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INDUSTRY COMPETITION AND CONSOLIDATION: THE TELECOM MARKETPLACE NINE YEARS AFTER THE TELECOM ACT

HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

FIRST SESSION

APRIL 20, 2005

Serial No. 109–26

Printed for the use of the Committee on the Judiciary

Available via the World Wide Web: http://www.house.gov/judiciary

U.S. GOVERNMENT PRINTING OFFICE

20–708 PDF WASHINGTON : 2005

For sale by the Superintendent of Documents, U.S. Government Printing Office
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INDUSTRY COMPETITION AND CONSOLIDATION: THE TELECOM MARKETPLACE NINE YEARS AFTER THE TELECOM ACT

WEDNESDAY, APRIL 20, 2005

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Committee met, pursuant to notice, at 2:14 p.m., in Room 2141, Rayburn House Office Building, the Honorable Chris Cannon presiding.

Mr. CANNON. The Committee will be in order.

I'd like to apologize to the Members of the Committee and the panel for my being late. Work as we try here, sometimes we just get hung up and caught. I appreciate your indulgence.

The House Committee on the Judiciary and the antitrust laws have played a central role in fostering competition in the telecommunications industry. This Committee and the Department of Justice played a major role in the historic breakup of "Ma Bell;" and the antitrust laws formed the primary legal basis for decades of congressional efforts to bring about telecom competition, first in long distance, and then in local services.

These efforts culminated in the clearest expression of congressional determination to bring about local competition, the Telecommunications Act of 1996. The act was conceived as a comprehensive, pro-competition mandate to remedy decades of monopoly control of the local exchange. The 1996 act also expressly preserved an active and continuing role for the antitrust laws in this marketplace.

Today, the Committee will examine the current state of competition in the telecom marketplace and the vitality of the antitrust laws in preserving and promoting competition 9 years after the act.

We do so against a backdrop of proposed industry consolidations, FCC rulings that largely abdicate a muscular role for the Commission in ensuring access to local monopoly facilities, and troubling court decisions that question the coexistence of the 1996 act and the antitrust laws.

Taken together, these developments have dramatically recast the competitive landscape in the telecommunications industry, undermining the pro-competitive goals of the 1996 act. Moreover, recent vertical and horizontal industry consolidation has created what some perceive to be a telecommunications oligopoly comprised of a diminishing number of Regional Bell Operating Companies (RBOCs) that increasingly resemble the "Ma Bell" monopoly from

which they were created and that do not compete in local interregional markets.

For example, if some of the proposed mergers are finalized without divestitures, then two companies may have a dominant market position, controlling a combined 80 percent of the business telephone market and as much as two-thirds of the regional Bell operating companies' residential customers. One of the combined entities alone might control 44 percent of the business market.

And any merger poses particular concern when one of the merging entities is currently the primary competitor for business customers within the other merger partner's region. In addition, RBOCs do not presently compete in each others' regions for non-cellular residential or business services; thereby risking merger to monopoly in a key market segment and a fractured competitive landscape harmful to consumer choice and innovation.

The 1996 act was predicated on a common-sense notion that the regional Bell operating companies, or "Baby Bells," provide non-discriminatory access to the local monopoly networks the Bells inherited from the breakup of "Ma Bell." Since last-mile facilities built by the decades-old, Government-sanctioned, guaranteed-rate-of-return "Ma Bell" monopoly could not economically be replicated, the 1996 act clearly mandated non-discriminatory local exchange access for competing local services.

In the immediate wake of the act, the FCC enforced its provisions and issued regulations to implement it. As a result, competition briefly flourished, and meaningful consumer choice accrued to millions of Americans. Nine years later, the competitive landscape envisioned by the act has not been realized, and is receding. In 2000, there were 375 Competitive Local Exchange Carriers (CLECs) in operation; today, there are less than 100, and that number continues to dwindle.

Section 271 of the 1996 act, and the proactive role of the Department of Justice that it established, were a capstone of the act's early success. Put simply, the incentive for RBOCs to continue, or to comply, and open access to their legacy monopoly networks under the act was the carrot of gaining approval to enter long-distance service in States where they complied; a privilege expressly prohibited by the consent decree that broke up AT&T.

The act also contained the stick of potential FCC fines, injunctive relief orders for non-compliance with the local market opening provisions of the act, or withdrawal of long-distance authority. In addition to this regulatory scheme, the antitrust laws and treble damages served as a pro-competitive bulwark to moderate the anti-competitive potential of newly vertically-integrated telecom providers.

But if today the carrot has been eaten, since RBOCs have received approval to offer local and long distance, and the FCC has decided to no longer wield the stick of regulatory enforcement, what legal incentives remain to promote local competition and discourage anti-competitive behavior by ever larger incumbents in the telecommunications marketplace?

As intermodal competition and new technologies such as Voice Over Internet Protocol continue to shape the telecom marketplace, the antitrust laws serve as a tested and vital tool to prevent vertical monopolization of broadband and the Internet backbone.

As Congress moves forward in the telecom debate, the Committee on the Judiciary will play a vital role in any rewrite of the Telecom Act, by protecting and promoting meaningful competition in this marketplace, defending the primacy of the antitrust laws, examining the need for State tax preemption to maintain a level playing field, encourage promising pro-competitive technologies, and ensuring that the Communications Assistance for Law Enforcement Act (CALEA) and other law enforcement tools are properly updated to reflect changing technology in the communications marketplace.

Let me conclude by observing the following: Some critics contend that political conservatism and respect for the free market are somehow inconsistent with a commitment to antitrust. However, to paraphrase Chairman Sensenbrenner, as a conservative who adheres to the primacy of free markets, I believe the proper application of the antitrust laws serves to preserve and promote the integrity of the free market upon which America's economic prosperity and consumer welfare depend.

I look forward to the testimony of the witnesses, and I now yield to the Ranking Member, Mr. Conyers, for opening remarks.

Mr. CONYERS. Thank you, Mr. Chairman—while the other Chairman is signing the—or is watching the President sign the Bankruptcy Act. I want to welcome this particular panel of witnesses because of the long experience they bring to the subject matter today.

First of all, it's important that this Committee make it clear that our jurisdiction has been here; we were there for the 1996 act; we're going to be here now. And we want to begin to examine, along with anyone else in Congress that wants to, the very important issues that are involved here.

Now, several things become clear. Since 1996, we're not so sure of how successful that Telecommunications Act was. Lots of problems have come up. The main one, of course, is that telecom keeps changing; new developments, unforeseeable. And we also have a—we have some Bells, or former Bells, that are very determined to keep, and expand as much as they can, their area in the fields that they started in.

So I'm looking for Mr. Grivner and Mr. Moir to explain to us why there may be an exception to my general rule against mergers. The general rule is: Mergers drive up costs, take choice away from consumers, and bring back the monopoly experience that we had up until 1984. Now, I'm perfectly aware that Mr. Kellogg and Mr. Verveer may have another position to add to this discussion, which makes this a very good panel.

I'm particularly impressed with those of you who feel that the *Trinko* decision, which involves us greatly in Judiciary—namely, that antitrust is a very important concept, which brought about the breakup in '84 to begin with—has not been vitiated by the fact that we have regulatory agencies over the Telecommunications Act.

Antitrust exists with or without regulatory supervision. And so it's hard for me to think that we should go much longer without taking some action to limit the effect and implications of *Trinko.*

What we are dealing with now is a very sensitive market. And we have proposals for mergers that are very compelling, in one sense. That is that, without which, we may not have any large,

global telecommunications operation anywhere, if we don't view these things in the context of where we find ourselves today.

So for more than a century, antitrust laws—an economic bill of rights, if you will—have provided the ground rules for fair competition. It's even more true today than they were at the time of the Sherman and Clayton Antitrust Acts. And so, Mr. Chairman, I join with you in looking forward to the testimony of the gentlemen before us today.

Mr. CANNON. Thank you, Mr. Conyers. And I also thank you for pointing out that Mr. Sensenbrenner would be here but for the fact that he's down at the White House with the President signing the bankruptcy bill.

I'd ask unanimous consent that all Members be allowed to submit their opening statements for the record. So ordered.

Let me now introduce our witnesses. Our first witness is Carl Grivner. Mr. Grivner is chief executive officer of XO Communications. He appears today on behalf of XO and its competitive industries trade association, Comptel/ALTS Alliance and Association for Competitive Telecommunications. Mr. Grivner's career in telecom and technology spans over 25 years, where he has held senior executive positions in a variety of telecom companies. He graduated with a bachelor's of science in biology from Lycoming College.

Our second witness is Brian Moir, an attorney for the e-Commerce and Telecommunications Association. Mr. Moir previously served as chief counsel for the House Energy and Commerce Committee, staff attorney for the FCC, and assistant corporate counsel for Tele-Communications, Inc. He received his juris doctorate from the University of Denver, where he was honored with the International Legal Studies Award, and was a member of the Denver Journal of International Law and Policy.

The third witness is Michael Kellogg, a partner in the Washington, D.C. law firm of Kellogg, Huber, Hansen, Todd, Evans and Figel. Mr. Kellogg appears today on behalf of the United States Telecom Association. He served—he previously served as an assistant to the Solicitor General at the Department of Justice. Mr. Kellogg graduated from Stanford University and Harvard Law School, where he was the editor of the Law Review.

And the final witness is Philip Verveer, a partner in the telecommunications department of Willkie Farr and Gallagher. Mr. Verveer previously served as the antitrust counsel at the Department of Justice during the original filing of divestiture against AT&T, and as a supervisory attorney in the FCC's Bureau of Competition. He graduated from Georgetown University, and received his juris doctorate from the University of Chicago.

Now, it is our habit to swear our witnesses in, so if each of you would please rise and raise your right hand, I'll administer the oath.

[Witnesses sworn.]

Mr. CANNON. The record should reflect that each of the witnesses answered in the affirmative.

Thank you. You may be seated. Without objection, the written statement of each of the witnesses will be included in the record as part of their testimony.

We would like to ask the witnesses to confine their remarks to 5 minutes. We don't expect you to just stop, but if it goes—you'll see before you a light panel that goes green and then, when you have 1 minute left, yellow, and when you have finished the five—and I may tap my pencil or something, just to remind you. We will have a 5-minute rule here in the panel and so you'll have, I suspect, quite a bit of time to respond to questions as we continue. Thank you.

Mr. Grivner, would you like to begin?

TESTIMONY OF CARL J. GRIVNER, CEO, XO COMMUNICATIONS, INC., ON BEHALF OF COMPTEL/ALTS ALLIANCE AND ASSOCIATION FOR COMPETITIVE TELECOMMUNICATIONS

Mr. GRIVNER. I would. Good afternoon. My name is Carl Grivner. I am CEO of XO Communications. And after that introduction, I am glad my son John is going to get his law degree, and not to have to sit in front of a panel again with just a bachelor's degree. So, thank you for the introductions.

I am CEO of one of the nation's largest facility-based providers of telecommunications and broadband services to business customers. XO is headquartered in Reston, Virginia. We have nearly 5,000 employees nationwide. It was formed in 1996.

XO has expanded its telecommunications offering from its original four small markets, to more than 70 metropolitan-area markets in 26 States today, serving nearly 200,000 business customers.

Today I'm also testifying on behalf of our association, Comptel/ALTS, an association representing over 350 competitive companies and entrepreneurs in the telecommunications industry.

I want to first thank the Chairman and Ranking Member Conyers for inviting me to testify before the Committee on the competitive ramifications of the SBC acquisition of AT&T, and the Verizon acquisition of MCI. These mergers are truly monumental in scope, as they seek to join the largest telephone monopolies with their largest competitors.

There is no doubt that these mergers will reduce the amount of competitive choices for your individual constituents and businesses. With the loss of AT&T and MCI, future competition between the incumbents and the remaining competitors will be, in a word, a mismatch.

My written testimony addresses a number of our concerns in detail. However, I'd like to highlight a number of specific points that we hope the Members of the Committee will consider.

First, the SBC-AT&T merger and the proposed Verizon-MCI deal will fundamentally reshape this industry; marrying the two largest local telecommunication providers with their two largest competitors. Only the breakup of AT&T in 1984 and the 1996 Telecom Act can compare to the massive industry restructuring that will result from these mergers.

Second, these mergers are particularly harmful to business customers, both retail and wholesale, in local markets. We have gathered for the subcommittee preliminary, high-level data that demonstrates the substantial injury that occurs. The charts here, which use the same data employed by the Bells in the FCC's triennial re-

view process, provide a sobering look at what these mergers can do to local competition.

The first set of charts shows the current status of competition in Cleveland and Milwaukee, as measured by the presence of competitors in commercial buildings. AT&T is in red, with all the other CLECs in green. Indeed, competitors have made some headway in these local markets.

The second chart shows what these markets will look like after the mergers, with the removal of AT&T. You will notice that the markets are significantly altered. The presence of competitive providers drops a staggering 53 percent for Cleveland, and 64 percent in Milwaukee. In other words, the competitive injury to customers from AT&T exiting the market will be real and substantial.

And don't expect alternative providers to make up this competitive gap. AT&T is unique. It entered local markets with an enormous advantage. It had tens of millions of long-distance customers, including relationships with top business customers throughout the country. It had tremendous financial resources; $11 billion of which it spent to acquire the largest local provider, Teleport, that it continued to expand its local network. The only other local competitor with similar resources is MCI. And as I am about to demonstrate, post-merger it, too, will not fill this gap.

The next chart depicts the effect of MCI's departure from the market. You can see that the competitive presence declines further; a total of 61 percent for Cleveland, and 70 percent for Milwaukee.

The reason we took MCI out of the market leads me to my third point regarding these mergers. No one should expect that SBC and Verizon will compete head-on. Today, SBC and Verizon are the number one and number two local telephone providers.

In the handouts that were provided to you, you will see that in the Los Angeles market SBC and Verizon share common geography; and yet, neither is really competing in the other's territory. So why should we assume that when we complete these mergers and they are approved that they will compete then?

SBC and Verizon operate under that old, Cold War principle of "Mutually Assured Destruction." Each company is a mirror of the other, and each knows the other has an overwhelming competitive advantage in its home territory. So why attack, and face annihilation? Better to operate under a strategy of containment.

The basic fundamentals of antitrust law demand a thorough examination of these mergers. It is not consolidation, per se, that is a paramount concern. It is the massive concentration and the injury to customers that result.

This Committee has maintained its dedication to preserving the applicability of U.S. antitrust laws to the telecommunications industry. With the *Trinko* decision by the U.S. Supreme Court, antitrust actions are now limited in addressing anti-competitive acts in the telecommunications industry. In other words, no one should count on the current Government oversight scheme to correct any competitive abuses post-merger.

The Committee does retain its jurisdiction over section 271 of the '96 act, which elevated the Department of Justice role in examining competitive conditions and local markets before the FCC could approve a Bell's application to provide long-distance service. With the

two largest Bell companies planning to purchase the two largest long-distance carriers, it is important that incentives exist to ensure they maintain open local markets.

We hope that steadfast resolve will continue as Congress examines the proposed mergers we are discussing today. Thank you for your time today.

[The prepared statement of Mr. Grivner follows:]

PREPARED STATEMENT OF CARL GRIVNER

Good afternoon. My name is Carl Grivner and I am CEO of XO Communications, one of the nation's largest facilities-based providers of telecommunications and broadband services. Prior to joining XO as CEO in 2003, I served as Chief Operating Officer for Global Crossing and held various positions at telecommunications companies including Worldport, Cable & Wireless, and Ameritech. I am appearing here on behalf of XO and our competitive industry's trade association, Comptel/ALTS.

I want to thank the Chairman and Ranking Member for inviting me to testify before the Committee on the competitive ramifications of the SBC acquisition of AT&T and the Verizon acquisition of MCI. These mergers are truly monumental. They join the largest incumbent telecommunications providers, SBC and Verizon, with their largest competitors, AT&T and MCI. As a result, competition is certain to diminish in markets throughout the country. I am confident that once the government reviewers examine the evidence in depth, they will find these mergers cause substantial competitive injury to customers, competitors, and vendors. As such, they do not meet the legal standards for approval.

You are to be commended for understanding the important implications of these mergers. I urge you to follow-up on this hearing by pressing the merging parties to completely produce and disclose all information and by ensuring the Department of Justice and Federal Communications Commission undertake in-depth analysis of all possible competitive harms.

Let me begin by telling you about XO Communications, the largest independent competitive local exchange carrier. I believe who we are and what we bring to customers is particularly relevant to issues before the Committee today.

BACKGROUND ON XO COMMUNICATIONS

Originally formed as Nextlink in 1996, XO has expanded its telecommunications offerings from its original 4 small markets to 70 metro area markets in 26 states. Our company provides a comprehensive array of voice and data telecommunications services to small, medium, and large business customers. Our voice services include local and long distance services, both bundled and standalone, other voice-related services such as conferencing, domestic and international toll free services and voicemail, and transactions processing services for prepaid calling cards. XO data services include Internet access, private data networking, including dedicated transmission capacity on our networks, virtual private network services, Ethernet services, and web hosting services.

XO has invested heavily in building its own facilities spending over $8 billion and constructing over 1.1 million miles of fiber. We have metro fiber rings to connect customers to our network, and we own one of the highest capacity and scalable IP backbones in the industry, capable of delivering data end-to-end throughout the United States at speeds up to 10 Gigabits per second.

Even with this extensive network, we are nowhere close to having ubiquitous on-net coverage—and after AT&T and MCI, we can be considered the nation's largest local competitive carrier. To build such a network would require over $100 billion and many decades to construct—not to mention monopoly rights like the Bells have had. Instead, we reach most customers by procuring facilities or circuits from other providers. The major suppliers are the Bells, from whom we lease loop and transport unbundled network elements (pursuant to the Telecommunications Act of 1996) and special access circuits. Where we can find competitive alternatives, we will use them, since their prices tend to be lower, and they actually want to do business with us.

INTRODUCTION TO THE MERGERS

For 40 years, it has been the innovation of entrepreneurial companies coupled with market opening regulations that have brought choice to customers and new technologies and services to the market. This tradition is continuing with the numerous competitive companies that are creating new ways to serve customers using

cutting edge technologies. However, the choice customers have seen and the dramatic growth in innovation that has occurred in our industry, started by the break up of Ma Bell, is now threatened by SBC's acquisition of AT&T and Verizon's current deal to purchase MCI.

Whenever companies of this scale merge, there are always the same warnings, and rightfully so. Here are some comments,

> "This merger should not be approved as it presently stands because it will limit rather than promote local exchange competition. The proposed merger constitutes a setback for consumers. Furthermore, we saw that when SBC took over Pac Bell, prices rose and service dropped in California."

> "It's hard to see how new competition promised by the Telecommunications Act can be attained if existing monopolies simply combine into larger ones. The concern is especially great when these two companies otherwise would have had powerful incentives to compete against each other."

By the way, these comments were made by AT&T at the times of SBC's acquisition of Ameritech and the Bell Atlantic-NYNEX merger.

With such increased concentration of power coming to both the business and residential consumer telecom markets what will be the impacts on competition and innovation?

I will begin by putting the mergers in context of the development and status of telecommunications competition, particularly in local markets.

THE DEVELOPMENT AND STATUS OF TELECOMMUNICATIONS COMPETITION

No discussion about the telecommunications industry can take place without recognizing the unique nature of the business. The Bell Operating Companies and other incumbent local companies are not like other American businesses. By virtue of having the sole local telephone franchise for so many years, they have developed an enormous degree of market power. As a result, they have the incentive and ability to harm customers, competitors and vendors.

The government has sought to rein in this market power by regulating the provision of their services and often by restructuring them or limiting their operations. The most well known effort at restructuring by the government was the 1984 divestiture of AT&T of its local telephone operations (the birth of the "Baby Bells"). It created SBC and Verizon, which in the past decade have swallowed 3 of the 7 original Bell companies—and, in the case of SBC, now seeks to acquire its former parent, putting the old Bell system back together again.

In 1996, Congress believed it could eliminate this market power and bring to customers the same benefits in pricing and innovation for local service that were being seen in the long distance market. The Telecommunications Act of 1996 was a watershed law, and it set in motion a massive undertaking: bringing competition to a market dominated by monopolists where tremendous amounts of capital needed to be expended up front and where returns on investment would not be appreciable until economies of scale were reached.

To expedite this process and enhance the chances of success, Congress adopted two fundamental policy mechanisms. First, it permitted the FCC to lift the 1984 Consent Decree provision prohibiting the Bells from entering the long distance business, but only if the Commission found the Bells provided competitors access to their networks at non-discriminatory and pro-competitive terms. This was the so-called "carrot." Second, it adopted a "stick"—the Bells were immediately required to offer competitors access to unbundled network elements at cost-based rates.

It is clear from the Congressional debate on the 1996 Act that AT&T and MCI, the two largest long distances providers, were seen as the leading companies to enter the local markets. And, they did. Right after the Act was passed, AT&T bought Teleport for over $10B, and MCI bought MFS and Brooks Fiber for over $5B—the three leading facilities-based local telecommunications competitors. Since then, AT&T and MCI have expended many billions of dollars to expand and enhance these local networks. They have acquired about10 million local residential customers and many millions of business customers.

As a result of this surge in local entry, the FCC permitted SBC and Verizon to enter the long distance business in every market, and it most recently significantly deregulated the requirement that these companies provide unbundled network elements at cost-based rates.

Yet, even though AT&T and MCI have gained a toehold in local markets, facilities-based competition is just beginning, and there is a real question whether it can be sustained. Since I know this business first hand, I know how difficult it is. To truly sustain competition, these firms needed to gain scale. AT&T and MCI were

the closest to that goal. They had developed sufficient market presence to negotiate with the Bells on a more equal basis, and the beneficial prices, terms and conditions in their agreements became benchmarks for the entire competitive sector.

Now we are faced with the two largest competitors being snapped up by SBC and Verizon, and the resulting competitive harms to customers and the overall market landscape are easy to detect are substantial.

THE EFFECTS OF THE MERGERS ON TELECOMMUNICATIONS COMPETITION

Ten Myths about Competition and the Mergers

When the mergers were announced, the leaders of the merging parties carried on endlessly about synergies, efficiencies, innovation, globalization, and other corporate buzzwords. Their PR departments worked overtime to paint these mergers as good for all Americans and all businesses. I'm not surprised. They've got a big job convincing people that greater market concentration is good for them. I've gone through many of their arguments and selected my top ten list of myths used by SBC and Verizon to support these deals.

First, they claim these are ordinary, garden-variety mergers. Nothing could be farther from the truth. As I said at the outset, they will fundamentally reshape the industry. We have seen such events before and so have a sense of their importance in the marketplace. In the 1980s, it was the divestiture of AT&T. In the '90s, the 1996 Telecommunications Act. In this decade, it is these two mergers, and the reason is obvious. These mergers marry the two largest local telecommunications providers with their two largest competitors.

SBC and Verizon are the two dominant local telephone companies, controlling their own local markets (for instance, with a residential market share exceeding 80%) and providing service to 3 out of 4 customers nationwide. In these markets, their bottleneck control has only begun to be eroded by a decade of competition. Yet, in the very short time they have been permitted to enter the long distance business, SBC and Verizon have begun the second and third largest providers. Their residential market shares are about 50% and 40% respectively. These two behemoths also have a firm grip on the wireless market, again controlling almost two-thirds of the customers in the country. And now, they seek approval to merge with the two most prominent local, long distance, and Internet competitors.

Second, don't be fooled by all the rhetoric that the telecommunications industry is somehow so completely different than ten years ago when Congress passed the 1996 law. The basic rules about marketplace competition still apply, and this is precisely where antitrust enforcement and the public interest inquiry need to be focused. Companies like SBC and Verizon, which control bottleneck facilities, have both the incentive and ability to use their market power to harm customers, competitors, and vendors. What's more, they have an insatiable appetite to use that power to leverage themselves into markets that are competitive where they will use their monopoly rents to harm competition.

Third, it has been ten years since Congress opened local telecommunications markets, and competition is just beginning to take hold. Many companies have entered, but they face well-entrenched monopolists—companies that have 100% of the customers and their entire, capital intensive network in place. It will take time to achieve true facilities-based competition. XO embraced the intent of the market opening provisions of the 1996 Act and invested $8 billion in its own infrastructure. As one of the major new entrants seeking to compete on a facility-by-facility basis, we want to see the law's objective achieved. But, local competitors still have a small share in most markets, and this share will diminish substantially if these mega-mergers are consummated.

Fourth, should the mergers receive approval, don't expect SBC and Verizon to compete head-on. It goes against their basic constitution. Over the past decade, both companies have had numerous opportunities to compete in each other's markets, and they just don't do it. In several major markets—such as Los Angeles, Dallas/Plano, and New York/Connecticut—their territories abut, and yet neither crosses over. In the SBC-Ameritech merger, the FCC placed conditions on SBC to compete outside its region, and it made only the most minimal effort. I've tried to obtain SBC service here in Washington and had no luck. The reason is easy to understand. SBC and Verizon each know that it has a significant cost advantage in its home market. Consequently, they have, in effect, a tacit non-aggression pact. With these mergers, the value of this pact increases immeasurably.

Fifth, the joke in the old Bell System was that every customer had a choice: a black rotary phone or a black rotary phone. Plastic shells with different colors were a major innovative breakthrough that took decades to come to market. No one seriously believes that companies with market power innovate. They don't have the in-

centive because these innovations could spin out of control and inject new competitive forces. It was only when the government enabled competitive entry that innovation blossomed. DSL, VoIP, managed services for businesses all were first brought to market by competitors. Consequently, because the mergers greatly reduce marketplace competition, there is absolutely no way innovation will burgeon. Rather, it will be stifled. At a time when our global leadership is being challenged, this would be a disaster.

Sixth, once these mergers are approved, there is no government backstop. By virtue of deregulatory actions by the FCC combined with activist court review, the government has largely ceded its oversight role of SBC and Verizon. In addition, with the Trinko decision by the U.S. Supreme, antitrust actions are hardly useful to address anticompetitive acts in the telecommunications industry. In other words, no one should count on the current government oversight scheme to correct any competitive abuses post-merger.

Seventh, by any objective measure, AT&T and MCI are not failing firms. In fact, both were just named to the "Fortune 100." You can't get much more successful than that. AT&T had revenues of over $30B in 2004; MCI over $20B. In the 4th quarter of last year, AT&T's EBITDA was $7B, and MCI's was $2B. In the second half 2004, both companies experienced growth in their EBITDA. A recent Wall Street analyst report forecasts that both companies will have positive earnings for the next two years. So, there is absolutely no support for justifying these mergers based on the business weaknesses of AT&T or MCI.

Eighth, the merging parties tout the synergies and efficiencies of the deals, particularly because SBC and Verizon can place their long distance traffic on AT&T's and MCI's networks, respectively. But, they already have that capability. Because the long distance market is extremely competitive, efficient "integration" can occur via contract. In other words, all SBC and Verizon need to do is enter into an arm's length agreement with AT&T and MCI respectively to obtain the very same benefits they claim to be obtaining with the mergers. They also have the possibility of forming other relationships short of merging—all in the name of greater efficiency.

Ninth, SBC and AT&T claim that AT&T's decision to exit the local residential market is irreversible, but this flies in the face of AT&T's actions of the past 20 years. In that short time, AT&T has reversed course so often it makes my head spin. First, they're out of mobile wireless, then in, then out, and then in. As for fixed wireless, they have had so many starts and stops that it gives you whiplash. And, then there's the entry and exit into the cable business combined with more recent discussions with cable operators about possible partnerships. As a CEO in a dynamic industry, much of this is understandable. Technologies and markets change. Any decision can be reversed given the proper circumstances.

Tenth, contrary to the public filings of the acquiring companies, these mergers will not improve the national security of this country or otherwise improve the telecommunications services received by the federal government. AT&T and MCI are already prominent government contractors, as are SBC and Verizon, and they are providing the government with innovative, high-quality services. If they remain standalone entities, they would continue to provide these services. In fact, it is the mergers—by reducing competition and combining networks—that will generate significant problems for the government. First, it is likely government will end up paying more for telecommunications services. In addition, just when the government wants to have a diversity of facilities to increase the odds of survivability of the network, these mergers combine the largest local networks. These are problems that must be addressed by the government reviewers of the mergers.

The Merger Review Process: It is Essential that the Department of Justice and FCC Conduct a Rigorous Examination with Complete Information

Because of the magnitude of these mergers—their impact on the entire telecommunications marketplace—and their evident competitive problems, the Department of Justice and the Federal Communications Commission (along with the relevant states) have an obligation to carry out a thorough, deliberate review. In a very real sense, these mergers pose a test to these government officials and to the value and integrity of these merger review processes. I very much want them to pass this test.

I believe it is critical that these mergers be reviewed through the "regular order." That is, the Department of Justice needs to gather complete information to identify markets, pre- and post-merger concentrations, barriers to entry and exit, and other relevant features of market, and then through application of the Merger Guidelines it should determine whether these mergers substantially diminish competition in those markets. And, the FCC needs to do the same in application of its public interest requirements. As I've said, razzle-dazzle and hype about futuristic competitive

alternatives or distant possibilities for market convergence have no place in such an analysis. Determinations need to be based on facts engrained in current market realities, and I believe once this is done the conclusion will be clear: these mergers are bad for customers of all types and sizes and in all locations.

In undertaking this analysis, it needs to be made clear that neither of the filings at the FCC by SBC and Verizon provide much relevant data on the mergers. One could characterize them as long on rhetoric and short on evidence. They were filed quickly after the mergers were announced so that they could get the clock running as soon as possible. Because of this, I call upon the Committee to urge the Department of Justice and FCC to ask for complete information upon which all of us can review the mergers—and the clock should be stopped until that occurs.

Local Markets, Increased Concentration, and Competitive Harms

XO believes that on their face these mergers pose serious competitive concerns and is confident that upon closer scrutiny will fail to meet legal standards. We are now beginning the detailed analysis required to determine precisely the competitive harms. This is going to take months given the many markets involved in these mergers, the difficulty in gathering data (particularly data controlled by the merging parties), and then the complex analysis that will need to be conducted. That said; let me provide some preliminary thoughts about the basic issues involved here.

First, market definitions should be based on well-engrained concepts and current realities.

Applying traditional antitrust analysis—and following the precedent in all recent telecommunications mergers—the relevant product and geographic markets for analyzing the effects on competition of the proposed transactions include: the local high-capacity service market, the local mass market, the long distance termination market, and Internet access and backbone markets. For my company—and for business customers—the most important market is the first—the market for high-capacity local services.

I know that the proponents of the merger allege that the underpinnings of the telecommunications business have changed so dramatically that these market definitions should be scrapped. They allege that geography doesn't matter and that all products are fungible. That may be the case some day far down the road. But, that isn't true today, and it is within the current market context that we need to evaluate these mergers.

Second, the local high-capacity market will see increased market concentration.

By virtue of their century-old monopoly, SBC and Verizon serve the vast majority of customers in these markets—both retail and wholesale. Their market share for the provision local exchange services to business customers in almost all local markets is somewhere between 80%–95% depending on the market. They also provide the dominant share of wholesale circuits to competing providers. AT&T and MCI are the two largest competitors in virtually every local market—dwarfing the rest of the CLEC industry. In two markets—Cleveland and Milwaukee—where XO has conducted a preliminary inquiry (based on a methodology similar to that used by SBC last year in a submission in the FCC's Triennial Review Process), it has found that the presence of competitors will diminish substantially when AT&T is acquired. And, none of the competitors that remain—of which XO is the largest—have the resources to replace them any time soon. As a result, when these combinations are completed, the SBC and Verizon will increase their local market concentrations significantly.

Third, local market entry cannot occur expeditiously.

Such significantly increased concentrations are troubling, but they could be offset if other competitors could rapidly enter to replace the local facilities and competitive presence of AT&T and MCI. However, this simply won't occur. It's important to understand that AT&T and MCI developed their local presence because of the tens of millions of long distance customers they had and their enormous financial strength. Once AT&T's and MCI's local facilities are bought, they will be integrated into the Bell's facilities and won't continue to be available on the current standalone basis. (As I said earlier, SBC and Verizon have been reluctant to pursue opportunities out-of-region, and they have the incentive to continue this practice even after they acquire AT&T's and MCI's facilities that are out of their home territories.) Thus, both retail customers and carriers who resell their capacity are left without real alternatives.

Fourth, after AT&T and MCI exit, customers will see significant price increases.

Once AT&T and MCI exit the market, SBC and Verizon have an increased opportunity to raise prices to its customers. This harms competitors directly, and because it increases the prices of their inputs, it places the competitors at an extreme disadvantage against the Bell company in acquiring retail customers. This is the very definition of substantial harm to competition.

CONCLUSION

Ten years ago, Congress committed the government to the development of local telecommunications competition. Entrepreneurs took that commitment seriously, and many tens of billions of dollars were expended to build a competitive local market presence. Not surprisingly, in the gold rush atmosphere that ensued after passage of the 1996 Act, more firms entered than could succeed. A shakeout occurred, and a group of more financially and operationally sound competitors have survived. This competition benefits all customers.

Now, however, competition is threatened by these mergers, and it is time for the government to stand tall. I urge you to take this opportunity to renew your commitment to the development of local competition. These mergers require very careful and deliberate investigation—and, as we will prove, would produce serious competitive harms that must be addressed.

ATTACHMENT

XO Communications, Inc.

CHARTS TO SUPPLEMENT TESTIMONY BEFORE THE HOUSE JUDICIARY COMMITTEE ON MERGERS IN THE TELECOMMUNICATIONS INDUSTRY

CARL GRIVNER
CEO, XO COMMUNICATIONS, INC.
April 20, 2005

www.xo.com

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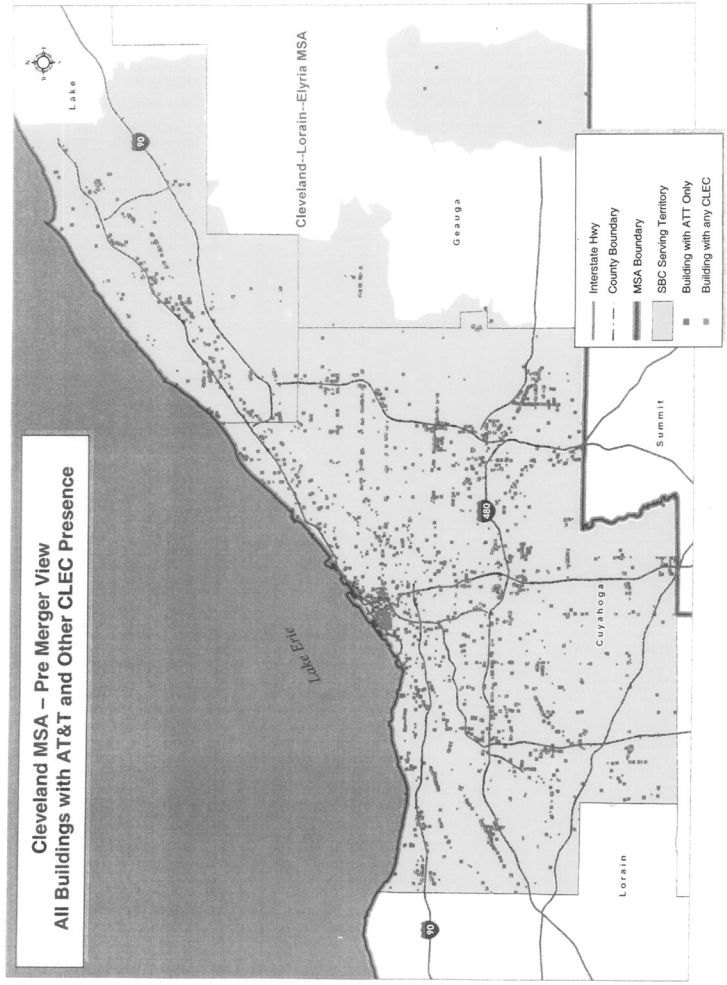
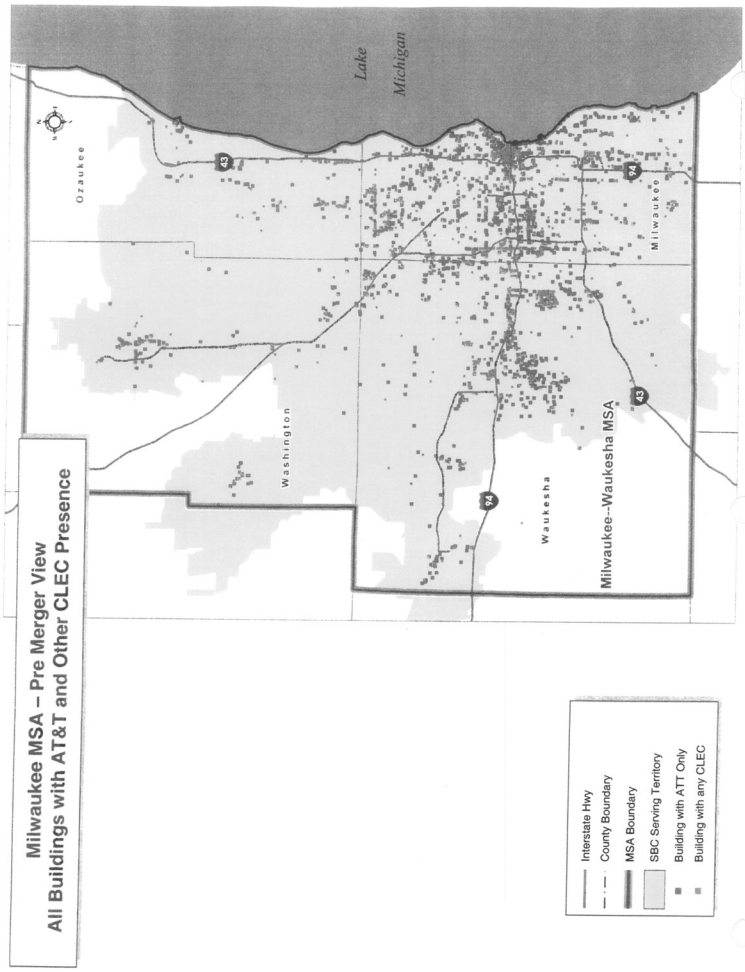
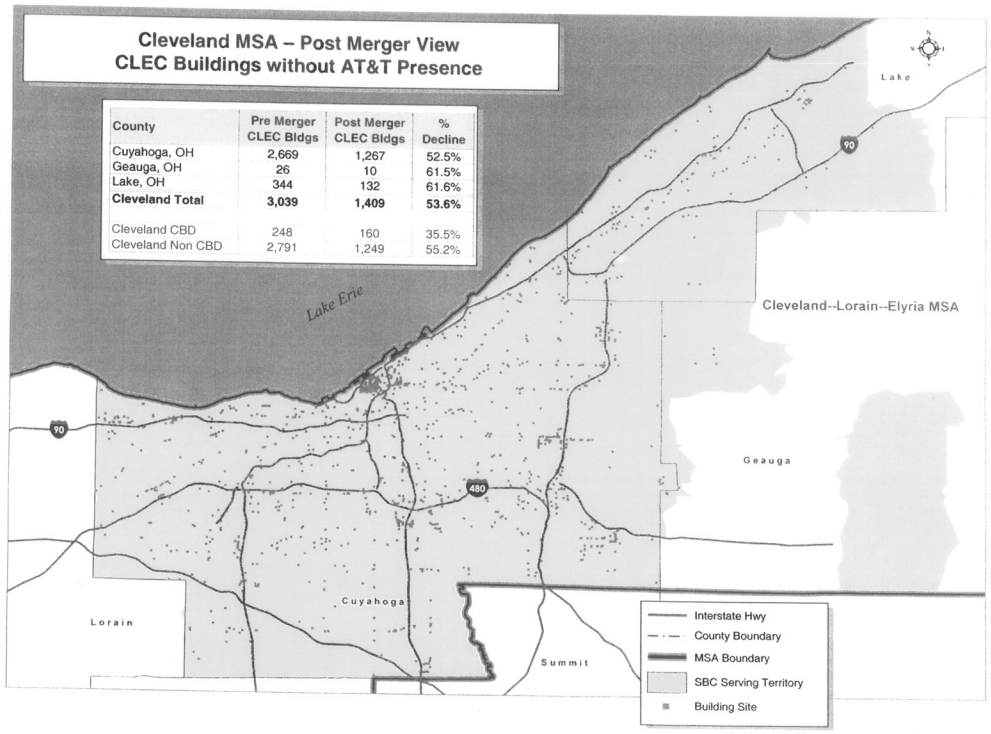

Cleveland MSA – Pre Merger View
All Buildings with AT&T and Other CLEC Presence
Lake Erie
Lake
Cleveland–Lorain–Elyria MSA
Geauga
Cuyahoga
Summit
Lorain
90
90
480
Interstate Hwy
County Boundary
MSA Boundary
SBC Serving Territory
Building with ATT Only
Building with any CLEC


Milwaukee MSA – Pre Merger View
All Buildings with AT&T and Other CLEC Presence
Ozaukee
Washington
Waukesha
Milwaukee
Lake
Michigan
Milwaukee–Waukesha MSA
Interstate Hwy
County Boundary
MSA Boundary
SBC Serving Territory
Building with ATT Only
Building with any CLEC

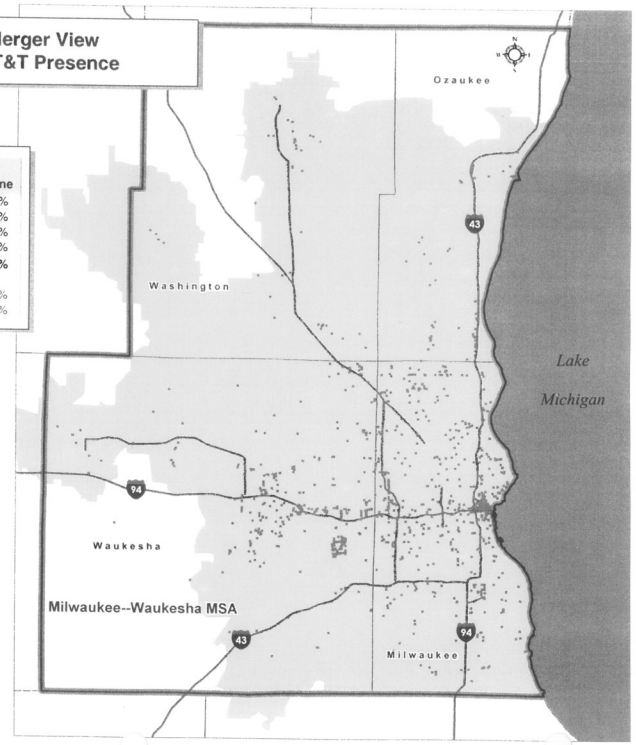
Cleveland MSA – Post Merger View
CLEC Buildings without AT&T Presence

County	Pre Merger CLEC Bldgs	Post Merger CLEC Bldgs	% Decline
Cuyahoga, OH	2,669	1,267	52.5%
Geauga, OH	26	10	61.5%
Lake, OH	344	132	61.6%
Cleveland Total	**3,039**	**1,409**	**53.6%**
Cleveland CBD	248	160	35.5%
Cleveland Non CBD	2,791	1,249	55.2%



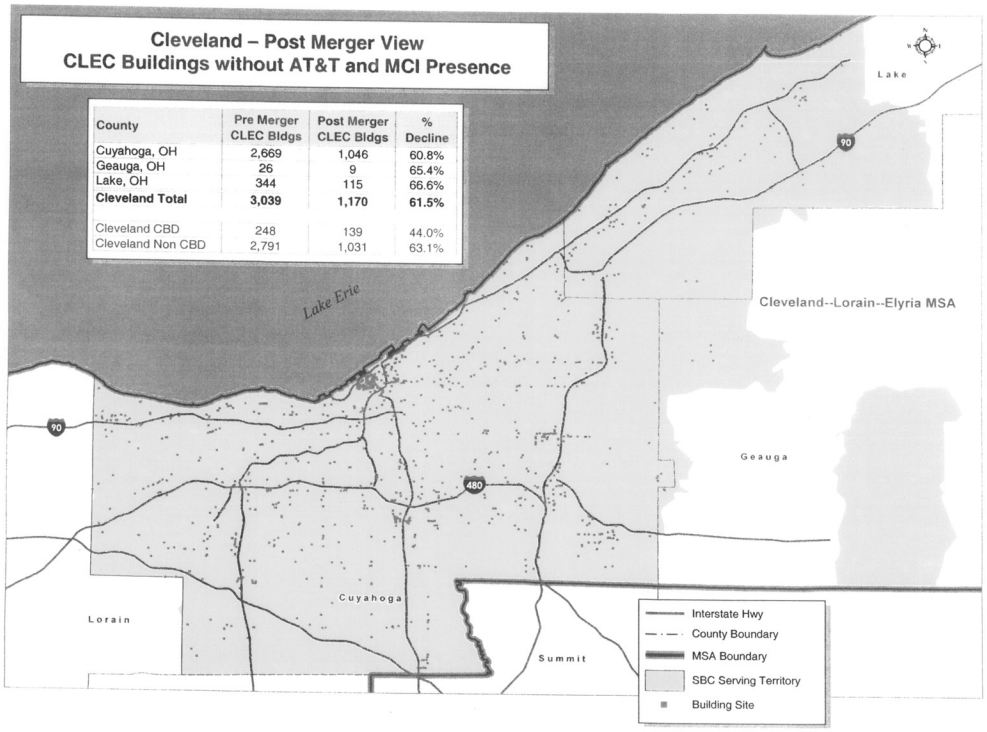
Milwaukee MSA – Post Merger View
CLEC Buildings without AT&T Presence

County	Pre Merger CLEC Bldgs	Post Merger CLEC Bldgs	% Decline
Milwaukee	1,819	665	63.4%
Ozaukee	168	59	64.9%
Washington	197	52	73.6%
Waukesha	1,108	410	63.0%
Milwaukee Total	**3,292**	**1,186**	**64.0%**
Milwaukee CBD	245	129	47.3%
Milwaukee Non CBD	3,047	1,057	65.3%



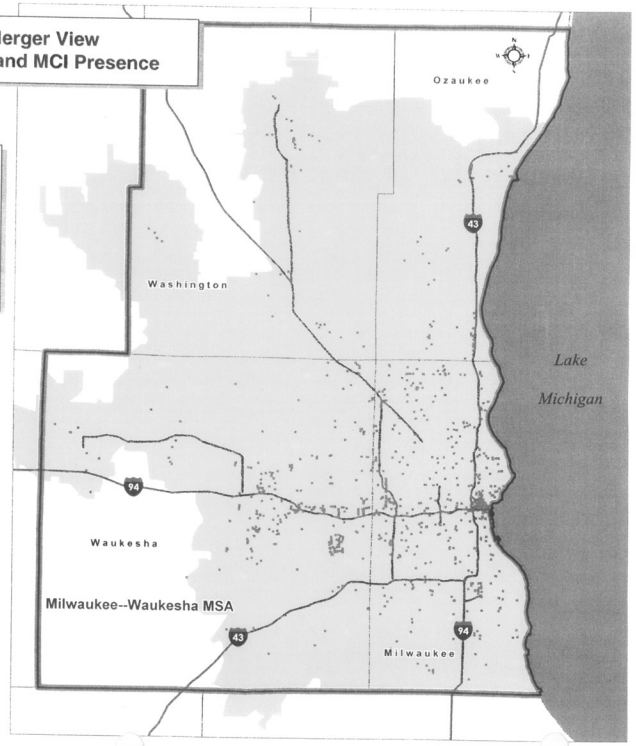
Cleveland – Post Merger View
CLEC Buildings without AT&T and MCI Presence

County	Pre Merger CLEC Bldgs	Post Merger CLEC Bldgs	% Decline
Cuyahoga, OH	2,669	1,046	60.8%
Geauga, OH	26	9	65.4%
Lake, OH	344	115	66.6%
Cleveland Total	**3,039**	**1,170**	**61.5%**
Cleveland CBD	248	139	44.0%
Cleveland Non CBD	2,791	1,031	63.1%

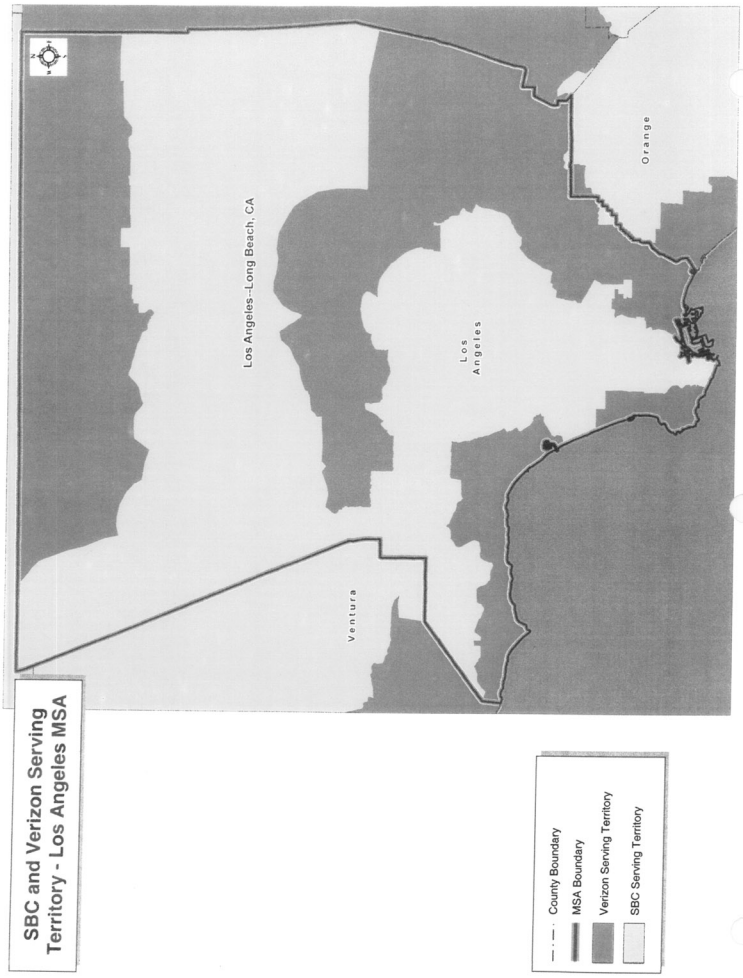


Milwaukee MSA – Post Merger View
CLEC Buildings without AT&T and MCI Presence

County	Pre Merger CLEC Bldgs	Post Merger CLEC Bldgs	% Decline
Milwaukee	1,819	546	70.0%
Ozaukee	168	54	67.9%
Washington	197	48	75.6%
Waukesha	1,108	347	68.7%
Milwaukee Total	**3,292**	**995**	**69.8%**
Milwaukee CBD	245	106	56.7%
Milwaukee Non CBD	3,047	889	70.8%

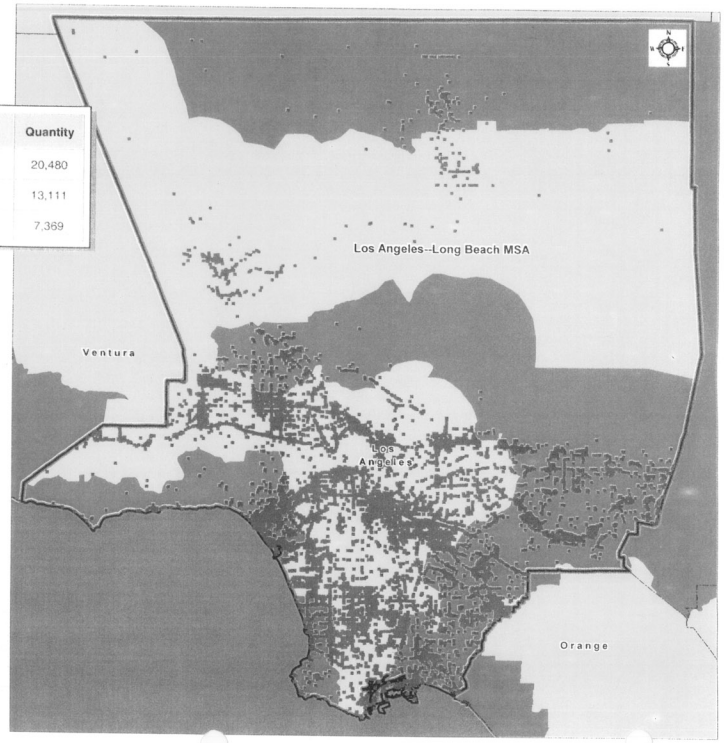


- Interstate Hwy
- County Boundary
- MSA Boundary
- SBC Serving Territory
- Building Site


SBC and Verizon Serving Territory - Los Angeles MSA
Ventura
Los Angeles–Long Beach, CA
Los Angeles
Orange
County Boundary
MSA Boundary
Verizon Serving Territory
SBC Serving Territory

CLEC Appearances - Los Angeles MSA

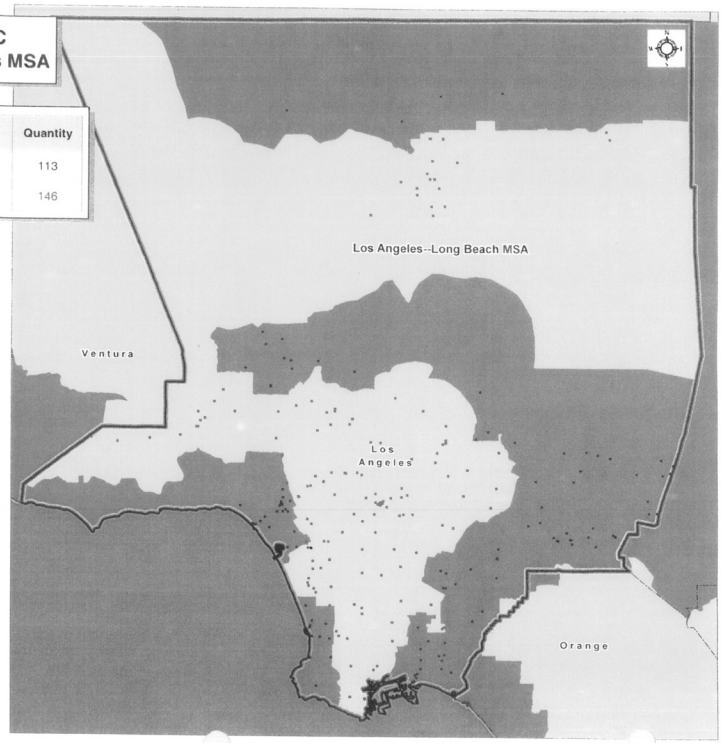
Category	Quantity
CLEC appearances	20,480
CLEC appearances in SBC Territory	13,111
CLEC appearances in Verizon Territory	7,369



- County Boundary
- MSA Boundary
- Verizon Serving Territory
- SBC Serving Territory
- Building with any CLEC appearance

SBC and Verizon CLEC Appearances - Los Angeles MSA

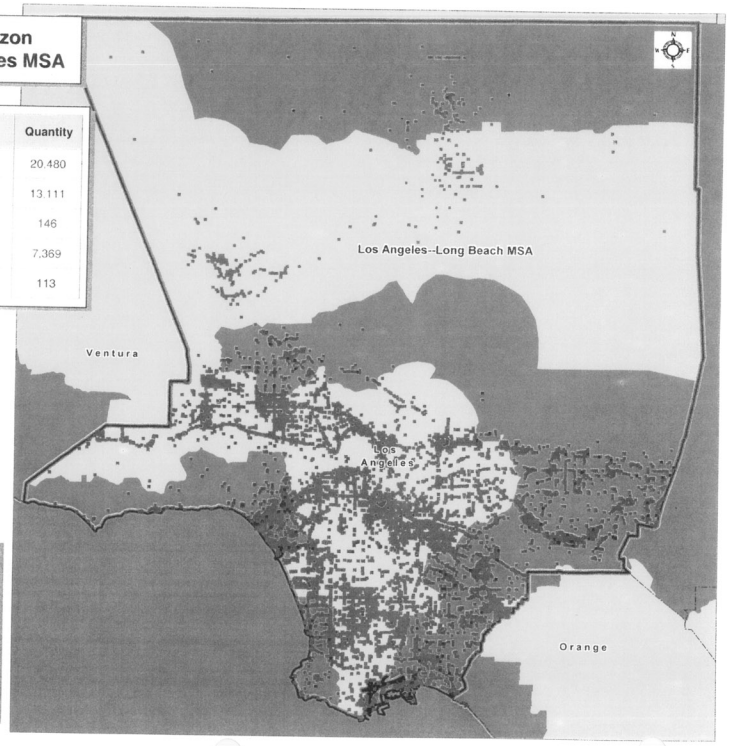
Category	Quantity
SBC CLEC appearances in Verizon Territory	113
Verizon CLEC appearances in SBC Territory	146



- County Boundary
- MSA Boundary
- Verizon Serving Territory
- SBC Serving Territory
- Verizon Sites in SBC Territory
- SBC Sites in Verizon Territory

All CLEC, SBC, & Verizon Appearances - Los Angeles MSA

Category	Quantity
CLEC appearances	20,480
CLEC appearances in SBC Territory	13,111
Verizon CLEC appearances in SBC Territory	146
CLEC appearances in Verizon Territory	7,369
SBC CLEC appearances in Verizon Territory	113



- County Boundary
- MSA Boundary
- Verizon Serving Territory
- SBC Serving Territory
- Verizon CLEC Sites in SBC Territory
- SBC CLEC Sites in Verizon Territory
- Building with any CLEC appearance

Mr. CANNON. Thank you, Mr. Grivner.
Mr. Moir?

TESTIMONY OF BRIAN R. MOIR, ATTORNEY AT LAW, ON BEHALF OF e-COMMERCE AND TELECOMMUNICATIONS ASSOCIATION (eTUG)

Mr. MOIR. Thank you, Mr. Chairman. My name is Brian Moir, and I'm here today on behalf of the large business users that Carl just referred to. I'm going to devote my oral testimony to discussing many of the abuses that we've been experiencing in the industry.

Unfortunately, what we find is that the Bell operating companies—as they did in '96, as they did earlier—today still retain pervasive market power. And these market powers are over the provision of these access services that everybody is dependent upon in order to move traffic within the ILECs, and particularly the Bells networks.

Their market power continues to have meaningful levels and, as a consequence, business users and the potential customers that are dependent upon accessing those facilities for terminating traffic, for moving traffic within a region, are all suffering.

Had the FCC and other Government policymakers been doing their job, many of the abuses I'm going to discuss here today would not have either happened, or would not have reached the level of severity that they have.

Unfortunately, the FCC's fallen down on the job. They haven't implemented the goals and objectives that many of you were talking about during the '96 act. And the rest of the industry is suffering. And we have companies now looking for suitors, because they find that the best way to preserve shareholder value.

The Bell market power, as I mentioned earlier, continues. And in particular, unlike most of the areas that get attention, which are more what I call retail residential, the perspective I want to talk about is particularly what I call the large business customers. We use huge data pipes. Cellular, the wireless services, don't have the throughput rates—the band width, throughput rates—necessary for the traffic that we move, and at the speeds we need to move them at. The cable television services that they provide to our homes also don't have the capability, the throughput rates, the speeds, that we need to handle our type of traffic.

And as a consequence, given the fact of the limited number of areas where the CLECs have been able to deploy facilities, and the additional problem that we just saw of then getting access to the various buildings that allow them to actually tie into the customer operations, we find that for the basic building blocks in our networks, which we call DS-1 lines—they're about 64 times the capacity of the typical voice lines we get at home. These DS-1 facilities, the most recent end-user study, where we actually go out and analyze the number of lines a customer is using, 95 percent of those lines are being provided by the Bells. Why? Because there aren't any other alternatives to utilize.

That same type of study is being replicated and reinforced by what we're hearing from the wireless industry. All of the cellular towers in the United States have to be tied into their networks. They use these same building blocks that business users use, and

their results—the only ones we look at are the non-Bell-owned ones; Nextel, AT&T Wireless before they became part of the Bell-owned Cingular system—found 90 to 95 percent of their towers were dependent upon the same blocks that we are dependent upon day in and day out.

What's happened to the rates of return they're making off of these services? Well, what's happened is, in 1999, the FCC didn't say there was competition in this market for these what we call high-capacity pipes that we use; they made a predictive judgment that competition would come. You know, like the "Field of Dreams." Unfortunately, you know, these alternative facilities were never built; the competition never came to sufficient meaningful levels that you all are normally accustomed to looking at. And as a consequence, rates have gone up for these building blocks that we have no choice but to use, because there's no other market.

And the rates of return—things the Bells don't like to talk about, but which any of us, when we analyze how companies are doing in the market, whether for business purposes or investment purposes, we look at rates of return. The market rules were changed in '99. The Bells are now making, as of 2004: SBC, 76.2 percent, an increase of 93 percent from 1999; Bell South, now making 81.9 percent, an increase of 153 percent over 1999; Qwest, 76.8 percent return on these services, an increase of 139 percent since 1999. I can go on, but these are the things that are happening. And the FCC, even though they have the data, has done nothing to rectify the problem.

So you could ask, why are the Bells, why are the CLECs, why are the wireless companies using these same facilities? Because for the majority of their needs, they don't have any choice, either.

[The prepared statement of Mr. Moir follows:]

PREPARED STATEMENT OF BRIAN R. MOIR

Thank you for the invitation to submit testimony on "Industry Competition and Consolidation: The Telecom Marketplace Nine Years After the Telecom Act" from the perspective of the large commercial and institutional end users of electronic commerce, information technologies ("IT"), Internet, and telecommunications products and services. Mr. Chairman, you and the Committee should be commended for your efforts to examine the telecom marketplace because significant problems to exist. I hope that the perspective of the large telecom end user will facilitate the Committee's deliberations by identifying some market realities and policy objectives that warrant serious attention.

INTRODUCTION

I have been representing the interests of the large end users of telecom services and products, as well as electronic commerce, IT, and the Internet for approximately 24 years. Through out that time large end users have consistently stated that *competition* is the ultimate safeguard for the telecom industry. In the absence of meaningful competition, just, equitable, and reasonable regulations, prices, policies and laws are necessary. My testimony will cover some of the problems within the telecom marketplace as well as regulatory policies.

LARGE END USER DEPENDENCE ON TELECOM

Large end users of electronic commerce, IT, Internet, and telecom services and products face competitors here in the U.S. and abroad in both technologically developed countries as well as low-wage and less-developed countries. To compete in these markets, large end user businesses have an absolute need for timely, accurate, cost-effective information that can be made available on demand. To accomplish this, large end user companies typically obtain, operate, maintain, and utilize cutting-edge technologies.

Large end user businesses have become increasingly dependent on efficient, reliable, readily available, and *reasonably priced* telecom services and facilities. Public policies that promote *increased* competition and user choice in those areas of the telecom marketplace that are already subject to competition while at the same time fostering meaningful competition where it is not fully available by providing just, equitable, and reasonable prices, regulations, policies, and laws significantly benefit large end user businesses and the American economy.

The U.S. telecom marketplace has evolved over many years. Beginning around the early 1970's, it was the large end user customers, not the then monopoly suppliers, who developed new and innovative methods of using the many technological telecom advances. As a consequence, large end users were forced to go outside the traditional providers of telecom services, such as the old Bell System, to obtain the technologies and services necessary to meet their growing requirements. This promoted new industries to develop equipment, information technologies, and transmission systems to meet these new and ever expanding user needs.

As the U.S. telecom marketplace evolved technologically, the traffic that transited the transmission systems evolved as well. What began as largely voice related traffic has now evolved to a point where the vast majority of large end user traffic is data. While the voice component has remained somewhat flat, the data component has been experiencing explosive growth. As a consequence, large end users largely focus their attention on ensuring that their data will be handled in a high-quality, cost-effective manner.

TELECOM MARKETPLACE

Federal Communications Commission ("FCC") decisions in the 1970's and 1980's, anti-trust actions and the AT&T Consent Decree triggered developments that lead to a healthy competitive environment (with the exception of the local telephone market) that has been capable of providing state-of-the-art telecom and IT services and equipment to large end user businesses. Many had hoped that the 1996 Telecom Act would bring the same results to the local telecom marketplace. Even if meaningful competition was slow to take hold, many expected that the Act's provisions (particularly sections 252,252. 271 and 272) would provide relief from some incumbent local exchange carrier ("ILEC") related problems including access pricing. Views of the Act's impact vary depending upon the supplier or customer market perspective it is viewed from.

A growing percentage of residential and small-to-medium sized businesses have access to three different types of technology suppliers (CATV, wireline telco, and wireless) of voice services (either traditional voice service or VoIP), as well as broadband. Unfortunately, from the perspective of the large end user, the developments have not been as favorable. Due to the unique nature of large end user transmission needs (i.e., vast majority of traffic being data), large capacity transmission facilities are required. The transmission speed rates of the typical CATV and wireless service suppliers are just not adequate to meet the high capacity needs of the large user community.

The typical minimum bandwidth or transmission rate required by large end users is fulfilled by telecom carrier DS–1 ("digital signal") lines that are usually rated at 1.544 Mbps. [These DS–1 lines have the capacity of 24 voice grade lines if they are running at a full 64 Kbps.] Usually, the highest transmission rates typically available with copper wire transmission lines is 44.736 Mbps with DS–3 lines. Much higher transmission rates are available thru fiber optical carrier ("OC") lines (OC–1 at 51.84 Mbps thru OC–192 at 9.953 Gbps).

Today the ILECs are the suppliers of 90%–95% of the basic building block (DS–1s) in many large user networks. [The ILECs provide these facilities through their interstate special access services.] As recent survey of large end user petroleum companies indicated that approximately 80% of their large end user DS–3's were provided by ILECs. [See Keller and Heckman Ex Parte in FCC RM Docket No. 10593 on 1–6–2005.] While ILEC market power at these levels is troubling enough to large end users who strive for competitive choices in the markets they depend on, what is even more distressing is the fact that the FCC made a *predictive* judgment in 1999 (based on misinformation from major ILECs) that the ILEC special access markets were facing growing competition. As a consequence, the FCC radically changed its interstate special access pricing regulations to allow for pricing deregulation. Despite customer objections, the FCC began to grant ILEC special access pricing deregulation the next year with some ILEC rate-of-returns ("ROR") on their interstate special access services now reaching levels in excess of 80% ROR. These types of levels are clearly excessive. These continually escalating returns have occurred because the ILECs have increased their special access prices which is con-

tradictory to what the FCC had predicted would happened when it radically altered it special access pricing rules in 1999. Even if one used the FCC's very out-of-date authorized ROR of 11.25% as a basis to view the most recent regional bell operating company ("RBOC") interstate special access revenue data filed with the FCC, it would show that their returns are exceeding authorized ROR levels by *$6.4 billion per year*. The ILEC use of their special access market power has clearly resulted in excessive charges that serve as a monopoly tax on the critical information needs of this Nation's largest businesses and as a drag on the entire economy.

Another indicator of the ILECs' market power for interstate special access services is their use of "lock-in" provisions which "quite plainly deter special access subscribers from self-deploying facilities or shifting to bypass providers...." [See AT&T Ex Parte Letter in WC Docket No. 04–313 & CC Docket No. 01–338 on 11–12–2004.] While not relevant to the ILEC special access marketplace, the RBOCs have utilized a number of long-distance price squeeze strategies aimed at hampering local telephone competition by using their local market power. [See Declaration of Michael R. Lieberman & Robert Panerali filed by AT&T in WC Docket No. 04–313 & CC Docket No. 01–338 on 10–I22–4–2004.]

FCC RESPONSES TO ILEC MARKET POWER ABUSES

The FCC responses to ILEC market power abuses and their own mistakes has not facilitated the vision of increased competition and lower prices that many were told would flow from the 1996 Act's implementation.

After growing concerns regarding the effects of FCC's radical changes to its special access pricing rules in 1999, filing of a Petition for Rulemaking by AT&T in 2002, volumes of pleadings, and a Mandamus petition, the FCC released the text of a Notice of Proposed Rulemaking ("NPRM") which finally creates a proceeding to review the damage caused by its 1999 predictive judgments. [See *In re Special Access rates for Price Cap Local Exchange Carriers,* Order and Notice of Proposed Rulemaking, WE Docket No. 05–25, 2005 WL 235782 (Jan. 31, 2005).] While the FCC's NPRM raises many of the critical issues that many believe must be addressed by the Commission, the text of the NPRM is by no means an indicator of what, if anything, the FCC might do or when.

With regard to the major ILEC special access pricing provisions that are premised on their market power in the special access marketplace, ex parte communications and filings have been occurring at the FCC over the last few years with no indications that the FCC intends to eliminate the abuses.

Since FCC actions have largely eliminated unbundled elements ("UNEs") as a tool for potential local exchange competitors and the lack of any meaningful levels of venture capital monies for significant additional competitive exchange carrier ("CLEC") buildouts, ILEC special access services have become of extreme importance to many CLECs as the only practical tool available for targeting specific potential customers not passed by their facilities. Unfortunately, the excessive ILEC rates for these services have many CLECs wondering how cost-effective these services will really be to them.

CONCLUSION

The most recent industry merger proposals were driven, not by technological innovation or any dramatic changes triggered by the 1996 Telecom Act, but by the repeated failure of regulators to recognize the significance of ILECs' market power and to adequately respond to repeated facts, data, and requests from large end users, IXCs, non-RBOC owned wireless carriers, and CLECs. The long-distance companies that have sought these mergers were heavily involved in efforts to resolve the problems raised in this testimony. The FCC has largely ignored their concerns as well as those expressed by the rest of the non-ILEC industry. Significant harm has been done to their industry as well as the CLEC, non-RBOC wireless and large end user sectors. I agree with SBC that these problems should not be made part of these merger proceedings. These issues are too important to the future competitiveness of the telecom marketplace and this country's non-ILEC economic engines that are still dependent upon critical telecom services subject to ILEC market power. The resolution of these issues must be solved now—well before government merger decisions are completed.

Mr. CANNON. Thank you, Mr. Moir. We appreciate that.

Mr. Kellogg?

TESTIMONY OF MICHAEL KELLOGG, PARTNER, KELLOGG, HUBER, HANSEN, TODD, EVANS & FIGEL, PLLC, ON BEHALF OF THE UNITED STATES TELECOM ASSOCIATION

Mr. KELLOGG. Thank you, Mr. Chairman. Mr. Conyers was absolutely correct when he said that the telecom marketplace has changed radically since the time of the 1996 act. And it's very helpful to go back and think of where we were in 1996. Wireless was still in its infancy. Broadband had not been deployed anywhere. VoIP had not even been conceived. The inter-exchange market was a cozy oligopoly, protected from competition. And local exchange service was protected by local franchises.

Now, some of the changes that have taken place since 1996 are the result of the 1996 act. The local franchise was eliminated; competition was allowed in; the inter-exchange market was opened up to competition, and proved to be a fairly artificial market, as customers realized they wanted bundles of minutes that covered both local and long distance.

But the major developments, and the most important ones for your consideration, are the ones that happened in the marketplace and that were not fully expected. One is that wireless and data now significantly outpace voice, wireline voice, in terms of revenues. At the time of the '96 act, it was 90-10, voice revenues over wireless and data; today, it's 40–60. That is a sea change that has tremendous implications for policy.

And the wireless story generally really has to be understood. Today, this year, the tipping point is being reached, and there will be more wireless access lines than there are wireline access lines. Over 180 million wireless lines are increasing dramatically; wirelines are decreasing. Eleven million people have abandoned wireline telephone service altogether, in favor of wireless. And another three million are doing that every year.

There is intense competition in wireless; three to five providers in every market. There is improved service; there's decreased prices. As a result, it is not uncommon for people at home to use their wireless phones to make long-distance calls, because it's cheaper to do so.

Now, the second major development is in broadband. The U.S. is currently 11th in the world in deployment of broadband. That should be shocking. We had the greatest telecom industry in the world throughout the 20th century, and excessive regulation dramatically impaired investment in that infrastructure.

It's starting to turn around. The FCC is starting to turn things around. The new chairman has pledged to open up broadband markets freely to competition. But there's still a lot of—a lot of room to grow there. There's 90 percent access now to U.S. homes. Cable has about 60 percent of that market, compared to DSL. It's about a two-to-one margin.

The big story is going to be wireless broadband, next-generation wireless, which is going to blow this market wide open.

Billions of dollars has to be invested over the next decade in this market to make the U.S. competitive. And it will happen if there is a competitive marketplace and a level playing field for all competitors.

The most significant development, probably—the third—is VoIP, or Voice Over Internet Protocol. In the next five to 10 years, voice is going to be merely an application over broadband service. It's going to completely transform the way that people get their ordinary telephone service. Comcast today is adding a thousand customers per day in New York City alone to VoIP service.

And these developments are terrific for consumers. They pose complicated challenges, though, for the incumbent telephone companies and for the regulators. The incumbents have to innovate, if they are going to survive. Their access to capital is highly constrained.

Consolidation in this industry is inevitable, and very healthy. The wireless experience ought to be a lesson. Back at the beginning, the FCC gave multiple licenses and limited how much spectrum could be provided, and growth was sluggish. They eliminated those caps. Consolidation occurred, three to five providers per market. Competition is intense, and growing.

The regulators have an equal challenge, because they have to get out of the way. They've got to clear away a lot of the underbrush based on an old model of how telecommunications was served; a model that leads to inefficiencies, subsidies, calls for special interests, not to consumer benefits.

The market-based approach will work, and it will return the U.S. to the top telecom industry in the world. But it has to be allowed to work on a competitive framework. Thank you.

[The prepared statement of Mr. Kellogg follows:]

PREPARED STATEMENT OF MICHAEL KELLOGG

Mr. Chairman and Members of the Committee. My name is Michael Kellogg. I am a partner at the law firm of Kellogg, Huber, Hansen, Todd, Evans & Figel, P.L.L.C. I am appearing today on behalf of the United States Telecom Association.

For more than a century, the telecommunications networks and services in this country were the envy of the world. We had the fastest, cheapest, most advanced technology and an infrastructure that reached into just about every home and business in the nation. No other country could boast comparable levels of service and technology.

As a result, our telecom industry has long been a critical engine for domestic economic growth. The telecom sector standing alone accounts for nearly 3 percent of the U.S. GDP—more than any other high-tech industry.[1] The existing infrastructure reflects literally trillions of dollars in invested capital. At its peak in the year 2000, the sector as a whole was investing about $110 billion per year, and thus accounted for about 10 percent of all annual capital spending in the United States.[2]

Through its impact on productivity, moreover, the telecom sector's capital investment boosts economic output across the board. The Bureau of Economic Analysis estimates that each dollar invested in U.S. telecom infrastructure has resulted in nearly three dollars of economic output.[3] That multiplier is likely to get larger as low-cost broadband service becomes more widely available.

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[1] Industry Analysis & Technology Division, Wireline Competition Bureau, FCC, *Telecommunications Industry Revenues 2002* at Table 1 (Mar. 2004); Bureau of Economic Analysis, *Current-Dollar and "Real" Gross Domestic Product,* http://www.bea.gov/bea/dn/gdplev.xls (GDP for 2002). According to an October 2000 news article, for example, the personal computer industry earned $180 billion in revenue. D. Bartholomew, *E-Business Commentary—PC Industry Stuck in Neutral,* IndustryWeek.com (Oct. 1, 2002), http://www.industryweek.com/CurrentArticles/ASP/articles.asp?ArticleId=1330.

[2] United States Census Bureau, *Annual Capital Expenditures: 2001* at 10–11 (Jan. 2003).

[3] Bureau of Economic Analysis, *Input-Output Accounts Data: 1999 Annual I-O Table Two Digit* at Table IOTotReqIxCSum.xls, http://www.bea.doc.gov/bea/dn2/i-o.htm#annual.

The telecom sector has had a commensurately large impact on employment. In the year 2002, it employed almost 1.2 million workers.[4] Employment in the telecom sector as a whole grew more than twice as fast as the national average between 1998 and 2000, and, by the year 2000, the telecom sector was paying nearly twice the average U.S. salary.[5]

As we all know, that situation has changed dramatically. We are currently in a period of "creative destruction" that is transforming the industry. Since 2000, telecommunications service providers and the equipment manufacturers that supply them have lost over 700,000 jobs[6] and over $2 trillion in market capitalization,[7] while annual investment declined by more than $70 billion[8] and the United States fell to 11th in the world in deployment of advanced broadband networks.[9]

These developments are attributable to two main factors: first, mistakes by the FCC in its implementation of the 1996 Telecom Act and, second, the growth of new technologies have advanced at a rapid pace to compete with and displace traditional telecommunications services. The first factor has to some extent been corrected by the Courts and by changes in FCC policies that are now more pro-competitive; but there is still progress to be made to eliminate anti-growth policies that have stifled investment in recent years. The second factor will make this industry more competitive and vibrant than ever, provided that current de-regulatory policies are continued and expanded.

Let me begin with the first point. In order to jumpstart competition in local telephone services, Congress decided not simply to eliminate existing franchises and open up markets; Congress went further and required incumbents affirmatively to assist new entrants through the mechanism of unbundling incumbent facilities. Whatever the merits of that idea, the FCC responded with a form of heavily managed competition more suitable to the old Soviet Union than to the new frontier of technology and innovation here in the United States.

Congress wanted unbundling as a temporary crutch upon which new entrants could rely while getting on their feet and building their own networks. The FCC turned it into a cradle-to-grave welfare system for bogus business models. As a result the FCC's unbundling rules led to a quick boom as hundreds of new entrants flooded the market. But it then led to an even quicker and deeper bust when markets finally realized that the FCC was promoting forms of competition that were untenable.

The focus of unbundling regulation was on creating hundreds of new competitors as quickly as possible. At the height of the competitive local exchange carrier ("CLEC") industry in 2001, ALTS—the CLEC trade organization—reported that there were more than 200 competing providers. Although these carriers invested nearly $100 billion, much of this investment proved wasteful: there were as many as 50–60 competitive providers in some metropolitan areas.

Moreover, very little investment was made in residential markets, due to the availability of the ultra-cheap resale, known as the UNE platform ("UNE-P"). While the traditional long-distance carriers were at one time viewed as serious competitors

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[4] Bureau of Labor Statistics, U.S. Dep't of Labor, *Career Guide To Industries: Telecommunications,* http://www.bls.gov/oco/cg/cgs020.htm. As of end of year 2000, a total of 5.6 million workers were involved in IT occupations—nearly 5 percent of all U.S. workers. Economics and Statistics Administration, Dep't of Commerce, *Digital Economy 2002* at 42–44 (Feb. 2002).

[5] United States Census Bureau, *Statistics of U.S. Businesses: Tabulations by Enterprise Size, Number of Firms, Number of Establishments, Employment, and Annual Payroll by Employment Size of the Enterprise for the United States, All Industries—1998,* http://www.census.gov/csd/susb/usalli98.xls; United States Census Bureau, *Statistics of U.S. Businesses: Tabulations by Enterprise Size, Number of Firms, Number of Establishments, Employment, and Annual Payroll by Employment Size of the Enterprise for the United States, All Industries—2000,* http://www.census.gov/csd/susb/usalli00.xls.

[6] *See Layoffs Near 2 Million in 2001,* San Jose Bus. J. (Jan. 3, 2002) http://sanjose.bizjournals.com/sanjose/stories/2001/12/31/daily23.html; V. Godinez, *Tech Posts Are Out There, If You Do a Little Looking,* Seattle Times (Feb. 2, 2003); *December Job Cuts Top 100K,* CNN/Money.com (Jan. 5, 2005), http://money.cnn.com/2005/01/05/news/economy/jobs—challenger/.

[7] *See* S. Rosenbush, *et al., When Will the Telecom Depression End?,* Business Week at 66 (Oct. 7, 2002).

[8] *See* Skyline Marketing Group, *CapEx Report: 2002 Annual Report,* Carrier Data Sheet 1 (June 2003) (overall investment by wireline and wireless carriers in 2000: $126 billion); Skyline Marketing Group, *CapEx Report: 3Q04,* Carrier Data Sheet 1 (Feb. 2005) (2004 est. based on data through 3Q 2004: $51 billion).

[9] *See, e.g.,* G. Arlen, ed., *TR's Online Census* at 11 (Fourth Quarter 2003) ("The United States ranks 11th worldwide in broadband use, according to a recent United Nations report."). *See also* FCC Chairman Michael K. Powell, Remarks at the National Association of Regulatory Commissioners General Assembly (Mar. 10, 2004) ("The greatest nation on earth should not be content to be 11th in broadband deployment.").

of the local telephone companies, due to the UNE-P, all they ever did was resell local service.

The FCC's unbundling rules have now been thrown out three times in the Courts; once by the Supreme Court and twice by the D.C. Circuit. On all three occasions the Courts have chided the FCC for adopting an excessively regulatory model to implement what was supposed to be a deregulatory statute. The FCC's mismanagement on this issue must bear a fair share of the blame for the high-tech boom and bust of the late 1990s and early 2000s.

But that is all water under the bridge at this point. My desire today is not to criticize anyone for past mistakes, but to learn from those mistakes. The much more important point is thus the second one: the dramatic changes in technology and whether these new technologies will be allowed to flourish in a truly competitive marketplace.

We must recognize that the telecommunications industry is very different today than at the time Congress passed the 1996 Act. Indeed, circumstances have changed so drastically as to warrant Congress in revisiting and updating the current law.

In 1996, ordinary wireline voice calls still generated 90 percent of the telecom industry's total revenues, with wireless and data splitting the rest. Today, the split is about 40–60. In another four years it is expected to be 30–70.[10] Traditional wireline telephone service is under tremendous pressure, as it has been at no other time in our history.

Three areas in particular—wireless, broadband, and the advent of Voice Over Internet Protocol ("VOIP")—warrant discussion.

Wireless. The growth of wireless has exceeded even the most optimistic projections. The number of wireless subscribers has grown from about 35 million at the time the 1996 Act was enacted to more than 180 million today.[11] By contrast, there were approximately 180 million wireline access lines as of June 2004, and that number has been in decline since 2001.[12]

There is intense competition for wireless, with an average of 3–5 providers in virtually every geographic area.[13] An increasing share of wireless subscribers, moreover, are abandoning their wireline phones altogether. As of year-end 2004, approximately 11 million primary wireline access lines were displaced by wireless, and that number is expected to reach about 22 million by the end of 2008.[14] Approximately 3 million wireless subscribers are now giving up their wireline phones each year.[15] At least 14 percent of U.S. consumers now use their wireless phone as their primary phone.[16] Even larger percentages of young consumers—which will make up the next generation of homeowners—are disconnecting their wireline service, which makes it likely that the rate of substitution will increase even further in the future.[17]

Wireless prices have fallen to the point where it is now considerably cheaper for many customers to use their wireless phone. Wireless prices have declined—by as

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[10] *See* J. Halpern, Bernstein Research Call, *U.S. Telecom Update: Revising Earnings Forecasts, Raising AT&T Target Price, Maintaining Ratings* at Exhibit 1 (Dec. 17, 2004).

[11] *See* CTIA, *CTIA's Semi-Annual Wireless Industry Survey,* http://files.ctia.org/pdf/CTIAYearend2004Survey.pdf.

[12] *See* Industry Analysis & Technology Division, Wireline Competition Bureau, FCC, at Table 1 (Dec. 2004).

[13] *See Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993,* Ninth Report ¶9, WT Docket No. 04–111, FCC 04–216 (rel. Sept. 28, 2004) (Ninety-seven percent of the total U.S. population have three or more operators offering mobile telephone service in the counties in which they live. Approximately 87 percent of the population have five or more operators offering mobile telephone service in the counties in which they live.).

[14] B. Bath, Lehman Brothers, *Final UNE-P Rules Positive for RBOCs* at Figure 2 (Dec. 10, 2004).

[15] *See id.* at 4 & Figure 2.

[16] C. Wheelock, In-Stat/MDR, *Cutting the Cord: Consumer Profiles and Carrier Strategies for Wireless Substitution* at 1 (Feb. 2004) ("14.4% of US consumers currently use a wireless phone as their primary phone").

[17] *See, e.g.,* Frank Louthan, Vice President, Equity Research, Raymond James, prepared witness testimony before the Subcommittee on Telecommunications and the Internet of the House Energy and Commerce Committee, Washington, DC (Feb. 4, 2004) ("We believe the roughly 9.6% of the population that are single between the ages of 20 and 34 are the most likely to disconnect their wireline phone for a wireless phone (with a significant proportion of this age group having already done so). As young consumers between 15 and 19 (another 6.6% of the U.S. population) become households, we believe these households could become prime wireless substitution candidates."); A. Quinton, *et al.,* Merrill Lynch, *Telecom Services: Unraveling Revenues* at 5 (Nov. 20, 2003) ("[W]e believe that demographic trends favor wireless. . . . So, as the US population ages, more young people are likely to become wireless subscribers—and either displace the purchase of a wireline service with wireless or cut the cord on an existing line.").

much as 10 to 20 percent a year in recent years.[18] Wireless service packages include unlimited long distance calling, which has contributed to wireline traffic substitution and increasing average minutes of use among wireless carriers. As a *Wall Street Journal* article explained, "[t]hanks to unlimited night and weekend minutes . . . cellphone plans are the method of choice when it comes to long-distance calling from home."[19] The Yankee Group estimates that wireless subscribers make 60 percent of their long-distance calls on their wireless phones.[20]

Wireless service quality has also improved dramatically. Consumers now report high levels of satisfaction with the quality of their wireless service. For example, a GAO survey found that 83 percent of wireless users were satisfied with the call quality of their cell phone, while only 9 percent were dissatisfied.[21] Analysts similarly report that "[c]ultural awareness and acceptance of wireless as an acceptable/preferred communication medium is growing."[22]

The wireless story is one of unqualified success: competition is intense, output is increasing, and prices are falling. That is exactly what we should all want to see. And it has happened—I cannot stress this point enough—because the FCC has stayed out of the way. Wireless is a deregulated industry. Competition is untrammeled. And the results of that competition are plain for all to hear.

Broadband. Broadband, unfortunately, is a more complicated story. Although the 1996 Act promotes deregulation as the approach to spur broadband deployment, the FCC ignored this mandate for many years and imposed unbundling here too. The FCC's broadband unbundling policies created disincentives to investment that slowed the deployment of broadband. These policies were all the more misguided as they were imposed only on local telephone companies, not on cable companies that have been the leaders in broadband deployment from the outset by an almost two-to-one margin. As a result, the U.S. fell behind many of its main competitors (such as South Korea, Japan, Canada, and parts of Europe) in broadband deployment.

Only after the FCC eliminated these policies did broadband competition intensify. And the FCC's current Chairman, Kevin Martin, is strongly committed to a deregulatory broadband market. As a result, prices have dropped significantly and penetration has increased at record rates. But there is still a long way to go, both in rationalizing FCC policies and in preventing outdated state regulations from blocking or delaying new broadband services, such as IP video.

It is worth remembering that there was no broadband at all at the time of the 1996 Act. Today, DSL and cable modem service are available to more than 90 percent of U.S. homes,[23] and more than 25 percent of homes subscribe.[24] At the end of 2004, approximately 47 percent of all residential Internet connections were either provided over cable modem or DSL; analysts expect broadband to surpass dial-up subscribership this year.[25]

Broadband prices have dropped rapidly. Consumers are now able to purchase broadband services bundled with their cable television and/or phone services. As the Congressional Budget Office has observed, "current providers face the prospect of new broadband market entrants and other competitive pressures from converging telecommunications markets."[26] These new broadband market entrants include

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[18] *See, e.g., Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993,* Ninth Report, Appendix A at Table 9, WT Docket No. 04–111, FCC 04–216 (rel. Sept. 28, 2004) (showing average revenue per minute declining every year since 1995 (1998: 21%; 1999: 23%; 2000: 20%; 2001: 30%; 2002: 9%; 2003: 13%)).

[19] W. Mossberg, *The Mossberg Solution: Turning Your Home Phone into a Cellphone—Call-Forwarding Devices Let You Use Cellular Service on a Traditional Phone,* Wall St. J. at D6 (Dec. 3, 2003).

[20] P. Marshall, *et al.,* The Yankee Group, *Divergent Approach to Fixed/Mobile Convergence* at 7 & Exhibit 4 (Nov. 2004).

[21] General Accounting Office, *FCC Should Include Call Quality in Its Annual Report on Competition in Mobile Phone Services* at 27, Report No. GAO–03–501 (Apr. 2003).

[22] S. Ellison, IDC, *U.S. Wireless Displacement of Wireline Access Lines Forecast and Analysis, 2003–2007* at Table 1 (Aug. 2003).

[23] *See, e.g.,* C. Moffett, *et al.,* Bernstein Research, *Broadband Update: Broadband Trends Towards Ubiquity* at 5 (Apr. 1, 2005) (estimating that DSL is available to approximately 79 percent of homes passed, while cable modem is available to approximately 96 percent of all cable subscribers).

[24] *See* C. Moffett, *et al.,* Bernstein Research Call, *Broadband Update: Broadband Trending Towards 100% of Internet Connections* at Exhibits 3 & 13 (Mar. 15, 2005).

[25] *See* C. Moffett, *et al.,* Bernstein Research, *Broadband Update: Broadband Trends Towards Ubiquity* at 2 (Apr. 1, 2005).

[26] Congressional Budget Office, *Does the Residential Broadband Market Need Fixing?* at 30 (Dec. 2003), http://www.cbo.gov/ftpdocs/48xx/doc4868/12–03–Broadband.pdf.

companies providing Wi-Fi, WiMax, satellite technologies, fiber-to-the-home, and broadband over power lines.[27]

The market leader is cable modem service, which accounts for more than 61 percent of residential and small business customers receiving download speeds of 200 kbps or more in at least one direction, and 83 percent of customers that receive more than 200 kbps in both directions.[28] One analyst estimates that at the end of 2004, there were 21 million residential cable modem subscribers, but only 11 million residential DSL subscribers.[29] Simply put, local telephone companies are still secondary players for mass-market customers of broadband Internet access.

But with deregulation, that may change. In order to remain serious competitors in the 21st century, SBC, Verizon, BellSouth and other incumbent telephone companies have embarked on ambitious plans to spend billions of dollars to deploy fiber networks that are capable of providing video as well as a host of other new services. This is an unalloyed boon for consumers and for the U.S. economy generally, which depends so heavily on its critical information infrastructure.

VOIP. In just the last two years, VoIP has gone from barely a blip on the radar screen, to arguably the most significant competitive development in decades. All of the major cable operators have begun offering new voice-over-IP ("VoIP") services over their networks, and by the end of this year will be offering service to more than 40 percent of U.S. households;[30] major cable operators like Time Warner Cable and Cablevision already make service available in all of their markets, while Comcast expects to reach that milestone by the end of next year.

Time Warner Cable is now adding 11,000 VoIP households *per week.*[31] Cablevision has been adding another 1,000 cable VoIP households *per day* in the New York metropolitan area.[32] Comcast expects to achieve 20 percent penetration within five years.[33] In addition, there are literally dozens of independent VoIP providers, such as Vonage, which serves more than 500,000 lines, and has been adding more than 15,000 lines per week.[34] Earlier this month, AOL launched its own VoIP service.[35]

These new VoIP providers have deployed voice services over broadband networks and IP backbones that offer many advanced features and functionalities—such as online call management, personal conferencing, and locate-me services.

All three of these developments—wireless, broadband, and VOIP—are unqualified goods for consumers and the U.S. economy. But they pose more complicated challenges for the incumbent wireline telephone companies. These companies are facing unprecedented competitive pressures. They must rapidly innovate to survive and they must do so at the time when market access to capital is highly constrained.

Technological transformations cannot be sustained and expanded without extraordinary further investments of capital. But the capital markets—burned in the tech boom—are acutely aware of the business risks inherent in traditional telecommunications firms. Constrained access to capital and increasing costs are the results. So, too, is a measure of industry consolidation.

It is important to remember that when wireless first began in the early 1980s, the FCC tried a policy of promoting hundreds of small competitors, and awarded licenses by lottery to companies that had no ability (or even intention) of providing competition. The FCC then put a cap on how much spectrum each carrier could own. More recently, the FCC eliminated the spectrum cap and has permitted industry consolidation, while maintaining deregulatory policies. Wireless competition has thrived as a result.

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[27] *See Availability of Advanced Telecommunications Capability in the United States,* Fourth Report to Congress, 19 FCC Rcd 20540, 20547 (2004).

[28] *See* Industry Analysis & Technology Division, Wireline Competition Bureau, FCC, *High-Speed Services for Internet Access: Status as of June 30, 2004 at Tables 3 & 4 (Dec. 2004).*

[29] *See* C. Moffett, *et al.,* Bernstein Research Call, *Broadband Update: Broadband Trending Towards 100% of Internet Connections* at Exhibit 13 (Mar. 15, 2005).

[30] *See* J. Halpern, *et al.,* Bernstein Research, *Quarterly VoIP Monitor: How High Is Up for Cable VoIP?* at 4 & Exhibit 2 (Apr. 1, 2005).

[31] *See also* P. Grant, *Time Warner's Phone Service Shows Cable's Growing Clout,* Wall St. J. at B1 (Feb. 23, 2005).

[32] *See* R. Black, Blaylock & Partners, *4Q04 Wireline Preview—The Telecom Landscape Is Evolving, Tread Carefully* at 2 (Jan. 20, 2005).

[33] *See* Thomson StreetEvents, *CMCSA—Q4 2004 Comcast Corporation Earnings Conference Call,* Final Transcript at 7 (Feb. 3, 2005) (Comcast COO & President Steve Burke: "[W]hen you look at what Cox, and more recently Cablevision, and others have done in this business, we think the 20 percent penetration is very reasonable within a five-year time period.").

[34] Vonage Press Release, *Vonage Becomes First Broadband Telephony Provider To Activate Over 500,000 Lines* (Mar. 7, 2005).

[35] *See* AOL Press Release, *America Online Introduces AOL(r) Internet Phone Service* (Apr. 7, 2005).

As the experience in wireless and many other non-telecom industries shows, capital intensive industries like telecom, typically are characterized by a handful of major competitors. It is therefore fruitless for regulatory policy to focus on promoting an industry structure with a certain number of like competitors. As the past eight years show, the market is much better than regulators at determining the best industry structure.

The focus should instead be on ensuring that intermodal competitors have opportunities to flourish, as it is these types of competitors that are most likely to provide sustainable competition going forward. This is what happened in transportation, where trucks and planes emerged to compete with railroads.

The 1984 break-up of AT&T created an artificial regulatory divide between local and long distance service. That divide is completely obsolete today, as the wireless experience shows. Consumers buy buckets of minutes that they can use equally to call across the street or access the nation. AT&T and MCI cannot survive as independent companies. The hundreds of CLECs started in the wake of the 1996 Act cannot survive alone either, and they are joining forces and consolidating into much stronger, more vibrant competitors.

These are trends to be embraced, not resisted. Unless we learn from the past, we are doomed to repeat it. The time has come for regulators to get out of the way and let telecom markets once again become the engine of growth in our economy and the United States be the world leader in telecommunications throughout the 21st Century.

Mr. CANNON. Thank you, Mr. Kellogg.

Mr. Verveer?

TESTIMONY OF PHILIP L. VERVEER, PARTNER, WILLKIE FARR & GALLAGHER, LLP

Mr. VERVEER. Good afternoon, Mr. Chairman, and Mr. Conyers, Members of the Committee. I appreciate your invitation to testify today.

The availability of the antitrust laws, and especially the Sherman Act, to protect the competitive process in telecommunications is as important today as it ever has been. Recent judicial decisions have tended to diminish our ability to rely upon the Sherman Act. This is an issue which should be a priority in connection with any legislation or oversight involving the communications industries.

The broad social concern that this hearing raises is whether the current changes, marked by disruptive technology and reflected in convergence and consolidation, will turn out to be positive. While there are reasons for optimism, the reality is we do not, and we cannot, know if the telecommunications sector will retain its progressive quality. And that counsels caution.

Now, in my written statement I've tried to elaborate somewhat on that. I'd like to devote the rest of my oral statement to my concerns in particular about section 2 of the Sherman Act.

The monopolization provision is the economy's ultimate protection from the exercise of market power. It is seldom used successfully; and that is as it should be. But its status as a legal device of last resort should not be compromised.

Given the inherent uncertainties in the telecommunications marketplace, it is particularly important that the residual authority represented by section 2 remain unimpaired. It is unfortunately the case that it has been impaired recently by *Trinko* and other decisions in the *Goldwasser* line of cases. *Trinko* seems to me to have recklessly weakened our ability to rely upon the Sherman Act to correct instances of monopolization as they arise.

This is not accidental. The *Trinko* opinion is remarkably tendentious and unremittingly hostile to the application of the antitrust

laws to regulated industries. There are three features of the opinion that I think are especially troubling.

The first is the extended dicta about the relative capabilities of regulatory agencies and antitrust courts. *Trinko* gets this exactly backward. The decision greatly overvalues the ability of regulatory agencies to adjudicate monopolization claims, and undervalues that of antitrust prosecutors and courts.

Second, and more significant, is the way in which it approaches section 2. Similar to others in the *Goldwasser* line of cases, it invites an examination of component parts, rather than of the whole. This approach looks at a course of conduct one element at a time, and dismisses each as lawful or as individually immunized; and then concludes, based on these intermediate steps, that there is no violation. Prior to *Trinko*, the Supreme Court had found this methodology to be impermissible. The post-*Trinko* segmentation approach severely undermines section 2.

Third, as with other cases in the *Goldwasser* line, *Trinko* tends to conjure idealized or imaginary commercial environments largely free of positive law—or at least, regulatory law—strictures. It seeks to measure a firm's conduct not against the law as it exists, but against some conception of the law as it once was, or should be.

In *Trinko*, this takes the form of disallowing considerations of the alleged device of denying, delaying, and degrading the provision of local loops; because the defendant would not have provided them, but for the statutory obligation to do so.

Section 2 should not be predicated on this type of fictive environment, reduced to a game of counter-factuals. Whether a course of conduct constitutes monopolization, or attempted monopolization, should be determined against the commercial realities as they actually exist.

Those realities are influenced in many ways by statutory law. The proposition that statutory provisions, and the legal obligations they create, should be ignored in determining if monopolization has occurred will deprive our telecommunications industries, and other regulated industries as well, of protection against monopolization. Thank you.

[The prepared statement of Mr. Verveer follows:]

PREPARED STATEMENT OF PHILIP L. VERVEER

Good afternoon, Mr. Chairman and members of the Committee. I am Philip Verveer. I am a partner in Willkie Farr & Gallagher LLP.[1]

I appreciate your invitation to testify on telecommunications industry competition and consolidation. I have spent more than thirty years, almost all of my professional life, considering these matters, as a Justice Department attorney in the AT&T antitrust case, as a bureau chief at the FCC, and as a private attorney.

In the nine years since the passage of the Telecom Act, there has been a telecom boom and bust, significant consolidation among the Baby Bells, disappearance of numerous competitive local exchange carriers and interexchange carriers through liquidation and merger, financial accounting scandals, and now the imminent absorp-

[1] My law firm represents companies and associations directly interested in the development and administration of public policies affecting the communications industry. In particular, I want the Committee to be aware of my representation of Sprint Corporation in connection with its proposed merger with Nextel Communications and of Telmex-related interests in connection with their proposed sale of MCI Corporation shares to Verizon Corporation. However, my appearance today is a result of the invitation of the Committee to express my personal views on the state of competition in the telecommunications business. My testimony is not intended to represent any of my firm's clients and it does not necessarily reflect their views.

tion of AT&T and MCI. And, in the nine years since the passage of the Telecom Act, there has been an enormous expansion of wireless service, even greater expansion of the Internet, great increases in residential and small business broadband service through cable modem and DSL technologies, lower prices for many telecommunications services, and increasing deployment of digital technology.

So recent history is very mixed. Despite appalling losses of employment and investment with all of their attendant dislocations, there is genuine reason to regard the performance of the telecommunications sector as good and equally genuine reason to protect the process that produced the performance. And that will be challenging because the telecom marketplace nine years after the Telecom Act almost certainly is in the early stage of a fundamental transformation.

The last time this happened was two-to-three decades ago, when the preference for competition over regulated monopoly established itself as the prevailing paradigm in both an intellectual and an operational sense. This preference was reflected in the realm of antitrust law in the divestiture of the Bell System. It was reflected in the realm of regulatory law in policies favoring open entry and disfavoring restrictions on output. The result of this paradigm shift was what its proponents had hoped and predicted. We have had decades of remarkable progressiveness in our communications industries. It is observable in the many products that did not exist in 1975 and in the vastly lower prices for products that did exist. This was not, of course, a matter of single causality. More than anything else, it was a function of technological possibilities being deployed quickly and imaginatively under the pressure of growing competition. One legacy, then, is the great improvements in product variety, quality, and price that we enjoy today. The other is, or at least should be, very strong confidence that policies favoring the dynamic aspects of competition are to be preferred.

In sum, the fundamental transformation of three decades ago turned out to be almost entirely positive. The issue raised by this hearing is whether the current changes will be as well.

The telecom marketplace nine years after the Telecom Act, from the perspective of consumers, offers great promise and some risk. Just as three decades ago, the promise is a function of extraordinarily favorable developments in technology combined with competitive imperatives to reduce the developments to practice and bring them to the marketplace quickly. The risk resides in the equally extraordinary institutional upheaval affecting the production of telecommunications services.

My testimony will address the risk side of the equation. It is important, however, not to lose sight of the enormous benefits that have been produced by the telecommunications sector in the era of divestiture and deregulation and of the high probability that innovation will continue, at an accelerating pace, for the foreseeable future. The policy issues that we confront involve protecting the process that has produced these gains and insuring that they are available across all of our society. In that sense, they are good problems to have.

One way—I think the best way—to consider the risks to our telecommunications future is to consider the state of the institutions on which we depend. What has gotten us to the present desirable state is a workably competitive industry operating in a legal framework that takes seriously the threat of undue market power and seeks to prevent its creation or deter its exercise. The institutional arrangements that embody this experience are today under great pressure.

To begin with the business institutions: the most significant aspects of today's telecommunications marketplace are consolidation and convergence. Both mergers and liquidations have reduced the number of businesses operating across many parts of the telecommunications sector. The most obvious examples involve companies that in traditional terms principally offered local exchange or interexchange services. In parts of telecommunications where this has not yet happened as dramatically—equipment manufacturing and distribution most prominently—it will. All else equal, of course, consolidation threatens to undermine the workably competitive environment that has produced the benefits that our society enjoys today. But the phenomenology of convergence of previously distinct modes of communication means that all else is not equal. Convergence has been anticipated for the better part of forty years. It is occurring dramatically in the case of wireless service displacing wireline service and in the case of local exchange telephone companies and cable television companies competing in what had been the other's core business.[2]

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[2] It is instructive that the government's anticipation of this intermodal competition was accompanied by affirmative steps to protect the cable industry and ultimately the public from exercises of market power by the local telephone companies. These affirmative steps took the form of FCC pole attachment regulations and cable-telco crossownership prohibitions that were, in time, incorporated into the Communications Act by Congress. In wireless, they took the form

The broader point for public policy is that convergence makes it difficult to assess the competitive effects of consolidation. Both the definition of product market and the identification of suppliers of the product become a great deal more difficult.

One other factor makes competitive assessment more difficult yet. That factor is disruptive technology. Technology, especially digital technology, is drastically affecting the way in which telecommunications services are produced just as it is enabling the creation of entirely new services. To take the obvious example, at present it appears that broadband-enabled services will be the preferred objects of consumption in our telecom future. From today's perspective, it also appears that for most consumers and small businesses the broadband transmission will be supplied by one of two providers, either the local telephone company or the local cable company. However, there are two other technological possibilities, wireless and broadband over powerline, that could become important in the supply of broadband transmission services to consumers and small businesses. Overall, it is virtually impossible to predict how quickly and how extensively broadband transmission service will spread across our country, how many providers will be available in any given geographic area, and what the comparative qualities of broadband produced with different technologies will be. There are reasons to be optimistic that broadband will be available in a workably competitive environment and there are reasons to be cautious about our legal and regulatory arrangements in the event that it is not.

Changes of this kind have very large consequences for our assessment of whether businesses enjoying high market shares are in fact as entrenched as the shares might make them appear. By way of example, should we consider the local telephone industry's share of narrowband circuits in the face of possible broadband substitution any differently than we should have considered paging companies' shares in the face of cellular substitution or international telex companies' shares in the face of facsimile substitution? I happen to think that we should, but the possibility of widespread substitution obviously influences any estimate of effective market power.

Given where I believe we find ourselves, in the early stages of a fundamental change in telecommunications industry structure brought about by disruptive technology resulting in convergence and consolidation, what should we do? The best answer I can provide is, proceed cautiously.

With respect to our legal and regulatory institutions—the Communications Act and the antitrust laws: the recent tendency on the part of the FCC , the Department of Justice, and the courts is to play down the possibility of socially harmful single firm conduct and to play up the possibility that government constraints on single firm conduct will damage consumers and the broader public interest. In some respects, this merely reflects the present state of an endless and ultimately irresolvable debate that is grounded just as firmly in political philosophy as in economics and empirical evidence.[3] Assuming agreed desiderata, is government intervention in the marketplace likely to make matters better or worse? Is it good policy to risk interfering with productive efficiencies for the sake of enabling or protecting additional producers? Is it good policy to risk interfering with productive efficiencies for the sake of distributional considerations? Is it necessary to secure the desired level of investment in new technology to permit investors to appropriate the full value of their investments, or should some of the surplus be spread to consumers and to others in the productive realm?

When we look at the legal and regulatory institutions affecting telecommunications, my thesis is that the present legal tendency in the present industrial context is dangerous. It is dangerous because the industrial setting is changing fundamentally, but the legal arrangements are not reacting to this development in an appropriate way, that is, with caution.

From the perspective of regulatory law, what has emerged from both FCC and numerous appellate decisions related to the 1996 Telecommunications Act is a policy that strongly favors incentives to invest and equally strongly avoids intrusions into corporate decisions. In a significant sense, the recent Commission and court decisions can be seen as a reaction against the activist interpretations that constituted the initial FCC effort to implement the 1996 amendments shortly after their passage. The controversy surrounding Unbundled Network Elements constitutes a tell-

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of repeated FCC efforts to force wireline interconnection rates to be reciprocal and reasonable. These measures had costs, as all regulations do, and no doubt produced occasional unintended results, but there is little doubt that today we are better off as a society for the existence of the requirements.

[3] Arguments over economic regulation are not over whether there should be regulation, but rather over the type of regulation. The dichotomy is between regulation based upon public utility concepts and regulation based upon the law of property, contract, and tort.

ing example. Simultaneously, there has been an inability thus far to amend adequately a whole series of important traditional arrangements that have come under pressure as a result of changes in the telecommunications business. These include universal service and intercarrier compensation, major matters that have significant distributional implications. While these issues have only an indirect effect on competition, they contribute to instability in a sector already significantly destabilized by disruptive technology.

From the perspective antitrust law, the observable and incipient changes in the telecommunications industry make Section 7 of the Clayton hard to apply and Section 2 of the Sherman Act more important than ever.

As noted, at the local level the relevant product markets are changing and important competitors are attempting to enter. There is a reasonable basis to debate whether incumbent local exchange companies are more entrenched than ever given the failure of many competitive local exchange carriers and the diminished state of UNE competition, or more vulnerable than ever due to substitution of wireless service and of broadband facilities and internet protocol for narrowband facilities and circuit switching. Whether the substitution will occur on a large scale and over what time frame are uncertainties that inevitably affect the predictive judgments required by Section 7 in ILEC transactions. To say it more simply, confident predictions are much more difficult when so many of the salient facts are changing. Given the manner in which the Clayton Act distributes burdens of proof—mergers are permissible unless proven harmful—the uncertainties have the effect of permitting mergers. In these circumstances, most telecom mergers would be cleared even if Justice Department policy makers were not philosophically disposed to avoid government intrusion, which they plainly are.

If the vast changes overtaking the telecommunications industry tend to narrow the scope of Section 7, they make Section 2 more important. The monopolization provision is the economy's ultimate protection from the exercise of market power. It seldom is used successfully, but I have always believed that its existence serves to make firms with strong market positions circumspect in the way they use their economic power. This is especially important in telecommunications, where relatively high market shares are commonly found. Given the inherent uncertainties in the telecommunications marketplace, it is particularly important that the residual authority represented by Section 2 remain unimpaired. It is unfortunately the case that it has been impaired recently by Trinko[4] and other decisions in the Goldwasser line of cases.[5]

Trinko seems to me to have materially weakened our ability to rely upon the Sherman Act to correct instances of monopolization as they arise and thus to have weakened its deterrent effect. This is not accidental. The Trinko opinion is remarkably tendentious and unremittingly hostile to the application of the antitrust laws to regulated industries. Three features of the opinion are especially troubling.

The first is extended dicta about the relative capabilities of regulatory agencies and antitrust courts. Trinko gets this exactly backward. The decision greatly overvalues the ability of regulatory agencies to adjudicate competitive disputes and undervalues that of antitrust prosecutors and courts. It does not denigrate the social value of the FCC and of state public service commissions to note that adjudication of competitive disputes is not what they do best. What they do best reflects the essentially legislative nature of regulatory agencies. They are designed and staffed to formulate and articulate policies that apply prospectively. In the process, Commissioners bring to bear their preconceptions about what is best for society and of necessity often compromise among themselves. These tendencies—to draw upon experience and belief rather than solely on a bounded record and to reach pragmatic compromise—are the opposite of adjudication. Although Trinko loads up the scale with the "sometimes considerable disadvantages of antitrust" and the "cost of false positives," the conclusion that competition in telecommunications in its most fundamental aspects will be protected with diminished possibility of Sherman Act prosecutions seems to me utterly wrong.

It also ignores history. As the Competitive Impact Statement in United States v. Western Electric indicated, regulatory failure was one of the bases for the Justice Department's prosecution that led to the Bell System divestiture.[6] The regulatory failure did not reflect a lack of effort on the FCC's part. The FCC had compiled a remarkable record in opening several telecom markets to competition. It also made significant efforts to stop Bell Company violations of its competition-related orders. History makes it clear that the FCC could not do so quickly enough, nor in a way

[4] Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004).
[5] Goldwasser v. Ameritech Corp., 222 F.3d 390 (7th Cir. 2000).
[6] 47 Fed. Reg. 7170 (Feb. 17, 1982).

that threatened sanctions for future violations that were sufficiently severe to act as a deterrent.

Trinko's objection that telecom-related antitrust prosecutions bring courts into contact with the "highly technical" does not distinguish them from many other controversies that we ask the courts to consider. The availability of primary jurisdiction referrals offers amelioration of this concern. The related objection that telecom-related judicial decrees could prove difficult to administer is correct, but, again, this does not distinguish them. The goal of a workably competitive telecommunications sector is worth the price of imperfect remedies, even recognizing the risk that they could inadvertently deter some socially beneficial conduct.

The second and more significant concern stemming from the Trinko decision is the way in which it approaches Section 2. Similar to others in the Goldwasser line of cases, it invites an examination of component parts rather than of the whole. This approach looks at a course of conduct one element at a time and dismisses each as lawful or as individually immunized and then concludes, based on these intermediate steps, that there is no violation.[7] Prior to Trinko, the Supreme Court had found this methodology to be impermissible.[8] In other words, monopolization is an independent violation of the antitrust laws. A finding of liability does not depend on finding that a component activity in a course of conduct separately and individually violates the antitrust laws. If it is to be effective, Section 2 must require that courts look at the alleged conduct whole. It should not matter if each of the individual components is lawful, benign, or immune when viewed in isolation if the end result, taken as a whole, adds up to an anticompetitive effort to maintain a monopoly.

Looking at a course of conduct one element at a time highlights a third, particularly troubling feature of the Trinko opinion. As with other cases in the Goldwasser line, it tends to conjure idealized or imaginary commercial environments largely free of positive law, or at least regulatory law, strictures. It seeks to measure a firm's conduct not against the law as it exists, but against some conception of the law as it once was or should be. Section 2 should not be predicated on this type of fictive environment, reduced to a game of counterfactuals. It was designed to, and to be effective in protecting competition in telecommunications it must, take the world as it finds it, including the world of positive law-required or -influenced activity. In other words, whether a course of conduct constitutes monopolization or attempted monopolization should be determined against the commercial realities as they actually exist. Those realities are influenced in many ways by positive, statutory law. The proposition that positive law and the legal obligations it creates should be ignored in determining if monopolization has occurred is exceedingly strange, but if and as it is adopted and extended it will deprive our telecommunications industries, and other regulated industries as well, of protection against monopolization.

To conclude, the availability of the antitrust laws, and especially of the Sherman Act, to protect the competitive process in telecommunications is as important today as it ever has been. Recent judicial decisions have tended to diminish our ability to rely upon the Sherman Act. This is an issue that should be a priority in connection with any legislation or oversight involving the communications industries.

Mr. CANNON. Thank you, Mr. Verveer. And may I just lead to the question to you. You were the lead antitrust counsel at the Department of Justice at the time of the original filing for divestiture of "Ma Bell." If the *Goldwasser* and *Trinko* decisions had been in effect as of 1974, is there a significant danger that the Federal courts would not have been able to order the breakup of AT&T, and may in fact have had to grant a motion to dismiss the department's case?

Mr. VERVEER. Yes, sir. I think if *Trinko* had been the controlling law at the time, it is doubtful that the case could have been successfully prosecuted. A large part of that case was predicated on

[7] Covad Communications Co. v. Bell Atlantic Corp., 398 F.3d 666 (D.C. Cir. 2005), decided on the basis of the Trinko precedent, provides an example of the diminution of Section 2 through the device of segmenting an alleged illegal course of conduct.

[8] "Plaintiffs should be given the full benefit of their proof without tightly compartmentalizing the various factual components and wiping the slate clean after scrutiny of each." Continental Ore Co. v. Union Carbide & Carbon Corp., 370 U.S. 690, 699 (1962). This citation often invokes rejoinders that Continental Ore is not authoritative on this point. I note that the Antitrust Division relied upon Continental Ore for precisely this point in its Section 2 prosecution of Microsoft.

the refusal of the Bell companies to interconnect with other carriers and to permit interconnection of terminal equipment. Those obligations were found in the Communications Act, and had been ordered by the FCC to take place; and so, as a result, appear to me to be almost exactly conceptually the kinds of things that *Trinko* has now apparently ruled out of bounds.

Mr. CANNON. Thank you, Mr. Verveer.

Mr. Kellogg, in your testimony, you seemed to agree with Mr. Conyers that the telecommunications industry has radically changed since 1996, for the better. But you seem to think it is, in spite of the act, rather than because of the act—rather than because the act opened up competition.

Mr. KELLOGG. That's not completely correct, Mr. Chairman. In fact, I think the act did two terrific things: which is eliminating local franchises, and opening telecom markets to competition and opening up long-distance markets to competition; and in preempting State attempts to block competition.

What I am mainly concerned with was the FCC's implementation of that act, which turned what was intended to be a temporary crutch for new entrants to allow them access to incumbent networks until they could build out their own facilities—and they took those basic, limited principles established by Congress and turned them into essentially a cradle-to-grave welfare program for new entrants. That encouraged a huge amount of inappropriate entry by CLECs, as Mr. Conyers pointed out. There were 200 CLECs at one point. That was simply not sustainable competition.

Mr. CANNON. Well, did you expect CLECs to create facilities that would have wires all the way to every house?

Mr. KELLOGG. I expected CLECs to do what they have done; which is to build ring networks in major municipalities, where most of the large customers are located, where most of the revenues are to be found; and then to build out from those ring networks to individual customers, which they all advertised that they will do.

Mr. CANNON. But that would have been largely individual business customers; is that correct, in your mind?

Mr. KELLOGG. In terms of the large inner-city networks, that's true. That's large- and medium-sized business customers.

Mr. CANNON. So you expected that the CLECs would never have the opportunity to use the last-mile wire to offer services that the RBOCS had known about, had on the shelves, but refused to offer their customers all that time?

Mr. KELLOGG. No, that's incorrect, Mr. Chairman. Three things: One, cable companies already had a last-mile wire into the house, which they're using for VoIP. Second, wireless, of course, goes directly into the house——

Mr. CANNON. Right, but I think you testified that those things were not really in the mind of people at the time. But DSL was on the shelf of the RBOCs, and hadn't been promoted at all. And CLECs—I don't usually think of the cable companies as CLECs. Those are companies that came in to offer services on a system that had been built in a subsidized environment by a regulated industry.

And so my thought of the 1996 act—it was passed before I got here—but my understanding was that it was to open up those—that investment that society made through these regulated companies, so that we would have more services available.

Mr. KELLOGG. I don't think anyone disputes that the last-mile copper loop has been appropriately opened up by Congress and made available to competitors. It's still available today. What's not available is what's called the "UNI-P," which was a sort of contrivance of the FCC as a substitute for resale at extremely low, subsidized rates.

Mr. CANNON. Let me just ask, if I may, Mr. Kellogg, do you and USTA agree with the Court's reasoning and decisions in *Goldwasser* and *Trinko*?

Mr. KELLOGG. Absolutely, Your Honor——

Mr. CANNON. Thank you——

Mr. KELLOGG. Oh, do you want me to explain, or just to——

Mr. CANNON. No, certainly go ahead.

Mr. KELLOGG. One thing I would point out, it was a unanimous decision. Two, it followed the letter of this Congress' law, in preserving antitrust law and saying that it was not changed by the Telecom Act.

Mr. CANNON. Because my time is up, and I want to be a good example for the rest of the panel, let me just ask one other question.

Mr. KELLOGG. Fine.

Mr. CANNON. Why is Qwest the only RBOC to offer naked DSL in America today?

Mr. KELLOGG. Well, it's actually not true. Verizon has begun to offer naked DSL.

Mr. CANNON. Where?

Mr. KELLOGG. The service was developed as a complement to voice. It's extremely expensive to provide it on its own. Different businesses are going to make different business decisions about whether it makes sense to do that.

Mr. CANNON. Thank you. My time has expired. Mr. Conyers?

Mr. CONYERS. Thank you, Mr. Chairman.

Gentlemen, a couple of things need to be on the record. Are most of you in agreement with the notion that inevitably there will probably only be two, maybe three, telecoms that can serve global customers; and that might be used as an argument for—that one of these global operations may be United States based?

And the other consideration that I have is, how can we assure, in today's fast-changing marketplace, that innovation and price reduction are not driven out of the marketplace when we go into these mergers? Can they provide more competition, and we do have these goals happen as a result; or are the antithetical? Let's quickly chime in, before my 5 minutes run out.

Mr. GRIVNER. Okay. Let me start, then. First of all, do I think there can be more than two or three global telecommunication companies?

Mr. CONYERS. Yes.

Mr. GRIVNER. I do. Because I think telecommunications, as we know it today, is certainly changing. And I think if we fixate ourselves just on the wire-based business, that's the wrong fixation.

Because I do think broadband wireless will be something that will happen, probably in three to 5 years.

I also think large companies, very large companies, can be their own telecommunication company, because VoIP and technologies like VoIP really unmask a lot of the capabilities for large companies to be their own telecommunication providers.

Mr. CONYERS. Mr. Moir?

Mr. MOIR. On the global front, no, I think we'll have more than that. At first, I thought your question was whether we'd have two global providers, U.S.-based.

Mr. CONYERS. No.

Mr. MOIR. I think that's a given, and I think we'll clearly have more, if you look at the number of global providers; although I think a low single-digit still.

I think the problem that we're having is not in the pricing area; isn't so much driven by the mergers, but driven by the failure of the FCC to provide the safeguards that we thought they were going to provide after the '96 act. So the abuses are already occurring; which is negatively impacting customers, competitive suppliers, and even the wireless industry.

Mr. CONYERS. And some of these decisions aren't helping anything, either; are they?

Mr. MOIR. Absolutely not.

Mr. CONYERS. Mr. Kellogg?

Mr. KELLOGG. I'd like to direct to the second question about post-merger competition. Mr. Grivner cited two examples, Cleveland and Milwaukee. I would like to point out to the Members that in Cleveland there are today 11 operational CLEC networks. Eleven. There'll be one eliminated after the mergers, because SBC will combine with AT&T. There'll still be ten. They'll be strong competitors.

In Milwaukee, there are six operation networks. There will be five after the merger. Today, there are three to five wireless providers, and that is considered a paradigm of competition.

Mr. CONYERS. Uh-huh.

Mr. VERVEER. Well, Mr. Conyers, the only way we're going to continue to get good performance out of our industries is if we maintain a competitive environment. That seems to me to be the critical point.

As to the number of firms that may be available to serve the so-called enterprise market, or the big business market, I guess I'm hopeful that we will have certainly at least three, and probably a good many more; and particularly if one looks at it on a worldwide basis. Thank you.

Mr. CONYERS. Uh-huh. Mr. Moir?

Mr. MOIR. One add-on——

Mr. CONYERS. And then Mr. Grivner.

Mr. MOIR. —vis-à-vis what troubles me is the discussion of the number of suppliers in a market.

Mr. CONYERS. Right.

Mr. MOIR. The only thing I care about as a user: How many people can supply my points of presence? So even though there may be 11, I don't care if there are a hundred carriers in the market. If for 95 percent of my points of presence from my high-capacity

pipes I only have one company to choose, Mr. Kellogg's numbers are totally irrelevant.

Mr. CONYERS. Okay. Last comment.

Mr. GRIVNER. I just want to add that Mr. Kellogg's remark is relatively meaningless. It's silly, in the sense of it doesn't have ubiquity that, certainly, an SBC and AT&T have.

Mr. CONYERS. Poor Mr. Kellogg.

[Laughter.]

Mr. CONYERS. No commentary. I'm out of time. But I thank you all for your discussion.

Mr. CANNON. Thank you, Mr. Conyers.

Mr. Smith?

Mr. SMITH OF TEXAS. Thank you, Mr. Chairman.

Mr. CANNON. The gentleman is recognized for 5 minutes.

Mr. SMITH OF TEXAS. I'm going to give Mr. Kellogg a chance to follow up on that. First of all, Mr. Kellogg, I want to read from the end of your prepared written testimony. You say, "AT&T and MCI cannot survive as independent companies. The hundreds of CLECs started in the wake of the 1996 act cannot survive alone, either; and they are joining forces and consolidating into much stronger, more vibrant competitors. These are trends to be embraced, not resisted."

And this is to follow up on a couple of the earlier questions you got regarding consolidation. but we've talked about numbers, we've talked about competition. We haven't talked about whether or not the consolidation actually helps the industry. We haven't talked about whether the consolidation will help America's competitiveness or not. Do you have answers to those questions?

Mr. KELLOGG. I hope so. On the issue of helping competition, I would point out that XO, for example, is an amalgam of CLECs. It has taken over a number of failing CLECs; taken over their networks, refurbished them; and turned itself into an incredibly vibrant provider of business services to large customers in over 70 markets around the country.

These companies focus on the large cities, because that is where the major customers are. They build fiber rings. They can afford to build out from those rings to the individual large customers.

And there is no question in my mind that the reduction in number of CLECs is leading to a stronger marketplace. There's also no question in my mind that a combination such as that between SBC and AT&T, or Verizon and MCI, because their networks and their services currently complement one another, will make them much stronger, better competitors in an increasingly competitive global marketplace.

Mr. SMITH OF TEXAS. Okay. What about the impact of consolidation on consumers? Is it going to raise prices? Is it going to reduce the number of options that consumers have?

Mr. KELLOGG. I think it will actually increase the options for consumers, in terms of having viable players who are capable of building out across the country and competing in all the markets. You only need three to five to really jumpstart and promote competition, and I think there's no question we're going to have that sort of competition.

Mr. SMITH OF TEXAS. Okay. Lastly, maybe this is to follow up or give you a chance to expand an earlier answer. Why is USTA so supportive of the *Trinko* decision?

Mr. KELLOGG. Well, the *Trinko* decision really follows in the line of standard antitrust analysis. That's why it was a unanimous decision written by—you know, joined by all sides of that court; because they recognized that the "essential facilities" and "refusal to deal" doctrines have only a very limited role to play in antitrust.

Ordinarily, no one has an obligation to assist their competitors. You don't want them assisting; you want them to be competing with one another. Congress imposed certain obligations on the ILECs, to share their networks with them. But those are regulatory obligations; those are not a transformation, a fundamental transformation of the antitrust laws of the sort that the plaintiffs were attempting to obtain.

Mr. SMITH OF TEXAS. Yes. Okay. Thank you, Mr. Kellogg. Thank you, Mr. Chairman.

Mr. CANNON. Thank you, Mr. Smith.

Mr. Delahunt, you're next if you have some questions. You're recognized for 5 minutes.

Mr. DELAHUNT. I noticed Mr. Grivner wishing to respond to, I think, a comment by Mr. Kellogg. So let me give you the chance.

Mr. GRIVNER. Thank you very much. First of all, based on Mr. Kellogg's kind remarks, I'd like to retract the "silly" comment—just kidding.

I want to clarify something, Congressman Smith. We're not opposed to—I'm not opposed to consolidation. I'm opposed to concentration in markets. And there's a big difference. For example, the proposed mergers, SBC and Verizon, will concentrate 80 percent of the business lines with those two entities. That's a fairly difficult task to overcome. That's concentration. That is not going to be good for business customers in the long term. There's a second point that I want to clarify——

Mr. DELAHUNT. But let me interrupt——

Mr. GRIVNER. Sure.

Mr. DELAHUNT. —and go to Mr. Kellogg. Respond to Mr. Grivner's observation about 80 percent and concentration.

Mr. KELLOGG. Well, Your Honor, there's no question that the geographic scope of these companies is going to be larger; and therefore, they're going to have——

Mr. DELAHUNT. Eighty percent.

Mr. KELLOGG. They're going to—I do not believe that that's an accurate number but——

Mr. DELAHUNT. Well, what's your number?

Mr. KELLOGG. I don't have a number.

Mr. DELAHUNT. Well, let's accept his number, then.

Mr. KELLOGG. But certainly, for the large business customers——

Mr. DELAHUNT. Let's accept his number, and please respond to my question.

Mr. KELLOGG. For the large business customers, the ILECs are actually bit players in that market today. They do compete within their own regions, but they have had a great deal of trouble attracting large business clients across the course of the country. And the merger is going to allow them to do that.

Mr. DELAHUNT. Mr. Moir?

Mr. MOIR. Right. Having spent many decades representing the very community Mr. Kellogg just referred to, let me make a couple of points. First of all, be careful about the terms being used. "Large market:" The market he is describing is large business customers that have what I call a true multi-State—like a multinational company. They're in every State in the country; they're in 200, 300 locations around the United States.

The reason is, if they were to compete for those markets when we put out an RFP—because we do all that by contract—outside their region they'd be nothing more than a reseller. They haven't chosen to build long-haul facilities outside of regions that are meaningful. They haven't chose to compete in the local exchange, like AT&T and MCI and the other facility-based CLECs. And as a consequence, they've made a strategic decision to compete within their own region.

For the large customers that are within—or predominantly within—their marketplace, they are vigorously competing for those, and doing a very, very good job of sustaining them as customers. So you have to be careful which type of large customer he's talking about.

Mr. DELAHUNT. Anyone else want to add anything to this conversation? Let's give you a shot, Mr. Kellogg.

Mr. KELLOGG. I could point out in response to his point that AT&T and MCI are vigorous participants in the residential market. They'd both withdrawn from the residential market because the business model that they had, which was a purely resale model, was not working, was not viable over the long haul.

The provision of their backbone networks and the combination with the regional facilities of the Bell companies will actually allow for much more vigorous out-of-region competition.

Mr. DELAHUNT. Mr. Grivner?

Mr. GRIVNER. Yes, I think an earlier comment that Mr. Kellogg made that I think needs clarification, he said that voice is declining. And I think, a couple of points there. One, it's declining because they're moving to wireless. And they are moving to companies that control 60 percent of the market, something you should also be concerned about. That would be Verizon and Cingular, part of SBC.

And secondly, the conversion to data. Well, Voice over IP integrated access devices, those are classified as data. Voice is still being carried over those circuits.

Mr. DELAHUNT. Mr. Moir?

Mr. MOIR. One thing, and it's troubling. It came up earlier in the dialogue between Congressman Smith and Mr. Kellogg. The statement, the paragraph that was read out of page 13 of the prepared statement, is factually incorrect. It references that the reason AT&T and MCI have been exiting the residential retail market—not the market that I'm responsible for, or that we're customers of at home—was, you know, because of wireless, buckets of minutes. And then the add-on description just made was because the UNE decision, their pricing plan was overturned by the courts and the FCC.

And then, he makes the statement that AT&T and MCI could not survive as independent companies. I don't know any analyst that

agrees with that statement. I don't know any of the management at either of the companies that are going to be acquired that agrees with that.

What happens is they made a strategic decision because of failed regulatory decisions that would provide safeguarded access at reasonable prices to the bottleneck facilities. When the regulators failed to do their job and those with jurisdiction over them didn't force their hand, AT&T and MCI, as they just mentioned, had to leave the market.

But it wasn't that they weren't going to continue as independent customers—companies—because they would continue to market to the type of large users which the RBOCs have decided not to go after and spend the money on. They decided it was cheaper to just buy companies that already did that. They were going to continue. They've decided to merge and seek mergers because they wanted to protect shareholder value before they totally exited the businesses that they were losing to the RBOCs.

Mr. DELAHUNT. Thank you. The gentleman yields back.

Mr. CONYERS. Mr. Chairman, could I ask, before Mr. Flake begins, for 1 minute?

Mr. CANNON. The gentleman asks 1 minute. Unanimous consent to take 1 minute out of order.

Mr. CONYERS. Because I——

Mr. CANNON. Without objection, so ordered.

Mr. CONYERS. Thank you. I just wanted to examine AT&T—the assertion that AT&T is not facing some kind of challenge at the local level. From what my staff tells me, there are some problems ahead there. Amazing, since they've been around so long. But I thought that there was some problem. Let me ask Kellogg first, and then Moir.

Mr. KELLOGG. Yes, Your Honor. The long-distance industry is declining rapidly. More and more minutes are shifting to wireless. It's simply not a profitable business; and yet it was the backbone of both AT&T and MCI. They've got great relations with large business customers, but they don't have a viable stand-alone business.

Mr. CONYERS. Mr. Moir?

Mr. MOIR. Again, mix and match of what I call retail customer market and large multi-State. They're clearly exiting the retail residential small-, medium-sized business market, primarily, as any of them will tell you—and they've said repeatedly in forums all over this country—because of failed abilities of the regulators—the FCC—to manage the access that we have to have to every ILEC in this country.

Those are the same concerns I talked about in my written and in my oral. For large customers, we're being gouged with these special access tariffs; again, because we have no choice but to use them. And as long as the Bells have refused to build long-haul fiber all over the country to duplicate the many long-haul carriers that are out there and outside a region, they're going to have to pay these same egregious charges. Verizon's going to have to pay, you know, the 80-percent rates of return charges that SBC's charging. SBC's going to have to pay when Verizon——

Mr. CONYERS. Well, they're going down. The point is—and I agree——

Mr. MOIR. Well, they're going down but it's——

Mr. CONYERS. I agree with you that there are multiple reasons. But the fact is that things ain't what they used to be.

Mr. MOIR. Absolutely not.

Mr. CONYERS. All right.

Mr. MOIR. And the FCC is the major problem.

Mr. CANNON. Thank you. The gentleman yields back.

Mr. Flake, I think you're next in line. The gentleman is recognized for 5 minutes.

Mr. FLAKE. I thank the Chairman and the witnesses. Mr. Grivner, if you were over at the FCC, if you were in that position——

Mr. GRIVNER. Uh-huh.

Mr. FLAKE. —what concerns you more? Verizon-MCI merger, or the SBC-AT&T?

Mr. GRIVNER. Both mergers would concern me because of the concentration, in the business market specifically, at 80 percent. Both mergers are of a concern. Again, I want to go back to Congressman Smith's point earlier. It's not consolidation that's the issue; it's the concentration and the customer base. Both mergers have a concern for customers as well as the competitive industry.

Mr. FLAKE. Mr. Kellogg, you're not troubled by those mergers, either one? If those were to merge, and then merge again, would you be concerned?

Mr. KELLOGG. It would depend upon the market circumstances at that time. Currently, I think the two mergers as proposed will actually lead to stronger competitors and more competition at all levels. How the market's going to transform itself over the course of the next 5 years is really impossible to say.

Mr. FLAKE. As long as we have an American League and a National League kind of thing, it's all right then? Just the two? A third league?

Mr. Moir, do you want to comment on that?

Mr. MOIR. Actually, the American League—the two-league proposal is appropriate because typically—and even Baltimore would speak up on this—you know, they don't compete in each other's markets. That's much the case with the Bells, also. They don't compete in each other's markets. And for those who are dependent upon accessing those markets, you either pay the freight, or you're not in business.

Mr. FLAKE. There is something called "Inter-League Play" now—limited though it may be.

Just getting kind of back to that, at what point is it your contention, Mr. Kellogg, that because of the huge shift to Voice over Internet and wireless that we simply do not need to be concerned with the land line consolidation?

Mr. KELLOGG. I do think that's correct. And I would point out that the Bell companies are competing vigorously with one another today through their wireless infrastructures. They're spending billions to build out these wireless infrastructures throughout the country. They're taking away lines every day from one another, through that means.

Mr. FLAKE. And Mr. Grivner, is there a point at which Mr. Kellogg becomes correct, and that, you know, the wireline position or

controversy is moot, because of this shift to wireless and Voice over Internet?

Mr. GRIVNER. Well, I guess, a couple of points. First of all, that would be contradictory to what he said earlier, in terms about the investment in fiber to the home and to the business. Why would you do that, if you think it's going to become moot at some point in time?

I think secondly, from a shareholder perspective, you would have to question why they're spending billions of dollars to buy "failing businesses." That probably doesn't make a lot of sense.

And third, wireless and broadband, and VoIP, are different things. It's like saying Microsoft Windows, and the PC. Without the two together, they don't make any sense. VoIP is primarily software. Wireless and broadband, wireless broadband, are delivery mechanisms. They're transport. They're hard—hard assets, if you would. The two need to be combined together. If you look at Vonage, 650,000 subscribers: Very innovative, but they still rely on that underlying infrastructure to deliver service to customers.

Mr. FLAKE. Yes, Mr. Moir?

Mr. MOIR. The wireless example, again, as I—we keep hearing the example go back and forth. On the retail market, these are relevant, for a percentage of the customers out there. But for the major business industries in this country, this is totally irrelevant. And Mr. Kellogg and this industry's well aware of the absurdity that anybody that's going to run major data networks in this country with any type of wireless facility. It's just not going to happen.

Just as the cable industry doesn't, you know. They—for security reasons, through-put rates, it's wireline, period. Hopefully, fiber; as opposed to copper. But that's what you're stuck with. And for 95 percent of the points of presence in this country, there's only one person supplying those building blocks. And it's your local ILEC, and that's a fact.

Mr. FLAKE. Thank the Chairman.

Mr. CANNON. The gentleman yields back. Is Mr. Gallegly nearby?

[No response.]

Mr. CANNON. Mr. King. The gentleman is recognized for 5 minutes.

Mr. KING. Thank you, Mr. Chairman. I appreciate the testimony on behalf of all the witnesses here, and the introspective questions that have been asked by the other Members of this panel.

I would maybe bore into this maybe a little bit in some more detail. With regard to the questions asked by Mr. Flake, I thought that the question of what's the next stage if both of these major mergers do go through—and I recognize your answer, Mr. Kellogg, with regard to that.

I'm curious as to what your viewpoint was on the breakup of the "Baby Bells." How did you view that?

Mr. KELLOGG. Back in 1984, I thought actually it was a very procompetitive thing that happened of splitting up the AT&T into geographic regions. I think a serious mistake was made by the Department of Justice then at that point—limit the lines of business that the broken-off companies could go into, because that created an artificial, separate long-distance industry, which AT&T and MCI and Sprint dominated for a long time; instead of, you know, breaking

them up and then letting them go at one another across all lines of business.

Mr. KING. And these, both of these proposed large mergers that we have in front of us, does that simplify or complicate the approaching obligation that we'll have to find a way for Voice over IP to be properly paid for by the customers?

Mr. KELLOGG. Well, I think it will actually promote Voice over IP, because it will allow for more investment to the network and the speeding of broadband. And once broadband's there, as somebody pointed out, Voice over IP is just software that you add on to your computer. And there's no gateway function that they're going to be able to prevent that. That's here; it's going to be the future.

Mr. KING. And what will that do to the ILECs, then?

Mr. KELLOGG. Well, it's going to mean that they have to be very nimble; that they're going to have to focus on broadband, on wireless, because those are really the futures. And voice, which used to be the whole market, is going to be, you know, an application over wireless and over broadband.

Mr. KING. Thank you. And I'd direct the same questions to Mr. Grivner.

Mr. GRIVNER. I think what we need to be concerned about is the level of innovation, especially on things like Voice over IP. The example of DSL that we've talked about, I worked at Ameritech in the '80's and the '90's, and it was available in the late 1980's. Not deployed, because we didn't want to cannibalize our second lines. It was a revenue decision: "Let's not deploy that technology, because it'll eat into future revenues and future profits." Wasn't deployed by the RBOCs until the mid-1990's—post Covad, post Rhythms, post Northpoint—deploying that technology.

Voice over IP, having worked at a technology company in the mid-1990's, was available. The technology was being developed at that time, and could have been more rapidly deployed with higher investment.

So I think the concern has to be relative to the speed of innovation you're going to see when you see the concentration of these mergers, what it's going to mean to the existing revenue streams, and why people would be willing to cannibalize those streams early for the customer benefit or for business benefit.

Mr. KING. And would you speculate as to whether new technology will be deployed more quickly or more slowly if both mergers take place?

Mr. GRIVNER. More slowly.

Mr. KING. Because of less competition?

Mr. GRIVNER. Less competition. Why do it? Again, history would prove that that's not going to happen.

Mr. KING. Thank you. Mr. Moir?

Mr. MOIR. One thing that underpins the VoIP aspect to your question, in order to have VoIP, you first have to have a non-narrow-band pipe. I can go, do Internet access with a dial-up telephone line just fine, unless, you know, there are kids in the house that want to move legal video files back and forth, and all of the things they do. But for, you know, typical Internet access, sending e-mails, I can use a regular narrow-band voice line. So you could have a first and second line in the house, and you're fine.

To do VoIP, I have to have a line that's—what?—two and a half times as expensive as the voice grade, or twice the expense, either from the cable company, or the phone company. So if you just look at the VoIP side and not at the additional revenues that flow from the underlying pipe, you miss the total dollar-and-cents picture.

Mr. KING. Mr. Moir, though, I want to go to streamed, full-speed, interactive video some day. What's best going to facilitate that?

Mr. MOIR. The fattest pipes you can get ahold of. And right now——

Mr. KING. What mergers will best facilitate that?

Mr. MOIR. Well, actually, the people that have 95 percent of those are the very companies that are called "ILECs," local phone companies. They have the biggest ones.

Mr. KING. I'm out of time. Thank you, Mr. Chairman.

Mr. CANNON. Thank you. The gentleman yields back. And I think the next person to arrive here is probably Mr. Coble. Mr. Coble?

Mr. COBLE. Thank you, Mr. Chairman.

Mr. CANNON. The gentleman is recognized for 5 minutes.

Mr. COBLE. Mr. Verveer, for the past few moments, you've maintained a vow of silence, so I'm going to let you start off, if I may. And the rest of you may join in. As you all know, section 271 long-distance approval has been granted to the Bells in all States.

If you will, Mr. Verveer, start us off by discussing the importance of section 271 in creating effective telecom competition. And explain, if you will, why the Justice Department should have a continuing active role in monitoring section 271 compliance.

Mr. VERVEER. Well, Mr. Coble, as Mr. Cannon said, section 271 is a situation where the carrot has been eaten, at this point. And while there is an opportunity, in theoretical terms, to go back, try to propose sanctions, or even withdraw the authority to offer long-distance service, these are the kinds of sanctions that in reality will never be applied.

So we have—from the standpoint of the entry into long distance, we have something that's been accomplished. It's not really going to be undone. The reason to want to keep the Justice Department, and the antitrust laws generally, engaged is, in fact, despite all of the discussion about the future, we really do not know how in the present environment—how things are going to evolve.

And the reason we don't know is because we are in the midst of a fundamental change; in the midst of a fundamental change because technology has enabled that, and competition, at least to this point, is demanding that the technology be deployed quickly for the benefit of customers.

Now, if we had a clearer picture of how the world was going to evolve, and if we thought it was going to be a very stable environment over several decades, one might be able to configure an arrangement that could be handled by conventional regulation. But I think, in the face of these uncertainties, we need something in the way of a backstop, if you will. We need something to protect the competitiveness, the dynamism, of the industry, in the event that the more optimistic perspectives—some of which you've just heard—turn out not to be realized.

Mr. COBLE. Thank you, sir. Anybody else want to weigh in on that? Mr. Moir?

Mr. MOIR. Just briefly. I think, hopefully, the most critical safeguard that would accomplish what Mr. Verveer was referring to is, at some point, these carriers, no matter how big or small they are, have to talk to each other. They have to exchange traffic. Whether it's high-speed, you know, wide-open, bits and bytes flowing back and forth, or whether it's narrow-band, voice conversation. And the FCC has totally failed in managing that process. And as the market becomes more consolidated, those issues are going to be even more critical.

Mr. COBLE. Let me have another question, maybe for Mr. Grivner and Mr. Kellogg. Rural carriers tend not to be companies usually that attract a lot of venture capital, or have the structure to support extensive R&D. But many of them, however, have deployed advanced technologies, once they're available. So they do have an interest in innovation. What does the—what do you, Mr. Grivner and Mr. Kellogg, think will be the impact of these proposed mergers on innovation, if approved?

Mr. GRIVNER. Well, as I said earlier, I think that you should be concerned about innovation, based on past history; DSL being a great example. I also think, back to your earlier question on 271, 271 was granted based on local competition. And the basis for that local competition in many cases was AT&T and MCI. That's now gone. So I think—back to answering your first question, I think 271 needs to be reexamined by the Department of Justice as a result of that, because that basis is no longer there.

But I think you should be concerned about innovation, if these mergers do go through. And I also think that we should reexamine the overall use of the universal service fund, so that it applies on a broader base of communication companies, as well.

Mr. COBLE. Thank you. Mr. Kellogg, you haven't been heard yet.

Mr. KELLOGG. Yes, thank you. If I may make a brief caveat, I've been talking a lot about the mergers. I should note that I don't believe USTA has taken an official position on the mergers. So I am speaking more in my own capacity on these issues.

But I do think that they will lead to tremendous innovation, which will redound to the benefit of rural carriers. AT&T's Bell Labs, one of the great innovating arms in the United States over the past century—taking the benefit of those technologies; deploying them with the resources that the Bell companies have, down to consumers; giving IP video to everybody, in competition with cable.

It's going to have huge consumer benefits, and cost reductions, because even though that pipe may be expensive, you're going to get your cable TV over it. You're going to get your long-distance service over it. You're going to get your local service over it. And everybody's going to benefit, and the economy is going to benefit, as well.

Mr. COBLE. Mr. Moir?

Mr. MOIR. Just one—an aspect of your question, I believe, was the impact on the 1,100 or so rural phone companies out there. I mean, one of the advantages, as we've learned over the years, of not being the first one to deploy a new technology is if you—they don't always work; they're not always the most cost-effective. And some of the best-built systems out there are in rural America, be-

cause they took a more prudent approach to deploying tested technologies, as opposed to being on the absolute cutting edge.

Mr. COBLE. Yes. Thank you, gentlemen, for being with us.

Mr. Chairman, I'll yield back my time.

Mr. CANNON. Thank you. The gentleman yields back.

Ms. Lofgren?

Ms. LOFGREN. Thank you, Mr. Chairman.

Mr. CANNON. The gentlelady is recognized for 5 minutes.

Ms. LOFGREN. I won't take the whole 5 minutes. First, let me apologize for my tardiness in appearing. I had my Cyber Security Bill finally up for markup, and it passed. But I had to be there.

I have, however, read the testimony. I'm very interested in this. And I will just say, I don't have a question to ask, but I am concerned about the mergers. And I know that there's value in some respects—and everyone has to love the Bell Labs. But the history is, when you have competition, you have innovation. And I think the consolidation should give us pause and concern, in terms of innovation for the future. And you know, I just do have some concerns.

And we saw, really, a flowering of technology innovation for a while, and I am concerned that that may diminish as time goes on, as a result of the lack of competition. So I'll just state that. I mean, if someone wants to counter that statement, you'd be welcome to do so.

Mr. GRIVNER. I don't want to counter it. I just want to make one comment; that the Bell Labs innovation, a lot of that was spun off when they created Lucent Technologies.

Ms. LOFGREN. That's right. That's right.

Mr. GRIVNER. And I don't think that—as my best guess, that's still not part of AT&T today.

Ms. LOFGREN. No. But I mean, if you take a look at, really, the explosion of innovation——

Mr. GRIVNER. Right. Right. Right. I agree with that.

Ms. LOFGREN. —it was a result of the competition.

Mr. GRIVNER. Right.

Ms. LOFGREN. And that's always the case.

Mr. GRIVNER. I agree.

Ms. LOFGREN. So, unless there's further comment from one of the witnesses, I'll yield back, Mr. Chairman.

Mr. CANNON. The gentlelady yields back. And let me associate myself with her comments. Competition has resulted in remarkable things, and that's a matter of deep concern.

Mr. Franks, the gentleman from Arizona, is recognized for 5 minutes.

Mr. FRANKS. Well, thank you, Mr. Chairman. And Mr. Grivner, I have to say that most of the questions that I had in mind to ask have been asked one way or another already. And so perhaps I can just rephrase some of them, and give me what you can.

Mr. GRIVNER. Okay.

Mr. FRANKS. When I was in the legislature about 20 years ago—I was only a kid then, of course—we voted to break up the Bell system, the "Ma Bell" system.

Mr. GRIVNER. Uh-huh.

Mr. FRANKS. And of course, the end goal there was to do everything that we could to foster competition and to create innovation and create new entrants into the market; and also, to get away from the Government subsidy that was such a part of that system.

And I think, in a sense, you know, I look at my cell phone today, and I can pull up my web site, and I can talk to Australia for ten cents a minute. I find the whole explosion of technology to be a fascinating and magnificent thing.

Having said that, I know that perhaps the biggest challenge on the table here are these mergers. I mean, that's kind of the pink elephant in the room that everybody is talking about. And without, again, repeating some of the previous questions, do you believe, given some of the statements made, that—if the mergers do occur, that the business wireline would be concentrated, at least in the majority sense—do you believe that that will have a negative or positive effect on new entrants in the market, new innovation, and competition in general?

Mr. GRIVNER. The answer is, I absolutely do believe that. And as I said earlier—I'm not sure you were here at the time—that these two mergers will concentrate 80 percent of the wireline business inside these two mergers. That cannot be good from a competitive perspective. It can't be good for customers.

And I think, you know, these mergers are so massive that a branding suggestion might be to call them "AT&T East" and "AT&T West." Because that's really what we're doing, is we're back to that time frame again of putting AT&T back together again.

Mr. FRANKS. You said AT&T East and West.

Mr. GRIVNER. East and West, right.

Mr. FRANKS. But do you sense any distinction between the two mergers that is of consequence?

Mr. GRIVNER. Not between these two particular mergers. And again, to clarify a point, I am not opposed to consolidation. I'm not opposed to the mergers. These two do concentrate a great deal of business line access lines in two entities.

Mr. FRANKS. If the mergers should go ahead and be effected, do you think—and I understand that, you know, again, you know, there's a lot of people up here that are certainly not experts in telecommunications. But I understand a lot of times that the business services essentially end up carrying the residential services, to a large extent; at least, that's been our experience so far. Is that correct?

Mr. GRIVNER. When I was at Ameritech—but that was a while ago—yes, that was true. But I believe it's still true today. I'm not a hundred-percent sure of that.

Mr. FRANKS. Well, predicated on the notion that it might still be, if the mergers are effected, do you—what other entities are out there, what other companies are out there, that might provide some competition for the two companies that would be essentially a result of the mergers?

Mr. GRIVNER. I think that's a—in terms of size, you'd probably have to look outside the telecommunications industry for companies that could combat the cash flow of, for example, an SBC, in terms of what it brings in in terms of capital and what it could reinvest back in its network.

When you look at SBC and Verizon, and then you look at the next players, there's a substantial drop. You'd have to look at a merger of different companies in different industries, really, to combat something of that magnitude.

Mr. FRANKS. Well, Mr. Moir, I might ask you a question. You know, everyone seemingly on both sides of the aisle today understand the tremendous benefit of competition and innovation. And I'm certainly glad to hear that. I hope we can hear that in the future, you know.

But often times, Government doesn't just try to create competition. It tries to create a framework—or it should—a framework of trust, to where companies that are placing capital at risk and investment can say, "Well, we're in an environment where business at least will be done decently and in order, and where financial statements will mean what they say." And you know, the big challenge for Government, in my mind, is to create an environment where competition can take place and where we're essentially just the umpire, the referees; and that we don't favor one or the other.

Given that sense, what do you think would be the position that, if you were emperor of the world here and representative of Government—what kind of environment would you try to create here, given the dynamic of these potential mergers, and to the end that competition and the people are best served?

Mr. MOIR. Thank you. I think the answer is the greater a level of choice that exists in markets, the less need there is for Government policymakers to get in the way. Maybe it's at the high guideline, but it's a sliding scale. The less choice that exists, then the Government involvement in making sure everybody deals with each other fairly has to be less benign and more active.

And the types of customers I represent—not you and I at home, but the very large customers that spend, you know, tens to hundreds of millions of dollars a year on telecommunications—when 95 percent of their fundamental building blocks can only be purchased from the local phone company, then I'd say the scale needs to slide far more than the FCC has been sliding it recently. And deregulating those type of prices doesn't pass any business test I'm aware of.

And as a consequence, we have an ironic situation. Mr. Conyers mentioned earlier in the afternoon global issues. One point I haven't made is that we have a situation now where—which is absolutely unheard of at divestiture ten and 20 years ago—that I can now sit down with large users and, when we're putting together a global network, get these building block pieces in the U.K. cheaper than I can get them here in the United States.

So if I'm putting together a multinational network—which large multinationals have—and I'm putting multiple, you know, nodes around the globe—typically, data, for instance—I may choose to put a redundant facility—because you always have to deal with time zones and when there are problems—I may put a redundant facility in the U.K.; not just because, you know, I need a redundant facility, but also because it's cheaper. Whereas, 5 years ago, I would have put that redundant facility in the U.S.

That's what's happened when we have regulators making bad decisions, you know. That's the extreme I can take for choice. If I'm

here in the United States, I'm stuck for 95 percent of my choices. There aren't any.

Mr. FRANKS. Well, Mr. Chairman, last question, then.

Mr. CANNON. The gentleman's time has expired.

Mr. FRANKS. Yes, thank you.

Mr. CANNON. I think we're going to do another round. But given the fact that we have several people waiting, let me recognize—Mr. Issa is out, right? So, Mr. Pence, did you have some questions? The gentleman is recognized for 5 minutes.

Mr. PENCE. I do, Chairman. And I'd be pleased to yield 2 minutes of my time to Mr. Franks.

Mr. FRANKS. I'm fine. Thank you, sir.

Mr. PENCE. Okay. Thanks for holding this hearing, Mr. Chairman, and I thank the panel. I've been coming and going, like a lot of our Members, but I'm grateful for your expertise and the diversity of views that are represented here.

It's apropos—Mr. Moir? Thanks. Your comment about global competition is what occurs to me. I'm a free-market conservative. I wouldn't mind a different phone company in every county in America—theoretically—and just let them go after it. I'm just not sure that's realistic.

And I guess my question for the panel is—has to do with what may have come up from Mr. Conyers earlier—is this issue of global competition, and the recognition that while we do concern ourselves—and as the Chairman said, I identify myself, too, with Ms. Lofgren's comments about believing that in a competitive marketplace it is axiomatic that the quality goes up and the cost to consumers goes down.

But my sense about this—and I'd love Mr. Moir or Mr. Kellogg, specifically, to respond to it—is that in an increasingly global telecommunications marketplace, is there—are there economies of scale, are there efficiencies, are there capitalization issues and market access issues that actually will enhance the ability of these United States companies to compete in what is actually the real arena; which is a global telecommunications arena?

And I say that knowing that an awful lot of people pick up the phone and dial an "800" number and have those orders fulfilled over the telephone or over the Internet on the other side of the world. And the Midwest-dialect-speaking person on the other end of the phone, they haven't got the slightest idea—you know, literally, is in a country that would be very foreign to the people of Rushville, Indiana.

So it's recognizing that globalization of the marketplace. Do these mergers help or hinder the ability of these American companies to compete and succeed on the global stage? And if I could ask Mr. Moir and then Mr. Kellogg to respond to that?

Mr. MOIR. Well, let's look at the global market today, pre-merger, two ways. From a customer standpoint, I've got, as an example, let's say, points of presence in 50 countries around the world, so I'm going to have to run links to all of those countries. I'll use a combination of one of a limited number of very large U.S. providers, two of them being involved in mergers that we're talking about here today, maybe some others.

And I'll have—and if I sign the contracts with those, or avail myself of one of the other large global companies that compete with AT&T and MCI to provide these backbone services, I still have to connect locally. AT&T doesn't have a point of presence to every customer prem around the world. They're dependent upon these local phone companies.

The reference I made earlier was that in putting together, you know, kind of the long-haul facilities—in this case, really long-haul, because we're going across country boundaries and oceans—those facilities, we actually have a reasonable amount of choice now. And the mergers aren't going to change the number of people supplying that from the U.S.

Mr. PENCE. Okay.

Mr. MOIR. But the point I was making is that when I go to connect those facilities in some countries in the world now to my customer premises, even though I may not have the breadth of choices that I'd like in some of those countries, in the U.K., for instance, I'm not going to pay the same egregious rates that I'm now being forced to pay here in the United States, because the regulators did a better job of incenting more cost-effective prices.

Mr. PENCE. But would these mergers—to my point, because I know I'm looking at a yellow light.

Mr. MOIR. Yes. Okay.

Mr. PENCE. Do they help or hurt the ability of these companies to compete globally?

Mr. GRIVNER. Can I take a shot? Can I take a shot at that?

Mr. PENCE. I'd be pleased.

Mr. GRIVNER. Thirty seconds.

Mr. PENCE. Sure. Twenty seconds.

Mr. MOIR. The merger doesn't impact the prices they charge—the local phone companies charge us. Only the FCC can deal with that. So that remains a problem, regardless of the mergers.

Mr. PENCE. I see.

Mr. GRIVNER. I think it's a great question. And the reason I think it's a great question is because next week I'm supposed to speak in London at a global telecommunications conference. So beforehand, they give you a list of questions. The number-one question they want me to ask, companies from Asia, telecommunication companies, "If these mergers go through, are our rates for terminating in the United States going to go up? Because it's only going to be two companies, and it's only going to be those two we have to choose from." That's their concern. Is it going to be cost-effective to do business in the United States?

Mr. MOIR. And those rates are already excessive now. We're running in rates of return of 70 and 80 percent, which are good by any businessperson's——

Mr. PENCE. Mr. Chairman, could Mr. Kellogg respond to that briefly?

Mr. CANNON. Certainly.

Mr. KELLOGG. Thanks, Mr. Chairman. It's a very acute question, Mr. Pence, because we do live in an increasingly global marketplace. These are huge multinational companies, who need comprehensive solutions. Today, Verizon and SBC are negligible players in that market. AT&T and MCI are much more significant. To-

gether, they will be able to form flagship carriers from the United States that can compete in the global marketplace against British Telecom, the German telephone companies, the Japanese telephone companies, in order to get our share of that global business. It's an extremely important byproduct of these mergers.

Mr. GRIVNER. Once they buy these failing businesses.

Mr. CANNON. The gentleman yields back. For purposes of order, let me just point out the order of people left to ask questions: Mr. Lungren next, Mr. Gohmert, Mr. Chabot, Mr. Feeney, and then Mr. Goodlatte—well, it looks like Mr. Feeney may have left.

So Mr. Lungren? The gentleman is recognized for 5 minutes.

Mr. LUNGREN. Thank you, Mr. Chairman. Boy, am I frustrated. I feel like when I go and I ask a mechanic about my car. I don't know much about cars. And I can go to one mechanic, and he can tell me one thing, and it sounds great. And then I go to another mechanic, and he tells me another thing. And later on, I find out that they're 180 degrees away from the same position. But they both sound equally persuasive to me.

I've left the Congress for 16 years; I'm just back. Twenty-some years ago, we were dealing with telecom stuff here. It's always been my observation that usually the Congress passes legislation just about the time the communications technology changes, so the legislation we passed is not really applicable.

I was one of those that thought, "Hey, let's break up AT&T," and then had to answer questions of my wife why our telephone service wasn't as good as it was when we had AT&T. I've been to—my home town at one time was Roosevelt, California. We had a small, local company there that's done pretty well, now known as "Share West." I remember I was able to get broadband there. I move out to Northern Virginia, a piece of property that used to be owned by George Washington. I couldn't get broadband there. Yet I got advertising asking me to sign up for it, continually.

So frankly, I'm going to tell you, I'm not an expert on this. Maybe there are a lot of experts on this panel on this side, but I'm not one of them. I'm just one of those people that's tried to figure out why we're back where we were about 20 years ago. Only this time, AT&T is being purchased by one of the babies, but we're going to end up with something.

But one thing I am somewhat expert on is law enforcement, and now on homeland security. And so that's where I'd like to focus this on. And it's a question to all four of you, and you can answer it as best you can, or if you want to answer it.

And that is, I'm concerned about infrastructure protection. I'm concerned about us protecting ourselves from attack by terrorists, attack in various different ways that impact our overall communications infrastructure. And I guess my question is this. Would these mergers have any impact whatsoever on our capacity to be able to protect against that?

Or to put it another way, will these merged companies, because of enhanced capitalization, have the capacity to do more for infrastructure protection than otherwise? Or are there any incentives for them to do those things that are necessary to protect us against that? Because my observation is 85 percent of infrastructure of all types is privately owned, not Government owned. And yet, if we

have an attack here in the United States, they're going to go after everything that they can destroy.

So I guess that's my question to the four of you. Can you give me any idea whether these mergers that we're talking about would in any way impact the capacity of the United States to protect against infrastructure attacks by those who would wish to do us harm?

Mr. GRIVNER. I will start. I am not an expert in law enforcement; however, I have been involved quite extensively at one time in the CFIUS process, so I understand the concerns and issues at a very broad level. I think in telecommunications, when we sell something to a customer, especially a large business customer, one of the things they're always concerned about is diversity: more than one choice, more than one path. What happens if this happens?

When you narrow it down to two paths and you say if you target just those two companies, you've wiped out most of the telecommunication business market in the United States, by just targeting those two companies, yes, you should be concerned by those two mergers that comprise 80 percent of the business market.

And if you target just those two companies—and people spend day and night working on that stuff all the time—you should be concerned.

Mr. LUNGREN. Mr. Moir?

Mr. MOIR. One of the disadvantages that large customers have always seen with a, you know, one shop provides all, is that if there's true synergies within that network design from end to end, and they use the same protocols, they use the same network software, from a customer standpoint, many customers have historically—and Mr. Grivner knows this—have actually split their traffic between multiple carriers when they go out and do their RFPs. Government does that, too, from time to time.

And the reason is, even if the facilities from the two carriers are coming into my building in different sides, or using different power grids, the advantage is that every once in a while somebody reprograms the electronics, and the system crashes. So at least some of my traffic will continue to go. And that's why there are a number of smart users out there that take redundancy and diverse routing to the extreme.

I'm not sure whether the mergers really change—with the carriers, it's usually either an economic analysis, or the only way they're going to get a contract because the customer demands that. Many customers, with carriers screaming and hollering, have been demanding that type of protection for decades. There are a number who don't. A number of them are in the U.S. Government that don't.

And as a consequence, you know, you leave yourself more vulnerable in the way the networks are configured. And that's not really an antitrust issue or a merger issue; it's a network—it's the way the networks are designed for the customers, whether it's DOD or anybody else. And you'd be surprised.

Mr. LUNGREN. Mr. Kellogg, do you have any thoughts on that?

Mr. KELLOGG. May I answer, Mr. Chairman?

Mr. CANNON. Certainly. Go ahead.

Mr. KELLOGG. It's an infrastructure question. When the World Trade Center came down on September 11th, it destroyed a Bell Atlantic, a Verizon central office. Verizon, because it had the infrastructure in place, was immediately able to route around that and use redundancy. Working with AT&T, they set up wireless phone banks and such.

The CLECs couldn't help at all, because they were riding over Verizon's network, not building infrastructure of their own.

If we want to be safe from terrorist attacks if we want a robust network, we have to invest capital in our network. And these mergers are going to allow that to happen.

Mr. CANNON. Thank you, Mr. Kellogg. The gentleman yields back. I want to just point out that I think AT&T was a CLEC in New York City. And they were able to, as part of that rerouting and efficient service and——

Mr. KELLOGG. It was AT&T Wireless, Mr. Chairman; not AT&T as a CLEC.

Mr. CANNON. Mr. Boucher. The gentleman is recognized for 5 minutes.

Mr. BOUCHER. Thank you very much, Mr. Chairman. It occurs to me that the advent of a range of new Internet-enabled services, Voice over Internet Protocol, multi-channel video delivered by the Internet Protocol—a subject about which we had a hearing this morning, in fact, in the Commerce Committee—will help to promote competition.

I'm wondering if, in your view, the case can be made that the mergers that are the subject of this hearing would help to enhance the expansion of broadband in a way that would facilitate the delivery of these new Internet-based services? Mr. Kellogg, would you care to comment? Mr. Verveer, perhaps?

Mr. KELLOGG. Absolutely, Mr. Boucher. I think that these mergers will allow further investment of capital. It's going to cost billions of dollars to build out broadband to every home in America. There's a huge risk involved in doing that and it takes—It takes a great deal of capital.

The second thing that's going to be required is a regulatory framework in which people feel that they're going to be able to compete freely once they do invest that capital. And that means clearing away, frankly, a lot of the State franchise requirements. The telephone companies already have franchises to deploy their networks. And requiring a second franchise in order to provide video over those networks is simply going to allow the incumbent cable industry to block developments and to keep their entrenched position, instead of introducing competition.

Mr. BOUCHER. Well, without diving into what is going to be a very controversial subject, and that is the extent to which the new offerors of IP video would be required to comply with local franchise requirements—a debate we will have, but I think on another day—let me take from your comment the point that by allowing a greater aggregation of capital, these mergers would have the effect of enabling and enhancing a more rapid deployment of broadband. I take it, you would agree with that?

Mr. KELLOGG. Absolutely. Particularly with, for example, AT&T's backbone network, which is going to allow—which is going to be very helpful in combination with the local delivery facilities.

Mr. BOUCHER. Okay. Mr. Verveer, comment?

Mr. VERVEER. Yes, sir. It's certainly true that the larger companies will in some sense have greater financial capacity. I think the question is, will they devote that financial capacity to the expansion geographically of broadband types of transmission services?

The answer is, I don't know if they will do that. I am reasonably confident that they are more likely to do it if they find themselves in a competitive environment, if they are subject to competitive pressure.

Mr. BOUCHER. Well, thank you both for that. There's an issue that I'm very interested in, which is not exactly at the core of the subject matter of this hearing; but each of you has expertise that could bear on this, and I'm going to take the opportunity of this conversation to raise it with you.

I strongly believe that we should have a principle of network neutrality. And what that basically means, in the simplest terms, is that a broadband provider would be prohibited by law from discriminating against an unaffiliated content provider in favor of the content that happens to be affiliated with the broadband provider.

So, for example, an incentive might well exist for a local telephone company offering DSL service to block access to Vonage by the customers for that DSL service. And in fact, we have an actual example of that happening. By the same token, a cable company would have incentive to perhaps degrade or slow down access to content residing somewhere out on the Internet that is not affiliated with that cable company—multi-channel video perhaps being offered by some independent provider.

And it just seems to me that it's an important principle to say that networks have to be operated in a way that enables the subscriber to the DSL service or the cable modem service to reach any website that subscriber wants to, and to be able to do so unimpeded by the broadband provider.

I'd like to get a statement of agreement to that basic principle from you, if you're willing to provide it. Who wants to start?

Mr. GRIVNER. Well, based on how you've described it, I'd have to agree with that. I think the——

Mr. BOUCHER. Excellent. You're a terrific witness.

Mr. GRIVNER. I think the Vonage——

[Laughter.]

Mr. GRIVNER. I think the Vonage example is a fabulous one, where they were blocked. And I think, you know, that obviously not the way things are going to be able to work, if this is going to be truly a competitive industry.

Mr. BOUCHER. Thank you, Mr. Grivner. Mr. Moir?

Mr. MOIR. As a consumer every day at home, I totally agree.

Mr. BOUCHER. Thank you, sir. Mr. Kellogg?

Mr. KELLOGG. Mr. Boucher, I think the most—the key level of—level playing field is on an intermodal, rather than an intramodal level. I think as long as cable, broadband, wireless, DSL, are all treated alike from a regulatory perspective, you're going to have all the competition you want.

Mr. BOUCHER. Okay. I'll take that as something less than a direct answer; but thank you. Mr. Verveer?

Mr. VERVEER. Well, I think Mr. Kellogg actually has crystallized what is the critical question. It is: How competitive will the transmission systems be? If we have a workably competitive environment, we probably don't have to have the kind of duty to deal that we will require if we don't have a workably competitive environment.

And to, I'm afraid, repeat the same kind of things I've been saying right along, I think we cannot be sure at this point how that's going to work out. We might well find ourselves in a situation where in many parts of the country there's no broadband available to residential users; in other parts, there may only be one provider, or two providers.

A lot depends on how effectively the cable companies, the DSL—the telephone companies compete with one another in terms of deploying broadband. And a lot depends on whether or not the wireless possibilities, in terms of WiMAX and other things, and the broadband over power line possibilities mature into something that really is available. The less it's available, the more force there is to the proposition you've raised.

Mr. BOUCHER. Thank you very much. Let me say, I share your enthusiasm for competitive markets. And that's one of the reasons I'm so glad to see the advent of IP video and VoIP, which I think undoubtedly will benefit consumers through having choice of service.

But I do not share your unbridled faith in competition as being the answer to all problems. I think we still are going to need some fundamental principles about how platforms operate. But thank you very much for your comments. And thank you, Mr. Chairman.

Mr. CANNON. The gentleman yields back. Before I recognize Mr. Gohmert, I think that it was actually—Mr. Kellogg, it was actually AT&T, not AT&T Wireless, that had a backup switch. I think there was another—Covad or another CLEC. I'd appreciate it if you'd check that out. You may have some better information.

But I think the point is that when you have competition, by nature, you have redundancy. And that's why I think that point's important.

But let me recognize Mr. Gohmert. And unless you'd like to respond to that right now, we'd be happy to just have you submit that for the record.

Mr. KELLOGG. I'll be happy to investigate it further.

Mr. CANNON. Thank you. Mr. Gohmert, you're recognized for 5 minutes.

Mr. GOHMERT. Thank you, Mr. Chairman. Appreciate the hearing and the opportunity to hear from these good witnesses.

Gentlemen, I'd like to hear from each of you. And I don't want to be repetitive, or anybody to be redundant, but there's been discussion about the mergers, two mergers, creating actually 80 percent of the market within two companies.

I'm curious, from your perspective, are there any aspects to the telecom business that would prevent the 20 percent and those holding that 20 percent business from cutting in competitively to the 80 percent? You know, and in the back of my mind, I'm thinking

about the Sherman Antitrust Act and whether we're getting—you know, what problems might be gotten into there.

So do you see anything that would prevent those holding the 20 percent from cutting into that 80 percent? And if so, what?

Mr. GRIVNER. I certainly can't speak from a legal perspective, and I'm sure that——

Mr. GOHMERT. Well, I was not asking you from a legal perspective. That's where I'm coming from——

Mr. GRIVNER. But from a business perspective.

Mr. GOHMERT. —but I want your factual, business perspective.

Mr. GRIVNER. Yes. I think, from a business perspective, when someone has 80 percent of the market, you'd certainly have to be concerned with pricing pressures they would place on competition in the marketplace. Lack of innovation in the marketplace would be certainly one concern.

Mr. GOHMERT. How so, lack of innovation?

Mr. GRIVNER. Well, lack of innovation, I think as I mentioned a couple of times, has been a historical problem for the incumbents, in terms of DSL deployment being several years behind the actual technology being available, Voice over IP several years behind the technology being available. So I think you limit the innovation relative to customers. And I think you have got to be concerned about market power, when you start at 80 percent and there's only 20 percent of the market left.

Mr. GOHMERT. Yes, sir?

Mr. MOIR. You know, there are two perspectives. If you're looking at it from the perspective of a residential customer—you and I, when we go home—small- and medium-sized businesses, all three of those categories have one thing in common. They probably have one, or a handful, of points of presence that fall within any one local phone company's footprint. From that standpoint, the merger's probably not going to have a radical impact on these companies competing elsewhere.

But for another type of customer, the type that I've talked about earlier here today, the customer that's in, let's say, all 50 States, to date, the Bell operating companies, as a practical matter, refuse to compete outside their jurisdictional footprint.

And even though there are CLECs that have done it, even though AT&T has done it and MCI has done it, I think the interesting question's going to be—and none of us, despite the rhetoric that may occur from some of the players, really knows for sure what will happen out of region when this merger occurs. You know, will Verizon, if it follows through with the MCI merger, or SBC, start to aggressively pursue the construction or the expansion of existing AT&T or MCI CLEC facilities that are out of region? You know, SBC in New York, or Virginia——

Mr. GOHMERT. Connecticut.

Mr. MOIR. —or Connecticut, Verizon in Houston and Dallas. Will they take those existing CLEC facilities that they're acquiring through the merger and expand them with capital investment, extend out further? Will they build new ones out of region? I just don't know.

And I think we have to disregard what people are saying right now because, as we heard around the '96 act, there were a lot of

statements made that many of us—they filled a lot of hearing records, but basically they haven't carried one bit or byte of traffic so far.

Mr. KELLOGG. On a residential level, I think it's clear that intermodal competition is where competition is going to be. That's competition from wireless, competition from cable, competition from VoIP.

On a business level, in the major cities we have it. You know, you look at any big city in the country—Boston, there are 22 operational CLEC networks; in Atlanta, there are 21; in Seattle, there's 17. SBC Telecom is present in every one of those markets; as is AT&T. They will now join together, and they'll be an even stronger out-of-region competitor in those markets. I think there is going to be a tremendous increase in competition following these mergers.

Mr. VERVEER. I would assume, in answer to your question, that, first and foremost, the antitrust authorities will look at the metropolitan area networks that MCI and AT&T control within the regions of the companies that are acquiring them. And my guess is that ultimately they'll decide that these have to be divested, along with either the customers or some obligation to maintain the traffic on these, to make the divestitures successful. That's the one concrete thing you could do to try to effect the competition of the kind you were describing.

Beyond that, my assumption is that the antitrust authorities are going to look very, very hard at what is required to compete in the enterprise market, to try to understand what kinds of assets one needs, to see if there's anything that ought to be divested or otherwise effected in connection with the transaction.

But it seems to me it has to be the case that we are at least losing some potential—some actual competition, and some potential competition, with the merger of these two enterprises into the large Bell companies.

Mr. GOHMERT. Thank you very much. I appreciate your individual perspectives. Thank you, Mr. Chairman.

Mr. CANNON. The gentleman yields back.

Mr. Chabot.

Mr. CHABOT. Thank you, Mr. Chairman.

Mr. CANNON. The gentleman is recognized for 5 minutes.

Mr. CHABOT. Thank you. I'd like to apologize to the panel for not being here during most of their testimony; although I've heard a number of the very interesting questions and responses thereto. I was down at the White House signing ceremony of the bankruptcy bill. I know a lot of the business folks, especially, but many consumers have been waiting now for 8 years to get relief under this bill with the reforms there. So it's long overdue and, I can report, has been signed into law. I saw the President sign it. So it's now the law of the land.

Let me start out with you, Mr. Grivner, if I could. In a filing made at the California Public Utility Commission, CalTel, a group to which XO belongs, advocated that as a condition of approving the SBC-AT&T transaction, the California PUC should permit the abrogation of wholesale and retail contracts with SBC. This seems to be a somewhat radical request. Do you actually believe that a

regulatory agency should be permitted to frustrate contracts that have been lawfully executed and signed by willing parties?

Mr. GRIVNER. Well, first of all, those are contracts that were signed under regulatory rules, and are subject to regulation. And I think what we're currently asking for, before we jump to conclusions or remedies or anything along those lines, is a clear viewing by the Department of Justice and the FCC of both of these mergers. But certainly, I think contracts that were built under those regulatory rules need to be reexamined, because I assume the rules will change to some degree.

Mr. CHABOT. Okay. Let me ask the other panel members, if I could, a follow-up here. In the absence of any judicial finding that a party has an unlawful monopoly, for example, should an agency of the Government be able to declare that all signed contracts of a specific named party are open for renegotiation? Any of the other three that would like to respond, I'd be pleased to hear from you. Mr. Kellogg?

Mr. KELLOGG. I would certainly say, no, with one caveat. There are certain circumstances—for example, the FCC has imposed certain rules on unbundling which were incorporated into contracts between ILECs and CLECs, and those rules were thrown out by the court. And the ILECs had to enter into these contracts. The court said—subsequently threw out the rules. In that case, as a remedy, on remand to the agency, an opportunity to change those contracts could occur. But I would not say in the ordinary circumstance of a commercial contract, just because a merger takes place.

Mr. CHABOT. Okay.

Mr. VERVEER. Most traditional public utility commissions do in fact have the ability to require the reformation of contracts. It is the kind of authority that is not used very often. It's only used, presumably, when there is a very strong rational basis for doing it. But it's not the kind of requirement that is necessarily an unusual one. It's particularly true in the world of communications, as we have moved from a world of tariffs more and more to a world of contracts.

Mr. CHABOT. Mr. Moir?

Mr. MOIR. The answer depends. When they involve the world of telecommunications and they involve contracts where one party has been, you know, in control of the local bottleneck facility and has significant market power, Mr. Verveer is correct, we have seen the regulators from time to time get involved.

The first one I was involved in seeing abrogated was a divestiture—these huge, sophisticated switches that basically large companies and Government agencies had around the country, that basically you had no choice but to sign, if you wanted. The FCC led, through a series of decisions, the abrogation of those provisions, and allowed the parties to basically rebid those relationships, or seek other suppliers. So depending upon the situation, I'd say, yes, that's a good policy.

Mr. CHABOT. Okay. And finally, Mr. Moir, let me ask you this, if I can. XO and other competitive carriers have urged the California PUC to require the divestiture of AT&T's customer base as a condition of approving the SBC-AT&T transaction. Would the

business customers you represent want to be a part of a process in which they are told they cannot do business with their carrier of choice? And wouldn't a requirement of this nature be quite disruptive to businesses that depend on telecommunications as a key input to their business?

Mr. MOIR. Well, I think you probably know what my answer is going to be. And that is we are very, very concerned, anybody tells us, any time, who we can negotiate, and who we can't negotiate; and worse, anybody who's been through the process, it's necessary to come up with these contracts that typically take, end to end, 18 months to negotiate. To have them abrogated by a third party, over user objection, to me is very, very troubling.

And what's particularly concerning is the—when these piece-part contracts may be part of a sophisticated nationwide or even global network that the company has. Then problems are concerned.

I understand why some CLECs may be interested in ILEC facilities right now that either of the carriers have—you know, MCI or AT&T, the CLEC facilities they have. But if you start to monkey around with the contracts we have, which cover far more than service—there are all sorts of provisions being provided under those contracts that go beyond just the raw transmission of bits and bytes—then that's very, very troubling.

Mr. CHABOT. Thank you.

Mr. CANNON. I thank the gentleman. The gentleman yields back.

Mr. Goodlatte. The gentleman is recognized for 5 minutes.

Mr. GOODLATTE. Thank you, Mr. Chairman. Mr. Grivner, are you concerned about consolidation in the ownership of the Internet backbone, as we examine this? What does it mean for XO, and what should be done about it?

Mr. GRIVNER. Yes, I am concerned. Right now, XO deals with what's called a peering relationship with most carriers, tier-one peering; meaning the traffic that you import and export, you basically don't pay for, if everything is, you know, fundamentally equal.

When you combine these four companies together, you've now created a tier-one-plus, in which companies like XO and others will have to pay for that traffic which up until this point has been part of the Internet, part of building the Internet, and part of the process. Yes, I am concerned.

Mr. GOODLATTE. What would you do about it?

Mr. GRIVNER. Well, what I would do about it is not let the mergers go through. But barring that, I think there have to be some very specific restrictions placed on that traffic, so that pay-for-peering does not occur.

Mr. GOODLATTE. Mr. Moir, are you aware of the effects of the proposed mergers on the ownership of the Internet backbone? And is there any reason to be concerned?

Mr. MOIR. We are still looking at those issues right now; particularly as, you know, they have regional aspects and broader aspects. But at the moment now, we still don't have a position.

Mr. GOODLATTE. Let me ask Mr. Kellogg or Mr. Verveer if they want to respond to either of those two questions.

Mr. KELLOGG. My understanding in this area is somewhat limited, but it is that AT&T and MCI both have national backbone

networks. SBC and Verizon do not. So I do not see how the merger would lead to more concentration in the critical national backbones.

Mr. GOODLATTE. Mr. Verveer?

Mr. VERVEER. I wouldn't pretend to any great expertise in this area. My impression, generally, is that this is an area that has become increasingly competitive over the last several years, and is a competitive environment today.

Mr. GOODLATTE. Very good. Mr. Kellogg, Voice over Internet Protocol, it does require a pipe into one's home or business; does it not?

Mr. KELLOGG. That's correct.

Mr. GOODLATTE. And what is USTA's position regarding this? Are some of your members trying to deny non-discriminatory access? Or does USTA have a position on that?

Mr. KELLOGG. My understanding is that USTA's position is that Voice over Internet Protocol is a tremendously important service; that it's, you know, going to dramatically influence the future of telecom; and that it ought to be allowed to develop in a competitive environment.

Mr. GOODLATTE. Does "competitive" mean non-discriminatory access?

Mr. KELLOGG. Well, it's not clear to me that there's a problem there that needs addressing at this point. You say there has to be a pipe into the home. Of course, there's the cable pipe which two-thirds of customers currently use; and only one-third uses DSL. If people feel that there's restrictions on their access to broadband services, they are free to switch to the other carrier. Plus, next-generation wireless is going to be incredibly important in terms of broadband access and VoIP services.

Mr. GOODLATTE. Okay. Anybody else—Mr. Moir, Mr. Grivner—want to respond to that?

Mr. MOIR. VoIP as we presently hear it, is a phenomenon that's evolved from basically IP protocol voice traffic, which has been going on on a packetized basis within the large user community for—what, decades?

Mr. GOODLATTE. Yes.

Mr. MOIR. And the issue we're evolving to now is, you know, you're going to be able to get access to multiple VoIP suppliers from a residential standpoint. From a business standpoint, we get the pipe; albeit, we don't have choice for 95 percent of our locations. But you get the pipe. You run the packetized data out—in this case, VoIP data; which is really voice packets. And then the issue is, does it terminate on another VoIP network to the customer prem, or does it terminate on the switch network and then get subject to something more on the lines of traditional access charges? So some of those issues are still to be flushed out.

Mr. GRIVNER. Yes, full VoIP deployment, full effect of it, does depend on that broadband pipe, that last-mile access to the customer; whether it be fiber provided by an RBOC, or by XO. Or a municipality that decides to get into the cable business would be another option.

Mr. GOODLATTE. Do you think that that type of technology is receiving fair treatment from those who own the pipes?

Mr. GRIVNER. Receiving fair treatment from those who own the pipes? Well, if the CEO of Vonage were here, he'd probably say "No." Matter of fact, I know he would say "No." I was with him yesterday.

Mr. GOODLATTE. Very good. Mr. Kellogg, do you want to respond to any of that, or you're—please.

Mr. CANNON. We actually need to be out of this room in time, at about just about 20 after. So since Ms. Jackson Lee has joined us, we'll stretch that a little bit. But if you could give us a quick answer that would be——

Mr. GOODLATTE. That's all I'd ask, Mr. Chairman.

Mr. KELLOGG. My understanding is that Vonage has access now. They are adding customers at a rapid rate. And I don't see a problem that needs any sort of regulatory solution.

Mr. GOODLATTE. Very good. Thank you, Mr. Chairman.

Mr. CANNON. The gentleman yields back. Without objection, all Members will have 5 days to submit questions for the panel, and then we'll ask you gentlemen—I have several questions that I'll submit, and others may as well.

And with that, Ms. Jackson Lee, did you have questions?

Ms. JACKSON LEE. I do, Mr. Chairman.

Mr. CANNON. The gentlelady is recognized. I think we can only go 4 minutes, because we just need to vacate. Will that be acceptable?

Ms. JACKSON LEE. Thank you, Mr. Chairman.

Mr. CANNON. The gentlelady is recognized for 4 minutes.

Ms. JACKSON LEE. This hearing in the midst of the debate on the floor dealing with the energy policy legislation in the backdrop—and I know you gentlemen can help me with a proposed merger not in your industry at this point, but American West and another airline, making it competitive with Southwest—sets the tone, I think, for the importance of the question of competitiveness and quality of life for consumers.

And it looks like this is deja vu, to a certain extent. We were in this room some—maybe less than 10 years ago, trying to pick up where the AT&T antitrust case left off. We thought we were finding a solution and balance, particularly in the telecom industry, and finding some balance—I see it says 9 years—with respect to the importance of competition; yet, of course, the recognition of industry inclination, if I might.

I just want to pose—and you might jump in, since time is 4 minutes, but I think it'll be enough time—to Mr. Verveer and Carl Grivner, and then others who may wish to join in. I think, Mr. Verveer, you said that the most significant aspects of today's telecommunications marketplace are consolidation and convergence.

And when you say significant aspects—and you may have gone over this, and I apologize for not being in the room—significant in a positive sense, or a negative sense? But how do we then, based on that premise, or those two premise—two aspects of your statement, ensure both innovation and price reduction; that those are not driven out of the marketplace?

And I say that in the context of the fact, do mergers actually enhance the benefits to the consumers? Do we see any price decrease in large mergers because of, say efficiency? Mr. Grivner, if you

would respond to what you've probably been responding to all afternoon, that mergers—as a result of mergers, competition is certain to diminish in markets throughout the country? Might you reemphasize which market will be most affected by a merger resulting in the greatest concentration?

And I think if any of the other two panelists would like to add to that, I would appreciate it.

I hope, Mr. Chairman, that we can have more than one hearing, where Members are in and out, and particularly having to get out of a room at a certain time. But this is a very important question.

Mr. CANNON. I can assure the gentlelady that we're going to have other hearings on this.

Ms. JACKSON LEE. I understand that from the Chairman of the full Committee. I thank you very much. But in any event, I yield to the gentleman.

Mr. GRIVNER. Okay. Congresswoman, I share your concerns about the consolidation and what it could potentially do to innovation and pricing. I've pointed out several times this afternoon that the technology that we've spoken about in the market today—DSL technology, Voice over IP—they've been available for many years. But it has not been until smaller companies that have been innovative in the marketplace have deployed those that the bigger companies have accepted those and have moved in that direction. Consequently, you could argue we're years behind where we could be, from an overall deployment of these newer technology perspective.

And I also think, from a price perspective, we need to be concerned as we move forward when there's only two players in the business market, where in the business market these two mergers will have 80 percent of the wireline business. We need to be concerned about what that means for business customers—small, medium, and large business customers—from a price perspective.

Ms. JACKSON LEE. What do you consider two players?

Mr. GRIVNER. Two players, being Verizon and the other player being SBC, will comprise 80 percent of the business wireline market.

Ms. JACKSON LEE. Mister—Verveer. Sorry.

Mr. VERVEER. The thrust of my testimony I think really is that we are in the midst of a major transformation in terms of the telecommunications sector; as big a transformation, probably, as we saw 25 or 30 years ago. We really do not know how this is going to come out, from the standpoint of consumers. And the only way we can really be confident that the progressiveness we've seen in the industry over the last 25 or 30 years will continue is if we have a competitive environment. So it is awfully important to have the tools available to try to maintain a competitive environment in this sector.

Mr. CANNON. Thank you.

Ms. JACKSON LEE. And I thank the Chairman. I know that if the other gentlemen wish to answer in writing, I'd welcome that.

Mr. Chairman, I just want to say this final word to you. You indicated that this Committee—the full Committee Chairman and Ranking Member, I know, will insist on further meetings. I simply ask the rhetorical question: How can we continue to do good, and not make enemies? I hope that we can damper down the intensity

and the animosity, and find a way to review these questions in the thoroughness that we desire for the good of the American people. I yield back.

Mr. CANNON. Yes. Well, I thank the gentlelady. Let me just reiterate, this is my personal—matter of personal interest. And anything the Committee does would be subject to the Chair and the Ranking Member on the decision to go forward, but I'm fairly sure that there is an interest in doing that.

Either of the questions that we'll get to by way of written questions relate really to the FCC and how it does its rulemaking and the decision process; which are important for the Committee that I chair, which is the Commercial and Administrative Law Subcommittee of the full Committee.

I want to thank the panel. This has been very, very insightful and a very helpful hearing.

And I remind those of you who are here that we do have another hearing starting almost immediately. So unless you're here for the next hearing, we'd appreciate it if you'd move out of here very quickly. And with that, this hearing is adjourned.

[Whereupon, at 4:25 p.m., the Committee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

RESPONSE TO QUESTIONS SUBMITTED BY REPRESENTATIVE CHRIS CANNON TO CARL J. GRIVNER, CEO, XO COMMUNICATIONS, INC., ON BEHALF OF COMPTEL/ALTS ALLIANCE AND ASSOCIATION FOR COMPETITIVE TELECOMMUNICATIONS

Industry Competition and Consolidation:
The Telecom Marketplace Nine Years After the Telecom Act.

April 20th, 2005

Before the Committee on the Judiciary

US House of Representatives

Carl Grivner, CEO, XO Communications

Answers to Submitted Questions

Questions Submitted by Congressman Cannon:

Q: Can you briefly detail your experience of leasing access to the Bells network from the time of the passage of the 1996 Telecommunications Act to the present day, and explain any difficulties you encountered? In addition, what impact, if any, did regulatory actions and court decisions pertaining to the 1996 Act have on your dealing with the Bells.

A: XO is a facilities-based National Local Exchange Carrier (NLEC). We endeavor to build our own facilities wherever possible so that we can serve our customers and meet their requirements more effectively. Because the construction of local facilities is so time consuming and capital intensive, XO is forced to lease facilities from the Bells and other providers to fill out our network. There is a vast difference in dealing with the Bells and other network providers. The Bells view us only as competitors, while the other providers view us as customers. The authors of the 1996 Act understood this problem and attempted to correct it by requiring the Bells to lease facilities to XO and other competitors at cost-based rates. This regulatory scheme only works, however, if the regulators adopt the proper regulations and then are sufficiently responsive to any problems and firm in enforcing the law.

Since the law was adopted, some progress has been made in implementing this very difficult scheme and establishing a more normal commercial relationship between the Bells and the competitive carriers. But, it is far from the commercial relationship one sees between suppliers and providers in competitive markets. As a result, at any moment, a Bell company can -- and often does -- decide to push its own interpretation of the law. In such an instance, we are frozen in place, unable to meet customer requirements and instead must expend the time, energy and resources to go before the regulators and courts to obtain relief. This problem is exacerbated given the fact that the enforcement process at the

FCC and the states fails to produce any decision in a commercially acceptable amount of time. As such, both competitors and retail customers are disadvantaged.

More recently, these problems have increased. The Bells have spent the past ten years trying to undo the initial market-opening decisions of the FCC. The DC Circuit's decision in *USTA I and II,* **which overturned these FCC rules, combined with the failure of the government to appeal either of DC Circuit decisions to the US Supreme Court, has resulted in the rollback of key market protections for competitors. Not surprisingly, these court actions have emboldened the Bell companies to further challenge our right to interconnect and obtain network access, thereby forcing regulators to wrestle with a new set of complex problems.**

Our relationship with the Bells is not one of willing partners seeking to strike a fair bargain for both sides. Without renewed dedication on the part of the government to properly implement and enforce the law, these problems are bound to continue, competition and the consumer will ultimately suffer.

Q: In your testimony, you voice serious competitive concerns with the SBC/ATT and Verizon/MCI mergers. Can you explain why you and the entities you represent offer a more viable competitive option than what the post-merger telecom market will offer, for instance cable?

A: Even prior to the 1996 Act, it has been competitive companies, not large incumbents, who have been the first to develop and deploy new technologies. This derives in part from the incumbent's interest in preserving the status quo, with respect to legacy assets and with respect to market position. The Bells had DSL years before the 1996 Act, but did not deploy this technology until Covad aggressively deployed DSL. The same is true for VoIP. The Bells had no incentive to offer VoIP, until Vonage paved the way.

Cable should not be considered an alternative provider in the business market for the simple fact that cable's share in this market is negligible and is not expected to grow rapidly any time soon. This is not surprising since cable has concentrated on serving the residential market, where they have a large competitive advantage. In addition, moving from the residential to the business market will not be easy. The cable plant is a shared distribution system, where quality of service and security cannot be guaranteed. Business customers consider these guarantees essential.

Q: You suggest in your testimony that the pro-competitive goals of the 1996 Act were never reached for a variety of reasons. Should Congress consider a

rewrite of the 1996 Act, what should its major areas of focus be from the standpoint of a CLEC? Do you believe revisiting Section 271 of the 1996 Act is appropriate?

A: Government regulation has not effectively constrained the pricing power and anti-competitive behavior of the Bells in local markets. The FCC has granted the Bell companies pricing flexibility for "special access" services permitting them to keep prices high and earn enormous returns. Very recently the FCC granted relief from requirements that the Bells provide access to critical local network loops and facilities to competitors, based on the now ill-founded assumption that SBC and Verizon would face meaningful competition from well capitalized carriers such as AT&T and MCI. Similarly, the ability of competitive carriers to use the antitrust laws to discipline anti-competitive Bell activity was severely undermined last year by the U.S. Supreme Court's "Trinko" decision, which relied on the existence of FCC regulations at the same time these same regulations were being dramatically pared back. It would be prudent, in any future examination of our telecommunications laws, to revisit the obligations of Section 271 of the 1996 Act in order to provide the necessary oversight and antitrust enforcement that is needed.

Q: What has your experience been with the FCC in adjudicating anti-competitive issues with the Bells?

A: The years of litigation involving the Bell companies' challenge of FCC market rules (*USTA 1 and II*), in addition to the frequent disputes that arise between monopolists and competitors, have demonstrated one glaring problem in adjudicating anti-competitive issues with the Bells – the inordinate amount of time it takes to reach a decision.

This process is a distinct disadvantage for a competitor due to the fact that a potential customer will not wait for a resolution of the dispute. The longer a decision takes the better for the Bell companies as they can afford to delay the process given their enormous share of the market.

Q: XO boasts one of the largest facilities based competitors to the Bells, but is there any economically feasible way for a competitor to build your own competing facilities to the last mile while competing in the incumbent's core business? What are the non-economic barriers to building facilities to compete with preexisting incumbent facilities such as utility pole or conduit access, right of way fees, permitting, etc?

A: XO has invested over $8 billion in building its own network facilities, and we are committed to the additional construction of facilities if it is economically feasible. The fact is, however, there is no economically

feasible way to build a ubiquitous network that connects to every customer building. It can cost over $250,000 to build a 500 ft. lateral from an XO metro fiber ring, if everything goes perfectly. Furthermore, such installation can take a minimum of 6 months. Very few potential business customers are willing to wait 6 months for service. In addition to the actual trenching of new fiber, a competitive company must negotiate rights-of-way and building access. In many cases, cities place moratoriums on when line installations can occur and building owners can be hesitant to allow additional lines to connect to the premise. The incumbent Bell system is the only ubiquitous network that currently connects to most buildings.

Q: Are you concerned about consolidation in the ownership of the internet backbone, what does it mean for XO, and what should be done about it?

A: **We are very concerned about consolidation and ownership of the internet backbone. XO is a Tier 1 peer, meaning XO connects with other similar sized Internet backbone providers that meet recognized criteria through peering arrangements. The combination of SBC/ATT and Verizon/MCI would effectively create two "mega peers" that would be substantially larger than other providers. As such, the "mega peers" would have the incentive to raise prices for internet access because no other provider would be larger enough to be considered an internet peer to their network.**

Q: CLECs deployed DSL service before the Bells and are responsible for many innovations. Without intra-platform competition from CLECs, will innovation suffer?

A: Innovation will most definitely suffer. As previously mentioned, the innovations in the telecommunications industry resulted from competitive companies aggressively investing in, and deploying new technologies such as DSL, VoIP, and Fixed Broadband Wireless. The Bell companies showed no desire to deploy technologies that competed with their traditional business model prior to the 1996 Act. Without competition, there is no incentive for an incumbent to innovate.

Q: During the hearing, Mr. Michael Kellogg asserted that after the September 11, 2001 terrorist attacks on Lower Manhattan, CLECs were unable to restore their service offerings because they were "entirely dependent on Verizon's facilities" and Verizon was uniquely qualified to restore service there. Could you please elaborate on the presence of CLEC facilities in Lower Manhattan on September 11 and CLEC efforts to restore service in the aftermath of the

attacks? How might the proposed mergers affect communications capabilities should a similar attack occur?

A: 48 competitive companies played crucial roles in restoring the telecommunications infrastructure in New York in the aftermath of the September 11 terrorist attacks. Many of these companies provided the incumbent carrier, Verizon, with vital network elements necessary for the restoration of its services in lower Manhattan. The key was the redundancy that the competitive networks provided for the area. The concern with these proposed mega mergers is that two, large, independent networks will now fall under control of the two largest local carriers.

Q: During the hearing, Mr. Michael Kellogg asserted that in the aftermath of the terrorist attacks on Lower Manhattan on September 11, 2001, Verizon was the only telecommunications carrier able to restore service after the destruction of its facilities there. To be specific, he stated, "[The] CLECs couldn't help at all, because they were riding over Verizon's network, not building infrastructure of their own." Evidence presented to the Committee, including contemporaneous FCC filings, indicates that Lower Manhattan in September 2001 was perhaps the site of the most robust network of non-incumbent facilities in the nation and that CLECs and their facilities played a vital role in restoring critical communications immediately following the terrorist attacks. On the larger issue of redundancy of networks and national security, should the proposed mergers be approved, how might it affect communications capabilities should a similar attack occur?

A: **XO restored service to the Mayor's Office, as well as the city's Human Resources Administration and Housing Department offices located at 100 Gold Street in record time. XO was asked to provide over 50 T1s worth of service, a job that ordinarily takes about 45 days to complete. XO also deployed LMDS fixed wireless equipment and technical staff to provide connectivity to end user locations where access to alternative fiber facilities was limited or unavailable. XO was able to restore service at these locations within three (3) to seven (7) days. In addition, XO provided fixed wireless backhaul service to a cellular carrier that lost cell sites in lower Manhattan, ensuring that the City's rescue and emergency workers were connected and ensuring on-going service availability to the wireless carrier's customers in New York.**

It is difficult to say what the actual effect of these mergers on communications capabilities would be in the event of an attack similar to September 11. However, we can say that removing the two largest competing networks (AT&T and MCI) reduces the ability to provide redundant network operability in the event of a future attack.

Q: Do you support making the Internet Tax Freedom Act permanent?

A: Yes, if the proper provisions are included to ensure that companies, that compete with traditional common carriers, like XO, do not attempt to game the system to escape paying their fair share of taxes simply because they do not fall within a the regulatory definition of a telecommunications provider. XO does not support taxing internet access, however, if a company intends to provide voice service to compete with XO or other telecommunications carriers, they should have to comply with the same system. Similar services should be treated in a similar manner.

Q: Do you believe that the current manner in which telecommunications and information services are taxed is efficient, and the best that we can do in our increasingly information –driven society?

A: XO is a heavily regulated local telecommunications provider. Our share of local and federal telecommunications-taxes can amount to anywhere from 5-20% of the customer bill. Furthermore, the rules are complex and require an inordinate amount of time to be spent on compliance.

Q: As you, or your member companies, work to comply with the current system of telecommunications taxation, what is the most significant problem you face: the rate at which you are taxed, the administrative complexity associated with collecting and remitting taxes, or competitive disadvantages created by tax regimes that treat different technologies in a disparate manner?

A: All of the above. As previously mentioned, the amount of time and money we expend to comply with these complex and often varying requirements is excessive. Furthermore, the resulting administrative overhead can ultimately lead to higher consumer rates. Finally, these taxes and fees deter growth and exacerbate opportunities to game the system because the current system of taxation does not treat similar services in the same manner. We support efforts to lower these taxes and fees and make the system more rational. If we do it correctly, we can accelerate growth in the industry, which would offset any diminution in the revenues the government receives.

Q: For several years, this Committee has been considering legislation that would codify the current physical presence standard that has been observed for years and elaborated by the Supreme Court in its 1992 *Quill v. North Dakota* decision. As the Internet continues to transform our economy by allowing the seamless, borderless delivery of intangible property and services, how can we ensure that the states do not unduly burden interstate commerce through the exercise of taxing authority?

A: This is a difficult question for which there is little agreement on the solution. The telecommunications industry is one of the most heavily regulated and taxed industries in the nation. While states and local governments greatly rely on revenues from these taxes, it is the consumer that ultimately suffers as the costs of complying with tax requirements are ultimately passed through to the customers' bill. XO supports reform of the current system of taxation on telecommunications carriers and will be happy to work with the Committee on suitable legislation.

Q: Do you find that the FCC tends to make decision in a timely fashion? If not, can you give me a specific example of where the length of time it takes for the Commission to make a decision has been harmful?

A: The Commission needs to resolve commercial disputes more expeditiously. I suggest it follow a model employed often in commercial agreements: the use of an arbitrator operating under a strict deadline with limited rights of appeal and with the arbitrator's decision taking effect immediately even while an appeal is pending.

Q: In general, after the conclusion of the Administrative Procedures Act's (APA) notice and comment period, how long should it take for the FCC to make a decision – three months, six months, should there be a deadline for action?

A: The FCC's notice and comment proceedings vary greatly in type and nature. For instance, some proceedings are sharply targeted on issues with extensive debate. Others involve issues with great complexity. The FCC proceedings to review mergers provides a good example of these differences -- and why rigid adherence to a deadline can be bad for the public interest.

The FCC currently has a 180 day "clock" for reviewing mergers. This clock applies whether it is a simple merger -- say between two companies holding a handful of radio stations -- or highly complex mergers like the pending mergers between SBC and AT&T and between Verizon and MCI. In the case of these latter mergers, many different markets are involved. Any analysis will be complex and time consuming, and the impact will be enormous. The government's review of such far-reaching mergers should entail a thorough analysis based on legal requirements -- not a rush to judgment propelled by an artificial deadline.

In our experience, deadlines may work if the type, nature, and scope of a proceeding can be precisely defined. However, absent such clarity, a one-size fits all policy would be counterproductive.

Q: When the Commission issues a Notice of Proposed Rulemaking, one of the first things it does is set forth a schedule for the filing of comments and reply comments by parties with an interest in the proceeding. Would you find it helpful if the Commission also included in any notice a target date for conclusion of the proceeding?

A: We know that the Commission often sets an internal target date, which is usually relayed orally to interested parties. We do not see a problem in establishing a target date for conclusion as part of the NPRM.

Q: Commission decisions often are followed with appeals, and these appeals can take many months, if not years, to resolve. Doesn't a regulatory process of this nature tend to breed uncertainty and, if so, what suggestions can you offer for improving the process in a way that will encourage certainty and regulatory stability?

A: The FCC oversees many critical industry sectors and is involved in frequent "high-stakes" proceedings where the outcome may make or break a business. It is not surprising that these proceedings are contentious, and interested parties will expend all available resources to generate a favorable outcome. While market uncertainty is a byproduct of many of these proceedings, we must recognize the Commission's public interest objectives in ensuring that a full and complete record is developed for any major proceeding. There are many areas in need of reform at the FCC and we will be happy to work with the Committee in this effort.

QUESTIONS SUBMITTED BY REPRESENTATIVE CHRIS CANNON TO BRIAN R. MOIR, ATTORNEY-AT-LAW, ON BEHALF OF E-COMMERCE AND TELECOMMUNICATIONS ASSOCIATION (eTUG) [1]

Republican questions for Mr. Brian Moir

Rep. Cannon

- You described a bottleneck access problem in your testimony, particularly with respect to DS-1s, how do you see Congress or the FCC playing a role to allow competitive access to these vital building blocks?
- In your testimony, you state that the FCC improperly implemented the 1996 Act. From the enterprise perspective, how would you envision an effective implementation of the 1996 Act, and what do you see Congress doing to ensure that competition remains in the telecom marketplace?
- Are you aware of any instances in which an incumbent's failure to provide required timely access to the local exchange for a CLEC to provide service to a business customer in turn resulted in the CLEC losing that business customer to the very incumbent who denied access?
- While predatory pricing by an incumbent may in the short term benefit a business customer, are you aware of any instances where in the long term after driving out CLEC competitors the incumbent has significantly raised prices on business customers?
- Are you aware of the effects of the proposed mergers on the ownership of the Internet backbone, and is there reason to be concerned?
- Do you think Congress should revisit the Telecommunications Act of 1996?
- Do you see a need to revise Section 271 to provide a continuous, prospective role for DOJ in providing telecom competition?
- Do you support making the Internet Tax Freedom Act permanent?
- Do you believe that the current manner in which telecommunications and information services are taxed is efficient, and the best that we can do in our increasingly information-driven society?
- As you, or your member companies, work to comply with the current system of telecommunications taxation, what is the most significant problem you face: the rate at which you are taxed, the administrative complexity associated with collecting and remitting taxes, or competitive disadvantages created by tax regimes that treat different technologies in a disparate manner?
- For several years, this Committee has been considering legislation that would codify the current physical presence standard that has been observed for years and elaborated by the Supreme Court in its 1992 *Quill v. North Dakota* decision. As the Internet continues to

[1] The Committee had not received a response to these questions at the time this hearing was printed.

transform our economy by allowing the seamless, borderless delivery of intangible property and services, how can we ensure that the states do not unduly burden interstate commerce through the exercise of taxing authority?

- Do you find that the FCC tends to make decisions in a timely fashion? If not, can you give me a specific example of where the length of time it takes for the Commission to make a decision has been harmful?

- In general, after the conclusion of the Administrative Procedure Act's (APA) notice and comment period, how long should it take for the FCC to make a decision – three months, six months, should there be a deadline for action?

- When the Commission issues a Notice of Proposed Rulemaking, one of the first things it does is set forth a schedule for the filing of comments and reply comments by parties with an interest in the proceeding. Would you find it helpful if the Commission also included in any notice a target date for conclusion of the proceeding?

- Commission decisions often are followed with appeals, and these appeals can take many months, if not years, to resolve. Doesn't a regulatory process of this nature tend to breed uncertainty and, if so, what suggestions can you offer for improving the process in a way that will encourage certainty and regulatory stability?

RESPONSE TO QUESTIONS SUBMITTED BY REPRESENTATIVE CHRIS CANNON TO MICHAEL KELLOGG, PARTNER, KELLOGG, HUBER, HANSEN, TODD, EVANS & FIGEL, PLLC, ON BEHALF OF THE UNITED STATES TELECOM ASSOCIATION

Answers for the House Judiciary Committee

Question 1: It is your contention that fewer competitors in the telecom marketplace will ensure the most competition and technological innovation. In 1996, Congress sought to foster competition by promoting facilities-based competition. Is it your view that Congress was wrong and that the Telecom Act must be rewritten to correct this error?

Answer: No, as a general matter I do not contend that fewer competitors is better, though I do believe that quality is more important than quantity. The core problem with the FCC's implementation of the 1996 Act was that it purposely tried to create a large number of competitors that relied on resale-based strategies rather than foster the growth of a smaller number of facilities-based competitors. As a result, I believe it took longer for long-lasting facilities-based competition to develop than it otherwise would. Extensive facilities-based competition has finally emerged, however. There are now multiple wires into the home capable of providing both broadband and narrowband communications services. The wireless industry also has multiple providers throughout the nation, and that market is growing rapidly. Indeed, wireless minutes of use have now surpassed wireline minutes of use. USTA has supported and continues to support the policies necessary and appropriate to achieve, establish, and maintain a competitive telecommunications marketplace.

As to the issue of updating the Communications Act of 1934, as amended, it is important to note that USTA fully supported and endorsed the passage of the Telecommunications Act of 1996. But the marketplace of 2005 is far different than the one that existed in 1996. Indeed, telecommunications has changed more dramatically in just the past nine years than in the more than 60 years between the 1934 and 1996 Acts. Consequently, in USTA's judgment, the Communications Act requires additional updating. But that does not mean that Congress was wrong to enact the 1996 Act.

Questions 2: In your testimony, you stated that the FCC implementation of the 1996 Act was fraught with mistakes (p. 3). Is it your belief that the market conditions that existed prior to the enactment of the 1996 Act did not necessitate a legislative remedy?

Answer: No. Although I stand by my testimony that the FCC's implementation of the 1996 Act was fraught with mistakes, it does not logically follow that the 1996 Act itself was a mistake. The 1996 Act addressed many problems that were in dire need of a legislative remedy – the Act eliminated the Modification of Final Judgment (MFJ) that prevented Bell companies from competing in many lines of business, including long distance; it eliminated state regulation that prevented competition for local services; and it reformed the universal service system. USTA supported each of these aspects of the 1996 Act at the time it was enacted, and continues to believe they were sound policies.

As indicated above, however, I believe the FCC's implementation of the 1996 Act was problematic, particularly with respect to its unbundling policies. And this is not simply my view or the view of USTA. The FCC's unbundling policies have repeatedly

been rejected by the Courts. In *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366 (1999), the Supreme Court reversed the FCC's plan for blanket unbundling of network elements. Two subsequent D.C. Circuit cases – *USTA v. FCC*, 290 F.3d 415 (D.C. Cir. 2002) ("*USTA I*"), *cert. denied*, 538 U.S. 940 (2003), and *USTA v. FCC*, 359 F.3d 554 (D.C. Cir.) ("*USTA II*"), *cert. denied*, 125 S. Ct. 313, 316, 345 (2004) – again rejected the FCC's attempts to force blanket unbundling.

Question 3: In your testimony, you state that VoIP will present competitive challenges to the incumbent Bells (p. 12). In your opinion, what impact will the recent FCC decision to approve the Bellsouth petition have on independent VoIP companies presenting a viable competitive alternative?

Answer: The FCC decision to which you refer should have little or no impact on independent VoIP companies. That decision preempted state rules that required BellSouth to provide DSL service over the high-frequency portion of a loop where a CLEC was using the low-frequency portion of that loop to provide voice services. The FCC had already concluded that telcos such as BellSouth should not be required to offer stand-alone DSL service. In light of the competitive alternatives available, that decision should not impact the ability of independent VoIP providers to use broadband connections to provide their services. And, in fact, independent VoIP providers have continued to report significant growth in the wake of the FCC's decision. For example, on March 7, 2005, Vonage reported that "it has exceeded 500,000 total lines in service on its network, doubling its growth rate … with the addition of more than 15,000 lines per week up 50% from the 4th quarter."[1]

Question 4: Does VOIP require a "pipe" to get into the home or business? Are USTA members currently engaged in legal, regulatory, and legislative efforts to limit non-discriminatory access to that pipe while granting favorable bundled treatment to their own VOIP offerings?

Answer: USTA assumes that by "pipe" you are referring to a wireline facility (either the local telephone loop or cable service). If so, there is also wireless technology and equipment that can be used to provide VoIP.

USTA and its members are seeking to update our national telecommunications laws in order to establish a policy reflective of the telecommunications marketplace that exists in 2005 and that we foresee existing in future years. This is a marketplace in which multiple competitors are offering broadband service and local telephone companies are minority players. Consequently, telecommunications reform legislation should include reform of Section 251(c)(3) requirements. In addition, in light of the competitiveness of mass-market broadband, it is inappropriate to force broadband providers to share such broadband facilities with rival providers of information services. Notably, the FCC has

[1] Vonage Press Release, *Vonage® Becomes First Broadband Telephony Provider To Activate Over 500,000 Lines* (Mar. 7, 2005).

rejected such forced access for cable modem providers, a policy choice that the Supreme Court recently affirmed. To perpetuate a forced access policy for providers of DSL service or next-generation technologies such as fiber-to-the home, which already lag far behind cabel modem, would deter investment in broadband and hurts consumers.

Question 5: Do you endorse efforts by USTA members to require[ ] customers of an independent VOIP provider [to] purchase not only the DSL line from the incumbent that carries the VOIP calls but also [to] purchase a bundled voice line which they do not use? Is "naked DSL" a form of illegal tying under the antitrust laws?

Answer: A telephone company's failure to offer DSL service on a stand-alone basis – sometimes called "naked" DSL – does not constitute illegal tying under the antitrust laws. Nor is it in any other respect improper or anticompetitive.

The logic underlying the restriction on tying is that a defendant may exploit its power in a first product – the "tying" product – to force customers to buy a second product – the "tied" product – that they would have preferred to purchase elsewhere. But telephone companies do not have significant power in the market for broadband Internet access. To the contrary, as the Supreme Court, the D.C. Circuit, the FCC, and other federal courts have all recognized, DSL competes fiercely with cable modem (the industry leader) as well as other forms of broadband that are still coming into their own. Accordingly, telephone companies do not have the ability to "force" consumers to purchase telephone service as a condition of obtaining DSL – consumers can instead turn to cable modem providers for broadband access. The recent dramatic DSL price reductions offered by many telephone companies demonstrate the competitiveness of the broadband market and the benefits that it is delivering to consumers.

Furthermore, the nature and development of DSL service helps to explain why telephone companies have reached differing business decisions regarding the offering of a stand-alone DSL service. DSL was first introduced for use as a high-speed Internet access technology in the late 1990s. Telephone companies generally introduced Asymmetric DSL service ("ADSL") – which has higher download than upload speeds – because that service could be offered over an existing, in-service telephone line. That configuration has obvious pro-competitive benefits as contrasted with DSL service provided over a separate stand-alone loop. First, the provider can reap economies of scope, by using the same assets (including the local loop itself) to provide multiple services. Second, by providing the service as an add-on to voice service, the telephone companies are able to do common billing and reduce customer care costs.

Because ADSL was developed as an add-on to voice service, the providers' operational support systems ("OSS") were based on that configuration. For example, the systems that were developed by third-party vendors accounted for DSL service by associating the service with the telephone number on the line. As a result of this history, offering DSL on a stand-alone basis is a significant and expensive logistical challenge.

Moreover, companies face difficult judgments about how to price a stand-alone product to account for the loss of revenues associated with wireline voice service.

Until recently, the demand for stand-alone DSL service was limited, and companies may have determined that this limited demand did not justify the millions of dollars that would be required to develop a stand-alone product. The development of VoIP may require some providers to reconsider their offerings and encourage them to add a naked DSL alternative. For the time being, the overwhelming majority of telephone companies' customers want DSL as an add-on to voice. But, if that changes, telephone companies will face competitive pressures to develop a DSL product that is not provided as an add-on to wireline voice service, or they will lose customers to alternative platforms and competing providers. Given robust competition in broadband and rapid technological innovation, telephone companies are free to reach their own decisions, responding to the market with reasonable business judgments, without the threat of antitrust liability or regulatory interference.

Question 6: If VOIP is not an end user application and should be charged all relevant telecom fees and taxes, are there other end user applications delivered via IP, such as e-mail or IP video or online games that USTA would endorse assessing telecom voice taxes and fees upon? Doesn't it make more sense to assess those fees on the "pipe" itself rather than end user applications?

Answer: USTA recommends broadening the base of Federal universal service contributors to include service providers whose services enable an end user to receive, transmit, forward, retrieve, modify, or obtain voice, data, image, or video communications – which includes cable modem and other broadband service providers, VoIP providers, Internet service providers, and DLECs.

Question 7: Is your primary concern the implementation of the 1996 Act or the Act itself? You seem to believe that the FCC was overzealous in promoting local intramodal competition even though that was the clear intent of the Act, allowing RBOCs to offer in-region long-distance service was just a means to that end. Do you then believe that the FCC should not have made any attempt to enforce Section 251 of the Act and should have rushed section 271 applications?

Answer: I address the first part of this question in my response to Questions 1 and 2 above. In my view, it is too simplistic to state that the 1996 Act intended to promote local intramodal competition. The ultimate goal of the Act was to promote facilities-based competition for all communications services, local, long distance, broadband, etc. Both the Section 251 unbundling regime and the Section 271 regime governing BOC entry into long distance were intended as means to achieving that larger goal. I do not take issue with the fact that the FCC attempted to enforce these provisions – in fact, they had no choice. My concern has been that, particularly with respect to the unbundling

provisions of Section 251(c), the FCC overstepped its bounds. And, as I explained above, the courts have agreed with this view on three separate occasions.

Question 8: If unbundled access to the local loop at regulated conditions was not a core purpose of the Act, why does section 251 exist in your view? Should the FCC have just relied upon commercially negotiated access terms and prices to develop between incumbent monopolies and competitors, and has that ever worked before in telecom or any other sector?

Answer: There are really two separate issues here. First, with respect to unbundled analog loops, this is the one component of the local exchange network that traditionally has been most difficult to duplicate and is therefore the component of the local network that is the best candidate for unbundling. In fact, neither USTA nor its member companies have challenged the FCC's determination to require unbundling of these loops. That said, with the emergence of cable and wireless alternatives, such policies are increasingly difficult to justify. Second, there is the issue of the appropriate price for unbundled loops and other elements. And, on that score, I believe the FCC made a colossal error in adopting the TELRIC methodology. That is not to say that the appropriate course would have been to rely solely on commercially negotiated rates. Rather, the FCC could have adopted different and more established cost methodologies (such as ordinary LRIC standards) that would have produced a much more rational regime.

Question 9: During the hearing, you asserted that in the aftermath of the terrorist attacks on Lower Manhattan on September 11, 2001, Verizon was the only telecommunications carrier able to restore service after the destruction of its facilities there. To be specific, you stated, "[T]he CLECs couldn't help at all, because they were riding over Verizon's network, not building infrastructure of their own." However, evidence presented to the Committee, including contemporaneous FCC filings, indicates that Lower Manhattan in September 2001 was perhaps the site of the most robust network of non-incumbent facilities in the nation and that CLECs and their facilities played a vital role in restoring critical communications immediately following the terrorist attacks. In fact, this evidence indicates to the contrary that it was Verizon who was dependent upon and utilized the redundant facilities of competitive wireline carriers as a net recipient, sometimes free of charge, to restore its service offerings as quickly as it did.

In light of this additional information do you wish to recant or significantly modify the assertion in your earlier testimony quoted above regarding the contribution of CLECs in restoring service in the wake of 9/11?

Answer: Please see my May 16, 2005 letter on this issue.

Question 10: If not, could you please provide documentary evidence that Verizon did not in fact rely upon and use CLEC facilities in the aftermath of the attack on the World Trade Center to restore service?

Answer: Please see my May 16, 2005 letter on this issue.

Question 11: Could you also please comment on the presence of CLEC facilities in general in Lower Manhattan at the time of the September 11 attacks?

Answer: Please see my May 16, 2005 letter on this issue.

Question 12: On the larger issue of redundancy of networks and national security, does the robust presence of non-Verizon telecommunications facilities in Lower Manhattan in September 2001 and the role of their facilities in speeding restoration of service in the aftermath of the attacks on the World Trade Center provide tangible evidence that the presence of competitive wireline telecommunications providers in a market breeds communications redundancy against terrorist attacks?

Answer: There is no question that facilities-based competition leads to redundancy that can be critical in restoring service and maintaining communications during and after a terrorist attack.

Question 13: In response to the map provided by XO regarding the availability of competition you stated that in [Milwaukee] there were 11 competitors and that therefore there was plenty of choice for consumers. Could you explain what type of consumers to which you were referring (residential, small business, large enterprise)? For the large enterprise customers in what percentage of the buildings is there a fiber line that is owned by a competitor and not ultimately owned by the Bell Operating Company?

Answer: As an initial point of clarification, my testimony referenced six competitors in Milwaukee and 11 in Cleveland, not 11 in Milwaukee as the question suggests. In both cases, I was referring specifically to the number of "operational CLEC networks" in those metropolitan areas, which is a term used by the leading source of data on CLEC networks – New Paradigm Resource Group's *CLEC Report*. In most cases, operational CLEC networks refers to local fiber networks. Although I do not have any direct knowledge of the type of customers these carriers are serving over their networks, as a general matter, CLECs are using their fiber networks to serve enterprise customers – both large enterprise and medium-sized businesses – and in some cases smaller businesses.

With respect to the percentage of buildings served by competitor fiber networks, that is difficult to determine. Few competing carriers report the number and locations of the buildings they serve with their own fiber, so there is limited public data available to make this determination. According to what a limited subset of CLECs report,

competing carriers appear to be serving between 30,000-35,000 buildings nationwide with their fiber networks. This compares to roughly 750,000 commercial office buildings nationwide. But it is important to recognize that competing carriers typically target the buildings with the highest concentration of demand, so their networks have access to a much larger percentage of business customers than a straight comparison of these totals might suggest. In addition, these totals do not include the office buildings that competing carriers are serving using alternative technologies, such as fixed wireless and cable. A study by In-Stat/MDR found that 41 percent of "enterprises" and 32 percent of "middle market" businesses were using cable modem service in their main offices for some high-capacity services. A new generation of fixed wireless services has recently been deployed by companies such as Speakeasy (in Seattle) and Clearwire (in Abilene, TX, Daytona Beach, FL, Jacksonville, FL, and St. Cloud, MN).

Question 14: In response to a question from Representative Goodlatte on the peering issues you stated that neither SBC nor Verizon had a national backbone. It is my understanding, however, that SBC has built out its Internet backbone network. Could you explain what type of internet backbone facilities SBC currently has (footprint, number of peering locations, size of connections etc.) and, in particular, how SBC has built its network out of region since SBC received its 271 relief from the FCC? Can you also clarify whether SBC is in fact a tier one Internet backbone provider?

Answer: To the extent I stated in my testimony that neither SBC nor Verizon had an Internet backbone network, I wish to correct that statement, as it is my understanding that both companies do in fact have national Internet backbones, though in both cases these networks are relatively limited compared to other backbone providers. I am not familiar with the specific details of SBC's Internet backbone facilities. My general understanding is that SBC's backbone consists of longhaul fiber that SBC largely leases from third parties (mostly WilTel) as well as POPs spread throughout the country that SBC owns and controls. I understand that SBC provided specific details regarding its backbone network to the FCC, in response to the FCC's April 18, 2005 information request. This information was filed as confidential subject to the FCC's protective order, and I therefore cannot reproduce it here.

It is my understanding that SBC does not view itself as a Tier 1 backbone provider because SBC lacks settlement-free peering agreements with some of the carriers generally regarded as the major Tier 1 backbones. In general, a Tier 1 backbone provider is one that is fully peered with all other backbones such that they pay nothing for Internet backbone services. SBC does not meet that definition.

Question 15: Mr. Philip Verveer testified at the hearing that if [*Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004)] had been controlling legal precedent at the time DOJ filed its antitrust complaint against AT&T in 1974, the complaint would have been dismissed. Do you support his view?

Answer: The case against AT&T was a sprawling one. To the extent that Mr. Verveer intends to suggest that the mere existence of a regulatory scheme governing telecommunications is sufficient under *Trinko* to bar antitrust claims, his argument flies in the face of *Trinko*. The framework established in *Trinko* preserves pre-existing antitrust claims, but likewise holds that the existence of an effective regulatory regime is an appropriate basis for declining to expand the antitrust laws, particularly when the benefits of such expansion are uncertain. How the various elements of DOJ's case against AT&T would have fared under that framework is a question that I have not analyzed.

Question 16: If *Trinko* did not alter or supersede the application of the antitrust laws, will USTA support passage of legislation similar to H.R. 4412, introduced during the 108th Congress, the "Clarification of Antitrust Remedies in Telecommunications Act," this Congress?

Answer: The core provisions of the Sherman Act have been unchanged for generations, and legal standards have developed through adjudication by the courts and through enforcement decisions of the responsible agencies, including the DOJ and FTC. We do not believe that it is appropriate for Congress to attempt to intervene in that process by seeking to modify judicial decisions to suit short-term policy preferences in particular industries. Courts and responsible agencies have been applying and will continue to apply the *Trinko* decision, and have recognized that one of its key tenets is that the 1996 Act does not modify pre-existing antitrust rules.

H.R. 4412, moreover, did not correctly reflect pre-existing antitrust law. The text of that bill suggests that a failure to comply with duties under Section 251(c) or Section 271 could constitute anticompetitive conduct in violation of Section 2. That suggestion is incorrect under pre-existing antitrust standards, as the Supreme Court squarely held in *Trinko*: in fact, the network-sharing duties imposed under the 1996 Act go far beyond anything contemplated under the antitrust laws. H.R. 4412 is thus an effort to alter decades of antitrust precedent; it would spur destructive and wasteful litigation; and it is wrong as a matter of antitrust policy for the reasons the Supreme Court has explained.

Question 17: Do you support making the Internet Tax Freedom Act permanent?

Answer: Yes. USTA supports making Public Law No. 108-435 permanent.

Question 18: Do you believe that the current manner in which telecommunications and information services are taxed is efficient, and the best that we can do in our increasingly information-driven society?

Answer: No. The tax rates imposed on consumers and providers for telecommunications services should not exceed or, at a minimum, should more closely

approximate the tax rates imposed for other goods and services or competing technologies. Given the interstate nature of telecommunications, if the several States cannot do this, a federal solution should be sought.

Question 19: As you, or your member companies, work to comply with the current system of telecommunications taxation, what is the most significant problem you face: the rate at which you are taxed; the administrative complexity associated with collecting and remitting taxes; or competitive disadvantages created by tax regimes that treat different technologies in a disparate manner?

Answer: All of the above. Discriminatory taxes and tax-like fees currently in force at the state and local level include, but are not limited to, property taxes, sales and use taxes, and business taxes on communications/video service providers and their customers. For instance, several nationwide studies have persuasively shown that providers and consumers of traditional telecommunications service annually pay, in the aggregate, billions of dollars more in state and local taxes than they would if taxed under the tax systems generally applicable to most other businesses; are burdened with transactional tax rates that are more than double the tax rates on other goods and services; are subject, for purposes of property taxation, to selective property assessment practices that produce significantly higher effective property tax rates than the effective property tax rates applicable to other types of businesses; and are subject to other forms of discriminatory tax treatment. In many States and localities, such discriminatory taxes and tax-like fees have also now reached, and can be expected to proliferate with respect to, providers and consumers of newer forms of communications/video services. Additionally, the discriminatory and excessively burdensome taxes and fees imposed on providers and consumers of communications/video services have had and continue to have a deleterious effect on the nation's economy. They increase the cost of communications/video services to consumers, increase the cost of investing in network and other equipment, inhibit the growth and deployment of broadband and other advanced communications/video services, and inhibit the continued growth of the Internet and electronic commerce.

Question 20: For several years, this Committee has been considering legislation that would codify the current physical presence standard that has been observed for years and elaborated by the Supreme Court in [*Quill Corp. v. North Dakota ex rel. Heitkamp*, 504 U.S. 298 (1992)]. As the Internet continues to transform our economy by allowing the seamless, borderless delivery of intangible property and services, how can we ensure that the states do not unduly burden interstate commerce through the exercise of taxing authority?

Answer: By prohibiting and providing a federal remedy for state and local tax discrimination against communications/video services, communications/video service providers and their customers, and communications/video service property, and by prohibiting and providing a federal remedy for the imposition of discriminatory fees,

thereby ensuring the equal protection of the laws and safeguarding interstate and foreign commerce.

Question 21: Do you find that the FCC tends to make decisions in a timely fashion? If not, can you give me a specific example of where the length of time it takes for the Commission to make a decision has been harmful?

Answer: USTA takes no position on this question.

Question 22: In general, after the conclusion of the Administrative Procedure Act's (APA) notice and comment period, how long should it take for the FCC to make a decision – three months, six months, should there be a deadline for action?

Answer: USTA takes no position on this question.

Question 23: When the Commission issues a Notice of Proposed Rulemaking, one of the first things it does is set forth a schedule for the filing of comments and reply comments by parties with an interest in the proceeding. Would you find it helpful if the Commission also included in any notice a target date for conclusion of the proceeding?

Answer: USTA takes no position on this question.

Question 24: Commission decisions often are followed with appeals, and these appeals can take many months, if not years, to resolve. Does a regulatory process of this nature tend to breed uncertainty and, if so, what suggestions can you offer for improving the process in a way that will encourage certainty and regulatory stability?

Answer: USTA takes no position on this question.

Question 25: In the course of the hearing, you were questioned about the reluctance of the Bell companies (other than Qwest) to offer DSL service without accompanying voice services – so-called "naked DSL." It could be argued that the Bell companies resist offering this type of service due to the likelihood of customers requesting VoIP service from Bell competitors. You responded that the reason was economic – that naked DSL is very expensive to provide. Yet competitors like Covad have been selling DSL with no accompanying voice product for years, the economic equivalent of naked DSL, and seem eager to continue offering it. With that in mind, can you further explain the Bell companies' reluctance or refusal to offer this service?

Answer: Please see my response to Question 5 above regarding naked DSL. Telephone companies cannot prevent customers from purchasing VoIP service by refusing to sell

"naked" DSL, because customers can simply turn to alternative broadband service providers, including cable modem providers.

With regard to the second part of your question: the experience of competitive providers of DSL service (companies sometimes known as "DLECs") actually confirms both the economic logic underlying telephone companies' decision to offer DSL as an add-on to existing voice service and the absence of any basis for antitrust concern over that decision.

In some cases, DLECs offered *symmetric* DSL -- a product with higher upload speeds than residential ADSL service, primarily sold to businesses -- which cannot be provided on the same loop as wireline voice service. But in those cases where DLECs sought to provide ADSL, they complained that they could not compete with the greater economies of scope achieved by telephone companies that were able to offer DSL and voice service over the same line. At first, the FCC met DLECs' demands by ordering telephone companies to "share" their lines with DLECs – that is, provide DLECs with access to just the high-frequency portion of the line, usually for free or for very low cost.

But the D.C. Circuit vacated the FCC's line-sharing rules, because the FCC had failed to take into account the competitiveness of the broadband market before forcing telephone companies to share their lines. Such forced sharing cannot be justified in light of the competitiveness of broadband service.

Accordingly, on remand, the FCC reversed course and eliminated the line-sharing requirement. The FCC recognized that all providers should be encouraged to exploit all of the capabilities of the local loop facility, either independently or by teaming up with other willing providers. In light of the competitiveness of the market for broadband services, the cost of imposing line sharing as a regulatory requirement could not be justified. Nevertheless, today, Covad and other DLECs continue to use commercial line-sharing arrangements entered into with incumbent LECs and CLECs as a basis for their DSL services. This illustrates the substantial economic basis for offering DSL as an add-on to existing voice service – an economic rationale that has nothing to do with market power.

Question 26: Are there, or have there been, efforts by USTA members to demand that a customer of an independent VOIP provider purchase not only the DSL line from the incumbent that carries the VOIP calls but also purchase a bundled voice line which they do not use? Do you believe this advances the concept of VOIP as a competitive entity in the telecom marketplace?

Answer: Please see my responses to Questions 5 and 25 regarding naked DSL. There are USTA members that have chosen to offer DSL service as an add-on to wireline voice service provided over the same telephone line, and some continue to do so. This does not prevent subscribers from purchasing VoIP service.

With regard to the second part of your question: VoIP is a service that requires a broadband connection, which independent VoIP companies do not provide. By investing massively in the development and deployment of DSL service, telephone companies have unquestionably helped to make the development of VoIP possible. The only way to ensure that broadband applications continue to develop is to ensure that communications companies have appropriate investment incentives to continue the deployment of increasingly speedy broadband technologies. Given the variety of intermodal competitors and the pace of technological change, such investment is both expensive and risky. Rules that inappropriately burden providers' competitive choices in a short-sighted attempt to promote a particular favored application or provider will undoubtedly hurt competition and consumers.

RESPONSE TO QUESTIONS SUBMITTED BY REPRESENTATIVE CHRIS CANNON TO PHILIP L. VERVEER, PARTNER, WILLKIE FARR & GALLAGHER, LLP

April 20, 2005, Hearing before the Committee on the Judiciary

Philip L. Verveer's responses to questions propounded by Representative Cannon:

Question: From your testimony, you argue that it is not necessarily the convergence of the industry that would warrant concerns regarding these mergers but the fact that the courts have effectually removed any antitrust remedies to competing entities. In your opinion, do you believe that Congress needs to draft a legislative remedy to reinstate or reinforce the antitrust laws in the telecom market?

Answer: I think legislation to assure that the antitrust laws are fully applicable to the telecommunications industry would be very desirable. My opinion is predicated on the possibility that the Trinko decision will be interpreted as exempting from antitrust review any telecommunications conduct apparently required by the Communication Act. Whether warranted by Trinko or not, this would be a very unwelcome innovation in antitrust jurisprudence and it would occur at exactly the wrong time. The fundamental requirements of the Communications Act and of the Sherman Act generally have been held to be compatible. We are approaching a time of profound change for the communications industry and it is more important than ever that our fundamental national economic commitment to competition, protected when necessary by the antitrust laws, remain applicable to that industry.

Question: In your testimony, you state that it is your belief that technological innovation is, by itself, not a suitable replacement for intra-market competition. Would it be fair to derive then that your belief is that innovations such as VoIP, wireless, and broadband, or their face will not provide the necessary competitive forces to continue to drive innovation in the telecom marketplace?

Answer: My view is that we do not and cannot know at this juncture whether the various telecom markets will evolve in a workably competitive way. I believe competition has contributed materially to the enormous dynamism of the telecom marketplace in the last few decades. We are experiencing a great deal of consolidation in the various telecom markets at the same time that we are experiencing a great deal of convergence of what previously undoubtedly had been separate markets. If we are fortunate, the end result of this process will be workably competitive markets. The Justice Department and the Federal Trade Commission of course will seek to prevent anticompetitive consolidation. However, there are irreducible uncertainties about the future of any marketplace that is influenced by the sort of rapid adoption of new technologies that we are seeing in the communications industries. Thus, while I would recommend considerable caution about intruding into the evolution of these industries, I think it is important as a legal matter that the government have the undoubted ability to do so if it becomes advisable.

Question: Revisiting your determination that the FCC, by its very nature, is the improper arena to adjudicate anti-competitive concerns, should Congress look to alter the 1996 Act, what role would you like to see the Justice Department play with regards to these adjudications, in light of court decisions over the past decade?

Answer: I would like to see the Goldwasser line of cases, including Trinko, overturned by Congress to the extent of making it clear that an FCC-regulated entity's failure to

abide by requirements of the Communications Act may properly constitute the basis for actions brought pursuant to the Sherman Act. I believe that this could be accomplished by amendment to either the Communications Act or the Sherman Act.

Question: Do you see a need to revise Section 271 to provide a continuous, prospective role for DOJ in providing telecom competition?

Answer: In general, I do not believe it is necessary to write any special consultation rights for the Justice Department into the Communications Act as occurred with Section 271 (d) (2). Historically, the Department's competition advocacy initiatives before the FCC and other agencies of the government have been influential and useful. If the Department were to choose to renew this sort of initiative with respect to matters pending before the FCC, I am confident that its views would receive careful attention.

Question: I agree with your analysis of the Trinko and Goldwasser decisions, particularly your statements regarding the courts' approach to Section 2. In light of these decisions and the Supreme Court's ruling, what options do you see open to Congress as we determine the appropriate approach to ensure the proper application of antitrust laws with respect to the telecom industry?

Answer: As noted in my answer to a previous question, I believe that Congress should adopt an appropriate amendment to either the Communications Act or the Sherman Act to assure (1) that the interpretation of our laws protecting competition are effective and (2) that they conform to Congress' views of the sound public policy. Prominent examples of Congressional action to adjust the scope of the antitrust laws in the wake of judicial decisions deemed too expansive or too restrictive include the McCarran-Ferguson Act of 1945, the 1950 Cellar-Kefauver amendments to the Clayton Act, and the 1966 amendments to the Bank Merger Act.