

**FINANCIAL TURMOIL IN THE  
TELECOMMUNICATIONS MARKETPLACE;  
MAINTAINING THE OPERATIONS OF ESSENTIAL  
COMMUNICATIONS FACILITIES**

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**HEARING**

BEFORE THE

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

**ONE HUNDRED SEVENTH CONGRESS**

**SECOND SESSION**

—————  
JULY 30, 2002  
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Printed for the use of the Committee on Commerce, Science, and Transportation



U.S. GOVERNMENT PRINTING OFFICE

92-189 PDF

WASHINGTON : 2006

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SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

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**FINANCIAL TURMOIL IN THE  
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ESSENTIAL COMMUNICATIONS FACILITIES**

TUESDAY, JULY 30, 2002

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 Committee will please come to order. Let the Committee note that our distinguished Chairman of the Communications Subcommittee, Senator Inouye, is also the Chairman of the Defense Appropriations Subcommittee, and he is busily getting that bill ready for the floor, and could not be with us, but the Committee thought it was important that we proceed with this hearing. We particularly appreciate Chairman Powell being with us. I will put my statement in the record.

I would just note that one of the principal interests that this Senator has and, of course, the Committee has is with respect to all of these telecommunications companies going bankrupt, out of business, or otherwise in financial difficulty, and at the same time the commission and the Government is charged with keeping current lines of communications to ensure there is no disruption.

I would like to know from the Chairman what laws, if necessary, are needed, in addition to his authority now. Otherwise I would like to know how the commission intends to handle the requirement that there be no disruption from a bankrupt entity that is feeding into a for-profit last line, or CLEC, or otherwise Bell Company. They have got to keep those lines going, concerning bankruptcy, and how they are going to be paid.

Otherwise with respect to the regulations themselves. On the one hand, distinguished Chairman, I was noted as saying there is probably too much competition. You are now going in the other direction, particularly with respect to regulations. We found—and Congress is in a fever to strengthen the regulations and strengthen the requirements. There was too much flexibility given these accountants and auditors, and yet I find the commission having hearings to try to cut back on the auditing and the accounting and the regu-

lations with respect to it. It should be explained to the Committee so we will understand what we are about.

[The prepared statement of Senator Hollings follows:]

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

We are here this morning to address the state of the communications industry. As it stands, the industry is in the midst of a financial crisis. It is also experiencing a crisis of confidence, as it concerns the integrity of many of its key players.

The economic downturn that took hold of the American economy close to eighteen months ago indeed set back growth in a number of American industries. The telecommunications industry, however, has been especially hard hit. In 2001, the sector lost 317,777 jobs, and in the first 6 months of 2002, the sector lost 165,840 jobs an increase of 27 percent from the same period in 2001. The magnitude of the sector's present depression is exemplified by the fact that within this same period the industry lost \$2 trillion in stock value.

This economic devastation, however, has not been limited to the wireline companies. Both the wireless and cable industries also have had to deal with the negative effects of the market regression.

Unfortunately, and especially as it concerns the telecommunications sector, these economic problems have been exacerbated by allegations of accounting fraud by key entities in the industry, on both the long distance and Bell company sides. The most significant cases, of course, involve WorldCom—the number two long distance provider in the country—and Qwest—a major provider of local service in the Midwestern and western states. Both have been accused of doctoring their books to the tune of billions, with WorldCom alone having faked profits and earnings in an amount of \$3.8 billion.

Although these revelations have occurred in concert with incidences of massive corporate fraud across the spectrum of the American marketplace, this does not negate the particular devastation that has been experienced by the telecommunications sector and the communications industry as a whole. Not only were investors duped and cheated, so were the companies' competitors and potential competitors. By feigning earnings and profits, these companies were able to gain positions in the market that they otherwise may not have achieved. This is not right and cannot be tolerated.

I helped write and remain a strong supporter of the 1996 Telecommunications Act. However, it doesn't matter what act or law or philosophy governs the marketplace. When companies engage in out right fraud, no matter the particular industry, they gain the ability to upset the very purpose of those laws.

As a consequence of the misdeeds that have occurred with these companies, millions of Americans risk a disruption of service. This hearing is designed to shed some light on this situation and to ensure that both the FCC and Congress are poised to take the appropriate action necessary to protect consumers, maintain stability in the market, and preserve the mission of achieving a dynamic competitive telecommunications marketplace.

But we also cannot ignore the fact that part of the problems we are addressing involve larger policy issues—such as the broad policy of this Administration. We all know that the SEC has a major role in addressing the current crisis in the financial markets. This crisis has been precipitated not only by the fraud inside companies, but fraud that has been facilitated by accountants and financial analysts. But we should not be too surprised by the depth of restatements we are witnessing given that the current SEC chairman came into office making clear he would enforce SEC rules in concert with the Bush Administration's ideology—pursue massive deregulation at all cost. Well we can see what that policy has gotten us—Enron and billions of lost investments by average every-day working Americans. I want to make sure this policy doesn't destroy the telecommunications industry.

As it stands, we must take at least three major actions. The first priority must be to ensure that consumers continue to receive service, especially as it concerns companies that are currently in, or may be on the brink of bankruptcy. Second, there must be efforts to address issues concerning the state of all industry sectors. At this point, these industries are so inter-connected that major problems in one will certainly affect the other. Lastly, we must also make sure that we ensure a dynamic and competitive telecommunications market. It would be tragic if regulators sought to use this current crisis as justification for forgoing the goals of securing competition in the industry.

As noted, with regard to the financial troubles facing the telecommunications industry, my principal concern at this point is ensuring that consumers continue to receive service. This is particularly important since the nation's ability to engage in commerce is heavily dependent on communications. Also, residential consumers rely upon the communications network in emergencies as well as for day-to-day activities. The U.S. communications network is the best in the world; thus, we, as policy-makers, must make sure that as we weather this difficult economic period, our communications network does not become a casualty of this period.

The FCC has authority under Title Two of the Communications Act to intervene with respect to common carriers and work to maintain telecommunications service to consumers. I believe it will be useful to hear what actions the FCC is taking to address this issue in light of some of the existing bankruptcies. We also look forward to FCC guidance as to whether the FCC has sufficient authority, or needs additional authority, to ensure that consumers receiving communications services from companies that are not common carriers are, nevertheless, protected from abrupt service terminations. Most notably, with respect to Bell Broadband Service, I am concerned that the FCC is going down a path in which it could, in effect, relinquish its existing authority to intervene when a carrier terminates service.

I look forward, as well, to hearing from the companies about what is being done to remedy improper accounting practices, in addition to having a better understanding of the difficulties that they are presently experiencing. An understanding of these difficulties hopefully will aid us in taking appropriate action as members of Congress to keep the nation's viable telecommunications network properly functioning.

As I noted previously, the telecommunications network is an interlocking network. Carriers receive and hand-off traffic to other carriers. Therefore, if a carrier goes into bankruptcy and is required to continue service, but cannot pay its debts, this could have an adverse impact on other carriers if those carriers are required to continue carrying the traffic of the carrier in bankruptcy without compensation. The FCC should carefully examine these potential domino effects and the extent to which they could prevent carriers from serving consumers. A point that deserves considerable emphasis, however, is the fact that the FCC must actively guard against allowing carriers to use these unfortunate economic situations as a means to undermine competitors or competition in general.

With that said, I welcome the witnesses and look forward to hearing their testimony.

The CHAIRMAN. Senator McCain.

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

Senator McCAIN. Thank you, Mr. Chairman. Thank you for holding the hearing on the turbulent state of economic affairs in the telecommunications industry. Today, we will hear more stories of hype and corporate greed, hype relating to the Telecommunications Act of 1996, and about the market for data traffic, and corporate greed by senior executives whose interests vastly diverged from that of their company's shareholders.

There are many important issues to address in this hearing. We must ensure that despite the looming financial crisis within the industry, consumers can expect continuity of telephone service, and that the integrity of our telecommunications network is secure. I hope that is the first subject that Chairman Powell will address this morning.

We must also examine what must be done prospectively to ensure that the misbehavior of these companies does not take down the entire industry, including those companies that have not lied to investors. And we must also examine what lessons are to be learned from this collapse.

Last week, the *Los Angeles Times* reported that some experts now believe that the root of the meltdown now sweeping the indus-

try may be the Telecommunications Act of 1996. The article states, and I quote, much of the vision of the 1996 Act was flawed, leading to more than \$2 trillion in investment, much of it squandered in ways that may cause lasting economic damage. I do not need to remind anyone here I opposed the 1996 Act. I believe that by any measurement, it has not lived up to the promises of its sponsors when it was passed.

We reached the extremes of rhetoric on the passage of that legislation. And it is not just the Members of Congress who hyped the bill. It was the lobbyists that wrote it, too. We must now review what has happened since the passage of the 1996 Act, and learn from our mistakes.

In the late 1990s, there was similar hype about the demand for data traffic. Trillions of dollars were invested in data networks by banks, pension funds, employees, and every day Americans. Wild expectations fueled unprecedented investment. Much of that investment went toward infrastructure deployment that now spans the country. Massive networks capable of carrying unimaginable amounts of data traffic now sit in the ground untapped.

There are perhaps many reasons why that capacity lies fallow, many relating back to the thousands of regulations spawned by the Telecommunications Act. But the unfolding story of these networks reveals as much about corporate malfeasance as it does the hyper regulation of the telecommunications industry. Not all the money invested in telecommunications in the 1990s funded infrastructure. Much of it went to line the pockets of corporate executives who were paid to know better about the markets in which their companies operated. They conducted a confidence scheme unlike any ever seen before. Some corporate executives appeared to participate in systematic get-rich schemes at the expense of unwitting investors. These executives hyped their product by reportedly overstating demand for their services. In the process, they ran up the stock prices of their companies to the point where they were worth many billions of dollars. These executives built a house of cards upon a foundation of their own overstated promises.

Then, as this week's Business Week reports, "a small group of CEOs and financiers managed to save the family silver before the house burned to the ground." They pillaged the assets of these companies by granting themselves and selling huge volumes of stock, which is going on today, paying themselves exorbitant compensation, and, in some cases, arranging sweetheart deals for family and friends.

The way these executives cut and run on their employees when the going got tough simply reaffirms my belief that top executives should be precluded from selling their holdings in company stock until they no longer manage the company. These companies are the poster children for the need for reforms that would ensure that the financial fate of top executives is inextricably tied to the long-term health of their company, in line with the investors whose interests they have been charged to represent.

While Congress has acted, not enough, on accounting reform legislation that is now at the President's desk, we need to establish more safeguards against corporate fraud in this country. This Committee has already heard too many stories of investors who lost



their life savings due to fraudulent schemes. We will no doubt hear of more schemes today. Additional protections would help to ensure that such stories are not repeated. In my view, these changes are needed if we are truly committed to fully restoring the systemic checks and balances that will rebuild the faith of the American people in both our markets and the corporations who operate within them.

Finally, Mr. Chairman, I would like to thank Chairman Powell for appearing before us today. Because of the mandates of this Committee he has had to cut short a much-deserved vacation to be here. I hope he can return soon. You have provided leadership at a tremendously challenging time. I commend you on the initiation of proceedings that attempt to answer the hard questions that have polarized the Congress.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. Senator Burns.

**STATEMENT OF HON. CONRAD BURNS,  
U.S. SENATOR FROM MONTANA**

Senator BURNS. Thank you, Mr. Chairman, for this hearing today, and thank you for your leadership on this issue. My statement will be very short. As you know, we have already passed the Accountability Act, and the President signed it today. During that debate, I contemplated proposing an amendment to that legislation. However, after further reflection I determined that I wanted instruction and recommendations from the Department of Justice, so in response I wrote Attorney General Ashcroft on July 15 requesting to take a look at the forfeiture laws and how they could possibly be used against malicious corporate activity.

Forfeiture has long been an effective enforcement tool in cases pertaining to narcotics and controlled substances, yielding hundreds of millions of dollars in revenue for the government from the resale of seized ill-gotten assets. Witnessing the damage done to our institutions, investor confidence and, of course, the every day American by these corporate scandals is it is in my thought that it is time to take aim on the untouchability of the wayward corporate executives, CEOs, and others who would imperil the life savings of their employees, their boards of directors, and send shock waves through the American economy should not be allowed to maintain a lifestyle that was bought by wealth achieved through deceptive practices. As I have said before, America must never reward deceit.

Unfortunately, I have not yet received a response from my inquiry to the Justice Department, but I look forward to developing such an approach once they do respond.

The bottom line is, those who play fast and loose with the life savings of hardworking employees and their lives and the ripple effects through supporting industries, see their lavish and luxurious assets confiscated, and this includes their second homes, their boats, or whatever, the enormous amount of cash that is tucked away in off-shore accounts. These corporate felons should be brought to justice and properly punished for their crimes.

Finally, Mr. Chairman, today we look at the telecom marketplace, but it is important to remember that this financial fallback

is not solely taking place in the telecom marketplace. It is throughout our economy. It is just not in one place. Life savings have been devastated. Consumer-end confidence has been swept away by an unprecedented avalanche of financial destruction. The very foundation of the American economy is at stake as we look to reform our system of corporate governance.

I look forward to hearing from the witnesses today, and I appreciate the Chairman of the Federal Communications Commission in the middle of his vacation—I would just be madder than hell, to be right honest with you, but thank you for coming today, and we look forward to the testimony.

The CHAIRMAN. Senator Wyden.

**STATEMENT OF HON. RON WYDEN,  
U.S. SENATOR FROM OREGON**

Senator WYDEN. Thank you, Mr. Chairman. I appreciate your holding this hearing as well. It seems to me that the companies that we are going to hear from today are important symbols, and important symbols of both the crisis in the telecommunications sector and for the accounting reform bill that Congress passed and is being signed today.

My colleagues have been right to talk about the innocent investors that have been shellacked by the companies and others that we are going to be considering today and in the days ahead, but it seems to me we also have to focus now on the consequences of the telecommunications meltdown, and it seems to me that if this continues, and particularly if there are service disruptions, this is going to radiate enormous damage to the American economy, and I particularly—and I, too, join in thanking Mr. Powell for coming—want to hear about what he believes is the appropriate approach now, given the every different climate that we have compared to what it was when Mr. Powell assumed office. I think when Mr. Powell took on the job, the telecommunications sector looked very different, and he was hoping to chart a course to create more competitive waters. Instead, the Federal Communications Commission and Mr. Powell find themselves in the midst of a raging storm that has been sinking company after company and, in particular, I want to hear from the Federal Communications Commission and Mr. Powell, when is it going to stop? What can the Federal Communications Commission do now to help steer a course to calmer waters, and it seems to me that the current climate and the devastation we are seeing in the telecommunications sector requires a different approach than that that was envisaged early on, and I hope that Mr. Powell can tell us how, given the different situation, that the country faces today, what approach he can offer to help calm the waters and provide some assurance to consumers who are really up in arms about the prospect of losing service, seeing even more economic damage, and having it ripple, for example, to Internet connections and other areas that are so important to the public.

Mr. Chairman, my thanks again to you and I look forward to working with you and Senator McCain and our colleagues on a bipartisan basis.

The CHAIRMAN. Thank you. Senator Breaux.

**STATEMENT OF HON. JOHN B. BREAUX,  
U.S. SENATOR FROM LOUISIANA**

Senator BREAUX. Thank you, and good morning. Thank you, Mr. Chairman, for having this hearing. I think it is very timely in the sense that I think that every day we pick up the paper and we have one more telecom company that is facing difficulties, Internet providers facing difficulties, and obviously, if you are looking at 21st century jobs and the industrial and communications age, I think really these industries that are out there are having a very difficult time, and no matter whether you are long distance provider or service provider or Internet provider or content provider, it looks like every day we find yet another one of these very important industries having incredibly difficult problems.

I think that when they come to Congress to look for help and solutions sometimes they find a political bottleneck, where we spend a great deal of time arguing about the politics of what we should do and precious little time looking at the real substance of what we do.

We have had an approach that says, look, when it comes to broadband, which is incredibly important, that the FCC ought to be the one that tries to create a level playing field, that it is almost impossible for, I think, Congress to get into the technical details of what actually is a level playing field for these industries to compete. An appropriate forum is the agency that has been set up to regulate these industries, to help create level playing fields, and take it outside the political world, and we are attempting to do that, and I will ask the Chairman some questions if I have the chance.

Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. Very good. Senator Dorgan.

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

Senator DORGAN. Mr. Chairman, thank you very much. Just briefly, and I know you want to get to Chairman Powell, I think we have had a good number of hearings on the issues of corporate governance, some of these scandals, bankruptcies, financial problems that have existed, and I think this hearing is a very important one in the context of what is happening in the telecommunications industry, especially with respect to some very high profile, very serious problems, and I would say to Chairman Powell I think the underlying message today, at least for me, is the importance of effective regulation, the importance of effective oversight.

The market system is a wonderful thing, but the market system begs for effective regulation and oversight, and when it does not exist, whether it is at the FCC, the SEC, a dozen other federal agencies, FERC, when it does not exist, what happens is, we have very serious problems, and we likely will talk at some great length about the myriad of issues that are raised today with respect to accounting, accounting firms, law firms, CEOs—the one company that I have chaired hearings on I talked about a culture of corruption that existed inside that company.

That was confirmed by the board of directors. There is not much a regulator can do about people with corrupt hearts who are run-

ning a company, but on the other hand, I think the underlying issue here must be that we need effective, aggressive regulation. Those who have the handle on the ability to do that in the executive branch of government must work with us to achieve that effective level of regulation and I hope this hearing is helpful in furthering that objective.

Mr. Chairman, thank you very much.

The CHAIRMAN. Thank you. Senator Cleland.

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

Senator CLELAND. Thank you very much, Mr. Chairman.

In the 1960s in the Midwest, a small communications company used microwave technology to establish an internal communications system, just about the time that I was becoming a microwave radio officer in the United States Army Signal Corps.

Twenty years later, this company, MCI, was one of the main reasons for the Department of Justice action and the resulting consent decree that ended Ma Bell.

Today, almost 20 years later, this company, WorldCom, has become the Nation's largest bankruptcy filing after a downward spiral that would almost predetermined to end in bankruptcy when it declared that \$3.8 billion had been, quote, misclassified.

However, this corporate mistake translates into not only a loss of billions by investors and unemployment for thousands, many of whom are in my state, but potential problems for people's basic communications, upon which, Mr. Chairman, we thought the entire new economy of America was going to be built.

WorldCom is the Nation's number 2 long distance provider and a large local service provider. I have heard from someone in the telecom industry that WorldCom has threatened to cut off service to another company if they do not receive payment by this week. In Georgia, that would translate into 25,000 business lines. This is unacceptable, at the same time that the State of Georgia is thinking about a \$2 billion contract with WorldCom to handle the internal telecommunications of the entire State of Georgia.

How did we arrive at this point? A big part of this answer is the growth and promise of the Internet itself, and related economic trends that did not require actual assets, and allowed and even encouraged speculation and outrageous amounts of debt. Venture capital funds—I call them adventure capital funds—were virtually giving away money to anything with a .com at the end of its name, while more traditional businesses struggled just to get a loan from the bank.

I do not think policymakers fully understand the approach many Internet-based companies were taking while they were posting massive gains in paper value, and the results of this speculation are playing out today with only \$2 trillion in telecommunications stock value being eliminated. It was an era of buy now, pay later, but this Internet accounting contained some fatal errors in its system.

Today, investors and employees are left empty-handed by these Internet accounting practices, while some of these executives were able to cash in through stock options and bonuses. I have said it

time and time again, particularly in terms of Enron—it certainly applies now to the telecom industry—in my experience in the military, officers eat last. Within this economic combat, officers ate first.

I applaud the Department of Justice for acting last week to make the arrest of Adelphia executives, and I hope their investigations will continue and charges and arrests will follow in cases that warrant action. It was said in the newspaper that this particular family used that company as a billion-dollar piggy bank.

Chairman Powell, you are here with us today. Hopefully you can shed some light on where we have come from, where we are now, and what we ought to be doing. I hope that you can reassure us that the FCC is on the case and will take the necessary action against these companies and help us through this muddled environment.

Last week, Congress passed with my support—the President will sign it into law—legislation that will strengthen corporate accounting standards, and I would like to reassure the citizens of my state and of this country that the role of government as a law enforcement body, regulatory body, and law-making body has been exercised recently to prevent these scandals from happening in the future and ensure current protections are enforced.

I agree with Senator Dorgan, the marketplace is a wonderful thing, but without the countervailing power of government, it runs amok. This is an appropriate time to examine the role of the FCC in this telecommunications debacle, and I look forward to the Chairman's testimony.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. Senator Allen.

**STATEMENT OF HON. GEORGE ALLEN,  
U.S. SENATOR FROM VIRGINIA**

Senator ALLEN. Thank you, Mr. Chairman, and I very much appreciate your leadership and that of Senator McCain in holding this hearing. I will not refer to all of the concerns that were expressed by Senator Cleland, where the leaders are eating first and the troops last. The purpose of this meeting is to focus on that, but also, I think, to focus on the financial condition of Qwest Communications, Global Crossing, and WorldCom, and their ability to deliver services to customers through these financially trying times.

Obviously, I care about this as Chairman of the Republican High Tech Task Force. I also care about this from my experience as Governor, where we worked very hard to get a lot of telecommunications companies and technology companies into Virginia. One of those was WorldCom. We in Virginia have a lot of technology. It is a strong technology state, but when something like this happens, obviously it adversely affects jobs as well as communications.

Indeed, the Internet was invented in Virginia at the Pentagon, and 60 percent of all the world's Internet traffic currently travels through Virginia, so we in Virginia have a vested interest in this telecommunications policy debate, and I am hopeful that when we examine these telecommunications companies, we will have a better understanding not only of what went wrong financially in poor planning and deceptive practices, and stealthy and possibly crimi-

nal accounting practices, but also how we are going to keep their communications systems in operation so that they, or whoever takes it over, can deliver communications systems that are vital to our whole economy and our whole country.

Obviously, there are consequences of these bankruptcies for creditors who are not paid, for employees who are laid off, and last but not most importantly, I do look forward to hearing from our Chairman of the Federal Communications Commission, Mr. Powell, on their efforts to assure that the WorldCom bankruptcy does not mean customers will lose their services.

It is important that the Commission examine and work with WorldCom to maintain interconnection and ensure that data networks remain operational, and I thank the Chairman for cutting his vacation short to be here for this very important hearing, and I thank you, Mr. Chairman, and the Ranking Member, Senator McCain, for your continued perseverance and leadership on this important matter.

Thank you.

The CHAIRMAN. Thank you. Senator Nelson.

**STATEMENT OF HON. BILL NELSON,  
U.S. SENATOR FROM FLORIDA**

Senator NELSON. Mr. Chairman, we are starting to examine how this particular part of America operates and how it does not operate very well. I think it is going to be a real challenge for us, specifically in this Committee, as to how this telecommunications industry is going to shake out over time, what kind of combines are there going to be as we look, for example, also in this Committee at the aviation industry and the kind of combinations that we are going to see there, or the kind of mergers. But one aspect of what is going to happen to this industry is the subject that you bring to the table today, and I appreciate that you have done it, the fact of us making sure that the FCC has the authority and the initiative necessary to stop these kind of crises that come up.

We address part of it with the accounting reform legislation that we passed last week, but this Commission should not be afraid to use its section 214 authority to avoid service disruptions when problems arise and greater use of the Commission's accounting disclosure requirement should be used to eliminate fraudulent business practices.

Some attribute all of these problems to competition, and seek to use that as the excuse, but we have got to get to the bottom of how the Government's appropriate oversight and regulatory authority is to keep these people on the straight and narrow.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Boxer.

**STATEMENT OF HON. BARBARA BOXER,  
U.S. SENATOR FROM CALIFORNIA**

Senator BOXER. I would ask my full statement be in the record. I would just like to speak for about a minute.

The CHAIRMAN. It will be included.

Senator BOXER. Mr. Chairman, Senator McCain, thank you for staying on top of these issues. When we first heard about Enron,

we thought it was just a case of one bad apple, as President Bush likes to say, and then we see there are others, a lot of rotten apples. It is beginning to look like there is an orchard here, and I will tell you, it is very disturbing, and to put it into specifics, there is a WorldCom employee in San Ramon, California, whose name is Steve Vivien. He worked for the company for 19 years, and he accrued over \$400,000 in his 401(k) plan, and he has lost almost all of it.

In meetings with my staff, Steve said, "I invested with WorldCom because I was a loyal employee who believed in the goals of the company and believed the company's stated financial results. I am shocked," he said, "that WorldCom stock is worth pennies and the company has filed for bankruptcy. I am angry that I lost my hard-saved money due to apparent fraud" and so it goes over and over, again and again, and in terms of my state CalPERS they invested in WorldCom bonds, \$413 million. You know, how much can this go on with these pension funds.

So you know, luckily we have diversity required in these funds, otherwise we could be in worse shape, but in any event I am looking forward to hearing from Mr. Chairman, and Chairman Powell. This has got to stop, because it is infecting our whole economy.

Thank you.

[The prepared statement of Senator Boxer follows:]

PREPARED STATEMENT OF HON. BARBARA BOXER, U.S. SENATOR FROM CALIFORNIA

Thank you, Mr. Chairman, for holding this hearing. The Commerce Committee, under your leadership, has taken a lead in investigating the recent corporate scandals in America.

Before us today are FCC Chairman Powell and the heads of WorldCom, Global Crossing, and Qwest. In a sense, we have the watchdog and the foxes testifying here today. I assume we all know which side the foxes are on. The questions before us is: whose side is the watchdog on?

I know where I stand. I stand with Steve Vivien. Steve is a WorldCom employee in San Ramon, California. He has worked for the company for nineteen years. During that time, he accrued a little over \$400,000 in his 401(k) plan and now has lost almost all of it.

In meetings with my staff, Steve said, "I invested with WorldCom because I was a loyal employee who believed in the goals of the company and believed the company's stated financial results. I'm shocked that WorldCom stock is worth pennies and that the company has filed for bankruptcy. I'm angry that I lost my hard saved money due to apparent fraud."

I join Steve in his anger.

And I am also on the side of The California Public Employees' Retirement System (CalPERS), California State Teachers' Retirement System (CalSTRS) and Los Angeles County Employees' Retirement Association (LACERA). These funds invested a combined \$413 million in WorldCom bonds in May 2001 on behalf of California's public employees.

In deciding to invest in these bonds, these public pension funds relied on the Registration Statement that WorldCom had filed. The funds now allege that the Registration Statement contained misleading information about the company and that the banks who underwrote the offerings should have known this. Everything that I have read leads me to believe that these allegations are accurate and that my state's pension funds were robbed.

It is completely unacceptable that executives at these firms and others are floating to earth on golden parachutes while the savings of employees are plummeting to the ground without a safety net.

All three of these companies, WorldCom, Global Crossing, and Qwest put out misleading numbers. As a result, investors and employees have lost billions of dollars and many Americans have lost faith in the system. And to add additional pain to

this injury, these companies are crucial to our nation's telecommunication system. They are part of the backbone of our economy.

It is up to the FCC to make sure that our communication system works. It is the responsibility of the FCC to be informed on the state of the industry and to make sure that these companies are abiding by the rules that govern telecommunications. A lack of enforcement of those rules may have led to a sense of disrespect for rules altogether at these firms, whether they are accounting rules or rules related to competition or quality of service. If the FCC needs greater authority to enforce the law or greater authority to provide for the stability of our country's communications system, then we should give them that authority.

I have been amazed by the degree of arrogance with which various CEOs have come before us. Instead of contrition, we hear excuses. Instead of explanations and plans for making things right, we hear complaints that new reforms would be excessively burdensome. Instead of commitments to return ill-gotten gains, we find executives without any sense of guilt or shame holding on to their multi-million dollar homes and severance packages.

Mr. Chairman, I commit to working with you to make things right. It is time we sided with the people. I know that is where you are and it is where I hope we will all end up.

The CHAIRMAN. Very good. Senator Brownback.

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

Senator BROWNBACK. Thank you, Mr. Chairman. I would ask my full statement appear in the record. Thank you for holding the hearing. Thank you, Senator McCain, for your continued focus on this. I look forward to the presentations that will take place today.

One of the things that I think is important for us to look at is the issue of fraud and lying that has taken place, and to call it for what it is in a number of cases. We must also look at and examine the Telecommunications Act of 1996. Some people are going to lay blame there, at the Telecommunications Act, and others will reject that. I would note that that act only promised people the opportunity to compete, and nowhere guaranteed any success, profitability, or reward, for what individuals would do.

If we need to change that act to be able to address some of the issues in the market that have taken place, I hope the witnesses will bring that up, and address the specifics that should be addressed. I do not think we should lay corporate fraud or greed at the feet of the Telecommunications Act of 1996. Some people claim it is deregulatory, others would point out that it is not, but I would hope, if there are specifics that we need to change in that act for this issue and this system—I would note that while the stock market may be down, although I am pleased to see some of the rallying taking place, the telecommunications that we are providing to our people across this country and across this world continues to be the envy of the world.

We provide excellent telecommunications at very good prices, and some may suggest too good a price, with what is taking place today. I would simply want to note that if people want to look at and change the Act, because they think we need to for the benefit of telephone subscribers, let us address that. Let us put those on forward, but I do not think you can lay the issues of corporate greed, of fraud, at the feet of the Telecom Act of 1996. I would hope we would separate those out into different pools of issues that we need to resolve and deal with.

Thank you, Mr. Chairman.



[The prepared statement of Senator Brownback follows:]

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

Today the Committee convenes to review the status of our nation's telecommunications market in light of the corporate accounting scandals that have rocked the foundations of the corporate world in America, as well as investor confidence in our nation's corporate business leaders. I'm pleased that the Bush Administration has taken the lead in pursuing corrupt business practices, investigating companies suspected of wrong doing, and prosecuting those parties accused of perpetrating fraud on their shareholders and the public. Strong action to deal with such wrongdoers is appropriate, and can have a soothing affect on the market, as witnessed by the markets rise following the first arrests of accused corporate wrongdoers.

Two of the companies attending today's hearing have not been charged with wrongdoing, however they are under investigation. Another, WorldCom, has been charged with fraud for accounting certain expenses, like access charges, as capital expenses. As WorldCom's internal audit revealed, this had the effect of padding the company's books to the tune of \$3.8 billion. Global Crossing and WorldCom are now in Chapter 11, and there is speculation that Qwest is not far behind. These developments, as well as what I have seen referred to as the "cratering" of the telecom sector in general, have raised questions about the stability of communications in the U.S. and the impact the current environment could have on consumers.

While there can be no doubt that the telecom sector has been down for quite some time now, and this can be attributable to many factors such as increased competition and possible short-term over capacity, there can also be no doubt that the first priority in addressing what ails the telecom market today remains the issue of corporate governance.

Fraud. Lying. These cannot and will not be tolerated. I am sorry to say that Mr. Sidgmore's submitted testimony to this Committee is only representative of the very arrogance that has created a need for today's hearing in the first place. For a company accused of such practices against its customers, investors, and competitors—to which WorldCom owes hundreds of millions of dollars—to come before this Committee, and lay blame for its current woes on any and everything other than it's own practices, is sad.

The Telecommunications Act of 1996 promised only one thing—the *opportunity* to compete. Nowhere does the Act guarantee success, profitability, or reward for inefficiency, nor should it. Unfortunately, some companies continue to believe the Telecom Act was social security for telecommunications companies—guaranteeing them profitability in new markets, and ensuring that they would make not only a minimum profit per subscriber, but guarantee them a minimum level of subscribership as well. The Committee is seeking to determine the status of the market. In my view, while the *stock* market may be down, the U.S. telecom market is still the envy of the world. We have the most seamlessly integrated and robust network of any nation. What we need to do to revive the market is to reintegrate reality back into it.

Mr. Sidgmore's testimony often references the concept of innovation. I see little that is innovative about a company seeking to enter a new market, such as broadband, through the use of the facilities of its competitors. To be sure, Mr. Sidgmore, any questions about Bell compliance with the Act can be addressed through tough oversight and enforcement. But we must also raise tough questions—and provide answers finally—as to what is being enforced.

In my view our telecom market is full of valuable and fully functioning facilities, even if some of the corporate structures that own them disappear or are required to undergo restructuring to make use of them. To the degree the current telecom doldrums continue, mergers and acquisitions may help to alleviate some of the market congestion that many believe continues to drag the industry down. Nobody prefers mergers to multiple competitors in a market, but let's not kid ourselves about the reality of business and markets, and developments that would occur if we continue to experience market failures. The facilities at play are too valuable to lie dormant.

This is not to say that there is not the potential for upheaval where consumers are concerned, and that is the first duty of this Committee: protect consumers. The Federal Communications Commission has authority under section 214 of the Act to ensure that failing common carriers continue serving consumers so they may transition to alternate service providers. I have no doubt that the FCC is prepared to act if developments require.

The lack of section 214's applicability to information service providers, such as cable companies that offer consumers cable modem service, is a different matter. As we have seen with @Home, the Commission has no authority to require them to continue serving consumers. Nor should the Commission reclassify information service providers as common carriers simply to address this deficiency in the law. I would certainly support legislation providing the Commission with the statutory authority to extend section 214-like protections to consumers subscribing to information services.

Finally, while I am confident that the market will weather the current storm, and consumers will continue to be served, there are some developments associated with the bankruptcy of the second largest long distance company in the U.S. that need to be addressed. WorldCom is currently in arrears of several hundred million dollars in access charges and payments for the use of ILEC facilities. We must ensure that WorldCom's reorganization and subsequent shedding of debt does not also create mounting problems for incumbent local exchange carriers, not only forced to compete with a WorldCom made leaner and meaner through Chapter 11 protection and reorganization, but through defacto subsidization of their competitive efforts by ILECs who are prevented from collecting debts owed. I have 36 independent telephone companies operating in my state, and many of them are very small. They cannot be expected to bear the brunt of WorldCom's financial straits.

The CHAIRMAN. Very good.

Chairman Powell, let the record show we invited the CEOs of Qwest, WorldCom, and Global Crossing, Mr. Anschutz, Mr. Winnick, and Mr. Ebbers, and for obvious reasons they have not accepted our invitation. We have got the next best, we think, appearing on the panel just behind, otherwise we welcome you to the Committee and we will be glad to hear from you at this time. Your statement in its entirety will be included. You can summarize or deliver it, as you wish.

**STATEMENT OF HON. MICHAEL K. POWELL, CHAIRMAN,  
FEDERAL COMMUNICATIONS COMMISSION**

Mr. POWELL. Thank you, Mr. Chairman. I will try to do a little of both, if I could. I appreciate the full extent of it being put in the record.

I want to wish all of you a good morning, and I want to particularly commend Chairman Hollings and Mr. McCain for holding this hearing, because I think it is doing something extremely critical, which is focusing more broadly not only on the horrific accounting scandals that have dominated the headlines, but what are the broader implications for critical telecommunications services on which our individual citizens depend and our economy rests, and so I applaud the focus of the hearing, and I am always anxious and able to be an active participant in that discussion.

As the Chairman of the Federal Communications Commission, before I go forward with my formal remarks, I would like to say one thing, given the tenor of some of the remarks I heard. I grew up in a leadership culture where officers eat last. I find deplorable and despicable the drumbeat of stories in which individual leadership purporting to act on behalf of an organization and institution with a public trust profit handsomely at the expense of not only the employees and their shareholders. I find such conduct in my cultural background despicable.

A WorldCom MCI employee who I respect greatly, when calling me informing me about the current crisis, stated to me, Bill McGowan would be turning over in his grave, and I suspect that he is, and I think that is a tragedy.

Moving forward, I am going to focus my comments on two areas. First, I want to discuss the immediate challenges posed by the WorldCom bankruptcy filing, and try to outline the Commission's responses in areas which it possibly could improve in order to ensure the continuity of service.

Second, just as importantly, I want to attempt to explain the current distress in the telecom market, how it came about, and the steps I believe are going to be critical for its recovery. Turning to the first topic, let me just state, protecting consumers from service disruption is the first and highest priority of the Government and the Federal Communications Commission, but I do want to say from the beginning, I am confident that we are not facing a crisis in the provision of service stemming from this bankruptcy.

We have spent many hours reviewing the situation, and everything thus far confirms this view. We have had first-hand discussions with creditors and lenders, with senior WorldCom executives, with critical WorldCom customers and Government users. All are presently confident that there is no imminent threat of major service disruption, and as a personal endorsement, I am a customer of MCI WorldCom long distance, and nothing I have seen has prompted me to switch service at this time, and I do not plan to.

In the last year, regrettably, the commission has had to cope increasingly with the specter of bankruptcy in this industry. Consequently, we have worked to develop responses to these situations in cooperation with our state colleagues that endeavor to do three things, first maintain the operation of the network, second, try to contain the fallout to prevent damage to other companies, and particularly consumers, and finally, to provide for an orderly transition of customers and assets should that become necessary.

Our actions generally have four components, which I will go over briefly. The first I list as heightened alert. It has become more critical than ever that the Commission and the Government have significant advance warning of trouble in the sectors with respect to particular companies, and in anticipation of those dangers begin to prepare to ensure that it has adequate responses when and if bankruptcy comes about.

In doing this, we have opened up many lines of communication that are relatively nontraditional for the Federal Communications Commission, particularly with lenders and creditors who are often calling the shots just on the eve of the bankruptcy filing in order to assess that imminency and possibility of a collapse. A day after the announcement of the problems at WorldCom, I traveled to New York City for the sole purpose of meeting with banks, investors, and others to discuss how critical the situation was and what the extent of possible collapse of the company was. We have increased our dialogue with the significant customer groups as well, particularly the Government, as a critical user in order to spot service degradation and service disruption.

The second component that is vital is, the commission needs to be engaged actively in intergovernmental coordination. This is one of the first critical steps. For example, we immediately began discussions with the Department of Justice, which is charged with being our legal representative in any imminent bankruptcy proceeding. In the case of WorldCom, we have consulted with the De-

partment constantly in preparing our responses to the bankruptcy court, and coordinating strategy in order to achieve those three objectives I mentioned. Those dialogues are continuing.

In addition, the Commission has long had formal relationships with the Government that aid in the protection of critical infrastructure. For example, we have a formal relationship with the National Communications System, which is responsible for monitoring and responding to mission-critical communication needs of the Federal Government. I also sit as a member of that organization, and we have been discussing the risk and possible responses.

In addition, we sit on the JTRB, which is an executive agency which considers emergency responses to preserve critical communications in time of emergency for the Federal Government, and the commission has discussed risk and responses with the Office of Critical Infrastructure.

And finally, given that there are allegations of fraud and misdoings in the WorldCom matter, we have been active as a member of the Corporate Fraud Task Force created recently by President Bush to ensure that there is a Government-wide coordination of the investigation, and we have also been in regular contact with state commissions, who often play a significant role in the context of protecting service in their jurisdictions and their appearances in bankruptcy court.

I personally have monthly conference calls, and more is needed in order to try to coordinate our response and share our experiences, and importantly, of course, we consult with this Committee and the U.S. Congress to keep them apprised of the situation and to advise them if any congressional action will become needed or is imminent, and I do have some suggestions in that regard, which I will get to near the end of my testimony.

The next phase is always the active engagement of the commission in bankruptcy proceedings, which is where we find ourselves today with respect to WorldCom. Bankruptcy actions often move extremely quickly, and the Commission must act promptly to assure the interests of consumers are protected before the court.

Our authority, as has been mentioned by a number of Members, stems largely from section 214 of the Communications Act. Briefly, our rules require that WorldCom, for example, needs to incorporate specific wording advising customers of their right to file comments with the Commission against any proposed discontinuance of service. WorldCom must then file a copy of that notice with the Commission, and the Commission then can issue a public notice of the filing. WorldCom may only discontinue service on the 31st day after the public notice, but it is important to note that this 30-day grace period is a minimum required by the rules and the Commission may extend this period should be public interest warrant such an extension.

The day WorldCom filed bankruptcy, we took several immediate actions to ensure our regulatory requirements would not be neglected. I promptly sent a letter to John Sidgmore, the CEO, advising him of his regulatory obligations. Additionally, I sent a letter to the company asking them to commit in writing to provide notice to customers of the company's plans to exit the wireless resale

business and to offer a transition plan for moving those customers to other networks.

Our Interbureau Task Force stands ready to handle applications or other regulatory implications, and I am proud to say that at this point the company has been very forthcoming and cooperative in all of these regards.

In addition to ensuring the company complies with the law, the commission will advise the bankruptcy court of our concerns with respect to the impact on consumers, and urge that any ordered shutdown provide for transition for customers. Given the significance of the bankruptcy involving WorldCom, our Deputy General Counsel flew to New York and appeared personally in the first hearing before the bankruptcy judge to urge consideration of important public policy objectives, which include, as I have noted, continuity of operations, the transition for any displaced customers, and due consideration of the impact on other telecommunications service providers that generally must continue serving bankrupt carriers.

As an outgrowth of that participation, Judge Gonzalez last week granted interim approval for WorldCom to continue making its payments to the Federal Universal Service Fund. I know this is of significant importance to many Members of the Committee.

Furthermore, the USAC, the Universal Service Administration Company, reports that presently WorldCom is current with its contributions to this important fund, that keeps high cost telephone service affordable. We have been advised that WorldCom expects to make its next payment, due in mid-August, and it will be made in a timely fashion. We will remain active in this bankruptcy phase.

Finally, it is important to continue the dialogue with customers and consumers. In an effort to do so, the Commission believes it is important to use our resources to communicate with them about the risks and the options they have available. In this regard, recently we issued a consumer alert with respect to WorldCom that was reported widely by the media, advising citizens and consumers of the risks and the options available to them. We will continue to do so as needed.

To date, I am proud to say, though, we are not prepared to sit at all on these laurels, that we have been fairly successful in managing the growing numbers of bankruptcy. In all of the 23 wireline or fixed wireless bankruptcy cases we have had since November of 2001, an orderly transition was achieved, and all but the most minor disruptions of customer service were avoided. In every major bankruptcy situation that we have encountered, we have been and we will continue to act vigorously as an active and aggressive participant in these proceedings.

Let me now turn to the other focus of this hearing which I think is vital, which is the broad turmoil in the telecommunications industry. As I said, while the corporate scandals are dominating the headlines, it is important to focus broadly on the distress that has hit the sector. It is important to note, for example, 24 hours before any of us learned about the wrongdoings at WorldCom its stock was still trading around \$1, down from somewhere in the sixties.

The stress long preceded the current raft of corporate misdeeds. Clearly, the telecommunications industry is riding on extremely

stormy seas. This is an industry where nearly 500,000 people in the United States alone have lost their jobs, and approximately \$2 trillion of market value has been lost in the last 2 years. By some estimates, the sector is struggling under the weight of nearly \$1 trillion in debt, and most segments of this industry have seen precipitous declines in their individual stock values. The long distance industry alone is down 68 percent year to date, the wireless industry is down 71 percent year to date, and ILECs are down nearly 40 percent.

Clearly, there are very serious stresses on this important industry, but let me turn to an optimistic note. This market is not collapsing and is not going to fail over time in my estimation. Communications services remain vital to consumers around the globe. Communications traffic continues to increase at historically formidable rates if not the halcyon levels we have seen previously, and importantly the closing of time and distance barriers to information will continue to fuel global economic productivity and change all institutions of society, but again, albeit slower than once fantasized.

It is in the interest of every citizen in the United States that this industry recover, and to ultimately succeed in bringing new and vital services capability to people's lives. Recovery, however, is not going to occur overnight, and it is likely to require very difficult, and I will even say painful choices. Successful recovery is dependent on the collective efforts of Congress, federal and state regulators, the private sector and, importantly, the financial markets.

A number of you have asked that I describe a little bit of how we got here. There are varying views, but an image is beginning to come into focus. The story at bottom I think is quite straightforward. It begins simply with the Internet gold rush. The Telecommunications Act of 1996 and the commercialization and mass market adoption of the Internet led to near hysterical beliefs that the opportunities for growth were limitless, talk of the Internet doubling every 100 days, infinite bandwidth and Internet time. These were the phrases that dominated the pages of magazines and newspapers. Very few in this country did not get swept up in the cloud of hot air.

Investors, too, bought into and fed the hype literally, as they flooded the market with capital that was consumed by thousands of companies in all sectors of the telecommunications industry from wirelines, undersea wireless across the globe, and with global ambitions set out to build global networks, to win the race, to stay ahead of the expected demand, and in doing so, companies throughout the world amassed staggering amounts of debt in building nearly identical networks.

The business model of the day would have made Kevin Costner proud. It was premised on a field of dreams. There was a belief that demand would materialize overnight in Internet time. Build it and they would come was the business model of the day for long haul carriers and many new entrants. The fiber gold rush was on, with carriers building massive national and global networks with astonishing amounts of capacity, by some estimates a five hundredfold increase in capacity.

The problem in the story line is, they did not come. The demand turnout was not doubling every 100 days, as pundits hypothesized,

but rather, merely every year. Anxious companies began to see the problem, and began to race to gain market share to boost revenues and pay down debts in hopes of being one of the survivors. Hyper competition ensued in various markets across the industry, as they contained more industry participants than the market could support, and vicious price wars ensued, driving down overall industry and individual company revenues. At the same time, many companies learned the painful lesson that traffic growth did not necessarily lead to a concomitant growth in revenues, as their markets were largely saturated.

These companies quickly found out there was simply not enough money to go around to pay down debt and generate a return on the investment. As we now know, the results were devastating. As some telecom companies began to fail and enter bankruptcy, others sadly resorted to fraud and deception to continue to mask the core fundamental problems facing their companies and their industries. Some went so far in their deception to not only mask failure, but to actually inflate artificially revenue growth to make it look like the dream was real.

The bursting bubble leaves us today with several core problems in the market segments that must be rectified. Accounting scandals have rocked an industry already fraught with problems, mountains of debt, inefficient industry structure characterized by excess capacity, lack of investor confidence, capital markets closing to new investment, and companies that have pulled back on capital spending in this capital-intensive industry, and there is collateral damage. Given the extraordinary interconnected and interdependent nature of the network the industry fallout hurts many suppliers in the value chains.

As telecom companies have dramatically had to scale back their expenditures, equipment suppliers and manufacturers have been brutalized, with their revenues and values falling dramatically. The access to capital crunch has taken the fuel out of many of the CLEC's operating in the industry, leading to bankruptcy in that segment as well. Long distance and wireless companies continue to face pricing pressures, along with cable companies' and ILECs' significant debt loads.

Though the problems are significant, I believe recovery can be achieved, but several critical steps will have to be taken. If you will indulge me, I have brought a chart to try to illustrate the steps that I think are critical for recovery. They involve all sorts of players at all sorts of levels. Let me just explain it briefly as I go through each section. I have characterized it as a pyramid. At the top of that pyramid I think are our highest and most pressing obligations and tasks at hand.

The first is to protect service continuity. As this hearing has tried to address itself to, we must work tirelessly as an institution with our state colleagues to absolutely ensure that service disruptions do not occur on a mass scale for our critical users and consuming public. This is our highest priority.

Second, rooting out corporate fraud. The degree of deception and malfeasance that has been uncovered in recent weeks again is just deplorable. There is no hope for any sector of the economy if corporate leadership and government do not root out and stomp out

such deception and breach of public trust. The Government must continue vigorously to seek out, prosecute, and jail corporate wrongdoers that have personally profited, often while defrauding the American public. Such actions have dealt a staggering blow to already suffering confidence levels. I commend the continuing swift and strong actions taken by the Government in bringing about those responsible for fraudulent actions. I commend the strong action taken by Congress in passing corporate oversight reform legislation which I understand the President is now signing into law.

The new corporate leadership that is taking the helm has been put on notice. Our hope is, indeed our demand is that they lead with strong and ethical moral foundation. These actions by Congress, the Administration, and firms in the industry must continue not only to address core fundamental problems but to restore investor confidence in corporate America and in this industry.

Third, restoring financial health and cleaning up the balance sheets. To address the capital shortage facing the industry, firms must work diligently to clean up the balance sheets to restore financial stability and reality to this industry. Companies have to become more transparent so that investors and buyers can assess the true value of their assets and their operations.

As I said, they are laboring under \$1 trillion in debt. Much of it will never be repaid, and will have to be written off by investors. As a result, capital markets are retrenching. Companies in need of financing to support their capital-intensive enterprises are suffering. Until firms substantially pay down debt, much-needed capital will continue to sit on the sidelines and recovery will be stalled. Many industry participants are finding ways to cut costs downsizing, shedding assets, et cetera, to try to lower expenditures.

These are very painful but vital steps. If the steps are taken, we have a chance. No matter what one's view of public policy and our ultimate objectives, they are simply unfunded mandates if capital will not flow to enforce the objectives we are trying to achieve.

Finally, a cautious word in step 4 about prudent industry restructure. Candidly, it is difficult to imagine this industry stabilizing without some modest and prudent restructuring. The long haul markets are absolutely glutted with excess capacity that is exceeding demand dramatically, even given the strong growth in demand that we have seen. Additionally, in some sectors, revenues are being deleted as price wars and aggressive competition make it difficult to secure an adequate return on investment in a very capital-intensive enterprise. This is particularly acute in the long distance and wireless markets. The pressure will continue to mount for companies to restructure or exit the market completely by merger or Chapter 7.

Depending on the facts of given transactions, such restructuring is not adverse to consumer interest. I would simply say that one cannot think long term about consumer benefits without considering long term the prospects of carriers that provide quality service to those consumers.

For other industry participants, survival and help will depend on some prudent restructuring, but let me state quite clearly at this hearing I emphasize the word prudence, because some mergers clearly could present a severe threat to competition and may not



and would not be in the public interest. That can only be determined upon careful and thorough review of a particular transaction. Regulators will have to walk an extremely fine line to achieve stability while not squelching competitive alternatives and opportunities, and we are committed to trying to walk that line as best we can.

Fifth, during the meltdown, carriers became acutely aware, as I said, that traffic growth did not directly correlate with revenue growth. Communication markets in many sectors have matured, or are doing so quickly respect to core services and the opportunity for further penetration is waning. Therefore, to grow and expand revenues, companies must find and offer new services, not just find new customers. In so doing, companies must strive to stimulate the demand that will help bring them into line with current oversupply of excess capacity.

I believe for the average citizen in a residential home for America, that opportunity rests in developing new services around residential broadband capability. The reasons are a couple. First of all, the provision of broadband service to residential consumers has the greatest room for substantial subscription growth over the next several years than any other. Currently, about 65 million households pay subscription rates to access the Internet. Approximately 14 million of those do so through broadband connections, leaving at least more than 50 million households who are in a near-term addressable market.

This market provides a rich source of potentially new revenue to help service the industry and stabilize it for consumers, and the benefits of the capability are too numerous to measure here in this testimony, but we must learn from our past mistakes of inflated expectations that simply will not line up with consumer demand, and recognize that build-out will achieve time to achieve a broadband future and harness its opportunities.

The construction project that has taken place over the last 6 years must now focus intensely on uncorking the network at the last mile and regulatory policy needs to lead the way. Let me emphasize that uncorking point. We have massive excess capacity in the long haul data networks. If we could uncork the flood of data services to the mass market, much of that excess capacity would be consumed in new and vital services for our citizens.

Finally, and perhaps rightfully at the foundation of the pyramid is economic and regulatory reform. The long term prospects of the industry will not be bright if state and federal policymakers do not continue the hard work and diligent efforts to create genuine and viable economic foundations for services growth and competition. I think nowhere is this more pressing than in the local markets. Currently, the cold fact remains that the economic foundations remain fairly weak in local competitive markets, especially for new entrants and increasingly for incumbents.

We, along with our state counterparts, must work together to improve the foundations through regulatory reform. We must consider rate rebalancing at the state level to provide carriers with flexibility and pricing. We must continue to doggedly pursue the worthy goals of universal service, which are ubiquity and affordability, as networks and new networks are deployed, and we must also pro-

vide incentives for effective and sustainable competitive entry through our network access policy for providing incentives to entrants and incumbents alike to produce efficient wholesale markets. We must continue also to engage in effective oversight enforcement of our regulations to ensure that competition is not stifled at the gate by unethical or, indeed, illegal conduct.

Finally, let me conclude with how I believe this institution can help. First, I would ask the Congress to seriously consider extending and clarifying our section 214 discontinuance authority to bring it in line with the realities of today's tumultuous marketplace so that we can unequivocally limit any service disruption in these troubled times. I am happy to work with this Committee in pursuing such legislation.

Second, I would once again respectfully call upon Congress to adopt Chairman Upton's proposal to help us put some real teeth in our enforcement authority by increasing the maximum fines allowable under the act from a meager \$120,000 per incident to a million for a single violation, and from \$1.2 million to \$10 million for continuing violations, and to lengthen the statute of limitations for common carrier enforcement. It has remained my strong view that these increased penalties, along with stepped-up enforcement, will have a solid deterrent effect against illegal activities.

While the House has adopted these measures, sadly, the Senate has yet to adopt a similar increase, and I would respectfully ask this Committee's consideration of such legislation and assist us in obtaining it.

Finally, I would urge the Congress to continue its deliberation and discussions to try and craft and implement legislation that would produce a healthy regulatory environment for the provision of broadband services. The importance of the development and deployment of broadband to all Americans is too important, in my mind, for Congress to ignore, and it must play a vital role in its deployment. Broadband very likely holds the key for the long-term recovery of the telecommunications industry and, indeed, our Nation's long-term economic growth, and its ability to compete on the global stage.

The Commission is committed to demonstrating leadership in this area by seeing through our core broadband policy proceedings, initiated at the end of last year. The importance of the development, however does merit that Congress take a look at the Telecommunications Act of 1996 and provide the regulatory framework for those services.

Let me make clear, I take no position on the myriad proposals that are currently before the body. I only wish to emphasize my professional judgment that the importance of residential broadband to improving revenue growth, stimulating demand to drain excess capacity, merits the attention of this august body.

I would welcome the opportunity to work with the Committee on these issues in the context of our longstanding bipartisan and productive approach to telecommunications reform. I thank the Committee for indulging my lengthy statement, and I am happy to take any questions you might have.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Powell follows:]

PREPARED STATEMENT OF HON. MICHAEL K. POWELL, CHAIRMAN, FEDERAL  
COMMUNICATIONS COMMISSION

Good morning, Mr. Chairman and distinguished Members of the Committee. I applaud your decision to hold this hearing—one that looks more broadly at the turmoil in today's telecommunications market and assesses its implications for the sector, public policy and consumers. I am pleased to participate in this important discussion.

I will focus my comments in two areas: *First*, I will discuss the immediate challenges posed by WorldCom's bankruptcy filing and outline our response, which will largely serve as a template for future bankruptcies, should they unfortunately occur. *Second*, I will attempt to explain the current distress in the telecom market—how it came about, and the steps I believe critical for its recovery.

### **I. Protecting Consumers From Service Disruption**

Protecting consumers from service disruption is our first and highest priority. Let me say at the outset that I remain confident that we are not facing a crisis in the provision of services stemming from WorldCom's bankruptcy. We have spent many hours reviewing the situation and everything, thus far, confirms that view. We have had first-hand discussion with creditors and lenders, with senior WorldCom executives, and with critical WorldCom customers and government users. All are confident that there is not an imminent threat of major service disruption. I am a MCI WorldCom residential long distance customer and, for what its worth, have no plans to change my service based on what I have seen.

In the last year, regrettably, the Commission has had to cope increasingly with the specter of bankruptcy in this industry. Consequently, we have developed responses to these situations, in cooperation with our state colleagues, that endeavor to achieve three goals (1) maintain the operation of the network, (2) contain the fallout to prevent damage to other companies or consumers, and (3) provide for an orderly transition of customers and assets, should that be necessary. Our actions generally have four components, all of which we have employed in addressing the WorldCom situation.

#### *A. Heightened Alert*

It is now more critical than ever to have significant advanced warning of trouble. In order to anticipate possible danger areas, the Commission is employing its industry analysts and other resources to keep close track of the financial health of the sector and individual companies. We have opened up new lines of communications with lenders and creditors—who often are calling the shots just before bankruptcy—in order to assess the imminency of possible collapse. This was the purpose of my trip to New York days after the accounting scandal was revealed. We have increased our dialogue with significant customer groups, who can also warn of difficulty, by spotting service degradation and service disruption.

#### *B. Inter-governmental Coordination*

One of the first critical steps is to coordinate our actions with other government entities. The Department of Justice represents the Commission in bankruptcy proceedings, thus we have been in constant contact with the Department in preparing our responses to the court. Additionally, in cases such as this it is vital to understand what risks are presented to critical government operations and discuss responses with other federal agencies. The Commission has a formal relationship with the National Communications System (NCS), which is responsible for monitoring and responding to mission critical communication needs of the Federal government. The FCC is a member of that organization and has had discussions about the risks and possible responses, should any disruption become a serious threat. The FCC is also a member of the JTRB, which considers emergency responses to preserve critical communications needs of the government. Additionally, the Commission has discussed risks and responses with the Critical Infrastructure Protection Board. Finally, given that there are allegations of fraud, in the WorldCom matter, we have been active as a member of the Corporate Fraud Task Force, created recently by President Bush, to ensure government-wide coordination of the investigation.

We also have been in regular consultation with State Commissions in an effort to assess the impact of bankruptcy on local markets and consumers, and coordinate our regulatory responses. State Commissions often play a key role in ensuring the continuity of operations and reconciling tensions between regulatory policy objectives and bankruptcy law. These efforts will continue throughout this proceeding.

Importantly, we also consult and inform the Congress as to the status of these matters and advise where legislative action may be required. We have engaged in an important dialogue with Members of Congress to help them better understand

developments in the telecommunications sector and to further explain the Commission's role in the bankruptcy process. We have been asked to explore and have provided insight as to whether we believe the Commission needs any additional authority in the context of protecting consumers while carriers undergo bankruptcy proceedings. I renew that call for additional legislation today. Although it may be that Congress, in its good judgment, finds it appropriate to provide the Commission with additional authority in this area, as I have demonstrated and as I pledge to you today, the Federal Communications Commission will be unwavering in our use of each and every tool at its disposal to protect the interests of consumers in these difficult times.

#### *C. Active Engagement in Bankruptcy Proceedings*

Bankruptcy actions often move quickly and the Commission must act promptly to ensure the interests of consumers are protected before the court. Our authority stems largely from section 214 of the Communications Act. The Commission's rules require WorldCom for example, to incorporate specific wording advising customers of their right to file comments with the Commission against such discontinuance. WorldCom must then file a copy of its notice with the Commission, and the Commission will then issue a public notice of the filing. WorldCom may only discontinue service on the thirty-first (31st) day after the issuance of the public notice. It is important to note, however, that this thirty (30)-day grace period is a minimum period required by our Rules and that the Commission may extend this period should the public interest warrant such an extension.

The day WorldCom filed for bankruptcy, we took several immediate actions to ensure our regulatory requirements would not be neglected. I promptly sent CEO John Sidgmore a letter advising him of his regulatory obligations. Additionally, I sent a second letter to the company asking them to commit in writing to provide notice to customers of the company's plan to exit the wireless resale business and to offer a transition plan for moving those customers to other networks. Our inter-Bureau task force stands ready to handle applications or other regulatory implications of WorldCom's bankruptcy.

In addition to ensuring the company complies with the law, the Commission will (as it did with WorldCom) advise the bankruptcy court of our concerns with respect to the impact on consumers and urge that any ordered shutdown, provide for a transition for customers. Given the significance of WorldCom, our Deputy General Counsel flew to New York for the initial hearing and worked with the Department of Justice to urge the Court to consider important public policy objectives; which include continuity of operations, a transition for any displaced customers, and due consideration of the impact on other telecommunications service providers that generally must continue serving the bankrupt carrier.

As an outgrowth of this participation, Judge Gonzalez, last week, granted interim approval for WorldCom to continue making its payments into the Federal universal service fund. Furthermore, the Universal Service Administrative Company reports that WorldCom is current with its contributions to this important fund that keeps high-cost telephone service affordable. We have been advised by WorldCom that it expects that its next payment, due in mid-August, will be made in a timely fashion.

In this bankruptcy phase, we will remain an active participant in the court proceedings and make additional preparations for possible questions and issues that arise. This may include a possible transfer of assets to other providers, which must be approved by the FCC.

#### *D. Consumer / Customer Awareness*

The Commission also believes it is important to advise consumers of the risks, if any, they are facing and remind them of options they may have. In this regard, we recently issued a consumer alert with respect to WorldCom that was reported widely by the media. (See Attachment A.)

In sum, if companies in the telecom industry enter into bankruptcy, either to restructure or to cease operations completely, there will be no greater role for the Federal Communications Commission than to ensure the continuity of operations for consumers, and for critical government users. To date, we have been fairly successful. In all of the 23 wireline or fixed wireless bankruptcy cases we have seen since November 2001, an orderly transition was achieved and all, but the most minor, disruptions of customer service were avoided. In every major bankruptcy situation that we have encountered we have been, and will continue to vigorously be, an active and aggressive participant in the bankruptcy proceedings.

## **II. The Broader Turmoil in the Telecommunications Industry**

While the corporate scandals are dominating the headlines, it is very important for us to focus on the broader distress that has hit the telecommunications sector.

I again applaud the Committee for taking up this important discussion. Clearly, the telecommunications industry is riding on very stormy seas. This is an industry where nearly 500,000 people in the United States alone have lost their jobs and approximately \$2 trillion of market value has been lost in the last two years. By some estimates, the sector is struggling under the weight of nearly \$1 trillion in debt. And, most segments have seen precipitous declines in stock values: The long distance industry is down 68 percent year-to-date, the wireless industry is down 71 percent, the ILECs are down 40 percent. Clearly, there are very serious stresses on this important industry.

However, this market is not collapsing and is not going to fail over time. Communications services remain vital to consumers around the globe. Communications traffic continues to increase at historically formidable rates. And, importantly, the closing of time and distance barriers to information will continue to fuel global productivity and change all institutions of society, albeit slower than once fantasized. It is in the interest of every citizen for this industry to recover and to ultimately succeed in bringing new and vital communications capabilities to people's lives. Recovery, however, is not going to occur overnight and is likely to require difficult—even painful—choices. Successful recovery is dependent on the collective efforts of Congress, federal and state regulators, the private sector and the financial markets.

#### *A. How Did We Get Here?*

In order to facilitate a recovery, we must understand what led to the current turmoil in the market. The story at bottom is quite straightforward. It begins with the Internet Gold Rush. The Telecommunications Act of 1996 and the commercialization and mass-market adoption of the Internet led to a near hysterical belief that the opportunities for growth were limitless. Talk of the Internet doubling every 100 days, infinite bandwidth, and "Internet time" dominated the pages of magazines. Very few did not get swept up in the hot air.

Investors, too, bought into and fed the hype—literally—as they flooded the market with capital that was consumed by thousands of companies. Companies in all sectors of the telecommunications industry, from wireline to undersea to wireless, across the globe and with global ambitions, set out to build national and global networks—some, as we all undoubtedly recall, by digging up streets to lay fiber, some through acquisition, some by bidding billions of dollars for spectrum, some by investing in foreign markets—to win the race to stay ahead of expected demand. In so doing, telecommunications companies throughout the world amassed staggering amounts of debt in building nearly- identical networks.

The business model of the day was one of which Kevin Costner would be proud—it was premised on "A Field of Dreams." There was a belief that demand would materialize almost overnight. "Build it and they will come" was the business model of the day for long-haul carriers and many new entrants. The fiber rush was on, with carriers building massive national and global networks, with astonishing amounts of capacity. (By some estimates, a 500-fold increase in capacity.) The problem is they did not come—demand turnout was not doubling every 100 days, but rather every year.

Anxious companies began to race to gain market share to boost revenues and pay down debt, in hopes of being a survivor. Hyper-competition ensued in various markets across the industry, as they contained more industry participants than the market could support and vicious price wars ensued, driving down overall industry and individual company revenues. At the same time, many telecommunications companies learned the painful lesson that traffic growth did not necessarily lead to concomitant growth in revenues, as their markets were largely saturated.

There were not enough untapped customers from which to derive new revenue. To make matters worse, many of these companies had to write off revenues as many of their customers (namely, bankrupt ISPs and dot-coms) disappeared through bankruptcy. These companies quickly found out that there was simply not enough revenue to go around to pay down debt and generate a return on investment for all of the vast number of competitors that had previously flooded to the market.

The results were devastating. As some telecom companies began to fail and enter bankruptcy, others resorted to fraud and deception to mask these core fundamental problems facing their companies. Some went so far in their deception to not only mask failure, but to inflate, artificially, revenue growth—to make it look like the dream was real. The bursting bubble leaves us today with several core problems in several market segments that must be rectified:

- Accounting scandals that have rocked an industry already fraught with problems;
- Mountains of debt—estimated at \$1 trillion worldwide;

- Inefficient industry structures characterized by excess capacity;
- Lack of investor confidence;
- Capital markets closing to new investment; and
- Companies that have pulled back on capital spending in this capital-intensive industry.

Given the interconnected and inter-dependant nature of the telecom network, the industry fallout has caused collateral damage across the industry worldwide. As telecommunications companies have dramatically scaled back capital expenditures, equipment manufacturers and vendors have struggled as sales have fallen precipitously. The access to capital crunch has taken some of the fuel out of the CLEC industry leading to many bankruptcies over the past two years and increasing liquidity concerns. Long distance and wireless companies continue to face pricing pressures and along with cable companies and ILECs, significant debt loads. Though the problems are significant, recovery can be achieved if several critical steps are taken.

I believe that there are six critical elements to managing the current turmoil and stabilizing the industry over time (See Attachment B):

#### 1. Protect Service Continuity

The road to recovery begins with our tireless efforts to protect consumers by ensuring continuity of service and in maintaining the integrity and reliability of our Nation's telecommunications network in light of the risks and realities stemming from current and continued bankruptcies. The Commission and our State counterparts will continue to work together and with telecommunications firms facing financial difficulties to stay well ahead of any service disruptions. We will also constantly keep the American public informed so that they too can take action to protect themselves if and when the need arises.

#### 2. Root Out Corporate Fraud

The degree of deception and malfeasance that has been uncovered in recent weeks is deplorable. There is no hope for any sector of the economy if corporate leadership and government do not root out and stomp out such deception and breach of public trust. Governments must continue to vigorously seek out, prosecute and jail corporate wrongdoers that have personally profited (often) while defrauding the American people. Such actions have dealt a staggering blow to already suffering confidence levels. I commend the continuing swift and strong actions taken by the government in bringing those responsible for fraudulent actions to justice. I also commend the strong actions taken by Congress in passing corporate-oversight reform legislation, which the President is now signing into law. The new corporate leadership that is taking the helm has been put on notice. One hopes—and demands—that they lead with a strong ethical and moral foundation. These actions by Congress, the Administration, and firms within the industry must continue not only to address core fundamental problems, but also to help restore investor confidence in corporate America and in the telecommunications industry.

#### 3. Restoring Financial Health: Cleaning Up the Balance Sheets

Next, to address the capital shortage facing the telecommunications industry, telecom firms must work diligently to clean up their balance sheets to restore some financial stability and reality to this industry. Companies will also have to become more transparent so that investors and potential buyers can assess the true value of the company's assets. It is estimated that telecommunications companies worldwide are carrying approximately \$1 trillion in debt, much of which will never be repaid and will have to be written off by investors. As a result, capital markets are retrenching and telecommunication companies in need of financing to support their capital-intensive enterprises are suffering. Until firms substantially pay down their debt, much needed capital will continue to sit on the sidelines and the recovery will be stalled. As we have seen, many industry participants are finding ways to cut costs, by downsizing, shedding assets, and significantly cutting back on capital expenditures to pay down debt. These are painful, but necessary steps. But, if these steps are taken, we must ensure that the integrity of the telecommunications network and the quality of service provided to consumers does not suffer. Alienating consumers during this time will only serve to further the pain as consumers turn away and take with them much-needed revenues.

#### 4. Prudent Industry Restructuring

It is difficult to imagine the industry stabilizing without some modest and prudent restructuring. The long-haul markets are glutted with excess capacity that dramatically exceeds demand (even given the strong growth in demand that we have seen). Additionally, in some sectors, revenues are being diluted as price wars and

aggressive competition make it difficult to secure an adequate return on investment in very capital intensive enterprises. This is particularly acute in the long distance and wireless markets. Pressure will continue to mount for companies to restructure or exit the market completely by merging with another.

Depending upon the facts of any given transaction, such restructuring is not necessarily adverse to consumer interests. One cannot think about long-term consumer benefits without also considering the long-term prospects of carriers that provide quality services to consumers. For other industry participants, survival and health will depend on prudent industry consolidation. I emphasize “prudence” because some mergers clearly could present a threat to competition and may not be in the public interest. That can only be determined upon careful and thorough review of a particular transaction. Regulators will have to walk a fine line to achieve stability, while not squelching competitive opportunity.

#### 5. New Revenue Through New Services

During the meltdown, carriers became acutely aware that traffic growth did not directly correlate with revenue growth. Many communications markets have matured (or are doing so quickly) with respect to core services and the opportunity for further penetration is waning. Therefore, to grow and expand revenues companies must offer new services. In doing so, companies must strive to stimulate the demand that will help bring it into line with the current over-supply of excess capacity. In the residential space, all indications are that the opportunities to develop new services and sources of revenue will come from residential broadband. The reasons are twofold.

*First*, the provision of broadband services to residential consumers has room for substantial subscription growth over the next several years. Currently about 65 million households pay a monthly subscription rate to access the Internet. Approximately 14 million are doing so through broadband connections, leaving more than 50 million households as a near-term addressable market. With the deployment of broadband over the next five to ten years, a whole new generation of the consuming public that will have grown up with the Internet as an integral part of their daily lives will enter the market, increasing the potential addressable market.

*Second*, the development and deployment of broadband infrastructure will provide firms—from telecommunications to entertainment to information to equipment vendors—with the opportunity to develop new services that will use the broadband infrastructure to reach consumers. Today we envision, and companies are beginning to provide, home networking, telemedicine, distance learning and home security; tomorrow’s visionaries will take the infrastructure to new heights not understood or appreciated today.

We must, however, be sure to learn from our past mistakes of inflated expectations that do not line up with consumer demand and recognize that the build-out will take time. To achieve this broadband future and to harness the opportunities it provides, the construction project that has taken place over the last 6 years must now focus on uncorking the network at the last mile, and regulatory policy must lead the way. Today, with the proliferation of cable modem services, DSL services and increasingly wireless platforms and other innovative networks, such as powerline, we are beginning the process of bringing capacity to the edges of the network—where it is needed most.

#### 6. Reform Economic and Regulatory Foundations

Finally, the long term prospects of the industry will not be bright if state and federal policymakers do not continue to work hard and diligently to create genuine and viable economic and regulatory foundations for communications services growth and competition. Nowhere is this more pressing than in local markets. Currently, the cold fact remains that the economic foundations remain weak in local markets, especially for new entrants and increasingly for incumbents. Local firms, many of whom are being tasked with the chore of upgrading networks to provide one of the platforms to deliver broadband services, have little pricing flexibility for retail services. We, along with our state counterparts, must work together to improve these foundations through regulatory reform. For instance, we must consider rate rebalancing at the state level to provide carriers with greater pricing flexibility. We must continue to pursue doggedly the worthy universal service goals of ubiquity and affordability as new networks are deployed, based on sound economic principles. We must also provide incentives for more effective and sustainable competitive entry through our network access policies by providing incentives to new entrants and incumbents to produce an efficient wholesale market and by providing a regulatory framework that promotes competition, investment and innovation to deploy advanced networks.

We must continue to engage in effective oversight and enforcement of our regulations to ensure that competition is not stifled at the gate. We must engage in better spectrum management that promotes more efficient use of spectrum while continuing to find ways to get more spectrum into the markets.

If we accomplish these objectives, it will be the consumer that is the ultimate beneficiary through the proliferation and adoption of new innovative services that the consumer demands and values. For the past year, the Federal Communications Commission has initiated proceedings to effectuate this reform and we will work diligently to implement these fundamental policies that will provide regulatory clarity and certainty, survive judicial scrutiny and promote long-term sustainable competition and growth to serve the public interest. I pledge to you that we will accelerate our efforts to complete the task before us.

### **III. How Congress Can Help**

We must all take the steps necessary for recovery and I ask that Congress also assist us in our efforts by providing the Commission with more tools to protect and promote the public interest.

*First*, we ask that Congress extend and clarify our section 214 discontinuance authority to bring it in line with the realities of today's marketplace so that we can limit any service disruption in these troubled times. Our authority under section 214 is at best unclear and, at worst, does not extend to certain critical services such as the Internet backbone.

*Second*, I once again, respectfully, call upon Congress to adopt Chairman Upton's proposal to help us put some real teeth in our enforcement authority (as I did 15 months ago to the House and over a year ago to the Senate) by increasing the maximum fine allowable under the Act from \$120,000 to \$1 million for a single violation and from \$1.2 million to \$10 million for a continuing violation and to lengthen the statute of limitation for common carrier enforcement. It has remained my strong view that these increased penalties along with the stepped up enforcement of our rules will have a solid, deterrent effect against illegal activities. While the House adopted these measures as part of H.R. 1542, the Senate has yet to adopt a similar increase in our enforcement authority. I respectfully urge you to pass legislation that would provide the Commission with increased enforcement authority to attack illegal activities.

*Third*, I urge Congress to continue its deliberations and craft and implement legislation that produces the right regulatory environment for the provision of broadband services. The importance of the development and deployment of broadband services to all Americans is too important for Congress to ignore and it must play a vital role in its development. Broadband very likely holds the key for the long-term recovery of the telecommunications industry and for our Nation's long-term economic growth and its ability to compete on the global stage. The Commission is committed to demonstrating leadership in this area by seeing through our core broadband policy proceedings initiated at the end of last year and the beginning of this year, and we will strive to complete those proceedings by year-end. The importance of the development, however, merits that Congress take a hard look at updating the Telecommunications Act of 1996 to provide the proper regulatory framework for broadband.

I take no position on the myriad proposals that currently are before this body. I only wish to emphasize that the importance of residential broadband to improving revenue growth and stimulating demand to drain excess capacity, merits the attention of Congress. I would welcome the opportunity to work with the Committee on these issues, in the context of its longstanding bipartisan approach to telecommunications reform.

I thank you for your time and I look forward to working with you all to implement our plan for recovery for the telecommunications industry.

#### ATTACHMENT A

### **Federal Communications Commission Assures WorldCom Customers Concerning Continuation of Phone Service**

Washington, DC—The Federal Communications Commission (FCC) has issued this Consumer Bulletin highlighting the rights and protections consumers have in light of WorldCom's bankruptcy filing.

Michael K. Powell, Chairman of the FCC said, "Our consumer bureau has heard many consumer concerns about the WorldCom situation and its effect on telephone service. The FCC will not permit a cut-off of a customer's service in the wake of WorldCom's bankruptcy filing. The FCC has regulations in place to protect consumers' telephone service, and we will vigorously enforce those rules."



The Consumer & Governmental Affairs Bureau (CGB) advises consumers:

- The WorldCom bankruptcy does not mean subscribers will lose their service.
- FCC rules prohibit abrupt cut-off of subscribers' telephone service.
- FCC rules require a telephone company to provide written notice to affected consumers of any planned discontinuance of service. The notice must specifically state the customer has the right to file comments with the FCC.
- After notifying affected customers, telephone companies must file for permission from the FCC to cut-off service.
- The telephone company would not be permitted to terminate service until a minimum of 30 days after the FCC issues a public notice.
- The FCC can extend the termination date.

During the bankruptcy proceedings, WorldCom may sell its customer base to another company. If that occurs, consumers are protected by FCC regulations:

- The new company must provide the customer 30 days' advanced notice of the transfer, including information about its rates and services.
- The customer may accept the new company or choose another company without penalty.
- A customer transferred to a new company without receiving notice is entitled to relief under the FCC's slamming rules.

K. Dane Snowden, Chief of the FCC Consumer & Governmental Affairs Bureau, said, "Recent developments indicate WorldCom has the necessary funding available to continue operations during bankruptcy proceedings, without disruption of telephone service or interruption of the operation of its Internet backbone facilities. The FCC will continue to monitor the situation closely."

Chairman Powell has put WorldCom on notice of the FCC's requirements and stressed the company's obligations to its customers during the bankruptcy process.

In a July 22 letter to WorldCom President and CEO John Sidgmore, Chairman Powell said, ". . . The [FCC's] process is intended to provide customers with a reasonable opportunity to find and transition to a new service provider, and the Commission will act promptly and vigilantly to ensure that customers are provided this opportunity. We will intervene in bankruptcy proceedings to advise the court if WorldCom or any other party to the proceedings takes steps that would result in an unnoticed termination of service." (The full text of Chairman Powell's letter is on the FCC Web site at <http://www.fcc.gov/commissioners/powell/72202-sidgmore.pdf>.)

The FCC was represented at the first bankruptcy hearing in New York on July 22 and is a party to the proceeding.

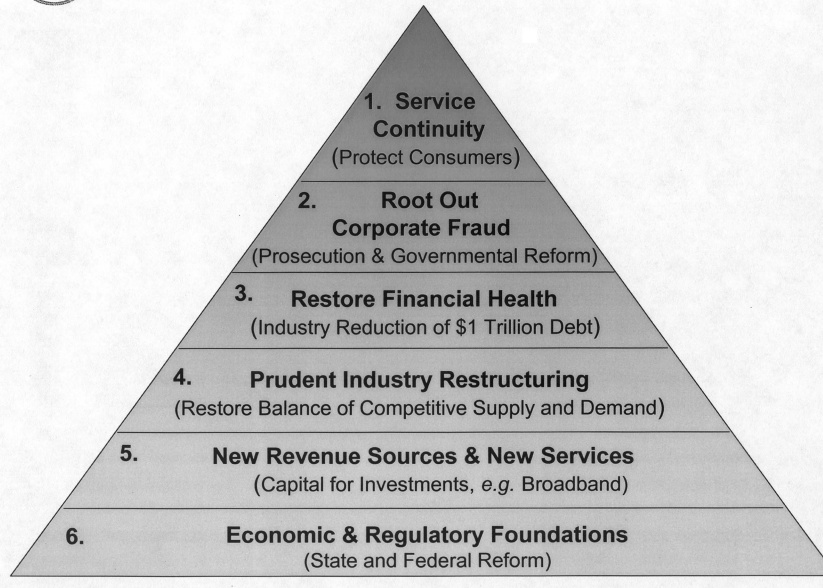
State law may offer additional protections. Consumers should contact their state public utility commissions for additional information.

Consumers with questions about the WorldCom situation can visit the FCC's Web site at [www.fcc.gov](http://www.fcc.gov) or call the FCC's Consumer Center at 1-888-225-5322 (CALL FCC).

## ATTACHMENT B

**TELECOM INDUSTRY**

Critical Steps for Economic Recovery



The CHAIRMAN. Thank you, Chairman Powell. That is an excellent statement.

Let me ask, when you say—that is what I was really interested in, the amendments to section 214, that you would greatly benefit, as you say, from a more definitive and concise statement of authority, for example, elaborate on that thought. Is it to regulate broadband like common carriers, or what?

Mr. POWELL. Senator Hollings, section 214, which was the provision enacted with the original Communications Act of 1934, has been generally interpreted to apply mostly to carriers regulated under title 2, which are generally the telecommunications common carriers. There are increasing classes of service providers who do not have to obtain 214 licenses to be in operation, for example, cable service providers, Internet backbone providers, and other service carriers that are providing critical services.

We have been successful to date, through the force of our own formal and informal actions, to provide orderly transitions in these cases, but there are questions marks as to whether, if we were in a serious dispute, whether section 214 would be sufficiently comprehensive to assert legal jurisdiction to insist on discontinuance procedures in the context of bankruptcy proceedings, so coverage, the scope of the provision should be considered as to whether we can more clearly make it applicable to other classes of critical service providers.

Additionally, while I do not have immediate suggestions today, I think one could consider what other kinds of steps, in addition

to the simple notice and discontinuance obligations, maybe perhaps more forceful authority the Commission may have in order to assure operations.

I would highlight the Committee one source of tension in the context of the cases, which is conflict between the bankruptcy laws and the communications laws. It is not always entirely clear that the bankruptcy judge would necessarily accept our protestations of the need for discontinuance, and might nonetheless order shutdown. I can tell you I have personally been involved in a few bankruptcies, and we had a very close moment when the bankruptcy judge came very close to ordering shutdown precipitously, regardless of our assertion of 214 jurisdiction.

The CHAIRMAN. There is one on appeal right now.

Mr. POWELL. Indeed, there is, and fortunately to date we have usually been able to wrestle these situations to ground, usually through the regulated entity themselves, but I think why should we continue to stumble on this when we could potentially close that loophole.

The CHAIRMAN. I am in agreement. Could you have yourself or your staff at the FCC just outline both ideas with respect to 214 on the one hand to give you the proper authority and otherwise a conflict between the bankruptcy court and the Federal Communications Commission? We need that immediately so we can try to include it here this summer before we leave. We will make every effort possible to do so.

With respect to—well, let me put it this way. What change would you make to the 1996 act, if any?

Mr. POWELL. Senator, as I stated, I think in my formal remarks, I do think there needs to be some serious consideration about some of the convergent emerging services that are broadly clumped.

The CHAIRMAN. Well, specifically broadband, I agree with you. The only thing is that the present broadband they are not subscribing to. It is \$50 a month, and I have tried and tested out, and we are presently looking at the next generation broadband to see if we could not finance it, subsidize it with the auction moneys. What do you think of that?

In other words, I look at Korea, and they have subsidized broadband and they have got it around to everyone. I am trying to subsidize that last mile with the next generation broadband with the combination of not only the fiber but Wi-Fi and others. Can I get your comment on that?

Mr. POWELL. Yes, Senator, I will try. I think there are only a handful of ways in which Government can be effective when you are talking about a massive private capital expenditure to build new services. One is, the Government can help try to stimulate and aggregate demand. To the degree that the U.S. Government, as perhaps one of the largest purchasers of communications services committed itself, or obligated itself to the use of broadband services, it made efforts to do so as a permanent proactive matter, and if state governments and state institutions did a similar thing, the stimulation of demand certainly would help pool and lower the cost of deployment.

I think the other area is, can you help pay for it somehow? It seems to me in government that can occur in one of two ways, di-

rectly subsidizing services either at the customer producer level, or indirectly doing so by providing tax or other investment incentives for the construction and deployment of those. I am not an expert on the merits of those traditional government vehicles, but I do think that they are certainly worth some consideration.

Finally, I think that it is important to note that regulatory policy is important here, though this can be complex and esoteric at times, because it is not easy enough to say something is a demand problem or a supply problem. Economics 101 teaches supply and demand are intrinsically linked. If demand is soft at high prices, part of the problem is the supply is not being provided at a price that stimulates demand, and that can have a lot to do with the cost, and the burdens associated with deploying service. Then you have a tragedy if the cost of providing such services far exceeds the consumer's willingness to pay for them, and so one of the things that we are willing to tackle and consider more thoroughly, and there could be a legislative component to it, is the degree to which one can minimize or lower the regulatory costs or obligations associated with building and construction of that narrow infrastructure.

I think one of the challenges presented to the Congress and presented to us is, it is very difficult to try to narrowly contain such kind of targeted limitations, but I still think that that effort is particularly worthy.

The CHAIRMAN. Senator McCain.

Senator MCCAIN. In your remarks and recommendations you cite a need to increase authority under section 214 in order to prevent disruption of telecommunications services. Do you believe that there is a possibility that without that increase in authority some services may be disrupted, i.e., WorldCom, or some other major bankruptcy?

Mr. POWELL. At present, I do not think there is a circumstance that presents itself in that way, but I could hypothesize that a carrier not covered by 214, when the Commission tried to assert its requirements for discontinuance would refuse to comply, arguing that they were not covered by that provision, possibly with the aid and assistance of the bankruptcy court.

One of the real struggles we often have is, we are trying to get blood from a turnip. Often, the bankruptcy judge, whose interest is protecting debtors and creditors, wants the service shut down to stop the bleeding, and when a regulator walks in and wants the operations to continue, it is interpreted as wanting the bleeding to continue, and it is a very difficult thing to try to strike a balance to continue to preserve transition disruption at the same time that an enterprise might be losing assets and revenue at a rapid pace, but yes, the short answer to your question is, I can imagine a situation where there would be a problem, but the answer is no that I do not presently see that situation in the context of WorldCom.

Senator MCCAIN. Many believe that we are in a major crisis in the telecommunications sector. Do you agree with that?

Mr. POWELL. Well, I have gotten into trouble for calling it a crisis, but I think you have to be naive not to suggest that it is a market in extremely fundamental duress. I mean, the statistics simply roll off the page in every measure you can imagine of the difficulties facing this issue. The reason I believe that it is not a crisis in

the traditional sense of the word is, I do not believe that it is on the verge of complete failure. I do believe that it actually has real prospects for recovery, and will recover.

I do think many of the fundamentals are presented, but I think none of them are achievable without many years of painful change, and I think that it would be naive and optimistic and probably drinking the same Kool-Aid we drank 5 years ago to suggest that there was any quick or magic bullet to that, or that policies that we genuinely believed in before do not deserve to come under equal amounts of scrutiny to try to prevent it happening in the future.

Senator McCAIN. We will have another set of witnesses that will give us their views, but I am concerned, and I think that all of us who serve are worried about a severe perception problem amongst average American citizens. Mr. Winnick of Global Crossing received \$735 million in stock, plus millions in compensation, Mr. Cook \$36 million, three members of the board, \$516 million combined, Mr. Anschutz, \$1.5 billion, Mr. Slater, \$18 million, Mr. Nacchio, \$226 million. The list goes on and on. The numbers are really staggering.

At the same time, thousands of employees are now out of a job, and in many cases retirees have had their entire retirement wiped out. This strikes many American citizens as patently criminal. I was in a grocery store Saturday morning. Five people came up to me and said, why should these executives of bankrupt corporations be receiving hundreds of millions or billions of dollars?

We had a witness, Mr. White, who made \$70, \$80 million, who was asked by Senator Dorgan whether he should give some of the money back, and he said no, of course not, because he did not do anything wrong. These employees and these retirees did not do anything wrong, either.

I guess I am asking you a general question as a person who has served, but also deals with these people on a daily basis. I believe you were up on Wall Street just not long ago. Have you got any ideas as to what we should do about that? Should we require them to give some of that money back? Should we take them to court? Should we have just these class action suits, where the lawyers seem to get most of the money and the average stockholder does not, and how do you cure this? Do you think Congress should pass a law limiting the amount of compensation that a chief executive should receive?

I do not think so, but yet in 1975 I believe the average executive compensation was some 20 times that of the average employee. Now, it is 500, or 1,000. The numbers are astronomical, and it is terribly exacerbated by the fact that employees are not working. I mean, there is no difference in their salary now. It is infinity now, because so many thousands of them have lost their jobs, and I know it is not exactly in your area, but you are a voice for the consumer. That is what one of the Federal Communications Commission's primary responsibilities is.

I wonder if you could just give us some of your overall views on this issue, perhaps in preparation for our next set of witnesses, and in preparation for perhaps further legislation, because I do not think the bill that we just passed goes nearly far enough, particularly in the area of stock options, which we did not even have a

vote on, much less a determination on the part of Congress whether stock options should be treated as an expense or not, as Mr. Greenspan and Mr. Buffett and others believe they should.

Thank you. Go ahead, Mr. Powell.

Mr. POWELL. Yes, sir. Well, I have to confess as a public employee who makes \$133,000 and is prohibited by law from owning any stock, these sorts of drumbeats and stories are mind-boggling to me, and beyond any ability I have to understand or rationalize the choices, even try as I might just to simply understand it.

I think what is more offensive, less than the aggregate amounts, is the timing, when there is relatively clear evidence that stock, employees' pensions and things are plummeting, but senior officials are permitted to withdraw value while individual employees are prevented from doing so. That is like closing the gates on the bottom of the *Titanic* and heading for the lifeboats, so on a personal level I would just share your deep offense about the whole thing.

Do I think it requires government intervention? Yes, I do, for simple reasons and others more complex. Simply put, because it is not just affecting those particular individuals. It is not just a private sector problem. It is a problem that affects society quite broadly on an individual wealth basis, but from my perspective, which I do know something about, I cannot tell you what a kick in the stomach the scandal has proven to an industry that could not take it.

An industry that was already on the ground trying to get back up has been kicked mightily by the actions of a few individuals that have compromised the ability to recover for a very long time, so the economic health of the country and the recovery of the sector is extraordinarily dependent on a perception, not only a perception but a reality that that credibility is restored and such actions are prevented.

I am not an expert on corporate governance or salaries or the appropriate measures. I do see things there that trouble me, but I do believe the bottom line is oversight. I think I continue to be amazed where the boards of directors are in the United States when these situations and judgments are being made about withdrawals and payments and compensation.

I think they need to also be under the appropriate amount of scrutiny in their fiduciary responsibilities, and I think that everything that I have read and followed in the actions of this Congress demonstrate a remarkably swift response by the people's House in an effort that seems to me to be generally on the right track, and I think that probably the institution will have to continue to monitor it and see whether additional actions are needed, but certainly I can only speak as a citizen, and I would be pleased and applaud the efforts of my representatives to tackle that problem.

Senator McCAIN. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Burns.

Senator BURNS. Thank you, Chairman Powell, for appearing—my questions, I just have a couple of them—and your response to them, Mr. Chairman.

The accountability act is being signed today by the President, and in your testimony you alluded that you need more transparency in your ability to audit and to gauge activities of those cor-

porations that fall under the common carrier clause. Does the accountability act that the President is signing today, does that give you enough authority, or does it present some answers to the challenges you have?

Mr. POWELL. A quick answer is, I do not believe anything in that act goes directly to our authority, the Federal Communications Commission. I do not know of any provision in it that expands or alters—

Senator BURNS. It may expand to the Department of Justice, where maybe you could require it. I mean, I am vague on that.

Mr. POWELL. I understand. Yes, to that extent, that it may mean that we as an institution have an opportunity to see things at an early stage, which could be appropriately referred to an institution that had the specific responsibility.

I take an opportunity to explain that we have done a few things to try to increase those channels. For example, we have proposed a Memorandum of Understanding with the SEC that would create a mechanism by which, if in the course of our jurisdiction of regulatory activity we came upon things that looked to be at least prima facie problematic, we could make referral and share resources in pursuit of that.

And then our role on the corporate task force, fraud task force created by the President I think also provides an opportunity to have a better flow of what we come into contact with, the agencies that would be responsible for the prosecution and investigation.

Senator BURNS. In your remarks with regard to section 214, and I look forward to working with you and visits with you and the FCC. I think with the Chairman's leadership and help on this, I think we can look at a way to approach 214. That is not the only area of 214 that maybe we have to take a look at the one we are providing here, but nevertheless, we look forward in working with you on that, but those are the two areas I think that are the building stones of everything else, before we do anything else.

The other parts of it are the fraud and all of that. That is out there in the Department of Justice or whatever, but I think with you being here today and pointing out those particular areas, those key areas where reform and some, let us say, tinkering around may enable us to solve future problems should they arise in the same way, and with the free market they will arise, it is inevitable, and that is Economics 101.

So I appreciate you coming in today, and answering these questions, and I look forward to working with you on 214 and any other suggestions you might have from your position, and I thank the Chairman.

The CHAIRMAN. Very good. Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman. Thank you, as well, Mr. Chairman, for your helpful statement.

Let me turn to the question first of fraud in the telecommunications sector. You mentioned the FCC is participating in the overall effort to root out corporate fraud, and I think that makes sense, because there is a lot of pressure out there, and when that is ratcheted up, you certainly have people trying to cut corners. What are the particular types of fraudulent practices in the telecommunications sector that you are especially concerned about now?

Mr. POWELL. That is a good question, because it is important to try to distinguish whether there is anything particularly acute or unique to the telecommunications sector that is leading to this problem being more prominent than some other sectors, though I think a fair evaluation of the number of companies that have come under scrutiny crosses the wide range of spectrum of companies in corporate America, and is not limited to telecommunications.

I think it is also interesting to note, at least for the moment, that the vast majority of telecommunications carriers that have come under scrutiny, or many of those carriers, as I said earlier, were most aggressive in their pursuit of the Internet gold rush. That is the extraordinary expectations and pressures to continue to deal with the ever-expanding competitive environment for those things may have put more pressure and led to a willingness to start cooking books in order to cover the previous actions of the Committee, so to my extent, I just always have a generalized concern about whether that kind of environment or culture would have reproduced itself in other companies, so I think that it is generally prudent to sort of be looking quite carefully at the sector, as well as related sectors in which these pressures might have been simulated.

We have also undergone some internal efforts to sort of relook at any information or data that has come into our possession over the past year or so to consider whether we would want some of it recertified in the context of what we know about some companies' willingness to cook the books on the financial side.

Senator WYDEN. Are there companies now that you are looking at with an eye toward requiring them to recertify, because that strikes me as very important, and I really do want to know what you bring to the table in terms of this overall administration effort. I think there is a concern that there are other examples of books being cooked, and to hear that the Federal Communications Commission is looking to see whether there does not need to be a recertification of some companies I think could really give consumers some confidence that this is going to be tackled in a serious way. So can you confirm, is there an examination of whether some are going to have to be recertified?

Mr. POWELL. I would describe it as, there is a consideration, because we are presently reviewing the kinds of accounts we have and the kind of data we have received in trying to make some thoughtful judgment about which kinds of things might be implicated.

Senator WYDEN. I would urge you to be very vigorous on that.

Let me talk about the consumer situation, and I have divided it into short term and long term. Short term, it seems to me what the consumer wants is no chaos with respect to service, and no disruption. You have described steps that are being taken, but long term for the consumer. What I am concerned about is the prospect that we are going to have far fewer choices and significantly less competition. What are you looking at to try to avoid that?

Mr. POWELL. Well, as I mentioned, I would like to note a few things. First, with respect to the pressures for mergers and consolidations, as I mentioned, one of the most difficult tasks the commission will have, as well as the Antitrust Division or any other entity



that is charged with considering those transactions, it is going to have to be extremely careful with regard to what kinds of combinations would have the beneficial effects of stabilizing the market, but not in a way that seriously damages or forecloses competitive opportunity. That would be a case-specific merger evaluation in the context of that.

In addition, the Commission has initiated a number of proceedings in the hope and expectation that it would be able to create more sustainable economic and regulatory foundations to create more viable competitive entry in a way that would be more sustainable, given the severe constraints of capital that exist in the market. Those proceedings we have made an effort to try to accelerate, hopefully closer to the end of the year to try to bring some clarity and certainty in that area.

We have also been particularly vigilant, I think, in the context of 271 applications to make sure that the large incumbent carriers continue to abide by those applications. I would note that in our first year we rejected just as many 271 applications as we approved, and maintained the line on a number of important elements in considering pricing, and then two final things I would mention, one which I have asked this body to consider.

The first is, we have a proceeding which we are focusing intensely on trying to require real strong performance measures so that elements will be provided to competitive entrants in a much more timely and effective way that proceeding is underway as a part of the trilogy of proceedings we are doing.

And then lastly, I have emphasized over and over again, I continue to think it is an important function that I do not think we are yet up to speed on, which is much stronger enforcement. To do that, I think we have created the organization and structure for doing that, but the resources for doing that in terms of not only money and personnel, but whether we have effective penalties, is an important question.

Senator WYDEN. Let me if I might, Mr. Powell, ask one last question, and to contrast it to when you came to this room at your confirmation hearing.

When you came to this room for your confirmation hearing, you described how you wanted to chart a course to new, more competitive waters in telecommunications, and my own view, and I think you could tell it from my desire, for example, was to have you review the books of a number of those that you have said are now under consideration by the Commission. I think that the current climate requires a very different regulatory approach than the one you envisaged when you came here for your confirmation hearing, and what I would like you to tell me is, what different regulatory tools, if any, are you using now than what you envisaged when you came to this room for confirmation?

Mr. POWELL. Well, let me take it in two parts. First of all, I continue to think the course we charted continues to be a productive one. The course we charted was to create vehicles for the consideration of important questions about economic and regulatory foundations for effective and sustainable competition. When we charted that course, the stresses on the market were not unknown to us.

Indeed, the CLEC market had begun collapsing long before we had even initiated the proceedings.

I had held a number of very significant CLEC CEO summits with the leaders of many of the competitive industries to get a strong assessment of the kinds of problems they were facing and try to find ways to deal with them. From that effort is where the enforcement initiatives were born, the performance measures were born. These were things they specifically identified as critical, so that part of the course I think was a response to a growing recognition that the economic foundations continued to need work.

Additionally, we are always buffeted by the winds that come blowing out of judicial judgments and litigation, which are constantly putting the commission back on its heels to relook at, reexamine decisions that are made in the context, and as early as a few months ago we are still dealing with massive decisions coming out of the Supreme Court and the DC Circuit over a statute passed 6 and 7 years ago, and I have got to tell you, it is an extraordinarily challenging and frustrating thing to be halfway down and be constantly having to start over.

So I think the vehicles are there. People will have legitimate and honest debates about what the outcome should be, but those outcomes are yet predetermined, and we have been looking at every one of those proceedings to consider questions that we might add, or additions that we might put on it to take into account the growing body of information that we are having.

Finally, I would say that the current environment does give us pause to be cautious in a number of areas that seemed less problematic before.

Senator WYDEN. It is correct that we need to look a bit more carefully at some of the streamlining of accounting functions that was originally contemplated at a time when there wasn't apparent evidence of a need for some of those accounts. I think that we will now proceed much more slowly and consider whether any of those judgments that have already been made or were being contemplated continue to merit direction in that regard. That's something we'll do that is a change.

We have had to spend, as we've talked about here today, a lot of time and resources developing a much more robust response and jurisdictional basis for managing disruption of service and bankruptcy proceedings. That's taken an enormous amount of our attention and resources. That has now been added as a major component of our tenure and what we're going to have to be focused on, sadly. But that's where I think we're going, and I think that we have most of what we need underway to that.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Breaux?

Senator BREAUX. Thank you, Mr. Chairman. Thank you, Chairman Powell, for being with us, and for your statement. Early on in your statement, you said that WorldCom is still providing you your telephone service. I would just observe when WorldCom cuts off the telephone service to the Chairman of the FCC, we can probably all plan to attend a funeral in the very near future.

Chairman POWELL. It happened once, but I'll leave that out.

[Laughter.]

Senator BREAU. Oh, it did. Hmm, that's a story.

You mentioned several times in your testimony about potential for broadband services to really be a bright spot for the telecommunications industry in residential areas. The indications are that opportunities to develop new services will come from residential broadband.

You talk about approximately 50 million households in the near term would be a potential broadband market that could be provided for and that there's a great opportunity in all of the broadband services. It seems to me that we have a situation in broadband where almost 70 percent of the services are provided basically through cable services, which are generally unregulated, to a large extent. And the competition being the—for digital subscriber lines being basically the phone companies, which are heavily regulated as to what they can do and cannot do.

As you know, we've introduced legislation that basically says—look, I don't think Congress is ever going to be able to decide the nitty gritty of what is the proper approach in some of these new technology areas—and the legislation basically says to the Federal Communications Commission to try and come up with some rules and regulations that create a level playing field in this new and exciting technology that you speak to.

So I guess my general question would be, can the FCC, if given the appropriate amount of time, comply with a requirement like that to try and attempt to come up with a level playing field for the broadband services?

Mr. POWELL. Well, if that were our task, I'm confident we could do it, yes.

Senator BREAU. In trying to figure—I'm glad to hear you say that—but in trying to figure out what would be an appropriate time—I mean, legislation, I think—I forgot what he said on 180 days—is there a timeframe that the FCC would need to embark upon that type of a process?

Mr. POWELL. Well, I'd put it this way. I think, at the very minimal, it would need to be 6 months. And I think, at the optimal, when you consider enormous amount of notice and comment and administrative procedures that would have to be followed to get the kind of full and complete record necessary to make those judgments prudently. But this body, when it created the Telecom Act in 1996, I believe gave the Commission 6 months to introduce the local competition rules.

And to the credit of Chairman Hunt and all the hardworking employees who were running the show back then, they were able to accomplish that. But I would urge the Committee, as I must as the leader of the institution, to keep cognizant of the wide-ranging amount of portfolio we're dealing with and whether, you know, we actually have the resources to have too many major efforts. We have 17,271 applications pending right now. We have five, six major proceedings hoping to conclude by the end of the year. We've been consumed by bankruptcy proceedings. So all of that would have an affect on timing.

But I think, you know, given, you know, no other additional catastrophic drain of resources, that we could probably accomplish something like that in a, you know, eight to 10 month time.

Senator BREAUX. Can you comment—I'm not sure you can—but, I mean, on the advisability? I'm just trying to figure out how we create a level playing field. I mean, I'm happy to do it from a congressional standpoint, which I think is really very difficult because of the battles that occur when you attempt to do some of these things. Can you comment on the advisability? I mean, our legislation that I'm part of basically says, "You do it." And my question is really—from a policy standpoint is, is that something that makes policy sense—I mean, or not, or can you comment on that?

I mean, we set policy, you carry it out, but I mean, you also head up the agency that supervises these industries. I mean, is that something that, not only as you said, you could do it, is it something that makes sense to attempt to do?

Mr. POWELL. Yes, I suppose so, but I—I think I would answer this way. This commission, your commission, is best when it's making technical and economic judgments that underlie broad policy conclusions by the people's representatives, broadly represented by the Congress. And so I think one of the most difficult areas is when the commission is in grayer territory, when there isn't a clearly demonstrated consensus in the legislature, and then we take the buffeting, too, of trying to make those very difficult decisions in an unambiguous environment. And I think that there would—there are some very fundamental threshold questions that I think would probably benefit from Congress in its wisdom making judgments initially about—

Senator BREAUX. Assuming that Congress said that, look, we want to have a level playing field. And it's hard to say what's a level playing field, but basically we're talking putting everybody on an equal competitive basis. And it seems like a lot of the things that are needed to be done in order to accomplish that are very technical. I mean, there are pages of regulations that apply, I think, to the local phone companies if they're going to get into this area. And a lot of it's very technical. I mean, a lot of us really probably don't know the details of what each one of those require. So it does seem to be a great deal of technical adjustments that would be made in order to create that level playing field. And as you've indicated, one of the things that the FCC is supposed to do is to handle the technical issues. I mean, am I correct in talking about that, or am I missing the point somewhere, or do you—

Mr. POWELL. No, I think you're correct, but I also think that all those technical judgments have to stem from some very fundamental conclusions. For example, will there be a—will parity include wholesale access by other competitors on an intermodal basis? Right? I mean, if you really wanted to confer that judgment to me, we'd figure it out, but it's one of the most fundamental things that I think is probably decided by this institution. Now then, whether we could technically figure how and what manner that is done, I am quite confident that we could.

Senator BREAUX. Well, I'm not sure the policy direction is enough. I mean, policy direction is fairly simple, and our effort is to create a level playing field so everybody can compete with the same rules. And the question is, is that enough of a policy direction, or do you have—would we have to do more than that?

Mr. POWELL. Well, I'd like to think about that more, but generally I think that I would lean toward wanting to discuss with Congress more fully slightly more than just a simple mandate to achieve parity, which is a relatively—bit of a—

Senator BREAU. It's in the eyes of the beholder, to a certain extent.

Mr. POWELL. Yeah.

Senator BREAU. And I understand that. It's very difficult to say, look, make it fair. I mean, how do you do that? I mean, you know, that's what we're struggling for.

Mr. POWELL. But I will only offer to you that this is something we have worked on, thought about in the most exhaustive terms, and I know that you've often asked me to come and talk to you about it, and I openly and happily commit to any member to do that. I think it's a very, very difficult area, and I think it's very, very hard to think through, and—but we have done a lot of thinking about it and would be more than happy to engage in—

Senator BREAU. Thank you.

The CHAIRMAN. Senator Dorgan?

Senator DORGAN. Mr. Chairman, thank you.

Mr. Chairman, I could ask some questions—lengthy questions about all of these companies who will follow your WorldCom, Global Crossing, and Qwest. But let me, for purposes of this discussion, ask some questions about Qwest. Qwest serves 24 exchanges in North Dakota. Let me also say to you that I had a rather lengthy discussion with the new CEO of Qwest. I believe it was the week before last, and I was impressed. He comes from a no-nonsense side of the industry—many, many years steeped in that side of the industry. I was impressed with him, and I think he wants to take this company in the right direction.

Having said all that, I want to try to get you to tell me and tell North Dakotans who are customers of Qwest who they should rely on, who they should look to for these kinds of problems. And I'll give you an example. Qwest is in 24 exchanges in North Dakota. It offers DSL service in only four of them—4 of 24. Question, why?

Qwest is also working in 27 other countries, has investments in 27 countries. Qwest, as you know, while it couldn't provide DSL service in 20 of the 24 exchanges it works on in North Dakota, it had the folks at the top of the company making a substantial amount of money even as they were making investments in foreign countries. Mr. Anschutz reaped \$1.9 billion from company stock sales since 1998; Mr. Nacchio, over \$300 million. And when he left the company, he was given a \$15 million bonus on top of his \$1.2 million salary and then given a \$10 million severance check as he went out the door. Now, that's—for stewardship at a time when we are now told by the new CEO that it appears the company, during the 3 years most recent—2 years, rather—has exaggerated revenue and understated costs, and they will have to restate their earnings.

Now, so here's a company that says, "I want to invest in 27 other countries, but don't want to do DSL in 20 of the 24 exchanges in the state of North Dakota. I want to sell \$300 million worth of stock, some of them within 60 days after saying that the company would meet its targets, and then failing to meet the targets by 10 percent." He sold all that stock. In addition, it now appears that

they were cooking the books, that the new CEO has to restate all these earnings and expenses. And if I'm a customer in Qwest in an exchange in North Dakota where I'm not able to get DSL service because Qwest says, "We're not going to offer it," who do I look to to see that this company is doing what it ought to be doing accounting-wise, in terms of executive compensation, service, DSL, and so on? Do I look to the FCC? Do I look to the SEC? Who do I look to? I'm a customer, and I see all this, and I think it stinks. I mean, it's just disgusting. So who do I look to?

Mr. POWELL. There was a lot in there. I'll try to get through them. You don't have DSL, I think you look to, one, the company. Why do I say them first? Because whether one thinks, regrettably, there is no provision I know of that compels a company to deploy service somewhere. That's regrettable perhaps, but that company ought to account for the citizens in the state that it operates, why isn't it providing a certain kind of service to them.

But just as importantly, I think the North Dakota Commission, which is quite notable, has a lot to do with the conditions and the local exchange markets and can consider whether in the context of its regulatory responsibilities at the local level is complying fully or that citizens would prefer other judgments being made by that—by that group, particularly when that group is fundamental to questions like whether it will grant 271 approval within the state, whether it will continue to consider regulatory requests of the company as it continues to operate. I think that they sit at the fulcrum of many of those decisions.

Us, depending on what it involves, to the extent that it has an interstate component system, I think the Federal Communications Commission ought to serve them as well.

On the accounting stuff, you know who I think they should have called is the state prosecutor and the Department of Justice if they are things that constitute criminal or other kinds of regulatory violations.

And if it turns out that there are not sufficient laws that cover the kinds of conduct that creates that sort of outrage, they turn to you and they turn to this institution, which I think that the public has, and they ask for these conducts to be incorporated into a legal regime that would permit prosecution.

Senator DORGAN. Would you agree that everyone has failed these customers at this point, given the recitation I've just offered you? For example, on 20 of the 24 exchanges, no DSL service. I guess it costs about, what, \$100,000 to set up a station to extend beyond the station for DSL. They say, "Well, we don't intend to spend the \$100,000," but then they give Mr. Nacchio a \$10 million severance check on top of his \$1.5 million bonus, on top of his \$1.2 million salary, on top of his \$300 million from the sale of stock, all during a period in which they apparently cooked the books. Do you agree that, if you're a customer, you must think that everybody failed you and probably also would agree that if you're a stockholder, you certainly think everybody has failed here?

Mr. POWELL. Oh, yes.

Senator DORGAN. And the reason—

Mr. POWELL. They probably do.

Senator DORGAN.—the reason I asked the question earlier when I made the statement is—you know, first of all, I like you personally. I voted for your confirmation, but sometimes I get heartburn when I read the things you say in the newspapers and the speeches. You say, “I believe we should trust that the market will lead to the most beneficial outcomes.”

I’m a great believer in the market. I’ve studied economics, and I taught economics, and I’m a great believer in the marketplace. I’m a firm believer that in many instances, you must—must—have effective regulation. For if you don’t have effective regulation, you will have a perversion of the market. And I worry very much about a philosophy that says, “Well, let me go take a break here and watch things for awhile.” I worry very much that that—when the part of the FCC—the SEC, FERC, the FCC—I worry very much that that gives people in this country less than they ought to get in terms of regulatory oversight.

So I hope, Chairman Powell, that you are a tiger on these issues and you ratchet up an effort to say that on my watch, your watch, you’re going to use all the tools at your disposal to prevent these kinds of things from happening again. I regret all of this has happened, and it’s not—you know, I don’t know that you lay the blame to one particular location. There’s avarice and greed and, you know, some folks that are crooked and have a heart that doesn’t respect honesty and fairness and, you know, there’s a whole series of reasons. But I think it’s also the case that in hearings in here and the Energy Committee and elsewhere, we’ve seen federal agencies that have not done their job as—in their oversight role. So my hope is that you will be very aggressive.

I wanted to ask about universal service here, but this is not the hearing to do that. And, as I said, I could have asked questions about the other two companies. I chose Qwest only because they serve 20 of 24 exchanges in North Dakota. You might want to respond to that, Mr.—Chairman Powell.

Mr. POWELL. Sure, I’d be happy to. I make no apologies for believing in the importance of market principles in economics, but I often think that this is widely misperceived as not believing that regulation has a place in the operations of economic activity in the country. I don’t think I’ve ever said such a thing. I wouldn’t be doing the job I’m doing if I was a complete libertarian and believed in *laissez faire*.

Indeed, I think that if you really look at our rhetoric rather than the reportage of it in trade magazines, you’ll find that we often employ our regulatory authority quite effectively to protect the interest of consumers. As I said, almost on any metric—people may not be happy with every 271 we’ve approved, but we’ve disapproved just as many because they have not met their regulatory obligations.

In our call for stronger enforcement to punish wrongdoing of incumbent local exchange carriers that violate merger conditions and violate the conditions, we are calling for regulatory power to aid in enforcement efforts. Under our—under my leadership at the commission, we’ve brought more enforcement actions than any previous commission and have brought the largest and first fines against Bell operating companies of any Commission. That’s, to me, an im-

portant regulatory function that we serve, and serve proudly, and, indeed, want more of that authority to do so effectively.

I think that I also believe deeply that most of these policy judgments are first minted by you. And I have a very profound and sincere commitment to trying to be faithful to the objectives of that. Much of it, however, has been left to us for implementation. We struggle sometimes to find the balance in that. But I do believe that when we're done, our record will show a good balance of understanding that it is not regulation versus deregulation. We need both, and we need to do both well.

Senator DORGAN. Chairman Powell, thank you for that response.

Let me just say, in conclusion, that what Senator Wyden talked about is important to many of us, as well. Fewer choices, by definition, almost always means less competition, and I worry about that in the context of all of this, as well.

Mr Chairman, thanks for your indulgence.

The CHAIRMAN. Surely.

Senator Cleland?

Senator CLELAND. Thank you, Mr. Chairman, and thank you, Chairman Powell.

I've been sitting here listening to this, and several thoughts have come to mind. A line by William Butler Yeats that life is like a spiral staircase; we keep coming back to the same point, but always from a different perspective.

When I was a young signal officer in Vietnam, particularly with an infantry battalion, I was the communications officer. It was my job to provide communications. It was my job to do job No. 1, service the battalion in terms of communications. If I didn't, I got relieved, because somebody got hurt.

And I think what we see now, as they say in my part of the country, there's something bad wrong. I don't know what it is. I wasn't here—in government here when MCI, which is the precursor of WorldCom, ultimately took the Bell system to court and you had the breakup of the Bell system. Now WorldCom itself is bankrupt. I wasn't here in the 1996 Telecom Act which glorified competition in the marketplace, and that was going to make it all well. Something's bad wrong.

We now have an implosion in the telecom industry that's not only hurting our economy, it's hurting America, and we are beginning to compromise job one. We're coming back to this point of service, and that is our mission, but we're coming at it at a different perspective. Some things have changed in the last 10, 20 years, and something is wrong, because we're winding up with Adelphia, where that family company was charged with, in effect, misappropriating a billion dollars. WorldCom misplacing \$4 billion. Qwest accused of cooking the books. Global Crossing was going down. Something is bad wrong.

I would like your opinion as to what went wrong and what you, the guardian of the telecommunication industry in this country and making sure that service is, indeed, the number-one priority of your agency and of this government, what we do to restore that service to the American people so they're not threatened either with unemployment in the telecommunication industry, losing their 401(k) plans to heartless CEOs, or being disrupted in their telecom



service without which you can't do personal business or regular business. What went wrong, and what do you propose to do about it?

Mr. POWELL. Well, I would just abbreviate what I said in my statement about what went wrong. I think there was a gold-rush mentality in the 1990s. People rushed aggressively to be the winners. I think they over expended. I think they raised debts to staggering levels, and I think they couldn't service them with revenue, and they destroyed themselves in that regard. I think the most fundamental crossing of the Rubicon was that some companies, under those unrelenting pressures, chose to cheat, and they chose to cheat in order to keep the party going, a party that was ultimately doomed to fail, but nonetheless, we were going to keep it going.

I think the blame for that rests in lots of places, but in differing degrees. I think it certainly has to, first and foremost, rest with the failure of leadership of those units, failure of leadership in the governance of those units and those fiduciaries, like accounting firms and lawyers, who are charged with the sacred responsibility of trying to prevent that from happening. All of that fell apart in these cases. I think everybody's doing the right thing to try to root out why that went wrong and how to prevent it in the future.

From a matter of telecommunication policy, I think that we have an obligation to look at how did it get this far? Did we do anything to contribute to, stimulate, inadvertently facilitate the kinds of business judgments that led to getting to that moment of crossing the Rubicon? I think we're looking at that hard.

I think that we have to be aggressive and learn to be very effective in this bankruptcy context, something that's new to the commission. As you were alluding to in the days of Ma Bell, you know, we didn't have bankruptcies. This is a relatively new phenomenon to regulatory agencies at the state and at the federal level, and we're working quickly to adopt responses so that as the transitions that need to take place to recover take place, consumers are not the ones who pay the price in terms of service.

Those are some of the things that we're going to do, and we keep looking tirelessly for other ways to do it. But we take seriously our responsibility and role to use our resources and our jurisdiction to do what we can to restore that confidence and credibility.

And just as importantly, because I think the—it's important to highlight that the commission does not have authority to regulate securities and banking questions, but that we do work as a sister agency with those institutions that do so that we can bring not only information as necessary, but expertise. The role I've played to date on a corporate task—fraud task force and with the SEC is to help explain what are access charges, how does this happen, why does the telecom carrier do this—help us be better at our job of investigation and prosecution, something that had not revealed itself to communication policy before, but I suspect is here with us from this point out.

And we have opened up, as I said, Memorandums of Understanding. We're working to develop our interagency participation with Justice. And I hope and pray and we'll spend every effort we have trying to make sure that that bears fruit.

Senator CLELAND. Thank you, Mr. Powell. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Allen?

Senator ALLEN. Thank you, Mr. Chairman. And thank you, Chairman Powell, for your, in my view, very logical, outstanding statement and prioritization of the tasks of those issues that are within the jurisdiction of the FCC.

I, first of all, agree with your approach of service continuity being No. 1, job No. 1. And that is important to make sure that our nation's communications system stays reliable and useful. I also commend your more of the long-term—as you get down these priorities, your long-term vision of what needs to be done.

There is also a thread of optimism there that it is still going to be good some day, somehow, in the future. Of course, right now we see this corporate meltdown. You see the fraud. You see the scandals. And I appreciate that you recognize the importance that all of this has on a lot of vendors and suppliers and others that are involved in it.

Now, when you get to the—your second point, the rooting out corporate fraud, a lot of that's, I think, going to be addressed by the bill that President Bush signed today: The Corporate Accountability Bill. When you get into three and four and five—restoring financial health, prudent industry restructuring to restore a competitive supply and demand matter and all, and revenue sources, services and so forth. You look at this as an economics matter in that obviously a tremendous amount of investment went into communications infrastructure. Clearly, either because the prices were not high enough to consumers or consumers did not demand the added access or the added services, they're not recouping that investment. Thus, the bankruptcy, beyond all of the fraud and deception and so forth.

Now, when you talk about these three companies and indeed, the rest of the industry, one of the reasons you mentioned as to why the industry is suffering so badly is it's a supply and-demand matter. Now, the rate of consumer and business demand is continuing to grow. That's staying stable and growing, not—albeit not at the rate they projected. None of this infrastructure is perishable. In other words, you can have fiber optics, and it's not going to perish, it's not going to atrophy from a lack of use. So the question is, is that—with the expectations never materializing, when you look—and this is my understanding—that an estimated 39 million miles of fiber have been laid in the United States as part of this massive build out in the industry, yet only 10 percent of that fiber is use today. The CLECs, the ILECs, the cable carriers have spent billions of dollars, yet only 10 percent of the fiber capacity that is available is being used.

Now, can you, from your perspective, comment on why this is the case? It clearly is a lack of demand. Is it cost? Is it content? Why, in your view, does this lack of demand exist? Because that's what's going to eventually, when you get into restoring financial health, restructuring revenue and so forth, that's what's going to have to come—either they're going to have to drop their process or some-

thing is going to happen. But why do you feel that there is this lack of demand for this expanded investment in opportunity?

Mr. POWELL. Sure, Senator. Let me start with something you alluded to which is, it's a little bit of a mischaracterization to say that there really is a lack of demand. Doubling—Internet doubling every 100 days may be fanatical, but it is doubling every year. It's an extraordinary growth rate by any historical measure of other services. So there is demand out there. People do want services. What's astonishing is the incredibly quick way that the competitive pressures and carrier optimism led to infinite belief in the amount of supply that would be needed to meet demand. And we say demand is out of whack, but I don't think any level of demand could swallow the kinds of capacity that has been put in the ground, certainly in the short-term, and of some question, ever.

The thing that we haven't had in this discussion is the relentless power of technology, which I think is the other part of the story that I didn't allude to specifically, which is, whether we like it or not, no matter what the economy is doing, the laws of physics are dramatically increasing capacity and microprocessing power while simultaneously cutting costs, which means that every carrier out there has got a serious problem all the time.

The minute I lay this fiber, the minute I throw this box on the end of it, you know, within a matter of months or a year, or if you follow Moore's Law, 18 months, somebody's going to be able to do twice as much at half the price. It's sort of this declining cost curve forever phenomenon in which the technology is relentlessly undercutting the investments. And I think that one of the things is not only the physical capacity of the fiber, but the extraordinarily powerful exponential increases in its capability. Now we can light not 16, but 280 more and constantly increasing capacity. Technology is just on a more vicious curve than consumer adoption and demand. And this is a big problem in the market on a going-forward basis.

So, we should be careful not, I guess, not to fall for the false premise that, oh, all that capacity will always be usable; it's just a matter of finding the killer app. I do think that part of the market's going to have to fix itself, in terms of restructuring, to some degree, to cut out excess supply as opposed to just utilize it.

But back to the other half of your question. I do think there's still a lot of demand stimulation. This is the classic chicken-and-the-egg problem of new technologies, which is people don't want to build it until there's something to do with it; nobody wants to make anything to do with it until there's something to do it on. And I think that it's an iterative process. There'll be a little of one, and then a little more of the other, and a little of one, and a little more of the other, until it hits a tipping point which it really finds something sweet. I've always believed that consumers generally do not think of themselves as ever buying pipes. I don't think they care what's in the ground. I don't think they pay attention to where their NID is. I don't think the average consumer knows what a NID is. All they want is that thing to work when it turns on.

What they are buying is Amazon.com. What they are paying attention to, where they are gaining their value is in the services and content information they come to. I do think that stimulation of content and applications is a critical part of our modern economy

and it's a critical part to making this work. And I think that most have recognized that. I know Senator Burns and the Internet Caucus and the Congress talk a lot about that. Senator Hollings is trying to consider questions about copyright policy. All are integrated into the question of how to make content and applications sufficiently viable and cost effective so consumers will buy this thing. And when a consumer sits down and the computer is \$50 for broadband, there's a lot of people who say that's not worth it. Let me tell you something. When I bought my wife my network for \$150, and suddenly that \$50 could serve every computer in my house and I could wow my neighbors by surfing my Internet on my back deck, which I do regularly, it's suddenly worth it to me. And that's something nobody every heard of almost a year and a half ago.

So those things have got to keep coming, that suddenly slash what seems like ridiculous propositions into really value-added propositions. The danger is if everybody stops playing, or takes large hiatuses, it's hard to keep that iterative process going.

Thank you. My time's up. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Nelson?

Senator NELSON. Thank you, Mr. Chairman.

Mr. Powell, I was particularly intrigued by your comment about No. 4, the prudent industry restructuring in which you stated, "Survival and health will depend on prudent industry consolidation. I emphasize prudence, because some mergers clearly could present a threat to competition and may not be in the public interest. That can only be determined upon careful and thorough review of a particular transaction. Regulators will have to walk a fine line to achieve stability while not squelching competitive opportunity."

I certainly agree with those words that you spoke to the Committee. Could you give us some specific hypotheticals of what would be the—as this shakes out—as this industry shakes out, as combinations occur, which I said in my opening statement, which are inevitable, just like the airline industry?

How are you, other than these words which are, I commend you, which are the watch words that you have to strive for as a regulator. But what do you have in mind as you see this industry on down the line so that we protect—through competition, protect the interest of the consumer?

Mr. POWELL. Yes, sir. The—I should be quite frank and say that I'm asked this question a lot, and I always feel incompetent and unable to answer it effectively. Why? Because I don't know how to hypothesize on what is a good combination and eminently thinkable, and what's a bad combination eminently unthinkable. I can generalize about what the risks and possible dangers are and the possible benefits.

But I was trained in antitrust and competitive policy and feel extremely strongly that these are enormously fact-intensive and case-specific reviews. The Department of Justice, when it reviews a transaction, often is collecting 800 and thousands of boxes of documents in an effort to assess the market and the particular strengths of the actual carriers and what services they have. And I think the understandable desire to be able to have a vision and know in advance that, if I were king for a day, I would put these

two guys together and not let those two guys—one, is an arrogance that I don't subscribe to. I don't personally believe that I'm capable of doing that effectively. And even if I was, I don't think that's what you pay me to do. I think that the only thing we can do is be guided by those watch words and the process which we employ when they are presented to us and ensure that the proof is in the pudding of our implementation of it. And I hope that, if and when this occurs, that I'll sit here and you will be pleased with the results, but I—I don't know how to say unequivocally what they would be.

Senator NELSON. All right, I'll accept your answer—

Mr. POWELL. I don't have any other ones.

[Laughter.]

Senator NELSON.—recognizing that you can't go out and lay out a scenario. But by me asking the question—

Mr. POWELL. Sure.

Senator NELSON.—we're going to be watching you like a hawk.

Mr. POWELL. You won't be the only one.

[Laughter.]

Senator NELSON. But there are others who watch you for their own self-interest—

Mr. POWELL. That, I know as well.

Senator NELSON. Are you going to be looking out for the—

Senator BURNS. And you're not?

Senator NELSON. No, I'm looking out for the interest of the average Joe Citizen who has benefited as a result of the increased competition that occurred. The fact of the cost of long-distance service today, the fact of the multiplicity of cell phones and wireless transmissions, I think has been a benefit of the increased competition. And that's what I'm looking out for, Senator Burns.

Now, let me ask you this. We are going to see some shake out from telecommunications bankruptcies. And as companies emerge from Chapter 11 having shed their debts, there's always the possibility that they are going to undercut their debt-laden rivals, causing further collapses. Give me the benefit of your thinking with regard to how does the FCC take this scenario into account.

Mr. POWELL. That is actually an excellent question to which I think a lot of discussion is ensuing. I don't think there are a lot of great answers to that at the moment, in this sense, that, one, it's not clear how genuine or imminent that kind of scenario is, but it is a possibility. It has occurred in industries in the past. I mean, we have a wonderful system that allows people to go into Chapter 11 bankruptcy and reemerge having shed their assets. That ought to be a consumer-enhancing prospect. A company emerges healthier, more financially capable.

It works really well on an individualized basis, but when you're looking at a total industry, it runs the risks, as you point out, that I think are relatively legitimate, that that carrier emerges free of a lot of its debt that was burdening it before, but it is in competition with carriers that have successfully managed to stay out of bankruptcy, but are nonetheless struggling to maintain financial health while continuing to carry that sort of debt. And if what happens is the emerging carrier unleashes yet another price war with other carriers unburdened by the restrictions it had prior to bank-

ruptcy, there's always the danger that the other carriers simply cannot compete on those unfair premises, that they simply cannot match prices with a company that has shed all its debt while you're carrying \$30 billion of it. And there has been scenarios postulated, at least in the press and among analysts, that other carriers could be forced into bankruptcy in an effort to compete.

I don't yet know how possible or imminent I think that is. I'm a little skeptical of this scenario happening on a large scale basis—just out of instinct, to be honest, and sort of a look at the industry and whether—you know, how much more room in the bottom is there in long-distance pricing, for example. Will WorldCom emerge and charge 2 cents a minute? I doubt it. Although I'd like it on my bill, but—

So we don't—we don't know how imminent that scenario is, and we're not quite sure what the government responses could be to it. It could be one—if it were really genuine, it could be one of these spiraling things that would be very difficult to figure out how to prevent. This is another area we'll just have to continue to think about and—

Senator NELSON. In your mind, is there a role for the FCC in that scenario?

Mr. POWELL. I'm not sure what it is, but I wish there was. I mean, I wish we could think of an effective way within our jurisdiction to help dampen that. I think one of the things that gets into painful areas is if there are restructuring and consolidations that provide price stability, if there are rules or procedures that could help minimize the rising costs of infrastructure or provide a more productive way for companies to both pursue financial health and remain competitive, I think we'd be very open to trying to pursue those rules and regulations, whether prices could be allowed to do things that they previously were not allowed to do, or impose new restraints that we previously wouldn't have imposed. But I think it's early in the thinking to offer specifics at this point.

Senator NELSON. Thank you, Mr. Chairman.

The CHAIRMAN. Chairman Powell, my colleague, Senator Dorgan, teaches me better tact or better manners or otherwise, because you have given me heartburn. But Senator Dorgan says he voted for you. So did I. And I've been always a good friend of the—and admirer of the Powells. Ms. Alma and my wife are good friends. The General and I got our honorary degrees together down at Tuskegee, and I work with him very closely as Secretary of State. I've got his appropriation.

But the statements, as Senator Dorgan says, that you came on saying that the public interest was just too vague, it was hard to really determine, and otherwise that market forces, the market forces were going to operate—I can tell by your statement this morning that, I had an idea that you really didn't know, but I can tell that's an excellent statement. You're a highly intelligent individual. But what really bothers me is, when you make these statements—when this thing occurred—I've got the quote where you thought that maybe the whole matter was as result of too much competition. We believe these markets didn't need to be natural monopolies, and they could be competitive. Nevertheless, Chairman Powell went on to say that the—to permit the competitors access

to the Bell networks may have contributed to the current telecommunications crisis by encouraging an ever proliferation of competitive entrants that together couldn't justify the collective capital investment.

Well, that's just bootstrapping the fraud that's been going on in the stock market that you rushed to, and Chairman Abernathy. That's why I'm glad to see you here—Commissioner Abernathy—she noted, quote, “The previous Commission seemed intent on stimulating competition as quickly as possible without regard to the kind of competition that was being promoted and whether or not it would be long-lasting and beneficial.”

You see, it hadn't been too much competition. The CLECs have gone, like you noted in your statement, from 300 down to 80, and everybody are back on their heels hardly able to survive, much less compete. But when you indicate there's too much competition, that you're streamlining the Class A accounting, cutting in half the requirements, giving flexibility, that's exactly what we had too much with the Securities Exchange Commission—too much flexibility. And now we're trying to tighten it.

And then that, you've got hearings that communications really get out from under the regulations themselves by classifying them as information. That's what's been bothering me. But now that's off my mind. Let me ask this.

[Laughter.]

The CHAIRMAN. With respect to actually getting to the point, you can see the interview that's going on. That Bell Company cloud. Ranking Member McCain is exactly right. We did have the lobbyists' lawyers write the bill. But we oversaw every bit of it. We asked them over a 4-year period. This communications law is very, very complicated. And so they would meet on a Friday, the Bell Companies, and on long distance on Tuesday morning, and they'd go back and forth to each lawyers checking each other. They all wanted to get into long distance, the Bell Companies. And instead, they didn't want to compete at all, they wanted to hold on to their particular monopoly. They questioned what they had written, actually, as their own lawyers, the constitutionality. They kept us tied up in the courts. And here, 6 years later, now, we're still—they've still got 90 percent of the last line, so there's not too much competition. They've still got a monopoly.

And what the gentleman from Louisiana says, that we want parity, we want parity. Parity? They've got parity. One, we've got a monopoly, the cable crowd, going into the residents, and the DSL crowd into the business. Both of them have got about 80 percent of it. Now, what we have resisted here on the Senate side is extending the monopoly. All this idea of giving them parity is giving them both a monopoly. That's not competition at all, and we're not about to vote for it.

And even though this Tauzin-Dingell and the parity bill and the Bell Companies buying up all the lobbyists—every friend I've got in South Carolina has a lawyer that has been bought and come to see me, “What can we do to get together,” and that kind of stuff. You have to smile, and I have to smile. I go through it. It's the full employment act.

[Laughter.]

The CHAIRMAN. But it's the Tauzin-Dingell intermural and now called parity and everything else to extend the monopoly. They don't want to compete. And what we have got to do doesn't go along with that parity and—they think you—as a result of your market bent that you'll do what they can't to get through Congress. That's what they really—that's what the Senator from Louisiana wants you to do. Please don't do that, and don't worry about—some of these things here still bother me.

When you talk about the fines, for example, we know irrespective of their fines or the amount, they just pass them on into the rate-payers. For example, Bell South has a total fine of \$20.5 million, but they had total revenues of \$20.13 billion. And Qwest had \$878 million in fines, but that's onto revenues of \$19.7 billion. And similarly, SBC had \$639 million in fines, but that's on \$45.91 billion. And similarly, Verizon—Verizon paid \$300.4 million in fines, but Verizon has \$67.19 billion in revenues."

So they're playing a sordid game. Here we are. We've got the demise and the downfall now of telecommunications. My idea and comments here this morning is to plead with you, as the chairman of that Commission, to continue on with competition, try to short-stop, and don't let's use the demise of telecommunications to be used to extend the monopoly. If they—if Bell Companies have lost any moneys—my Bell South is in the 22 countries. There's Qwest and so forth was into all of these other countries. They've been investing everywhere. They're not extending the competition.

The only reason we didn't re-regulate cable—and I would think maybe the next Congress will; I don't mind saying that. But the only reason we haven't done it is that's been the only competition to the Bell Companies on getting out the broadband. That's the actual fact here at this particular level in the Congress.

So we're trying to continue the competition. We want to make sure that the Bell Companies are not just increasing the fines. You've got to watch them more closely than that. And otherwise, I had some other notes here to comment on, but we'd be glad to yield to you for your comment. You can see what I'm getting at. They're trying to get you to extend the Bell Company monopoly. That's all it is. And they have held onto it and held onto it and thwarted at every turn anybody to try to get into that 251 and compete. And now they've even written you with respect to advance payments. Here the CLECs, like everybody else, are just teetering financially. And they say, "Well, if we can get the Commission, by gosh, to get advance payments and everything else like that and additional securities in order to do business, even though we have had a good financial picture all along, then that additional advance payments and financial securities being pledged and everything, that'll really put the—40 of the other—remaining 80 under. I hope the Commission doesn't go along with that particular—they've got every gimmick in the book to extend their monopolies, take you over and take me over, and I want to plead with you, you won't allow it.

Mr. POWELL. You left me speechless.

[Laughter.]

The CHAIRMAN. Yes, sir. You've got all the time. I'm going to be here. The rest of them can leave.



[Laughter.]

Mr. POWELL. I'm not so easily rolled over. I'll just leave it at that.

The CHAIRMAN. Very good, thank you very much.

[Laughter.]

The CHAIRMAN. Senator Burns?

Senator BURNS. I am done with this witness. I'm looking forward to the next panel, sir.

The CHAIRMAN. Good. I am, too.

Senator Allen?

Senator ALLEN. Mr. Chairman, I enjoyed listening to your questions. And in conjunction with what Senator Nelson said, the solution to this is not more monopolies or more regulation. Deregulation has generally been very, very good. Look at all the advancements. And I loved listening to you, Chairman Powell, on all the advancements. And maybe it won't be all fiber optics. It may be wireless, satellites, other ways of delivering broadband or Internet services. And so my view is while these decisions that were made were obviously on poor business assumptions, wrong economic forecasts, and, on top of it all, the fraudulent or misleading statements, the solution is—in my view, is not a curtailment of competition.

Competition is good. I think people will go into it now with eyes wide open. That is one of the reasons why some of the capital markets have shrunk, because they want to make sure there's a rate of return. And through it all, what we do need to do, though—and this is what your role is—we have deregulation and regulation. We are for free markets. We trust free enterprise, but it is all under the rule of law, which is the regulations here, to make sure that people are complying with the laws.

And I do appreciate, Mr. Chairman, that I find that this chairman of the FCC uses an attitude that I like to see in our judges, and that is he does not create law. He understands that elected leaders, whether in the Senate or the House, bills signed by the President, are the laws, and then he executes them. And where there is discretion and implementation, he uses it, but he's a strict constructionist, so to speak, and I'm confident that the Chairman will do that.

And I thank you, Mr. Chairman. You're the right man at the right time in a time of crisis, but nevertheless I think you have the right principles, the right attitude, and the right priorities to get us through this and keep our communications the strongest in the world. Thank you.

Mr. POWELL. Thank you.

Senator ALLEN. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Dorgan?

Senator DORGAN. Mr. Chairman, just an observation. Strict constructionism, I hope, means something different with respect to the courts than it does with the respect to regulators. I remain, of course, concerned that regulators use all of the tools at their disposal to address the kinds of things that we've seen recently in this country, which represents a carnival of greed, something that undermines our economic system. So I don't quite understand the term "strict constructionist" with—

Senator ALLEN. If I may, Mr. Chairman?

Senator DORGAN. Yes.

Senator ALLEN. In light of what the Chairman was talking about and worries about what the SEC might do that exceeds its authority as per laws passed—duly passed, is what I'm talking about. Now, the Chairman, of course, has asked for increased fines to make these disparities in profits, versus the fines more meaningful to get compliance. He cannot have fines that exceed what is allowed by law, nor can he change competition rules when investments have been made by companies such as CLECs without authority from the Congress. I'm one who's not real thrilled about changing those. But nevertheless, he cannot do what is not allowed by the legislative branch.

Senator DORGAN. Yeah, I understand. The only reason I took the bait was that as I've watched the SEC, FERC, and other agencies, I have not seen any agency in danger of finding the limits of their authority. The problem has been just exactly on the other side. You know, an impression of a statue, while all the other things are going on around them.

And I just—I want agencies—well, I don't need to repeat it. I want agencies to be aggressive, using all of the tools at their disposal to deal with the kinds of things that we have now been confronting: avarice, greed, manipulation, cooked books, criminal behavior. And the result is people at the top left with a pocket full of gold, they got incredibly wealthy, and the people at the bottom lost their shirts, lost their jobs, lost their investments. And I just want regulators to use all the tools at their disposal. That's the only point I make.

The CHAIRMAN. Chairman Powell, I know you've interrupted your break to be with us, and you favored the Committee, and we appreciate it very, very much.

Mr. POWELL. My pleasure, sir.

The CHAIRMAN. Thank you.

Mr. POWELL. Thank you.

The CHAIRMAN. Next appearance will be the panel of John W. Sidgmore, the Chief Executive Officer and President of WorldCom; Mr. John Legere, Chief Executive Officer, Global Crossing, Limited; and Mr. Afshin Mohebbi, President and Chief Operating Officer of Qwest Communications International.

We appreciate your patience, and we apologize for the long delay, but it was necessary. You could understand the questions we had of the chairman of the Federal Communications Commission. We welcome you, and each of your full statements will be included in its entirety, and you can summarize it, perhaps. That's what I would suggest, the hour is late, a five or slightly over 5 minute summary. Or if you really want to, just go ahead and deliver the full statement.

Mr. Legere, we've got a street named after you in Charleston, South Carolina. We call it Legere. It's a French pronunciation. We welcome you, and we'll be glad to hear from you first.

**STATEMENT OF JOHN LEGERE, CHIEF EXECUTIVE OFFICER,  
GLOBAL CROSSING, LIMITED**

Mr. LEGERE. Good morning, Chairman Hollings and Members of the Committee, and thank you very much for inviting me here

today. We have a submitted a longer statement, and I'll make a few summary comments in my opening remarks.

Before I commend—before I begin, I really want to commend this group for holding this hearing to address, in a serious and thoughtful way, the financial turmoil facing the telecommunications industry, an industry that is vital to our Nation's health and well-being. Since my last appearance before a congressional committee this past March, the industry-wide crisis has deepened, and several of our competitors have filed for bankruptcy. The time is right for congressional attention and expression of congressional confidence in the country's telecommunications infrastructure.

Having filed for bankruptcy protection in January, we've made significant progress at Global Crossing toward turning around the company. We hope that our experience and perspectives will be useful to the Committee as it assesses the prospects for the future of the telecommunications industry.

Now, how did our Nation's telecommunications industry, with its unparalleled infrastructure, advanced telecommunications service, and vigorous competition find itself in a state of financial crisis? Before attempting to answer that question, I'd like to talk briefly about Global Crossing and our experience.

Our company was launched in 1997. And in just a few years, we've completed a global fiber optic network that spans 101,000 miles and is operational now in 220 cities in 27 countries. We provide some of the world's most advanced telecommunications services to tens of thousands of customers, both in the United States and around the world. Many of the world's telecommunications carriers, multinational corporations and governments depend on us for their communication needs. And even in bankruptcy, we continue to sign up new customers based on the strengths of our state-of-the-art Internet protocol-based network and our industry-leading advanced services as well as continued superior network performance and customer service. And, on behalf of Global Crossing and its employees, let me say how proud we are of that accomplishment.

So what has happened to our industry over the last year or so? I believe we were caught in what I'll call the "perfect storm" of unexpected drops in demand, rapidly declining prices, a perception of capacity glut by our customers, an economic and financial downturn, a closure of capital markets, and, finally, the debt we incurred to build our unprecedented global network. These factors cannot be oversimplified, and they have forced telecommunication companies of every sort—domestic as well as international, local as well as long distance, wireless as well as wireline, into the protection of the bankruptcy laws.

Going into last year, the telecommunications industry and analysts who studied the industry foresaw a nearly unending appetite for capacity fueled by customer demand for broadband applications. At the time, the growth of the Internet usage was astonishing, posting gains of several hundred percent a year. New bandwidth-consuming applications seemed to be just around the corner, and the capital markets were providing funds to new telecommunications and Internet companies.

Global Crossing as well as other next-generation telecommunications companies relied on these forecasts, as did capital markets that supplied the funds to build our businesses. We built our networks to meet this expected demand. In fact, we built ahead of demand by necessity, given the long lead times required to build new capacity. But demand forecasts were predicated, in part, on hurdling the last mile, deploying broadband to the home and to the office. And, for various reasons, take-up of broadband has taken a lot longer than industry experts had expected.

In the middle of 2001, our customers began to perceive that there was an oversupply of capacity. Many of them decided to wait out the market hoping for prices to drop. And drop they did, much more rapidly and dramatically than had been forecast by all the industry analysts.

Finally, the larger economic crunch hit our industry and hit hard. The economy slowed worldwide, affecting our business customers. And, at the same time, many of our carrier customers faced both slowing demand and financial difficulties of their own. Short-term demand for our network and services began to decline rapidly in the last half of last year, and the cash needed to support our cost structure and business plan did not materialize.

It has been suggested that our company and the industry's financial issues were caused by accounting irregularities. Speaking for Global Crossing, it's this perfect storm that I've described, not how we accounted for a relatively small portion of our overall revenues, that left us no choice but to file bankruptcy. We take very seriously the accounting allegations, and we're cooperating fully with the SEC and other investigations in their inquiry into our accounting practices. But accounting practices are neither the cause nor the cure for the business problems that we faced at Global Crossing.

Since I joined the company last October, through our bankruptcy filing and to this very day, we've taken aggressive measures to turn the company around. We reduced operating expenses by over 50 percent, and capital expenditures by over 90 percent since last year, and far greater when compared to expenditures in 2001. We're changing our cost structure. We're redesigning our business model. But, importantly, we are not compromising at all on the quality of our networks or our service. We've focused on customer retention and lost very few customers. In fact, we've gained new ones.

Despite all the odds, we're delivering on our promises. We have—thousands of dedicated and loyal employees have maintained service across our network. We've maintained—we've met or surpassed every operational financial target this year. And the future of our company is looking far brighter than it did in January, in a large measure due to some very painful but necessary actions that we've taken during the past year. We're proud not to have compromised on the integrity of our expansive telecom infrastructure during these times, and customers in this Nation will benefit enormously from this in years to come.

Now, is there a role for public policy as the industry moves through this painful period of transition? First, there should be a commitment to encourage fair competition in the telecommunications marketplace. Second, we urge the remaining telecommuni-

cations bottleneck, the local market, to be opened up to the extent possible by enforcing and monitoring compliance with current regulations. Third, we believe that Congress ought to look at ways to ensure that fees and policies for access to public rights of ways are reasonable and also to ensure that competitors have access to buildings. Fourth, it's essential to promote competition and, most important, bring down the price of local access so that promise of broadband can be realized.

And maybe I can illustrate the last point by simply noting that sending a signal from London to New York on our network costs a fraction of the amount we pay to a local incumbent to terminate that same signal in Manhattan for the last-mile connection to a customer.

In closing, we remain confident of the original vision of a global, seamless, fiber optic-based IP network with a full suite of advanced services. And when we emerge from bankruptcy, which we hope will be early next year, we fully believe that we will be in a position to create jobs and create value.

With the cooperation of our industry partners, the financial markets, and the Congress, we can work together to restore the confidence of the American people. We believe that our industry can recover from this current financial crisis and will continue to serve as an integral part of the engine for economic growth. And on behalf of thousands of Global Crossing employees and customers, let me reaffirm that we very much expect to be a part of that recovery.

Thank you once again for the opportunity to share our perspective.

[The prepared statement of Mr. Legere follows:]

PREPARED STATEMENT OF JOHN LEGERE, CHIEF EXECUTIVE OFFICER, GLOBAL CROSSING, LIMITED

Chairman Hollings and Members of the Committee, thank you for inviting us here today to discuss the state of the telecommunications industry. We want to commend you and this Committee for holding a hearing on the critical issue of how the industry's financial health can be restored. This hearing will make a significant contribution to the continuing public dialogue on how we can ensure that the communications infrastructure on which the American people have come to rely is not compromised while the industry makes its way through a period of transition. By holding this hearing, you are sending a positive signal to the financial markets and to the public that Congress is confident that our Nation's telecommunications companies will weather the financial turbulence that we face and that government and the private sector can work together to address the issues in a cooperative and constructive manner.

Despite the much-publicized economic problems of the telecommunications sector, we should not lose sight of the fact that our country has the world's most sophisticated and advanced communications infrastructure and services. Propelled by our enterprising culture and funded by private capital, America's communications companies have created networks that are unparalleled anywhere in the world—networks that are critical to maintaining our Nation's security and our leadership in the world economy. Every day, Americans are able to reap the substantial benefits of innovation, efficiency and competition that are the product of these investments.

Global Crossing and its thousands of employees are proud participants in this competitive market. We have completed a global fiber optic network that spans 101,000 route miles. We provide some of the world's most advanced telecommunications services to tens of thousands of customers, both in the United States and abroad. For our company, for our employees and, most of all, for every one of our customers, which include many of the largest telecommunications carriers in the world, we ask that this Committee and the Congress do what they can to ensure that competition in the telecommunications industry remains healthy. Ensuring

that the industry remains strong and competitive is vital to delivering the innovation and cost efficiencies on which the global economy depends.

We are here today because America's telecommunications industry is threatened by a financial crisis of enormous and unexpected proportions. I hope to share some observations on the sources of this crisis and on how the industry can best survive it. Global Crossing believes that government can play an important role in helping those segments of the communications industry that are in a state of turmoil to recover. Today's hearing is part of our collective opportunity to restore confidence and rebuild the industry.

Given the expressed interests and responsibilities of this Committee, today I intend to address the following: (i) the formation and growth of Global Crossing; (ii) the profound changes in the telecommunications industry, which began in mid-2001, and have brought us to where we are today; (iii) the status of the various governmental inquiries into Global Crossing; (iv) Global Crossing's performance since it filed for bankruptcy on January 28 of this year; and (v) our vision for the future.

I believe that the industry-wide crisis we are experiencing is a product of the interplay among the overall business environment, changing patterns in the supply and demand for network capacity, marketplace perceptions, access to capital and the regulatory environment. These are among the principal industry-wide factors that have caused not only Global Crossing, but also many other companies, to declare bankruptcy within the past 15 months. The pandemic nature of the problem we are facing is demonstrated all-too-clearly by the broad range of telecommunications companies that are now in bankruptcy: they are U.S.-based, as well as international; they own subsea cables, as well as terrestrial systems; they provide long distance services, as well as local access; and they are built on wireless, as well as wireline, technologies.

It is important to emphasize that despite the popular perception that this industry's problems stem from alleged accounting irregularities at a handful of companies, the turmoil we are experiencing is far more complex and more fundamental than the media have led many to believe. Allegations of accounting irregularities properly need to be addressed and may play larger or smaller roles in the difficulties faced by particular companies. Only by understanding the fundamental business factors underlying today's crisis, however, can we all work together to restore the strength of this vital sector.

#### **Formation and Growth of Global Crossing**

Global Crossing was created by visionaries who saw an unmet need in the marketplace for an integrated global high-capacity, fiber-optic network under common control. Throughout the history of the telecommunications industry, international traffic had been handed off, from one national carrier to another. As the world entered the age of the Internet, some saw that these legacy networks had neither the capacity nor the functionality to provide adequately for the envisioned Internet-based services. The vision of the founders of Global Crossing was to facilitate, in a more cost-effective manner, the worldwide transport of the surging traffic flows stimulated by the emergence of the Internet.

Global Crossing was launched in 1997 and became a publicly traded company in 1998. The founders of the Company successfully raised substantial amounts of private capital, capital that was essential to Global Crossing's ability to compete with the huge incumbent players (such as, AT&T) and to the construction of a new fiber-optic network that reached most of the world. Based on the widespread belief in multiple independent forecasts of rapid growth in demand for data services, the capital markets supported the project and construction was completed in record time.

Today, as a result of these efforts, Global Crossing has 101,000 route miles of fiber worldwide, fully operational in 220 cities in 27 countries. In addition, the Company has built a large and loyal customer base of public and private entities of all sizes. Our customers range from Kay Bee Toy Stores, with hundreds of stores worldwide, to the British Foreign Commonwealth Office, with over 240 embassies around the globe. Just last week, we announced that we are now linking research telescopes around Europe over our fiber-optic network, allowing research institutions worldwide to advance the science of astronomy. We connect thousands of financial institutions, completing millions of transactions every day over our network.

Our backbone network makes it possible for Americans to phone their relatives and friends in Europe, Asia, Latin America and Australia for dramatically lower costs because those calls can be transmitted over our fiber-optic backbone. And, our network is an important backbone for the Internet, enabling people and businesses to communicate in ways we simply could not have imagined just a decade ago. Despite our Chapter 11 filing and the substantial cost restructuring that we have undertaken, the size and reliability of our network continues to attract some of the

world's most important companies, financial institutions, and governments as customers. As a major supplier of wholesale capacity and services, our network supports nearly every major carrier in the world.

As our operations have continued without interruption, even as we proceed with our Chapter 11 reorganization, we are fortunate to have lost very few of our customers. We are enormously grateful for the loyalty of the thousands of customers who have understood that the value of Global Crossing's services was not diminished simply because we had to restructure our finances. That new customers are willing to trust us with their critical communications needs validates the vision of Global Crossing's founders and gives us confidence for the future. Our experience suggests that continuing to focus on customers and service is essential if the industry is to emerge from the current crisis with renewed vigor.

Although we are a global concern, the vast majority of our customers and most of our employees reside in the United States. Our corporate headquarters are in the United States and we have network operations centers here. Global Crossing is an integral part of the Nation's vital communications infrastructure, and we are doing everything we can to keep it that way. Our future as a company depends on it.

#### **Changes in the Telecommunications Industry**

The Committee has asked how we got to where we are today. To answer that question, we need to take ourselves back to how the telecommunications world looked just a few short years ago, when optimism—and demand forecasts—appeared nearly unbounded. Throughout the late 1990s and well into 2001, the telecommunications industry and those in the financial world who analyzed the industry foresaw an unending appetite for additional bandwidth capacity. Growth of Internet usage was astonishing, posting gains of several hundred percent a year, increases that were forecast to continue for some time, both in the United States and around the world. Enterprise customers were moving toward feature-rich, IP (Internet Protocol)-based networks of just the sort that we have built at Global Crossing. Many observers foresaw a world in which graphics, music and movies, with other gigabit-rich content, would flow directly to the home, and where new applications—games, virtual reality, distributed computing—would consume huge quantities of bandwidth.

In part, these expectations relied significantly on overcoming the last hurdle in the telecommunications world: the last mile. High-bandwidth intercity and international networks were constructed to facilitate commerce and satisfy consumer demand. Consumers and businesses, we all thought, would embrace broadband applications. But, those applications depend on making sure that broadband networks go right to the home and office. And, although Global Crossing serves few individual consumers, we are an important supplier of network facilities and services to other telecommunications providers and businesses who count individuals among their retail customers.

Even leaving aside the slow deployment and take up of broadband to the home, today there remain significant constraints on local access for thousands of businesses. This is particularly so for those outside the main metro areas. For new telecommunications competitors, who want to satisfy that demand, the costs of local access are still high, given the current structure of the industry.

Global Crossing and other next-generation telecommunications companies relied on forecasts of explosive demand for bandwidth, forecasts that were based on expectations of new applications and on hopes of addressing and resolving the issues of access and cost of local infrastructure. We built out our networks to meet this expected demand. Creating bandwidth, whether across oceans or land, is not instantaneous. Due to the long lead times necessary to plan, finance and construct new facilities, companies such as ours always have to build ahead of actual demand, which requires that our planning for new facilities looks ahead for several years. With actual and projected growth rates for capacity that approached 100 percent annually, it is clear that planning ahead for even one year implied the need to build massive amounts of capacity ahead of actual demand. For these reasons, we always have more capacity than we would need to serve our present customers. In short, at any point in time and in any one market, supply may well, and quite appropriately, exceed the existing demand.

For this reason, Global Crossing, like other large telecommunications companies, understood that, as new capacity came on-line, there might well be a temporary excess of the supply of capacity over demand in some markets and for a limited period of time. Multiple independent studies undertaken at the time, however, suggested that demand would continue to increase at very high rates and that any temporary oversupply would be extremely short-lived. The reports of experienced industry analysts indicated that any overcapacity would be swallowed up within a year or two

in all geographic areas. Multiple industry experts and analysts predicted that the temporary oversupply in trans-Atlantic capacity would be consumed by 2003, and in trans-Pacific capacity by 2004. These same studies suggested that even after this supply had been exhausted, demand would continue to grow by leaps and bounds for years to come.

What happened in the middle of 2001, however, is that our customers increasingly perceived that there was an oversupply of capacity. In fact, competing systems were built, while many more were announced, but never built. Carrier and enterprise customers decided to wait out the market because they thought that if they held off on making purchases, they could negotiate a better deal from telecommunications providers. In addition, deployment of broadband across the last mile was turning out to be slower than had been forecast by industry experts. For these reasons, demand for our network and services did not increase as much as we had planned, in significant measure because our carrier customers did not continue to buy capacity to serve their retail users.

At the same time, and partly as a consequence of the perception of a supply glut, prices dropped more rapidly than had been expected in many of the major markets that we serve. Our industry had been accustomed, of course, to price declines that were driven by advances in technology that were even more rapid than those experienced in the computer industry in recent decades. In the market for broadband telecommunications capacity, the declines in prices had been more than offset by the exploding demand for more capacity, leading to growing revenues. By the end of 2001, however, while price declines had continued to exceed forecasts and expectations, the demand for capacity had slowed.

In addition to the slower-than-expected rollout of broadband applications, the broader economic crunch hit our industry, and hit it hard. The economy slowed down in the United States and worldwide, and our service revenues did not grow as rapidly as we had predicted. The capital markets, which had previously enabled, even encouraged, the existence of many emerging telecommunications and Internet companies who were large purchasers of bandwidth, closed down for these companies. Even the large incumbent telecommunications carriers, who were large customers of ours, had financial challenges of their own, whether from the economic slowdown, increased competition, the demands of improving their own networks or acquisitions of 3G wireless licenses at auction in Europe.

We were not the only telecommunications company to get caught in this “perfect storm” of slowing growth in demand, declining prices, a perceived glut and an economic and financial downturn. We had incurred over \$8 billion in debt in order to construct and operate our global network and, as the year progressed, we realized that it would be increasingly difficult to meet the requirements of that debt.

Early in the fourth quarter of 2001, I was asked to serve as Global Crossing’s CEO. My leadership team and I quickly undertook the further steps that were needed to streamline the company’s operations. We eliminated layers of management, implemented dramatic cost reductions, including a reduction in force from nearly 14,000 to 5,000 employees, and redesigned the company’s business and financial models. Despite these necessary and painful measures, it became apparent that our debt service, coupled with a realistic assessment of the market opportunities in the context of a continued slow-down in the economy, required Global Crossing to explore all its options.

Towards the end of the year, we accelerated discussions with banks and potential investors. As the pressure of loan obligations increased, however, our advisors counseled us that the Company’s situation called for measures more drastic than originally expected, and, with great regret, we filed for bankruptcy protection on January 28 of this year.

We were neither the first nor the last telecommunications company to seek bankruptcy protection. As *The Wall Street Journal* reported in early 2001, telecommunications companies had borrowed more than \$1.5 trillion from banks since 1996 and issued over \$600 billion in bonds in order to invest in their networks. Given these debt loads, many telecommunications enterprises were forced to cut back their operations and, in the case of some, file for bankruptcy. Inevitably and unfortunately, many people who were employed by them, and many others who invested in these companies, personally experienced the ensuing turmoil.

#### **Government Inquiries**

The media continue quite naturally to highlight allegations of accounting irregularities and the role that they may have played in bringing about the current crisis. Each of us sitting at this table is reportedly the subject of government inquiries into various accounting practices. With respect to Global Crossing, the media have reported that the government is examining issues related to the accounting methods



or procedures our company used for sales and purchases of capacity in the form of Indefeasible Rights of Use, or IRUs, in connection with concurrent transactions with our carrier customers.

I do not believe that the way in which Global Crossing accounted for specific transactions played any role in our financial troubles. The sale and acquisition of capacity via contracts known as IRUs is an essential part of creating efficient networks. Transactions involving IRUs are legitimate and important to both buyers and sellers of capacity and have been used for many years in the industry. Accounting for the concurrent transactions raised several very complex issues; in fact, we spent a great deal of time working with our independent auditors to determine how to account for them appropriately.

It is far too simplistic to assert that the widespread problems in the telecommunications industry were caused by particular methods of accounting. Whether other companies' difficulties are accounting-related, we cannot say. At Global Crossing, however, we know that the transactions in question represented a relatively small portion of our business, and that our accounting for them does not explain why we found it necessary to seek bankruptcy protection.

We are, of course, cooperating fully with the investigations by government bodies into our accounting practices. We have provided documents and testimony to the SEC regarding the subject transactions and precisely how we accounted for them. We have also made our employees available to be interviewed by the staff of the Energy & Commerce Committee of the House of Representatives, and in March I testified before the Subcommittee on Oversight and Investigations of the Financial Services Committee of the House of Representatives. For our own part, Global Crossing's Board of Directors has appointed a special committee of independent directors, which is conducting a review of the Company's accounting practices for the concurrent transactions.

#### **Post-Bankruptcy Events at Global Crossing**

I believe there are important lessons to be learned from our experience at Global Crossing as we look forward. Our network is still fully operational. We have thousands of dedicated and loyal employees who have maintained uninterrupted service across our network since our bankruptcy filing. We have substantially cut our capital and operating expenditures, and we have met all of our operational goals.

Delivering top quality service is still our highest goal. We continue to meet the national and worldwide needs of our tens of thousands of customers. The fact of our bankruptcy has not disrupted or affected a single customer. It is our hope that the steps we have taken will allow Global Crossing to continue to compete as an ongoing business. We are aggressively pursuing plans to emerge from Chapter 11 with our network intact.

Our financial performance since filing for Chapter 11 protection has met or exceeded our expectations. We are winning new customers and retaining our existing customers at rates higher than we had forecast. We continue to achieve an availability rate of 99.999 percent on our IP network, a level of performance that matches the best in the industry. Since we filed for Chapter 11 protection, our revenue, earnings, and cash have all exceeded the expectations that we established with our creditors. At the same time, our monthly operating expenses are now 40 percent lower than they were at the end of last year. IP traffic across our network shows healthy growth in light of the current environment.

What does the future hold for Global Crossing? It is hard to say, because we are in the middle of a complex restructuring process governed by the bankruptcy law. The future ownership of the company is being determined by the confidential auction that is now proceeding, and we expect to present the results of that auction to the Bankruptcy Court next week. Although our future is not entirely certain, we believe that we will emerge from this process with our network intact, and with new, more efficient ways of running our business.

Before I conclude, let me add some thoughts on the role of government in restoring financial health to the telecommunications sector.

Although some have argued that, in a time of turmoil, it may be appropriate for government to intervene in the market, to apply a heavier regulatory hand to the telecommunications industry, we believe that the FCC should stay on course in instituting measures that ensure fair competition and a level playing field between incumbents and new competitors. We believe the FCC, supported by the Congress, can continue to play an important role, working with industry and Wall Street, to assist the industry in transitioning out of our financial crisis.

We urge the Committee, along with the rest of Congress, the Administration and the FCC, to do what they can to open up the remaining telecommunications bottleneck in the local market, including through enforcement and monitoring of the obli-

gations of Section 271 of the Communications Act. With respect to the local market, it is essential to do what is needed to promote competition and, most importantly, to bring down the prices of local access so that the promise of broadband can be realized. In addition, Congress has an opportunity to legislate on the issue of the fees charged for public rights of ways and for access to buildings. Adopting non-discriminatory policies and ensuring that fees are reasonable, to allow fairer access to public rights of way, will help stimulate demand, promote consumer choice and lay the foundation for a healthier industry.

We believe that this industry will, one way or another, come through this difficult period. We cannot be sure how long the crisis will last. At Global Crossing, we started down the path of restructuring nearly a year ago. We have demonstrated that a turn-around is possible where management implements a focused and pragmatic plan, including often painful, but necessary, cost-reductions. This week, we expect that the competitive bidders who have come forward with proposals to invest in Global Crossing will make their final offers. And, early next year, we expect to emerge from the Chapter 11 process. When we do, we fully intend to continue serving our customers, just as we remain confident in our founding vision, of a global, seamless fiber-based IP network.

Mr. Chairman and Members of the Committee, the current financial turmoil need not have a permanent effect on our world-leading telecommunications industry. With the cooperation of our industry partners, the financial markets, the Congress, the Administration and the FCC, we can restore the confidence of the American people and the world. During the last decade, our country has undergone a communications revolution that has produced substantial social and economic benefits. We believe that the industry will recover from its current financial crisis and that it will continue as an integral part of the engine for economic growth. On behalf of the thousands of Global Crossing employees and our customers, let me reaffirm that we very much expect to be part of that recovery and resurgence.

Thank you, once again, for inviting us to testify.

The CHAIRMAN. Very good, sir.  
Mr. Sidgmore?

**STATEMENT OF JOHN W. SIDGMORE, PRESIDENT AND CHIEF  
EXECUTIVE OFFICER, WORLDCom**

Mr. SIDGMORE. Good morning, Mr. Chairman and Members of the Committee.

My name is John Sidgmore, and I'm the president and CEO of WorldCom. There are three points that I would like to highlight as I begin. First, despite our Chapter 11 filing, WorldCom will continue to deliver world-class service to all of its customers—residential customers, business customers, and the government—without disruption. Second, on behalf of WorldCom, I want to apologize for the accounting irregularities that we discovered and disclosed last month.

We share the outrage of the American public, and we are committed to cooperating with investigators of all kinds—and there are many—to identify the wrongdoers and to taking the appropriate steps to ensure that this can never happen again, and to move forward as a highly ethical company. And, finally, we strongly urge policymakers to reaffirm their commitment to pro-competitive policies.

Let me return to the subject of serving our customers. There is a perception that when a company files for bankruptcy protection, its business operations cease. In our situation, this is just not the case, and service will not be disrupted. To be sure, WorldCom has been through a very difficult period recently. When I became WorldCom CEO at the end of April, the company was facing very serious, but not insurmountable financial problems. We undertook a plan to cut costs and to restructure our debt. But before we could

complete those efforts, WorldCom on June 25th disclosed accounting irregularities that require the company to restate our earnings for 2001 and for the first quarter of 2002. These accounting irregularities led directly to our Chapter 11 bankruptcy filing on July 21st. Because of the need to restate earnings, we suddenly lacked audited financial statements, which in turn caused the public debt markets to close to our company. Critically required financing, which we had been very, very close to obtaining—I would say within hours—was no longer available, and some of our existing credit was withdrawn. The only door left open to us at that time was debtor and possession financing, which is only available in connection with a Chapter 11 filing.

Entering Chapter 11 allowed us to arrange for up to \$2 billion in such financing, \$750 million of which has been secured already. Ironically, it is because of our Chapter 11 filing that we now have the financial wherewithal to continue serving all of our customers—again, without any disruption.

I would like to further commend FCC Chairman Michael Powell for his efforts to reassure a nervous marketplace. It has been very, very helpful. And we will continue to work closely with this Committee and the FCC to ensure that customers continue to receive our highest-quality service.

Second, WorldCom has been very proactive in responding to the accounting irregularities matter openly, expeditiously, and responsibly. And I want to make it clear that we reported ourselves. Our board of directors moved very swiftly and decisively to terminate our CFO and to report that matter to the SEC and to the public immediately. We have cooperated fully with the various official investigations by the SEC, the Justice Department, and those in Congress.

William McLucas, the former chief of the enforcement division of the SEC, was retained to perform an independent investigation of the facts and circumstances that underlie these numbers that were problematic.

Further, two new members have been elected to our board: Nicholas Katzenbach, a former U.S. attorney general, and Dennis Beresford, a former chairman of the Financial Accounting Standards Board. Both were appointed to a special investigative Committee of the board that will oversee the McLucas investigation.

Just yesterday, I appointed a new CFO, John DeBell, and a chief restructuring officer, Greg Rayburn. They are two of the most highly qualified and experienced restructuring executives that are available. They will play very key roles in our efforts to emerge from bankruptcy as quickly as possible with a very healthy business.

Third, I'd like to amplify on the need to preserve telecommunications competition. We think Congress got it right when it passed the pro-competition Telecommunications Act in 1996. Hundreds of new competitors entered the marketplace at that time, and network investment boomed. New technologies were deployed. Customers enjoyed innovative services and lower prices.

A couple of years ago, however, the sector began to experience significant problems, as were discussed before. Several factors, including a bad economy, excess capacity, pricing pressures, con-

verged to create, to use Mr. Legere's words, a kind of perfect storm—and I guarantee you we did not rehearse this—that ripped through the telecommunications industry.

But there is good news. The competitive telecommunications sector, while battered, is far from destroyed. Competition can survive, and the industry can prosper, but it can only do so if we remain committed to the pro-competition principles underlying the Telecommunications Act. The 1996 act set the right policy direction. We think it must be fully implemented and enforced.

In conclusion, Mr. Chairman, I assure you that we will work hard to regain your trust and the trust of the American people. We plan on emerging from Chapter 11 as quickly as possible with our competitive spirit intact, and we think we can wind up a healthier and stronger entity.

Finally, we will strive every day to provide the industry's best service to our customers and to operate WorldCom in accord with the highest ethical standards.

Thank you, Mr. Chairman, for your time.

[The prepared statement of Mr. Sidgmore follows:]

PREPARED STATEMENT OF JOHN W. SIDGMORE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, WORLDCom

My name is John Sidgmore. I am the President and Chief Executive Officer of WorldCom, Inc. I am proud to be leading a team of 60,000 people who are working hard to support our 20 million-plus customers.

I am here this morning to discuss the state of the telecommunications industry, including the events that led up to WorldCom's recent filing under Chapter 11 of the Bankruptcy Code. WorldCom has obviously been through a difficult period recently, but we are determined to overcome our problems and to move forward. We are intensely focused on ensuring that all of our customers—consumer, business and government—continue to receive the highest quality service without disruption. At the same time, we are planning for the future. We are committed to emerging from this process a stronger company with its competitive spirit intact.

Mr. Chairman, I've spent over twenty years in the information services and telecommunications industries. I've been honored to serve in several senior posts during that time, including a stint as Vice President at General Electric Information Services in the days before the Internet and as CEO of UUNET Technologies, which was the first commercial provider of Internet services.

That 20-year span has marked a tumultuous time in the industry's history, with many ups and downs. What we're witnessing today, however, is unprecedented. Clearly, the entire industry is experiencing severe problems. While many competitive companies have experienced difficulties—many have gone out of business—it's important to emphasize that competition is alive. I strongly believe that those companies that survive this bleak period will, as the result of vigorous competition, continue to bring product innovation and consumer savings to the marketplace. That will be true, however, only if federal and state regulators complete their implementation of the Telecommunications Act of 1996 and fully enforce this historic law.

**Introduction**

In April, when I agreed to take over as CEO of WorldCom, it was clear that both our industry and our company faced significant challenges. I knew then that, among other things, the company was struggling under the weight of \$30 billion in debt. But I never imagined what else was in store for us. I could not have imagined that in June we would uncover and publicly disclose significant, past accounting irregularities. Nor could I have imagined that about one month later WorldCom would file for relief under Chapter 11. As I will explain, there was a direct link between these events.

WorldCom announced on June 25, 2002 that the company misstated its earnings for 2001 and the first quarter of 2002. While the misdeeds we uncovered occurred before I became CEO, I want to apologize again on behalf of everyone at WorldCom. WorldCom's new management team and our employees share the public's outrage over these events. You have my commitment to continue to do everything possible

to obtain the facts, to fully cooperate with investigators' efforts to bring wrongdoers to justice, to develop safeguards to prevent such an event from recurring in the future, and to operate this company according to the highest commercial and ethical standards. Every effort will be made to ensure the long-term viability of this great company.

Saving this company is what led to the decision to file a voluntary petition under Chapter 11 on July 21. We fought hard to avoid doing so, but our need to restate earnings virtually eliminated other debt restructuring options previously available to us. Of all the options we examined, none could accomplish our goal of restoring corporate health as effectively. In the end, we believe that this process, while painful, is the best way to help the most people. Most importantly, it enables us to maintain quality customer service without disruption and it provides the best alternative for preserving the maximum number of jobs.

We have every intention of overcoming the challenges now facing us. We will operate our business normally while focusing on our business plan and getting our finances in order. We intend to emerge from Chapter 11 as soon as possible as a strong and healthy competitor.

#### **Telecommunications Industry: Competition Alive But at Risk**

Any analysis of the telecommunications industry today must begin with an acknowledgment of the significance of the 1996 Act, which created a sea change in the regulatory paradigm governing the telecommunications sector in this country. For the first time, the last-mile monopolies were opened to all forms of local competition—facilities-based, elements-based, and resale-based—and the competitive industry responded in kind. Hundreds of new competitors entered the marketplace and the capital markets financed their entry.

Investment in the telecommunications sector was driven by two fundamental factors: vibrant new competition and expectations of burgeoning customer demand. Competitive local exchange carriers (CLECs) poured tens of billions of dollars into the deployment of new telecommunications facilities and services. It's estimated that CLECs invested some \$55 billion during the four years following the passage of the Act. While much of this money went into building thousands of miles of new fiber-based networks, CLECs also invested in network elements leased from the incumbents, or purchased retail services at wholesale rates. Moreover, the Bell companies and other incumbent local exchange carriers (ILECs) responded with significant new investment of their own—over \$100 billion during that same time period. Thus, the Act helped spur investment by competitors and incumbents alike.

As the 1990s wound down, however, the sector began to experience some significant problems. The market version of a "perfect storm"—a slowing national economy, plummeting prices and excess network capacity—was brewing and became more real with each passing month. The bursting of the "dot-com" bubble made matters worse. Many of the "dot-com" companies were among the largest users of high-capacity data services.

In sum, an unprecedented number of competitors were fighting for a diminishing number of customers and available revenue. Customer demand never materialized to the extent expected. Dozens of providers began to curtail service or go out of business. It was a case of fundamental, supply-and-demand economics. The downward spiral created by the "storm" remains an issue for the industry.

Aside from pure economics, other factors also were at work. In particular, the incumbent Bell companies fought aggressively to thwart or retard implementation of the 1996 Act—a statute they had sought and supported. Whether filing court challenges to the very constitutionality of the Act, or slow-rolling the negotiation process for network interconnection, or refusing to pay CLECs for services rendered, the Bells did everything in their power to obstruct the development of competition.

The economic "storm," exacerbated by anticompetitive Bell activity, was further complicated by the incomplete or unsatisfactory implementation of the Act by some regulators. On the positive side, early Federal Communications Commission (FCC) decisions, such as the *Local Competition Order* and the first 271 decisions (regarding approval of Bell company entry into the long distance market), laid out a rational and well-crafted blueprint both for competitive entry into local markets, and for Bell company entry into long distance markets. Many states, such as New York, Texas, California, and Illinois, took the lead in implementing pro-competitive rules.

Unfortunately, just as the "storm" began to hit, public policy progress began to slow, as the Bell companies fought back against these laudable reform efforts. Today, CLECs still lack some of the fundamental tools promised by the 1996 Act, and several proposals at the FCC—as well as legislation pending before this Committee—threaten to turn back the important progress achieved thus far.

There is some good news: the competitive telecommunications sector, while wounded and bleeding, is far from dead. Amazingly enough, despite the unprecedented economic turmoil engulfing the industry:

- CLECs still managed to invest over \$12 billion in 2001, bringing total competitive industry-wide capital investment to over \$65 billion since passage of the Act.
- CLEC share of the local market continues to rise, slowly but steadily. According to the FCC's latest figures—released just a week ago and based on end-of-year 2001 numbers—while the ILECs control some 173 million switched access lines serving end user customers, CLECs now have almost 20 million lines, or 10.2 percent of the total in service. This compares favorably to just under 15 million access lines, and 7.7 percent market share, at the end of 2000.
- Of those CLEC lines, about 30 percent are provisioned over the CLEC's own last-mile facilities, 47 percent by means of unbundled network element (“UNE”) loops, including the UNE-Platform, leased from other carriers, and 22 percent by reselling the services of other carriers. Thus, CLECs continue to build out their networks, and sign up new customers, using all three market entry methods stipulated by Congress.

Another positive note: the FCC's critical statutory role in fostering local competition also has been confirmed by the Supreme Court. First in 1999 and again earlier this year, the Court firmly endorsed the FCC's pro-competitive authority under the Act. In particular, the May 2002 decision upholding the so-called “TELRIC” costing standard swept away much of the economic mythology being generated by the incumbents, and confirms that competition is best built on the framework of a forward-looking costing methodology.

In addition, competitive companies continue to bring innovative products to market that benefit all customers. In April, WorldCom's MCI unit launched *The Neighborhood*, a suite of products that offers residential consumers a “bundle” of services—local and long distance calling, plus features such as voice mail, Caller ID and call waiting—all for one flat monthly price: about \$50 in most states. Consumer response to *The Neighborhood* has been amazing. It confirms the pent-up demand across the country for the same kinds of value and choices in the local market that they have enjoyed in the long distance and online spaces for many years. Now available in thirty-four states and the District of Columbia, *The Neighborhood* will be available in almost all states by the first quarter of next year.

In WorldCom's view, there is a light at the end of this tunnel; there will be a return to prosperity in this industry. Our view assumes that Congress does not undermine the pro-competition policies of the Act by adopting legislation that would effectively repeal them. It further assumes that the FCC accepts the overwhelming consensus of both consumers and competitors regarding ILEC “deregulation” proposals now pending before the Commission. The 1996 Act sets the right policy direction. It is critical that the FCC finish the job of implementing the Act and enforce the Act aggressively. If it does, the industry will once again flourish and consumers will continue to benefit.

#### **WorldCom: Overcoming Challenges and Moving Forward**

Again, Mr. Chairman, I am confident that if the visionary policies embodied in the Act are carried forward, the telecommunications marketplace of the future will be characterized by vigorous competition and even greater benefits for consumers. To fully appreciate the promise of the future, it's often helpful to consider the experience of the past. WorldCom's legacy—and that of its key operating units, MCI and UUNET—is unmatched.

#### *WorldCom's Pro-Competition Legacy and Industry Leadership*

MCI and UUNET literally changed the face of an entire industry. MCI pioneered competition in the long distance industry, the first company to attack the old Bell System's monopoly. UUNET was the first commercial provider of Internet services. Indeed, both companies played leading roles in the development of the Internet. No other company in the world has the legacy that we do in promoting competition.

Unlike virtually every other major telecom firm, WorldCom was never a monopoly. Our company had to compete for every customer we have and today we have the privilege of serving over 20 million customers. A company with \$30 billion in annual revenues and 60,000-plus employees, WorldCom is:

- The second largest long distance company in the U.S.;
- The largest competitive provider of local telephone services;
- The largest carrier of international voice traffic; and

- The world's largest Internet services provider.

WorldCom clearly has been, and continues to be, an industry leader. We have been blessed with world-class employees whose great ideas and marketing savvy have produced innovative services and consumer savings. *The Neighborhood* is the latest innovation we've brought to the marketplace. Our competitors are scrambling to match us. And that really makes the point—when *we* innovate, *all* consumers benefit. Savings may be the ultimate measure of our success and our continuing value to the marketplace. Since MCI introduced competition to the old Bell System, residential, business and government users have saved many tens of billions of dollars.

Millions of people have a real stake in WorldCom's survival—our customers, our employees, our suppliers and our creditors. It is worth noting that WorldCom is a provider of network services for critical applications for the United States government. These applications include the provision of customer service to 80 million Social Security beneficiaries, air traffic control applications for the Federal Aviation Administration, network management for the Department of Defense, and critical data network services for the U.S. Postal Service. In addition, WorldCom provides long distance voice and data communications services for the House, the Senate, and the General Accounting Office. Our company provides those same kinds of services for virtually every government agency under its FTS2001 contract. In addition, WorldCom provides support for law enforcement and homeland security agencies, as well as agencies concerned with national security.

In other words, WorldCom is a key component of our nation's economy and communications infrastructure. Both commercial and national security interests rely upon WorldCom's operations continuing without disruption.

In that regard, I would like to commend FCC Chairman Michael Powell for his efforts to reassure a nervous marketplace. The FCC has a critical role to play in ensuring the continuing integrity of the nation's communications network. WorldCom takes its own legal and regulatory responsibilities very seriously. I can assure this Committee that we will continue to work closely with the Commission to ensure that customers will not suffer adverse consequences as a result of our current financial status.

#### *Financial Crisis at WorldCom*

Despite all the good things WorldCom had going for it, when I became CEO in April, WorldCom was a very troubled company. The sluggish economy and a variety of industry issues had caused a steep decline in the company's revenues, and the company was struggling to deal with its massive \$30 billion debt load. The debt load alone required more than \$2 billion a year in interest payments.

Notwithstanding these financial challenges, I truly felt that WorldCom could get back on the right track through a series of aggressive moves designed to reshape the company and restructure our debt without the need for a Chapter 11 proceeding. On June 14, at the annual meeting of WorldCom's shareholders, I set forth my blueprint for the future.

As part of that plan, WorldCom would sell or eliminate unprofitable lines of business. To that end, we began the sale of WorldCom's wireless resale service, largely by selling our customers to the underlying carrier providing the service.

We also continued to bring expenses in line with revenue. For a number of years, WorldCom's workforce had been increasing in anticipation of continued growth and we had, frankly, gotten far too big for the revenues that we were generating. Thus, we embarked on a plan to eliminate 17,000 from our workforce, including through attrition, the sale of non-core assets, and the discontinuation of contract services that were no longer required.

Together, shutting down our wireless resale unit and reducing our employee base will save WorldCom about \$1.8 billion per year.

Even with those savings, however, WorldCom still needed to restructure its debt. Although not easy, we were beginning to have some success in accomplishing this as well. We negotiated a \$1.5 billion accounts receivable securitization program with several of our lenders to replace a similar facility that was expiring. We were also engaged in productive negotiations with a consortium of banks on providing us with a new \$5 billion credit facility that would have enabled us to operate without concern of bankruptcy for at least several more years while we got the rest of our financial house in order.

Unfortunately, WorldCom's world changed for the worse on June 25th.

*Disclosure of Accounting Irregularities and the Need to Restate Earnings*

When we disclosed the need to restate earnings for 2001 and the first quarter of 2002 on June 25, we committed to deal with this matter openly, expeditiously and responsibly. As I will outline below, we have done so.

Let me remind you at the outset, however, that WorldCom uncovered this problem internally. Our external auditor at that time was Arthur Andersen. In effect, we audited our external auditor and we found what they missed.

WorldCom is being proactive. Our actions are guided by our commitment to restore public confidence in this great company and to operate WorldCom according to the highest standards of ethics and integrity. To that end, we have taken several specific actions:

- When this matter was brought to its attention, our Board of Directors moved swiftly and decisively. Its actions included terminating our Chief Financial Officer and promptly reporting the matter to the Securities and Exchange Commission (SEC) and to the public.
- We are cooperating fully with the various official investigations—by the SEC, the Department of Justice and the Congress. For example, on July 1, 2002, we filed a written statement with the SEC that included a summary of key events, known to us at that time, that led to our June 25th announcement. At the SEC's request, a revised statement was filed on July 8. A copy of the revised statement is available on two websites: the SEC's [[www.sec.gov/](http://www.sec.gov/)] and ours [[www.worldcom.com/](http://www.worldcom.com/)]. It details how the accounting irregularities were discovered by our internal audit team, led by Ms. Cynthia Cooper. The kind of initiative demonstrated by our internal audit group is to be applauded and will continue to be encouraged.
- William McLucas, a former Chief of the Enforcement Division of the SEC, was retained to perform an independent investigation of the facts and circumstances underlying the transfers. He will investigate not only our past and current management team, but also our Board regarding any individual involvement. His report will identify the wrongdoers and, in addition, will enable us to put into place new or modified internal procedures to prevent any recurrence of this type of event.
- Coincident with our Chapter 11 filing, WorldCom announced the election of two new members to its Board of Directors: Nicholas deB. Katzenbach and Dennis R. Beresford. Mr. Katzenbach is a former Attorney General of the United States. Mr. Beresford has served as Chairman of the Financial Accounting Standards Board (FASB). Both were appointed to a Special Investigative Committee of the Board to conduct an independent review of the company's accounting practices and preparation of financial statements. They will assume an oversight role with respect to Mr. McLucas' investigation.
- If we are to be a model for corporate behavior going forward, we must be transparent and above reproach. Therefore, in our July 1 SEC statement, we clearly stated that we were examining whether additional earnings restatements might be required for periods going back to 1999 with respect to the accounting for reserves established by the company. We are committed to completing this analysis, with the assistance of our new external auditors, KPMG, at the earliest possible date and to announcing the results of that analysis promptly.

Many questions still remain. We won't know the answers until the conclusion of the pending investigations. We will continue to cooperate fully with the various agencies and the Congress to answer those questions.

*Filing for Protection Under Chapter 11 of the U.S. Bankruptcy Code*

As noted earlier, WorldCom had successfully negotiated a new accounts receivable securitization program and was nearing accord on a new \$5 billion dollar credit facility when we announced the accounting irregularity and the need to restate earnings. Because of the need to restate, WorldCom no longer had valid, audited financial statements. Within a matter of days, the banks withdrew the receivables program and ended negotiations on the new credit facility. Without audited financial statements, the public debt markets were closed to WorldCom. Our hand was forced—we had no choice but to file a Chapter 11 petition and seek Debtor-In-Possession (DIP) financing.

On July 21, WorldCom filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. Chapter 11 allows a company to continue operating in the ordinary course of business and to maximize recovery for the company's



stakeholders. WorldCom's non-U.S. subsidiaries are not included in the filing and will also continue to operate normally.

WorldCom also announced that we had obtained an agreement to arrange up to \$2 billion in DIP financing. The company already has secured a commitment of \$750 million of this amount from Citibank, N.A., JP Morgan Chase Bank and General Electric Capital Corporation to supplement the company's cash flow during the Chapter 11 proceeding.

We struggled to avoid this outcome. Unfortunately, our need to restate earnings left us few options. In the end, we believe Chapter 11 is the best way to help the most people. The principal reasons for pursuing this option were:

- It allows us to continue our company's high quality service and customer programs. We will work closely with our lenders and federal and state regulators to ensure that there will be no disruption in service to any of our consumer, business or government customers. We have already had significant feedback from customers stating their support for our efforts to move the company forward and their commitment to stay with us through this process.
- It provides the best alternative for preserving jobs for our employees.
- It allows us, post-filing, to pay all suppliers, vendors and employees in the normal course of business. We are a very large customer to most of our suppliers. This action allows them to keep our business. The nation's economy will avoid a negative "ripple effect". We will not, however, be allowed to pay claims arising prior to filing without Bankruptcy Court approval.
- It provides our company with a systematic, legal framework to operate our business normally, while we focus our business plan and get our finances in order. It allows us to reconfigure our capital structure, reduce the unmanageable debt burden, improve cash flows, and deal with legal and financial issues in an organized manner—all of which are intended to make the company leaner and stronger, and to put it in a position to create future value for our stakeholders. Many companies having nationwide operations—including Continental, Texaco, Federated Department Stores, Southland Corporation—have emerged from Chapter 11 as stronger, fiercer competitors.

#### *WorldCom's Future*

Our intention is that WorldCom emerge from Chapter 11 as quickly as possible. I strongly believe that WorldCom is most valuable as an intact enterprise—clearly an example of the whole being greater than the sum of its parts. I believe that a large number of our creditors recognize this as well.

Unlike many companies entering Chapter 11, WorldCom has significant assets that will help it successfully emerge from the process: a significant customer base that is balanced between large enterprise customers and smaller mass-market consumers, a first-class global network that provides us with a superb platform with which to compete in the marketplace, and talented and dedicated employees.

When we do emerge from Chapter 11, we plan to be a competitive force to be reckoned with in the marketplace. We intend to eliminate a substantial amount of our debt, dispose of unprofitable lines of business, and significantly lower our costs. WorldCom's presence will continue to ensure competition in the rapidly consolidating telecom industry. No other company's legacy matches ours in terms of promoting competition and delivering its benefits to consumers and businesses in both pricing and product innovation. WorldCom is one of the last hopes for America to realize the intended benefits of the 1996 Act.

#### **Conclusion**

In concluding, I urge this Committee and the Congress to stay the course in promoting competition. The telecom industry, as a whole, is struggling, but competition is alive. The Act provides the right policy direction; to ensure the future vitality of competition, the Act needs to be fully implemented and enforced. Reversing course via legislation or regulation would cause even more harm to the industry and to the economy.

As for WorldCom specifically, our pro-competition legacy will continue. Mr. Chairman and Members of the Committee, we will work hard to regain your trust and that of the American people. We will work hard to rebuild the value of the company. We will continue to be straight about any problems we may discover and act aggressively to solve them. We will operate WorldCom according to the highest commercial and ethical standards. We will return your faith in us by continuing to make a significant difference in the marketplace—providing industry-leading telecom services and unsurpassed value to all of our customers.

The CHAIRMAN. Thank you, Mr. Sidgmore.  
Mr. Mohebbi?

**STATEMENT OF AFSHIN MOHEBBI, PRESIDENT AND CHIEF  
OPERATING OFFICER, QWEST COMMUNICATIONS  
INTERNATIONAL, INC.**

Mr. MOHEBBI. Mr. Chairman and Members of the Committee, my name is Afshin Mohebbi, and I am President and Chief Operating Officer of Qwest Communications International, Incorporated. I want to thank you for allowing me to appear today at your hearing on maintaining operations of communications facilities in the telecommunications industry.

Permit me to tell you a bit about Qwest. Qwest is a local telephone company with 25 million customers. We provide local telephone service in a 14-state area throughout the West. We have 56,000 employees and annual revenues of more \$19 billion. About 80 percent of our revenues and more than 90 percent of our profits come from our local phone services. We also provide data and long-distance services to businesses in major United States markets outside the 14-state local service area.

In addition, Qwest has a state-of-the-art global fiber optic network that spans more than 175,000 miles. Qwest's optical network is among the most advanced in the world. Qwest does business with more than 60 percent of the Fortune 1000 companies worldwide.

I want to assure the Committee and Qwest's customers that Qwest expects to be around for a long time and that the critical telecommunications services Qwest provides are not in jeopardy. We have multiple sources of revenue and a solid customer base. We're the first company to blend the assets, products, and customers of a regional Bell operating company with that of a carrier of high-speed telecommunication services. As the industry changes and matures, we are in a position to be equipped to continue to grow.

Because the Committee has inquired as to financial contingencies, I wish to assure the Committee that Qwest is fully prepared to ensure that customer service continues uninterrupted. In addition, Qwest has already dealt with the issue when telecommunications service providers have filed for bankruptcy, and we have successfully maintained the level of service and reliability that our customers expect from Qwest.

In fact, over the past 2 years Qwest has invested billions of dollars that have resulted in significant improvements in customer service. A Qwest analysis of FCC service data shows Qwest is first in overall service quality among the 12 largest local service providers. Qwest recently announced that its first-quarter 2002 service performance was the best in 7 years in key areas of installation and maintenance.

On Sunday, as the Committee is aware, Qwest announced that it expects to restate its financial statements for 2000 and 2001 to reflect adjustments in, among other things, revenue recognized from the sale of optical capacity assets, which are sometimes referred to as IRUs. Earlier this year, the company began an analysis of accounting treatment for IRUs. We have tentatively concluded

that our accounting policies at the time were incorrectly applied in connection with certain transactions.

In terms of Qwest's preliminary conclusions, let me emphasize the following. First, in the accounting of these transactions, Qwest sought, in good faith, to comply with the Generally Accepted Accounting Principles (GAAP) and all applicable accounting guidelines in regular consultation with its outside auditors. Next, when it completes its analysis, Qwest expects to restate its financial statements for prior periods. The \$591 million of revenue recognized with respect to the optical capacity asset sales identified in the Sunday press release represents 1.4 percent and 1.8 percent of total revenues in 2000 and 2001.

We are proud of our company. As a company, we feel we are ready to address the continuing difficulties within our industry and to address the steps necessary to complete our analysis of the company's accounting policies and practices. Our new chairman and CEO, Dick Notebaert, has said that increasing Qwest's credibility with investors and the public in general is his top priority and that he is, quote, "confident that Qwest is moving in the right direction and we have the ability to perform for our customers, our employees, and our shareholders," unquote. I could not agree more with Mr. Notebaert.

Qwest's voluntary and public disclosures about our accounting is an important step in the process of turning the company around. We're also proud to have the support of our employees in this effort. We were gratified by the statement recently issued by the Communications Workers of America president, Morton Bahr, who said that Qwest has now the customer base, the highly skilled and dedicated workforce, and the leadership team to restore Qwest's reputation and business success. It will not be easy, but we are intent on working hard to win back the trust of our employees and our investors and move this company forward while continuing to provide the very best telephone service possible to our customers.

I will be glad to try and answer any questions that you may have. Thank you.

[The prepared statement of Mr. Mohebbi follows:]

PREPARED STATEMENT OF AFSHIN MOHEBBI, PRESIDENT AND CHIEF OPERATING OFFICER, QWEST COMMUNICATIONS INTERNATIONAL, INC.

My name is Afshin Mohebbi and I am President and Chief Operating Officer of Qwest Communications International Inc. I want to thank you for allowing me to appear today at your hearing on maintaining operations of communications facilities in the telecommunications industry.

Permit me to tell you a little about Qwest. Qwest is a local telephone company with 25 million customers. We provide local telephone service in a 14-state area throughout the West. We have 56 thousand employees and annual revenues of more than \$19 billion. About 80 percent of our revenues and more than 90 percent of our profits come from our local phone service. We also provide data and long-distance services to businesses in major markets outside the 14-state local service area.

In addition, Qwest has a state of the art global fiber optic network that spans more than 175,000 miles. Qwest's optical network is among the most advanced in the world. More than 4.2 billion megabits of traffic travel across the network at any given time, along with web hosting centers that safeguard the critical data of banks, corporations, health care providers and government agencies among others. Qwest does business with more than 60 percent of the Fortune 1,000 companies.

I want to assure the Committee, and Qwest's customers, that Qwest expects to be around for a long time and that the critical telecommunications services Qwest provides are not in jeopardy. We have multiple sources of revenue and a solid cus-

tomers base. We're the first company to blend the assets, products, and customers of a regional bell operating company with that of a carrier of high-speed telecommunications services. As the industry changes and matures, we are in the position to be equipped to continue to grow.

Because the Committee has inquired as to financial contingencies, I wish to assure the Committee that Qwest is fully prepared to ensure that service continues uninterrupted. In addition, Qwest has already dealt with the issue when telecommunications service providers have filed for bankruptcy, and we have successfully maintained the level of service and reliability that our customers expect from Qwest.

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On Sunday, as the Committee is aware, Qwest announced that it expects to restate its financial statements for 2000 and 2001 to reflect adjustments in, among other things, revenue recognized from the sale of optical capacity assets, which are sometimes referred to as IRUs. Earlier this year the company began an analysis of accounting treatment for IRUs (particularly sales to customers from which the company agreed to purchase optical capacity assets). We have tentatively concluded that our accounting policies at the time were incorrectly applied in connection with certain transactions.

In terms of Qwest's preliminary conclusions, let me emphasize the following:

First, in accounting for these transactions, Qwest sought in good faith to comply with generally accepted accounting principles (GAAP) and all applicable accounting guidance, in regular consultation with its outside auditors.

Next, when it completes its analyses, Qwest expects to restate its financial statements for prior periods. The \$591 million of revenue recognized with respect to the optical capacity asset sales identified in the Sunday press release represented 1.4 percent and 1.8 percent of total revenue in 2000 and 2001.

We are proud of our company. As a company, we feel we are ready to address the continuing difficulties within our industry and to address the steps necessary to complete our analysis of the company's accounting policies and practices.

Our new CEO, Dick Notebaert, has said that "increasing Qwest's credibility" with investors, and the public generally is his top priority—and that he is "confident that Qwest is moving in the right direction, and we have the ability to perform for our customers, employees, and shareholders." I could not agree more. Qwest's voluntary and public disclosures about our accounting is an important step in the process of turning the company around.

We are also proud to have the support of our employees in this effort: we were gratified by the statement recently issued by CWA President Morton Bahr, who said that Qwest now has the "customer base, [a] highly skilled and dedicated workforce, and the leadership team . . . to restore Qwest's reputation and business success." It will not be easy, but we are intent on working hard to win back the trust of our employees and investors, and move this company forward while continuing to provide the very best telephone service possible to our customers.

I will be glad to try and answer any questions you may have.

The CHAIRMAN. Well, Mr. Mohebbi, you talk about the Sunday news release. Of course, if we just look at the morning *New York Times* release, and that's what's disturbing everybody, because we see everyone having to restate their financial statements or otherwise declare for bankruptcy, and you find, on page C4 of the *New York Times*, Phillip F. Anschutz, board member, former chairman between 1999 and 2000, and the company—1.453 billion—one and a half billion bucks to take out of a company.

I'll ask each of you, What about stock options? I'm like Senator McCain. We haven't really legislated stock options. That's the big attraction to take the money and run rather than look out for the company, look out for the employees, look out for the customers, and everything else like that, when you can get away with one and a half billion in a 2-year period, you say, "Well, ta-ta and goodbye.

Forget about Qwest. Forget about WorldCom or any—or communications.”

Mr. Sidgmore, what about stock options?

Mr. SIDGMORE. Well, my personal opinion is stock options are a very important part of the compensation program in many industries, telecommunications being one of them. But really all technology-based industries have used stock options as a central piece of their compensation programs for a long period of time. That—

The CHAIRMAN. But you’ve got a double accounting for them—you don’t account them as an expense.

Mr. SIDGMORE. Right, I’m not saying that we shouldn’t account for them as an expense. I’m just saying—

The CHAIRMAN. Do you think they should be counted for as an expense?

Mr. SIDGMORE. I think there are arguments in both directions, but I—

The CHAIRMAN. Yeah, but I know about the arguments. What do you think?

Mr. SIDGMORE. I think—I think they should be accounted for as an expense.

The CHAIRMAN. The thing that puzzles—when did you come with WorldCom? I know MCI—I worked with Bill McGowan over the years. I remember when he got a farmer’s loan, an agricultural loan, down in downtown Georgetown here in the District 30-some years ago to start MCI and to give competition to AT&T.

Mr. SIDGMORE. Right.

The CHAIRMAN. Now, when did you join WorldCom/MCI?

Mr. SIDGMORE. I was running a company called UUNET Technologies, it was actually the first Internet service provider, over in Virginia. And that was a company that went public in 1995, and then we sold it to a company called MFS in 1996. I became president of MFS. And then we sold that company to WorldCom in December 1996. So I joined WorldCom as chief operations officer in December of 1996.

The CHAIRMAN. So you’ve been there 6 years and you couldn’t tell you were 3.5 to 4 billions dollars shy?

Mr. SIDGMORE. No—

The CHAIRMAN. You didn’t know anything about this necessary restatement of—

Mr. SIDGMORE. In my own defense, I was the operations officer for 1997 and 1998, and I stepped down from that role in September of 1998. In 1999, I remained with the company, but my role basically was to do strategic acquisitions. For example, I was the one that worked on the Sprint acquisition, or the attempted Sprint acquisition. And for the last 3 years, really, I haven’t had a role other than to work on some strategic development in technology, but I have not had any role in operations.

The CHAIRMAN. So this was all news to you when—

Mr. SIDGMORE. Yes, it was.

The CHAIRMAN. I was made to understand that the reason you gave—well, excuse me, the company—WorldCom/MCI gave a \$400 million loan to Mr. Bernie Ebbers was because he had that many in stock options, and if he had exercised all the options, it would

have ruined the financing of the company or ruined the market for the stock itself. What's your comment? Is that the case?

Mr. SIDGMORE. Well, that was the theory at the time. The compensation committee at that time apparently was concerned that if Mr. Ebbers had sold his stock, which he had to do to pay off some loans, apparently, that the stock would be injured and the company would be injured. And the compensation committee granted that loan. The rest of the board, which included me, ratified that after the fact.

The CHAIRMAN. But stock options should never put a company in jeopardy to the tune of 400 million without the approval of the stockholders.

Mr. SIDGMORE. I couldn't agree more. I couldn't agree more with that.

The CHAIRMAN. But, unfortunately, we, at the congressional level, haven't been able to get that amendment up either. We'll keep trying.

Let me yield to Senator Burns.

Senator BURNS. Thank you, Mr. Chairman.

I'm going to be very parochial here in my questions, and that's to my good friend from Qwest. Being as I live out there and you were talking about investment in new technologies and things, well, Montana has been sort of about a half a step behind. Could you take a look at that up there and—we've got some old 56 switches that need replacing and some of those kind of things.

I want to—a problem that we have in Montana, so this is very parochial, and I'd like to just get your response to is—that I'm sure you're aware. TouchAmerica is an extremely important organization to Montana, given that it's headquartered in Butte, Montana, runs one of the largest fiber networks in the country.

With this in mind, I've been following the recent suits and countersuits surrounding the billing dispute between Qwest and TouchAmerica very closely. This conflict has arisen from the sale of long-distance assets from Qwest to TouchAmerica as part of its FCC approval process to buy USWest in 1999. As I understand it, Qwest claims that TouchAmerica has not paid amounts Qwest says it's due for Qwest's billing and operational support services. TouchAmerica, on the other hand, alleges that Qwest has improperly billed TouchAmerica and failed to account for the revenues due TouchAmerica.

So what else little argument we've got on the schoolyard, you might say. While I don't judge the merits of the dispute, which are currently in arbitration, I am very concerned that, as it continues to drag out, it is imperiling the Montana high tech company that provides numerous jobs in my state. Do you anticipate this dispute can be solved? Is there any way we can get the lawyers out of the way and bring this to a close?

Mr. MOHEBBI. Senator Burns, as you well stated, the dispute with TouchAmerica is a billing dispute. It is unfortunate that it has to drag this long. And there were a number of attempts made to try to settle it outside of the legal procedures. Certainly there has been continued willingness from Qwest, and the matter has gotten the utmost attention in our company. I have personally flown to Butte three times to try to deal with this situation, and

we will continue to work in that area. TouchAmerica is a customer of ours, as well, and we are interested in its well-being and growth, and so we are hoping that we could work the issue.

Senator BURNS. Well, I'd like to see it taken care of as soon as possible because it's inhibiting some of the things that they want to do. And it's a fairly important question to TouchAmerica.

In the announcement of Qwest, you have a new CEO—

Mr. MOHEBBI. Chairman and CEO, yes.

Senator BURNS.—and I'm very excited about that. I knew him when he was at Ameritech. He has taken some bold steps now that is going to—the courage to do that to get them back on the, let's say, bed rock, so to speak, and do what you do best, and that is local service and the services through the local switches. So I'm very happy about that.

Can you comment specifically on the IRUs and the swaps? Give us an idea on how they work. And I know that's where, that's been discovered by Qwest now as being one of those practices now that's causing real problems. Could you give us an idea on how that worked?

Mr. MOHEBBI. Yes, Senator. As part of the Qwest's original company plan, we built a network for our own use, and we also built network assets to be sold to other communication companies who were interested in building a national and then international networks. The IRU, as a product or as an asset, is essentially the right of—the indefeasible rights of use that a particular company purchases along with its liabilities and opportunities and risks to be able to meet its requirements. So it is a sale of assets that involves assets that were created to be sold, and that's what we did as we built the original Qwest, the long-haul network throughout the United States during the years 1996 through 2000.

Senator BURNS. Well, now—ok, now, how can that be—how can that—you relate that to swapping?

Mr. MOHEBBI. In terms of what has been called “swaps,” one of the things that we did was, once Qwest was done with building out its U.S. network, we were interested in building a global network because the business customers, which were the focus of our global expansion, required that you, as a service provider, carry their services on your own network throughout the world. So we looked at building our global network, again through buying these assets from other companies that had built assets throughout the world. And in some cases, when we bought assets from some of these companies, those companies were also building plans on a global basis, needed assets in the United States, for example, and purchased those assets from us. The timing of some of these transactions were close, and that's what being looked at and called as “swaps.”

Senator BURNS. I am—well, I thank you for coming today.

And I thank the Chairman for not demanding this, the new head of Qwest, because he just got there, you know, Mr. Chairman, and I think we can see some changes there happening. So I appreciate that very much.

The CHAIRMAN. Very good.

Senator BURNS. But as far as building the global networks, you'd better talk to the guy on the right-hand end of the table—your

right—and he can probably tell you about that. But I appreciate that, and I appreciate the testimony of all three of you.

Mr. Chairman, I—

The CHAIRMAN. Senator Dorgan?

Senator DORGAN. Mr. Chairman, thank you. Is it Mr. Legere?

Mr. LEGERE. Legere.

Senator DORGAN. Mr. Legere, I'm sorry. Mr. Legere, Global Crossing recently had to restate its earnings. There are questions about the way its accounting was handled. It's under FCC investigation. And apparently it concedes that documents were shredded in several of Global Crossing's offices. Is that the case?

Mr. LEGERE. We have not restated earnings, because we do not have audited results for 2001, so we have not filed the 10(k) for 2001 yet.

We are under FCC investigation. We've been cooperating fully and looking forward to getting input and feedback from them, which will lead to us taking action.

Senator DORGAN. Do you expect to be required to restate earnings?

Mr. LEGERE. We don't—we don't know at this point in time. But, again, since we haven't closed 2001 numbers, the outcome of 2001's financials would be dictated by their input.

Senator DORGAN. Mr. Legere, let me ask you about something else that's controversial about your company and some others. Global Crossing effectively renounced its U.S. citizenship by reincorporating in Bermuda. You were a U.S. company. You decided that you wanted to renounce your U.S. citizenship and become a Bermuda company. It's called an "inversion." Can you tell me, are the members of the board of directors that were with the company and helped make that decision still predominantly the board of directors today?

Mr. LEGERE. Senator, if I could just clarify?

Senator DORGAN. Yes.

Mr. LEGERE. When Global Crossing was created, it was created as a global company. And at that time, it was incorporated, the holding company, in Bermuda. Second, though, we are a very complex global set of assets. And, for example, when we purchased the Frontier Corporation in the United States, that still is a U.S. company. It does pay taxes in the United States.

So we have a holding company that was created in Bermuda, basically because of the fact that we were creating global assets, but we do have legal entities in most countries in the world, including many in the United States that are paying. So anything we bought in the U.S. stayed headquartered in the U.S. and does pay taxes here.

Senator DORGAN. Yeah. Well, I won't go further, because there are other questions.

Let me just say that I think inversions that are occurring for the purpose of saving taxes are shameful. To be able to decide you should renounce your citizenship—we're talking about a number of companies—Tyco, Stanley Tools and others—you know, we're at war with terrorists, and we see a spectacle now of companies deciding that they want to become citizens of another country? I don't understand the thinking process. When they get in trouble, do they



want to call out the Bermuda navy, the Bermuda army, Bermuda marines? I don't think so. They want all the benefits America has to offer them, except the responsibility to pay taxes.

But I won't go further, except to say that I think we need to—this Congress needs to address inversions aggressively. The House of Representatives has begun to do that, and I hope we will do so in the Senate.

Mr. Mohebbi, you heard my questions about Qwest. We have 24 exchanges owned by Qwest in North Dakota. My preference is either they serve them or sell them. Qwest was engaged in 27 different countries but couldn't put DSL on 20 exchanges in North Dakota, and I have a little heartburn about what happened. And I also—it's also interesting to note that they couldn't do it because it wasn't worth the investment. But the compensation committee of Qwest, last year, met 7 times—compensation committee in the board of directors met 7 times at a—all during the period when the Qwest stock was falling 60-some percent, and it was meeting to give the CEO cash and bonuses and incentives. And then when they pushed him out the door, they gave him a \$10 million severance package. Do you think that's nuts? Sounds nuts to me.

Mr. MOHEBBI. Senator Dorgan, I'd like to address the issue in terms of service in North Dakota, because—

Senator DORGAN. Please do.

Mr. MOHEBBI.—in my direct responsibility, I have responsibility for that. And if we look at the overall, the number of exchanges that you actually mentioned have DSL are absolutely correct. There are 4. And we'd like them to be higher than that. One of the things that I think we need to work with our customers as well as the chambers of commerce and others in North Dakota is to try to encourage people to try to actually buy more DSL. I can tell you the take rate that we have in the four exchanges that we have installed DSL is about 7 percent—

Senator DORGAN. But, Mr. Mohebbi—

Mr. MOHEBBI.—which is low.

Senator DORGAN.—excuse me for interrupting, but let me tell you this. Other representatives of the Bell systems have sat at that table and described their build-out of DSL at 50, 60, and 70 percent of their exchanges and their customers in their areas. Qwest decided not to do that, and the executives at Qwest were off busy working in China and Europe and not so interested in our exchanges, and they were also running off with a substantial amount of money as they got canned. And I was asking you the question whether you think it's nuts to see the record of what has happened.

Having said that, let me also say that the new CEO gives me some heart. I think he's an extraordinarily well-qualified person. I feel good that he's where he is.

But do you not agree that what happened here with Qwest is just Byzantine and wrong?

Mr. MOHEBBI. Senator, I'm not an expert, in terms of what's the right compensation for the right individuals and how that compensation was derived. What I can tell you is, on the issues of service, we're interested in making sure that all our customers in the 14 States receive the rights of the services.

Senator DORGAN. Well, without sounding arrogant, I'm just a flat-out expert in these matters. I think when somebody runs a company into the ground, the last thing you do is give them a \$10 million bonus. When somebody cooks the books, the last thing you do is give them incentive payments.

And so, you know, I come from a really small town of 400 people. And it's very simple. If pay is based on performance, when somebody's cooking the books and running a company into the ground, you don't give them big bonuses. That—I mean, that doesn't—that's not rocket science.

But, look, I want Qwest to succeed. They do business in Montana, North Dakota, and our part of the country. I want them to succeed. But I have great heartache about what went on, and great anger about what went on, as a matter of fact, with Qwest.

One question, if I might, for Mr. Sidgmore. Mr. Sidgmore, I know that you have a substantial background in this industry, and I want you to succeed, but what you're telling the Chairman is that, although you were affiliated with WorldCom, that you—and I suspect you would say many others at the top level—had no knowledge of what was happening with respect to the development of costs and revenues. And the evidence suggests, of course, that a substantial—in fact, announced by you—a substantial amount of costs and revenues were inappropriately applied and the earnings had to be restated as a result of it.

So how does it work that that happens inside a corporation to the extent of billions of dollars, and yet you and others really don't know anything about it?

Mr. SIDGMORE. Well, first of all, let me just say it was the equivalent of a corporate disaster that we had to restate earnings and that others, you know, did not see that. But let me just explain to you how it possibly happens.

A board of directors protects itself in a number of ways. You have an audit committee, which we had a very significant audit committee with very highly qualified people. We have an internal audit department that is independent of the financial organization that goes out and does checks frequently. And then on top of that, you hire a professional audit firm—in this case, Arthur Andersen.

And in every one of those cases, the audit reports came back totally clean. And, in fact, even as recently as February, we had a major audit committee meeting with Arthur Andersen, and they specifically responded to questions about the exact transfers that occurred and said that the books were totally clean. So, you know, there possibly is no total defense for this, but that's just an explanation. I mean, every step along the way, we had audits done, and the audits came back clean. Unfortunately, you really can't very easily defend against a deliberate change to the books. And that's really what happened.

I could give you a much more lengthy explanation of the mechanics of how it happened, or how we think it happened, but that will come out in great detail after our investigation is over.

Senator DORGAN. But normally in a corporation or other organizations, there's a culture. If you're skating way up to the line, everybody understands, "Boy, we're aggressive. We're finding ways—we're finding the route through the keyhole here," and people have

a sense of that, even though they may not know the details. You're saying that there was no sense of that in the company?

Mr. SIDGMORE. I don't think there was, and I'll—the only other thing I can tell you is our books are extraordinarily complex because of the number of acquisitions that have been made over the last 4 years, about 78.

And so, I mean, I understand your point. I'm just saying that this is a very, very complex and difficult situation. I don't think anyone thought that we were steering that close to the edge.

The CHAIRMAN. Senator Allen?

Senator ALLEN. Thank you, Mr. Chairman.

I'd like to address my comments and questions to Mr. Sidgmore, who, first of all, I want to thank you for coming to this Committee hearing, and I also thank you for your efforts to bring WorldCom out of Chapter 11 bankruptcy as soon as possible. I encourage you, Mr. Sidgmore, to work with the FCC and the SEC and other Federal authorities—and I think you have been doing it, but I want to encourage you to do so. I will say that WorldCom has been a very good corporate citizen in the Commonwealth of Virginia, and I do encourage your efforts to try to restore that credibility.

When you took over as CEO in April, WorldCom was carrying \$30 billion in debt, you had a blueprint to come out to handle that. I note, on page 17 of your statement, where you mention that WorldCom has significant assets that will help it successfully emerge from the process, which is Chapter 11, a significant customer base—which I might add includes the U.S. Government—and you have large-enterprise customers, small-market consumers, first class global network, which provides you all, with WorldCom with a superb platform with which to compete in the marketplace, and talented and dedicated employees.

The employees mean a lot of me, and there was the—in my understanding, part of the plan was to eliminate 17,000 from your work force, about 1,300 of whom were in Virginia. Subsequent to the—or due to the restatement, and subsequent to the filing of Chapter 11, do you envision any additional layoffs in the future that you can share with us?

Mr. SIDGMORE. Well, let me just say that there are none of any kind of significance. There are always people that changed in and out during the year, but there are none of any significance that are planned now.

I might also add that that 17,000—by the way, this doesn't change your point, but it just modifies it slightly—that 17,000 includes about—about half of those 17,000 were actually associated with a division which we have sold, so they weren't really employees that got removed from the payroll. They were sold.

Senator ALLEN. But you do not envision any, at this moment, reduction in positions.

Mr. SIDGMORE. We have no plans at this time for that.

Senator ALLEN. Now, as you know from your history, starting off with UUNET, and when I was Governor and we were working on the WorldCom deal, it was WorldCom UUNET before you merged with MCI right in late 1997, early 1998, the UUNET was the largest—not only was the first, but it's the largest commercial Internet service provider in our country. With regards to the Internet back-

bone facility that WorldCom maintains in Northern Virginia, I understand that it is one of only three major Internet hubs that WorldCom operates throughout the world.

Now, I'd like to hear from you what precautions, what procedures have been taking place to ensure its sustainability and its service. And as WorldCom goes through this reorganization and restructuring, what plans do you have for that segment of the corporation, which is very, very important?

Mr. SIDGMORE. OK. Well, this is probably not surprising to anyone that knows me, but, from my standpoint, the Internet backbone network that we run that is called UUNET is probably as central to our asset base as you possibly have. It's as central to our future success as it could possibly be. People ask me all the time what segments of the business have we considered selling? And I can tell you that, you know, from my standpoint, the Internet backbone, which is the world's largest, the long-distance business, both here in the United States and in Europe, those are the central core pieces of WorldCom and MCI. And I consider, in the long-distance network, by the way, both the consumer business and the long-distance business.

We have no plans to change the structure, the concept, the technology or anything about the UUNET network. That is probably our No. 1 most valuable asset in most people's minds today.

Senator ALLEN. Do you see business or economic activity increasing? That is a good indicator. It's almost like a railroad, to some extent, to see the usage—

Mr. SIDGMORE. Well, I mean—

Senator ALLEN.—of it. Is that increasing? Is it stable?

Mr. SIDGMORE. The Internet business, I would say, is stable, and, in some cases, in some segments is growing slightly. It is still the fastest-growing piece of the telecommunications industry. It doesn't grow quite like it used to, but it's still the fastest-growing piece.

Senator ALLEN. Can you share with us or tell us a little about some of the services that you do provide to the U.S. Government, currently?

Mr. SIDGMORE. We provide a great many services to the U.S. Government, including the use of our Internet network. We provide long-distance services to many, many agencies, including the FAA and many others. We provide lots of different kinds of service to the Defense Department in various places, including places outside the United States. The Government business is significant to us. It's over 8 percent of our business. And we plan—you know, we plan on being very aggressive about holding onto that business.

I know there have been some rumors about some agencies being nervous about, you know, service disruption. And I want to reiterate again, we are not going to have any service disruptions as a result of this bankruptcy—to the Government or anyone.

Senator ALLEN. That's why I asked the question.

Mr. SIDGMORE. Right.

Senator ALLEN. Thank you, Mr. Sidgmore. I'm about out of time.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Brownback?

Senator BROWNBACk. Thank you very much, Mr. Chairman, and thank you, gentlemen, for being here.

Mr. Sidgmore, and the whole panel, obviously, there are a lot of people very mad, disappointed across the country, and they want to know how these things could possibly happen. And I want to focus in on those and then talk a little bit about a way that maybe we can get more market income taking place.

Mr. Sidgmore, you're primarily here because of a \$3.8 billion accounting restatement, I guess you would say, where you took line access costs and capitalized them instead of expensing them. It seems to me, and just to a layman looking at this, that this is a big decision that a company would make—\$3.8 billion, how are you going to treat that on the ledger? And that that's not just something that mechanically gets caught in the grind at a fourth or fifth level down in a company, but somebody pretty high up in the system has to decide we're going to go left or right with this \$3.8 billion. This is a pretty clear decision. Where was that decision made, that \$3.8 billion, whether it would be expensed or capitalized?

Mr. SIDGMORE. Well, let me just say that, you know, this is the subject of a great many investigations, including our own independent investigation, which is not concluded, so I can't give you a specific—you know, a specific set of names. But let me just say that that would have been a decision made at, you know, the highest levels of the company.

I can tell you further that the way it happened is a very interesting scenario. We had line costs and a line cost budget that were very much in line with prior years as a percentage of our revenue. We also had capital expenditures that were very much in line with the plan. So it looked to the world, including the board and apparently to others, like Arthur Andersen, that there were no irregularities happening. What we didn't know is that we weren't actually spending the money on capital—you know, we weren't spending the capital budget on hardware and communications equipment. We were actually capitalizing the line costs. And that's really how, at the end of the day, the mechanics worked.

But that decision would clearly have been made very specifically. This was not a mistake. This was a decision that was clearly made by people close to the top. No question about that.

Senator BROWNBACk. And it would have had to bounce up through several layers of people asking this same question, "How do we treat this?" So there had to have been a number of people in that company that knew that this decision was going to be made. And how it would be made would have a significant impact on the financial disclosures at the bottom of the sheet.

Mr. SIDGMORE. No question about the significant impact. You're right about that. But it's not necessarily true that there were multiple layers involved. It could have been one person very, very close to the top that had the direct access to making changes in the journal.

Senator BROWNBACk. And he would be able, he or she would be able to say this is going to be treated as a capital—

Mr. SIDGMORE. That's why I said it would have to be somebody very high up in the organization.

Senator BROWNBACk. And then that would have gone and would have been cleared by Arthur Andersen and the audit committee of the board?

Mr. SIDGMORE. Well, frankly—

Senator BROWNBACk. I mean, they would have seen, then, this decision was made and it was treated that way, at least those two groups, wouldn't they? The audit committee and Arthur Andersen?

Mr. SIDGMORE. You would think so. And, frankly, Arthur Andersen told us that they never caught it. In the check in the entire audit that we paid them \$4 million for, they claim that they never saw it. And, frankly, it's an outrage to our company that that happened. I mean, that should have been caught in an audit, in my judgment, and it wasn't.

Senator BROWNBACk. Well, it just strikes me as beyond belief it wouldn't be caught. What about at the audit committee?

Mr. SIDGMORE. Well, the audit committee apparently went through the same checks as Arthur Andersen, but obviously in much less detail. And I guess my only point to you is that if the auditor that you're paying \$4 or \$5 million for exactly this purpose could not catch it, it was a little bit more difficult to catch than you might think on the surface. I mean, that's the only thing I can say. But that doesn't mean, I mean, we are quite upset that that was not caught by our audit.

Senator BROWNBACk. It's just astounding to me. Even when I read that in the paper—and then that's not only impacted WorldCom. That impacts the entire marketplace, because everybody wants to know, well, what else has been misstated?

Mr. SIDGMORE. Right.

Senator BROWNBACk. Or what else have people been playing close to the line with? I hope companies now are setting the atmosphere that says we don't play close to these accounting lines. We're going to play very—we're going to be very judicious on this, and we're going to be very careful on these particular issues.

You stated that you just hired a CFO. The issue of stock options is something that a number of people are very concerned about and questioning what we should be doing on this issue. Are you providing stock options to the new CFO that you've hired?

Mr. SIDGMORE. We actually hired a new CFO and a chief restructuring officer at the same time, and we actually hired them from an agency, so they're actually in those roles for a long period of time. But they will be provided by that consulting firm on a consulting basis. So they're not technically employees of WorldCom, and they don't have stock options.

Senator BROWNBACk. Are you going to offer stock options in the future at WorldCom, to the people you bring in?

Mr. SIDGMORE. Well, right now we don't have stock options that people would be interested in, but—

[Laughter.]

Mr. SIDGMORE.—in fact, we can provide those very inexpensively now.

But hopefully, when we emerge from bankruptcy—and I believe we will emerge as a stronger entity—we will again wind up with a stock that people are interested in having, and we will probably use stock options as an incentive, as we always have.

Senator BROWNBACk. Will you expense those?

Mr. SIDGMORe. We believe that we will probably expense those.

Senator BROWNBACk. Will you expense stock options at Global Crossing?

Mr. LEGERE. The only question that I'm trying to deal with in this issue is questions of valuation and matching principles associated with the cost. But those being overcome, as long as it's consistently applied, you know, we'll abide by it.

Senator BROWNBACk. Will Qwest?

Mr. MOHEBBI. Senator, our board of directors has not made a decision on that particular issue.

Senator BROWNBACk. I still want to make one other point, and it's just on an issue that Chairman Powell had talked about, about the build-out to the last mile. We need to get broadband competition out there. The expense of doing that, Corning has estimated, would cost about \$200 billion to rewire all access line with fiber optics. That last mile—\$200 billion. I think we're going to need to look at serious policy options if we're going to try to incentivize the deployment of real broadband service out to the community, and particularly companies that are capitally challenged as much as the telecom industry is now. I think we're going to have to really provide some incentive here to be able to do that.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Fitzgerald?

**STATEMENT OF HON. PETER G. FITZGERALD,  
U.S. SENATOR FROM ILLINOIS**

Senator FITZGERALD. Thank you, Mr. Chairman. I've just been going back and forth between an Enron hearing over in the Governmental Affairs, and I'm back over here. And I—we're getting—over in the Governmental Affairs, we're getting involved in the minute details of how Enron was engaged in fictitious transactions to artificially inflate their earnings. My suspicion all along has been that the motivation for Enron executives to do what they did was because they were getting very rich on their stock options. The top managers at Enron, the top 29 cashed in \$1.1 billion worth of stock options. Most of them left the company and aren't anywhere to be found right now. And everybody else was left holding the bag—the long-term shareholders, the employees who had their 401(k) life savings invested in Enron stock—was left holding the bag.

Now, I sit here and I see the three of you. Mr. Legere, from Global Crossing, the insiders at your company topped the insiders at Enron in cashing in stock in the last 3 years before the company was put in bankruptcy. Is it correct that insiders cashed in \$1.3 billion worth of stock options—well, stock; I won't say it was all in options—in the 3-years before Global Crossing filed for bankruptcy?

Ms. LEGERE. Well, that—I mean, I don't know the exact number, but it sounds in the right range.

Senator FITZGERALD. Now, Mr. Winnick, as I understand it, the former chairman of the company, alone, realized \$735 million in profits either from selling the stock that he had or from earnings realized by buying collars in April of 2001 to protect himself from

a downfall in Global Crossing's stock, and he now lives in a \$95 million home in Bel Air called Casa Encantada or some—"enchanted house", or something like that.

Are you doing anything—now that it's come out that the company was artificially inflating their revenues to keep the stock price high, are you doing anything to go after the former executives who did that? They have a big pot of money out there, \$1.3 billion in profits recognized. Are you pursuing Mr. Winnick for any of those potentially ill-gotten gains?

Mr. LEGERE. First of all, at this point there has been no findings yet to the allegations against our company. And once the SEC finishes its work, you know, we'll know the answer as to some of the accounting questions. They're not—there are very complex accounting questions yet to be answered.

We are in bankruptcy process, so the court, the creditors, and the banks have total jurisdiction to look over all the—

Senator FITZGERALD. Is the trustee in bankruptcy pursuing any ill-gotten gains by your—

Mr. LEGERE. All of—

Senator FITZGERALD.—previous executives?

Mr. LEGERE.—all of the information associated with every financial transaction to insiders for the company is provided to the court. It's my understanding they're still reviewing the information.

I would make one point, if I could, which is, at this point in time, my entire senior leadership team at Global Crossing, except for one individual, has never sold a single share of stock in the company, or an option, and the one individual has sold a very minor amount. So the team that's focused on bringing this company forward has very clearly not been participating in this situation.

Senator FITZGERALD. Are you aware of a Mr.—I think his name—is it Roy Olafson?

Mr. LEGERE. Yes, I am.

Senator FITZGERALD. He made allegations about a year ago. He was a senior vice president or a vice president of the company. He made allegations that the company was capitalizing recurring expenses, as happened at WorldCom, about a year ago. Now, I have articles here where Global Crossing was fighting Mr. Olafson in court and saying his allegations were without merit. Is that still your opinion, that Mr. Olafson's allegation were without merit?

Mr. LEGERE. Mr. Olafson's allegations are taken very seriously. They happened to be, you know, the substance of the investigations by our special committee of our board, and they're being taken very seriously. So we're looking at everything he outlined.

Senator FITZGERALD. Is there litigation between you and Mr. Olafson right now?

Mr. LEGERE. I believe Mr. Olafson has filed a wrongful termination suit against Global Crossing, and it is pending.

Senator FITZGERALD. And are you still fighting that? You are, then.

Mr. LEGERE. Well, it's a wrongful termination suit that's not settled, so—

Senator FITZGERALD. Well, he's saying he was fired because he was blowing the whistle on the improper accounting, and you're still trying to uphold his termination and say it wasn't wrongful.



Mr. LEGERE. The case is pending.

Senator FITZGERALD. Well, it's pending because you're fighting it, is that correct?

Mr. LEGERE. We—at this point in time, there's no closure. We don't believe he was wrongfully terminated, so we are defending ourselves.

Senator FITZGERALD. Mr. Mohebbi, from Qwest, I gather you aren't on this list that appeared in the *New York Times* where insiders at Qwest in the last 3 years, they cashed out \$500 million worth of their stock options, and now they're gone. Are you going to go after any of these people? You just came out Sunday and said that you're restating the earnings of the last few years, that they were overstating revenues, perhaps understating expenses, apparently to goose their earnings to keep—in my judgment, probably to keep the stock price high to keep getting rich. And they did get rich. Your former chairman, Mr. Nacchio, cashed in \$226 million worth stock options. But he has that \$226 million. The long-term investors have got nothing. They've gotten the shaft. They've been betrayed here. Are you going to do anything about it, or are you going to let it slide?

Mr. MOHEBBI. Senator, on Sunday, what we said publicly was that we have an ongoing investigation, and there are a number of other agencies, government agencies, that are looking, obviously, at different pieces of the ongoings in Qwest. What I can tell you is that the new company, the management of the company, if there are any improprieties or if there are any—there is found any rules—laws to be broken, obviously we will be very proactive on that, and I'm sure the government agencies will be proactive on that.

Senator FITZGERALD. Will you try to recover, for the company, any ill-gotten gains if you find that there are any?

Mr. MOHEBBI. To the extent that the wrongdoing is identified and proven, we have no choice, Senator.

Senator FITZGERALD. OK. Well, I'm glad—I'm glad to hear that.

Now, Mr. Sidgmore, WorldCom. Ebbers got a loan from the company. How much was the loan?

Mr. SIDGMORE. Well, it's now about \$400 million.

Senator FITZGERALD. Are you trying to collect the loan?

Mr. SIDGMORE. We are in the process of supporting all the investigations that are going on. And, as I mentioned before—

Senator FITZGERALD. Have you filed suit to collect the loan?

Mr. SIDGMORE. No.

Senator FITZGERALD. Is it being paid back?

Mr. SIDGMORE. No. But let me just—let me just say that we're waiting for the results of the investigation. And our position on all these matters is if—

Senator FITZGERALD. Is the loan in default? I'm not asking about—

Mr. SIDGMORE. It's not in default.

Senator FITZGERALD. It's not in default, so he's making payments on the loan.

Mr. SIDGMORE. He starts making payments in January.

Senator FITZGERALD. Oh, no payments are due until January.

Mr. SIDGMORE. That's right. It was a term note.

Senator FITZGERALD. And there are no defaults now. Even a material deterioration in Mr. Ebbers' financial condition doesn't trigger a default in the——

Mr. SIDGMORE. Right now we do not believe he's in default. OK? Let me just——

Senator FITZGERALD. Who is responsible for——

Mr. SIDGMORE. If I could just make one point on that, OK? We are of the opinion that we will cooperate with all the investigations, including our own. And if there are any improprieties found, we will go after them, to the full extent we can, not only directly, but we will support the Government in going after them.

Senator FITZGERALD. If the loan is not timely paid by Mr. Ebbers——

Mr. SIDGMORE. We'll go after it.

Senator FITZGERALD.—will you sue him to collect the note?

Mr. SIDGMORE. We'll go after it. Yes, we will.

Senator FITZGERALD. And you'll exercise the full powers to get——

Mr. SIDGMORE. Yes, we will.

Senator FITZGERALD.—a judgment against him, file the judgment against his house, take everything he has to get that money back for WorldCom.

Mr. SIDGMORE. I guess at this point, I just want to, I don't want to go through the details of it, but we will go after it, to the full extent we can.

Senator FITZGERALD. Was there collateral for the note? Just the shares of WorldCom within——

Mr. SIDGMORE. No, there's real estate, there are boat yards, there are all kinds of——

Senator FITZGERALD. You have mortgages on——

Mr. SIDGMORE. Yes, we do.

Senator FITZGERALD.—real estate?

Mr. SIDGMORE. Yes, we do.

Senator FITZGERALD. So you can foreclose that real estate, then.

Mr. SIDGMORE. Yeah.

Senator FITZGERALD. And you won't shy away from that if he is in default.

Mr. SIDGMORE. No, we won't.

Senator FITZGERALD. I'd urge you to look to see whether he isn't already in default just based on a material determination——

Mr. SIDGMORE. There are about 400 lawyers looking at that right now.

[Laughter.]

Senator FITZGERALD.—Thank you, Mr. Sidgmore.

Mr. SIDGMORE. Thank you.

The CHAIRMAN. Senator McCain.

Senator MCCAIN. Thank you, Mr. Chairman.

For all three of the witnesses, Mr. Winnick got \$735 million in stock options; Mr. Nacchio, \$300 million since the 1990s; Chairman Roberts, \$22 million, at WorldCom. Aren't these stock options, these huge compensations, aren't they supposed to be based on performance of the corporation? Starting with you, Mr. Legere.

Mr. LEGERE. Obviously stock options are inherently based on performance of the company, because they don't become exercisable

unless the company's stock price at that point in time is greater than the option—

Senator MCCAIN. Do the other witnesses agree? Do you agree that—

Mr. SIDGMORE. Yes.

Senator MCCAIN.—it's supposed to be based on the performance of the—

Mr. SIDGMORE. Yes, absolutely.

Senator MCCAIN. Then why wouldn't you immediately ask for that money back?

Mr. SIDGMORE. Well, I—

Senator MCCAIN. Because all three corporations are either in bankruptcy or, in the case of Qwest, having to restate earnings to a tremendous degree, and the stocks have tanked. Shouldn't you ask for that money back and distribute it maybe to the stockholders or to the employees that have been laid off or the retirees whose pensions have been wiped out?

Mr. LEGERE. I mean—

Senator MCCAIN. Did that ever cross your mind?

Mr. SIDGMORE. Well, part of it depends on when the stock was sold. I mean, it is possible that you have—predecessor companies, for example, did extremely well. People had stock options based on this companies. They cashed in those stock options and moved on.

Senator MCCAIN. I'm talking about your companies. I'm talking about your companies. Mr. Legere, shouldn't Mr. Winnick be asked to give some of that \$735 million back that he cashed in?

Mr. LEGERE. Senator, I believe legally, at this point in time, the company has no rights to the money that Mr. Winnick took, unless he is seen to do something inappropriate.

Your broader question really is one associated with the pain that's been caused to so many people, which, you know, is the hardest part of everything that we've gone through. I don't think that's a—

Senator MCCAIN. A lot of—

Mr. LEGERE.—legal question. I think it's a broader personal question that I can't answer.

Senator MCCAIN. A lot of Americans are saying, you know, maybe it's legal. And if it's legal, there's something terribly wrong.

Mr. Legere, do you think, can you explain why—I'm sure you probably can, but just out of curiosity, do you know why Mr. Winnick refused an invitation to testify here today?

Mr. LEGERE. I don't know why he wasn't available, Senator, but I also, as we looked at the topic of the hearing today, with the over 22 years of experience I have in telecom and the fact that I'm running the company full force right now, I think we believed that I'd be a good witness to come here and represent the business.

Senator MCCAIN. Well, I would have asked him about, he and three other members of Global Crossing's board starting a company called PCG Telecom that was a subsidiary of Mr. Winnick's holding company, Pacific Capital Group. PCG Telecom signed a 25-year contract with Global Crossing to provide, quote, "advice on the development and marketing of the network."

In 1997, Mr. Winnick and three other executives split \$7.2 million for arranging the financing of a portion of Global Crossing's

network. In March 1998, they split \$2 million advance against future revenues. In June 1998, Global Crossing cancelled the contract and paid Mr. Winnick and the three other executives \$135 million in stock as a, quote, "contract termination fee." Were you aware of that?

Mr. LEGERE. All of the intercompany arrangements of the company are part of the things that are being investigated by our special committee. My focus, since I came here in October, was getting this company turned around and saving what we have. And a lot of issues of the past are being looked at. Action needs to be taken. And right now we have no outcome to those investigations.

Senator MCCAIN. But you didn't know anything about that deal.

Mr. LEGERE. I was not with the company at that point in time. I do know the details, because I have seen the filings and I've seen the questions.

Senator MCCAIN. According to the L.A. Times, a company controlled by Gary Winnick is demanding \$500,000 in overdue rent from Global Crossing. Is he still demanding that from you?

Mr. LEGERE. I don't know the status of it, but, as part of my turning around the company, I've very aggressively closed 227 real estate sites, including the ones owned by Mr. Winnick, and I used the bankruptcy court proceedings to do some of those. If he has filed some suit against those, it's a, you know, business transaction, and I don't know the status of it.

Senator MCCAIN. Did Global Crossing rent office space from a company called North Crescent? Do you know anything about that?

Mr. LEGERE. I believe North Crescent Holdings would be the holding company in the Beverly Hills office that I recently closed.

Senator MCCAIN. But as far as you know, Mr. Winnick is still asking for \$500,000 in overdue rent.

Mr. LEGERE. If he's asking, he'll be asking the bankruptcy procedure. And if it's his legal right to do so, he can push it forward.

Senator MCCAIN. According to an article appearing in the *Los Angeles Times*, "Stacks of documents were destroyed at Global Crossing in the days before and as well as after the company filed for bankruptcy. A Global Crossing receptionist said she saw a secretary and a relative of Global Crossing's vice president of finance leave a storage room containing a shredder at the company's Madison, New Jersey, offices."

What's your response to those allegations?

Mr. LEGERE. Well, on the—on the whole information preservation question, in February of this year, when the SEC sent us requests for documents, we immediately, under my watch, executed a policy company-wide for full document retention. The item that you're speaking of was part of a filing by a plaintiff's attorney in our bankruptcy procedure several weeks ago. We interviewed the people. We found no merit to the allegations.

But just to be clear, we did a full worldwide review of the processes, and we did come forward to all constituents and say we found one or two locations in the world where there were some documents being destroyed. They were non-critical information that was backed up, but yet there was some information being destroyed. We disclosed that. It had no relevance to the proceedings that had taken place.

Senator MCCAIN. Mr. Sidgmore, it's been reported that former WorldCom CEO Bernie Ebbers will receive \$1.5 million per year for the rest of his life and the use of WorldCom's corporate jets. Is that still an existing arrangement?

Mr. SIDGMORE. That is—that is correct, as of now, and that will be looked at in the context of these investigations, as well.

Senator MCCAIN. Mr. Mohebbi, press reports indicate that former Qwest CEO Joseph Nacchio sold over \$300 million of Qwest stock since 1997. This is after the fact that, under his watch, Qwest shares tumbled from \$65 a share to under \$2 today.

In addition, Mr. Nacchio will reportedly receive a \$10 million severance package. Do you believe that Mr. Nacchio was aware of the reported accounting discrepancies at the time he was selling millions of dollars of Qwest stock?

Mr. MOHEBBI. Senator McCain, obviously we have ongoing investigations in the company. I have no knowledge to tell you whether he did or did not know, at this time.

Senator MCCAIN. You don't—you don't have any idea.

Mr. MOHEBBI. I do not.

Senator MCCAIN. Yesterday, Qwest announced it would restate its results for 2000 and 2001. According to your CFO, Qwest uncovered misstatements that led it to book approximately \$874 million in revenue for 2000 and 2001 in lump sums up front, instead of over a period of time.

In your testimony, you acknowledge that certain accounting practices were related to the sale of capacity. Can you explain why these practices weren't discovered earlier?

Mr. MOHEBBI. Senator, at the time that Qwest accounted for these transactions, we did so in good faith and in conjunction with our former auditor, in terms of the policies that were set for those particular transactions. Earlier this year, what we did was we started an internal analysis as a result of the increased attention that obviously was put around this area of these particular transactions, to review them, each and every one, in detail and make sure that we can see whether every part of our Qwest policies were followed for each of these transactions.

What we announced on Sunday was that, at this point, we have found some of these transactions where our internal policies have not been followed. And we went public. We wanted to make sure that there was full disclosure on that. And what we have stated is that we are going to, throughout this process, make sure that everyone knows how we are making progress.

Since the investigation and the process—the analysis is not completed, Senator, I can't tell you what were the specific reasons for the process and policies not being followed in the case of a number of transactions. But we will find that out, and we will share that information widely.

Senator MCCAIN. Is the board contemplating any action concerning Mr. Nacchio's retirement package?

Mr. MOHEBBI. Senator, as I was stating, if, during the analysis and the work that's being done independently by the board-appointed Committee, as well as other agencies that are looking at it, if evidence of impropriety has been found, obviously then the company and I'm sure as well as other agencies will act on that.

Senator MCCAIN. Wouldn't you act on it, just on the basis of stock for the performance of the corporation itself?

Mr. MOHEBBI. Senator, I believe we need to have specific evidence of wrongdoing for an action to be taken against companies or individuals. And the board of the company and the new management—

Senator MCCAIN. I thought a compensation package was given on the basis of performance of the CEO, not whether it's illegal or not.

Mr. MOHEBBI. Senator, to the best of my understanding, if a legal contract is signed with an individual, then there should be legal evidence if you want to—

Senator MCCAIN. I thank you.

I thank you, Mr. Chairman. I thank the witnesses for being here today.

The CHAIRMAN. The Committee thanks the witnesses for their appearance. The record will stay open for further questions.

The Committee will be at ease, subject to the call.

[Whereupon, at 1:15 p.m., the hearing was adjourned.]

## A P P E N D I X

### PREPARED STATEMENT OF JOHN ROSE, PRESIDENT, ORGANIZATION FOR THE PROMOTION AND ADVANCEMENT OF SMALL TELECOMMUNICATIONS COMPANIES (OPASTCO)

Mr. Chairman, I commend you for acting quickly to convene this morning's hearing to examine the impact of recent financial failures in the telecommunications marketplace. It is not surprising that the focus of this hearing is to gather information from three of the largest telecommunications providers, WorldCom, Inc., Global Crossing Ltd., and Qwest Communications International, each of whom has faced significant financial difficulties in recent months. However, it is important for Members of this Committee to understand that "financial turmoil in the telecom marketplace" has far-reaching consequences for hundreds of small, rural Local Exchange Carriers (LECs) across the nation and the customers they serve in each of your states.

In contrast to the average Regional Bell Operating Company (RBOC) that serves approximately 40 million access lines, the typical rural telephone company represented by OPASTCO serves approximately 6,500 access lines. Nationally, the population density in areas served by rural carriers is only about 13 persons per square mile. This compares to a national average population density of 105 persons per square mile in areas served by non-rural carriers. The ability of rural telephone companies to provide affordable and quality telephone service to communities such as Reynolds, Georgia; Circle, Montana; Walterboro, South Carolina; Burkes Garden, Virginia, and New Florence, Missouri relies in large part on revenue streams provided by toll providers such as WorldCom to support their high fixed network costs.

As you know, the recent bankruptcy filing by WorldCom, Inc. has resulted in heightened uncertainty throughout the already challenged telecommunications industry. OPASTCO members believe that it is essential for federal policymakers to take steps to ensure that the business failure of WorldCom does not spread to other companies. More specifically, OPASTCO members are quite concerned with WorldCom's ability to continue fulfilling its obligation to pay inter-and intrastate access charges to LECs for their initialization and completion of toll calls on the local network. We are also concerned with WorldCom's continued ability to contribute their required share to the federally-mandated universal service fund (USF). OPASTCO members, who already face the operational challenges highlighted above, would find it increasingly difficult to make added investments in advanced services, such as broadband, were these portions of their revenues negatively impacted.

Mr. Chairman, small, rural carriers rely much more heavily than other LECs on access charge and universal service payments. In fact, on average, access and USF payments collectively account for over two thirds of all revenue received by rural LECs.

The table shown below illustrates this point.

Revenue Source	Amount Received By Price-Cap Regulated (Large) Carriers	Amount Received By Rate of Return Regulated (Small) Carriers
Direct from Customers (Subscriber Line Charges)	\$6.00/Month (residential) \$6.80/Month (multi-line business).	\$6.00/Month (residential) \$9.20/Month (multi-line business)
Interstate Access Charge Payments from Interexchange Carriers	0.55 cents per Minute (for RBOCs). 0.95 cents per Minute (for rural Price-Cap Carriers)	2.1 cents per Minute
Universal Service Fund (USF) Payments	0.50 cents per Line/Month	\$13.50 per Line/Month

As these statistics demonstrate, were small, rural LECs to lose a significant portion of either or both of these revenue streams, access charges and/or local rates would need to be increased in order to continue to provide quality service. In turn, such increases could force many rural residents to drop off the network. Therefore it is crucial that these payments continue to be met, in order to avoid a broader catastrophe that would threaten the ability of rural Americans to remain connected.

First, OPASTCO members believe that WorldCom should be required to reasonably guarantee that it will continue to meet both its access charge and universal service contribution commitments. With regards to its access charge payments, WorldCom has asked the U.S. Bankruptcy Court for the Southern District of New York (the Court) to classify its access obligations as "Utility Services Payments" with "administrative expense status." It is our understanding that "administrative expense status" payments are assigned a lower repayment priority than the category of "Critical Vendor Payments." Access charge payments are *not* just another cost of doing business for WorldCom. Access is a critical input in the provision of toll service; without it toll calls could not be initiated or completed. Therefore, any disruption of access payments would jeopardize both WorldCom's efforts to continue its operations, as well as the reliability of our national telecommunications network.

Second, OPASTCO members feel that it is essential that the Court and federal regulators demand that WorldCom specifically guarantee that it will continue to make its ongoing contributions to the USF. We note that within its bankruptcy petitions WorldCom pledges to make payment for all of the required "regulatory fees," it incurred up to the July 21st filing of its bankruptcy petition. Although WorldCom's bankruptcy petitions tangentially reference universal service contributions as one of these "pre-petition regulatory fees," more direct guarantees from WorldCom would provide the marketplace with a greater degree of certainty with regards to this issue. Furthermore, it is still unclear as to whether additional provisions have been made for those regulatory fees incurred in the time since WorldCom's petition was filed.

Mr. Chairman, WorldCom's payment of its universal service contribution simply cannot be treated in the same manner as other governmental fees that it may incur. Universal service programs ensure that Americans living in rural and high-cost areas receive affordable and comparable access to the same high-quality telecommunications services enjoyed by citizens living in more urban locations. Were WorldCom's ongoing USF contributions reduced or disrupted in any way, the obligation on other contributing carriers would necessarily increase. Consequently, the universal service line-item charge placed on other carriers' end-user bills would have to increase dramatically to make up the shortfall.

The Commerce Committee has demonstrated its commitment to the ongoing stability of the federal universal service program, as was noted during the Committee's June 19th hearing examining the future of the universal service program. Clearly, now is not the time to introduce any added stresses into the system. In our view, it is essential that Congress and the Federal Communications Commission ensure that the WorldCom crisis does not lead to a broader universal service crisis. Concrete assurances must be required of WorldCom vis-à-vis its current and future universal service contribution obligations.

The current financial failures within the telecommunications industry are of great concern to many Americans. At this time, it is absolutely essential that Congress work collaboratively with the courts, key regulators, and other stakeholders within the telecommunications marketplace to contain the damage that industry financial breakdowns, such as the WorldCom bankruptcy, may have. Only by doing this can the stability and continued reliability of our nation's telecommunications network be guaranteed for all American consumers.

Thank you.