S. HRG. 109–48

SBC/ATT AND VERIZON/MCI MERGERS: REMAKING THE TELECOMMUNICATIONS INDUSTRY, PART II—ANOTHER VIEW

HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

FIRST SESSION

APRIL 19, 2005

Serial No. J–109–8A

Printed for the use of the Committee on the Judiciary

U.S. GOVERNMENT PRINTING OFFICE

21–757 PDF WASHINGTON : 2005

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

COMMITTEE ON THE JUDICIARY

ARLEN SPECTER, Pennsylvania, *Chairman*

ORRIN G. HATCH, Utah
CHARLES E. GRASSLEY, Iowa
JON KYL, Arizona
MIKE DEWINE, Ohio
JEFF SESSIONS, Alabama
LINDSEY O. GRAHAM, South Carolina
JOHN CORNYN, Texas
SAM BROWNBACK, Kansas
TOM COBURN, Oklahoma

PATRICK J. LEAHY, Vermont
EDWARD M. KENNEDY, Massachusetts
JOSEPH R. BIDEN, JR., Delaware
HERBERT KOHL, Wisconsin
DIANNE FEINSTEIN, California
RUSSELL D. FEINGOLD, Wisconsin
CHARLES E. SCHUMER, New York
RICHARD J. DURBIN, Illinois

DAVID BROG, *Staff Director*
MICHAEL O'NEILL, *Chief Counsel*
BRUCE A. COHEN, *Democratic Chief Counsel and Staff Director*

SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS

MIKE DEWINE, Ohio, *Chairman*

ARLEN SPECTER, Pennsylvania
ORRIN G. HATCH, Utah
CHARLES E. GRASSLEY, Iowa
LINDSEY O. GRAHAM, South Carolina
SAM BROWNBACK, Kansas

HERBERT KOHL, Wisconsin
PATRICK J. LEAHY, Vermont
JOSEPH R. BIDEN, JR., Delaware
RUSSELL D. FEINGOLD, Wisconsin
CHARLES E. SCHUMER, New York

PETER LEVITAS, *Majority Chief Counsel and Staff Director*
JEFFREY MILLER, *Democratic Chief Counsel*

CONTENTS

STATEMENTS OF COMMITTEE MEMBERS

	Page
DeWine, Hon. Mike, a U.S. Senator from the State of Ohio	1
prepared statement	49
Kohl, Hon. Herbert, a U.S. Senator from the State of Wisconsin	3
prepared statement	64

WITNESSES

Citron, Jeffrey, Chief Executive Officer, Vonage Holdings Corporation, Edison, New Jersey	7
Cleland, Scott, Founder and Chief Executive Officer, Precursor Group, Washington, D.C.	9
Grivner, Carl, Chief Executive Officer, XO Communications, Reston, Virginia	5
Kimmelman, Gene, Senior Director for Public Policy and Advocacy, Consumers Union, Washington, D.C.	11

SUBMISSIONS FOR THE RECORD

Citron, Jeffrey, Chief Executive Officer, Vonage Holdings Corporation, Edison, New Jersey, prepared statement	25
Cleland, Scott, Founder and Chief Executive Officer, Precursor Group, Washington, D.C., prepared statement	38
Grivner, Carl, Chief Executive Officer, XO Communications, Reston, Virginia, prepared statement	52
Kimmelman, Gene, Senior Director for Public Policy and Advocacy, Consumers Union, Washington, D.C., prepared statement	66

SBC/ATT AND VERIZON/MCI MERGERS: REMAKING THE TELECOMMUNICATIONS INDUSTRY, PART II—ANOTHER VIEW

TUESDAY, APRIL 19, 2005

UNITED STATES SENATE,
SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS, OF THE COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The Subcommittee met, pursuant to notice, at 3:04 p.m., in room SD–226, Dirksen Senate Office Building, Hon. Mike DeWine, Chairman of the Subcommittee, presiding.

Present: Senators DeWine, Brownback and Kohl.

OPENING STATEMENT OF HON. MIKE DEWINE, A U.S. SENATOR FROM THE STATE OF OHIO

Chairman DEWINE. Good afternoon. We apologize for being late. We had two consecutive votes on the Senate floor, but we are here. The good news is the Senate is now in recess for a while, so we will not be interrupted.

Let me welcome all of you to the Antitrust Subcommittee hearing examining the proposed mergers between SBC/ATT and Verizon/MCI. As promised, this is a continuation of the examination that we began last month with the full Judiciary Committee. The difference today is that rather than hear from the CEOs of the merging parties, we will hear from witnesses who take a somewhat different view.

As you all know, at that time I expressed some reservations about these mergers. Not surprisingly, the CEOs of the four respective companies acquitted themselves quite well at the hearing and emphasized very clearly that ATT is already leaving the residential market and MCI is likely to follow. In other words, they made the important point that in some ways these mergers don't change the competitive landscape for consumer services.

They also emphasized the impact of intermodal competition, meaning competition from other forms of service such as wireless cable and voice over Internet protocol. These are important arguments and the companies made them very effectively. But, frankly, I am still worried. I think there is still a lot more to it. In my mind at least, it is still an open question between the SBC/ATT merger and the Verizon/MCI merger are good for competition and for consumers. That, of course, is what we are here today to discuss and to look at.

As we began to explore last month, there are a range of issues that raise concerns. Perhaps the one which has received the most traditional antitrust scrutiny so far is the so-called enterprise market, the sector of the market comprised of large businesses with sophisticated telecommunications needs. All four of the merging parties currently compete in this market sector. So large business customers will likely be affected by the deals. This area will require close scrutiny.

There are also questions regarding the impact of these deals on the markets for long-haul capacity and in the market for Internet backbone that today's witnesses are particularly well-suited to answer. We are looking forward to these discussions.

As we discussed in our last hearing, however, the critical issue here is intermodal competition. According to the testimony we heard from the company CEOs, they are facing competition on numerous different technological platforms, specifically, as mentioned, cable companies, wireless companies and companies that provide voice over IP services.

Once again, we must keep in mind that intermodal competition, by definition, does not always provide the type of direct competition we are used to seeing. Wire line, wireless, cable—these services are inherently different and provide similar services in different ways with different pluses and different minuses. Not all will always provide sufficient and competitive benefits for all consumers. In fact, there are a number of concerns that have been raised about each which I know we will explore today.

But most important in this context, we must discuss whether or not merger conditions are required to ensure that these multiple modes of competition are, in fact, available. For example, voice over IP is often held up as the poster child for intermodal competition. In fact, Vonage, one of our witnesses today, is a voice over IP provider.

It is certainly a very promising product, but our witness himself will testify today that voice over IP is a type of service that is available to the consumer only if he or she has broadband access, and currently that access is widely available only from the phone company or the cable company. Think about it. Voice over IP providers must rely on their competitors to get access to their customers. Clearly, that is a somewhat tenuous situation and we will need to consider if the mergers change it at all.

There are several other issues to explore. In most places, residential consumers currently face duopoly choice—buy an expensive bundle of local, long-distance, Internet and wireless service from the phone company or buy an expensive bundle of similar services from the cable company. What impact will the purchase of ATT and MCI have in this situation? Will it allow the phone companies to provide better products and services, or will it remove two of the few potential existing market entrants?

Another important point is that high-speed and wireless broadband will clearly be required for the next generation of services and will certainly help competitors such as voice over IP and cable telephone service. ATT and MCI, as independent competitors, had a big stake in promoting the development of broadband. How will these mergers impact the development of those broadband ca-

pabilities? Similarly, how will the mergers impact the availability of new wireless spectrum?

Finally, I hope that the panelists will share their thoughts about what we in Congress can do more broadly to help promote competition and innovation in the telecommunications industry. Many have noted the need for a rewrite of the 1996 Telecommunications Act, and it is time to start thinking about what such a rewrite would entail.

Certainly, it seems that there is a need to free up the spectrum necessary to enhance wireless broadband development. Another issue is the need for the FCC to expeditiously rule on their own proceedings on inter-carrier compensation, special access pricing and the regulation of IP-enabled services.

These proceedings have been going on for an extended period of time and the industry is to some extent in limbo awaiting the rulings. Outdated legislation and incomplete regulations can only hinder the type of aggression competition that leads to innovation, better products and lower prices. So with that in mind, we look forward to hearing from our panelists today on a wide range of issues.

Before I turn to Senator Kohl, I would just to acknowledge some news that we all heard this morning. Verizon has announced that it will be making stand-alone DSL service available to some of its customers in certain regions. This is an issue that we discussed at some length in our last hearing, and I think we all agree that to the extent that stand-alone DSL is available, it makes voice over IP a stronger and more valuable competitor and provides more choices for consumers. So I applaud Verizon's actions in this regard, and we will be watching to see if Verizon and others within the industry are able to continue down this path.

Let me now turn to my colleague and my friend, Senator Kohl.

STATEMENT OF HON. HERB KOHL, A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator KOHL. Thank you, Senator DeWine.

Today, we return to the topic we began considering a month ago at the full Committee's hearing on consolidation in the telecom industry. As we noted then, the mergers we are examining and the technological changes we are witnessing will fundamentally change how Americans communicate and what we pay for these services.

At our Committee's hearing last month, we heard from the four CEOs of the merging companies explain why they believe these deals are in the consumer's best interests, and we agree that today's telecom market is very different from the market that existed when the ATT phone monopoly was broken up 21 years ago, and that there is the great potential for many consumers to benefit from new forms of competition and new choices.

But the sheer magnitude of these mergers and a potential to concentrate market power in the hands of two large telecom companies requires us to carefully examine the competitive consequences of these deals. Today's hearing will be an important opportunity to hear the views of consumer representatives, competitors and independent experts as to whether the mergers will be good for competition and for consumers.

The Bell companies and their merger partners have testified that new technologies and innovation should allay any concerns we have about the size and market power of the companies that will emerge once these mergers are completed, and we hope they are proved correct.

Our first responsibility therefore must be to ensure that the development and deployment of these new technologies are not stifled in their infancy by today's consolidation. We must seek to avoid the creation of a world where consumers are left with only two choices for a bundle of telecom services—the Baby Bell phone company and the cable company.

Our witness from the Internet telephone company Vonage is an example of one exciting new way consumers can make telephone calls without using traditional phone lines controlled by the companies involved in these mergers. However, in order to access Vonage's service, consumers still need to obtain high-speed access to the Internet. And, today, the only provider of such high-speed Internet connection for most consumers is either the Bell phone company or the cable company.

We need to ensure that these Internet connections come without strings attached and that consumers are free to buy Internet connections without also being required to buy conventional phone service. We need to make sure that the phone or the cable company providing the Internet connection does not attempt to block or degrade the consumer's access to these Internet-based telephone services.

So our concerns remain the same as we stated them last month. First, how can we ensure that this consolidation will not decrease the choices and increase the cost to consumers and business customers, both large and small? Second, how can we ensure that new technologies and new services can get access to the Bell company networks?

Our goal must be the nurturing of a truly competitive telecom marketplace with a maximum of choice for consumers, a market that will not be controlled by a few dominant players. We must insist that the Justice Department and the FCC scrutinize these mergers properly so that the tremendous gains in telecom competition over the last 20 years are not lost in the midst of this industry consolidation.

We thank our witnesses for coming to testify today and we look forward to hearing their views.

Thank you, Mr. Chairman.

[The prepared statement of Senator Kohl appears as a submission for the record.]

Chairman DEWINE. Senator, thank you very much.

Let me briefly introduce our panelists, and thank you all for being here.

Carl Grivner is CEO of XO Communications, the largest independent competitive local exchange carrier. Prior to his tenure at XO, he served as CEO of Global Crossing. He has worked in the telecommunications industry for the past 25 years. Thank you for joining us.

Jeffrey Citron is the Chairman and CEO of Vonage. In 1999, he co-founded the company. In addition to his work in the tele-

communications industry, he has worked extensively in the financial services industry and founded both Island ECN and Daytech Online Holdings.

Mr. Scott Cleland is the founder and CEO of Precursor, and also serves as the chairman of the Investor Side Research Association. He has testified before the Subcommittee on prior occasions and we certainly welcome him back.

Gene Kimmelman is the Director of the Washington, D.C. office of Consumers Union, certainly no stranger to this Subcommittee or to the full Committee.

Gene, thank you for joining us again.

Mr. Grivner, thank you. We will start with you. We will go from my left to right. Each one of you will have five minutes and we would ask you to kind of keep your eye on the clock and that will give us the opportunity to have plenty of questions for you. Thank you.

STATEMENT OF CARL GRIVNER, CHIEF EXECUTIVE OFFICER, XO COMMUNICATIONS, RESTON, VIRGINIA

Mr. 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 telecommunication and broadband services to business. XO is headquartered in Reston, Virginia. We have nearly 5,000 employees nationwide. We were formed in 1996, and since then XO has expanded telecommunications offerings from its original four small markets to more than 70 area markets in 26 States today. Our company provides a comprehensive array of voice and data telecommunications services to small, medium and large businesses serving nearly 200,000 customers.

I want to thank Senator DeWine and Senator Kohl for inviting me to testify before the Subcommittee on the competitive ramifications of the SBC acquisition of ATT and the Verizon acquisition of MCI.

I believe a number of questions were left unanswered following the previous hearings held on these mergers, and I hope that our testimony today will provide you with additional information needed to properly analyze the effects of these mergers.

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 ATT and MCI, future competition between the incumbents and the remaining competitors will look much like a match between the Green Bay Packers and a Pop Warner team. And I didn't mean that as a partisan comment. I have been a Packer fan for 40-plus years.

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

First, the SBC/ATT merger and the proposed Verizon/MCI deal will fundamentally reshape this industry, marrying the two largest local telecommunications providers with their two largest competitors. Only the breakup of ATT in 1984 and the 1996 Telecommuni-

cations 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 demonstrate the substantial injury that occurs. The charts here that we are showing, which use the same data employed by the RBOCs in the FCC's triennial review 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, Ohio, and Milwaukee—no coincidence.

Chairman DEWINE. We thought that looked familiar.

Mr. GRIVNER. Yes, okay. I hope so.

Chairman DEWINE. The shoreline looked a little familiar to us, yes.

Mr. GRIVNER. As measured by the presence of competitors in commercial buildings, ATT is in red, while all other CLECs are in green. Indeed, competitors have made some headway in these local markets as a result of the 1996 Act.

The second chart shows what these markets will look like after the mergers with the removal of ATT. You will notice that these markets are significantly altered. The presence of competitive providers drops by a staggering 53.6 percent for Cleveland and 64 percent in Milwaukee. In other words, the competitive injury to customers from ATT exiting the market will be real and substantial.

And don't expect alternative providers to make up this competitive gap. ATT 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, and then 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 set of charts depict the effect of MCI's departure from the market. You can see that the competitive presence declines even further, a total of 61 percent for Cleveland and 69 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 hand-outs that we provided you, you will see that in the Los Angeles market SBC and Verizon share a common geography. Yet, neither is competing in the other's territory. So why should we assume they will compete if these mergers are approved?

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.

Fourth, these mergers will reduce, not encourage the innovation that has flourished in the competitive environment. It was competitive companies that brought your constituents DSL, and now voice

over IP. It was companies like XO that incurred the enormous expense of laying much of the fiber that is now used for advanced telecommunications services, and it is competitive companies that are continuing to innovate to find solutions to the so-called last-mile access.

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

It is important that Congress understand that if these mergers are approved, SBC and Verizon will control nearly 80 percent of the business wire line market, more than 63 percent of ILEC lines and more than half of all wireless subscribers nationwide. We hope that the members of the Subcommittee will resolve to fully examine the competitive impacts of these proposed mergers we are discussing today.

I thank you for the opportunity to testify today.

[The prepared statement of Mr. Grivner appears as a submission for the record.]

Chairman DEWINE. Thank you very much.

Mr. Citron.

STATEMENT OF JEFFREY CITRON, CHIEF EXECUTIVE OFFICER, VONAGE HOLDINGS CORP., EDISON, NEW JERSEY

Mr. CITRON. Good afternoon, Chairman DeWine, Senator Kohl and members of the Subcommittee. Thank you for the opportunity to appear today. I am Jeffrey Citron, the CEO of Vonage Holdings Corp. We are the largest provider of consumer and small business voice over IP service, as we refer to the industry, with over 600,000 subscriber lines.

For once, the entire telecommunications industry can all agree that today's phone service market is highly competitive. Consumers have many choices, from plain old telephone service, to wireless service, to new and exciting offerings from voice over IP providers like Vonage. But no matter what kind of competitive phone service you choose, all providers need access to certain critical facilities. These facilities are network bottlenecks where there is little or no competition.

Vonage would like to express our concern that the proposed mergers of SBC and ATT or Verizon and MCI would diminish existing competition by further consolidating the ownership and control over the critical building blocks upon which all communications service rely.

A good example of this critical infrastructure is the 911 emergency service network. There is only one 911 network for every market, which is typically owned and operated by the local phone company. There is no competitive marketplace for 911 services. All calls to 911 must go through this unique system.

Vonage has requested access to the Bell's 911 network and to date has been denied by all but one of the major phone companies. In an attempt to resolve this issue, Vonage has built a basic 911 solution, but it has limited functionality. Since there is no alternative to the Bell 911 network, Vonage cannot offer true 911 service if not guaranteed access to this public trust. At this critical

juncture, we are crippled from meeting our collective social policy goals to deploy 911 for all. These mergers cannot be approved without conditions guaranteeing consumers with Internet phones direct access to 911 service.

Another good example of critical telephone network infrastructure are the Bells' network tandems. Tandems are where competing providers of phone service meet to link their networks together. The core of the public telephone network is made up of these tandems. These tandems are essential because they enable customers from one phone network to talk to customers of all other phone networks, and vice versa.

To be clear, this is not about reselling the Bells' network, as it has been debated to death. I don't want to resell plain old telephone service. I just want my customers to be able to call grandma. In an effort to link Vonage's network to the public telephone network, we have requested direct access to the tandems that are controlled by the major phone companies and all these requests have been rebuffed.

This has forced Vonage to seek other alternatives such as purchasing these services from third parties like MCI and ATT. Now, the combination of MCI with Verizon and ATT with SBC puts two of the largest competitive carriers and long-distance companies under the control of the two largest Bells, giving them additional ability and incentive to deny competitors access. Congress must ensure that voice over IP providers have the right to directly interconnect with the merged companies that comprise the public telephone network to prevent the collapse of the competitive phone market.

Another essential piece of many new communications services is the Internet itself. In order for us to offer our service, Vonage must have access to both the Internet and the traditional telephone network. MCI and ATT are two major providers of access to the public Internet backbone. Post-merger, the Internet would largely be controlled by the Bells, all of whom have the incentive, ability and history of denying Vonage access in order to gain a competitive advantage in the retail market. Congress must ensure that the merged entities provide their competitors nondiscriminatory access to the Internet backbone.

Furthermore, wireless spectrum has slowly been consolidated into the hands of the powerful local phone companies. As the spectrum caps and resell requirements for these services have eroded, to accommodate our increasingly mobile customers Vonage must have access to this critical infrastructure in order to compete with local phone companies. Recent industry analysis indicates that when these mergers are complete, SBC and Verizon will control more than half of the wireless market. These mergers leave the interconnection rights of yet another essential facility at the discretion of the Bells.

The final concern I would like to raise today is that the consolidation of retail services and broadband network providers will continue to put pressure on consumers' rights to switch their phone service to a provider like Vonage. Today's consumers are prevented from moving their phone service to Vonage if they have DSL. If a customer wants to transfer their number to Vonage or to another

competitive service, SBC and Verizon will cancel their DSL service. This practice slows broadband adoption and reinforces anti-competitive practices.

DSL tying also holds consumers hostage by controlling which services they can and can't use their phone number with. Less than 20 percent of our customers use Vonage over DSL. Stand-alone broadband is a critical driver for this emerging competitive market. Therefore, Congress should ensure that the merged companies allow existing customers to switch their phone service and keep their stand-alone DSL.

In light of all these concerns, we respectfully submit that these mergers cannot be approved by the FCC and the DOJ without appropriate conditions to remedy these problems. Policymakers must ensure that retail providers like Vonage have fair and equal access to the essential facilities, the 911 network, the tandems and the Internet backbone. These conditions are necessary in order to protect retail customers and to allow for the continued innovation of voice over IP and other Internet-based applications.

I look forward to answering any questions that you might have. Thank you.

[The prepared statement of Mr. Citron appears as a submission for the record.]

Chairman DEWINE. Thank you very much.

Mr. Cleland.

STATEMENT OF SCOTT CLELAND, FOUNDER AND CHIEF EXECUTIVE OFFICER, PRECURSOR GROUP, WASHINGTON, D.C.

Mr. CLELAND. Yes, thank you, Mr. Chairman and Senator Kohl and Senator Brownback, for letting me share my views today. I will take a little different tack today. What I want to do is emphasize kind of a forward-looking view to the extent that I can.

I think antitrust is very relevant to these transactions, but in a traditional way I am not one that believes that these mergers pose a potential antitrust threat that warrants disapproval. On the condition issue, I think these mergers are subject to a tremendous amount of existing regulation that can be adapted and modified to address many of the concerns that people have in this merger context.

Now, that being said, that does not mean that I don't think that there are serious antitrust and enforcement issues here. I want to respectfully suggest how I think antitrust needs to adapt to what we call a techcom future. What is really going on here is we are seeing the convergence of tech and telecom. It is becoming a new industry which we call techcom. In my testimony, we have a piece that summarizes it and explains kind of where that is going.

The one point on a going-forward basis that is absolutely critical to get right is there is, I think, in the United States a core constant, unshakable principle that is embedded in the 1934, the 1996 Act and in the Internet, and that is the national value of free and unfettered access of every American to every other American. That is critical for our social and political cohesion as a Nation, our economic growth and innovative society, and for national security and homeland security.

Let's remember the 1934 Act basically required interconnection because ATT successfully monopolized the market by denying interconnection to small players. The 1996 Act in this respect got it dead right—a mandated duty to interconnect and be interoperable. Then the Internet is the ultimate example of this principle, where it is what connects everybody as simply, broadly and universally as possible.

So I think the biggest anti-competitive threat that faces the techcom world is not pricing power that many may discuss here. Pricing in this market is plummeting because of Internet protocol substitution. Prices are plummeting. Now, that does not mean there aren't antitrust issues here. What it means is you all should be concerned about subtle and naked attempts to gain market power by impeding or denying interconnection or network access for the purpose of competitive gain. It is going to require, I think, some real vigilance among the Congress, the Department of Justice and the FCC. But I think with market forces and with that vigilance, I think it will turn out to the benefit of all.

What I want to do is list four anti-competitive concerns on a going-forward basis that are very important to focus on. The first is bit interference. That is basically trying to impede, sabotage, block, slow down somebody else's traffic that is going over your network. And we know from the recent Madison River case that affected Mr. Citron's company that this exposed potentially the most lethal risk to emerging techcom competition. If companies are allowed to technologically sort, block, impede or sabotage bit transmissions, competition cannot develop or flourish.

Another one that you should be looking at very closely is the rather innocuous term of "quality of service." That can be used to discriminate where, say, a large network says I am going to allow my customers to get premium passage and fast traffic and anybody that doesn't use my service gets put in second-class or the slow lane. And the fastest way for an incumbent to win and shut everybody else out is to create two tiers of discriminatory quality of service. That has to be watched very, very closely. It could also be lethal to competition.

The most insidious form of anti-competitive behavior that I have seen is the non-cooperation on 911. It is absolutely unacceptable that people are denying or impeding or not cooperating as incumbents with any competitor that is trying to promote what we all agree is a national goal of 911. Every American expects that that is there and it needs to be. That is very insidious.

Another one that people don't think about as being insidious is muni broadbands, the opposition to municipal networks, and I want to characterize that in a little different way. These are technological and equipment companies that are trying to sell to the single largest market, which is municipal broadband buyers. If they are banned by the government, that is probably singularly the most anti-competitive thing that can go and prevent most Americans from enjoying the benefit of alternative competitive sources.

So with, I believe my time is up, but thank you for the opportunity to talk about this in front of the Subcommittee.

[The prepared statement of Mr. Cleland appears as a submission for the record.]

Chairman DEWINE. Mr. Kimmelman.

STATEMENT OF GENE KIMMELMAN, SENIOR DIRECTOR FOR PUBLIC POLICY AND ADVOCACY, CONSUMERS UNION, WASHINGTON, D.C.

Mr. KIMMELMAN. Thank you, Mr. Chairman, Senator Kohl, Senator Brownback. On behalf of Consumers Union, the print and online publisher of Consumer Reports, it is a pleasure to be here again to discuss with you these mergers.

I want to take all the points that Mr. Cleland makes and put them into a consumer context, because I believe he is right on the mark and I believe all the conditions that XO and Vonage have requested are on point.

Enormous technological explosion leaves us at a juncture now where consumers ought to be in the near future receiving broadband service, local telephone and unlimited long distance for as little as $40 a month. If you put together the prices that the muni wireless broadband networks can offer with the $25 package like Vonage offers for unlimited local and long distance, that is the average phone bill today for local and long distance for more than 50 percent of consumers, but that would have broadband included in it. It would be a marvelous innovation.

But the companies that are merging are charging $75, $80 for it, as are the cable companies, and they have every incentive to prevent that from happening. That is what is the fundamental danger for consumers in these mergers. They may not see the day of these price declines that Mr. Cleland pointed out we have had in the past and that we ought to have in the future.

Let's look at the world of intermodal competition that could have and should have brought us this with these mergers. Who are the biggest players out there to challenge the Bells? ATT, MCI, gone, part of the almost total dominance in the SBC territory for local and long distance, and in the Verizon territory as well.

Wireless is out there, someday may be price-competitive, may improve its quality, but it is still twice to three times as expensive as wire line service for the average consumer use package. And who owns wireless? Verizon wireless is dominant in the Verizon region; Cingular, owned by SBC and Bell South, dominant in the SBC territory. It doesn't solve the problem.

Voice over Internet offered by cable. Well, if you are going to pay the high price, you might be able to get it. Only 30 percent or less of consumers right now have it. It is not clear how many can afford it at those price levels. And what you heard from these witnesses is the underlying Internet backbone that needs to be there with the adequate resources available to support competition may decline, may diminish, because ATT will pick up a lot of the traffic they were carrying, as will MCI. We may not have that service fully available to consumers.

The final opportunity for meaningful intermodal competition is municipal wireless. You have companies like Verizon and SBC leading the charge to prevent communities from building out these networks. Whether it is not the community and a public entity, the critical point there is that, looking at the actual costs of providing wireless broadband, Philadelphia has found they could offer it at

wholesale for $9 a month to Internet service providers, who claim at that price they could turn it around for as little as $15 a month for residential consumers. I don't care if it is municipality or if it is a start-up company. That is where the market ought to be moving. These companies are trying to block that innovation, block that competition.

So we believe from a consumer perspective that these mergers need to be substantially revamped. The conditions that Mr. Cleland were not that big a deal—quality of service, bit interference—yes, there are regulatory tools for them. But, boy, are they hard to police. That has been the Achilles heel in getting competition in telecommunications for 35 years. They are very important. We need the right incentives. They are not just a regulatory police force. So conditions are very significant here.

I am not even sure that is enough. Even if you have DSL standalone, naked DSL, what is the price? How much control of the customer information, the quality of service, the bits, is there still going to be in these dominant Bell companies?

Mr. Chairman, members of the Committee, we think it is really time for Congress to step in beyond the merger and look at whether your goals of competition in the 1996 Act are really being delivered to consumers, whether we are going to be able to sustain it in this environment, mergers conditions or not, and reopen the Act and think about what really needs to be done. Do you really want competition? Do you really want a $40 package for all these wonderful services? If you do, I suggest it is going to take some reworking by Congress.

Thank you.

[The prepared statement of Mr. Kimmelman appears as a submission for the record.]

Chairman DEWINE. Senator Kohl.

Senator KOHL. Thank you, Mr. Chairman.

Mr. Citron, Mr. Kimmelman, one important new way for consumers to make phone calls is through the technology, as we know, voice over Internet protocol. This allows consumers to make phone calls over the Internet rather than over conventional phone lines. Making phone calls using voice over Internet requires a high-speed Internet connection, a service many consumers obtain from their phone company.

With the exception of Qwest, until now none of the regional Bell companies will sell consumers high-speed Internet service without also requiring that the consumer also buy local phone service. This clearly eliminates any incentive for the consumer to purchase voice over Internet phone service and is therefore a significant obstacle to the deployment of this technology.

At our last hearing, we asked the Bell companies whether they would be willing to sell high-speed Internet DSL service without also requiring that the consumer buy phone service. The Bell companies answered that they would do so only if they could make a profit on stand-alone DSL service.

Mr. Citron, what is your reaction to this statement? Can you market your voice over Internet service to consumers who use DSL Internet connections if these consumers are also required to buy phone service?

Mr. Kimmelman, I am interested in your view, and what do you think of Verizon's plan announced today to offer limited stand-alone DSL to their existing customers in the Northeast?

Mr. CITRON. Senator Kohl, Vonage has found it incredibly difficult for our ability to sell voice over IP services to customers who have DSL. We find the problem in two forms. First, in order to go ahead and get the DSL, most customers are required to buy phone service. So buying voice over IP and then being required to keep a phone service you don't want makes it, of course, too cost-prohibitive to go out and get the service.

Even in examples where people are able to go ahead and purchase stand-alone DSL, the ability does not exist yet for people to transfer their phone service, when tied with DSL, over to Vonage's service, the ability for them to keep their phone number and move the service seamlessly over. Both are enormous barriers to competition and for people to switch.

Senator KOHL. Mr. Kimmelman.

Mr. KIMMELMAN. From the consumer perspective, you pay $25 for your local phone service and then you can get, for about $30, DSL. But they have told us up until now you have to buy both. Well, why go out and then pay extra money to get the same service you have already paid for? It undermines competition, as Mr. Citron says.

Is what Verizon is offering a real stand-alone DSL? Boy, I hope it is. It doesn't look like it. At least from what I saw from press accounts, they are offering it to existing DSL customers. Well, that leaves out more than 90 percent of their current customers.

Why can't somebody who is interested in getting a high-speed connection tomorrow call Verizon and say all I want is high-speed? Why can't they get the same thing that they have just offered someone else? I don't understand it. I mean, limited is better than nothing. I don't want to criticize it in that respect.

Once you get past technical barriers, which clearly Qwest has shown there are not—they offer this on a stand-alone basis—I don't understand why Verizon is offering so little. It is really very little for very few people. Hard to understand.

Senator KOHL. Mr. Citron, on February 17 the Washington Post reported that the FCC was investigating complaints by your company that local phone companies were blocking or disrupting access to your voice over Internet service. Has your company's service been the victim of such actions by telephone companies, and are you concerned that this will occur in the future? Will these mergers make it easier for phone companies to have increased capabilities to block or to degrade access to your phone service in the future?

Mr. CITRON. Well, yes, it is true, Senator. A company known as Madison River, a small ILEC, went out and started blocking Vonage's service. Of course, we did go to the FCC and the FCC under its Title II authority was able to investigate the matter and ultimately a censure and a fine against this company.

Vonage is highly concerned about this problem. We see the effects of what we call port blocking or disruption of the service occurring in a number of different sectors. We are seeing it occur right now with a wireless Internet service provider. We are seeing it with a very, very, small cable company that is also blocking

Vonage's service. So we find this to be problematic and we find this to be a growing trend.

But beyond the last mile, we are also concerned about being able to purchase that Internet backbone. As I have already mentioned in my testimony, we buy a lot of capacity from MCI and ATT and others, and with the majority of the Internet backbone controlled by the Bells post this merger, we are concerned that not only do we have to worry about tampering in the last mile, but potential tampering inside the core of the network with, quite frankly, the inability to purchase services at the core of the network level.

Senator KOHL. Are there remedies that the regulators can enforce that will prevent this from happening?

Mr. CITRON. Well, in the case of a phone company DSL provider, yes, under the Title II authority the FCC did find that capability. But there are a lot of concerns about whether or not you can enforce this on other providers or players. So this is something that we take issue with.

Senator KOHL. Mr. Kimmelman and Mr. Cleland, as you know, one important possible alternative to traditional phone service for consumers will be wireless connections to the Internet. Using these connections, consumers can access alternative phone providers such as voice over Internet and provide the Bell companies connections to their homes.

Cities and municipalities such as Philadelphia have begun to build such wireless networks and plan to offer it to their residents as a municipal service. At our hearing last month, the Bell companies admitted that they were actively lobbying State legislatures around the country to pass laws forbidding cities from building these new networks to deploy these technologies. Pennsylvania recently adopted such a law and other States considering such laws include Illinois, Texas and Florida.

What are we to make of such lobbying efforts? Do these municipal networks offer competitive alternatives? What do you make of the Bell companies' claim that it is unfair to ask them to compete with a municipal system?

Mr. Cleland?

Mr. CLELAND. I think it is patently anti-competitive, and what they have done is they have framed the debate that it is a municipality that is trying to compete directly with them and it is a fundamental misunderstanding of the technology and how they service is provided.

Essentially, the WiFi phenomenon emerged because Intel decided without telling anybody that people wanted wireless access and they put it in a chip. And then people bought for less than $50 a WiFi stick and they put it in their home or in Starbucks or wherever it was. It is a form of a gorilla network. It doesn't require an operator or a service provider like we know that a Bell is. Somebody can put up a WiFi stick for virtually no cost and you can replicate not everything that a DSL can have, but you can replicate a lot of it.

Why it is anti-competitive is incumbents don't fear the municipalities as competitors. What they fear is the massive price deflation of people realizing that there is an extremely cheap technology that replicates what they do that can be put up very, very simply.

You can put up WiFi sticks on light poles, on mailboxes, or whatever. You put them around extremely cheaply and it can be a tech company supplier who is in this instance is a competitor to the incumbent. By getting it banned, what they are doing is they are basically shutting down the greatest competitor potentially to an incumbent, which is technology companies selling new technology that really doesn't require a traditional operator.

So the last analogy that I will leave you with here that I think is a powerful one is would you have thought it was good public policy in the past when railroad companies came and said I don't think municipalities should be in the road-building business, they shouldn't build highways and they shouldn't build an airport because that would be an unfair subsidy to the automobile companies and the plane companies? Of course not. It is patently absurd in the sense that municipal broadband networks are much like what it was to build roads and to build airports in the past.

Mr. KIMMELMAN. I couldn't agree more with Mr. Cleland. This is patently anti-competitive, it is unfair. It is embarrassing to come in and talk about innovation and competition and then to be out there actively blocking competition. It takes a lot of gall.

This ought to be one of the first conditions I would urge the Committee to look at both for the antitrust officials and communications policy in general, the notion of barring entry in a world in which we have seen SBC swallow up two other Bell companies—former Bell Atlantic, now Verizon, swallow up two of its equi-sized colleagues. They all swallow them up.

How many times did they tell you that was going to be the merger that was going to get you the competition? And, oops, it never is; it is always the next one. And here they are blocking competitors. It ought to be stopped.

Senator KOHL. Thank you, Mr. Chairman.

Chairman DEWINE. Senator Brownback.

Senator BROWNBACK. Thanks, Mr. Chairman. Thank you for holding the hearing. I have a written opening statement I would like to submit for the record, if I could, too.

Chairman DEWINE. That will be fine.

[The prepared statement of Senator Brownback appears as a submission for the record.]

Senator BROWNBACK. Gentlemen, I was on the Commerce Committee before and so I have been around this issue for the years I have been in the U.S. Senate. It does strike that, for whatever reason—and it was partially, I think, the 1996 Act, but it also is just a lot of technology—competition is very robust now.

We sought to create that in 1996. We sought to be able to take advantage of some of the competition in the marketplace that we thought could be there with that Act. We got it partially right, probably got a lot of it wrong. But at the end of the day, we are at a point now where there is robust competition, there is a declining price structure, there is good quality of service on a lot of different platforms, to the point that I can't keep up with my latest device. They change it on me about every six months and it is something new and it is better.

So I commend you as a group and as a field for that taking place. I think that has just really been a great innovation and I think it

has been a great competitive advantage for the United States and I think it has been a great efficiency factor for us, increasing productivity across the United States, plus I can keep track of kids a lot better now than my parents could keep track of me, which is good for both of us.

I am curious, though. Mr. Cleland—and I want some of the others to comment on this—you seem to look at this merger and say, okay, this is going to really stifle this continuation, and I guess I just don't have the degree of fear of this taking place, given all of the competition that is coming into this field right now, whether it is in Internet protocols or whether it is happening in cable or other places. I think you are going to have robust competition, it seems like, because of the technological factors and the number of ports that people can get into the phone service.

Mr. Cleland, let me put the question, though, in reverse to you. What happens to these large companies that are merging if the merger does not go through? What would be the likely impact on them and on competition if it doesn't go through?

Mr. CLELAND. Well, to answer that specific question, I am an analyst for the investment community and so while I have one position—when I analyze these under antitrust law, I don't think that they warrant disapproval or necessarily heavy conditions. However, if you are asking my opinion on what would these companies do if they didn't merge, I think they would be a lot better off.

I think in SBC buying ATT and Verizon buying MCI, they are changing their risk profile and their growth profile and they will become negative growth companies. So I am scratching my head about why they are wanting to do it. This is a free country. They have chosen to do it.

I think that whether they are merged or not, that is not the competitive dynamic that is the real concern. I am a believer in intermodal competition and deregulation and in market forces, and I believe it is increasingly competitive. Right now, you have DSL, you have cable modems, you have three 3G networks coming on board nationally this year from Sprint, from Verizon, from Cingular. You have companies like Clear Wire doing WiMax. You have broadband over power lines that is very promising; it is not right now, but it is coming down the pike. You have WiMax that is very promising.

And so I personally believe that these companies, whether they merge or whether they don't, are dinosaurs and they are going to be affected very negatively by competition. Their prices are going down. They offer services that are on the wrong side of technology, the wrong side of history. And you can provide techcom services, services like Mr. Citron is, for anywhere between 20 and 90 percent less than what the incumbents offer. So competition is coming more furiously, but it is coming from technology.

Senator BROWNBACK. I understand. So regardless of the merger, the competition is going to be furious for the consumer out there.

Mr. CLELAND. Increasingly, if—and there is a big "if"—as a strong proponent of deregulation and of market forces, I also believe that deregulation does not mean a state of lawlessness or obligationlessness. Just like there is 911, CALEA, consumer protection, disability access, universal service, antitrust—all of those are social and national obligations we all agree should be on there—

in addition to that, the critical one is protecting the duty to interconnect and making sure that people don't mess with the freedom to access any content, to access any application or attach any device. That is critical. Competition without those protections is really going to collapse.

Senator BROWNBACK. I appreciate you mentioning that because coming from a rural State, a number of these services and needs are things that are built into the law that we need to be able to maintain a set of infrastructure support that can be cost-competitive. I actually think that is a far bigger issue than these mergers as to what we need to do to be able to maintain those services and the funding streams to be able to do that, because I think those funding streams are going to have to be altered, it looks like to me, to collect the new people that are coming into the field and make sure everybody is sharing in this.

Mr. Citron, I am not sure maybe if you would be the right one to ask this or not, so I will apologize ahead of time if you are the wrong to ask. But when you hear Mr. Cleland say that there is going to be robust competition, regardless, and we shouldn't have a state of lawlessness, but there is going to be robust competition, don't you agree with that as you look at the overall factors? Regardless of the merger, this is going to be a robust field?

Mr. CITRON. Well, I think I would agree in a sense. I believe already that there is robust competition for consumers' business. I think that has led to obviously pricing declines. We think that is a very positive trend. I think one thing that people sometimes miss is that all providers of communications services still rely on critical infrastructure and if access to that critical infrastructure is not provided, then all of a sudden you will not have competition.

Vonage is already facing problems in getting access to many systems that are critical, like the 911 infrastructure, and that is problematic. In addition, I notice that Mr. Cleland did mention wireless broadband opportunities. One of the new wireless broadband providers in this country actually is disrupting and blocking Vonage's access to its customers. They literally stop our packets from flowing over the wireless links to the consumers to provide them voice over IP service. So what good is voice over IP competition if the broadband provider that is delivering those packets interferes with them for their own benefit? That is the problem that we see.

Senator BROWNBACK. Now, Vonage, as I understand it, is the largest VoIP provider. Is that correct?

Mr. CITRON. That is correct.

Senator BROWNBACK. Much larger than ATT on that type of service?

Mr. CITRON. That is correct as well.

Senator BROWNBACK. And it doesn't seem to be that you have had problems providing that sort of service to date, or competing with the large telephone incumbents to date. I mean, you are identifying other fields where there are blockages and not particularly this one?

Mr. CITRON. No. Actually, if you look at our problem, say, with interconnecting to 911, we have asked all four Bell companies for direct access to the E911 system so that we can provide an E911 solution that is on parity with the regular wire lines—something

that everyone in this room should be very concerned about. Only one of those four Bell companies has granted us access to date. The other three Bell companies still refuse to give us access. Some are talking to us about it.

Senator BROWNBACK. On what basis? What do they articulate to you?

Mr. CITRON. They don't have to.

Senator BROWNBACK. And they have not?

Mr. CITRON. They have not. Now, I will add one more point to that just related to these mergers. Today, Vonage wants to go ahead and access the PSTN network, the core tandems, to be able to take our customer calls and have them communicate with other networks, basically for my mom to call her friend who is not on the Vonage service.

To make that happen, we need to interconnect at the tandems. These are critical core network elements. Vonage has asked for access to these tandems. The incumbent Bell operating companies have told us no. Why? They can.

Senator BROWNBACK. Let me ask Mr. Cleland kind of a tight question, if I can, on this. Mr. Grivner's testimony states that the DOJ, upon close scrutiny of the geographic markets, will find that the SBC/ATT merger will fail to meet legal standards.

Would you agree with that assertion? Do you feel in a position to be able to make any statement regarding that assertion today?

Mr. CLELAND. Well, if they drill down and look at individual markets like that, there may be some difficulties. I think what I expect DOJ to do is to draw back a little bit bigger in the markets. Remember, each one of these markets has been declared in a congressional act and through all the painful, ad nauseam regulation to be irreversibly open to competition.

So the regulators have deemed that local and long distance integration is now allowable. There is a lot of competition and potential competition. I think it would be very difficult for the Department of Justice to go to court and say that these mergers were anti-competitive.

Mr. KIMMELMAN. Senator Brownback, can I just say here is the interesting conundrum: the irreversibility was based upon a set of regulations that enabled ATT and MCI to come in aggressively and offer local phone service that have now been obliterated, where those companies will now be part of the companies they were competing against. So I think there is an open question as to how irreversibly open any of these markets are, given these changed circumstances.

Senator BROWNBACK. Thank you, Mr. Chairman.

Chairman DEWINE. Mr. Grivner, let's get back to that map you put up there. I found that kind of interesting. Isn't it true that ATT actually had announced its withdrawal from providing these services before the decision to merge, and isn't the lack of competition in the local market really the result of a court decision that made it difficult for ATT to compete rather than a product of these mergers? In other words, would blocking the mergers change anything?

Mr. GRIVNER. I think, Senator, it is part of, to give kudos to where they are, a very comprehensive overall strategy. ATT specifically withdrew from the consumer business when the writing was

on the wall that they were going to have to charge more to their consumers and not be able to compete with the local Bell operating companies when UNEP went away. They were two of the largest users of UNEP.

So if you look at it from a regulatory perspective, the regional Bells have been very successful in lobbying the FCC. When you go to the courts, you have got the *Trinko* decision. You have the issue now that they are fighting through relative to the municipalities.

So they have put their two biggest competitors on their backs in the consumer market and then decided to buy them. I think it is a very remarkable overall cohesive strategy on their part, so failing perhaps in those particular markets, but still very, very strong in the business market, where they will still control 80 percent of the wire line business market between Verizon and SBC.

Chairman DEWINE. So your answer to my question is what? You are telling me that blocking the mergers will change this reality. Is that what you are telling me?

Mr. GRIVNER. I am saying that what the FCC and the Department of Justice need to do is they need to exhaustively examine both of these mergers to understand the impact to consumers, which will be substantial, as well as to business customers. These companies are not failing. They are Fortune 100 companies with $30 billion and $20 billion, respectively, in revenue, and producing significant cash flow as businesses as well.

Chairman DEWINE. But the specific question I asked you had to do with this market, though. ATT had announced it was withdrawing from providing their services. That is correct. I am not wrong on my facts, am I?

Mr. GRIVNER. You are not wrong on your facts. It is how they got to that point. They got to that point because they were pressured out of the market.

Mr. KIMMELMAN. Mr. Chairman, could I add one thing there?

Chairman DEWINE. Mr. Kimmelman.

Mr. KIMMELMAN. Even as they announced they were withdrawing, ATT still has more than 25 million consumer accounts. That is a big chunk of the consumer population there.

Chairman DEWINE. Consumer accounts?

Mr. KIMMELMAN. Yes, consumer accounts. They were withdrawing from marketing to new customers to offer this package of services as the regulations were wiped out. On the business side, what this reminds me of is the 1970s. Do you remember the old MCI? MCI started out not offering the kind of services consumers now know. They offered services to businesses, and the way competition developed was from a new upstart coming in serving businesses and expanding out to the residential market.

That is where we are again here with the new technologies and a new set of players. We need companies that can serve the business market independent of the Bells and then expand out to consumers.

Chairman DEWINE. Mr. Cleland, let me turn to you, but also Mr. Grivner. Both of you have staked out somewhat divergent views on how we should react to these mergers. Mr. Cleland, you said these mergers will not really pose a serious risk unless the Government fails to be vigilant in deterring anti-competitive behavior and urges

Congress, the DOJ and FCC to apply vigorous antitrust oversight after the fact.

Mr. Grivner, on the other hand, has stated his concern that the current Government oversight scheme cannot be counted upon to correct abuses post-merger. is Mr. Grivner correct to be concerned that our current oversight scheme is inadequate to the task of policing this industry post-merger?

Mr. CLELAND. Well, where I come from is I believe that in the totality when you look at this thing that it won't be blocked and that it is best for competition going forward not to block it. Does that mean that I don't think there is going to be any anti-competitive effect in certain markets? Of course not, but I think competition is rough and tumble.

The old CLEC model is one that was built upon the Telecom Act of essentially interconnecting in a certain way with an overbuilding of the Bell network. And now what we have is a whole new set of technologies that are able to break the bottleneck and don't have to lean on it and I think those will cure many of the ills that Mr. Grivner is talking about.

Will it be a totally pretty transition? No. I think we should expect that there will be probably some market power exerted in some localities in some places for a certain period of time. However, if we had that fear, we would never get from here to there. So I think a competitive transition and intermodal transition takes time and will be a bumpy road.

Chairman DEWINE. Mr. Grivner, do you want to comment?

Mr. GRIVNER. Senator, there were conditions placed on the SBC/Ameritech merger back in 1998, and post that merger SBC has paid $1.2 billion in fines in non-compliance for those conditions. Now, in most States that is a lot of money. That would be a lot of additional revenue, $1.2 billion. But apparently to SBC it is not; it was cost of doing business. So I think those conditions need to be very, very carefully analyzed and I don't think we are at that point yet.

Chairman DEWINE. Let me ask all of you this question. The testimony we have heard and seen had a great deal of emphasis on the idea that access to the local network may be the most important factor in allowing other market entrants to compete. However, this certainly may be easier said than done.

When we tried to implement the unbundled network elements method as a way to assure that the long-distance companies had access to Bell company networks after the 1996 Telecommunications Act, we saw years of fighting and litigation. How exactly do all of you suggest ensuring access to the local network?

Mr. Kimmelman, do you want to start?

Mr. KIMMELMAN. Well, I think there are some straightforward conditions that have been mentioned. Unbundling DSL and making sure it is offered at a reasonable price in its terms and conditions would be helpful. Let's push Verizon to go much further than they have here and get SBC to the table on that. That would certainly be helpful. The variety of non-discrimination requirements that have been mentioned could be helpful.

I believe, given that history, I believe you are absolutely right, Mr. Chairman. It was a tough row to hoe and it didn't really work.

Really, the best thing we could do is back these companies off of blocking new entrants, whether they be power companies, whether they be municipalities, find a way to make this a merger condition or enact it into law, if Congress has to, because the best way to ensure there is new availability of competition for consumers is to have a wireless broadband network offered by somebody else.

Chairman DEWINE. Mr. Cleland.

Mr. CLELAND. Yes. I really want to hammer home the point that in a deregulatory environment I think the incumbents have basically gone to the extreme of saying in a marketplace there are no obligations, there are no requirements. I think that is way overreaching and very anti-competitive and a problem.

Price deregulation didn't work. I think it is a failed policy and a lot of the reason we had the legal fights that we had was I think the FCC was overly aggressive in price regulation and less concerned about making sure that there was good interconnection and good access.

So I think that the emphasis should be very, very strong toward enforcing and policing interconnection, and whenever there are people that are impeding or denying access to 911 or other networks, tandem networks, that is the thing that should raise the ire of regulators and antitrust enforcers, and they should back off of trying to micromanage the prices and the economics of the market.

Mr. CITRON. Clearly, we already have a framework for allowing for interconnection, and clearly that framework doesn't work because that framework does not currently extend beyond the current providers. It doesn't encompass voice over IP, it doesn't encompass our company. That is why we are having such difficulty in gaining access.

I think there are a couple of prescribed approaches to this problem. One, of course, is as a condition of these mergers you can force the emerging entities to make sure they provide that their network is open and available to us on a competitive basis and to similarly situated companies.

Another way is to actually look at the current laws and the constructs and to expand those laws on interconnection to allow players like ourselves to go ahead and compete and gain access to services.

Mr. GRIVNER. While competition exists in the market today, it is extremely fragile. We all depend on that last-mile access. We have talked about some very innovative technologies—broadband, wireless and some new things. But those things are years away, and in the meantime the current FCC rules need to be enforced and they need to be innovative enough to allow new entrants into the market as well.

Chairman DEWINE. Mr. Kimmelman, in his written testimony Mr. Cleland has mentioned a number of technologies—wireless, cable modem, WiFi, WiMax, broadband over power lines—all as likely competitors against traditional wire line service.

First of all, do you agree with this, and are these technologies ready for prime time do you think?

Mr. KIMMELMAN. I agree with all them being potentially out there. Some of them have been potentially out there for 5, 10, 15, maybe 20 years.

Chairman DEWINE. Emphasis on the potential.

Mr. KIMMELMAN. Yes, a lot of potential. He mentioned 3G networks and he mentioned Cingular, Verizon and Sprint. Well, two of those are the merging parties here with their most likely competitors. The problem is not just the technology. You have to look at the market power they have in using the new technologies bundled with the old technologies.

I do believe there is potential here. I really do urge you to look at this like the 1970s when old Ma Bell was being broken up, when MCI was challenging it. It took some hefty intervention to open up that market to more competition, and I think all the technologies Mr. Cleland is talking about are there. They are ripe for consideration in the marketplace. It is rough and tumble, but there needs to be some non-interference from public officials in order to make that happen. Otherwise, it won't happen.

Chairman DEWINE. Mr. Cleland?

Mr. CLELAND. Yes, thank you, Mr. Chairman. There is a lot going on right now. We call this dynamic techcom, and why these technologies, broadband over power lines? I followed it for nine years and was yawning and saying when is it going to come? Well, it finally has come.

The reason why many of these technologies that we are talking about—they are not pie-in-the-sky; they are real and they are coming on now for several reasons. We have a critical mass of wireless access. We have a critical mass of processing power. Essentially, Moore's law. Silicon chips have gotten so fast and so cheap that they are solving problems that before were barriers to competition.

Storage is getting dramatically cheaper and dramatically smaller. We now have 185 million people with cell phones, so there is mass penetration there. We have broadband access all through the enterprise market, 90 percent. Thirty percent of the consumer market has broadband access. That is 60 percent of the buying power, so broadband access has been critical. Deregulation—we have displays, foreign factors.

There is a confluence of things that are coming together, and we call it the techcom dynamic, where the things that we have all been talking about in pieces are finally starting to come together. What we call the techcom dynamic is mobility times convergence times the any-to-any connectivity of IP.

What you have is a very, very dynamic, innovative marketplace that really was kind of started in the last year. VoIP is just one dimension of the exciting changes that are going on. People have been talking about convergence for a long time. What they are going to see is in the next two to three to four years it is going to happen much faster than people anticipate.

Chairman DEWINE. Mr. Cleland and Mr. Kimmelman, some have raised concerns that after the merger SBC and Verizon are not likely to compete in one another's territory even for enterprise customers, since they have not very aggressively competed in the past. However, a large part of the motivation for this merger on the part of SBC and Verizon is to gain access to the large enterprise clients currently served by ATT and MCI.

Why would SBC and Verizon spend all this money to acquire ATT and MCI if they did not intend to compete head-to-head to get these big business clients?

Mr. KIMMELMAN. I will start. Well, they clearly are spending money because they think they can make money here, and Mr. Cleland has made some good points about why it may not make total sense.

The enterprise market is not where I focus, but there are very few competitors today in the enterprise market. They may be willing to challenge each other somewhat, but the real problem there is there are deregulatory pricing rules for a two-player market involving what is called special access that are leaving very high prices for business customers. This will not solve any of that problem and it will create the political environment that makes it impossible to solve that problem. There will be nobody else out there who is well-positioned to serve the enterprise market.

I will just go back to my earlier point. While we don't focus on business customers, the history of telecommunications has been that many players coming in servicing business markets first end up in residential markets. So the danger here is that this just locks in a very tight oligopoly even further.

Chairman DEWINE. Mr. Cleland.

Mr. CLELAND. Well, the problem with the enterprise market—and SBC and Verizon are going to learn it quickly—is you tend to covet and want what you don't have, and the Bells don't have those large enterprise customers. When SBC and Verizon buy them, they will realize that that customer segment is rapidly moving away from them and ATT and MCI.

What is happening in that marketplace is essentially enterprises are in-sourcing. They used to have to out-source and they needed ATT and MCI. They are now moving most of their voice traffic and their data traffic onto their own networks. They just don't need telecommunications providers anywhere near as much as they did in the past.

So that market, we believe, is going to be a steadily declining market for several years. I don't think in that marketplace that SBC/ATT and Verizon/MCI are going to be able to exert market power. They are going to have to do their best just to hold their own.

Mr. KIMMELMAN. Mr. Chairman, what I hear Mr. Cleland saying is there really is no competition and big businesses ultimately will spend on their own if the prices are too high from the commercial market. That is not a very good set of policies, I believe.

Mr. CLELAND. Well, once again it is very important. You have to understand techcom competition is different than telecom competition. In the techcom world, large enterprises already have networks. They are Microsoft, they are IBM. They have their own networks. They don't need ATT, MCI, Verizon and these companies like they did in the past. So that is what technology is allowing them to do. Technology is allowing these enterprises to totally bypass or do without what they used to absolutely have to have.

Chairman DEWINE. I want to thank all of you very much. I think it has been a very helpful hearing. I think we can safely say we have heard just about all sides of the many issues raised now by

these mergers. This panel has done a great job of balancing out the testimony that we heard last month from the merging parties themselves and really, I think, given our Subcommittee a lot to think about, which we will. As we have said, there are a wide range of issues raised by these deals.

So we again thank our witnesses. I want to thank Senator Kohl for his great work, and we thank all of you. Thank you.

[Whereupon, at 4:15 p.m., the Subcommittee was adjourned.]

[Submissions for the record follow.]

SUBMISSIONS FOR THE RECORD

Written Statement of Jeffrey Citron, CEO
Vonage Holdings Corp.
U.S. Senate
Antitrust Subcommittee
of Judiciary Committee
April 19, 2005

Good afternoon Chairman DeWine, Senator Kohl, and members of the Subcommittee. Thank you for the opportunity to appear here today. I'm Jeffrey Citron, CEO of Vonage Holdings Corp. We are the leading provider of consumer and small business Voice over Internet Protocol service, or "VoIP" as it is referred to in the industry, in the United States, with over 550,000 subscriber lines.

I. Introduction

Vonage's innovative VoIP service offers consumers a choice in the retail market for communications services. However, Vonage's service is dependent upon reasonable and non-discriminatory access to the network infrastructure owned and controlled by telephone companies. As the leading provider of VoIP services, Vonage has a unique perspective on the proposed combinations of these companies. We are "true believers" that competitive markets are aligned with the public interest in that such markets produce high-quality services at the most efficient prices.

Vonage has consistently supported deregulation and opening markets to increased competition. But Vonage is concerned that the proposed mergers would diminish the retail competition that exists today not by removing two large competitors from the retail market, but by further consolidating ownership and control over the communications infrastructure on which Vonage and other competitors, including cable providers, rely to provide service to end users.

My comments today first detail the innovation and consumer benefits that Vonage's service provides in the marketplace. Next, I provide a brief description of the

market for broadband Internet access services. Finally, I discuss what safeguards are necessary to preserve competition both in the wholesale and retail communications marketplaces.

II. Vonage Offers an Innovative Service at a Competitive Price

Vonage has experienced explosive subscriber growth due to the innovative features and the competitive price of its service. Simply stated, Vonage enables customers to use their broadband Internet connection to place and receive telephone calls. By leveraging the power of the Internet, Vonage offers its customers a panoply of new features simply not available from the incumbent providers of telephone service. These include the ability to obtain online real-time information concerning their account, call detail and billing status, the ability to receive voicemails as an attachment to an e-mail directed to their desktop, laptop, PDA, or Blackberry as well as other features that traditional carriers can't offer.

In terms of price, consumers are experiencing widespread residential local and national competition for the first time. Vonage offers customers the ability to replace their existing telephone service with its service for as little as $14.99 per month. This includes 500 minutes of calling throughout the U.S. and Canada, with popular features like caller ID, call waiting, voicemail, and many others all included for free. Moreover, for just $24.99 a month, our customers can make unlimited local and long distance calls throughout the United States and Canada.

Because of Vonage's low price, most customers can subscribe to a broadband Internet connection – via cable or telephone companies – and receive telephone service at a price lower than what many consumers pay for traditional telephone service. In this

way, Vonage's services are driving broadband adoption which in turn increases broadband deployment, especially in rural and other underserved markets.

III. Intermodal Competition Is Not Robust Enough to Restrain Anticompetitive Behavior by the RBOCs

It is important to realize that as a practical matter, there are only two sources of intermodal competition: wireline and cable.[1] The leading providers of wireless services in the United States (BellSouth, SBC and Verizon) are also the leading providers of wireline telephone services. Thus, the existence of wireless services and the developing technologies that will lead to wireless broadband services cannot be relied upon as a third source of intermodal competition. This leaves the wholesale market for communications services dominated by two modes: telephone companies and cable providers.

Many incumbent providers of telephone service argue that deregulation is necessary so that telephone companies can effectively compete with cable companies that also offer high-speed Internet access. Legacy providers of telephone service frequently attempt to support this position by claiming that 60% of the market for broadband Internet connections is controlled by cable companies. However, these statistics require further analysis in order to obtain an accurate picture of the market for broadband Internet access services.

According to the most recent data available from the Federal Communications Commission ("Commission"), high-speed connections in service over asymmetric digital subscriber line technologies increased by 20% during the first half of 2004, compared to

[1] Broadband over power line technology is still being developed and has not advanced beyond a handful of trials limited to a few geographic areas.

a 13% increase for cable companies for the same time period.[2] For the full twelve-month period ending June 30, 2004, high-speed ADSL increased by 49% compared to 36% for high-speed cable modem.[3] Further, almost 10% of the broadband Internet access services available in the marketplace today are provided by satellite, wireless, or wireline technologies other than ADSL, and fiber high-speed connections.[4] Many of these high-speed Internet connections are provided either by incumbent telephone companies or their affiliates.

In light of these facts, arguments that point to intermodal competition as a means to regulate anticompetitive practices are unpersuasive. Intermodal competition, that is, competition between wireline, wireless and cable companies, cannot be relied upon to restrain anticompetitive behavior in every instance. Indeed, as I will explain, even cable telephony providers must rely in part on access to the telephone companies' network infrastructure in order to provide voice service to their end users. Therefore, Congress should not rely on intermodal competition to restrain anticompetitive behavior by the merged entities. Rather, Congress should adopt safeguards as a condition of the mergers that will permit continued competition for voice services in the residential market.

IV. Certain Safeguards Must Be Established to Preserve Competition in the Wholesale and Retail Communications Marketplace

In order for Vonage to compete against an incumbent dominant carrier like a combined SBC and AT&T, stand alone VoIP providers need nondiscriminatory and reasonable access to the following key inputs: (1) interconnection to incumbent telephone

---

2 *See* Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division, *High-Speed Services for Internet Access: Status as of June 30, 2004*, at 2 (rel. Dec. 2004)).

3 *See id.*

4 *See id.*

companies' network infrastructure necessary to reach the vast majority of telephone users that are connected to the public network and to provide comparable 911 services; (2) the ability of end users to use their high-speed data lines provided by telephone companies (digital subscriber line or "DSL") to access Vonage's application; and (3) Internet backbone facilities. Because a combined SBC and AT&T in SBC's region, and a merged Verizon (or Qwest) and MCI in Verizon's (or Qwest's) region, will further consolidate these merged entities' control over these key inputs, Congress should adopt safeguards to ensure end users continue to enjoy access to competitive Internet applications such as Vonage's.

Today CLECs provide the bulk of Vonage's access to the public telephone network, including necessary inputs such as interconnection and numbering resources. The merger of SBC and AT&T, coupled with the merger of Verizon (or Qwest) and MCI, will remove two of the largest CLECs with a national footprint, and have a detrimental impact on VoIP providers' ability to exchange calls with the vast majority of telephone users who still receive their local service from incumbent telephone companies.

Aside from access to essential "bottleneck facilities," competitive VoIP providers need assurance that firms that provide high-speed Internet access connections will not engage in broadband discrimination and will permit access to broadband wireless platforms. "Network neutrality" is the principal that end users should have access to all applications provided over the Internet. An end user's choice of application should not be restricted by the entity that either owns or controls the end-user's connection to the Internet. Providing independent VoIP providers with the ability to purchase for resale broadband wireless spectrum will also become increasingly important as broadband facilities and technologies are rolled out and users begin to adopt such technologies. A

critical component of preserving both wholesale and retail competition is ensuring that VoIP providers are able to obtain access to a wireless platform in order to offer new innovative VoIP offerings to the wireless space and thus compete with a dominant wireline and wireless provider like SBC and Verizon. Accordingly, Congress should adopt conditions on the mergers that will remove the above anticompetitive threats, in order to preserve and promote competition in the U.S. telecommunications marketplace.

A. Access to Network Infrastructure

In the face of the threat of competition that Vonage poses, the incumbent providers of telephone service have the incentive and the power to undermine us. The concerns relating to access to the public telephone network are not an imagined "Parade of Horribles." In fact, SBC has already used that power to put Vonage at a competitive disadvantage, by denying or impeding its access to the E911/911 network that they control. Moreover, both SBC and Verizon require consumers to take their voice service with their broadband service. The merger with AT&T and MCI will significantly increase the ways in which incumbents can block VoIP providers from competing robustly in the retail market. Ironically, the incumbents incorrectly rely on the existence of stand-alone VoIP providers like Vonage as a source of competition to support their claim that the mergers will not reduce competition in any market. Yet, by allowing the merger to go forward without proper safeguards, the merger could in fact impair competition in several areas of the telecommunications market, including not only the retail competition from stand alone VoIP providers, but also the wholesale competition that provides key inputs necessary for VoIP providers to compete.

In order to offer our service to customers, Vonage must have access to both the Internet and the traditional telephone network infrastructure to which the vast majority of

customers are connected. With the merger, that network infrastructure would be largely controlled by two incumbent telephone providers – both of whom have the incentive and ability to deny Vonage access in order to gain a competitive advantage in the retail market.

When a Vonage customer picks up his or her telephone to make a call, the call is initiated using Internet technology, but will in most every case travel over the Internet backbone and be "handed off" at some point to an incumbent provider of telephone service for completion. This is because the vast majority of telephone users are still customers of incumbents. Therefore, Vonage and other VoIP providers need access to incumbent providers' network facilities in order to provide service. Without such access, our customers, and even cable telephony customers, cannot reach the vast majority of the telephone users in the United States.

This is especially critical when considering the provision of 911 emergency services. While Vonage is technically able to provide E911 call-back and location information, it has been stymied in its efforts by the RBOCs who control essential facilities. Because Vonage is an "information service" provider, not a "telecommunications carrier" as defined by the 1996 Act, the Company has not been able to have customer communications routed directly to the E911 trunks operated by the RBOCs and other ILECs. Section 251(c)(1) of the 1996 Act only requires ILECs to provide interconnection to these trunks to other "telecommunications carriers," not "information service" providers. As a result, even though the 911 infrastructure was paid for by end-user 911 surcharges and other subsidies, the RBOCs own and control it and will not willingly make it available to VoIP providers. If SBC, for example, continues to deny us the ability to directly connect with the E911/911 network that SBC controls, we

cannot compete with them. By denying us access to the E911/911 network, SBC obtains a competitive advantage in the end user market by claiming that Vonage's 911 dialing solution is inferior to the E911/911 service SBC provides. SBC and Verizon must be required to provide Vonage and other VoIP competitors direct access to the same E911/911 network infrastructure the incumbents use to serve their own customers.

The importance of access to the incumbents' networks is even more basic than the ability to receive equivalent E911 service. Imagine picking up your phone to call your grandmother, only to learn that you cannot reach her because your grandmother has SBC local service and you have Vonage's service. As an information service provider, Vonage has no rights to connect its network directly with the incumbents' to exchange calls between our end users. Competitive local exchange companies have agreements with the incumbents to connect their networks so that competitive local customers can talk to incumbent customers. Vonage currently relies on these competitive local exchange companies so that Vonage customers can call the incumbents' customers. The mergers will result in the acquisition of two of the single largest competitive local exchange companies, drastically reducing the number of options available for connecting Vonage's Internet-based service to the traditional telephone network controlled by the incumbents.

Finally, as another witness will explain today, the remaining competitors lack the financial stability and the geographic diversity to provide Vonage the network facilities it needs to connect to the legacy telephone network and reach its end users. Accordingly, it is necessary for Congress to ensure that VoIP providers are able to obtain access to the facilities of the merged companies that comprise the public telephone network as well as to ensure a right of interconnection with the E911/911 infrastructure.

B. "Naked DSL" Should be Made Available to Consumers

Consumers should be able to choose which services they want to purchase and which ones they do not want to buy. The widespread practice of bundling or "tying" a broadband Internet access service to a basic voice offering must come to an end, especially in light of the mergers. Today, if a customer of SBC or Verizon would like to purchase a high-speed Internet connection, they cannot do so without also buying a basic telephone line. The net effect is to make services like those offered by Vonage economically unattractive because there is no cost savings to the retail consumer. The practice slows broadband adoption and is anticompetitive. Again, the proposed mergers remove two significant sources of competitive broadband access for consumers. Therefore, Congress should ensure that the merged companies offer standalone broadband Internet access services so that consumers have a real choice of voice providers.

C. Access to the Internet Backbone

Because we are an Internet-based service, a related concern is continued access to the network that comprises the Internet backbone. The mergers will result in incumbent providers owning these networks as well since the two premier providers of such services are UUNET (owned by MCI) and AT&T that together control a significant segment of the market for such services. The mergers will increase concentration of these facilities and may permit the new merged entities to discriminate against their competitors in the retail market on the basis of terms of service, price and/or the quality of service. Congress must ensure that the merged entities provide their retail competitors non-discriminatory access to these Internet backbone facilities on the same terms and conditions as provided to themselves or their affiliates.

V. "Network Neutrality" and Access to the Broadband Wireless Platform Are Critical Elements in Preserving Retail Competition

Broadband is widely viewed as an open pipe over which any end user can access competitive applications such as Vonage's, thus increasing competition in retail markets. Unfortunately, this is not always true. The mergers also increase broadband discrimination concerns. Broadband discrimination is the ability of providers of high-speed Internet access connections to both discriminate and block certain communications.

Broadband discrimination could take three different forms. First, an entity that either owns or controls a broadband Internet connection could prioritize packets associated with the application it provides to its end users over the packet generated by a third-party provider like Vonage. In this instance, Vonage would be placed at a significant disadvantage as compared to the network provider because the network provider would provide superior quality service by allowing its packets to supercede those transmitted by third-party Internet application providers. Second, an entity that either owns or controls a high-speed Internet connection could inject latency or otherwise degrade the packets sent by a third-party Internet application provider. In this way, the network provider would discourage their users from taking advantage of a service like Vonage's because of performance related concerns that are caused entirely by the actions of the network provider.

Another form of broadband discrimination occurs when entities that either own or control broadband Internet access facilities block certain transmissions. The industry has established certain standards that define what pathways a certain Internet application will use when it is provided to an end user. VoIP services are assigned to a specific route or port. By blocking the port associated with VoIP services, a broadband Internet access provider can prevent VoIP providers from providing their service.

The concern about broadband discrimination is not theoretical. The Madison River Companies ("Madison River") recently entered into a Consent Decree to settle an investigation arising out of a complaint by Vonage concerning the company's practice of preventing its customers from using Vonage's VoIP service. Madison River engaged in port blocking whereby all of the communications generated by Vonage's users were blocked. While admitting no wrong doing, Madison River agreed to pay $15,000 to the United States Treasury.

Although the Commission acted swiftly to address this situation, there is no guarantee that the Commission will be able to do so in the future. Further, some parties have argued that the Commission does not have the authority to regulate the conduct of companies that, unlike Madison River, are not providers of telecommunications services. In fact, one provider of wireless broadband services already explicitly blocks third-party provided VoIP services from its network. Further, even in the face of Commission action against Madison River, the practice continues across all modes of communication – wireline, wireless, and cable.

The merged companies will have increased incentives to engage in such broadband discrimination in favor of their own and affiliates' services. SBC and Verizon have made no commitments that would preclude them from engaging in broadband discrimination and have, in fact, opposed any conditions that would restrict their ability to engage in such anticompetitive behavior. Therefore, Congress should ensure that the merged companies commit to broadband antidiscrimination or network neutrality. Such commitments are necessary to ensure that all Americans continue to receive the open Internet they both expect and deserve.

Finally, access to the wireless broadband platform is critical. Increasingly, VoIP and other Internet applications will be delivered through a wireless platform. Neither SBC's wireless affiliate nor Verizon Wireless will actively engage in discussions to resell wireless spectrum. As the wireless market becomes increasingly consolidated due to the lifting of spectrum caps and these firms gain more market share in related industries due to mergers, third party providers face tremendous hurdles in delivering new innovative VoIP offerings to the wireless space. Accordingly, Congress must ensure that wireless spectrum is not concentrated in the hands of a few providers.

VI. Conclusion

In light of all of these concerns, we respectfully request that Congress condition these mergers to ensure retail providers, like Vonage, have access to the wholesale network facilities necessary to serve our customers. These conditions are necessary in order to protect retail consumers and to allow for the continued innovation of VoIP and other Internet-based applications. I look forward to answering any questions you may have. Thank you.

9214895v3

Summary of Testimony of Scott Cleland, Founder & CEO of Precursor
Before the U.S. Senate Judiciary Subcommittee on Antitrust, April 19, 2005

"Telecom Mergers in a Techcom World: How Antitrust Must Adapt to the Techcom Future"

1. **I do not believe these mergers pose a potential antitrust threat warranting disapproval.** In the 1996 Telecom Act, Congress authorized a pro-competition process to re-integrate local and long distance. More importantly, wireless, technology convergence, and Internet Protocol (IP) are rapidly transforming the former monopoly *tele*com industry into a vastly more competitive *tech*com industry (see Attachment 1, "*Techcom: The Future of Telecom*"). In the consumer and small business space, technology has already largely broken the traditional local bottleneck (see Attachment 2, Competitive Broadband Access Facilities). And the enterprise market is increasingly competitive.

2. **Merger conditions may not be necessary** given the intense legal and regulatory requirements these merging companies already operate under to mitigate anti-competitive behavior.

3. **Antitrust is still highly relevant to these transactions and the market going forward.** Antitrust in the more competitive techcom world needs to shift focus to rigorous anti-competitive enforcement of the duty to interconnect or more specifically the duty to not deny or impede access to the network. This fundamental point will be the focus of the rest of my testimony.

How Antitrust Must Change to Adapt to a Techcom Future

The core constant and unshakable principle embedded in the 1934 and 1996 Acts, and also the Internet, is the national value of Americans' free and unfettered access to one another – for political and social cohesion, economic growth, innovation and national security. The 1934 Act required interconnection because AT&T successfully used denial of interconnection to monopolize telecom. In this respect, Congress got the 1996 Act dead right in that for competition to be possible in communications, there had to be a mandated duty to interconnect and be interoperable. The Internet is the ultimate example of this principle – facilitating interconnection of networks and people as simply, broadly, and universally as possible.

The biggest anti-competitive threat to the techcom world is not pricing power (prices are plummeting from IP substitution), but subtle and naked attempts to gain market power by impeding or denying interconnection or network access for the purpose of competitive advantage.

What are some of the **anticompetitive risks to techcom competition going forward**?

- "Bit Interference"
- "Quality of Service" Discrimination
- Non-Cooperation on "911" Competitive Enablement
- Imposition of "Transit Fees"
- Opposition to Municipal-Broadband Networks

Conclusion: Don't re-fight yesterday's antitrust war; prepare for tomorrow's

I do not believe the SBC/AT&T and Verizon/MCI mergers pose a substantial risk to competition warranting government disapproval or conditions. However, these mergers do pose a serious potential risk to techcom competition IF the Government (Congress, DOJ, FCC) is not vigilant in deterring anticompetitive behavior through rigorous antitrust/FCC oversight and enforcement. The biggest anti-competitive threat to the techcom world is incumbent attempts to gain market power by impeding or denying interconnection/network access for the purpose of competitive advantage. **Another key to maintaining a competitive techcom future is the vigilant protection of the FCC's "Net Freedoms;"** the freedom of consumers to:

- Access the legal content of their choice;
- Run the applications of their choice unimpeded; and
- Attach any device they choose to their network connection.

"Telecom Mergers in a Techcom World: How Antitrust Must Adapt to the Techcom Future"

Testimony of Scott Cleland
Founder & CEO of Precursor

Before the
Senate Subcommittee on Antitrust,
Competition Policy and Consumer Rights
Of
The United States Senate Committee on the Judiciary

On
"SBC/ATT and Verizon/MCI Mergers:
Remaking the Telecommunications Industry, Part II Another View"

April 19, 2005

Thank you for the honor and opportunity to share my views with the Subcommittee on the pending SBC/AT&T and Verizon/MCI mergers.

I am Scott Cleland, Founder and CEO of Precursor, an independent investment research firm specializing in technology, telecom and media issues. In December of 2004, Institutional Investor Magazine, in its first national rankings of independent research firms, ranked Precursor #1 in Telecom and #3 in Technology research. Precursor has blazed a trail in the new specialty of Change Research, anticipating investment risk and opportunity from changes in technology, competition, regulation, competition and other external factors – for institutional investors.

I. Summary of Conclusions

1. **I do not believe these mergers pose a potential antitrust threat warranting disapproval.**
   - **In the 1996 Telecom Act, Congress authorized a pro-competition process to re-integrate local and long distance.** The states, the DOJ, the FCC, and the courts diligently concluded after protracted review that the Bells' local markets were "irreversibly open to competition" in all fifty states. This process effectively addressed historical antitrust concerns with the Bell-long distance combinations. Both these mergers are a natural market evolution from the artificial separate markets created by the 1984 breakup of AT&T to the more market-driven competitive market place envisioned by the 1996 Telecom Act.
   - **More importantly, wireless, technology convergence, and Internet Protocol (IP) are rapidly transforming the formerly monopoly *tele*com industry into a vastly more competitive *tech*com industry** (see Attachment 1, "*Techcom: The Future of Telecom*" to better understand the underpinnings of this powerful techcom dynamic and transformation).
     i. **In the consumer and small business space, technology has already largely broken the traditional local bottleneck.** Wireless has proven to be an effective competitive substitute and most all Americans have three or more wireless choices. In addition, broadband and VoIP technologies are rapidly creating a range of techcom local access alternatives to the Bells for consumers. In other words, an

increasing number of Competitive Broadband Access Facilities (CBAFs) are becoming increasingly available. Cable modems and WiFi have grown very rapidly and are widely available. By the end of 2005 there will be three national 3G wireless networks: Sprint-Nextel, Cingular and Verizon Wireless. And over the next two years, Broadband over Power Lines, WiMax, and possibly Ultra Wide Band will become more widely available (see Attachment 2, Competitive Broadband Access Facilities).

ii. **The enterprise market is increasingly competitive.** IP technological substitution and in-sourcing are giving enterprise customers massive price leverage to demand huge price discounts. One need only look at AT&T's and MCI's plummeting revenues in a growing economy to see ample evidence of their lack of market power. We do not believe these merging companies will be able to monopolize the enterprise market. On the contrary, these are defensive mergers at the core, because our analysis shows these merging companies face massive share and revenue loss and exceptional price pressure *with or without* these mergers.

2. **Merger conditions may not be necessary given the intense legal and regulatory requirements these merging companies already operate under to mitigate anti-competitive behavior** and given the FCC's vigilance in enforcement (i.e., the recent rapid Madison River enforcement action addressing bit-interference). However, fact and market specific information, which I am not privy to, potentially could warrant divestitures or conditions for these mergers.

3. **Antitrust is still highly relevant to these transactions and the market going forward** – even if it is not in the traditional way. Antitrust in the monopoly and competitive transition telecom era needed to rely on price regulation because there were insufficient access substitutes or market forces to naturally discipline monopoly power. Antitrust in the more competitive techcom world needs to shift focus to rigorous anti-competitive enforcement of the duty to interconnect or more specifically the duty to not deny or impede access to the network. This fundamental point will be the focus of the rest of my testimony.

II. How Antitrust Must Change to Adapt to a Techcom Future

The core constant and unshakable principle embedded in the 1934 and 1996 Acts, and also the Internet, is the national value of Americans' free and unfettered access to one another – for political and social cohesion, economic growth, innovation and national security. The 1934 Act required interconnection because AT&T successfully used denial of interconnection to monopolize telecom. In this respect, Congress got the 1996 Act dead right in that for competition to be possible in communications, there had to be a mandated duty to interconnect and be interoperable. The Internet is the ultimate example of this principle – facilitating interconnection of networks and people as simply, broadly and universally as possible.

The biggest anti-competitive threat to the techcom world is not pricing power (prices are plummeting from IP substitution), but subtle and naked attempts to gain market power by impeding or denying interconnection or network access for the purpose of competitive advantage. This real antitrust threat will require vigilant enforcement at every level of the Government. Market forces combined with effective antitrust/FCC enforcement will increasingly lessen the need for traditional telecom regulation.

So what are some of the anticompetitive risks to techcom competition going forward?

- **"Bit Interference."** The recent Madison River bit blocking case **exposed potentially the most lethal risk to emerging techcom competition** – the technological ability to sort, block, impede, sabotage, or interfere with bit transmissions of competitors for competitive gain. Antitrust and regulatory officials must be exceptionally vigilant to the anticompetitive practice of bit interference for commercial gain. Bit interference is among the purest forms of anti-competitive behavior in the techcom world. (Fortunately, the same technology that enables bit interference also enables its detection for enforcement action.)
- **"Quality of Service" Discrimination.** Denying competitors the ability to have the same quality of service for bit transmission over their network is potentially anticompetitive bit-interference if it's designed to disadvantage a competitor. The innocuous sounding term of "quality of service" could be anything but innocuous if used to slowly and

steadily degrade the ability of competitors to compete with an owner of one of the largest networks like SBC/AT&T or Verizon/MCI.

- **Non-Cooperation on "911" Competitive Enablement.** As a legacy responsibility of the monopoly era, the local telcos essentially operate and control much of the 911 emergency-infrastructure. Regulation requires 911 services and consumers widely assume and expect it. Therefore denial, impedance, or non-cooperation by incumbents in providing VoIP/techcom competitors access or interconnection to the 911 infrastructure represents a particularly insidious potential form of anticompetitive behavior.
- **Imposition of "Transit Fees."** Every Administration and Congress since the late 1960s has supported the policy of not subjecting data transmissions to usage based fees or charges. This policy fostered the Internet's innovation and growth. Now that voice over the Internet (VoIP) is main stream, there will be increasing pressure from legacy telecom players to reverse current longstanding policy and tilt inter-carrier compensation reform to favor legacy networks over techcom competitors and new entrants. Some incumbents see new "transit fees" as a way protect and squeeze more value out of legacy networks that are increasingly obsolete.
- **Opposition to Municipal-Broadband Networks.** Another potential form of anti-competitive risk to techcom competition is current opposition to municipalities buying WiFi or other broadband networks from incumbents' techcom competitors. This is potentially anticompetitive behavior because it seeks to ban or inhibit private-sector tech competitors' (equipment/network providers) ability to sell a superior competitive technology to one of the largest potential customer segments for their equipment and service (i.e., the municipal market). Techcom is so threatening to incumbents because it is dramatically cheaper to build and operate techcom networks than legacy telecom networks. Incumbents don't fear municipalities as competitors; they fear price deflation from techcom's superior value proposition. A pertinent historical analogy exposes the potential anti-competitive issue here. Would it have been a pro-competition policy in the past to ban municipalities from building highways or airports because it would be an unfair subsidy to auto and plane companies competing against incumbent railroad companies?

As a consistent supporter of price deregulation and relying on the market forces policy of inter-modal competition, I do not believe deregulation means there is no role for government in communications. Contrary to the hopes of incumbents and the fears of their opponents, deregulation does not mean a state of lawlessness or obligation-less-ness. Even in a price de-regulated, inter-modal competitive world, there is widespread consensus around the continuing governmental obligations of 911, CALEA law enforcement/homeland security assistance, consumer protection, disability access, universal service, and antitrust enforcement.

III. Conclusion: Don't re-fight yesterday's antitrust war; prepare for tomorrow's

Congress, the DOJ, and the FCC should focus on how a techcom future requires a very different antitrust role than the telecom past. There are real antitrust issues affecting these two mergers in a techcom future. I mentioned five potential ones earlier, but I am sure there will be more.

I do not believe the SBC/AT&T and Verizon/MCI mergers pose a substantial risk to competition warranting government disapproval or conditions. However, these mergers do pose a serious potential risk to techcom competition IF the Government (Congress, DOJ, FCC) is not vigilant in deterring anticompetitive behavior through rigorous antitrust/FCC oversight and enforcement.

The biggest anti-competitive threat to the techcom world is incumbent attempts to gain market power by impeding or denying interconnection/network access for the purpose of competitive advantage. This could be done by bit interference, quality of service discrimination, non-cooperation on "911" competitive enablement, imposition of transit fees, denial of municipal broadband competition, and other ways.

Finally, another key to maintaining a competitive techcom future is the vigilant protection of the FCC's "Net Freedoms;" the freedom of consumers to:

- Access the legal content of their choice;
- Run the applications of their choice unimpeded; and
- Attach any device they choose to their network connection.

Enforcement vigilance is so important here, because the mainstream consumer exercise of these "Net Freedoms" is a serious competitive threat to the business models of SBC/T, Verizon/MCI and the other traditional telecom players. The freedom to run any application enables VoIP and the cannibalization of traditional voice monthly service revenues. The freedom to attach any device also threatens these merging companies "control" of their wireless customers' network usage.

Once again thank you for the opportunity to be of assistance to this Subcommittee in reviewing the SBC/AT&T and Verizon/MCI mergers.

Attachment 1: "Techcom: The Future of Telecom," Precursor 4/15/05
Attachment 2: Competitive Broadband Access Facilities Chart

Precursor®
FIRST IN CHANGE RESEARCH

Scott Cleland, John Freeman,
Rudy Baca, Bill Whyman,
Bart Kaplan

Technology, Telecom & Media Research

April 15, 2005
Washington, DC
Phone 202.828.7800

www.precursor.com

CHANGE VIEWPOINT™

Techcom: The Future of Telecom *(Part III in a Techcom Series)*

This strategic analysis spotlights why telecom is poised to rapidly transform into techcom over the next few years, and how investors should position their portfolios to benefit from techcom revenue growth and guard against telecom revenue erosion.

Summary: "Techcom" is the convergence of tech and telecom. "Tech" any-to-any, integrated IP communication as a software application is quickly replacing "tele" one-to-one circuit voice communication as a carrier service because techcom offers a superior value proposition at much less cost than telecom. We believe **the techcom dynamic of mobility x convergence x IP will drive exceptional demand and growth, and also an exponential increase in potential new greenfield opportunities, products, niches, services, and innovation** (see attached chart). Long talked about, techcom demand/growth and substitution is **finally happening**. A broad confluence of many key factors have reached critical mass: wireless access (WiFi, 3G, WiMax), processing power, storage, displays, form-factors, cell phone penetration, broadband access, SIP adoption, and deregulation. While the individual components of techcom are widely appreciated, their exponential *dynamic* for innovation, demand and growth – is not. We see the techcom dynamic benefiting non-telecom tech new entrants that cannibalize traditional telecom's $300b+ revenue base. We also see the most dynamic techcom growth and innovation of all occurring on the handset. Lastly, we see FON-NXTL as the best-positioned telecom large cap to leverage techcom.

Techcom Is Much More Than VoIP. Techcom is broader, more dynamic and more multi-dimensional than voice over IP (VoIP). Techcom also encapsulates: voice integration into any software application as a feature (MSFT LCS, IBM Sametime); communications enablement of edge devices (INTC's Centrino, industry SIP standard); voice convergence with other functions (email, camera, music, GPS); voice mode convergence (wireline, wireless, WiFi, GPS); emerging last mile competition between Competitive Broadband Access Facilities (DSL, cable modems, BPL, WiFi, WiMax, 3G); new "voice-client-server" business models of VoIP+handsets (Skype phone, Vonage smartphone); voice portals (Yahoo, AOL, MSFT-MSN, Google, Earthlink); and other business model dimensions not yet germinated. We believe the landmark FCC "Pulver" decision in early '04 marked the official beginning of the techcom era because it liberated tech companies to freely leverage existing technologies to pursue and supplant the $300b U.S. voice market free of regulatory risk.

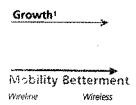
Techcom Fueled by Betterment. We purposely employ the word "betterment" to capture *demand-creating technological advances which substantially improve utility and productivity for consumers and/or businesses.* We put forth the "betterment" concept as an excellent forward-looking causation proxy for techcom demand. **(1) Mobility.** Mobility betterment is the convenience, utility, and productivity that come from being freed from the limitations of location; it has at least three demand-creating dimensions. (A) Wireless. The most obvious is traditional wireless portability and mobility. (B) SIP. Less obvious is the SIP standard applied to VoIP, which allows one to create an easily-locatable virtual location regardless of the actual physical location of the person. (C) Minaturization. Increasingly inexpensive miniaturization allows people to easily carry or wear devices capable of functionality that used to tether people to a particular location. **(2) Convergence.** Digital technology convergence (hardware and software) integrates multiple, useful, and often complementary applications onto one device. This also creates value and fuels demand because it meets fundamental needs, lowers cost, drives need for further miniaturization and mobility, spurs competition and fuels innovation. Convergence breeds new applications, products, services and niches that did not exist before and also washes away stand-alone products and industries that are inferior to newly converged products and industries. **(3) IP Any-to-Any Connectivity.** IP connectivity generates betterment by: shifting network control from the central carrier to the edge user enabling personalization; standardization which accelerates adoption and lowers price; and networking devices and information not connected before. (A) IP value-creation. Each and every mobile and converged application is made better and more valuable by the network effect, convenience, and utility of IP any-to-any connectivity. By embedding IP WiFi access into nearly all of its chips, INTC single-handedly created alternative cheap wireless access to traditional wireless providers that were not meeting this clear betterment need. We expect IP to increasingly create value on edge techcom handsets because IP shifts intelligence of the network from the network provider to the user. Similarly, IP created value at the edge for "server farm" companies like Ebay, Yahoo, Amazon, and Google. (B) Value cubed. IP exponentially increases the potential permutations of features, uses, and innovations. IP also accelerates the migration from a limiting phone number to a more integrate-able web address and consequently from the more limiting *tele*com numeric keypad, to the dramatically easier-to-use *tech*com text or graphical user interface. (C) Customization/Personalization. We believe IP betterment creates demand by enabling dramatically more customization for different segments needs and personalization to meet individual consumer needs and desires. * *

Copyright © Precursor Advisors 2005. All rights reserved. Reproduction or retransmission without written permission prohibited. Neither Precursor Advisors nor The Precursor Group Broker-Dealer LLC engage in investment banking, proprietary trading or money management. Advisory personnel may not personally invest in any public company except through mutual funds or blind trusts. The information contained herein is prepared solely for institutional investors. While based on sources believed to be reliable its completeness and accuracy are not guaranteed. ***The authors of this report certify 1) this report accurately reflects their personal views regarding the subject companies; and 2) no part of their compensation was, is or will be related to the views contained herein.***

How Mobility x Convergence x IP = Techcom Exponential Increase in Betterment/Demand

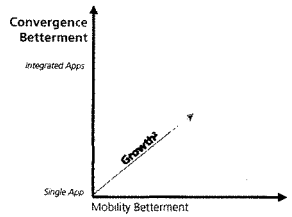
("Betterment" is tech advances which substantially improve utility and productivity for consumers and/or businesses)

Betterment[1] = Mobility



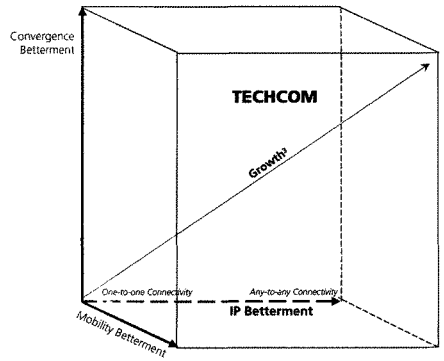
- Mobility Betterment is the convenience, utility, and productivity that comes from being freed from location
  - Wireless
  - SIP-virtual location
  - Miniaturization portability

Betterment[2] = Mobility x Convergence



- Convergence Betterment is the digital integration of multiplying useful and complementary applications on one device
  - Meets unmet needs creating new niches
  - Lowers costs
  - Better and new applications

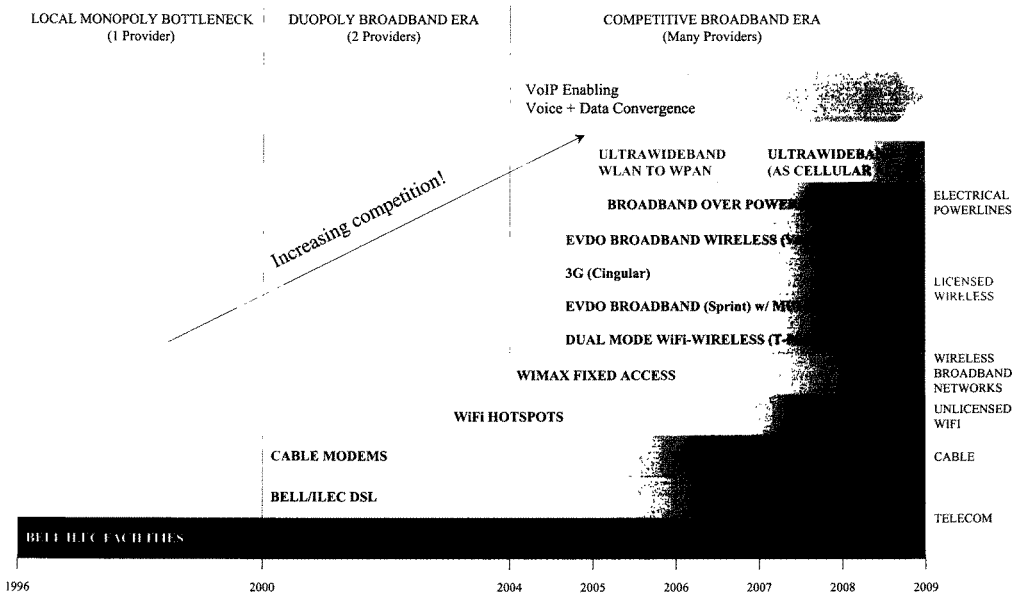
Betterment[3] = Mobility x Convergence x IP = Techcom



- IP Betterment is every mobile and converged application made better and more valuable by the network effect, convenience, and utility of any-to-any connectivity
  - Accelerates value shift to edge user
  - Exponentially increases potential and permutations of features, uses, and innovations
  - Fosters customization and personalization

Competitive Broadband Access Facilities

Opens Consumer Last Mile to New Competition



UNITED STATES SENATOR • OHIO
Mike DeWine

FOR IMMEDIATE RELEASE
APRIL 19, 2005

CONTACT: AMANDA FLAIG
JEFF SADOSKY
(202) 224-2315

HEARING STATEMENT
[AS PREPARED]
ANTITRUST SUBCOMMITTEE HEARING
SBC/ATT & VERIZON/MCI MERGER

Good afternoon and welcome to the Antitrust Subcommittee hearing examining the proposed mergers between SBC/ATT and Verizon/MCI. As promised, this is a continuation of the examination we began last month at the full Judiciary Committee. The difference today is that rather than hear from the CEOs of the merging parties, we will hear from witnesses who have a somewhat different view.

As you know, I expressed some reservations about these mergers when we first took up this topic. Not surprisingly, the CEOs of the four respective companies acquitted themselves well, and emphasized very clearly that ATT is already leaving the residential market and MCI is likely to follow. In other words, they made the important point that in some ways, these mergers don't change the competitive landscape for consumer services.
They also emphasized the impact of inter-modal competition, meaning competition from other forms of service, such as wireless, cable, and Voice Over Internet Protocol.

These are important arguments, and the companies made them effectively. But frankly, I'm still worried. I think there is still a lot more to it. In my mind, at least, it is still an open question whether the SBC/ATT merger and the Verizon/MCI merger are good for competition and for consumers. That, of course, is what we are here to discuss today.

As we began to explore last month, there are a range of issues that raise concerns. Perhaps the one which has received the most traditional antitrust scrutiny so far is the so-called "enterprise market" -- the sector of the market comprised of large businesses with sophisticated telecommunications needs.

All four of the merging parties currently compete in this market sector, so large business customers will likely be affected by the deals, and this area will require close scrutiny. There are also questions regarding the impact of these deals on the markets for long-haul capacity, and in the market for Internet backbone that today's witnesses are particularly well-suited to answer. We are looking forward to those discussions.

-more-

As we discussed in our last hearing, however, the critical issue here is inter-modal competition. According to the testimony we heard from the company CEOs, they are facing competition on numerous different technological platforms -- specifically, as mentioned, cable companies, wireless companies, and companies that provide "Voice Over I.P." services.

Once again, we must keep in mind that inter-modal competition, by definition, does not always provide the type of direct competition we are used to seeing. Wireline, wireless, cable -- these services are inherently different and provide similar services in different ways, with different pluses and minuses. Not all will always provide sufficient competitive benefits for all consumers. In fact, there are a number of concerns that have been raised about each, which I know we will explore today.

But most important, in this context, we must discuss whether or not merger conditions are required to ensure that these multiple modes of competition are, in fact, available. For example, Voice Over I.P. is often held up as the poster child for inter-modal competition. In fact, Vonage, one of our witnesses today, is a Voice Over I.P. provider.

It is certainly a very promising product, but our witness, himself, will testify today that Voice Over I.P. is a type of service that is available to the consumer only if he or she has broadband access, and currently that access is widely available only from the phone company or the cable company. Think about it -- Voice Over I.P. providers must rely on their competitors to get access to their customers. Clearly, that is a somewhat tenuous situation, and we will need to consider if the mergers change it at all.

There are several other issues to explore, though I will mention them only briefly. In most places, residential consumers currently face a duopoly choice -- buy an expensive bundle of local, long-distance, Internet, and wireless service from the phone company, or buy an expensive bundle of similar services from the cable company. What impact will the purchase of ATT and MCI have in this situation? Will it allow the phone companies to provide better products and services? Or, will it remove two of the few potential existing market entrants? Another important point is that high speed and wireless broadband will clearly be required for the next generation of services and will certainly help competitors, such as Voice Over I.P. and cable telephone service. ATT and MCI, as independent competitors, had a big stake in promoting the development of broadband. How will these mergers impact the development of those broadband capabilities? Similarly, how will the mergers impact the availability of new wireless spectrum?

Finally, I hope that the panelists will share their thoughts about what we in Congress can do more broadly to help promote competition and innovation in the telecommunications industry. Many have noted the need for a rewrite of the 1996 Telecommunications Act, and it is time to start thinking about what such a rewrite would entail.

Certainly it seems that there is need to free up the spectrum necessary to enhance wireless broadband development. Another issue is the need for the FCC to expeditiously rule in their open proceedings on inter-carrier compensation, special access pricing, and the regulation of I.P.-enabled services. These proceedings have been going on for an extended period of time and the industry is, to some extent, in limbo awaiting the rulings. Outdated legislation and incomplete regulations can only hinder the type of aggressive competition that leads to innovation, better products, and lower prices. So with that in mind, we look forward to hearing from our panelists today on a wide range of issues.

Let me yield at this time to my distinguished colleague, Senator Kohl, Ranking Member of the Subcommittee.

###

TESTIMONY BEFORE THE SENATE JUDICIARY SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS ON MERGERS IN THE TELECOMMUNICATIONS INDUSTRY

CARL GRIVNER
CEO, XO COMMUNICATIONS, INC.

April 19, 2005

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 want to thank the Chairman and Ranking Member for inviting me to testify before the Subcommittee 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 incumbents 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 incentive 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 Subcommittee 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.

news from

HERB KOHL

United States Senator
Democrat of Wisconsin

330 Hart Senate Office Building • Washington, D.C. 20510 • (202) 224-5653

FOR IMMEDIATE RELEASE: **April 19, 2005**
Contact: Lynn Becker Phone: (202) 224-5653

Statement of U.S. Senator Herb Kohl
Hearing on "SBC/ATT and Verizon/MCI Mergers: Remaking the Telecommunications Industry, Part II–Another View"

Today we return to the topic we began considering a month ago at the full Committee's hearing on consolidation in the telecom industry. As we noted last time, the mergers we are examining and the technological changes we are witnessing will fundamentally change how Americans communicate and what we pay for these services.

At our Committee's hearing last month, we heard the four CEOs of the merging companies explain why they believed these deals are in the consumers' best interests. And we agree that today's telecom market is very different from the market that existed when the AT&T phone monopoly was broken up 21 years ago, and that there is the great potential for many consumers to benefit from new forms of competition and new choices. But the sheer magnitude of these mergers and the potential to concentrate market power in the hands of two large telecom companies requires us to carefully examine the competitive consequences of these deals. Today's hearing will be an important opportunity to hear the views of consumer representatives, competitors, and independent experts as to whether these mergers will really be good for competition and consumers.

The Bell companies and their merger partners have testified that new technologies and innovation should allay any concerns we have about the size and market power of the companies that will emerge once these mergers are completed. We hope they are proved correct. Our first responsibility, therefore, must be to ensure that the development and deployment of these new technologies are not stifled in their infancy by today's consolidation. We must seek to avoid the creation of a world where consumers are left with only two choices for a bundle of telecom services – the "Baby Bell" phone company and the cable company.

Our witness from the internet telephone company Vonage is an example of one exciting new way consumers can make telephone calls without using traditional phone lines controlled by the companies involved in these mergers. However, in order to access Vonage's service, consumers still need to obtain high speed access to the Internet. And today, the only provider of such high speed internet connections for most consumers is either the Bell phone company or the cable company. We need to ensure that these Internet connections come without strings attached – that consumers are free to buy Internet connections without also being required to buy conventional phone service. And we need to make sure that the phone or cable company providing the internet connection does not attempt to block or degrade the consumer's access to these internet-based telephone services.

So our concerns remain the same as we stated them last month. First, how can we ensure that this consolidation will not decrease the choices and increase the costs to consumers and to business customers, both large and small? Second, how can we ensure that new technologies and new services can get access to the Bell company networks?

Our goal must be the nurturing of a truly competitive telecom marketplace with a maximum of choice for consumers, a market that will not be controlled by a few dominant players. We must insist that the Justice Department and FCC scrutinize these mergers properly so that the tremendous gains in telecom competition over the last twenty years are not lost in the midst of this industry consolidation.

# # #

Statement of
GENE KIMMELMAN
Senior Director for Public Policy and Advocacy
Consumers Union

On Behalf of
Consumers Union
and
The Consumer Federation of America

On
SBC-AT&T and Verizon-MCI Mergers
Remaking the Telecommunications Industry
Part II

Senate Judiciary Committee
April 19, 2005

The recent wave of proposed mergers in the telecommunications industry — SBC attempting to gobble up AT&T, and Verizon trying to swallow MCI — mark the ultimate demise of the era during which consumers were led to expect more and more choices and lower prices for local, long distance, wireless, and the new Internet-based services exploding on the market.

Consumers Union (CU),[1] the nonprofit publisher of *Consumer Reports* magazine, and the Consumer Federation of America (CFA)[2] believe that if not rejected or dramatically altered, these mergers could set the marketplace back to a world more akin to deregulated monopoly than competition.

SBC CEO Ed Whitacre promised the House Energy and Commerce Committee last month, "I don't think there's any question there will be more competition, not less." But as we show, telecommunications competition is as sturdy as house of cards, because the competition that exists is dependent on the generosity of the big Bells and giant cable companies. From local and long-distance, to wireless, to VoIP, to broadband, big Bell companies are blocking access to their networks and thwarting competition before it can even begin.

But regardless of whether these mergers are approved, the telecommunications marketplace is broke and needs to be fixed. Congress must immediately rewrite the 1996 Telecommunications Act, to jumpstart the vigorous competition necessary to bring down prices and increase choices for consumers.

With the appropriate competition-promoting regulatory policies and tough antitrust enforcement, our nation's telecommunications market could head towards an era of competitive unlimited local, long-distance calling and high-speed Internet services for as little as $40 a month. Unfortunately, misguided regulation and mergers like the ones proposed here between SBC and AT&T and Verizon and MCI, are making this low-cost competitive market an impossibility.

The Current Marketplace Serves Big Telephone Companies —Not Consumers

Anyone who has passed economics 101 knows the basic dynamics of a marketplace; when companies vigorously compete against one another, they have incentives to beat the competition through lower price and are driven to make the investments necessary to improve quality or develop new services. The market forces firms to invest and price aggressively, for fear of falling behind. Vigorous competition ensures that we all pay fair prices for the goods and services we enjoy. Unfortunately, the telecommunications marketplace is anything but competitive.

Rather than competing with one another for each customer, the telecom giants got even bigger by merging with one another, resulting in less and less competition. As these large companies acquired a larger and larger footprint, it became harder and harder for new entrants to gain a toehold in the market. Today, the result is a concentrated market that is far

from the economic vision of vigorous competition. And the proposed SBC-AT&T and Verizon-MCI mergers, if approved, will be the final nails in the coffin of the local competition experiment the Congress launched in the 1996 Telecom Act.

In their statements and filings, the merging parties fantasize about competition and present nationwide data that purports to show that telecommunications markets are highly competitive. This approach to market analysis is simply wrong. Telecommunications markets are still essentially local markets. In order to provide telecommunications services, one must have a last mile technology to distribute the service to the consumer and a middle mile medium to aggregate traffic and deliver it to large national and international communications and Internet networks. These last- and middle-mile facilities are the bottlenecks through which all telecommunications must flow. These are the bottlenecks that the incumbent local exchange carriers (ILECs) like Verizon and SBC have leveraged to maintain their market power over customers. These are the bottlenecks that competitive local exchange carriers (CLECs), AT&T and MCI foremost among them, were trying to break down. When the analysis moves from this macro-level to take a more granular view of real product and geographic markets, the impact of the merger becomes even uglier from the consumer point of view.

Today, consumers have at most two choices for their telecommunications services: the local telephone company or the cable company. In as much as one third of the country, consumers have no such choice. Even where there is a duopoly, this is hardly the vigorous competition that forms the basis of the economic ideal; in fact, *Business Week* has called this a "cozy duopoly."[3] "Cozy duopolies" do not serve consumers well. They do not compete vigorously on price or innovate, bringing benefits (lower prices and new goods and services) to consumers. Rather, each protects its own base (phone or cable service), generally staying out of the other's service territory. They bundle services (e.g., phone or cable with broadband) in order to keep potential competitors (such as satellite, which lacks a viable broadband service) at bay. As a result, to get a variety of good marketplace choices and prices, consumers must buy extra services – DSL tied to local phone service, or cable modem service tied to a cable video package. In order to get the benefits of this "bundle-only" competition, the average household must double or triple its spending.[4]

CU and CFA believe that these mergers should be stopped or substantially modified. But regardless of whether this occurs, the telecommunications marketplace is fundamentally broken and needs to be fixed. The vigorous competition Congress had envisioned during passage of the 1996 Telecom Act has failed to materialize. Congress must take action to correct fundamental errors that have occurred as a result of the FCC's implementation of the Act. Rather than the abundance of competition that the Bells claim they face, we see a vastly different marketplace – one where the technologies supposedly competing against the Bells simply do not compete. For example:

- **Local phone "competitors."** CLECs were supposed to bring competition to the marketplace after passage of the 1996 Act. But SBC and Verizon litigated, stymied,

and strangled local voice competition until it has almost completely withered. As a result, the CLECs that were supposed to offer so much competition to the dominating Bells are dying in droves.[5] Born as local monopolies, the Bell companies have remained anti-competitive to the core. Once the 1996 Act was signed into law, the Bell companies immediately set out to bulk up their local monopolies into regional monopolies through mergers and acquisitions. In the end, they never competed in one another's regions as envisioned by Congress, and they never fulfilled the promises they made during their pervious mergers. This will only get worse if these mergers are approved.

- **Long distance.** SBC and Verizon have run a brutal bait-and-switch game with long distance service. After having been allowed to re-enter the long-distance market because policymakers determined local markets were open – a finding that was overwhelmingly based on the availability of UNE-Ps – they launched a vigorous campaign to eliminate the availability of UNE-Ps. SBC and Verizon's gambit was a success and, as expected, the competition is drying up.

- **Voice over Internet Protocol.** SBC and Verizon often point to new technologies, such as Voice over Internet Protocol (VoIP) as the source of the supposedly great level of competition, but these are actually quite limited. Given that 70 percent of households don't have broadband service and therefore cannot take advantage of VoIP calling,[6] VoIP is not yet an effective competitor to the traditional wired phone service. And VoIP has other problems with it; it does not have reliable 911 service that does not work when the power goes out. Even worse, SBC, is blocking access from VoIP providers to enhanced 911 networks. And SBC, Verizon and BellSouth are hindering VoIP competition, as we describe in the Broadband section.

- **Wireless.** Two critical factors limit the ability of wireless services to effectively compete with traditional services. First, even with a big bucket of minutes, wireless costs about ten cents a minute for the typical pattern of use of local calls – five times as much, on a per-minute basis, as local flat-rate dialtone, which is the staple of local service. Wireless is also less reliable than wireline and has limited access to the 911 system. Second, Cingular and Verizon Wireless, the nation's two largest cell phone companies, are owned by two large Bells – SBC (with BellSouth) and Verizon, respectively – and therefore have little incentive to compete with their own wireline affiliates. Through mergers and acquisitions, as well as their brand name prominence, SBC and Verizon are each the leading wireless supplier within their respective local market.[7] If competition is to come from wireless companies, SBC and Verizon should be willing to accept limits to the amount of licensed spectrum they own, and allow more unlicensed spectrum to be given to innovators.

- **DSL Broadband.** Making matters worse, SBC and Verizon (as well as BellSouth) also use an anti-competitive bundling tactic to ensure that VoIP can never effectively compete with their basic local voice services. Neither Verizon nor SBC will sell a

consumer DSL on a stand-alone basis, what is known as "naked" DSL. Both force consumers to buy their voice service in order to get a DSL line. So a consumer who wants to buy VoIP from a competitor has to pay for local service twice.

In March 2005, the *New York Times* reported on the problems of bundling DSL with local wireline phone service, citing numerous examples of DSL customers like Justin Martikovic, who rely on wireless phones for normal calling, never using the wireline phone that he pays $360 a year to keep connected. He is not alone—there are thousands more who, like him, "have to pay for a service I'm never using."[8] Tacking on local phone service to a DSL bill raises the monthly price from $20-$40 (which are often only for a limited trial period and for those willing to sign a one-year contract) to $50-80 (See Exhibit 1). This practice mirrors cable, which sells broadband for $40-60, so long as you purchase its television service bringing your total to $80-100 every month. Both telephone companies and cable operators force consumers to buy bundles of services – to pay twice – if they want to purchase VoIP service from a competitor.

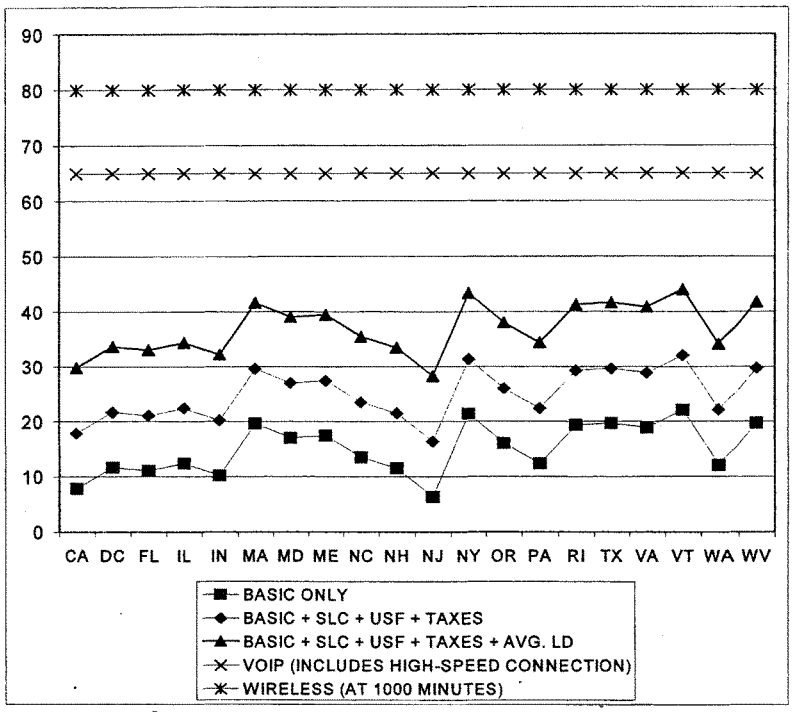
• **Community Broadband Internet Providers.**

Communities not well-served by telephone companies and cable operators should be able to deploy their own digital infrastructure. Many communities have only a single broadband provider or a cable or telephone company duopoly. In these communities, rates remain high and service remains poor. As the market becomes more concentrated, the threat of municipal entry becomes necessary to promote competitive services such as voice or video over the Internet. A new study released by CFA, CU, and other public-interest groups shows that community Internet providers, or even the threat of municipal entry, could provide the competition necessary to keep rates low and quality of service high.[9]

For example, community Internet providers are charging lower prices than Bell DSL service providers are charging: $16 in Chaksa, Minnesota, $20 in Rio Rancho, New Mexico, Moorhead, Minnesota and Lompoc, California, and an estimated $15 in Philadelphia. And if a consumer wants it, they can pay an additional $25 for unlimited local and long distance VoIP service—a significant monthly savings. In other words, today's market conditions could have evolved to a world where broadband and unlimited local and long-distance calling are available nationwide for as little as $40 a month. The SBC and Verizon mergers plus wrong-minded regulatory policies are almost certain to make this lower-cost, more competitive market disappear before it ever gets a chance to take hold and spread.

But SBC and Verizon do not merely oppose these networks. They actively fight community efforts by misleading consumers and policymakers about economic operation and effects. When they fail, they move their efforts to state legislatures to

EXHIBIT 1: LOWEST PRICED ALTERNATIVES FOR TELEPHONE SERVICE



Sources: Billy Jack Gregg, *A Survey of Unbundled Network Element Prices in the U.S.*, February 2005; Verizon Application, *Declaration of Husser, et al.*, Exhibit 2. State prices are statewide averages. Wireless assumes 400 minutes at the average cost of $.10 per minute

block towns, cities and counties from deploying broadband networks—work the companies should be doing more of themselves.

The more competitors they gobble up and the bigger these companies get, the less incentive they have to devote resources to competing in the marketplace for consumers, and they have greater incentive to prevent other entities from competing with them. And even when a community provides Internet service, it doesn't mean that private investment from companies like SBC and Verizon runs away. A recent economic study shows that these municipal broadband networks don't crowd out private investment and competition,[10] while another new study analyzes a community

with municipally-operated broadband, which has had significantly faster economic growth compared to matched communities.[11]

If Congress does not fundamentally realign the telecom marketplace, we are headed on a collision course. The lack of competition has consequences for all of us. The United States has slipped from third in the world in broadband to thirteenth.[12] Americans pay more per megabit for broadband than a dozen countries around the world. Penetration of the Internet in households has stagnated. But it's not just broadband—we're failing to connect households even with dial-up Internet access. Half of all households with incomes above $75,000 per year have broadband, yet half of all households below $30,000 do not even have dial-up Internet access at home.[13] Families of color are particularly hard hit by the digital divide; white households are fifty percent more likely than Black or Hispanic households to have Internet access at home and twice as likely to have high speed access.

Horizontal Consolidation: These Mergers Make the Telecommunications Market Worse

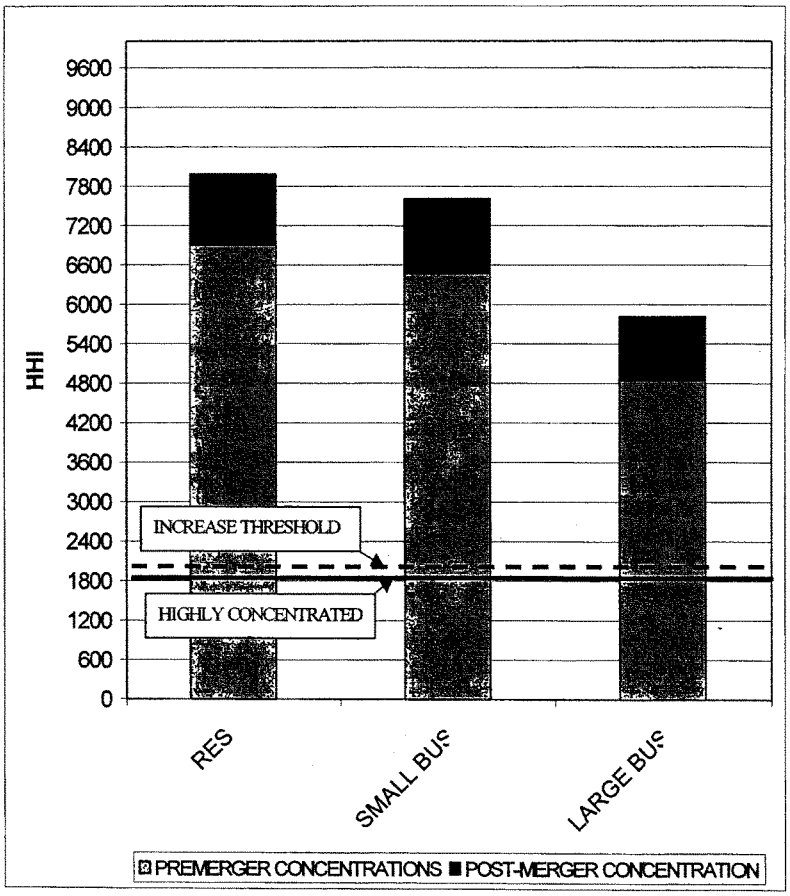
The SBC/AT&T and Verizon/MCI mergers will have a deep impact in important telecommunications sectors like the local and long-distance residential and business markets.

Today, pre-merger, SBC and Verizon have about an 80 percent residential market share of local telephone service in their regions,[14] and that number will increase as a result of the latest acquisitions and the decision of the Federal Communications Commission to eliminate unbundled network element platforms (UNE-P), which allowed AT&T and MCI to compete in local markets. By buying up their largest competitors and eliminating the last vestige of competition, the market shares of these two behemoths in their regions will likely exceed 90 percent in the residential sector.

Although the merging companies have failed to voluntarily provide meaningful information on product and geographic markets, state commissions have begun the process investigating the impact of the SBC/AT&T merger and the severe problems it will cause are becoming clear.[15] As the Committee well knows, merger analysis starts by evaluating industry structure with a measure of concentration know as the HHI (Hirschman, Herfindahl Index). A market with an HHI of more than 1,000 is considered concentrated and any merger that raises the HHI by more than 100 points in such a market is suspect. A market with an HHI above 1800 is considered highly concentrated and any merger that raises concentration more than 50 points is suspect. By these standards, the merger's anti-competitive impact will be extremely large.

A dominant firm with a local telephone service market share of 80 percent would ensure an HHI of 6400. But in California, the concentration ratio for residential customers today, before the merger, is just over 6900 (see Exhibit 2). The SBC/AT&T merger will increase the concentration in the California residential market to 90 percent, creating an HHI of 8100.

EXHIBIT 2:
IMPACT OF THE SBC-AT&T MERGER ON CALIFORNIA LOCAL MARKETS COMPARED TO DOJ/FTC MERGER GUIDELINES



Source: "Protest of the Utility Reform Network, Utility Consumer's Action Netowrk, Disability Rights Advocates, Consumer Union of the U.S., Inc., The Greenlining Institute, and Latino Issues Forum," *In the Matter of the Joint Application of SBC Communications Inc. ("SBC") and AT&T Corp. (AT&T) for Authorization to Transfer Control of AT&T Communications of California (U-5002), TCG Los Angeles, Inc. (U-5462), TCG San Diego (U-5389), and TCG San Francisco (U-5454), to SBC, Which Will Occur Indirectly as a Result of AT&T's Merger With a Wholly-Owned Subsidiary of SBC Pursuant to Section 854(a) and 854(b) Before the Public Utilities Commission of the State of* Califoria, Application 05-02-027, February 28, 2005, Exhibit 2

residential long-distance market within their regions, but if this merger is approved, this will increase substantially to an estimated 70 percent.[16] In fact, if these mergers go through, the telecommunications market will look a lot like the old days of "Ma Bell" before AT&T was broken up. SBC and Verizon will have about a 90 percent market share in residential local wireline,[17] 70 percent in long distance,[18] and 40-50 percent in wireless.[19] They will have the incentive and opportunity to squeeze out competitors that need access to the local or interstate "long-haul" networks.[20]

And if VoIP is a competitive threat, these mergers will add to the problems outline above, and remove the two largest potential VoIP competitors from the market where they are needed most – in the home service territories of the two largest Bells. AT&T will no longer exist to compete against SBC's wireline business in SBC's service territory. The same holds for MCI, which will no longer compete against Verizon's wireline business in Verizon's service territory.

The big business service market appears to be only barely more competitive, and again these mergers would exacerbate the already-significant problems in this market segment. On average, these two companies have about a 75 percent market share for medium and large business customers.[21] These two proposed mergers, if allowed to go through, will increase the in-region market share substantially to the 80 percent range, since AT&T and MCI are such large players in the market and because of the geographic pattern of competition.[22] These regional fortresses would also anchor their dominance over national corporate accounts.

The HHI in the large business segment is just under 4900. A dominant firm with a market share of 70 percent would cause the HHI to be at least 4900. The merger would raise the HHI in the California large business market to over 5800.

Given this increasingly consolidated market for wired services, and especially considering the demise of competitors to the Bells – CLECs – it is critical for policymakers to consider the geographic distribution of the SBC and Verizon markets when analyzing these two mergers. MCI had its most intense competitive presence in Verizon's service territory; the Verizon-MCI merger will eliminate Verizon's most vigorous in-region competitor.[23] The situation with SBC-AT&T is similar. AT&T has a large presence in SBC's service territory. If these mergers go through, policymakers will effectively be allowing SBC and Verizon to buy market power that eliminates their strongest in-region competitors.

Vertical Integration: The Proposed Mergers Will Harm Competition

These mergers also pose severe problems because they would allow the companies to control many of the critical inputs into the market, making it that much more difficult for competitors to obtain access to such inputs. Specifically, AT&T and MCI are large providers of Internet and interstate transport (backbone). As independent companies, their interest is in maximizing traffic. SBC and Verizon are large purchasers of Internet and interstate backbone services. As unaffiliated buyers, they make up a large portion of the market. From a competition standpoint, it is important to keep SBC and Verizon, which need the Internet and

interstate backbone services as inputs, separate from AT&T and MCI, which provide this critical input. Otherwise, SBC's and Verizon's competitors will have difficulty gaining this input and are more likely to go out of business.[24]

The result of these proposed mergers – called "upstream vertical integration" in the parlance of economics – would therefore likely have a dramatic impact on the market for Internet and interstate backbone traffic. SBC and Verizon would have an incentive to abuse their control over those assets to diminish competition for their retail businesses, rather than maximize the revenue flowing over those assets.

As a vertically integrated entity, both of the resulting behemoth companies would have an incentive to maximize profits by using their leverage in the form of a price squeeze. Unfortunately, the opportunity to run a classic price squeeze will be readily available in the form of excessive access charges. The regional Bell companies have been overcharging for access, particularly special access that was prematurely deregulated by the FCC. AT&T and MCI were the leading critics of the access charge system. Should these mergers go through, those who profit from those overcharges will have swallowed those who sought lower access charges that drive down prices for consumers. These mergers should not be allowed to proceed until access charges are reformed.

This prediction is no paranoid delusion, but the logical extension of SBC and Verizon's current activities. In Court cases like *Brand X*[25], regulatory proceedings such as the wireline proceeding, and petitions to the FCC, SBC and Verizon both support the elimination of the obligation to interconnect and carry traffic on just, reasonable, and nondiscriminatory rates terms and conditions. They are buying the assets that provide critical inputs for their competitors, but at the same time they are seeking the right to discriminate against those competitors. These mergers would undoubtedly exacerbate the price-inflating, anti-competitive dangers that already exist in today's market.

If these mergers are not blocked or substantially altered by the Antitrust Division of the Department of Justice and the FCC, these regional Bells will become regional Behemoth Bells that swallowed up their original parent company (AT&T) and its main competitor (MCI), leaving consumers almost no better off than they were before the old Bell monopoly was originally demolished.

The magnitude of the two pending mergers is indisputable (see Exhibits 3a and 3b). The number 1 (Verizon) and number 4 (MCI) companies in terms of total industry revenue are proposing to merge into a segment leader with one-third of the total industry revenue. The number 2 (SBC) and number 3 (AT&T) firms in the industry are proposing to merge to form a company that would have one-quarter of the total revenue. These two industry leaders would account for over half of all revenue. The third largest company would be less than a quarter the size of the industry leader. It also has a substantial joint venture with the number two firm.

EXHIBIT 3: TOTAL TELECOMMUNICATIONS REVENUE MARKET STRUCTURE

EXHIBIT 3 (a): PRE-MERGER TOTAL REVENUES REVEAL A MODERATELY CONCENTRATED MARKET WITH TWO LARGE LOCAL COMPANIES, SBC AND VERIZON AND TWO LARGE LONG DISTANCE COMPANIES, AT&T AND MCI, WHICH ARE ALSO THE LARGEST LOCAL

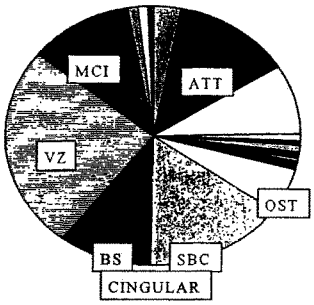


EXHIBIT 3 (b): POST MERGER (SBC-AT&T, VERIZON-MCI) TOTAL REVENUES ARE HIGHLY CONCENTRATED AND THE INDUSTRY IS DOMINATED BY TWO LARGE PLAYERS

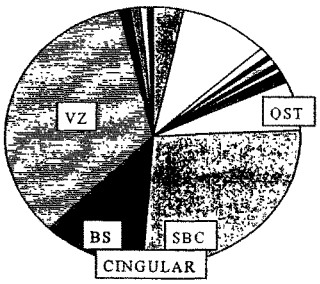
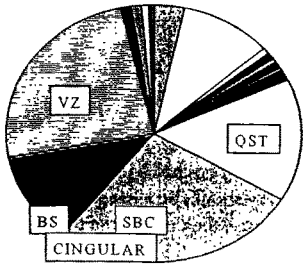


EXHIBIT 3 (c): A QWEST-MCI MERGER CAUSES A MUCH SMALLER INCREASE IN CONCENTRATION AND LEAVES A THIRD LARGE PLAYER IN THE MARKET



FEDERAL COMMUNICATIONS COMMISSION, *STATISTICS OF COMMUNICATIONS COMMON CARRIERS, 2003-2004*, TABLES 1.1 AND 1.2.

As a result of the competitive dangers described by CU and CFA, we believe the Antitrust Division of DOJ and the FCC should reject these mergers – or do massive surgery to minimize the harm that would result from these transactions. Specifically, we believe SBC and Verizon should be required to offer their broadband services on a stand-alone basis under reasonable prices, terms and conditions to ensure that consumers can purchase VoIP without paying twice for local phone service. In addition, Verizon and SBC should be required to divest substantial network equipment at a reasonable price to potential competitors who would otherwise be unable to serve consumers and businesses in local markets as a result of these proposed mergers. Finally, we believe it is critical that SBC and Verizon abide by detailed non-discrimination requirements which are essential to ensure a competitive market for applications and new services that rely upon the merging parties' networks to reach consumers.

Implicitly and explicitly, the question frequently arises as to what would happen if the mergers are not approved. Indeed, this question came up explicitly during a hearing before the House Commerce committee. In the case of MCI, there is a ready answer. It would likely be acquired by a second suitor, who has offered a higher acquisition price per share. It is appropriate to ask, therefore, what the impact of that merger would be. Exhibit 3c shows the results graphically. It is quite apparent that the competitive impact of a Qwest-MCI merger would be much less severe. The Qwest-MCI merger increases the concentration by only one-sixth as much as the Verizon-MCI merger, less than 100 points. It also produces a much more balanced industry structure, with three large firms. Measured by the routine Merger Guidelines, even if it was approved after an SBC-AT&T merger, it would not violate the threshold for closer scrutiny at the national level.

The Failure of Previous Mergers to Create Competition—Why New Mergers Won't Help

America was promised a national competitor in 1998 when SBC merged with Ameritech. Their actions did not match their words, and SBC was fined millions by the FCC for blocking competition and it closed sales offices in new markets outside its regional territory almost as soon as they opened. These promises made, promises broken are nothing new in the telecommunications industry.

These two proposed mergers represent a double dose of anticompetitive chutzpah that spells disaster for consumers.

- Within their regional market, first the Bells made life so miserable for competitors that they go into bankruptcy or throw up the hands in despair. Then the Bells say should be allowed to buy up our largest local competitors, because they really aren't very good current or potential competitors.

- When competing head-to-head with other companies outside their region, they flip the argument around, with the same result. In order to secure

> approval of their previous mergers, which eliminated the potential competitors the proposed to buy up, the Bells promised to compete out of their home regions markets, but they did not try very hard and have not done very well. So the Bells say, since we cannot be considered really good competitors now or in the future, we should be allowed to buy up the companies we were supposed to compete with.

The failure of competition becomes an excuse for the further re-consolidation and re-integration of the market, which eliminates the vestiges of competition and makes new entry into the market more difficult.

How Congress Can Mend a Broken Market

The failure of the "cozy" duopoly to provide affordable broadband service is at the bottom of the decline of America from third in broadband penetration to 15th in the world.[26] The culprit for the digital divide is not population density or spendthrift government subsidies; rather, it is the lack of competition and the abuse of vertical market power. With lagging broadband penetration, innovation in the applications layer—the services that use the physical connection—has gone abroad. Jobs follow the exit of innovation.[27] The precipitous decline in leadership has been widely noted in well respected rankings, as recently reported in the Harvard Business Review.

> Harvard Business School's Michael Porter, for instance, ranked the United States as the world's most competitive nation in his initial 1995 Global Innovation Index. According to Porter's projections, by 2005, the U.S. will have tumbled to sixth among the 17 member countries of the Organization for Economic Co-operation and Development (OECD) – trailing (in order) Japan, Finland, Switzerland, Denmark, and Sweden. The 2004 Globalization Index developed by A.T. Kearney and published in *Foreign Policy* ranks the United States seventh behind Ireland, Singapore, Switzerland, the Netherlands, Finland, and Canada.[28]

There are obviously many causes of this decline, but it is interesting to note that eight of the nine countries ranking ahead of the U.S. in this list have higher levels of penetration of broadband than the U.S.

To promote innovation and competition, Congress should look to these key principles:

- **Nondiscriminatory Interconnection and Carriage.** Congress must clearly establish that the monopoly Bells and cable companies must let competitors use their infrastructure at a reasonable cost. This non-discriminatory interconnection ensures that telecommunications services will be available on a ubiquitous, affordable service for the broadband services that are necessary in the information age.

Congress clearly defined telecommunications service in the 1996 Act, regardless of the facility used. The FCC ignored this language and invented a new definition to let cable operators escape from the obligation of nondiscrimination. It is seeking to let the telephone companies evade the obligations as well. Congress should remove from the FCC the ability to abrogate the most basic right of nondiscriminatory treatment.

- **Community Access to the Public Airwaves.** Congress must reaffirm the interconnected principles of community-based provision of local services, which has been part of our heritage since the founding of the Republic, and public ownership of the airwaves, which has been recognized for almost eighty years. When Congress says that "any entity" should be allowed to provide communications services, it should mean any entity, including communities and counties—not just the ones that the Bell or cable behemoths want.

  Unlicensed spectrum, which is the transmission medium that supports Wi-Fi and community Internet applications, must be expanded. The practice of licensing the public's spectrum for exclusive use by a single entity was adopted eighty years ago in a response to weak technologies that could not handle interference well. Technological progress over the past century is enabling more spectrum to be shared for multiple purposes free from problems of interference. Congress should encourage expanded use of unlicensed spectrum for public benefit.

- **Universal Service.** Congress must give much more precise and updated meaning to the goal of universal service, which has been the cornerstone of the communications marketplace for seventy years. The FCC must be required to take this goal seriously and not cut advanced telecommunications services off from universal service by misclassifying them as information services.[29] Sometimes traditional values are the best. The balance that this nation struck between private investment and public obligations has worked remarkably well since the founding of the Republic. The merger trend in the telecommunications marketplace threatens these principles by consolidating power in the hands of a few giant corporations who have shed most of their public interest obligations. We need to return to those traditional public interest values.

- **Re–opening Local and Long Distance:** The 1996 allowed the Bell operating companies to re-enter the long distance business in their home territories only after their local markets were found to be irreversibly open to competition. Based upon the availability of Unbundled Network Element Platforms (UNE-P), the FCC concluded that this condition had been met, then it eliminated UNE-P, under pressure from the Bells and the courts. It can no longer conclude that the markets are irreversibly open. The Bells refuse to make alternatives that available that which would re-open local markets to competition. Their ability to acquire new long distance customers – including

both marketing and acquiring existing long distance companies – should be frozen until they do.

Given the troubling track record of the regulatory authorities and the behavior of the cable and telephone "cozy duopolists," it is imperative that in its review of the Telecommunications Act of 1996, Congress takes a critical look at the communications landscape. Congress should update policies to ensure the existence of competitive markets and provide as little room as possible for the FCC to flout the will of the Congress.

Unless antitrust officials and federal regulators block or substantially alter the SBC/AT&T and Verizon/MCI mergers, consumers are likely to face fewer choices and higher prices for broadband, local and long-distance telecommunications services. CU and CFA call for vigorous enforcement of our nation's competition policies to prevent the recent explosion in telecommunications choices and technology from being undermined by market consolidation. However, even without these mergers, more needs to be done to bring vibrant competition across all communications sectors to bring down consumer prices and expand marketplace choices. Now is the time for Congress to repair current flaws in telecommunications policy.

Endnotes

[1] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the state of New York to Provide consumers with information, education and counsel about good, services, health and personal finance, and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* with more than 4 million paid circulation, regularly, carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.
[2] The Consumer Federation of America is the nation's largest consumer advocacy group, composed of over 280 state and local affiliates representing consumer, senior, citizen, low-income, labor, farm, public power an cooperative organizations, with more than 50 million individual members.
[3] Yang, Catherine, "Behind in Broadband," *Business Week*, September 6, 2004
[4] *A Nation Online*, (Washington, D.C.: National Telecommunications Information Administration, September 2004), Current Population Survey Data Base, for subscription to specific services. Zimmerman, Paul R., *Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service* (Washington, D.C.: Industry Analysis and Technology Division, Wireline Competition Bureau, Federal Communications Commission) for local and long distance bills. Bundle prices are from visits to web sites of major carriers. Comparisons based on average basic local plus average long distance. Cable modem service costs about $45 per month. DSL service costs about $30. However, the local phone companies serving 85 percent of the nation require DSL customers to also take voice, making the basic connectivity costs for a high speed line that will support VOIP even more expensive. *UNE Fact Report 2004, Prepared for and Submitted by BellSouth, SBC, Qwest, and Verizon, In the Matter of Unbundled Access to Network Elements, Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Docket No. 04-313, CC Docket No. 01-338, October 2004. Federal Communications Commission, *Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service*, 2004.
[5] Cooper, Mark, *Stonewalling Local Competition: The Baby Bell Strategy to Subvert the Telecommunications Act of 1996* (Consumer Federation of America, January 1998); *Competition At The Crossroads: Can Public Utility Commissions Save Local Phone Competition?* (Consumer Federation of America, October 7, 2003)
[6] Cooper, Mark, *Expanding the Digital Divide and Falling Behind in Broadband Falling Behind in Broadband*, (Consumer Federation of America and Consumers Union, October 2004), shows that penetration of the Internet into homes has stalled below 60 percent, while just over half of all Internet households have broadband.
[7] Letter to Michael Powell, September 16, 2004.
[8] Richtel, Matt "Dangling Broadband from the Phone Stick," *New York Times*, February 2, 2005.
[9] Consumer Federation of America, Consumers Union, Media Access Project, Free Press, "Connecting the Public: The Truth About Municipal Broadband," April 11, 2005.
[10] Ford, George, "Does Municipal Supply of Communications Crowd-Out Private Communications Investment? An Empirical Study," Applied Economic Studies, February, 2005.
[11] Ford, George and Thomas Koutkey, "Broadband and Economic Development: A Municipal Case Study from Florida," Applied Economic Studies, April 11, 2005.
[12] *Expanding the Digital Divide.*, Thomas Bleha, "Down to the Wire," *Foreign Affairs*, May/June 2005.
[13] *Expanding the Digital Divide.*
[14] Federal Communications Commission, *Local Telephone Competition: Status as of June 31, 2004*, December 2004, Tables 6, 11, show this figure at just over 80 percent of SBC and just under 80 percent for Verizon. This is prior to the impact of the UNE-P decision. Facilities-based competition accounted for only about one-fifth of total competition (Local Competition, Table 10). Most of this competition was in the medium or large business market.

[15] "Protest of the Utility Reform Network, Utility Consumer's Action Netowrk, Disability Rights Advocates, Consumer Union of the U.S., Inc., The Greenlining Institute, and Latino Issues Forum," *In the Matter of the Joint Application of SBC Communications Inc. ("SBC") and AT&T Corp. (AT&T) for Authorization to Transfer Control of AT&T Communications of California (U-5002), TCG Los Angeles, Inc. (U-5462), TCG San Diego (U-5389), and TCG San Francisco (U-5454), to SBC, Which Will Occur Indirectly as a Result of AT&T's Merger With a Wholly-Owned Subsidiary of SBC, Tau Merger Sub Corporation,* before the Public Utilities Commission of the State of Califoria, Application 05-02-027, February 28, 2005.
[16] See note 4 above.
[17] *Local Telephone Competition*, Tables 6, 11.
[18] Precursor, *Telecom Vital Statistics: Pillars of the Bell 2005 Competitive Respite Thesis,* January 24, 2005, put Verizon and SBC long distance market shares at close to 40 percent at year-end 2004, and predicted a gain of another 10 percent, without the mergers. AT&T and MCI national market shares were approximately 30 percent and 20 percent, respectively, as reported in Industry Analysis and Technology Division, *Trends in Telephone Service* (Washington, D.C.: Federal Communications Commission, May 2004), p. 9-5. Because of their respective geographic foci, the in-region market share of the long distance companies being acquired respectively is likely to be higher than the national average. Thus, a 70 percent residential market share is a cautious estimate.
[19] Consumer Federation of America and Consumers Union, Letter to Chairman Michael Powell, September 16, 2004.
[20] See Cooper, Mark, *The Public Interest in Open Communications Network* (Washington, D.C.: Consumer Federation Of America, July 2004), Chapter IV, for a discussion of past anticompetitive practices of telephone companies against CLEC and ISPs. For a discussion of the problem of vertical leverage against intermodal competitors see "Petition to Deny of Consumer Federation of America and Consumers Union," *In the Matter of Application for the Transfer of Control of Licenses and Authorizations from AT&T Wireless Services Inc., and Its Subsidiaries to Cingular Wireless Corporation,* WT Docket No. 04-70, May 3, 2004 and "Reply of Consumer Federation of America and Consumers Union," *In the Matter of Application for the Transfer of Control of Licenses and Authorizations from AT&T Wireless Services Inc., and Its Subsidiaries to Cingular Wireless Corporation,* WT Docket No. 04-70, May 20, 2004.
[21] *Local Telephone Competition*, Tables 6 and 11.
[22] Richtel, Matt "Valuing MCI in an Industry Awash in Questions," *New York Times,* February 2, 2005, C-4, puts AT&T's national market share for the "corporate telecommunications market" at 15 percent and MCI's at 12 percent.
[23] That the geographic overlap of assets is more concentrated in specific regions and products than the national average has been noted in the press accounts of the proposed mergers. Almar Latour and Dennis K. Berman, "Qwest Presses Its Bid for MCI," *Wall Street Journal,* February 4, 2005, C-4, the *Wall Street Journal* described Verizon and MCI as follows: "A tie-up between Verizon and MCI also could face cultural challenges: The companies have been fierce competitors and have been at loggerheads in court." The map accompanying Matt Richtel, "Valuing MCI in an Industry Awash in Questions," *New York Times,* February 2, 2005, C-4, shows a concentration of MCI data centers in the Northeast.
[24] The vertical problem in the cable video and high speed Internet markets are discussed in Cooper, Mark, *Cable Mergers and Monopolies: Market Power in Digital Communications Networks* (Washington, D.C.: Economic Policy Institute, 2002), Chapters 4 and 5; see also The Public Interest in Open Communications Networks, Chapter IV; Petition to Deny and Reply, not 9 above.
[25] *National Cable & Telecommunications Association, et. al. v. Brand X,* Nos. 04-277 & 04-281.
[26] International Telecommunications Union, *The Portable Internet*, Septermber 2004, p. A-32, gives the complete list of nations.
[27] Richard Florida, "America's Looming Creativity Crisis," *Harvard Business Review,* October 2004.
[28] Florida, p. 3.
[29] "Brief for the Respondents States and Consumer Groups in Opposition to Petitioners," *National Cable & Telecommunications Association, et. al. v. Brand X,* Nos. 04-277 & 04-281.

○