawing board and make sure that we have a meaningful implementation process, so that we are not driven by ideology and buzzwords, we are driven by meaningful facts in the marketplace.

The core reality here is that there is very little facilities-based competition. Mr. McLeod's company, Mr. Holland's company, need the local phone network. We are not at a point where we have meaningful local competition from multiple wires and we may not be for a long time. We may never be for parts of the country. I think that is a fact we need to address and regulators need to address and not be driven by the buzzwords.

So we hope that through your oversight process that you will get the FCC refocused, realigned to look at the real facts in the marketplace, and understand that this is not a fight for who can be more deregulatory or who can have the more powerful, potent rhetoric, but this ought to be a fight for serving consumers.

I must say, from a consumer perspective we are not necessarily always unhappy with a monopoly if it is offering the good service that Senator Cleland was talking about, with fair prices and where there is no price-gouging. That is not the end of the world. We have had that before in telecommunications and it has offered enormous benefits, and it may be the case that we need that in parts of rural America as well, that just bringing in another player, if the prices go up, is not worth it for the consumer.

If we bring in other players, surely we need to grow them fairly and honestly so that they have a chance in the marketplace.

So we hope that, through your oversight process, that you will get the FCC back on course, and your colleagues will help out, to make sure that we separate out where we have monopoly from where we have competition, provide the appropriate public oversight to ensure there is no price-gouging where there is monopoly, and make sure that where that competition is there the we can sustain it and grow it, and hopefully expand it back in these other markets.

Thank you.

[The prepared statement of Mr. Kimmelman follows:]

PREPARED STATEMENT OF GENE KIMMELMAN, CO-DIRECTOR, WASHINGTON OFFICE, CONSUMERS UNION

By now, and certainly by 2004, AT&T as well as the company once called MCI and perhaps even Sprint, were expected to be significant forces in local communications markets across the country. New communications companies, lots of them, were supposed to be bringing smiles to both investors and consumers by delivering innovative bundles of services, worrying the old carriers and stealing their customers.

Many people thought that cable companies would be offering local phone service broadly, even as phone companies would be offering television service, adding choices and driving down prices in both markets. The Internet, or at least wireless technology, was supposed to threaten the traditional telecommunications oligopolists with irrelevance.

Consumers were supposed to be able to choose from many new local carriers, leading to better service and lower prices.

Little of that has happened. The Bells—the race's tortoises—have won.

The local phone companies have networks that cannot be duplicated. That is why, lawmakers' rhetoric aside, unfettered deregulation will not lead to more competition. If competition and lower prices are the goal, pro-competition oversight is required to ensure that the companies with essential assets do not use them to stifle others.[1]

Unfortunately for consumers, this quotation from the *New York Times* accurately describes how the 1996 Telecommunications Act's goal of promoting broad-based local telephone competition has failed to become a reality. Consumers Union[2] and the Consumer Federation of America[3] believe that, if Congress remains committed to expanding telecommunications choices and lowering prices for consumers, significant regulatory oversight for a considerable period of time will be necessary. The attached Appendix A entitled "The Status of Residential Local Telephone Competition," describes in detail how we got to this market and regulatory situation.

More than 5 years of experience under the Act illustrates how deregulating entry into local telephony does not do nearly enough to open that market to competitive forces. You will recall that, in preparation of the Act, cable television industry representatives unequivocally told this Committee that "cable television companies are the most likely competitors to local phone monopolies" and asserted that eliminating cable rate regulation would make that competition happen:

If you look at the entire structure, the competitive theory of the broad legislation in front of this committee, the theory is that you are going to allow the Regional Bell companies to move into manufacturing, information services, burglar alarm services, cable, other areas, and that their potential for anticompetitive behavior is going to be checked because they are going to have competition. And then you look around, and who is going to prove that competition?

And I would submit to this committee it is us. We are the other wire, and if we do not have the financial and investment environment to make those investments, those tens of billions of dollars, then the end result is that this committee and this Congress will have opened up a Pandora's box in terms of extending the regional phone companies' monopolies, and you will never close it again.[4]

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[1] Seth Schiesel, "Sitting Pretty: How Baby Bells May Conquer Their World," *New York Times* April 22, 2001.

[2] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance. Consumers Union's income is solely derived from the sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* with approximately 4.5 million paid circulation, regularly carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions that affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

[3] The Consumer Federation of America is the nation's largest consumer advocacy group, composed of over 280 State and local affiliates representing consumer, senior, citizen, low-income, labor, farm, public power and cooperative organizations, with more than 50 million individual members.

[4] Statement of Decker Anstrom, National Cable Television Association Before the Committee on Commerce, Science, and Transportation, U.S. Senate, Mar. 21, 1995, S. Hrg. 104-216.

While the cable industry has invested billions since the Act phased out cable rate regulation, industry revenue has increased by more than $14 billion per year,[5] rates are up nearly 34 percent[6] but less than 1 percent of consumers receive local phone service over a cable wire (see Appendix A at 6). Wireless is not a substitute for local phone, because it is not flat rate and because it is significantly more expensive for the same amount of usage. Other technologies that were supposed to obliterate the local phone monopoly have not materialized. In other words, the dream of wire-to-wire or other facilities-based competition has failed abysmally.

Some have argued that flash-cut Bell entry into long distance (or data long distance) will spur retaliatory local facilities investment from long distance companies. They believe that these companies are hiding behind regulatory "transition" mechanisms designed to open the door to local competition, which in reality allow the long distance carriers to slow-roll investment in local facilities. However appropriate this skeptical attitude was a number of years ago, it makes no sense in today's economic climate.

It now appears that not only small competitive carriers, but the likes of Sprint, Worldcom and AT&T long distance are either on the ropes financially or likely to be taken over by one of the large local phone companies.[7] So long as the high costs and technical problems related to cable, wireless, Internet telephony or other technologies persist, the only way to sustain potential facilities competitors is to prohibit Bell entry into long distance until competitors are able to use the Bell infrastructure in approximately the same manner and under the same financial conditions as the Bell company itself.

As we point out in Appendix A, so long as the Federal Communications Commission (FCC) and State regulators pursue rigorous oversight of the Bell companies' pricing and market-opening practices, there is some chance that consumers will receive the benefits of local telephone competition promised in the 1996 Act. If the careful oversight of Bell practices initiated and ongoing in New York were the norm in other States considering Bell entry this year, we estimate that consumers could save as much as about $7 billion a year on their local and long distance calling (see Appendix A at 15). In New York this rigorous oversight and fact checking has translated into local and long distance price reductions ranging from 5 to 20 percent (see Appendix A at 13).

Of course, the New York process involves considerable regulation of Bell company facilities, enabling competitors to take advantage of a monopoly infrastructure to jump-start retail competition. Will this lead to full-blown facilities build out and broad based competition? We do not know. However, if Congress believes the "cost" associated with this ongoing regulation of the Bell companies is too severe, we urge you to consider the alternatives.

Relaxing regulation of the Bell company infrastructure is likely to lead to the demise (or consolidation) of the major residential long distance and small local phone competitors. While Verizon in New York, and SBC in Texas, entered the long distance market offering significant long distance savings—up to 50 percent for low volume consumers—(see Appendix A at 15) it is extremely unlikely that these savings would exist in a significantly less competitive long distance market. In fact, in States where non-Bell local phone companies have entered the long distance business, without the market-opening obligations that the 1996 Act imposed on the Bell companies, long distance companies have lost substantial market share to local carriers that did not need to discount their rates at all (see Appendix A at 16). If the Bell companies end up dominating both the local and long distance residential markets, Congress will face the need to impose a much more extensive regulatory oversight model than currently exists, to prevent local and long distance price gouging.

Unfortunately, in this economic environment, we find no "silver bullet" to deliver local phone competition through multiple facilities to consumers in the foreseeable future. We therefore believe Congress should direct the FCC and urge the States to follow the paths of New York and Texas, using careful regulatory oversight to at least test the notion that non-discriminatory sharing of local monopoly infrastructure can ultimately lead to full-blown facilities competition.

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[5] In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, CS Docket No. 00-132, Seventh Annual Report, January 8, 2001, pg 102.

[6] Bureau of Labor and Statistics, Consumer Price Index for Cable, May 2001.

[7] Legg Mason, "The Coming Communications Consolidations," June 2001.

APPENDIX A—THE STATUS OF RESIDENTIAL LOCAL TELEPHONE COMPETITION

[Prepared by Dr. Mark Cooper, Research Director Consumer, Federation of America]

## I. The Failure of Local Competition

### *A. The Paradox of a "Level Playing Field" and One Hundred Years of Government-Sanctioned Monopoly—Why Facilities Based Competition Does Not Exist*

The central public policy embraced by the 1996 Telecommunications Act was the introduction of competition into all telecommunications markets in a measured and structured fashion. Congress recognized that the most difficult area to accomplish this goal was in the local exchange market of the monopoly Regional Bell Operating Companies (RBOCs, also known as the Bells). The insurmountable barrier to entry in this market has been the paradox of attempting to create a "level playing field" when the incumbent leader has enjoyed nearly one hundred years of government-sanctioned monopoly as well as seven decades of public policy and subsidies directed at making that company's network ubiquitous.[8]

It is also important to remember that the Bell System ran afoul of the antitrust laws. In settling a decade long antitrust case against the Bell system with the 1984 Modification of Final Judgment (MFJ), these companies agreed to stay out of long distance services in markets where they had local monopolies. They agreed to be subject to very demanding antitrust tests should they seek to provide long distance to their local customers.

When Congress stepped in to replace the MFJ, it laid out an elaborate plan for opening the markets of all local exchange companies (LECs) (in sections 251, 252 and 253 of the Act). In the case of the RBOCs, Congress required that they meet a specific set of additional conditions in the local market before they are allowed to sell long distance (InterLATA) service to their home territory customers (in Sections 271 and 272 of the Act).[9]

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[8] The FCC took the opportunity of its first 271 decision to outline in detail the competitive advantage the local companies have in entering the long distance market compared to other companies entering the local market. The most crucial observation is to recognize, as the Antitrust court had, the power inherent in the incumbent monopoly status of the local exchange companies; Federal Communications Commission, *Memorandum Opinion and Order In the Matter of Application by Ameritech Michigan to Section 271 of the Telecommunications Act of 1934, as amended, to Provide In-Region, InterLATA Service in Michigan*, CC Docket 97-13, August 19, 1997 (hereafter FCC Michigan) para 10).

The court found that, if the BOCs were permitted to compete in the interexchange market, they would have "substantial incentives" and opportunity, through their control of local exchange and exchange access facilities and services, to discriminate against their interchange rivals and to cross subsidize their inter-exchange ventures.

These advantages include a history of legal barriers, economic and operational barriers, the fully deployed, ubiquitous network of the incumbents which lowers their incremental cost of entering other markets, and the need for interconnection. (FCC Michigan, paras. 11-12).

For many years the provision of local exchange service was even more effectively cordoned off from competition then the long distance market. Regulators viewed local telecommunications markets as natural monopolies, and local telephone companies, the BOCs and other incumbent local exchange carriers, often held exclusive franchises to serve their territories. Moreover, even where competitors legally could enter local telecommunications markets, economic and operational barriers to entry effectively precluded such forays to any substantial degree.

These economic and operational barriers largely are the result of the historical development of the local exchange markets and the economics of local networks. An incumbent LEC's ubiquitous network, financed over the years by the returns on investment under rate of return regulation, enables an incumbent LEC to serve new customers at a much lower incremental cost than a facilities based entrant that must install its own network components. Additionally, Congress recognized that duplicating the incumbents local networks on a ubiquitous scale would be enormously expensive. It also recognized that no competitor could provide a viable, broad-based local telecommunications service without inter-connecting with the incumbent LEC in order to complete calls to subscribers served by the incumbent LECs network.

[9] In light of this structure of the Act, the Department of Justice (DOJ) succinctly summarized the public policy balance that Congress struck in the 1996 Act when it addressed the issue of RBOC entry into in-region long distance (Evaluation of the United States Department of Justice, Federal Communications Commission, In the Matter of Application of SBC Communications, Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc., d/b/a Southwestern Bell Long Distance for Provision of In-Region InterLATA Services in Oklahoma, CC Docket No. 97-121, May 16, 1997 (hereafter, DOJ, SBC), p. 4.: InterLATA markets remain highly concentrated and imperfectly competitive, however, and it is reasonable to conclude that additional entry, particularly by firms with the competitive assets of the BOCs, is likely to provide additional competitive benefits. But Section 271 reflects Congressional judgments about the importance of opening local telecommunications markets to competition as well. The incumbent local exchange carriers (LECs), broadly viewed, still have virtual monopolies in local exchange service and switched access, and dominate other local markets as well. Taken together, the BOCs have some three-quarters of all local revenues nationwide, and their reve-

Reflecting the more highly developed level of competition in the long distance industry and the fact that local exchange markets are a bottleneck input for long distance markets, Congress placed its emphasis on ensuring that local markets would be competitive. While today's long distance oligopoly could be expected to perform better if greater competitive forces were brought to bear in it, the crucial barrier to competition in the telecommunications industry is the local monopoly.[10]

More than 5 years after the passage of the 1996 Act, it is evident that those Congressional concerns were well founded. Predictably the incumbent monopolists resisted opening their markets to competition, while they sought to get into long distance as soon as possible. The campaign to get into long distance without opening their local markets started with a constitutional challenge to the section that required them to open their local markets. Failing that, they repeatedly filed applications to enter long distance markets before coming near to treating competitors at parity with their own operations for the critical functions of ordering and billing, installation and repair and, above all, in pricing elements of the network.

Prospects for facilities-based, wire-to-wire competition—the promise that led many legislators to support the 1996 Act to the public—are dim at best.[11] The industrial organization and regulatory oversight of the communications industry are a shambles from the point of view of competition for residential consumers.[12] Across the nation, new entrants to the local phone market have been unable to crack the local telephone monopoly to any significant extent. Competitive local exchange carriers

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nues in their local markets are twice as large as the net interLATA market revenues in their service areas. Accordingly, more considerable benefits could be realized by fully opening the local market to competition.

[10] DOJ, SBC, pp. 4-6. Section 271 reflects Congress' recognition that the BOCs' cooperation would be necessary, at least in the short run, to the development of meaningful local exchange competition, and that so long as a BOC continued to control local exchange markets, it would have the natural economic incentive to withhold such cooperation and to discriminate against it competitors. Accordingly, Congress conditioned BOC entry on completion of a variety of steps designed to facilitate entry and foster competition in local markets.

[11] The only facility mentioned in the Conference report on the Telecom Act was cable (see p. 148).

[12] The Consumer Federation of America has charted the unfolding failure of local competition at the national level and in a series of State-specific studies. See, Cooper, Mark N., *Last Chance for Local Competition: Policies to Open Markets Before Baby Bells Begin to Sell In-Region Long Distance Service* (June 17, 1997); *Affidavit of Mark N. Cooper on Behalf of the Consumer Federation of America*, before the Public Utility Commission of California R.93-04003, I.93-04-002, R.95-04043, R.85-04044, June 1998; Consumer Federation of America and Consumers Union, "Reply Comments," before the Federal Communications Commission, *In the Matter of Deployment of Wireline Services Offering Advanced Telecommunications Capability, Etc.,* CC Docket Nos. 98-147, 98-11, 98-26, 98-32, 98-78, 98-91, CCB/CPD Docket No. 98-15, RM 9244, October 18, 1998; The Consumer Stake in Vigorous Competition in the Illinois Local Telephone Market, March 1999). See also, Cooper, Mark, *Situation Report on Local Competition in New Jersey,* November 1998. See also, comments filed by the Consumer Federation of America in "Reply Comments Of The Consumer Federation Of America," The Matter Of The Application By SBC Communications, Inc., For Authorization Under Section 271 Of The Telecommunications Act Of 1996 To Provide In-Region, Interlata Service In The State Of Missouri, CC Docket No. 01-88 May 16, 2001: "Reply Comments Of The Consumer Federation Of America Massachusetts Consumer Coalition," before the Federal Communications Commission, *In the Matter of the Application by Verizon New England, Inc., for Authorization Under Section 271 of the Telecommunications Act of 1996 to Provide In Region, InterLATA Service in the State of Massachusetts,* CC Docket N. 01-9, February 28, 2001; "Comments Of The Consumer Federation Of America*, In the Matter of Application of SBC Communications Inc. and Southwestern Bell Telephone Company and Southwestern Bell Communications Services, Inc. D/B/A Southwestern Bell long Distance for Provision of In-Region, InterLATA Services in Texas,* Before the Federal Communications Commission, CC Docket No. 00-4, February 28, 2000; "Comments Of The Consumer Federation Of America," In the Matter of Application of New York Telephone Company (d/b/a/ Bell Atlantic—New York, Bell Atlantic Communications, Inc. NYNEX Long Distance Company and Bell Atlantic Global Networks, Inc., for Authorization To Provide In-Region, InterLATA Services in New York, Before the Federal Communications Commission, CC Docket No. 99-295, October 20, 1999;; "Reply Comments of the Consumer Federation of America," In the Matter of Application by BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in Louisiana, Federal Communications Commission, CC Docket No. 97-231, December 19, 1997; "Reply Comments of the Consumer Federation of America," In the Matter of Application by BellSouth Corporation, et. al. For Provision of In-Region, InterLATA Services in South Carolina, Federal Communications Commission, CC Docket No. 97-208, November 14, 1997; "Comments of the Consumer Federation of America, before the Federal Communications Commission*, Memorandum Opinion and Order In the Matter of Application by Ameritech Michigan to Section 271 of the Telecommunications Act of 1934, as amended, to Provide In-Region, InterLATA Service in Michigan*, CC Docket 97-13, August 9, 1997 "Comments of Consumer Federation of America," before the Federal Communications Commission, In the Matter of the Local Competition Provisions of the Telecommunications Act of 1996, 1996.

(CLECs) have captured about 8 percent of the total local lines in the country, but for residential and small business consumers the figure is about 4 percent.[13] Worse still, most of this competition is not with new wires. Wire-to-wire competition accounts for only about 1 percent of the total number of lines nationwide and in the residential and small business sector, it is less than 1 percent.[14] In other words, the incumbent monopolists still have a complete stranglehold on local telephone wires.

In addition to the shelter afforded the Bells by the immense costs of building an entirely new network, the Bells have protected their local monopolies with more overt anticompetitive practices, such as by promoting legislation against building new networks. For example, Bristol, a rural Virginia town, saw that a high-speed network would help spur development in their area and realized that the Bell company serving them was not likely to provide it to their community (because they were either too remote or had demographics that did not support the case for the Bells to build a network in their area). They chose to build a municipal high-speed network, but in response, Verizon successfully lobbied the State legislature to pass a law that prevented municipalities from building such networks. Such laws have been passed at the Bells behest in nine States.[15]

The failure of new entrants to break the monopoly of the incumbents is reinforced by the failure of incumbents to compete against one another. It was hoped that the large incumbent local monopoly companies might attack their neighbors' service areas, as they are the best situated to do so. But such competition has not happened.[16] The incumbent local exchange carriers (ILECs) have simply not tried to enter each other's service territories in any significant way. In fact, they have done quite the opposite. Rather than compete, they have merged. Before the 1996 Act was passed, the largest four ILECs owned less than half (48 percent) of all the lines in the country.[17] Today, the largest four local telephone companies—Verizon (made up of NYNEX, Bell Atlantic and GTE), SBC (made up of Southwestern Bell Telephone, PacTel, Southern New England Telephone, and Ameritech), BellSouth and Qwest—own about 85 percent of all the telephone lines in the country.[18]

Ironically, although the market power of the incumbent local exchange companies has not been significantly reduced, at his first press conference as Chairman of the Federal Communications Commission (FCC) Michael Powell made the striking statement that "deregulation is not like dessert," suggesting that deregulation should come before competition is established.[19] The Bells have redoubled their efforts to cut back on obligations to open their markets.[20]

*B. Wooing the Bells into Opening Their Local Markets Has Not Worked—The Failure of § 271*

1. The Design of § 271

Regardless of his personal preferences, as Chairman of the FCC, Mr. Powell is duty bound to enforce the Telecommunications Act of 1996 (the Act or the 1996 Act), which does not take that point of view.[21] The provisions of § 271 seek to redress the

[13] Industry Analysis Division, Common Carrier Bureau, *Local Telephone Competition at the New Millennium* (Federal Communications Commission, December 2000) (hereafter, *Local Competition 2000*, p. 1.

[14] Based on ratios in Industry Analysis Division, Common Carrier Bureau, *Local Competition: August 1999* (Federal Communications Commission, August 1999) (hereafter *Local Competition 1999)*, which gives the most recent available data on residential versus business wire-to-wire competition.

[15] Wigfield, Mark. "Rural Virginia Town Fights for Broadband Access," *Dow Jones Newswires*, June 7, 2001.

[16] Reply Comments Of The Consumer Federation Of America, Consumers Union, And AARP, before The Federal Communications Commission, *Proposed Transfer Of Control SBC And Ameritech,* CC Docket No. 98-141, November 16, 1998); Citizen Action of Indiana, et al., *The Consumer Case Against the SBC-Ameritech Merger* (January 20, 1999).

[17] FCC, Statistics of Common Carriers, 1995/1996, Tables 1 and 2.5.

[18] FCC, *Statistics of Common Carriers, 1998.1999, Tables 1 and 2.5,* adjusted for Bell Atlantic/GTE merger and CLEC line count.

[19] The Cato Institute Daily Dispatch, February 7, 2001, reported the comment as follows: Clinton administration officials had maintained that many large telecommunications companies like the regional Bell operating companies should be deregulated only after their markets were sufficiently competitive, but Mr. Powell approached the subject from the opposite direction today.

"I do not believe," he said, that "deregulation is like a dessert that you serve after people have fed on their vegetables and is a reward for the creation of competition. I believe that deregulation is instead a critical ingredient to facilitating competition, not something to be handed out after there is a substantial number of players in the market."

[20] The Tauzin Dingell bill would allow them into long distance in the data market without meeting the market opening conditions of section 271 of the Act.

[21] Conference Report on the Telecommunications Act of 1996, No. 104-458, p. 1.

imbalance of market power between local companies and their potential competitors.[22] The Department of Justice and the FCC adopted a common sense approach to the implementation of the Act. At least until recently, these agencies have insisted that meaningful local competition actually exists as the standard for a central component of the § 271 approval process. The Department of Justice has also pointed out that the failure of competition to spread beyond a very small number of select markets is a concern. The FCC has noted that it was this competitive imbalance that Congress sought to address in § 271.

By requiring BOCs to demonstrate that they have opened their local markets to competition before they are authorized to enter into the in-region long distance market, the 1996 act enhances competition in both the local and long distance markets.

If the local market is not open to competition, the incumbent will not face serious competitive pressure from new entrants, such as the major interexchange carriers. In other words, the situation would be largely unchanged from what prevailed before the 1996 act. That is why we must ensure that, as required by the Act, a BOC has fully complied with the competitive checklist. Through the competitive checklist and the other requirements of section 271, Congress has prescribed a mechanism by which the BOC may enter the in-region long distance market. This mechanism replaces the structural approach that was contained in the MFJ by which BOCs were precluded from participating in that market.[23]

Without § 271, there was little in the Act to give the BOCs incentives to open their markets.[24]

Congress was not satisfied that the general requirements placed on the local exchange companies to open their networks to competition would be effective in the case of the RBOCs because of their dominant position and history of abuse of monopoly. Congress required additional conditions and oversight by other agencies before the RBOCs would be allowed to sell in-region long distance. Congress required the FCC to make findings in four areas before RBOCs were to be allowed into in-region long distances.

Part III of the Act, "Entitled Special Provisions Concerning Bell Operative Companies," which includes section 271, deals almost entirely with the additional steps Bell Companies must take in opening their markets before they are allowed into in-region long distance. Together Section 271 and 272 includes a number of conditions:

- a requirement that actual, facilities-based competition for both business and residential customers exist within a State;
- a checklist of 14 technical conditions and services that had to be provided to competitors on rates, terms and conditions that are just, reasonable and nondiscriminatory;
- safeguards to prevent abuse of transactions between local companies and their affiliates; and
- satisfaction of a public interest test.

These findings were to be made in consultation with the States and the Department of Justice (whose advice was to be given substantial weight).[25]

2. Resistance from the Bells to Opening Their Local Networks

[22] DOJ, Michigan, pp. 32-33.

[23] FCC Michigan, paras 15-18.

[24] FCC Michigan, para 14. A salient feature of these market opening provisions is that a competitor's success in capturing local market share from the BOCs is dependent, to a significant degree, upon the BOCs' cooperation in the non-discriminatory provision of interconnection, unbundled network elements and resold services pursuant to the pricing standards established in the statute. Because the BOCs, however, have little, if any, incentive to assist new entrant in their efforts to secure a share of the BOCs' markets, the Communications Act contains various measures to provide this incentive, including section 271. Through these statutory provisions, Congress required BOCs to demonstrate that they have opened their local telecommunications markets to competition before they are authorized to provide in-regions long distance services. Section 271 creates a critically important incentive for BOCs to cooperate in introducing competition in their historically monopoly local telecommunications markets.

[25] DOJ, SBC, pp. 7-8. Section 271 establishes four basic requirements for long distance entry. The first three such requirements—satisfaction of Section 271 [c] (1) (A) (Track A) or Section 271 [c] (1) (B) (Track B), the competitive check list, and Section 272—establish specific, minimum criteria that a BOC must satisfy in all cases before an application may be granted. In addition, Congress imposed a fourth requirement, calling for the exercise of discretion of the Department of Justice and the Commission. The Department is to perform competitive evaluation of the application. "Using *any standard* the Attorney General considers appropriate." And, in order to approve the application, the Commission must find that "the requested authorization is consisted with the public interest. In reaching its conclusion on a particular application, the Commission is required to give "substantial weight to the Attorney General's evaluation."

*(a) Verizon*

It took more than 2 years after the Telecom Act became law before any of the Bells would accept the fact that they were going to have to open their markets. Verizon in New York (originally NYNEX and later Bell Atlantic) finally agreed to take the necessary steps to open its local market in its "Prefiling Statement."[26] This document, negotiated between the New York Public Service Commission, the DOJ and Verizon, outlined the steps necessary to achieve legitimate market opening.

The prefiling statement did not end resistance to market opening, even for Verizon. Verizon continued its strategy of resisting opening while insisting it should be allowed into long distance. It delayed implementing tariffs for months, thereby denying entrants access to the market opening measures to which it had agreed. The test of operating support systems (OSS) had not even started, but it repeatedly declared that it would immediately apply for entry when the test was complete. These tactics of delay cast serious doubt on Verizon's ability to pass the public interest test of market opening. By restricting the availability of the market-opening measures, those markets that were least developed were retarded the most upstate and residential markets. Resistance to market opening also continued in other States. When the Chairman of the New York PSC endorsed the prefiling statement, he noted four key elements of the agreement as indicators of the progress that had been made. Unfortunately, when Verizon was asked to adopt the same conditions in Pennsylvania, it refused to commit to implementing every major market opening concession.[27] The repudiation of the New York roadmap by Verizon-PA is stunning. Verizon has taken essentially the same approach in New Jersey.[28]

Verizon's lack of good faith in extending the New York approach to other locations and its continued devotion to getting away with anything it can was demonstrated when it filed its application in Massachusetts. It filed an initial application based on unbundled network element (UNE, described in detail below) prices that were completely unjustified—as much as $20 per month for usage.[29] Faced with certain denial, it threw in unbundled network element prices from another State, which, themselves, were based on a methodology that has been demonstrated to be faulty.[30] Instead of presenting the Commission with legitimate, reasonable and efficient rates from Massachusetts, it threw in old rates from New York, which the New York Commission had already begun to revamp.

Verizon used a similarly flawed application in Pennsylvania. After years of litigation the Pennsylvania Commission was severely divided over whether Verizon had complied with the Act. In other words, 3 years after making the open market commitment in New York and a year and a half after being granted entry in New York, two of the five Commissioners in Pennsylvania were still not convinced the market has been opened in their State.[31]

*(b) SBC*

SBC was the second company to gain entry into long distance, starting in its flagship State, Texas. In a pattern similar to New York, after months of collaboration, the Texas Public Utility Commission found 129 things that SBC had not yet done to open its markets. SBC resisted, but when the commission held its ground, it took another 2 years to get the application in order. Moreover, agreeing to open the Texas market did not ensure other markets would be opened rapidly. SBC continues to drag its feet in its other States, trying to gain entry with applications that fall far short of what was done in Texas.

SBC has pushed forward a series of applications that fall considerably short of the Texas standard in a number of ways. SBC resists extending the same conditions

[26] PSC Chairman Supports Conditions for Bell Atlantic's Entry into Long Distance and Irreversible Opening of the Local Telephone Market, April 6, 1998, p. 2; "Pre-filing Statement of Bell Atlantic—New York, In the Matter of Petition of New York Telephone Company for Approval of Its Statement of Generally Available Terms and Conditions Pursuant to Section 252 of the Telecommunications Act of 1996 and Draft Filing Petition for InterLATA Entry Pursuant to Section 271 of the Telecommunications Act of 1996, Case 97-C-027, State of New York Public Service Commission, April 6, 1996.

[27] "Comments of Bell Atlantic—Pennsylvania, Inc.," In Re: Bell Atlantic- Pennsylvania Entry Into In-Region InterLATA Services Under Section 271 of the Telecommunications Act of 1996, Docket No. M-00960840, I-00980075, June 11, 1998.

[28] "State Regulators Tell Bell Atlantic-New Jersey to Share Market," *The Record*, Oct. 22, 1998.

[29] "Recommended Decision, by Administrative Law Judge Joel A. Linsider," *Proceeding on Motion of the Commission to Examine New York Telephone's Rates for Unbundled Network Elements,* Case NO. 98-C-1357, May 16, 2001.

[30] "Reply Comments of the Consumer Federation of America, Massachusetts. The decision to allow entry has been appealed by MCIWorldcom and the Massachusetts Attorney General.

[31] June 26, 2001.

to other States, until the last moment. After it agrees to implement similar conditions, it then seeks immediate entry, denying competitors an opportunity to establish business plans on the basis of a final set of conditions. As a result, SBC has gained entry under conditions that are much less conducive to competition than New York. Seriously flawed applications were given eleventh hour approval by the William Kennard-led FCC. There is growing evidence that the Kansas/Oklahoma applications were seriously flawed, in that they contained substantial misrepresentations, notwithstanding the fact that SBC has claimed those misrepresentations were accidental and inadvertent. SBC has recently withdrawn an equally flawed application in Missouri.

*(c) BellSouth and Qwest*

BellSouth and Qwest (formerly US WEST) have yet to have a request for entry into long distance approved in any of the States that they serve. Early on, BellSouth pressed several very premature applications, but was rebuffed. Its efforts currently are focused on Florida, North Carolina and Georgia.

Qwest appears to be the farthest aware from gaining entry, due to its failed attempts to explain Operating Support Systems (OSS, i.e. the systems that enable subscription, billing, installation, repair and customer transfer) problems for its competitors.

*C. Alternative Technologies Have Failed to Provide Effective Competition for Local Phone Service*

(1) Cable Telephony Has Not Been Deployed at Promised or Significant Levels

Wire-to-wire competition has been a bust in another very evident way—the promise of alternative technologies such as cable telephony to deliver residential local phone competition has not been borne out by business reality. Where big cable companies once guaranteed they would deliver all communications and entertainment services on a single platform with a single bill, business reality intruded and they found it was more efficient and they could extract more value from consumers by offering distinct service offerings.

Throughout October 2000, AT&T conducted a flurry of board meetings, press conferences and conference calls with Wall Street analysts to explain its decision to break itself up into three companies.[32] The admission that its business strategy had failed was obviously bad news for AT&T stockholders, but it was even worse news for telephone consumers. It signaled the failure of the Telecommunications Act of 1996 to deliver local phone competition.

AT&T justified its purchases of cable TV companies to regulators and bankers by claiming that local telephone competition over cable wires could be provided only as part of an integrated package of voice, video and data services.[33] It promised to use the tens of millions of cable lines it was buying to compete for local telephone service.[34] Now AT&T is going in the opposite direction. The company is splitting the cable business from the telephone business from the wireless business, and creating a separate tracking stock for its consumer long distance business. The difficulties of providing switched telephone service over cable networks render such activity un-

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[32] Cooper, Mark, "Picking Up the Public Policy Pieces of Failed Business and Regulatory Models," presented at *Setting The Telecommunications Agenda,* Columbia Institute For Tele-Information, (November 3, 2000).

[33] Application for Consent to Transfer of Control of Licenses and Section 214 Authorization from Telecommunications, Inc., Transferor, to AT&T Corp., Transferee, Public Interest Statement, Federal Communications Commission, CS Docket No. 98-178; Application for Consent to Transfer of Control of Licenses and Section 214 Authorization from MediaOne Group, Inc., Transferor, to AT&T Corp., Transferee, Public Interest Statement, Federal Communications Commission, CS Docket No. 99-251.

[34] This was always a dubious proposition, see Consumers Union, Consumer Federation of America and Media Access Project, *Breaking the Rules: AT&T's Attempt to Buy a National Monopoly in Cable TV and Broadband Internet Services* (August 17, 1999). AT&T's promise to deliver service to about half a million residential households, which it labored to try to keep constitutes less than one half of 1 percent of all households in the nation.

economic.[35] It appears that two separate networks, each optimized around very different functionalities, make perfect economic sense, for three reasons.[36]

(1) Functional specialization (letting the network do one thing well rather than several things poorly) is a sound economic principle, especially when there are diseconomies of integration between switched (i.e. telephone) and non-switched (cable TV) services. At present, it costs too much to make one network do very different things.

(2) "One-stop-shopping" sounded like a good idea but it was not compelling when one-click shopping is available for almost anything. Consumers are not clamoring for one huge package of voice, video and data services.

(3) Business goal planning, setting and achieving is much more difficult. It is EXTREMELY challenging to sell three distinct services to very different kinds of customers. Specialized networks that do not compete directly for their core businesses pose a problem for policymakers. Without wire-to-wire competition, the plain old problem of monopoly power in cable TV and local telephone networks still exists.[37]

(2) Wireless Does Not Compete with Basic Service

Wireless telephone service technologies have not solved the problem of lack of competition for local service and will not solve it any time soon. Cellular phones have become popular, but this service has not emerged as a substitute for basic telephone service for several reasons.

(1) Even though the price of wireless has come down, for the average consumer wireless costs about five times as much as local service.[38] The average flat rate telephone is in use for local calling about 1300 minutes per month.[39] The average monthly charge is about $20 per month. The average cost per minute of use is $.015. Assuming half the usage is outgoing, the cost per minute of a call made is $.03. This is much less than average cost of cellular calling plans, which run in the range of $.10 to $.15 per minute.

(2) Cellular service is measured service; local exchange service is generally flat rate.

(3) Cellular service does not allow multiple phone hookups on the same phone number, in contrast to wireline service.

(4) Cellular charges not only for outgoing calls, but also for incoming calls, which is never the case with wireline service.

The proof that wireless and basic wireline services occupy different product spaces can be seen in the numbers of consumers subscribing to each. Both wireless and wireline have been growing at strong rates. In fact, since the 1996 Act was passed, the number of local access lines has grown faster than at any time since the 1984 break-up of the AT&T system. Local exchange revenues have been growing twice as fast as other wireline revenues, and faster than they had in the in the first half of the 1990s.[40] Thus, although cellular has achieved a high market penetration, it does not represent an economic substitute for wireline local telephone service.

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[35] The local exchange companies recognized the difficulty that cable companies would have in providing telephone service. Bell Atlantic described the problems in detail in its aborted attempt to purchase TCI. (See *Bell Atlantic's Request for an Expedited Waiver Relating to Out-of-Region Interexchange Services and Satellite Programming Transport*, *United States of America v. Western Electric Company, Inc., and American Telephone and Telegraph Company*, Civil No. 82-0192 (HHG) January 20, 1994. The request consists of six parts, the request itself and five affidavits ( *Affidavits in Support of Bell Atlantic's Request for an Expedited Waiver Relating to Out-of-Region Interexchange Services and Satellite Programming Transport,* January 20, 1994. Individual affidavits include Alfred E. Kahn and William E. Taylor; Gary S. Becker; Robert W. Crandall; Robert G. Harris; and Brian D. Oliver. Ironically, prior AT&T management apparently reached the same conclusion. However, current AT&T management confesses to being unaware of these analyses (Cauley, Leslie, "Armstrong's Vision of AT&T Cable Empire Unravels on the Ground," *Wall Street Journal,* October 18, 2000). At least one cable company has publicly admitted that it cannot pursue a typical telephone service (circuit switched telephony) and will have to try to provide Internet telephony, although there are no guarantees when, or whether, this approach will be viable for basic telephone service (Comments of Joe Waz at Setting The Telecommunications Agenda, Columbia Institute For Tele-Information, November 3, 2000).

[36] It was always a dubious proposition. See Cooper Mark, *Expanding the Information Age in the 1990s: A Pragmatic Consumer Analysis* (Consumer Federation of America and American Association of Retired Persons, January 1999); *Developing the Information Age in the 1990s: A Pragmatic Consumer View* (Consumer Federation of America, June 8, 1992)

[37] Consumer Federation of America and Consumer Action, *Transforming the Information Superhighway into a Private Toll Road* (September 1999), looks at problems in both the cable TV and the telephone industries from the point of view of advanced services.

[38] See Comments of the Consumer Federation of America, Lousiana.

[39] Industry Analysis Division, *Trends in Telephone Service*, December 2000.

[40] Federal Communications Commission, *Trends in Telephone Service, 2000* (March 2000); Federal Communications Commission, *Statistics of Common Carriers* (various issues).

*D. Resale Markets Are Broken*

Congress realized when it passed the 1996 Act that the Bell companies' near century of government sanctioned monopoly gave them a tremendous competitive advantage—it allowed them to build out a vast network without fear of a competitor coming in and forcing them to lower their prices—market conditions that cannot be replicated today. Accordingly, in addition to providing incentives for facilities-based competition, Congress provided for the resale of unbundled network elements (UNEs). That is, the piece parts of the local network must be made available to new entrants to create competition. However, the RBOCs have used a host of subtle and not-so-subtle tactics that have hampered the development of UNE resale. Making unbundled network elements (UNE) available on prices, terms and conditions that will support competition is the primary battleground at the public utility commissions in the year ahead. These UNEs were the central focus of the 14-point checklist.

Vendors need two things to succeed in the UNE market: operating support systems (OSS) that treat competitors equally and reasonable, cost-based prices for unbundled network elements. The subtext here is that competitors need certainty. By making life difficult for their competitors with respect to OSS and pricing, the Bells have been able to introduce market uncertainty that has made it nearly impossible for CLECs to raise needed funding in the capital markets. Faced with uncertainty, competitors find it extremely difficult to raise funds and make major commitments to invest in local competition.[41] Uncertainty is most likely to inhibit their entry into the less attractive markets.

(1) Bells Leverage Operating Support Systems (OSS) to Their Competitors' Disadvantage

In order to win customers, competitors must be able to seamlessly transfer new subscribers from the incumbent. The Bells, through control of OSS, are able to block entry through institutionalized incompetence. The Bells refused to allow competitors to use their operating support systems to sign up customers. Instead they set out to develop new systems to give competitors access. They have been unable, or unwilling, to develop those systems to treat competitors equally.

It is critical for customers to be smoothly transferred when they decide to switch telephone companies. Consumers will not tolerate loss of service, misbilling, or being left out of customer data bases because telephone service is too important for consumers to do without. Competitors have found that interfaces are not in place and have not even been tested in some instances. They are not automated, so that customers seeking to change service providers are forced to experience serious delays.[42]

A recent *Wall Street Journal* article[43] noted that the FCC is investigating how SBC provided incorrect information regarding OSS to regulators who were considering allowing SBC into the long distance markets of several Southwestern States. Apparently, SBC knew for at least 2 years that when competitors tried to put in a help or repair request into its support system, they would receive an incorrect error message saying that the customer in question belonged to SBC (when the customer in fact belonged to the competitor). In order to process the order, the competitor would have to fax or phone in the repair request. While this may seem trivial with respect to any particular order, over the course of thousands of requests this could serve to practically shut down a competitor's operation.

While it is difficult to quantify the current level of OSS functioning across the nation, in a broadly comparative framework, it is clear that most of the large States that are being targeted for entry by the Bells (see Exhibit 1) have not satisfactorily solved the problem of providing non-discriminatory access to the business and technical features and functions necessary to allow competition.

(2) Bells Charges for Unbundled Network Elements (UNE) Are Unfair and Anticompetitive in Many Cases

UNE pricing has been a second major leverage point for the Bells to block entry into their local markets. By including items in UNE prices that are unfair to competitors, those competitors are unable to squeak by on the thin margins offered by UNE resale. Establishing fair prices for competitors to use unbundled network elements has been a monumental struggle. Although the courts have upheld the FCC's decision requiring prices to be based on efficient, forward-looking costs, the final decision is pending a ruling by the Supreme Court. This resistance has resulted in

[41] DOJ, SBC, pp. 61-62.
[42] DOJ, SBC, p. vii., p. 27.
[43] Dreazen, Yochi. "FCC Probes Incorrect Data in SBC Phone Bid," *Wall Street Journal*, June 15, 2001.

protracted proceedings that have resulted in prices in many States that make competition impossible.

Assessing the current status of the pricing of unbundled network elements is a complex task. At the current stage of development, most competitors need to purchase a complete unbundled network element platform (UNE-P). This comprises the wires (loop), the port into which the wires are connected, local switching services, and transport of calls in the local area. The pricing of these four elements varies widely from State to State.

As a practical matter, in the large States identified in Exhibit 1, there is not a great deal of difference in the cost of the service or in the total revenue per line. In these States, when basic local rates, access revenues and additional features are included, telephone bills converge. However, Commissions have arrived at dramatically different prices even when there are not large differences in costs. This is especially true for the switching costs, which should not be subject to a great deal of variation.

## EXHIBIT 1: COMPETITION, MARKET CHARACTERISTICS AND OBSTACLES

| | COMPETITIVENESS INDICATORS | | | | TELECOMMUNICATIONS MARKET CHARACTERISTICS | | | | | OBSTACLES TO COMPETITION |
|---|---|---|---|---|---|---|---|---|---|---|
| | Intensity | Extensiveness: Number of CLECs in zip code areas | | Balance | % Res/ Small Business lines | TELRIC Cost (Loop + Port, per month | Household Income | Long Distance Calls (number per line per year) | | |
| | | 6 or more | none | | | | | IntraLATA | InterLATA | |
| NY | 1.00 | 1.00 | 1.00 | 1.00 | 66.19 | $16.31 | $37,390 | 31 | 583 | |
| TX | 0.41 | 1.03 | 0.44 | 0.22 | 80.95 | $19.35 | $35,780 | 32 | 317 | |
| MA | 0.31 | 0.51 | 0.64 | 0.27 | 63.57 | $17.33 | $42,350 | 138 | 485 | PRICE, PREMATURE ENTRY |
| PA | 0.29 | 0.38 | 0.22 | 0.24 | 69.67 | $19.84 | $39,020 | 108 | 539 | OSS |
| IL | 0.26 | 0.44 | 0.14 | 0.20 | 72.37 | $17.10 | $43,180 | 43 | 567 | OSS |
| GA | 0.23 | 0.85 | 1.00 | 0.09 | 84.46 | $21.37 | $38,660 | 61 | 522 | OSS |
| CA | 0.19 | 0.72 | 0.47 | 0.21 | 79.03 | $16.77 | $40,930 | 221 | 373 | OSS, PRICE |
| CT | 0.16 | 0.00 | 7.00 | 0.14 | 82.48 | $22.47 | $46,510 | 327 | 370 | PREMATURE ENTRY |
| WA | 0.15 | 0.18 | 0.24 | 0.12 | 74.22 | $18.75 | $47,420 | 80 | 452 | OSS |
| AZ | 0.15 | 0.00 | 0.16 | 0.24 | 76.59 | $17.94 | $37,090 | 31 | 490 | OSS, PRICE |
| FL | 0.12 | 1.23 | 1.17 | 0.06 | 81.55 | $17.12 | $34,910 | 44 | 497 | OSS, PRICE |
| NJ | 0.08 | 0.18 | 0.88 | 0.14 | 64.99 | $17.28 | $49,830 | 164 | 460 | OSS, PRICE |
| MO | 0.07 | 0.03 | 0.10 | 0.04 | 82.30 | $22.09 | $40,200 | 76 | 263 | OSS, PRICE |
| OH | 0.06 | 0.08 | 0.13 | 0.08 | 78.98 | $18.74 | $38,930 | 58 | 590 | OSS |
| MD | 0.04 | 0.33 | 0.19 | 0.06 | 61.75 | $18.52 | $50,020 | 46 | 637 | OSS |

**Sources and Notes:**

Competitiveness indicators are from Industry Analysis Division, Local Telephone Competition: Status as of December 31, 2000, May 2001, expressed as ratio compared to New York with New York set as 1 and then each state's performance

Intensity = % of residential & sm. business lines served by CLECs in state X / % residential & sm. business lines served by CLECs in NY

Extensiveness Competitors 6 or more = % of zip codes with 6 or more CLECs in state X / % of zip codes served by 6 or more CLECs in NY

Extensiveness Competitors none = 1/(% of zip codes with no CLECs in state X / % of zip codes with CLECs in NY)

Balance = 1/(ratio of lg business to residential & small business lines served by CLECs in state X / ratio of lg business to residential & small business lines served by CLECs in NY

TELRIC cost is from the FCC, Synthesis Proxy Cost Model; Household Income is from U.S. Bureau of the Census, *Statistical Abstract of the U.S.: 2000,* Table 724.

Long Distance Usage is from FCC, *Statistics of Common Carriers: 60th Anniversary Issue*, Tables 2.4 and 2.5.

In fact, in the past few months, the FCC and utility commissions in Illinois, Florida, Michigan and Pennsylvania, as well as an Administrative Law Judge in New York, have all pegged the cost of switching at a much lower level than had been the case. In these States, switching costs will be in the range of $2 to $3 per month for typical levels of local usage. New Jersey, California, Arizona, and Massachusetts have rates in place that would cost three to four times that much, $8 to $10 per month.

The pricing of other unbundled elements also remains a problem. In some States fixed monthly costs have been the problem. Very high charges for loop stand out in Arizona, Colorado and Louisiana. In other States, there are also very large differences for non-recurring charges.

There is no end of Bell shenanigans in UNE pricing. For instance, Verizon adds "Annual Cost Factors" into its loop rate, a 12 percent charge that includes the cost of Verizon's wholesale marketing organization. That wholesale marketing organization includes a stable of technical experts that testify for Verizon at State proceedings. In other words, competitors are forced to pay the salaries of the very people that fight against them in State proceedings when they want to try and provide service in Verizon's territory.

**II. Elements of Effective Market Opening**

Although the Bells have resisted lower in the barriers to entry into their local markets, there have been a couple of successful market openings. These are the exceptions that prove the rule and indicate the direction that public policy should follow.

*A. Success Stories*

Although Verizon in New York resisted opening its local markets across its service territory, when regulators in New York and at the Department of Justice insisted on genuine market opening, Verizon was forced to comply. New York has proved different from other States' attempts at market opening because the New York Public Service Commission insisted on rigorous market opening conditions, implemented an effective performance assurance plan, provided detailed oversight over the process, and was committed to ensuring that pricing was fair.

As many other States, New York started out with high UNE prices, but the New York Commission made them interim in nature, when it became clear that the data the Commission had been given was faulty. It made the rates subject to refund and immediately instituted a new cost proceeding to address outstanding questions. As noted, an administrative law judge recently ordered a dramatic reduction in switching rates to bring them in line with other States like Illinois, Michigan and the Federal Communications Commission.

Although fewer residential/small business customers have switched to CLECs in Texas, the extensiveness of competition is strong. Texas switching rates have been low throughout. Loop rates are almost identical in the two States. It should be stressed that these markets were opened without raising basic service rates. New York is a "high" priced basic service State. Texas is a "low" priced basic service State. They were both able to open their markets without basic rate increase.

Consumers do not think the path to competition is to raise rates to attract competition in the hope that rates will come down at some time in the future. The consumer view is that incumbents should charge and new entrants should compete against efficient, forward-looking prices. We do not believe it is necessary to produce inefficient redundant facilities just for the sake of competition, especially when captive customers will bear the burden of that redundancy. If current deployment of distribution facilities (loop) is less expensive that new deployment of competing facilities, then those facilities should be made available at forward looking economic costs.

It also is a mistake to focus on basic service rates for competitive analysis, for one simple reason—competitors do not. When competitors determine whether to enter a market, they calculate the profit margin on all the services they are likely to sell to the customer, not just basic service.

When a competitor wins a customer (or the incumbent retains that customer), he will get not only the basic service revenue but also the Federal subscriber line charge and any Federal access revenues that the customer generates. The local service provider will also capture any revenues for vertical services (like call waiting or Caller ID) that the line is likely to generate. The competitor also is likely to capture

intraLATA toll revenues. Many of the competitors also hope to capture the interLATA long distance business too. Most companies are also planning to capture Internet (high-speed data) revenues and some even have expressed interest in cable TV revenues. It is the total local bill against which the entrants are competing and the loop is used to provide all of these services.

*B. New York-Style Competition*

New York has been extremely successful compared to the rest of the country in fostering competitive entry into the local exchange market. Competition is much more intense in New York than elsewhere, with almost 20 percent of residential customers having switched. It has among the highest number of zip codes with six or more competitors. It has among the fewest zip codes that are not being served by a competitor. We believe that this is the model toward which all States should strive. Few have come even close.

On a national average basis, competition for local residential service is about one-fifth the level of New York. Texas ranks second, with New York having a bout two and one-half times as many residential consumers who have switched. The competition in the local markets in the other States that are being touted by the Bells for entry is nowhere near as developed. For example, in California and Florida, the two most populous States awaiting entry, competitors have achieved only one-fifth the market share among residential customers as in New York.

After 5 years of finger pointing it is clear that the fundamental problem in the local market is a failure of incumbents to open their networks and regulators to set prices that will allow competition to gain a foothold (see Exhibit 1). Although New York has certain characteristics that make it an attractive market, it is not unique by any means. Many of the theoretically attractive characteristics that are found in New York are absent in Texas, which also has a much higher level of competition than the other large States we have examined.

New York has a relatively low percentage of residential lines, but so do Massachusetts, Pennsylvania, New Jersey and Maryland. It has a relatively low TELRIC cost, but so do Massachusetts, Illinois, California, Florida and New Jersey. Average household income is lower in New York than most other States under study. New York has relatively low intraLATA long distance usage, but relatively high interLATA usage. Nevertheless, several other State are close to or exceed New York on interLATA long distance usage, including Illinois, Ohio and Maryland.

Rather than blaming the competitors for not going to these States, where the telecommunications market is as attractive as in New York, the obstacles to competition lie in prices that are too high for unbundled network elements and operating support systems that do not treat competitors fairly. We conclude that there is no reason to believe that New York style competition could not be implemented in these other States. Not only would consumers save substantially on their telephone bills, but the potential base for a residential CLEC industry be much larger and stronger.

*C. Consumer Savings in New York*

As a result of genuine market opening in New York, new entrants offered statewide local rates at a substantial discount. One major competitor offered a statewide discount of at least 5 percent and when bought in combination with long distance (any plan) an additional $5 was taken off the bill. Given the rates in New York, this constituted an additional discount off the typical local bill of 10 to 15 percent. Customers, who want a bundled local and long distance company, could save between 15 and 20 percent off their local bill.[44]

In the long distance market, Verizon entered with a range of competitive offerings, anchored by an anytime, anywhere rate of $.10 per minute. Compared to the products in the market at the time, this was about a 50 percent savings for low volume customers. Other products offered by Verizon were attractive as well.[45]

As a result of genuinely open markets, consumers in New York have switched companies in droves (2.7 million local and 1.5 million long distance). Companies have engaged in "tit-for-tat" competition, matching each other's offers. Prices for

[44] Comments Of The Consumer Federation Of America, In the Matter of Application of New York Telephone Company (d/b/a Bell Atlantic—New York) Bell Atlantic Communications, Inc. NYNEX Long Distance Company and Bell Atlantic Global Networks, Inc., for Authorization To Provide In-Region, InterLATA Services in New York, Before the Federal Communications Commission CC Docket No. 99-295, November 8, 1999.

[45] The Telecommunications Research and Action Center, *A Study of Telephone Competition in New York*, September 6, 2000.

both local and long distance service have dropped substantially (approximately 20 percent for those who shop).

*D. Creating a Competitive Industry Would Benefit Consumers*

Real market opening in New York has produced substantial benefits for consumers, but it is also critical to the development of a competitive local exchange carrier (CLEC) industry. Exhibit 2 shows a number of large States that have recently been mentioned as near-term candidates for RBOC requests for entry into long distance. These States, representing each of the regional bell operating companies, include 50 percent of all the residential lines in the country. In short, the future of the industry is in play. The difference between achieving a New York-level of competition compared to the current level of competition would be huge. Note that New York alone has almost as many CLEC residential lines as the other twelve, closed States combined.

Exhibit 2—Characteristics of Key States in the 271 Process

[Residential & Small Business Lines (in thousands)]

| | TELRIC ($) | ILEC LINES | CLEC in Dec. 2000 (actual) | CLEC if at NY Level (extrapolated) | Competitors' Lines "missing" due to lack of NY-level competition (extrapolated) |
|---|---|---|---|---|---|
| VERIZON: | | | | | |
| MA | 17.33 | 2849 | 178 | 581 | 403 |
| MD | 18.52 | 2434 | 17 | 471 | 454 |
| NJ | 17.28 | 4521 | 74 | 882 | 808 |
| PA | 19.84 | 5853 | 339 | 1189 | 850 |
| SBC: | | | | | |
| CA | 16.77 | 19,008 | 716 | 3786 | 3070 |
| IL | 17.10 | 5944 | 316 | 1202 | 886 |
| OH | 18.74 | 5617 | 69 | 1092 | 1023 |
| MO | 22.09 | 2997 | 39 | 583 | 544 |
| BELLSOUTH: | | | | | |
| FL | 17.12 | 9587 | 222 | 1883 | 1661 |
| GA | 21.37 | 4339 | 198 | 871 | 673 |
| QWEST: | | | | | |
| AZ | 17.94 | 2398 | 69 | 474 | 405 |
| UT | 18.33 | 869 | 33 | 173 | 140 |
| WA | 18.75 | 2952 | 87 | 583 | 496 |
| Total | | 66,371 | 2357 | 13,377 | 11,412 |
| NY | 16.31 | 7345 | 1745 | 1745 | (Actual) |

Source: FCC, Local Competition 2001.

Source: Lines and CLEC penetration from Industry Analysis Division, Local Telephone Competition: Status as of June 30, 2000 (Federal Communications Commission, December 2000); TELRIC based on Hybrid Proxy Cost Model; In the Matter of Access Charge Reform, Price Cap, Performance Review for Local Exchange Carriers, Low Volume Long Distance Users, Federal-State Joint Board On Universal Service, Before The Federal Communications Commission, CC Docket Nos. 96-262, 94-1, 99-249, 96-45, Comments Of Texas Office Of Public Utility Counsel Consumer Federation Of America, Consumers Union, November 12, 1999.

If a New York-type outcome could be achieved in these other States, the residential CLEC industry would reach just over 13 million lines in these States, compared to just 2 million today. That is to say that because New York-level competition is absent in these populous States, about 11 million lines that should be in the hands of competitors are effectively "missing." Including New York, the residential CLEC industry in these States would consist of over 15 million lines, compared to four million today. A 15 million-line industry would have a substantial base for national residential competition.

If the approximately $6 per month saving on the total local bill were achieved by the additional customers won by CLECs in these States, consumer savings would be over $750 million per year (see Exhibit 3). Adding in long distance savings of $4 per month, would push the total to over $1.25 billion. As "tit-for-tat" competition spread to the whole local market, the total savings could rise to more than $7.5 billion. The larger States, like California would experience very large savings, $220 million in the local market gained by customers who switch and potentially over $2.25 billion as competition spreads across both local and long distance. Even in a smaller State like Washington, the local market savings for consumers who switch would be about $36 million and the total market impact could be over $350 million.

Exhibit 3—Potential Consumer Savings from New York-style Competition

| Customers Who Switch Competition | | | Total | Total Market Tit-for-Tat |
|---|---|---|---|---|
| | Local (@ $6/ month) | Long distance (@4/month) | | |
| MA | $29.0 | $19.3 | $48.4 | $341.9 |
| MD | 32.7 | 21.8 | 54.5 | 292.1 |
| NJ | 58.2 | 38.8 | 97.0 | 542.5 |
| CA | 221.0 | 147.4 | 368.4 | 2281.0 |
| IL | 63.8 | 42.5 | 106.3 | 713.3 |
| OH | 73.7 | 49.1 | 122.8 | 674.0 |
| MO | 39.2 | 26.1 | 65.3 | 359.6 |
| FL | 119.6 | 79.7 | 199.3 | 1150.4 |
| GA | 48.5 | 32.3 | 80.8 | 520.7 |
| AZ | 29.2 | 19.4 | 48.6 | 287.8 |
| UT | 10.1 | 6.7 | 16.8 | 104.3 |
| WA | 35.7 | 23.8 | 59.5 | 354.2 |

*E. Competition Must Exist Before Allowing the Bells to Enter the Long Distance Market*

Claims that competition can be promoted by just letting the Bells into the long distance market without properly opening their local markets do not pass close scrutiny. Two States—Connecticut and Hawaii—experienced early entry because the principal statewide incumbent was not a Bell. Connecticut is particularly interesting in this regard, since it borders New York. As the figures on the intensity, extensiveness, and balance of competition in Exhibit 1 indicate, the results for consumers with respect to local competition are disastrous. Connecticut is well below the national average for the amount of competition available to residential consumers. Hawaii, which is the second State that was not served by a Bell and had immediate long distance entry, has virtually no local competition.

The root cause of the success in New York is not the mere fact of entry by incumbents into long distance. The cause of the success in New York is the irreversible market opening that took place *prior to* allowing the company entry into long distance.

Prematurely allowing incumbent local companies into the in-region long distance market undermines the prospects for competition. If the incumbents are allowed into long distance markets before their local markets are irreversibly open, local competition will not develop and long distance competition will not be vigorous. Bundling, or selling more than one telecommunications service to a particular customer (e.g. local and long distance) produces a much higher take rate for individual services and dramatically decreases churn rates, making it difficult for entrants to capture new customers. For example, Sprint long distance has a take rate of about 10 percent nationally. However, in regions where it sells local service, the take rates are approximately 40 percent. Similarly, when Southern New England Telephone entered the long distance market in Connecticut, it quickly captures about a 35 percent share of the residential market without offering prices that were more attractive than existing long distance competitors.[46] It was the bundle of local and long distance that gave it the edge.

If the local market is not irreversibly open, only the incumbent can effectively offer the local/long distance bundle and that badly distorts competition. The incumbents can capture long distance customers without having to compete on price because barriers have not been removed. They face little real local competition and their hold is reinforced by their unique ability to offer a bundle of services. The risk that arises from a rush to approve 271 is that the incumbent can exploit the anti-competitive conditions, or "competitive imbalance," in the critical early days of the bundled telecommunications market. It can then rapidly capture long distance customers by bundling local and long distance service, while competitors are unable to respond with a competitively priced bundle.

*F. The Important Role of State Public Utility Commissions*

In addition to downplaying the importance of having competition well established before entry into long distance, the Bells have been attempting to pressure the States—principally via public utility commissions or PUCs—into supporting their applications for entry by downplaying the important role that the States play.

[46] See CFA, "Reply Comments, Louisiana."

The State PUCs can use independent judgment and standards to decide whether to support an application for entry into long distance. The New York prefiling statement and collaborative process, which created the first and by far the most successful road map to § 271 entry was developed largely without FCC input. Given the stunning success in New York, it is certainly reasonable for the other State commissions to press for a model similar to New York.

In fact, the FCC has never approved an RBOC application without the support of the State utility commission. Although no RBOC has brought an application over the objection of the State, the Michigan application did not have the full support of the Commission, and it was rejected. Obviously, the State PUC must exercise reasonable judgment in determining whether an RBOC has opened its market to competition, but there is considerable leeway.[47]

*G. Conclusion*

The clear—though unfortunately unusual—success of market opening in New York provides strong affirmation for the decision of Congress in the Telecommunications Act of 1996 to require not only that rigorous conditions to support local competition be in place before the Bells are allowed into the long distance market, but also that substantial competition be in place. The real world experience is consistent with common sense. A century old monopoly that continues to enjoy massive market power and crucial strategic assets will not easily, or willingly, relinquish its hold on the market.

Deregulating a dominant monopolist in the hopes of spurring competitors to enter the local phone market, when the competitors are at a severe competitive disadvantage, is not likely to lead to more competition. Rather, such a course is much more likely to lead to significant re-monopolization of both the local and long distance markets. Should that result, consumers will be denied the substantial benefits of a competitive market.

The CHAIRMAN. Very good, sir.

Mr. SULLIVAN.

## STATEMENT OF HON. DAVE SULLIVAN, STATE SENATOR FROM ILLINOIS

Mr. SULLIVAN. Thank you, Mr. Chairman. My name is Dave Sullivan. I am a State Senator from Illinois from the northwest suburbs of Chicago in Congressman Henry Hyde's district.

As you know, Illinois has had an extensive history of having very forward-looking telecommunications policy, dating back to the days when now-U.S. Speaker of the House Denny Hastert was a State Representative in Illinois and he headed the effort in the mid-1980s to get our telecommunications law moving forward.

We have just completed a nearly 2-year process to rewrite that legislation that dates back originally to the mid-1980s. We made it a very bipartisan, bicameral effort. I chaired a working group that included all four caucuses and industry leaders from throughout Illinois, as well as consumer groups, to make sure that we were going to come up with a fair package. I think all sides were heard and they were heard well. We made sure of that.

I think the testament that it was truly a bipartisan effort is the vote total when the bill went up in front of the Senate and the

[47] The framework was substantially defined in the rejection of the first two applications, in addition to the earlier discussion of Michigan and Oklahoma, see including Michigan Public Service Commission, *In the Matter of the Commission's Own Motion to Consider Ameritech Michigan's Compliance with the Competitive Check List in Section 271 of the Telecommunications Act of 1996*, Case No. U-11104; Federal Communications Commission, *In the Matter of Application by Ameritech Michigan to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Service in Michigan*, CC Docket 97-1 Oklahoma Corporation Commission, Cause NO. PUD 97-64) Federal Communications Commission, *In the Matter of Application of SBC Communications, Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc., d/b/a Southwestern Bell Long Distance for Provision of In-Region InterLATA Services in Oklahoma*, CC Docket No. 97-121.

House was 45-to-2 in the Senate and 112-to-1 in the House. We anticipate that Governor Ryan will sign this legislation next week.

Let me touch on a few points in this bill in response to some of the issues that have been discussed this morning. We were faced with the quandary of what do we do about advanced technologies, what do we do about DSL. Our largest incumbent, SBC-Ameritech, did not like an order that they had received from the Illinois Commerce Commission, so they basically publicly and privately told us that they would not be deploying their advanced technologies in Illinois. As you can imagine, you would not want to hear that in your State. We did not like to hear it in our State.

We literally mandated in this legislation that they will deploy advanced technologies in Illinois to 80 percent of their market by 2005, which is 6 months before the sunset of this bill. We have a 4-year sunset on this bill simply because as we went through this process and we asked the industry to describe their industry to us just 5 years from now, none of them could effectively do it. So we did not want to go too far out into the future. We wanted to make sure that we would take another look at this.

We did in this legislation recognize that in Illinois, in most areas of Illinois, the business market is competitive, and in this legislation the business market is declared competition in the Ameritech region.

We also wanted to make sure that enforcement was increased, so we give the ICC, the Illinois Commerce Commission, greater powers to enforce provisions to open the network. We want to make sure that we have full network availability to all CLECs, so the ILECs open their markets. We want to make sure that that happens in Illinois.

To go along with those enforcement provisions, we felt the need that we needed to increase the penalties. We chose to do it across the board for the companies on a percentage of their intrastate revenue, annual revenue. We chose the percent of .00825 percent, which comes out for Ameritech-SBC, the largest carrier in our State, to be about a $250,000 fine.

That is per day and that fine can start accruing from the date that the carrier is notified that a violation has been posted before the ICC, that someone has filed a complaint.

So that is a quarter of a million dollars a day. That is in line with what Chairman Powell has suggested federally, taking the Federal penalties from $1.2 million to $10 million, an eightfold increase. We are taking it from $30,000 to $250,000, approximately an eightfold increase.

Earlier there was discussion about the digital divide and how do we approach that, what should we do to make sure that in Illinois, in the Chicago area, urban poor as well as downstate Illinois rural poor have the access to high technology. We have set up two digital divide funds through this legislation, one to take care of the rural, one to take care of the urban, to make sure that nobody is left behind, that as digital advances move on there will not be a divide, so that we can take care of it and limit it and make sure the all Illinoisans are properly taken care of.

I would be happy to answer any questions you might have.

[The prepared statement of Mr. Sullivan follows:]

PREPARED STATEMENT OF HON. DAVE SULLIVAN, STATE SENATOR FROM ILLINOIS

Thank you Chairman Hollings and Members of the Committee.

I am State Senator Dave Sullivan. I represent Illinois Senate District 28 in the northwest suburbs of Chicago. I am pleased to appear here today at Senator Hollings' request to describe provisions of recent Illinois legislation related to competition in local telecommunications service markets.

During the past 2 years, I served as Chairman of a Telecommunications Study Committee in the Illinois Senate. This spring, I was the Chief Senate sponsor of revisions to the Illinois telecommunications act, which Governor Ryan is expected to sign into law in the next 2 weeks.

First, let me begin by telling you a little about Illinois. In the past couple years there have been many changes in Illinois. In particular two significant mergers, Ameritech Illinois, which is Illinois' largest telephone company, merged with SBC to form SBC/Ameritech and GTE merged with Bell Atlantic to form Verizon. Verizon is the next largest telephone company in Illinois. Therefore, in re-writing this Telecommunications Article, we were in many ways working with two new companies to Illinois.

In 1986, the Illinois General Assembly enacted a major rewrite of the Telecommunications Article of the Public Utilities Act, causing Illinois to become one of the first States in the Nation legalizing local competition. US Speaker Denny Hastert was a major force in that rewrite when he was a member of the Illinois House. In 1992, the General Assembly revised the 1985 Act to permit the Illinois Commerce Commission (ICC) to implement alternative regulation plans, as opposed to the rate of return regulation. Thus far, Ameritech/SBC is the only ILEC to choose the alternative regulation plan in Illinois. In 1997, Illinois passed SB700 (P.A. 90-185) in order to implement provisions of the Federal Telecommunications Act of 1996 (TA'96). The bill encouraged competition, and prohibited carriers from knowingly impeding the development of competition in any telecommunications service market. Other revisions included empowering the ICC to impose penalties of up to $30,000 per day for a violation of a Commission order pursuant to impeding competition.

Hence, Illinois has held a strong record of encouraging and attempting to develop competition in the local telecommunications market. In 1997, in particular, it was envisioned that competition would have developed at a much more rapid pace that it is currently developing. There is competition in the city of Chicago and in a small number of Chicago suburbs; however, outside of those particular localities, competition is lagging. There is certainly more competition in the business market than in the residential market in Illinois.

In addition to delayed competition, there was a recent outcry over the deterioration of service quality in Illinois. SBC/Ameritech has had many service quality difficulties, particularly for installation and repair. To be fair, SBC/Ameritech has worked very hard to meet their service standards set by their merger conditions. However there was clearly a problem, and their customers were outraged.

Together, these conditions made the climate ripe for a re-write.

Many of the telecommunications carriers proposed their view of a re-write. Ameritech believed the law contained unnecessary regulations and rules, which leads to less innovation, less investment and less benefit for consumers. They wanted to avoid micromanagement of the marketplace.

Many of the competing carriers wanted stronger enforcement provisions. They were satisfied with the current law, but did not believe it was being abided.

The General Assembly recognized that regulation should only be a surrogate for competition, and that the marketplace should oversee whenever possible. However looking at the current marketplace in Illinois, competition has not developed to the extent by which the marketplace can be the sole determining factor of telecommunication prices with no regulation whatsoever.

Hence, the General Assembly conducted numerous hearings and negotiating meetings to develop an "intermediary" bill to help us reach the goal of accelerating competition in the local market. This bill, HB 2900, is an attempt to meet that end.

By the time of our investigations last year and this—the 12th year after local telecommunications competition was authorized in Illinois and the 5th year after passage of TA96—the total local market share of competitors in Illinois had grown to less than 10 percent. In the residential and small business markets, this share was under 3 percent. In addition, the number of competitors operating in Illinois diminished during the period; and the financial condition of those that remained deteriorated . This information, taken from FCC and investment analysts' reports, confirmed our common sense observations about the fundamental lack of competition

in the market for basic telephone service. It also contrasted dramatically with information from New York and Texas where Section 271 market opening requirements had been met and competitors had won as much as a 20 percent share by the end of last year.

Five years ago, Illinois was a leader in the effort to introduce competition in local telecommunications markets. In June 1996, the Illinois Commerce Commission concluded an investigation that resulted in the nation's first order requiring an incumbent local exchange carrier ("ILEC") to lease the elements of the public network to competing carriers both on an unbundled and on a bundled, or platform, basis. That Illinois order, like the Federal Act passed 4 months earlier, established that the initiation and development of local competition depended on new market entrants having the right lease and use the ubiquitous local public network without discrimination and at a fair price.

Within 18 months after that June 1996 order, over 300 companies received certification to offer local exchange telecommunications services in Illinois. But competition and customer choice did not follow. Among those 300 certificated competitive local exchange carriers ("CLEC s "), only 54 proceeded to the next step of filing tariffs for local service, and only about a dozen went on to provide service. Actual competitive choices have remained limited to a few services in certain high-density areas of the State, offered primarily to high-volume users.

What happened in Illinois? Why didn't competition develop more completely? Was there something wrong in the premise that competition might begin in local markets the way it had in long distance—through requirements that incumbent monopolies allow new market entrants nondiscriminatory access to lease and use the public network to provide services? Or, did the failure of local competition result from the failure to properly implement those requirements?

The New York Public Service Commission implemented an Illinois-type platform in the Verizon territory in December 1998. According to the U.S. Department of Justice, over 1,000,000 consumers were served by CLECs by the following July, most of whom were residential consumers served on the platform. And, the Texas Public Utility Commission ordered an Illinois-type platform in the Southwestern Bell territory in August 1999. The U.S. Department of Justice found that by September 2000, over 569,000 Texas consumers were served by CLECs, primarily through the use of the platform.

The successful introduction of competition in these two States using the framework of market-opening requirements developed in Illinois was critically important to our General Assembly's decision to explicitly codify those requirements.

There were many key provisions in the bill. The bill codifies several Ameritech/SBC obligations existing mostly under current Federal laws, Federal orders, and ICC orders. These obligations are all based upon making the ILECs network available to competing local exchange carriers (CLECs). The bill obligates Ameritech/SBC to make available its network to CLECs on reasonable and non-discriminatory terms. These provisions are not new. They have been mandated through orders and Federal law. Several of them have been tied up in the Court systems. The intention is to accelerate the availability of the ILEC network thereby increase the opportunities for local competition. By placing these obligations in this bill, Illinois has clearly stated the legislature's intentions to open the market to competition, and most importantly tied these obligations to the enforcement provisions of the bill.

In looking toward this competitive environment, the General Assembly declared all business services of a company under alternative regulation, "competitive". However, it protects small businesses by capping the rates of businesses with 4 lines and under until July 1, 2005 (the sunset date of the Act). Vertical services, excluding caller ID and call waiting, are also declared "competitive" as of June 1, 2003.

The bill also added four new per se impediments to competition which include (1) unreasonably refusing, providing inferior systems to or delaying access to the provisioning of OSS; (2) unreasonably failing to offer network elements that the ICC or FCC has determined must be offered on an unbundled basis; (3) violating the new obligations of incumbent carriers (Section 801); and (4) violating the order of the Commission concerning matters between carriers. These provisions are all tied to the enforcement provisions and the expedited complaint processes (rocket docket) of the bill.

This leads to the increased enforcement provisions of the bill. Under our current law, the penalties for violating the Act had not been revised since sometime in the 1920s. There was strong consensus that the $500-$2000 dollar penalties for violating the Act and the $30,000 penalty for impeding competition was out-dated, and clearly not high enough. In addition the penalty structure, which the ICC must abide by, was extremely cumbersome and overly restrictive. To date, no carrier had been fined of violating the Act.

Penalties under this bill may be assessed for up to 0.00825 percent of a carrier's intrastate gross revenues for each day of a violation. In the case of SBC/Ameritech, this penalty amount could be as much as $250,000 per day per violation. This coincides with FCC Chairman Powell's recent request to Congress for fines of up to $10 million per violation, noting that, for a multi-billion dollar company, fines of lesser amounts are meaningless as enforcement incentives.

The goal of our bill was to streamline this penalty process, provide the ICC with the teeth needed to have sufficient incentives for companies to comply with the Act, and to give ICC the tools needed to enforce the Act.

The bill increased the penalty amounts which carriers must pay for violating the Act or for impeding competition.

All penalties begin to accrue as soon as notice is provided to the carrier that they are in violation, and each day is considered a new violation.

Establishes certain mitigating factors for the Commission to consider in determining the amount of the penalty to be assessed upon a carrier Injunctive Relief—Authorizes the ICC to seek injunctive relief without first having a hearing before the Commission to stop egregious conduct of a telecommunications carrier. Also, the bill allows the carriers to seek injunctive relief in circuit court against another carrier found by the Commission to be in violation of the Act, an order or a rule.

In intercarrier disputes, allows for the Commission to issue a cease and desist order from violating the Act, rules or regulations. Provides that the Commission can award damages, attorney's fees, and costs to any telecommunication carrier in violation.

CONSUMER PROVISIONS

Service quality has been deteriorating in Illinois, particularly with out of service and installation. I will note that Ameritech/SBC has recently made many strides in correcting the problems. However the public outcry was overwhelming, and the legislators did not want such a serious problem to occur again. This bill provides strong service quality standards such as requiring installation within 5 business days and restoring service within 24 hours. The bill also provides automatic credits to consumers for violations and in cases of extended violations, the company must provide alternative phone service.

The bill outlines three flat rate packages which companies under alternative regulation (Ameritech/SBC) must offer at a savings to customers. The packages basically outline a budget package, a package for average telephone users, and a high-speed package.

SUMMARY

In conclusion, Illinois' HB 2900 is an attempt at accelerating competition in the local marketplace, by outlining specific incumbent carriers obligations for opening their networks to competitors, deeming business service competitive, streamlining the regulatory process, and giving the Illinois Commerce Commission more enforcement tools. Hopefully together these provisions will help to create a climate in which competition in the local market will thrive.

The CHAIRMAN. Senator Sullivan, your testimony is dramatic because that is out there where, as we say, "the rubber meets the road," a local legislature. They are all very competent folks. They have experienced what we have experienced at the Washington level, namely they have told us, just like they told you, they are not going to comply with the 14-point checklist, 271.

So, Mr. Kimmelman, it is either one of two ways. We either do it Senator Sullivan's way, the Illinois way, or you and I go back to price controls and reregulate them, one or the other. You have either got to mandate it—there is no use to tippie-toe around. That there 1996 Act should have been the "Free Employment of Lawyers" or "Lawyers Free Employment Act" or whatever it is, because all it has been is one legal morass to try to avoid 271, which in a sense was not an incentive.

The incentive was there. They had the incentive. They came to us begging during the 1980s and 1990s, please let us into long distance. So we said: Well, fine; we want you to get into long distance

anywhere in the country, save and except where you have a monopoly, because we just do not want you to extend it. And they agreed and they wrote it out, and now they act like they cannot understand it, it is technical, it is confiscatory, it is unconstitutional.

They have been into every court in the land and do everything except get into long distance.

Senator, we want to look carefully at your rule approach, mandate approach and the fine approach and everything else in there. You can see the interest amongst us here on the panel is definitely to try to take care of the rural areas and the universal service fund that we have and which is necessary.

Let me ask, because the hour is late, Mr. Rolka, explain to me when I ask, because I understood from the Bells that you could not do this functional, or functional structural or full structural separation. What is exactly the difference? I am an auditor and I am going out to audit the books of SBC in Illinois, and I come in and I am trying to audit and find out. The witness said, Ms. Greene, that we have already got that separation. But then she said, if you separate it it is going to add costs. If they have already separated it, but if we require then to separate it, it is going to add costs, you know, I am not understanding her correctly. See if you can straighten me out.

Mr. ROLKA. I am sorry, Senator, that I think I probably have some of the same fog that you do. I proceedings that we had in Pennsylvania when we were trying to establish what the cost of unbundled network element loops and things like that were, the company came in and explained to us how much it was going to cost to set up the business units that would be responsible for providing services through the OSS systems and things like that, and they gave us some estimates of what it was going to cost to set up those business units.

We rolled that case into the case that we had in front of us when we ultimately came up with structural separation and we had an experience from that case that told us what their estimate was of how much it cost to set up that business unit. They were really just going to be a separate set of operators, telephone operators, that were going to be plugged into their ordering and billing and provisioning and maintenance and repair systems that were going to do this work, but they were going to be dedicated to the wholesale CLEC community. They gave us a figure for that.

When we went through the structural separations case, we had that figure in mind. We were very well acquainted with it. So we said, well, look; we have had, at this point, an unending litany of problems. We have had CLECs come to us time after time after time after time and say: Well, you never really asked me that question. You did not tell me, you did not explain, you did not set a rule, you did not do this and you did not do that about what is actually required to get from here to there, the kinds of things that were important in defining things like platforms, unbundled network element platforms.

There are a lot of parts in there. But if you do not identify every one of them and put them all together from tail to end, you are not really sure what all you need. The CLECs had this never-ending litany of problems tripping across those things.

When we looked at the record in front of us, we said: The only way we are going to make this work is if we set up a unit, a company, whose existence really depends on satisfying its customers, just like the telephone company says it is their job to do, is to satisfy their customers. We need a wholesale entity whose job it is to deal with the retail arm of the ILEC the same way it deals with the CLECs who are trying to provide service to end user customers. That is the only way we are going to uncover all those thousands— and at this point there are literally thousands of questions that nobody except the ILEC knew how to ask.

So we demanded that we wanted them to go forward and set up that kind of business structure. After they found out that that is where we settled, then they came back to us and told us these wildly exaggerated stories of how it is going to cost billions of dollars now to set up a unit that previously was going to cost a very few million dollars to do.

The difference between the two of them is the functional unit exists within the existing company. You keep accounting records of where to charge the expenses associated with providing that service, and different sets of people service different entities. The structurally separated entity has to handle them both the same way. They have a contractual or an agreement that's set out in an interconnection agreement that specifies what they are supposed to do, and you can look at it in black and white and see whether or not they are providing the same things. You can look at it and you can say, the retail arm of the ILEC is ordering A, B, C through Z. You can see the piece parts of the network that they have to order, so somebody else that wants to provide comparable service can say: I really need A through Z, I do no need A, Q, D, P, M, and R, and find out that it does not work because I do not have all the other missing letters of the alphabet.

Those are the differences. Those are some of the major differences.

I was amused recently. My former colleagues in Pennsylvania issued a request to the CLEC community to find out why it is they cannot serve, why it is they cannot provide service in rural Pennsylvania. The answer is black and white in front of them. When they established the price of a loop, one of the basic ingredients for reaching the rural customers, the cost of the loop in rural Pennsylvania is greater than the retail price that the ILEC is charging its customers.

How in anybody's name can you provide service when the wholesale ingredients that go into your business cost more than your competitor's retail price? It cannot be done.

The CHAIRMAN. The business unit, you say that was pretty well studied out and the determined cost was in the millions. I do not want to sound frivolous, but, of course, millions is nothing, because we have got Verizon coming up here just recently with $233 million worth of fines and it did not make any difference to them. So it seems like they could sort of spend this amount and not have all the fines and maintain their reputation.

Mr. ROLKA. Senator, if I may.

The CHAIRMAN. They could provide more service here in comparison to, say, going overseas, down to Peru, if I have got to set up

a whole separate thing and I have to put it up in Spanish in order to understand the blooming thing.

Mr. ROLKA. Senator, if I may. To take you in a slightly different direction, but I think still related, I have heard people talk this morning about the necessity to increase the size of the stick that the regulator has to enforce penalties and create bigger fines and things like that. I would just call your attention, I guess, to a couple of from my perspective observations you should keep in mind.

One is that several of the State commissions around the country do not have the authority at all to levy fines. You can talk about any of those large—and from my perspective, relatively astronomical numbers that catch the headlines, but many of the State commissions do not have the authority to levy fines.

Second, as I sat here and listened to it I had to think back and recall. I have three children and I think about how frustrated I get every once in a while with my children, and every once in a while, I levy some ungodly penalty on my children or one or more of them, because I am so frustrated at what they have done, only to turn around and realize that, you know, I cannot really enforce it because it is too draconian. I cannot really ground my kid for the summer because of the consequences to me of grounding my kid for the summer.

The corollary is, if I make the fine so big that the ordinary guy on the street whose job it is to figure out whether or not the infraction has actually occurred to levy that penalty, you have brought a shotgun to kill a gnat.

From my perspective of being in the trenches and doing this and being trained to deal with this, from people what are responsible in many respects, who play roles in some of the REA things that happen in the rural electrification, you need not to increase the size of the gun. We do not need to move to the Cold War mentality of enforcing the Telecom Act provisions. But what you do need is when they step out of line a little bit you need to get on them right away so that they know that you mean it. You cannot wait until the problem is so big that none of us is brave enough to impose the larger fines that people are talking about.

What you really need is you need to be able to get on them when the things occur, you need to be able to get on them early and often with a fine that is commensurate with the problem. If you bring a shotgun, I am afraid that the people who are responsible for the enforcement are going to be afraid to pick it up.

The CHAIRMAN. Well, the Bell companies really belong to the people, and so when we put in 251 we required them to open up so that the CLECs could spawn and grow and provide services. The reason we did not make mandatory the 271 is they promised, they represented, they begged. That is all I heard, and I have got the statements here before me and the letters and everything else: We will be in within 6 months time, we will do this, we will do that, with no idea of complying with their promise and what they outlined in the 14-point checklist themselves.

I see, rather than going to $150 million fines, that shows me that there is an inadequacy in the Act and that it ought be mandatory. It ought not to be voluntary. If we made them comply and really opened them up, then you would see some prices, Mr. Kimmelman,

come down, just like they did in the 1980s in long distance. AT&T reduced itself to about one-third of its size and increased its profit when mandated by Judge Greene.

It looks to me that is the kind of thing that Congress ought to be looking at, and not take an end run around the Act claiming that what we are trying to do is to get data, and we are trying to get Internet services to the poor people of America, and the Bells are the only ones ready to do it, and that kind of thing, and therefore repeal the Act, and then enlarge, fortify, and extend the monopoly. That is all they are saying is what they want done.

I want to keep the record open because I know that many Members will have some questions, and if you have any additions please submit them. The Committee is indebted to each of you three. We appreciate it very much.

The hearing will in recess subject to the call of the Chair.

[Whereupon, at 12:20 p.m., the hearing adjourned.]