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on the State of Competition in the Telecommunications Industry

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

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

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

Unfortunately, the ILECs have resisted and challenged nearly every attempt to implement the pro-competitive provisions of the Act. They have spent five years playing their two hole cards – price and process. And with them, they've largely managed to keep competitors out of their monopoly. Their strategy of resistance, delay, and litigation has enabled the ILECs to maintain their dominance of the local telephone market, while dozens of their competitors are forced to scale back service plans, and many others go out of business entirely. And the incumbents now seek changes in the law that would repeal the rules that are essential to local competition and remove the incentives put in the statute to encourage them to open their local markets. Even considering such legislation creates the kind of market uncertainty that deters new investment and deployment. Enactment of such a bill would repudiate all of the hard work of Congress, and this Committee in particular, to bring consumers the benefits of a competitive marketplace, would jeopardize the significant investments made by AT&T and other new entrants to bring broadband and competitive local service to the American people, and would slow the deployment of advanced services. There is no justification for doing so.

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

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

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

Experience shows that the ILECs have deployed advanced services under the existing rules when faced with competition -- and absent competition did not deploy them -- even when the technology existed and the market-opening requirements of the 1996 Act had not yet been enacted.

Remove the possibility of DSL competition and the prospects for ILEC deployment of advanced services will be substantially reduced.

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

I will address each of these concerns in turn.

AT&T Is Committed To Local Competition

Soon after the enactment of the 1996 Act, AT&T realized that it could not rely solely on the incumbents for the network facilities it needed to offer local service. As a result, we began to acquire our own local networks. In 1998 we purchased Teleport for $11 billion to serve business customers. Then, in 1999 and 2000, we spent nearly $90 billion to buy the cable companies TCI and MediaOne so that we would have a line into the homes of residential customers. We spend billions more each year to upgrade those networks, lay fiber, and create data centers. These investments have paid off: we've gone from about 50,000 cable-telephone customers a year ago to nearly 825,000 today, and AT&T has local business customers in 71 major markets around the country.

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

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

Local Competition Is Emerging Where Regulators Have Upheld the Principles of the 1996 Act Against Anticompetitive Behavior By the Incumbents

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

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

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

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

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

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

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

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

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

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

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

Local Competitors Cannot Survive the Downturn in the Financial Market If More Local Markets Are Not Truly Open to Competition

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

The difficulty in entering local markets has also caused nearly all competitors to scale back their plans to offer service. Covad, originally another success story, is closing down over 250 central offices, and will suspend applications for 500 more facilities. Rhythms has cancelled plans to expand nationwide. Net2000 has put its plans for expansion on hold. Numerous other competitors have resolved to focus on a few core markets. Each of these decisions has been accompanied by hundreds of eliminated jobs. CLECs dismissed over 13,000 employees in the last year and a half, attempting to remain in business. While the ILECs conveniently dismiss the massive collapse of the CLEC industry as the result of "bad business plans," this cynical criticism clearly does not explain what has caused the failure of CLECs running the entire gamut of strategies, sizes, financial backing, and geographic location. In fact, what these companies had in common was their reliance on the promise of the 1996 Act for a fair chance to compete and the utter refusal of the incumbents to satisfy their statutory obligations to competitors.

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

Regulatory Relief For The Incumbent Monopolists Is Unwarranted

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

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

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

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

Nor is there any assurance that the incumbents would use the regulatory relief in H.R. 1542 to deploy broadband facilities any faster or to historically underserved areas like rural communities or inner cities. Their arguments that this bill will give them the incentive to bring high-speed access to rural areas ring particularly hollow when you consider the fact that they are selling off many of their rural exchanges, and there is little evidence that the ILECs have used the last five years to extend broadband to unserved communities.

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

Without the competitive spur of new entrants, the incumbents will slow the pace of deployment and raise prices for advanced services. Analysts at Yankee Group have observed that:

> With the majority of ILECs transitioning toward self-install models to improve provisioning time and reduce operating costs, the question that arises is: Why are DSL monthly prices increasing? The answer: The Return of the Monopoly. The downfall of DLECs such as NorthPoint effectively eliminated competition in the DSL market, leaving little motivation for the incumbent providers to maintain existing $40 per month price levels.[x]

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

Congress chose, correctly, to regulate telephone and cable companies *differently* because telephone companies still dominate their core business while cable faces video competition from DBS and other providers. Only a tiny percentage of Americans actually have a choice for local phone service. By contrast, nearly everyone in the nation has an alternative to cable for multichannel video.

Since 1993, the share of the multichannel video programming marketplace held by cable's competitors has increased to 20 percent. The incumbent telephone companies' demand for deregulation in the name of "parity" -- while their local markets remain closed -- ignores the facts that led Congress to reject a similar proposal prior to the enactment of the 1996 Act.

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

This is a particularly significant point because granting the Bell companies interLATA data relief would harm the very competition that Congress is seeking to promote. Congress' incentive-based approach takes full advantage of the long distance restriction to provide the Bell companies with a reason to open their local markets for the benefit of all consumers. And the ability to provide high speed data services across LATA boundaries is a powerful incentive: currently, the majority of traffic traveling over long haul networks is data traffic, not voice, and analysts predict that data traffic will make up 90 percent of all traffic within four years.

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

Vigorous Oversight and Enforcement Is Needed to Finish the Job Started in 1996

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

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

Conclusion

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

Thank you again for the chance to present our views.

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

[ii.] *Telecom Meltdown*, Business Week (April 23, 2001).

[iii.] *Id*.

[iv.] "SBC Communications," *Interactive Week* (June 4, 2001).

[v.] "Running on Empty; Industry Trend or Event," *Communications Week International* (Mar. 5, 2001).

[vi.] Duane Ackerman, *Talk Notes*, Salomon Smith Barney Conference (Jan. 9, 2001) at 7, 15.

[vii.] *Id*. at 11.

[viii.] *Id*. at 2; *see also* <www.sbc.com/data/network/0,2951,5,00.html>.

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

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

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