INDEX

TELCO MERGERS? ................................................................. 316

Moderator: Scott Cleland, Legg Mason Precursor Group, Managing Director
William Barr, GTE Corporation, Executive Vice President and General Counsel,
Former U.S. Attorney General
Anne Bingaman, Former U.S. Department of Justice, Assistant Attorney General for Antitrust
Zeke Robertson, SBC Communications, Inc. Senior Vice President
Reed Hundt, McKinsey & Co., Senior Advisor, Information Industries, Former FCC Chairman

INTERNATIONAL OUTLOOK .................................................. 330

Moderator: Daniel Zito, Legg Mason, Telecommunications Equity Research, Vice President
Rebecca Arbogast, Federal Communications Commission, International Bureau,
Telecommunications Division Chief
Larry Propero, IDT Corporation, President
Scott Harris, Harris, Wiltshire, & Grannis, Managing Partner
K. Paul Singh, Primus Telecommunications, Chairman and CEO

WIRELESS OUTLOOK .......................................................... 340

Moderator: Bradley Williams, Legg Mason, Telecommunications Equity Research, Vice President
Walter Catlow, Ameritech Cellular Services, President
Catherine Cox, Motorola, Vice President and Director of Strategic Marketing for PCS
Jay Kitchen, Personal Communications Industry Association, President
Thomas Sugrue, Federal Communications Commission, Wireless Bureau Chief

FCC CHAIRMAN’S OUTLOOK ............................................... 350

Introduction: Scott Cleland, Legg Mason Precursor Group, Managing Director
Speaker: William Kennard, Federal Communications Commission, Chairman

SUBSIDY REFORM II ........................................................... 355

Moderator: Patrick Brogan, Legg Mason Precursor Group
H. Russell Frisby, Jr., CompTel, President
Julia Johnson, Florida Public Service Commission, Commissioner
Roy Neel, USTA, President
Susan Ness, Federal Communications Commission, Commissioner

* Prepared by CommLaw Conspectus: Journal of Communications Law and Policy. The staff of CommLaw thanks Scott Cleland of the Legg Mason Precursor Group for his expert coordination of this exceptionally successful event. The CommLaw staff is also indebted to David Hoover for his invaluable guidance and support. It should be noted that this edition only includes selected conference seminars held on March 11. However, a complete version of the seminars can be located at the CommLaw Conspectus website: www.acad.cua.edu/law/Commlaw.
TELCO MERGERS?

MR. BARR: As probably many of you know, I view the Telecom world essentially as involving two parallel processes right now, ultimately converging, but still in many respects distinct. That is, the old telephony world and the opening up of the local market. Obviously, the most important issue of my time is merger approval. The remaining issues concern the implementation of the Telecom Act and what I see as important issues relating to the playing field and the future of competition in the data world.

My initial concern going into this merger was that regulators would tend to look at this through the prism of 1984 and I was concerned that they would not appreciate the big picture of what’s going on. The development of a national marketplace and also the implications of the rapid emergence of the data world in which the IXCs have a very substantial position and that many of the concerns and considerations that have applied in the telephone market are totally inapplicable on the data side.

But I was concerned that people would sort of still be looking at it through the narrow prism of 1984 and the most pleasing thing to me is that doesn’t appear to be the case in my discussions both at the Justice Department, the FCC and with several state commissions. I do think there has been a shift in the climate and there is an appreciation that we see emerging in the national marketplace, which will involve some major players and that some of those players have to be combinations of local companies, and also, an appreciation that decisions have to be made with a view toward the emerging data market.

In that regard, I think that there is a lot of sentiment that it’s very important for GTE and Bell Atlantic to be allowed to go forward and be a strong competitive force and build our position in the data market, and I think that is a major factor for the regulators in considering our merger.

In terms of the timetable, I would expect the Justice Department to make its decision on this as early as the end of this month. They’ve reviewed a number of issues. Obviously, they haven’t told me how they’re going to rule, but my expectation is they will approve the merger. I think the time frame now is really being dictated by one issue we’re discussing with them and that, frankly, has to do with spectrum cap and how much spectrum we can keep where there is PCS overlap of some our cellular properties.

I think the timing now for the Justice Department’s announcement of their decision is really in our hands in the sense that the more aggressive we are in how much spectrum we want to keep, the more analysis that will require and it could push up the Justice Department a couple of months. On the other hand, if we don’t want to be that aggressive right now, I think we could get a decision, as I say, around the end of this month.

I have been very pleased with the fact that the FCC has, from my perspective aggressively reviewed this merger and didn’t wait for the Justice Department to finish. The FCC has been very active. We’ve had scores of meetings with them, reviewed a host of matters with them, and I think that assuming that we do get the Justice Department approval around the end of this first quarter, I think the FCC is likely to make its decision in the June time frame and, as I said, in my discussions with the Commission, there is an appreciation of the importance of allowing us to go forward and be a strong competitor in the data world. An increasing concern, I think, with concentration in the data market and view that BBN, the GTE data company, married with Bell Atlantic will bring additional competition to that marketplace.

In terms of the states, we’re about halfway through. We have about two dozen states we need while about a dozen have approved it. I see the end of the process—California has told us they’re going to give us a decision on December 12th, I believe, Illinois by mid-November. I think those are sort of going to be the bookends, with the end of the process in December probably. That’s the most likely scenario, although we may try to move that up if we can. And nothing has developed in any of our states that indicate any possibility of derailing the merger.

The 271 process: I think we expect Bell Atlantic to get approval in New York by July, that is FCC approval in July, which is about a quarter of their lines—over a quarter of their lines. We see a number of major states falling into place very rapidly after that.

We’re exploring ways of expediting the process, both expediting a 271 so we have 271s in a suffi-
cient number of states to close the merger rapidly. We're also exploring ways of getting interim relief where we could close more rapidly than wait to go through all the 271 processes of those number of states that we feel we need to get in order to close. There are a number of scenarios where we could use some rather modest business adjustments in terms of the way we conduct some of our business to accelerate closure.

My best guess is that I would still say that it's likely we're going to close around the end of the year. It's possible the 271 process could push us a little bit into 2000.

If I can turn to briefly the telephone wars, sort of the status of the implementation of the Telecom Act, we view the UNE proceedings as a fairly important proceeding in the wake of the Supreme Court decision. I think that the Commission is going to engage in a good faith effort to comply with the Court's decision. As you know, I think the Court really made it clear that the Commission had to look at actual substitutes out there, look at the market realities, could not turn a blind eye to market realities. The cost differences were not enough and quality differences were not enough to require something to be an UNE.

The Court expects a rigorous process here because I think they understand that it was the failure to engage in that analysis in the first place and sort of the sweeping rules on what is a UNE that initially led to a number of problems including the arbitrage problem. So in the Court's decision, when they get to those other problems, you say well, you know, this may not even be a problem if you do that first step right.

So we intend to be very active in that docket and I'm pretty hopeful that in June or so we'll see a much more realistic UNE rule. I don't think the UNEP—at least I'm hopeful that the UNEP will continue to be a problem and I expect sort of more modest and more rational rules coming out of that.

As you know, the TELRIC case is pending in the 8th Circuit and is likely to be argued soon. Obviously, TELRIC and UNEs are closely related issues and from our standpoint, the more sweeping and unreasonable the UNE rule is, the more we have to fight for rational pricing on the TELRIC side, although we're—GTE, at least, is relatively satisfied with the prices that the state commissions have set.

And then the 5th Circuit, as you know we had the universal service argument there and that decision could be coming out soon and it's always hard to judge these things, but I think that it's going to be a mixed bag with the Commission losing some issues and perhaps winning some issues.

Finally, on the data side of things, I think in the long run, the issue of open access is going to be a very important issue in the data world. As you look at the marketplace and you have two lines into the house—we have evolved from different positions. Maybe we were chicken and now we're a duck and they were an ostrich and now they're the duck, but we're both ducks when you look at the data world. We're both performing the same function with high band with access and internet business and the notion that you're regulated in different ways because of your heritage. No one really is defending that position. In fact, no one really on theoretical grounds is willing to defend.

You will see a building recognition and pressure to adopt a consistent set of rules. Those rules will be open access rules for all parties. Not regulation of the internet, but open access to the internet, which, after all, is the basic rule—that is, the rule that gave rise to the internet. If it wasn't for open access there would be no internet. I think that ultimately there will be preservation of that principle and I think it is important.

With that I will close my remarks.

MS. BINGAMAN: Let me start out by saying Bill Barr has been probably one of the two or three significant people in the industry in the last three years. He has transformed it. He has had some big wins, some setbacks, but he has been phenomenally effective and I think the whole industry knows it. It's true. It's completely true.

With that, let me say I think what this is about basically, these mergers and the AT&T/TCI deal, and I'm stating the obvious, but it's best to state the obvious here. We're talking about bottleneck control over the last mile. That's what this is about. And the Telecom Act made a judgement and I will tell you I was at the table for the months and years the judgement was made and participated in it. I look back on it with a little bit of chagrin frankly.

The Antitrust Division that I headed from '93 to '96 when these historic decisions were made in the Congress, in 1984, of course, sought the AT&T Consent Decree and it was entered by
Judge Green. We administered it and it fell to my watch to oversee the administration of that and, of course, the Telecom Act largely repealed it.

The theoretical basis on which it was repealed was the idea that the original Consent Decree in 1984 had said the Bell companies with their local monopoly could not get into long distance because they had control of this bottleneck. The Bell companies, of course, immediately and effectively began a ten year campaign to get out of the Consent Decree.

Okay. The question 12 years later was what theoretical basis would justify that? Well, the idea was if you can break the bottleneck that was the whole reason for the Consent Decree in the first place; i.e., break open the local monopoly, let access to the customer, let other people get hold of the base of the customer, then there’s no theoretical basis for prohibiting this local monopoly in long distance.

It sounds great. You know, all the economists agreed with it. Everybody said great. And so that was the basis on which the Telecom Act of ’96 was passed.

I think we can all stipulate, on the competitive side of the industry as we call it, the long distance and the CLECs, it proves to be infinitely tougher than anybody realized.

This was a bold riverboat gamble that I believe ultimately will pay off for the country. In the long run I think it was absolutely the right thing to do. In the short run, it is tough, tough, tough. And that’s because these local monopolies have immense control of the technical, the back office, the pricing, they’re close to the regulatory procedure. It is incredibly hard.

The Telecom Act set three ways to break this local bottleneck. Resale, the UNEs and the UNE platform, and just straight overbuild were the three methods sought. WorldCom, of course, has sought the straight overbuild method. A number of companies, AT&T, MCI, my own company that I headed for 18 months, the local division, LCI, sought to do it by resale. And then you have the UNE method.

I think it’s fair to say we’ve learned in the three years since the Telecom Act was passed is that resale is a loser. The margins aren’t there. You can’t get the back office. There is virtually no way to break open the local monopoly by resale. I would say that three years ago, there was a blithe belief on the part of a lot of people because that had happened in the long distance industry. Competition had come through resale in long distance. So all the long distance companies sort of thought well, we can do it again. We can make this work by resale.

Totally different situation. Different industry, different incentives to resale, different margins. It just doesn’t work. Everyone has abandoned it.

Facilities based, fiber to the curb, duplicating the box networkChuge investments. Unbelievable investments. Obviously, it takes decades to build up anything—a parallel network to what they have. And then, you got the struggle over unbundle network elements that has been going on for three years because it is a way to get a price, a cost that makes a competitor able to do business and function and still use the box network. That’s the basis of it.

All of this has been immensely time consuming, immensely complicated and we’re not really close to a resolution. The bottom line is the bottleneck still exists in a large part and it will exist for years.

Now, what does that mean? The Bell companies, GTE, realize sort of the obvious, that the potential for leverage into adjacent markets, bundling and leverage, if you control the base is almost unlimited.

That’s what this is about and that’s what expanding the footprint is about. The more last mile you control, the more bulk you control at the base level and can leverage up and bundle, the better off you are. AT&T realizes it, too. That’s what TCI and the cable deals are about. The same thing. It’s the only other alternate route for the last mile right now that allows for a bundle.

So the regulators, having gotten into this three years ago with a blithe belief that the bottleneck can be broken open, are now faced with a situation where people realize this bottleneck isn’t going to break open for a long, long time and the controllers of the bottleneck, realizing the value of it, are seeking more bottleneck.

So the regulators are in a very tough position because the Bell Atlantic/NYNEX merger terms and the simple doctrines of antitrust law have not proven strong enough to give them, to date, the basis to have the most obvious attack on these mergers, which I think it’s fair to say among political people, the American public, just sort of the man on the street, if you have no dog in the fight
and you really don’t know much about it, after 15 years of getting used to seven Bell companies and the idea there’s going to be a lot of these guys, it’s an odd thought. People feel somehow there’s something wrong with this. This is not quite right.

I think the reason they feel that, you can see in the statistics. You have Bell Atlantic with 20 percent, GTE with 10—these are very rough numbers—SBC with 20 percent, Ameritech with 10. So you have four former companies, 20/20 and 10/10, going to two 30/30 companies. And the justification is gee, we're not big enough. We need more bulk in order to compete effectively.

Well, with who? There’s going to be very few people left to compete with. GTE and Bell Atlantic are using this beta network. You know, we have to combine to be able to compete in data. AT&T and BT on the international scene are doing the same thing. I have to laugh. These are the two biggest international companies in the world and they’re saying the only way we can serve international customers in the end is to get together. SBC and Ameritech, the same theory. You know, gee, we’re not big enough. We’ve got to combine in order to compete.

The emperor has no clothes, folks. This is a joke.

But it’s funny. Everybody seems to be taking it with a straight face and the reason is that the theory drives this stuff so much and the theory of the Telecom Act being what it was doesn’t handle these horizontal mergers well with no obvious direct competition. And so the people fighting these mergers—and I’m not in any of them. I have no stake in any of these things as I’ve mentioned. I have nothing to say about any of it. The opponents of the mergers are coming up with theories about size of the footprint and access charges and I was the author of such a theory myself a few months ago and I think it has some merit. They're coming up with a theory that gee, if SBC will keep people out of its region because it’s such a tough competitor and everybody knows it, if SBC takes in Ameritech, which was thought to be more competitor friendly, you’re going to discourage national competition. I don’t know what’s going to happen.

I predict, honestly, there is tremendous concern and unease and a sense that things are not going as people expected. This is not more competition. This is less competition. At the same time, at the end of the day I wonder what’s going to happen.

I mean, I’ve been preparing for this. I’ve made a number of calls around to people on this and you hear all sorts of prognostications. You hear everything from both ought to go down; to one will go through and the other won’t to both will go through.

So, I don’t know. I can tell you there’s unease. I can tell you the theoretical basis or not as obvious because of this doctrinal thing and the situation is the last mile is king and that’s where it is and I think that’s where it’s going to stay basically for a long, long time.

I think AT&T has unquestionably done the right thing with its move into getting the last mile. WorldCom, it turns out, is clearly doing the right thing with its last mile connection. And the Bells from their standpoint and GTE are doing the right thing.

Consumers, you can question what’s going to happen. You’re going to have two parties with the last mile, basically, and then WorldCom in the business district and everybody else sort of trying to get a niche markets on the top.

I don’t know if that’s satisfying, but that’s sort of an overview of how I personally understand what’s going on and where we are. All of that said, I think the energy and the creativity and the just pure dollars represented by you folks that has been unleashed by the Telecom Act and the building and the work and the activity in Data CLECs and Data and Internet and CLECs—typical CLECs, has been incredible and we’re only three years into it.

I honestly believe whatever these short term issues are that everybody—of course, we’re all focused on the short term/long term—10, 12, 15 years out. I think this will turn out to have been a great thing to have done. But in the meantime, it’s real interesting for you folks and everyone else watching it.

MR. ELLIS: I agree with Ann and Bill. I really wanted to say that. It can’t possibly be true.

I want to make a disclosure. All of the views I have reflect and are in perfect congruence of my economic self-interest. Actually I had the views first and then I tried to collect enough basis to have an economic self-interest afterwards.

I have a series of observations. First, I thought I
understood Bill just now to begin to make a very powerful rhetorical argument for the distinction between data and voice. The FCC appears to be moving in the exact opposite direction believing that data and voice should not be treated distinguishably. I would say that right now we have no coherent policy in this country with respect to these two great categories.

Are they the same or are they different? Are they the same because they use the same facilities or are they different because they don't use entirely the same facilities. What would be the way that we might distinguish between these two things? And I say things because it's not clear to me that they're services or that the distinction we're speaking about is the difference between circuit switch or packet switch or that the difference is between whether you use a computer or a telephone to access the bytes. It's not clear to me that anyone can stand up here and offer a reasonably consistent and coherent explanation of whether these things are the same or different. Maybe we'll be able to make some progress during the day.

Number two, I don't think that we have a serviceable and adequate merger policy in this country with respect to the information economy. I am talking about the high degree of difficulty in crafting such a merger policy. I think when Ann is talking about unease on this area, it stems from the fact that we don't have anything remotely equivalent to the Chicago school era, in which there was a fundamental, intellectual and academic prospective that pretty much swept the nation and most reasonable people found that they believed. That served its purpose.

It's not to say that it's now all wrong, but rather to say that there is tremendous evidence that the information economy behaves differently than the industrial economy in a number of key respects that ought to be very relevant to merger policy.

I'm not saying that I know the answer, but I am saying that it ought to be possible to reconcile, for example, the Microsoft trial with a view about the telephone companies and whether they exercise market power. Is there a difference between somebody who has a 90 percent plus share of the access to the workings of your computer, that is to say it has the window that you have to look through literally and that's the name of its product. Is there a difference between that and a company that has a 90 percent share of all of the means by which you access the Internet in a physical sense.

I'm talking about the copper loop. Are those two different in some way? Are they different illustrations of market power? Should our merger policy in this country, should our antitrust policy not in some way answer that question? I thought that Bob Pitofsky raised this issue in a very, very thoughtful way the other day in a speech that turned out to be the harbinger of the settlement of the Intel lawsuit. But I thought what he really did, was start stating the question, which is what is our antitrust and merger policy in the information economy. I think that there are some steps that ought to be taken to try to articulate that on a national level.

Next—no one's mentioned this, but I wanted to mention it. There's been a lot of talk lately about how the FCC shouldn't exercise merger review and that it was in some way lawless for the FCC to exercise merger review in any way that is separate from the Department of Justice.

Let me just say that this is cranky, nonlawyerly and almost illiterate commentary. And the reason is that all you have to do is read the law. It requires that the FCC apply a test and it makes it quite clear that that is a different test than the Department of Justice's test and the FCC has, in numerous decisions, articulated copiously and I think very, very coherently, since I edited the work—I told you this was self-interested.

Number one, it has a different burden of proof. You have to be able to prove that it is better for competition as opposed to worse in order to get a merger okayed where Congress gave the jurisdiction to the FCC. Number two, it has been made quite clear by the FCC that the way that it would choose to review a merger that by definition would already have been approved by the Department of Justice. By definition, it would already have been approved by the Department of Justice because the DOJ would always come first.

So, therefore, what the FCC would do, has done and should do is alter its regulations to be consistent with any approval. In other words, what it does is reconcile its regulatory scheme with the merger or decide that it cannot alter its regulations in order to be consistent with what the Department of Justice has decided and then regrettably say that it can't approve the merger.
Now, that's the concept. It's extremely clear and I think that assaulting the law and assaulting without reading these decisions the rationale of them is, with all respect or maybe not too much respect, extremely nonlawyerly, even a lawless thing to do. People ought to read the law and they ought to apply it.

Next, with respect to 271, Bill said that approval in New York would be in July?

MR. HUNDT: The FCC will approve it in July. I'm not sure that that's right because I don't understand that the extremely useful and revealing testing that New York is conducting through a third party of the ability, essentially, to change lines and fact will lead to positive results in that particular time period. So that's a caveat.

But the more important point that I'd like to make is this, the suggestion has also been made that after New York approves and the FCC blesses that, those being hypotheticals, the suggestion has been made that other states then thereafter will quickly fall into line.

As far as I know, no other state has instituted any processes that are remotely comparable to New York's. As far as I know, New York is the only one, other than Illinois, I think, that even has a version of deaveraging, and I believe New York has by far the most sophisticated testing process.

I think there's two ways to think about 271, even if you assume, as I do not, that the New York approval will be granted in the time frame that Bill has talked about. One is that New York sets a bar that other states then will have to jump as high to get over it. If that's the case, it will be quite a long time before other states are able to bless 271 entry.

The other way of looking at it is that this is largely a political process and the FCC and the states and the DOJ are just giving in to Congressional pressure and then having given in for one region and one Bell company, they will have to give in for others. I think that that is the fork in the road and we'll have to see if it is a case that we can see which fork has been traveled.

Let me say the following about the Telecom Act and its outcome. The great lexicographer, Samuel Johnson, was asked once to engage in a very low form of writing—not legal briefs, not that low—but rather the following advertising. And he was asked to write an advertisement for a brewery.

He wrote the following, "We are talking here not of a parcel of vats and boilers, but of the prospect of riches beyond the dreams of avarice." And he fetched a nice price for the brewery with that particular advertising.

In the communications revolution, we are talking about the prospect of riches beyond the dreams of avarice. Every single incumbent has done real, real well since the Telecom Act was passed. Our country has done incredibly well in this sector.

We have added in the information sector generally eight million new jobs in the last five years. Our productivity gains in the last quarter were 4.6 percent. The highest productivity gains in six years, we averaged from 1970 to 1992 in this country 2.5 points per annum in productivity gains. This communications revolution is creating consumer confidence, which, in turn, is the number one reason why we're able to endure the currency shocks around the world. It is attracting prodigious amounts of investment. It is helping the stock market generate new value all the time, which in turn is being used to acquire new products, both domestically and internationally by companies in the stock market. It doesn't get much better than this.

When everybody debates here in Washington with all kinds of waxed up sense of aggravation and grievance, the pushes and pulls here and there, we are talking truly about the proverbial battles between the rich and the wealthy.

But let me say this, we have had invested under a regime over the last three years about $25 billion in CLECs. All of that investment capital is dependent on the legal framework that requires the incumbent companies to share their networks with rivals. And if we were to back off on that in any significant respect in any way in the next five to ten years, we would see monumental reversal of all these positive trends in the communication sector. We should not back off. The Court should respect this fundamental commitment to have the incumbents share their networks because among other things something really important has happened. We have tens of billions of dollars riding on this idea at the present time.

The notion has been made that we have asymmetrical regulation emerging as between copper and cable. I would think that that assumes that a
The right goal here is not to regulate more, it is to regulate less. Probably the single thing that the FCC surely did right was preempting all state regulation of wireless retail pricing and wholesale pricing, so that the wireless sector is fundamentally at its core deregulated by national policy. We also "flooded the market" with licenses so that in almost all markets there is one more license than anyone can finance. That is totally a good thing because it now means when you look at the balance sheets of these companies you don’t have these artificial numbers ascribed to the license value and then all kinds of accounting gizmos to explain why. It somehow could be counted and borrowed on even though it was owned by the government.

It's a good thing that we have reduced the license value to the smaller part of the cost structure of wireless companies. What we must not do is have it be that our goal is to be lawyerly in all these matters and say we need to have regulation be symmetrical. Everybody who is the same should be regulated the same. I don’t even know what it means to say that everybody is the same. Does that mean the same technology? The same physical conduits? The same retail services? Where would you go to find a basis to talk about symmetry?

The right answer here is to look for the following. Where do you see someone who has real market power? Make them share it. Make them limit it in some way so they can’t leverage it to other markets and everybody else don’t regulate. Don’t regulate. That’s a really good hint.

Lastly, let’s not start talking about relaxing the spectrum caps because the spectrum caps are the fundamental reason why we, in fact, have this incredibly vigorous competition in wireless, which eventually will produce wireless voice transmission, a substitutable product for wire based voice and when that happens that will be the day that we can declare that the state commissions can go out of the business of regulating the retail price of voice communication in this country. That’s the goal for the state commissions by national policy to be put out of this business of regulating retail prices for voice communication.

It’s not going to happen in a year, but it’s actually going to happen a lot quicker than anybody thinks if we, in fact, continue the policies that we have in the wireless area; complete spectrum flexibility of use and spectrum caps that guarantee that we have everywhere at least one more large license than can be financed. That’s the test of easy availability to competitive entry in that sector.

Thank you.

MR. ROBERTSON: Good morning. I’m Zeke Robertson. Your program, I think, probably suggests J.D. Ellis would be here, but something came up yesterday afternoon and Jim asked me to sit in for him and you can imagine how I feel being a nonlawyer, the only one up here on the panel that’s a nonlawyer. Not only that, three very famous lawyers of which I have worked with in the past.

But my responsibility as a Senior Vice President at SBC very much relates directly with the subject that we’ve been asked to talk about today and that’s mergers.

What I would like for you to know is that we believe the decision by companies to merge is not the decision that gets this thing started. The consumers that we serve make the decision and they make it through the way they buy products, the way they ask for products, the way they ask for another provider to provide their products if they’re currently your customer. The decision to merge is the company’s response to what we believe the consuming public, be it business, residence or a very large business or even government wants.

The way you can back into that is to say well, why is the consumer the one that’s making the decision. The way we see it is that there are some enablers that have occurred that we have talked about a bit by the panelists over the last three to five years. I think the biggest one is the fundamental change in the way telecommunications are regulated.

The Telecommunications Act of ’96 says you no longer have a monopoly. Therefore, your consumers should have a choice with regard to who they buy their telecommunications services from. In addition, the Act suggests that just as Ann and Reed have mentioned, that if I want to provide telecommunication service in an area in which I’m not currently certified as an incumbent local exchange provider, I can be the person or I can be the company from which that consumer or another consumer can buy the product.

So the bottom line is fundamental change in
regulation did away with the legal monopoly and created an environment where the consumer is enabled to want something and has a reasonable expectation that he can get it.

Technology is the next big thing that makes this a reality. As the consumer is aware that he has choice, as a consumer is aware that he has choice in the way he receives different telecommunication services, technology is the one that delivers that.

To some extent, playing off of Bill Barr’s comment and Reed’s comment regarding symmetry and regulation, let’s just think for a second about how you or any other consumer might have the possibility of doing a communication that might reach only 25 miles from point A to point B. You or that consumer can use a wire line service totally. You might even be able to use a wireless service totally. You might be able to use a cable service only. You might be able to use some hybrid of wire line and wireless, some combination of ILEC and CLEC, some combination of a satellite communication with your local cable provider.

The bottom line is there is more than one way to skin a cat these days and the consumer, through technological development and through what the Act has provided, the opportunity to compete in different traditional markets, gives the consumer the opportunity to say what if you could do this, Southwestern Bell? What if you could do this, Pac Bell?

Customer demand for not only different services, but also more of the services that they’re getting today, and the other idea is that the idea of scale and scope of operations creates an environment. These are enablers. These are the things that make us as the providers of telecommunication services say to the consumer we hear you and here’s our competitive response.

With SBC and Ameritech I thought it would be good just to walk through some timetables where I think where we are today.

With regard to state proceedings, we have three state proceedings; Ohio, Indiana and Illinois.

We have entered into a stipulated agreement with the staff at the Ohio Public Utilities Commission and the full Commission will decide on that proposed stipulation sometime in April. Included in that stipulation were some things I think are very positive to the consumer that suggests to the consumer that competition is coming, that the merged company supports and embraces competition in the form of deeper discounts with regard to UNE loops, significant penalties if competition doesn’t take hold, things of that nature. That goes directly to some of the points that Anne Bingaman was talking about with regard to the promise going to the consumer.

In Illinois, we’re just getting started with the formal proceedings there and we expect those proceedings will be finished by the first of the summer, possibly around the first of July. In Indiana, those proceedings should be finished in the May/June time frame as well.

At the DOJ, taking Joel Klein at his word when he testified before Congress last week, he was expecting—he indicated and didn’t necessarily single out SBC or Ameritech, but he said the two large mergers he felt like would be finished in a month or two. I believe it will be closer to a month and two. So I’m looking for the DOJ to render us a decision very soon.

At the FCC, Bill Kennard has also mentioned on occasion that he felt like that a big issue on his plate that he had to deal with was the mergers and that they were moving ahead strongly to try to have those complete by mid-summer. So mid-summer is the first of July. I’m taking, based on what I know we’re doing, how we’re responding to both the DOJ’s data request, the issues that are outstanding yet, how we’re responding to the issues at the FCC, both at the staff level and the commission level are bringing up, and I think those dates are realistic.

What’s the benefit. That's the status of where we are in the merger, so what’s the story? Is there a customer benefit or does what Ann suggests is the issue?

I believe that our merger has the capability, as we’ve been able to demonstrate with the merger with Telesis (phonetic), is that it enables us to bring in more rapidly and more widely disburse greater technology for the benefit of the ordinary consumer and small business person, as well as large business accounts. It enables us to have the scope and scale to confirm and assure stable rates and in many cases lower rates over time.

An example, assuming that we complete our 271 processes and we have long distance and we provide additional services to the rural consumer. By the way, the rural consumer, I think, will have
a great deal of benefit with regard to price benefit via long distance.

The customer will have more competitive choice. And we’ve made the argument that—just the opposite of what Ann makes is that if I have the need to grow because I have the reality that I don’t have a monopoly and there is no question I’ll lose market share and customers, then the only place for me to grow is outside of my territory and there you have the national local strategy that is a companion to our merger.

We have announced going into 30 markets outside of our territory. So it’s put a situation at play where the table is balanced to some extent. I am as interested in getting the markets open in my competitors’ territory as I am in getting my markets open in my territory because when I get my markets open and recognize my territory, I get long distance. When the markets are open in Bell Atlantic and GTE territory, I’m in there providing service, including long distance.

So the table begins to level out. It gives me a combination of opportunities to grow. If I don’t do this, retaining the same territory, continuing to work on the same customers, understanding that the law now says there is no monopoly and there is no way you can maintain a monopoly, then my only opportunity is to stay the same or shrink and the opportunity of staying the same is not as great as the probability of shrinking.

We believe we can provide better service and our history shows that we can improve service and that’s not to say that the service in either Southwestern Bell territory, current SBC territory or Ameritech territory is deficient. But our history in California will show you that we can improve our service, the thing that is a direct benefit to the consumer.

I think we have a greater likelihood of providing high quality, rural telecommunication service, an area that is very high on the national agenda of things that are in the public interest and in areas where you have underserved—underserved customers, low income areas with the combination the size and the footprint that we present.

In addition, the group that you represent, I think the strategy that we have for growth while complying with what the Act says that your markets have to be fully open and you have to welcome competition, work with them and as Reed says, that investment—that $25 billion or more investment that’s been made by the CLEC community can’t be endangered by your unwillingness or inability to provide the sharing of the network.

If you do, I think we have the opportunity to grow, we have the opportunity to grow vertically with regard to more services in the territory, opportunity to grow horizontally out of territory, and it is my belief and our belief that when we go to Bell Atlantic and GTE in their territory to attempt to compete for their customers, they have no choice using the same business principles, but to come after ours in Dallas, ours in Chicago, ours in San Francisco. And that’s what you’re seeing the marketplace today with announced plans, as we have announced on our national local—our three first markets, which would be Boston, Miami and Seattle. It’s kind of a spreading across the country, but it’s a bottom line, an area where we have already identified we’re going to—we’re going to work and compete.

I appreciate the opportunity to come and talk to you. Many of you in this audience represent our largest owners and we’re excited about this opportunity for growth. We’re excited about continuing with the implementation of the Act. And, Scott, thank you very much for allowing me to come.

MR. CLELAND: Thank you. I think I’ll kick off the first question.

In April of ’95, about ten months before the Telecom Act passed I wrote a piece about how I expected the Bells to merge and at the time everybody laughed and said, “you know, there’s no way they can do that.” And, also as you remember, a couple of years back Reed, when he was FCC Chairman, gave a speech about how the AT&T/SBC merger was unthinkable. We wrote it about it being lipstick on a rhino.

But what I’m trying to get at here is many times the merger combinations that look impossible at one time, ultimately become possible as time goes on. And I guess what I asked to throw a little spark in the tinderbox is where does this lead us next after these two mergers are going and how much consolidation is too much? What’s thinkable? What’s unthinkable?

Why don’t we start with Bill and move on down?

MR. BARR: I think what is going to drive decisions in the telecom area are the dynamics of the data market.

Two years ago companies and regulators didn’t
really understand it. When we got the GTE exemption from long distance restrictions in the Telecom Act, we were happy because we thought that would let us get into long distance voice. That’s minuscule now. The real significance of that is it allows GTE to be a player on the data network.

And what’s happening is that increasingly industry and regulators are starting to look at the industry through an entirely different prism and the maneuverings in the Telecom area—I mean, in telephone arena fights over local access and stuff are, in fact, posturing because of their implications in the data arena. And I would all urge you to go and look at the opinion of the European Commission on MCI/WorldCom and then on the FCC’s opinion adopting the reasoning of the European Commission where it explains the market structure in the data world and where market power comes from.

And where it comes from is the backbone. And to have a backbone in the data world you need scope, you need an installed base, which then permits you to get peering agreements to exchange traffic. And it has become a chicken and egg problem for many people who have those networks, like Level 3, Qwest and others. They have the network. They don’t have the customers. And they can’t get the customers until they have peering arrangements. And they can’t get peering arrangements until they have a sufficiently installed base.

To be in the data world, you can only be there at the top. That is, you can only be a customer or a peerCyou’re a subordinate to another company. If you’re a peer, it’s because you have a big backbone installed base.

Now, right now the three IXCs are in that position and the only non-IXC really in that position is GTE because we didn’t have the long distance restriction.

C&W is essentially acting as a trust for MCI/WorldCom. I don’t think their business is growing very much and I think they’re having difficulty holding their customers. But they are, at least for the time being, a player in that world.

I think what’s going to happen, anyone who is not to be a major player in the Telecom world in the future, you have to be a backbone national—a global backbone provider. What’s going to drive mergers and consolidation in moving into that position.

Now, the Bells are in a handicap right now because they can’t do that vertically because of the 271 restriction. But I think that is going to become uncorked as people see the marketplaces being distorted and I think you will see mergers between RBOCs and companies like Level Three, Qwest and someone is going to take Sprint. There will be a merger involving Sprint at some point because Sprint has the bulk up on the data side as well. They’re not exactly gaining ground over there, although they have a pretty good position.

That’s going to be an expensive proposition for people because of the wire, the PCS issues and so forth, but it’s going to happen. I don’t know whether it’s going to be SBC or Bell South, but someone is going to do the deed there.

And just to say, there is a very distinct market structure if you think about it for a second. The telephone industryCif the local market was a viable market; that is, handling local calls and providing local access was a competitive market. I mean, that’s the whole theory of the Telecom, though. It’s a discrete market.

The whole end—long distance was non-interconnected exclusive long distance networks. You don’t interconnect with anyone. You take the traffic from Philadelphia on your network and you carry it to San Francisco. The theory was that if you control that local market you can—the reason you don’t want to let that person move up into long distance is because you actually hurt competition and distort the long distance market.

Now think of the data world. The long distance carriage in the data world is not done by exclusive end networks. It’s done by a mesh, a cooperative mesh of networks. It’s interconnected networks. You can’t discriminate against anyone because you’re hurting your own traffic in handing off traffic back and forth.

So the incentives are totally different on long haul traffic on the internet. Moreover, there’s no viable separate local market. I’m going to connect with my local library and that’s different than connecting with a library in Edinburg, Scotland. No, it’s the same.

In access markets, when you look at access to the internet, who thinks of the local Telecom?
Does the local company have a bottleneck on access? Excuse me. Gateway, Mindspring, you know table modems now. In fact, local companies are relatively—you know, in an emergent position in the access onto the Internet.

So the same consideration—none of the considerations apply in the data world. It's a different market structure with different networks. I think that what you will see is increasingly the old telephone paradigm no longer being used in assessing what's going on in the market, either for the players or the regulators and more of a recognition that in order to get robust competition on the internet at the top level with five, six, seven, eight companies up there operating as peers, that you do have to let some of these mergers, you know, ultimately the RBOCs get into the data world. I think GTE is in a little bit of a different position because we're already there.

But I think that unless someone has a good path to becoming a backbone, you know, in the next three, four years, they're not going to end up as a big national player or global player.

MS. BINGAMAN: Bill's not wrong about any of that, but I would just suggest the conclusion is wrong. The underlying facts are certainly right about need for customer based peering. You can't get peering unless you have the base. It's a chicken and egg problem for these companies and network alone doesn't do it.

But as he says, GTE has BBN. They've had them several years. Smart buy. They've got it. They've got the customer base and they have BBN. Who can believe that Bell Atlantic isn't going to be in that position when it gets 271 approval. What's the big deal about building a backbone? They can do that. They've got the customer base.

Although the facts are right, I personally think you would have more competition than backbone three, four years from now without the merger. All of that said, I'm just saying I don't think the conclusion leads where the facts go for it.

On the Bell mergers, I have to tell you I can't see what is to stop more of these things, if these actually go through. It's sort of hard for me to see. If potential competition isn't going to stop them and if a footprint argument isn't going to stop them, I sort of wonder if you won't end up with a Bell East and a Bell West and, you know, maybe ten years from now a Bell. I don't know.

But it's hard for me to see the theoretical reason for stopping it.

Frankly, I think that's why there's so much unease about this and concern. There's just sort of a sense. These are huge companies and they ought to be able to compete with each other and, as I said, it's a problem. It's a practical, but theoretical problem.

The last thing I would say, I forgot to say it in the start of this, is I disagree with Reed on the fiber versus copper. I may have an iconoclastic position here for someone formally with a long distance industry, but I got to tell you I cannot see why AT&T should be able to buy TCI and say okay, everybody gets @Home. But if you want—by the way, if you want to go ahead and buy AOL for another $19.95 a month, that's okay.

This is to me just like the Microsoft Word Processor case that I'd be honored to prosecute my first year in the Justice Department. Microsoft at that time was telling all the OEMs, "we're going to give you a preprocessor license that covers every machine you put out even whether you use our operating system or not, but go ahead and use another operating system. You've already paid for ours. But go ahead. You're free to use IBM's or someone else's." Well, it's obviously anti-competitive.

I think AT&T's position here on this ability to bundle at home, not let anybody else into it this last mile—I can't see it. What this is about is scarce resources. It's the last mile. It's a hold on the customer and the cable fiber and the telephone copper are really the two practical ways to do it. Fixed wireless isn't there. Wireless isn't there. Satellite isn't there. It's going to be years before there's an alternate technology.

So for my money what's sauce for the goose is sauce for the gander and I think everybody ought to open up. And I think that is—I think what Reed said about investment being driven by access to these scarce resources is right. But I think we ought to apply that principle and go for it.

I don't see the will to do it, frankly. The AT&T/TCI merger got passed without even a nod. Again, I've got no interest in this. I got nothing to do with any of these parties. Nothing.

But the AOL challenge was not even blinked at and I think the regulators had the best chance in that merger that they're going to have for a long time. So even though I may sit here and say I
think it's right in principle, whether it happens is something else again in the near future or even the intermediate future. I think it will take a battle.

I think maybe AOL will just cut a deal and move on. We'll see. I don't know.

MR. HUNDT: Scott —

MS. BINGAMAN: Beam me up.

MR. HUNDT: Scott mentioned—compared the notion that the SBC/AT&T merger was unthink-able to putting lipstick on a rhinoceros, which I did not understand at the time and I don't under-stand presently. I have simultaneous thoughts of endangered species and cross dressing and I cannot—I cannot reconcile these metaphors.

I will say this. If there is any change, however remote, that my humble remarks in some way de-terred that merger and indirectly led to the AT&T/TCI merger, then I ought to get an A+ even if it was only an accident from the American people and from the economy because AT&T’s merger with TCI is the single best merger in terms of competition that we have seen in the communication sector ever.

AT&T is the only company that markets a full suite of communication services to residences in America and has no access—has no physical ac cess to those residences. And to have that single company, the only one of its kind, commit to in vest in an alternative access to all the residences in America is a policymaker’s dream come true. Naturally, it would follow immediately upon the mere announcement of this merger that some people would think it’s such a good merger let’s regulate it.

Here’s the statistic that, at least, roughly is right if it’s not right to the last digit. three hundred thousand people get access to the internet over cable and 35 million get access to it over the copper plant. And that’s why we regulate copper and not cable. Because we don’t regulate new entrants, entrepreneurs, start-ups and that’s all that cable is as a communications provider at the present time.

If, in the fullness of time, it ever proves true that we have the emergence of a duopoly and that we need to regulate it, I will be surprised because that will mean that this hasn't proved to deliver what I think it will deliver. Unwired Planet is the name of just one among several companies that actually have workable wireless data technologies.

The spectrum is there. The devices will be there. Microsoft and Qualcomm announced a joint venture along these lines about a week ago.

There is an organization called WAP—I’ve for-gotten—Wireless Access Providers, I think, which includes Nokia, Ericsson, most of the major equipment suppliers in the world. They will all have browsers installed in these telephones. They will all have on their servers in the wireless provisioning networks facilities—software facilities that will give you access to the internet over wireless devices. Sony, Vaos and many other laptop computers that will come to the market in the next two years will easily give you wireless access to the internet.

I will be extremely surprised if it ever proves to be problematic that we have allowed AT&T to spend its $10 or $20 billion without the fear that it will be subjected to regulation that changes by government action its marketing plans.

MR. ROBERTSON: Scott, to simplify what I think your question is you said what’s next, right?

MR. CLELAND: Right.

MR. ROBERTSON: I think what’s next is kind of in the terms of a playground. We’ve chosen up, now it’s time for the game. And I think it’s a national game and I think what’s next then comes the international game.

Those people that wanted to play in this game made themselves available and I think we now have companies that have put themselves together, formulated alliances and I think we’re going to have the most intense competition for the American Telecommunication dollar that you’ve ever seen.

Then I think it goes overseas and I think it’s going—it won’t necessarily be one and then the other. I think it will happen simultaneously.

In response to Anne’s point of what stops us from moving to where there’s just one additional company, I think—I think the process that we have with regard to the Horace Scott Rodino re-view, and I’m not a lawyer and I’m not practicing law, but to me it seems like once you have what is happening today where you have mergers such as SBC and Ameritech and the plans to move out of territory into the Bell Atlantic, US West, BellSouth area, and they have plans to move into ours which are announced, you have an incredible amount of difficulty even then merging those particular com-
panies unless the antitrust laws change. That’s a practitioner’s point of view.

I think where we are is we have chosen up. It’s ready for the game, Scott. And the next frontier is the international site.

MR. CLELAND: If we could have questions from the audience. We have about eight minutes for the panel. Yes, Darrin.

MALE VOICE: Thanks, Scott. Could the panel please discuss what you expect the AT&T/TCI merger and the Time-Warner/AT&T long distance—or telephony deal, what effect do you expect that to have on access—local access charges and what will be the timing that you would expect to see significant competition coming from those deals?

MR. CLELAND: If on this we could try and keep our comments to about one or two minutes apiece?

Did people hear the question? Essentially what is the impact of AT&T/TCI and the Time-Warner deal on access charges and the timetable that would fall from that? Bill? Anybody want to tackle that one?

MR. BARR: Reed seems to have the inside track on AT&T’s thinking.

MR. HUNDT: I wish that were true. The inter-state access charge as a means of supporting the economics of the local telephone companies, and particularly rural telephone companies is doomed. And within five years, but—not one year, but within five years wireless and cable will provide such effective bypass to interstate access that my prediction will prove true.

That is why it is completely unfair to the telephone companies for state and national regulators to continue to use the interstate access charge and the intrastate access charge regimens to support the economics of these companies. It is completely unfair. And it is imperative that the state regulators and the national regulators recognize that those policies have to be changed.

Whatever is the amount of money that is necessary to be transferred to the local telephone companies to pay historical costs and to pay for universal service, whatever it is it has to be provided in some way other than through access charges. It is imperative that the regulators recognize that there is some amount of money, I don’t know what the number is and reasonable people can debate it, and it does have to be provided from somewhere and it cannot be provided from those two mechanisms, which invite bypass when the bypass now is certain to occur.

MR. ROBERTSON: The impact for us can be seen, and we operate in California and Cox Communications there, is well along the way in doing the type of business that AT&T/TCI will eventually be into in that they are very much concentrating on specific areas; billing their plant out, providing the full gamut of services all the way from local exchange, long distance, video, entertainment video as well as long distance and data.

I think that’s where it’s going and it is frightening me to death, but I think I agree with Reed Hundt that the ability to be able to keep the current access charge regime alive with that type of pervasive alternative to the local loop is really difficult and that’s what makes the effort that we’re going through to look at how we preserve universal service and how we make as deregulatory as possible, given the opportunities for the local company who is obligated with universal service, to have a vertical array of services to offer to increase the revenue as opposed to raising prices. Increased revenues by having additional services to provide like long distance and data. And this goes to Bill’s point.

If you can provide data in a rural exchange that today is underwater, access charge starts going away. It gives you an additional source of revenue to help keep that local access line in there. But I think the Cox Cable out in Orange County is an example of what will happen long term with AT&T/TCI.

MS. BINGAMAN: All I would like to say about this is when—if we’ve seen anything—mergers happen fast, but everything else happens slowly. The Consent Decree took ten years to do. The Bell companies getting the Telecom Act passed took 12 years. Long distance entry hasn’t happened yet and nobody would have believed that three years ago. The Bell companies love access charges. It’s a whole lot of money. The regulators are not inclined to do anything fast to hurt them and I think it’s going to—we’re on a very slow glide path.

All of that said, in other words I don’t think these sectors are going to cry soon. I think five years is a very short time frame for the demise of access charges. I think it’s going to take a lot longer. But that’s just my view.
MR. CLELAND: Last question. This is a consolidation panel and I would like any comments that the panelists have on—three’s 5,000 to 6,000 ISPs. Is that a viable market? And there are a lot of CLECs out there with property, pipe all into the same building. Is there going to likely be consolidation in those two industries?

MR. BARRY: Did you say ISPs?

MR. CLELAND: ISPs or CLECs?

MR. BARRY: Well, I think there will be consolidation in both areas. You’ll have an actual consolidation, but I think the big question there also is what the access rules are. I think if you have a closed access rule on the cable side, I think the first victims of that will be the independent ISPs and you’ll quickly move to large integrated ISPs or satellite ISPs that are essentially within the orbit of one of the big access providers.

And CLECs, I think also they’ll consolidate, but also they’ll be acquired. I think some of the large companies will acquire CLECs, just as AT&T has, including some of the Bells perhaps.

MS. BINGAMAN: I agree completely. That’s the last mile principle again, folks. The CLECs have it. It’s smart to do. You’ve invested in them. I think they’re all going to pan out eventually. There are bumps in the road and different stock prices, different quarterly results at different times, but over the intermediate to long term I think they’re all great investments because they’ve got the last mile on a scarce resource and they got copper in the ground.

I think ISPs—I agree with Bill on that. Mergers are the order of the day. That’s the reality here.

MR. HUNDT: Well, I believe that in three to five years we will see that there are two large national CLECs present in every one of the NFL cities. I hope one of them is Allegiance, because I’m on the Board of Allegiance. And I believe that we will see two or three large data CLECs and I hope one is North Point, since I’m on that Board. And I also think that we will have seen a lot of consolidation between now and then as opposed to failure in either the ISP or the CLEC business.

The ISPs are a more interesting and less predictable since. It’s pretty clear that the successful ones will backward integrate and begin to add additional services to their offerings. But I think we have such a stock market confidence in companies like Mindspring and Vario that it’s extremely likely that they will pull off that transition.

Now, that’s in the out years. The most interesting fact was referenced by Bill earlier and that is why do we have ISPs at all? Why is it that the existing telephone companies haven’t filled this space to the exclusion of the 5,000 ISPs? And I think that the telephone companies, themselves, have a couple of answers that they’re well aware of. One of the is that the state regulators have, in fact, created a large number of disincentives historically for the telephone companies to aggressively pursue these particular markets.

One example, just one of many, is the depreciation schedule. Still another example is the way that the state regulators have used pricing for a variety of products, like T-1s and a lot of vertical services as ways to oblige the telephone companies to generate subsidies that, in turn, underwrite below cost telephone service.

So I think that the state regulators have actually hand strung the telephone companies in many, many respects for pursuing in a variety of different ways the internet, also known as the data market. I think that notwithstanding that what we will see in the next year is a tremendous rush by the telephone companies into the provisioning of DSL. That is, by far, the most important data story for the telephone companies. It is much more important than regulatory changes or backbone issues for the local telephone companies.

It is incredibly important that the local telephone companies successfully penetrate this market because they’ve got a little bit of time to do so before cable actually can effectively compete, and the first mover advantages are much more important than the underlying cost advantages that might be in favor of cable.

What will we have at the end? I hope very vigorous competition in a variety of different ways in provisioning high speed data. But what we’re looking at—what we’re looking at is a market in which we will have roughly 60 to 70 million homes, ultimately, connected with high speed data. And we have now today a few hundred thousand, at the absolute most, across the country.

So this is the big race and I think that we’ll see that the telephone companies run it very, very well and it’s imperative that the state regulators make the changes that are necessary to bolster those horses in the race. Not because we like
them more than the others, but because we like a race.

MR. CLELAND: Well, we thank you. I certainly learned a lot during this panel. We are going to take about a two minute stretch break. There are a lot of seats up here for the people in the back. Please do move forward. And we're going to get started in about two or three minutes. Thank you very much.

INTERNATIONAL OUTLOOK

MR. CLELAND: I'd like to hand over the panel to Danny Zito. He's our Equity Analyst that covers long distance and competitive carriers. I've learned a tremendous amount from Danny. Thanks. Danny.

MR. ZITO: Thanks, Scott. Well, we're going to shift gears here. After talking about some Bohemeth companies and some really mega-mergers domestic—largely domestically, we are now going to focus on the international marketplace, the impact of deregulation internationally.

With us we have got a distinguished panel here from both the regulating—or the regulatory side, as well as the company side of the equation. So I think we'll get some good insight.

We've got Rebecca Arbogast, who is the current International Bureau Chief at the FCC. Scott Harris, who is the managing partner at Harris, Wiltshire and Grannis and has the distinction of being the first, I believe that is correct, former International Bureau Chief at the FCC. Larry Propero (phonic) is joining us from IDT, where he is the Director of International Carriers responsible for the discussions with, of course, the PTTs. And Paul Singh, who is the founder, CEO and President of Primus Telecom.

I have asked each of them in the format that we've got here to talk for five minutes or so about what they think are the two biggest investment implications going forward, and then we're going to turn it open to Q and A.

With that, I'd like to just come right down the table.

MS. ARBOGAST: Thank you. As the introduction indicated, I was asked to identify the two biggest events of this coming year that would be of significance to investors and I wouldn't presume to given everything that's going on this year nor will I be able to announce the current future International Bureau Chief.

What I'm planning on doing is just covering the three main policy goals that we're going to be pursuing over the course of the coming year, which in large part is a continuation in staying the course of what we've been doing for the past year.

First and foremost, we're pursuing competition—doing whatever we can to make sure the competition is working in the US, particularly as it relates to international services and foreign owned companies starting to provide service within the US. A key aspect of that is continuing to locate ways that we can minimize the regulatory process inasmuch as we can get out of the way so that companies can get into the market without being held up by our actions.

Second, we're working to take additional steps to make sure this competition is translating into reduced prices for consumers.

And third, we are working with other regulators and with industry to try to promote the benefits of the new technologies into the world at large with a particular focus on developing countries, trying to make sure that the global infrastructure develops in a way that's affordable to everyone.

A couple comments on competition. Obviously the cornerstone to competition on an international basis was the WTO basic Telecom Agreement that was completed in 1997. Two aspects of the WTO agreement are important to my Bureau now. The first is implementation of our own WTO commitments. That is nothing but a success story. Since we issued our own domestic order implementing our WTO commitments, we've licensed in the last little over a year 700—granted 700 applications to provide international service to the US and we've licensed nearly or a little bit over now 50 foreign companies to provide service into the US and a number of those are dominant carriers that before would have taken a significant of time to process their applications.

The second aspect of WTO implementation, and this is working with other governments, other regulators, other foreign carriers to make sure that there is faithful implementation of those countries' WTO commitments. This is much less dramatic and less glamorous than forging the initial WTO agreement, but I think clearly at least as important. The principles were elegant and gen-
erous. What’s important now is that the implementation be just as generous and that takes just a lot of hard work in the ditches month by month.

A major part of our efforts last year and continuing into this year are working with regulators in other countries. We’re approached more than I would have ever believed possible by regulators from everywhere. In the same week I met with Ghana—Ghanian regulators. We’re meeting with Norwegians today. We’re just continually approached by regulators in other countries that are struggling with many of the same issues we are or are just beginning and are eager to get the benefit of all the years of regulatory experience and the benefit of some of the mistakes, as well as the successes that we’ve made at the FCC.

One area that we’re focusing on quite a bit right now within Europe are some of the proposals that have been made by the regulators or by incumbents to require certain build-out and post certain build-out requirements that we think will harm and impede competition. The Chairman has met with German regulators and we’ve had teleconferences with Italian regulators to make sure that they don’t, in some ways, roll back a lot of the progress that has been made. That’s another big aspect right now that we’re focusing on.

In many countries there was an initial good push and we’re trying to guard against sort of a retrenchment or rolling back as some of the incumbents are starting to lose market share. We’re sometimes seeing sort of a counter reaction to that.

The second aspect of competition is, as I mentioned, our getting ourselves out of the way, doing what we can to streamline our license review process and we’ve gone a long way towards that. I think a number—about 85 or 90 percent of our international 214 applications now are on the streamline tract, which gets them out the door very quickly.

A big tension for us right now is making sure that we’re doing what we can to streamline and minimize our regulations, but at the same time making sure that we’re not doing it prematurely so that we open the door to anticompetitive conduct. That’s a tough balance to strike. I think right now we’re moving forward very aggressively on deregulation.

Two items that probably have coming out of the Commission in the near future are two that, in large part, came as a result of listening to the industry. We had, on a number of occasions, folks coming in from the industry who were telling us how they saw our regulations that at one point really made sense when there was no competition out there, not being necessary anymore. And one is our prior—our existing policies on the international settlements policy, which imposes certain safeguards for the negotiations that carriers can make with one another. We’re looking at ways to reform that in light of competition that’s developing in a number of markets. An NPRM was issued last summer and we’re working on an order right now.

The second is further streamlining our 214 application process and we’re looking at ways to reduce or eliminate the review period and try to open up that streamlining procedure to more classes of applicants.

Spectrum policy is another big section of the competition push. We’re working to adopt policies that provide as much as quickly as possible that gets the spectrum into the hands of the folks who are going to put it to use and that’s the overriding goal. That goal becomes more and more difficult as certain areas of the spectrum, particularly for the satellite services that are being overlaid over the terrestrial wireless, are just simply becoming more and more congested.

We have always had to work to be clever to avoid mutual exclusivity. We’re continuing to do that, but the task becomes more difficult if there is more congestion.

Second, we’re working to reduce rates that consumers are paying, and again that has really been quite a success story. A big piece of that, obviously, has been competition and liberalization. Another important piece of it has been the accounting rate reform that the Commission undertook again in 1997 that much to our delight was upheld by the courts just a couple of months ago. That gives some perimeters to what our US carriers can negotiate with our foreign correspondents when they hand off traffic on an international route. Again, now with the WTO Agreement, we’re in the implementation phase of that.

The first set of countries that needs to come down to what we call our benchmark rate started in 1/1/99 and we just last week had complaints filed by some US carriers saying that they had been unable to reach agreements with certain
countries that were in the high income category that are due to get down to the benchmark this year.

I, last week, signed an order where we disapproved an accounting rate agreement that had been submitted to us that did not reach the benchmark that we had set in that order. Again, we’re in the initial stages of the implementation of that. That is translated into remarkable amounts of decrease in prices to consumers.

We’re seeing, in the last year, prices have gone down to really quite dramatic rates. Overall, the average price has had a 30 percent decline in the last three years and in certain markets the drop is quite radical, particularly where those countries have liberalized, such as the United Kingdom and Sweden.

Third, and this is emphasizing a policy agenda that the Chairman has expressed his deep commitment to, which is working to insure that the benefits of the competition and the benefits of the technology reach everyone in the world and not just improving teledensity, but also broadband services, access to affordable broadband services.

We’re going to be doing a considerable amount over the next year working with other regulators to work with, in particular, developing nations to try to open up their markets and get independent regulatory regimes in place that we hope will help attract the private investments necessary to create the infrastructure globally that’s necessary for electronic commerce and the internet to flourish.

Those are the three policy goals. The challenges that we face in achieving those goals. I think some of them were highlighted in the last panel. A large one is reconciling the attention between convergence and the general principle of technological neutrality or what we’re calling—referring in the last panel to asymmetric/symmetric regulation.

On the one hand, we’ve always said we want technological neutrality. On the other hand, it’s clear that we do not want to saddle emerging technologies with what have become out-of-date and therefore dysfunctional regulatory regimes. That’s one set of tensions.

Another is what I mentioned in the beginning, which is making sure that we’re as aggressive as we can be in deregulating and, as I said, getting ourselves out of the way so companies can enter the market and at the same time making sure that we’re not doing that prematurely.

The third is continuing to try to introduce new services into congested spectrum. The two GHz policy is one example where we’ve worked very closely with industry to try to identify solutions to more applicants for a band and we have spectrum available and we got a lot of suggestions from the industry and we incorporated many of them into the NPRM. And I think that serves as a good model for what we will be doing more of over the next year.

Finally we’re looking forward to the regulatory implications for what Bill Barr mentioned, which is the shift of traffic away from the circuit analog system to the data and we’re just beginning to understand a lot of what that’s going to mean.

One particular issue that’s come up right this week is a discussion in the APEC regional organization is a number of Asian carriers, for instance, are urging that the FCC impose the traditional half-circuit model on the internet backbone that stretches between the US and Asia, which is something not surprisingly we’re not keen to do but it shows one example of the push to make sure that as the traffic is moving into the data systems. We don’t load it up with some of the rules that had applied to the circuit switch system.

Thank you.

MR. ZITO: Go ahead, Scott.

MR. HARRIS: 1998, I think, was the year of grand expectations in the international telecom market in two respects. First, and most obviously, the implementation of the WTO just after the turn of the year. The ideas you’re going to have, essentially the commercial equivalent of the fall of the Berlin Wall. All of these markets are going to open up new competitors for the first time. You’re going to have independent regulators, you’re going to have pro-competitive regulatory regimes and you’re going to have great investment opportunities all across the world as this rolls across the world.

And some of that, in fact, started to happen and there was a rush of investment, particularly in Europe, particularly in Latin America. As people saw the markets opening up, the barriers coming down and they rushed in with their money to compete. That was the first grand expectation.

The other is on the technology side, IP telephony. I would say that one out of three calls I get
in my office these days is from someone who has a new scheme to provide IP telephony. Voice services using the internet protocolC packet switching rather than circuit switching. Particularly, in the international market this is seen as a perfect business plan because it operates outside of the traditional regulatory model for international traffic where you have these ridiculous accounting rate structures and these calls handed off allegedly in the middle of the ocean and other nonsense.

And everyone saw this as a fabulous way to compete in the international market outside of this outmode of regulatory regime with enormous arbitrage opportunities. Those were the two big encumbrances in my view of '98, the WTO market opening deal and the new technological approach to go outside of the old regulatory framework.

In my view, 1999 is going to be the year of more reasonable expectations. Now, let me read to you first on the IP side a couple of articles.

China DailyCalthough not citing specific sources, stated that the government is acting to control the spread of internet telephony for international calls. Such services threaten China Telecom's revenues. The government hopes to turn the tide by naming China Telecom, Unicom and China Jitong as the official voice over the internet service providers. Okay. Well, that's China, right? We'd expect.

FranceCwhile recognizing that the United States has long since opted for minimum internet regulation, the ART, which is the French version of the FCC, states that we need to consider whether European regulators and operators wish to set out a European framework for the internet, rather than adopt completely the deregulated model which best suits the most powerful operators on the global market which have the ability to take advantage of a regulation-free environment.

You can read that to mean the French are concerned that if they don't regulate internet and voice over the internet, in particular, US companies will get an advantage and the French regulators will be damned if they're going to let that happen.

Canada. Close to home. They have just ruled that ISPs providing what they call PSTN voice must make contribution payments, essentially access charge payments. PSTN voice means real time voice communication via the internet to or from a telephone set or other equipment that doesn't look like a PC.

Hong Kong. Hong Kong is now requiring IP telephony providers to get licenses which they call public nonexclusive telecommunication service or PNETS licenses. PNETS licensees must pay access charges to local providers.

On the IP telephony side, folks around the world are beginning to figure it out. They're figuring out that if you do this IP telephony outside of the traditional regulatory model their incumbent carriers are going to start to be disadvantaged. Absolutely true and damn if they're going to allow it.

So you're going to start to get real push back on the IP telephony side. That's number one.

On the WTO side, there was a rush of exuberance in which I must admit I shared when the deal was struck and when the deal was first implemented. There actually weren't independent regulators created in Germany and France and in Latin America and little FCCs popping up like mushrooms. It is true that they came to Washington to say we don't have a clue. How should we do it?

The FCC conducted fabulous seminars for them on how to do it, how to regulate, how to create competition, and then they went home. And then they ran into the political reality of Deutsche Telecom and France Telecom. It's all basically the same company, just with different accents.

And what happened is they can't do what they know they want to do, which is to create a purely competitive regulatory environment, any more than the FCC can do it here. But keep in mind, the FCC at least has 60 some odd years of experience. There are competitors in the market with their own political clout and you can sort of have a creative tension here to move towards a pro-competitive regulatory environment. In Germany, it's not quite the same. In Mexico it's not quite the same.

Initially, I mean, it's sort of like a dog when it walks on two legs. The fact that it does it well isn't what counts. That it does it at all is the big deal. I think in the last year with the independent regulators that they were doing it at all was a big deal to everyone.

Now, as I have clients and other folks have clients who are actually putting real money in Ger-
many, real money in Italy, real money in Spain, the fact that they’re not doing it well starts to count and it starts to count big time. And on behalf of one client, we filed the complaint with the United States Trade Representative under Section 1377 of the US Code to complain that the Germans are not meeting their WTO obligations.

In 1999 you are going to see more of that. You’re going to see more complaining that it’s nice they’ve got a regulator in Italy, but goddamn, it has to get the interconnection rules right and in accord with the WTO Agreement because in my view, there are actually very few places that today are in accord with their obligations under the WTO Agreement.

Long term, I still think the international market is a great place to be, but it’s going to happen more slowly. It’s not going to happen in a big bang. It’s not going to happen overnight anymore than it happened here overnight.

Thanks.

MR. PROPERO: My experience in Telecom is relatively new, 24 months. My focus has been in the traditional carrier business. I’d like to give you a couple observations that I’ve experienced dealing with those dinosaurs, those PTTs and incumbent operators from the prospective of visiting about 56 administrations in 45 countries in the last 24 months.

We have had the opportunity at IDT to interface with every type carrier from Arento, now Telecom Egypt that sits in an oblique house type building with rotary dial phones to the Ettesolot, the 20 story Bohemic Telecom giant in the United Arab Emerites, the smallest country in the region with the biggest carrier business.

From that exposure to those carriers, you may draw your own conclusions in terms of where the business is going. I would suggest that there has been a mini-revolution, not as great as the fall of the Berlin Wall, but if you think about these carriers, which are government owned monopolies, they have changed dramatically. Let me just give you a couple instances.

Twenty-four months ago when I visited my first PTT I wasn’t exactly sure what that was, I was told to refrain from the word refile. It was a dirty word. The concept of sending traffic from country A to country C through country B without country C knowing the origin of the traffic, thereby getting a more favorable rate from that BC relationship.

Now, the first minute I walk in the door of the administration that is on their agenda list. They have various euphemisms for the word refile. They call it virtual transit or transit, but it is one of the top items on their agenda. And of the ten or so administrations I’ve last visited, I would suggest that 90 percent of them see that as the primary interest.

The last carrier we signed an agreement with, it was the fundamental issue. It was not the bilateral traffic, but rather their effort and interest to see how they could lower their cost. Still a monopoly carrier. They’ve been privatized. But they want to lower their cost dramatically and therefore they are very interested in a concept that just less than two years ago they wouldn’t talk about. They might have been doing it with close partners, but they certainly weren’t going to discuss it with new carriers and frankly they weren’t even interested in having those new carriers in the room.

For 100 years or so, they had dealt with AT&T, then with typical American arrogance we told them a dozen years or so ago that they had to deal with two other carriers and since they get all the traffic anyway and monopoly, they certainly don’t understand why they have to deal with IDT, which they’ve never heard of and doesn’t run national imagine advertising.

So refile is now the business and I think the Ettesolot illustration is a good example. The smallest carrier in the Middle East—or the smallest country rather and it is the most potent and dominant carrier there. Again, still a monopoly, but very aggressive in stealing traffic from everyone and refileing to their hearts content. No longer a dirty word and an essential part of the business.

Second, we have been surprised at the very formal, very legal conscious monopoly carriers with probably legal counsel that dwarfs our company in terms of numbers of lawyers who have approached us and said gee, we hear about this alternative access, the euphemism for a leaking PBX, the technology to get into a company—into a country and bypass the international gateway and save dramatically on those settlements.

We now see the biggest carriers in Europe; those that are perceived of as the most traditional, the biggest white elephants, the most bureau-
ocratic approaching companies like IDT and saying we, not only want to buy that alternative access, we would like to get into the business with you. I think that's clearly a result of the pressures of competition. They are looking at ways to dramatically lower their costs and one way is through alternative access.

Third, in the area of capacity and fiber I would never represent myself as even knowledgeable let alone an expert, but I can tell you one of the fascinating things is to see that IDT can now lease from one of its major European partners an E-1 from Paris to London that costs less per month than the rent I pay for my one bedroom.

So the facilities are out there.

MR. HARRIS: Where do you live?

MR. PROPERO: And last, but not least, we have noticed in our approach to doing business with big new carriers that they are less interested in the traditional half-circuit relationship. In fact, they are very excited about the prospects of meeting a third country. They want to have tremendous flexibility with their facilities. They do not want to have a traditional partnership of we own half the circuit, they own half the circuit and then they're stuck with us for ten years. So where that goes in terms of how people move their capacity, how they operate their facilities, I'll leave that to you.

I will say the 24 months that I've been at IDT, I think we're not an atypical carrier in the emerging market. By illustration, you can see where we've gone in 24 months. From 56 million annual revenues to six times that. We had no presence abroad. Today we will have within the next three months probably ten percent of our staff overseas. We were not in the phone card business two years ago. It is now a $400 million annual business. We had no overseas facilities. We now have two STM-1s across the pond. We had no licenses in Europe. We now have switches or licenses in five European countries. So that may give you a suggestion of where the emerging carriers are headed.

MR. SINGH: Well, unlike Larry, I have spent almost 20 years in telecommunications, always in international telecommunications. This is my third company that I have started and the first one was under the Reagan administration to launch satellites when International Telecom got deregulated. And we were one of the three companies and that was acquired by Panamsat.

Then in '85 the Comsat monopoly ended and I entered the business being the first company to offer international global private networks for data for multiple nationals. Then that company was acquired by MCI in 1991. And then I served at MCI to run the global services or global marketing. And then in 1994 we started Primus.

Let me just share with you kind of my views on it. I have seen industries. I have seen at least the death of satellite communications about three times in the last 20 years and you'll find you can now get satellite capacity internationally. I have heard about the flood of fiber capacity about three or four times and that has not happened yet.

But my views on international communications are: one, it's a tremendous growth opportunity. It's the opportunity that we had in the US in the early and late 80s—is what you have today in Europe as deregulated. We have it in Australia. We have it in some Asian countries, but then, again, they're just in the process of deregulating.

But if you pick any country, you just pick one in Europe, you would find it's a multi-billion dollar market. But, yes, it's in early stages of deregulation and as Scott said if you set the expectation just as the market got deregulated so the next day you should have $100 million in revenues, that should not be expected to start with. And remember what MCI had to go through in the US. So when we say that Telecom is not deregulating fast, I can tell you deregulating a lot faster than AT&T did. Ask any MCI executive what you have to go through.

But the reason is they all learn from the US market and all European markets you will see the same story run out again, but it will take maybe two or three years now.

So two or three years is not that long a period of time and, in fact, companies like Primus we need actually a couple of years so we can get our infrastructure set up, sales channel set up, cost structures set up. Actually, I'm all in favor that it actually goes slow because if you start going on day one everything open up, I can assure you no small company or new entrant can gain market share because it's almost impossible if you haven't had time to set yourself up at every stage in it. It will be positive for our first year to go slow.

I have been doing this for about 15 years, actually working with these PTTs and they are slow.
No question. A question is when you are entering their markets and you have an 18 month period to set yourself up, I think that’s a good thing to happen.

Now, it’s a good thing to happen for companies that want to build retail franchises in those countries. This is where I see the opportunity. There are shorter opportunities, arbitrage opportunities, wholesale opportunities, which we take advantage of. But in the long run your business is you want to be like MCI, like Sprint and like WorldCom in those countries, which is very different than when we talk about International Telecom. Everybody thinks of just sending international minutes. But in other sectors, every company is so different if you pay a little bit of attention to where the customers are.

Most of our revenues will come from overseas. We are building franchises in overseas countries. And that difference is very important because that takes longer, but that’s where long term fundamental values are.

And the second part is as Larry said, there’s all kind of refite opportunities that’s other than retail customers and for that you need a world class global network. You need a strong asset base where you own fiber capacity. You own end-to-end. You own switches and the switches have to be world class switches. Because if you don’t have those things what happens is you don’t have the cost structure to compete.

Okay. The arbitrage opportunities are all going to run their course in the next 18 months and then where do you stand?

So it’s the companies that are building world class networks who have the cost strategy to compete with PTTs long run. For those companies, it’s a very early stage of the market, but you can gain market share and we have gone from one million to now half a billion—more than half a billion in three years.

There are growth opportunities and as I have said publicly, I see no reason why we can’t be a billion dollar company by fourth quarter the year 2000. But when you’re building revenue you need a cost structure. If you don’t have a cost structure long term you don’t have the future to keep on building the business.

So it’s the difference between other companies building retail franchises in those countries that are deregulating versus the short term arbitrage opportunities which are enormous. Building networks to have a cost structure. Thirdly, is to build a brand name and a name recognition, again, to compete in the retail markets.

So this is how I see the opportunities. I think the timing is right. The speed is slow, but for companies of oversize it doesn’t hurt us to be a little bit slow. One year is not going to make a big difference, but we will be stronger.

MR. ZITO: Thanks. I’d like to ask the first question, but then I do want to open it up because you, guys, obviously are going to ask or have your own questions.

But one of the interesting dichotomies I see is the prior panel talked a lot about scale and scope as being critical and the fact the underpinning behind a lot of the mergers, and of course there were two different sides of that opinion. But I’m interested in this panel’s perspective as you fast forward out there, maybe two, three, five years. We see the PTTs. We see smaller companies like IDT, like Primus. And to get each one of your perspectives on the notion of pure size as a competitive necessity, which might be an overstatement of what I heard on the panel earlier. But I don’t think it’s too much.

MR. SINGH: Well, for sure in Telecom, scale matters because you are better off. But at this stage of the market cycle, I think the smaller companies have, indeed, advantages over the big companies. And the reason there are advantages come from different factors.

One, because the settlements are still the most prevalent way of doing business. What happens is companies like Primus, like IDT and others in the sector, we do have a cost advantage because the whole premise of our sector is that it is cost based.

The international portion of that, even if you have to lease a line and you didn’t own it, would be two to three cents at most. Now, when we own it, like in our case we have a 24 country network, you pick any country there, the cost would be one cent or less. So the international portion of the cost is kind of minimal.

Then the question is if you have negotiated a cost basis of terminating calls in the other country, other cost structure is going to be lower than most of the big companies. And this is the reason whether any company in the US, and you can start from AT&T down to every company, you can go to Germany, you can go to UK, you can go to
France, Japan, all big companies are Primus customers. And why is that? Because on some routes because we are cost based and they still have to go through, you know, their settlement part, we have distinct competitive advantage. And this is why they buy from us.

Now, it works much better in Europe. Again, the difference between companies is if you own another network and it is the world class network, which means the switches are the same the big company uses, the feature functions, the fibers are, the state of the art new fibers and we terminate calls in that country because we are in that country, then other route is no different than, for example, if KDD bought from AT&T or Deutsche Telecom. We are not doing any magic. It's exactly the same route, except it is cost based.

So they get the quality they want, they have the traffic, they have the routing transit traffic for years and we are the beneficiary of that part. So being smaller at this stage has advantages.

Now, after five years when they would try to go global, which I think most companies have to do now, then those advantages come lesser, but then retail advantages lessen. That's when the scale part of it would make sense and that's why consolidations happen.

MR. HARRIS: I think that's fundamentally correct. I think if you want to understand foreign markets, the best thing to do is look at the US market and dial back five or ten years and the market here and the Telecom markets, I suspect, overseas go through a life cycle.

First, you have 1,000 flowers blooming and you create competitive conditions with little players getting into the markets and then precisely as Paul said, then you get to a stage in the market development where consolidation makes sense. You got networks out there. Then you do have to get to the retail consumer and the market then develops.

So I think what you've seen here you will see in Europe, you'll see in Latin America and eventually you'll even see it in Asia. It just takes more time there because they started out behind us.

MR. PROPERO: One illustration of what Paul was suggesting in terms of, maybe, scale matters in the long run. Right now these PTTs don't know how to handle their high cost structures.

I represent a carrier in Europe. That particular carrier has at least half a dozen subsidiary interests in another part of the world. They now want us not only to quote them termination rates for that region, but they want us to send traffic through IDT to countries where they own the monopoly carrier. The reason is that they don't know how to yet manage these subsidiaries. Some of them are on an operational level, others on purely investment level.

But it's become such a grab bag assortment and with all the other things that are going on with those regional partners, they may own two adjacent carriers in two different countries who are re-filing against each other, they may have their managers down there, they don't know how to handle it, but they do know that the big parent company has desperately got to drop its costs.

When they originally made the investment, they said, well, we will continue sending all the traffic on the standard traditional relationship in that contract and now they're looking at ways to skin that off and they're actually cheating against their subsidiary.

Crazy world.

MS. ARBOGAST: When I look at some of the mergers and joint ventures that we have before us right now—we have BT, AT&T putting together the joint venture for the international service, AirTouch, Vote-A-Phone and the wireless, it suggests that obviously to a lot of companies size is inevitably going to matter.

What we're keeping a close eye on, it goes back to what I mentioned in the beginning of not getting out of oversight prematurely. I think we're going to keep a pretty close look on routes where there have become affiliations between, a US provider and a dominant player in that foreign market. That's still going to be an area that we're not going to just walk away from and assume everything is going to be fine.

On the other hand, we're probably going to pull back significantly which I mentioned earlier the international settlements policy. We're taking a look at reforming that because there we are finding from talking to many of the small carriers that a lot of the policies that we had originally undertaken to safeguard against competitive problems no longer are necessary where there is growing competition in the foreign markets and, in fact, probably are hurting some of the smaller
carriers in their ability to carry traffic on an international basis.

MR. ZITO: With that I'd like to open it up to questions from the floor.

MALE VOICE: I wonder what you believe the implications of data traffic are in the market?

MR. ZITO: The question was what really is the impact of the explosive growth of the data and the impact on the competitive environment, particularly with the fact that 80 percent of the content resides here in the US. Go ahead, Scott.

MR. HARRIS: One of the risks Rebecca mentioned in her opening remarks is that as carriers around the world take a look at this, they're terrified. They see their monopoly positions threatened not just by the WTO and people getting into their markets because in a sense they know how they want to deal with that. But they are clueless about how to deal with the growth and data traffic and the fact that it's going to swap voice traffic and it's going to include voice traffic.

This data traffic is basically taking over the world. And their first instinct is "oh, I know what to do." Let's regulate it. Let's do just like we did with Telecom. All right. Let's have some kind of regime where we hand off data traffic in the middle of the Pacific as it comes from Australia to the United States.

Only someone who grew up in the PTT model wouldn't even think of such a thing. But that is precisely what they're thinking about and that's the risk.

Do I think it will happen? No. Because it's too damn stupid and also because the FCC and some other enlightened agencies, both here and overseas, will dig in their heels and say this doesn't make sense. This is our chance to break it all open and get rid of all the stuff Larry was talking about.

All of the refiling. That's just arbitrage you come into that as a result of a dying regulatory system. That's what refile is, right? It's arbitrage.

This data thing has the chance to blow it all away and the dinosaurs are afraid of it being blown away. I think it will be, but not without a struggle.

MS. ARBOGAST: It goes directly to what I had mentioned at the end of my remarks about this so-called cost sharing issue that has been raised particularly by a number of Asian carriers wherein the bottom line argument that they're making is that they should because so much content is in the US. They should not be, what they call, subsidizing the traffic that's sent from an Asian country to the US and back. Our response has been and will continue to be that we do not see a problem and if there is any problem, the market is going to take care of it.

I think one of the responses that we always—one of the developments that we always point to are a lot of the innovative solutions that are coming up that companies are developing to take care of basically asymmetric traffic pattern where—because so much content right now is in the U.S., big amounts of data are getting out of the country in response to a quarry.

One of the things we're seeing are some companies coming up and doing asymmetric routing where they're using a small portion of leasing undersea cable to send out the quarry and then using satellites to dump the large amounts of data in response to it.

I think we'll continue to see a lot of innovation in handling the asymmetric traffic. I think we'll also see cashing that's going to be happening on a regional basis. And a lot of the concern—a lot of the patterns of the data traffic are not due—a lot of it, granted, is due to so much of the content being in the U.S.

That's continuing to change and it will change so that more and more content is going to be housed in other countries. But a lot of it is simply because it still costs less in many cases to send route traffic from one particular Asian country through the U.S. back to the Asian country. In other words, the U.S. is becoming sort of a hub for a lot of the internet traffic that really is just trying to exchange from Singapore to Taiwan. Subsequently, the answer is to continue to liberalize those other markets and get the prices down in those markets.

MR. HARRIS: It's also domestic. There is internal German traffic that comes back to the United States because it's cheaper to come to the United States from Munich and go back to Hamburg than it is to go from Munich to Hamburg.

MR. SINGH: Let me just make a general comment about the data part. I think from the carriers' point of view, it's very important and also from the investment community point of view. There are three types of data. One is, some folks would call fax us the data. In other businesses we
will say voice fax. Analog type of things. They’re all the same even though they do get converted into data anyway, but in terms of the way the customers are and the pricing and that segment of the market. So that’s the voice fax.

Then you have internet traffic. I think as we were talking about it’s asymmetric and most of it goes—the contents are here. I think it is true that over time that the costs of transmission changes will decrease. Some of the traffic will stay within the countries, within the region, but still I don’t think it’s going to change very quickly. It will change over time.

Now, what are the implications for the carriers? Implications as Primus saw them, that we got to supplement over 24 countries fiber network with a satellite overlay network because of the nature of traffic. Because of the asymmetric traffic, satellites will get even more popular and this is my prediction. Satellite capacity will get very short again because there is so much internet traffic. It’s a perfect medium, satellite for the asymmetric traffic just for the cashing purposes. As transmission costs come down, you can make them regionally. They can get the same content and the fact it goes mostly from U.S. and you can broadcast it.

With the combination of the fiber and the satellite, the companies that have that infrastructure would be best positioned to participate in the internet part.

The other thing for the international carriers is we have the customers who create internet traffic. So if you have a global network and then you have the consumers and business people who use internet, then it always comes back to the lowest cost structure that you have to have to be successful longer term.

The last one is the data that businesses create and that one does not fit into any of this asymmetric part of the story. I think that part is the carriers that have medium to large size business customers. Those are the multi-nationals you need for those. Those are ATM and private lines. All of those should be tied into whether the carrier has large scaled business customers. If you don’t have them, data in that traditional sense would not be applicable to the carrier. So you have to look at which carriers are focused on medium, large size account and then look at the network.

MR. ZITO: Okay. Next question? Yes, please.

FEMALE VOICE: Everybody agreed there needs to be a legal and predictable trade with the E-Commerce. What is your opinion of how the rest of the world is doing in establishing this?

MR. ZITO: Okay. The question was worldwide frameworks and consistent framework for E-Commerce. I would like to throw that right at Rebecca.

MS. ARBOGAST: I think it depends on which aspect of the legal framework you’re talking about. There’s so many components of that. The tax, the encryption, the digital signature and the extraterritorial control over the content.

I think it’s frankly hard to say right now. I think that there have been a lot of movements—not a lot of movements. There’s been a lot of attention given to a lot of the encryption, digital signature and security. That’s obviously an important underpinning to letting the commercial side of E-Commerce develop, but you know so many countries, including our own, have the concerns over the national security. That’s going to be a battle that I think is just continuing to progress. It needs to go forward.

There is also the issue of the ICAN, the top level domain names of the address system. There’s much more movement there than people expected there to be a year ago, but again a lot of work that needs to be done.

The issue, and I know Scott will have a lot to say about controlling the content. I think it is continuing to be a very thorny one and we’re seeing a lot of countries have an impulse to get in and Scott said, you know, the first impulse is to regulate. They don’t want the content and each area of the world has its own particular definition of what the most pernicious content.

The Europeans have been very afraid of a lot of child pornography because they’ve had problems in some of their member states, and we have our own issues about gambling and Congress is taking a look at those. I think that that is going to be an issue where there’s going to be a continual impulse on the part of a lot of legislators to respond to the major concern of the moment.

I think that at the end of the day with the exception of some countries, perhaps like China, trying to block in the same way—and some of the Middle East countries trying to block and they’re doing it with the BSS, with the Broadcast Satellite Services as well. I think most of the legislators and most of the regulators will find that it’s just impos-
sible to block that content and that they're not willing to step aside and completely get out of the other good aspects of the E-Commerce development. They'll think that that's too high of a price to pay.

Again, I think it's not clear to us whether in many cases we need an overarching global legal framework for this. I think we're a bit skittish and think that right now letting the market develop and letting the companies take advantage of some of the uncertainty probably is better than trying to impose from a "top down" consistent framework.

MR. HARRIS: India wanted to have a single international gateway into which all internet traffic must travel so that it could watch what went into the country and stop what it did not like. Martin Bonnamon (phonetic) in the EU wants to create a global framework for E-commerce and for the internet to use his word "make it better."

There is in most countries this enormous centralizing instinct, which is if government can only get its hands around it, it will improve it and make it better. Now, I'm skeptical that is the case.

Now, there are real issues, some national security issues and that kind of thing, but in my view as a general matter E-Commerce will be better if government backs off. On the other hand, it is simply too big an enterprise. It is simply too big a thing for governments and politicians to keep their hands off of it. So that isn't going to happen. So then it becomes a question of careful line drawing. This will be a tension you will see in the United States and overseas, and it will be the battle, I think, between deregulators and regulators of all stripes over the next decade.

By the way, the traditional notion that one party or one kind of philosophy is deregulatory and what not breaks down when it comes to the internet because Republicans like to regulate it as much as Democrats do and you can see that analog going on overseas as well. I hope governments do what they're going to do very subtly and very carefully. The risk is that they will charge in with a blunderbuss approach and disrupt it.

MR. ZITO: With that, Scott is signaling me back there either to steal third or that we are done.

WIRELESS OUTLOOK

MR. WILLIAMS: Thank you, Scott. Good morning. It's a pleasure to host this panel this morning on wireless and what's ahead for wireless. Wireless is certainly an ever-increasing component of the communications matrix. Look at the success that mobile wireless continues to have and the growth of minutes and even seeing some of the transition from wireline minutes or landline minutes over the wireless platform.

It means that there is a lot of issues in this space and have been for some time and there continue to be things, as I mentioned, such as landline replacement, the wireless data industry, which is starting to make a resurgence once again looking at applications, such as the internet and E-mail and bringing that down to a wireless device giving people full mobility. And also discussions are beginning over the next generation of digital standards commonly referred to as 3G.

This morning we are very lucky to have really what is an excellent panel. When you look at this panel we're covering the whole spectrum, pun intended I guess. Everything from the regulatory aspect to industry to the service provider aspect and also we are very lucky to have manufacturing representation as well from Motorola.

I will begin very briefly with an introduction of each of our panelists and then turn it over to them to give a short outlook, their thoughts on the industry and where we go from here, and then we will open up the floor to questions.

To start off, we'll go about this alphabetically, Walt Catlow is the President of Ameritech Cellular and Paging. Prior to that he was previously Executive Vice President of Ameritech and President of their international operations. Walt is a Veteran of the RBOC industry, starting out with Indiana Bell and AT&T back in 1968.

Next we have Catherine Cox with Motorola Personal Communication Sector. She is Vice President and Director of Strategic Marketing where she is responsible for the worldwide market and competitive analysis, market research and long range planning. She has actually brought with us a number of items for show-and-tell as well on the wireless side to show us where we are at right now and also where we are going. She also has a tremendous amount of experience. Ms. Cox has been with the Motorola team for about 20 years.

Next we have Catherine Cox with Motorola Personal Communication Sector. She is Vice President and Director of Strategic Marketing where she is responsible for the worldwide market-market and competitive analysis, market research and long range planning. She has actually brought with us a number of items for show-and-tell as well on the wireless side to show us where we are at right now and also where we are going. She also has a tremendous amount of experience. Ms. Cox has been with the Motorola team for about 20 years.

Next we have Jay Kitchen, President of the PCIA or Personal Communications Industry Association, a trade association representing wireless
carriers on an international basis. Prior to that he spent 17 years with the National Association for Business Education and Radio where he served as President from 1981.

Lastly, we have—not last—last but not least we have Tom Surgrue who was—recently became the FCC Wireless Bureau Chief the beginning of this year. Prior to joining the FCC, Mr. Surgrue was a partner with the Washington DC firm of Halprin, Temple, Goodman and Sugrue where he specialized in communications law, regulation and policy.

With that we will go ahead and turn things over to Walt.

MR. CATLOW: Thanks, Brad. When I talked to Scott and Brad about the format for this and what they want us to talk about, they said well, we want to have some trends. I mean, this is where people are going to put their money down on a roulette table and so what’s valuable and capital markets are thinking about trends.

I have three items I want to talk about, but first I think I will spend a minute or two on what I see as drivers in this business. I’m very new to the pure wireless business. My last five years before this was in Ameritech International where we made primarily investments in full service telecommunications companies. Very different from the model you saw on the previous panel. The privatization model that we were using just taking some of the things that we’ve learned, as Scott mentioned before, thinking of a lot of the rest of the world as four or five years, sometimes even ten, behind the deregulation model in the United States.

A lot of quality American operators can do very good things and make a lot of money by going into privatization and helping those same PTTs we want to complain about get ready for the future. In that process I think I probably will learn more about American business in that five years than I did the 20 years before that when I was working in North America.

But let me take from that what I see as some drivers in the wireless business today and then talk about a couple trends and then we’ll get onto this wonderful show of equipment here.

The first thing is probably overworn and overused, but it happens to be true and probably a little overlooked in the wireless business and that’s the customer. And the reason the customer has been overlooked is because it’s been a service that had such incredible demands, drives such incredible growth, that getting at the specifics, getting at segment, segment and resegment on how you’re selling to what it is the customer basically wants has kind of been forgotten. Basically it’s been a war or situation of price and form factor of the handset and availability of the service. And the demand has been so great it hasn’t been necessary.

We have found over the last year in Ameritech Cellular that if you work very hard on this there are not only things to learn about services and pricing that you want to provide but there are things to learn about how to use your capital investment and how to make the most out of what you have, and I will come back to some of those later. But I do think it’s a primary driver.

The second thing is just as obvious, but probably takes a little thought and that is the maturity of the business based on the current competition and the slope of the curve. The industry went along for a long time as a duopoly with the major spectrum allocations in major markets and the demand, again, was so high that it was—basically a “do you want per service?” or “do you want my service (the prices are about the same, the handsets are about the same and here you go)?”

During that period—without a whole lot of focus on what the customer really wanted—we set up a situation where new entrance—as they want to do coming in with lower prices—were able to bring a lot of market to them in a hurry and a customer acquisition model. But as that starts to mature what we find out is happening is you got to be, again, more understanding of the customer, more selective and start working on, everyone needs to work on, a total infrastructure cost, which brings me to the third driver.

All these things are simply the wonderful capital model that we always see happen. Competition brings lower prices, brings better service for customers, increases penetration, hopefully total revenue increases and, if you’re smart, you get your share or a little more of your share of the revenue.

What we need to do in that process is look at total infrastructure costs for running these businesses—and these businesses can eat up an enormous amount of capital and expense. And until you start to understand the customer base in
some level of detail, and some level of granularity, it is not intuitive where costs can come out.

So as you look at where your investments might flow in the future in the wireless business, my tip would be to look at where people are understanding the cost drivers and how they are getting at cost reductions and creating really good platforms and backroom infrastructures that do not harm customer service but, in fact, probably enhance customer service.

One example of that we have found is that we have prided ourself on having the best customer service at Ameritech Cellular for nine years and we did that by our measurements of how quickly we answer customer calls and how many times we satisfy each customer when they called in and so forth. Then we started to look in some detail at what customers tell independent researchers and our own research and people like J.D. Power, where we win the award over and over, and we have a tendency to take the J.D. Power award the fourth year in a row, Detroit/Chicago market, and stick it in the customer service center next to where our on-line associates are answering calls.

But customers told us the top priorities was their ability to initiate a call, the quality while they were on the call and the ability to keep that call established as long as they wanted to. In other words, not be dropped. That's the number one thing the customer likes. So taking that in more levels of detail, I think many of us will be able to be a lot smarter about how we spend our money.

Getting back to the third piece of the drivers in that model, the same thing we all learned in business school, but sometimes forget to use, those cost structures have to be established to keep these businesses profitable and, in fact, increase the profitability as competition continues to grow.

Let me run quickly to the trends and then I'll pass this along. From that I see about three and a half trends. The first driver, insanely, wildly growing is prepaid calling—we can come back and talk about that later if you want to. It is a big driver in Europe and becoming a very big driver for us. It was originally constructed to serve what our finance and marketing departments call our “credit challenged” customers. It turns out, however, that there are a whole lot of customers who want the convenience of a one time payment for the use of a certain number of minutes and then not have to worry about it anymore. Furthermore, the availability of refurbished or low cost analog handsets or an individual’s handset that the customer has kept after they were no longer on a contract service makes this a great and fast growing service.

The next trend I would tell you I think, and this is not a secret to anyone, is usage. Obviously as penetration rates increase, our ability to track more people on the network each year can also increase, but at a decreasing rate that dictates that revenue drivers must come from usage. I do not know of anyone who has created the magic of causing those customers to push/send more often and stay on longer. We are all working on it. Some of those applications will start to rise in the next year or so and I think that's going to be a major driver.

The third driver is differentiated services. I will not spend much time talking about that. Not only can we change our screen pops based on who's calling us and what value they are to us through our customer value management system. We are also investigating, thanks to deregulation, all alternatives for differentiated network service based on a customer’s value which is also something that can be done and can offer new revenue.

And the one-half of the three and a half drivers is data, because mobile data, as it has been for years, is just around the corner but how far away that corner is I don’t think any of us really know. We’ve had some good success with some targeted sales where the combination of day delivery and mobility was absolutely required. You know, State police, local law enforcement, those kind of things.

But to take those and generalize them to a population who is roaming around with a PC wanting fast internet access is probably a corner that's really far away. And I'll sit back now.

MS. COX: Good morning. I'm happy to be here today to speak to you about future trends from the perspective of the equipment manufacturer. I brought along a few slides to help illustrate my points and also a few toys here to show you along the way.

So, the first slide, I’d like to start out by just giving you a brief update here to calibrate ourselves on what is happening in the industry. The wireless industry—wireless telephone industry last year reached over 300 million subscribers worldwide. Growth, well over 40 percent, year over year
net subscriber basis and we expect it to reach over 400 million by the end of this year. So the good news is we see, you know, continuing, you know, strong growth in this industry.

Next slide. If we look at it, from a regional basis we see the trend towards increasing activity outside of the Americas. The US, kind of, started out as sort of the, the center of the wireless universe. But, we have seen strong growth in Europe and Asia that have actually brought those regions ahead of the Americas from a percentage standpoint.

And if we look at it from a technology standpoint, GSM, which is the technology that predominate outside of the US, continues to make up over half of the worldwide unit volume. As analog declines, we also see strong growth in TDMA and CDMA digital technologies as well.

Next slide. Another big trend that we see and driver going forward for the manufacturers—is in addition to the strong growth in net new users, we also see a growing trend of a strong replacement market. As we have a strong base of new users, over 300, you know, million users out there, replacement is an increasing opportunity for us. And this also brings new opportunities from a product standpoint.

As you've heard from Walt, we definitely agree that sedimentation is a strong requirement. Whereas new users might want a more basic, you know, value oriented product, the replacement users are increasingly looking for more sophisticated products and functions of their phones.

Next slide, please. I'd like to just give you a quick update on messaging. The personal communication sector now incorporates not only wireless telephone, but also a messaging and consumer two-way devices.

Next slide, please. Messaging also has seen—outside of the last year where we've seen some slowdowns, you can see also dramatic growth over the last five to six years, from 37 million up to, you know 160 million subscribers at the end of 1998.

Next slide, please. Getting to Motorola's Personal Communication Sector vision. We had a—kind of a shorter term and a longer term vision and our short term vision is really to rebuild our position in our current generation products. We have had some delays, coming to market with the wide variety of digital products that are required out there these days, but we've made a lot of progress in that and, certainly that's our top priority short term issue. And then, looking forward creating, you know, the vision, for the future, you see as a personal networking vision and I'll talk more about that in a minute.

Next slide, please. Getting back to our current position. Now, while we did lose some ground over the last couple years, we think we have, made a lot of progress in digital. You can see we've had extremely, strong unit shipments in digital.

Next slide. In 1998 we had a number of new product introductions that have been very favorably received. We have smallest and lightest V-phone available in GSM and analog and we've certainly working on the other technologies. We also have a number of new GSM, products—entry level. Value products as well as mid-tier, performance products that we've introduced and have had a lot of success with outside of the US where GSM predominates.

Next slide, please. We also introduced TDMA and CDMA versions at 800 megahertz of our popular, you know, Startac phone. We've also introduced new phones and pagers for the Iridium Satellite system. We've got a popular new IDEN. You can see on the far right there. The I-1000. No phone for the NexTel and e-commerce systems. So we've made a lot of progress over the last year.

Next slide, please. We have more ground to cover in 1999, but you can see here a sample of what you—if you stay tuned you'll see over the course of 1999. A lot of it is filling in the gaps in our product lines, particularly in TDMA and CDMA at the different, bands and combinations that are required, out in the marketplace.

Next slide, please. Moving onto our future vision. Looking beyond today, which is primarily a voice, you know, market. You know, we see the increasing desire for data and wireless internet access. Wireless. You've heard a lot from other panel members this morning.

Next slide, please. We see a consumer who, instead of having isolated devices that are primarily voice or messaging, we see a consumer who wants to take their world with them and have access—access wherever they are. To take their worlds to stay in touch, whether it's for personal use or to accomplish more in their business lives. Increasingly, they want integrated communication solutions. Devices that communicate and allow them to take their worlds with them wherever they are.
And this is really our vision for the future. The personal networking vision that we have.

Next slide, please. We also see that this fits very well in bringing our voice, our telephone products and our messaging products together in the same sector because where we have a strong base in wireless data throughout our messaging business and combining those two visions has made a lot of sense.

Next slide. And we also realize that this is going to take a lot of further investment on our part, as well as partnerships and collaborations. We’re not going to be able to do this on our own. And you’ve seen a lot of Motorola partnerships announced over the last year and you’ll see more to come. Just some examples within our sector: we’ve acquired the company Starfish, which has true sync technology, which allows these devices to synchronize whether it’s your phone and your computer. We hope to put that technology in all of our products going forward.

We just recently announced our first product, the Startac mobile organizer, which allows you to take the true sync personal organizer functions and attach them right to your Startac phone. We’ve also been very active as founding member of the Wireless Access Protocol (“WAP”) form. You heard about that earlier today. The wireless access protocol that’s going to allow you to wirelessly access the internet, as well as “blue tooth” for short range communications between devices. So we’ve been very active in a lot of these industry groups and to help make this future vision happen.

Next slide, please. Some examples of other products that you’re going to see here—looking forward—that are moving us towards this vision. As I mentioned, the mobile organizer product that uses the Starfish true sync technology. We are also developing a dual slot symcard Startac that will really be a driver for wireless E-commerce. We’ve got a smart phone in the works, as well as, future enhancements to our page writer, advanced messaging, a two way device. So there’s a lot of, you know, exciting things on the horizon.

Next slide, please. In summary, we see a strong continued industry growth with replacement marketing becoming a large, component going forward. We’re excited about creating the personal networking, future that we see in the industry through further collaboration and partnership.

We’re working really hard both in 1998 and going forward to rebuild our position and really create a strong future for the personal communication sector at Motorola and this great industry that we’re a part of.

Thank you.

MR. KITCHEN: An impressive array of products here, Catherine. Glad to see all that that Motorola is working on.

I think everyone in this room knows that the wireless industry is the fastest growing and most competitive segment of the telecommunications industry. And while PCS is a newcomer in the industry, it’s really beginning to make a real difference.

Just some facts that probably many of you already know, spending on PCS is more than doubled in 1998 and subscriberhip tripled. Customer use of PCS phones is at 300 minutes per month, compared to 140 minutes for cellular. So we’re seeing a difference there. I think you also probably have read that the latest statistics show that the monthly cost of the service has dropped about 40 percent since competition really hit the marketplace.

PCS providers have introduced service in 250 markets and that’s covering 84 percent of the population of the United States. I think there was an interesting article, maybe some of you all saw it in the Washington Post this morning, that the hotel industry is now getting very concerned about the amount of revenues being taken away from them by wireless devices where business travelers are now using their wireless devices in their hotel rooms instead of paying the, sometimes rather exorbitant, fees to hotels for the use of their service.

So I think all of this talks to the growth of the industry that I think you’re very familiar with.

I’d like to take a few minutes today to talk about several segments of the industry that have already been mentioned here, but perhaps you have not focused on. The first one is paging and Catherine mentioned some of the things that are happening in the paging and we’re really thinking of paging as reinventing itself and it’s more of a messaging service and data service. We think that the data segment of that is going to grow dramatically in the next couple of years. There are currently 50 million subscribers in the US and I think that coincides with the numbers you used, Catherine, on a worldwide basis.
It's an exciting industry with the two-way services and data that are coming down the pike and some of the equipment that Catherine showed you: the ability to tie in to your palm communicator and link into the internet and receive E-mail, get all kinds of news sources available, E-mail on a nationwide basis, these are the kinds of services that we're talking about.

Catherine just handed me her Page Writer 2000—I don't know if you all have seen this—which is a two-way pager with a full keyboard. I started carrying one several months ago and wouldn't be without it right now. It's just incredible what we're going to be able to do and we are looking at an incremental subscriber growth in the wireless area of about 25 million over the next five years because of these new devices.

I think you'll hear a great deal over the next two days about broadband networks and PCIA is very pleased to be working with the members of our newest membership section, the Wireless Broadband Alliance, in our efforts to speed up the broadband deployment. And these carriers for LMD—that have LMDS licenses are really unique and I think it's just incredible to think in terms of the amount of spectrum that they receive from the FCC: 1,150 megahertz. That's 40 times more spectrum than has ever been issue for a mobile telephony license in the past.

Just tremendous bandwidth and it creates all kinds of opportunities for the LMDS service. The small dishes that they provide are going to make it a unique service. We have some challenges there with respect to access to buildings. We're going to be working with that with other segments of the industry. PCIA has already filed some petitions with the Commission and we're looking for favorable and quick action on that, Tom. Nothing like a plug here.

The business plans for these carriers include not only internet, but also access, data services. As Walt was saying, we're looking at data really coming on strong. And even video applications along with traditional telephone service for businesses and ultimately residential customers.

And I think the early success that we've seen with Winstar Intelligent are both very encouraging and to see somebody like Craig McCaw's Nextlink purchase the largest LMDS license holder is another real sign that this technology is a serious contender in the industry.

So over the next two days of this conference, I think you can listen to the Telco and the cable folks and the debate about broadband, but don't believe for a minute that those are the only alternatives. Wireless is going to be right in there making the pitch and offering some very competitive services.

One final trend that I would like to mention in wireless that you may not have paid a lot of attention to and that's the phenomenal growth of the site industry. And the latest sign of this trend was earlier this week where BellSouth announced that they are selling all of their wireless towers to Crown Castle for an estimated $610 million. And we're seeing that happen more and more with the major carriers as they sell off their—some of their infrastructure so that they can concentrate on their core business, which is really communications.

And the consolidation in the site industry is causing it to grow. It is being dominated by a number of very large companies now that have gone public. So there are some interesting opportunities there.

You're here in Washington, so I think we have to make some comment about regulation and I'm sure Tom will have some comments about this as well. But I know one of the things that is a great concern to you folks is any uncertainty in the regulatory environment, both regulatory and legal.

And I think Scott and his team here, Legg Mason, who put together a terrific conference that hopefully over the next day will dispel some of that and maybe Tom will do that in the next few minutes here.

I started by saying wireless is the most competitive part of the industry and I'll close by saying it is the sector with the least amount of regulation and we're very pleased with that. We think there are some areas that we would still like to see further deregulation and we hope that the Commission and Congress will move faster on that. And we want to make sure that we work to insure that the government mandates that are imposed on us are reasonable.

But with growing markets, exciting new services on the horizon and a regulatory framework that has largely been resolved, we think the wireless industry will continue to reward the investors in this sector.

Thank you.
MR. SUGRUE: Well, my name is Tom Sugrue. I'm the new Chief of the Wireless Bureau of the FCC. I've been there about six weeks. Initially I want to apologize for coming up to the panel here after the introductory marks had started, but we moved down to the Portals Building in the last week and those of you who have been down there know you cannot catch a taxicab from there to anywhere. You sort of got to hike about a quarter mile to a half mile and then wave frantically and hope someone stops.

In addition to no taxicabs, I just warn you there is no parking and no restaurants and your cell phones won't work in the building. But other than that it's a nice spot. Actually when Scott Cleland was asking me to participate in this panel, he said well you'll be down at the Portals and there's no where to eat. I'll put you on at 11:00 right before lunch and I can give you a meal. So that clinched the deal right there.

In terms of looking forward and what I see coming down in the future in the next 12 to 18 months, this is more by way of aspiration than prediction, but I would like to see a world in which regulation and regulators have less to do with how the wireless industry is going.

This is an excellent conference and the Legg Mason folks and Scott and Brad ought to be commended for putting it together. I wish I could stay for the whole thing myself. I could learn a lot. But on every panel there's at least one regulator, in some cases two. It would be nice if a year from now—if not a year from now two or three years from now, a group like this would get together about the future of the telecommunications industry and there would be a paucity of regulators and government enforcement officials and so forth, and more folks who are dealing with technology and markets.

I am encouraged in that regard by this panel with a few exceptions or a few plugs Jay put in the last comments. There have been very few references to regulation and the focus on technology and the customer. I think that is a very good sign. If I'm not invited back because my job isn't considered important to this industry in the future, I'll consider it a success. But I'm here today and we are in the real world and at least for a little while I think the Wireless Bureau will have some impact on the wireless industry.

I'll just outline for you some of my thoughts as to some of our priorities over the next year.

Chairman Kennard has grouped his priorities under the banners competition, community and common sense, and I think that describes and is broad enough to encompass a number of things, I think, the wireless industry wants to do. In the competition front, this is, as Jay pointed out, I think the most competitive or among the most competitive sector in the telecommunications industry.

We would like to do things and look at regulations that promote that even more so, but also to look at the wireless industry and see our regulations inhibiting the delivery and the freeflow of services in an open market and to what degree are certain interventions, perhaps, still necessary.

To give an example, I'll just refer to an order we came out with last month on local number portability. The Commission has requirements, indeed is—the Statute, the Telecommunications Act of '96, requires incumbent local exchange carriers and I think all local exchange carriers to implement local number portability. The Commission extended that to the wireless industry and received petitions to forebear from that.

What we did, our analysis there was to look at the cost and benefits of that requirement in the particular circumstances of the wireless market. We concluded was that this is a different market at this point in time. I think it will evolve. But in this point in time it was different in significant respects from the wireline market.

I have three wireless phones and—this is just the way I use them, but I can't tell you the number right now of any of the three. Now, there are different reasons for that, but a lot of people are like that. Obviously, the number isn't a critical deterrent to my switching carriers. The marketplace churn data indicate that it's not—doesn't seem to be a significant deterrent to a lot of customers switching carriers.

Again, I think that will change. We want it to change because we want the wireless phone to be important enough to people that that number is widely distributed and widely used. But right now it didn't seem on the benefit side to be that important.

On the cost side we have a fairly aggressive list of things we want the wireless industry to do, in-
cluding build out the PCS networks, convert to digital for the incumbent cellular carriers, implement certain things like E-911. We lined up the set of costs that the regulation was going to ask of the industry or impose on the industry and the benefits, it didn't seem to add up to continue to impose local number portability in the short term.

That's just an indication, I think, that the Commission is capable of looking at these markets separately, looking at these markets in terms of their individual characteristics and their development at any particular point in time.

Going forward, we're going to look at—we're also interested in not only just wireless to wireless competition, but wireless to wireline and what can be done there. Are there regulatory impediments or enablers that could help that to happen? Making spectrum available is certainly one that the Commission can do and has been doing. We're going to look at calling party pays and take a serious look at whether that policy would enhance the use of wireless phones as a full fledged alternative to wireline and not just a complement.

We're going to look at what other impediments by way of access stability and conduit and things like that that we're hearing a lot about from some of the competitors, saying "we're up and ready to go, but we can't get our antennas on the roofs or our wires into those conduits."

There are some tricky questions there; legal, jurisdiction, policy, political, and the answers won't always be easy. But we're going to try and push because we think it's important.

Finally, I do want to say just a couple things that are sort of below the horizon level of some of the high flying policy questions. But in the Bureau one of the major things we do is just provide service to this industry and to users. The Wireless Bureau issues about 400,000 licenses, grants, applications per year. We want to do a better job in just making the trains run on time and getting those applications out and granting those licenses and having a process that's transparent and easy to use.

That won't always get the headlines. It won't be something that will be in the newsletters, but I think it will make this industry and these industries be able to operate more efficiently. We have a couple of initiatives to sort of take on, some of the—some of the problems that have existed in the Bureau on that front and if I am invited back a year from now I hope to have some progress to report there.

Thank you.

MR. WILLIAMS: Tom, thank you very much and thank you to each one of our panelists. I'm going to open the floor up to questions and answers here.

Before we get started I want to go ahead and ask the first question since I have the microphone. Being with the CTIA show last month and several of the panelists mentioned it this morning, wireless data is starting to show resurgence again. I'd like to, hear each of the panelists' thoughts in terms of how real it is this time around, what the expectations are of when this really starts to gather momentum for investors and seeing it in the underlying businesses? Is it this year? Next year?

What form that may take? Is it advance messaging or will it start to be one of the two-way mobile devices? And also, you know, briefly maybe a couple things that investors should really keep their eye on in terms of judging the progress?

MR. CATLOW: Okay. Brad, I will start real quickly. The whole concept to me breaks down into two pieces; one side is traditional laptop display and functionality and access to databases and servers by wireless. That's the kind of thing we're refining, improving applications. I mentioned earlier, obviously State Police, local law enforcement, meter reading, dispatch, those things that are growing and the growth rate is starting to improve. The applications are improving and data over our wireless network is reliable enough that people are really starting to move there. Those are not mass applications.

What most of us, I think, are waiting for and probably if we just stop for a second and think of where this industry is, is very much like the adaptation curve for wireless telephony in the early analog days—amps in the United States, which was—it was only—the uptake was only there for people who absolutely had the need to combine the communication with their mobility and, you know, we all know the stories.

We even got a museum. We donated to the Museum of Science and Industry in Chicago. One of the okie sets out of the original automobiles in 1983, when we were running out of the Oakbrook office, which the total weight I think is 81 pounds, including the radio that filled up the trunk. But
there were customers for that. And that's where we are in that kind of application, I believe today.

What's growing quicker are some of the things being facilitated by what Catherine talked about and the rest of the panel talked about, which is message services—two-way message services independent really of the device, but enhanced and enabled by the device.

I personally use this quite a bit with my CDMA service that we have in Chicago Network. My assistant and most of the people in our group use short message service, just like GSM or any other digital short message service, and we use it on our handsets as opposed to the pagers. So we get an indication of a message, we have a text message. We can choose to reply to the text message or reply over the voice network.

I think we're going to see a tremendous growth there and then the fixture or appliance industry, starting to work on standards, starting to work on things like the Starfish that Catherine mentioned, which gives "syncing" between all of your personal assistant type devices should take another plateau.

Now, in sum, although I hope the rest of the panel will argue with me, I still don't see that as the big push, for example, in 1999. There's sufficient applications out there and sufficient critical mass to make a big difference in the revenue line and all of this revenue right now—not all of it, but a good portion of it—probably isn't at a positive operating margin. So, again, doesn't that kind of tell us that that's—we're at that layer where voice mobility probably was ten years ago.

Now, what we do know about all data applications when the correct applications fit with the correct devices is the growth curve surpasses the voice curve by many factors. So the wise investor is looking at that first turn of the curve to get in there and I don't see it yet, but there are a lot of forces that say it is probably pretty close. And that's as far as I can take it.

MS. COX: I would agree with a lot of what Walt just said. Wireless data from Motorola's prospective has been something that we've been really invested a lot in over the years. But there's probably no other company that has invested more than Motorola and it does seem like it has been that service that is kind of the proverbial, you know, one or two year out, it's going to really boom. And we haven't really seen that yet.

Having said that, I think there are really positive things that we're seeing out there right now. Walt mentioned messaging, but I think also the evolution to packet data and use of packet for messaging is going to be a big driver of increased messaging and data applications.

Just as the internet has been a huge, sea change in the whole industry, certainly I think that people are going to want to access the internet and E-mail, not only when they're sitting in front of their desktop computers, but wherever they might be. And I think that's going to be a big driver of data as well.

Now you see a lot of the standard setting activity taking place. For example, we just introduced our first phone with unwire planet, a browser in it. You're seeing other phones out there such as smart phones. Although, kind of in their infancy right now, they are certainly going forward. They're going to be growing more and more.

So it's certainly—it is a big trend as I said in my presentation.

MR. KITCHEN: I think one of the big differences we're seeing now that we haven't seen in the past is the involvement of the software folks. Last time around when data was really being pushed several years ago, I think the technology was there, but there didn't seem to be the interest on the software side. We're bringing it altogether and we're seeing that being corrected.

I think another interesting fact that we have to look at is third generation and where that's going to take us. With 3G we're looking at tremendous increases in bandwidth technology that's going to make available multi-media type services and I think we're going to see a tremendous increase in the amount of data that's being used.

On the messaging side, I mentioned in my opening comments that that segment of the industry is growing. We're looking at the—at this device being the legs to the Internet. This is the way you'll be able to get into the Internet and have full capability carrying around—carrying it around on your belt.

I think data is here. I think we're going to see a tremendous increase in the use of it. I have to agree with Walt. I don't think it's a 1999 event. It's somewhere a little bit further down the road, but it's looking very positive.

MR. SUGRUE: I would only add that in addition to the mobile applications that people have just talked about, there are fixed wireless applica
tions in which data is a major part and certainly that LMDS spectrum where there is more than a gigahertz of available data and then with—going to be a critical part of the services there.

We’ve just had a presentation from Lucent last week. The bottom line was more spectrum. That’s the bottom line of a lot of presentations we get, but in lower bands that would be very versatile for high band with connection through wireless in a residential setting.

But we think wireless can be an important component of local infrastructure and in opening up local services to real robust competition. So, and if that’s going to happen, it has to be useful for data applications like Internet accesses and not just voice.

MR. WILLIAMS: Let’s go ahead and take some questions from the audience. Right here.

MALE VOICE: You mentioned even though there’s been long term great growth in paging but there’s been a funkiness in the recent last few years. So from an investor’s standpoint, where do you see the paging industry going and some of the data that you just talked about?

MR. KITCHEN: Well, I think we have to look at paging as an overall industry and categorize it into perhaps two categories and then there’s two ways to split that.

You got the personal use of paging and the beepers, the digital page where you just get the phone number. We’re seeing a tremendous amount of use of that by young people, teenagers, kids. It’s a very inexpensive service. It’s the most inexpensive wireless service. So there’s that segment of the industry that’s doing very well.

There’s the business side or the businessman who wants to be able to be in touch: make airplane reservations, change his calendar, that kind of thing with this device, and we think that’s an important part of the segment.

So there’s the high end and the low end of the industry and both of those have great future potential. I think the industry is trying to reinvent itself in looking at the data side that we’ve been talking about and we’re going to see a lot of emphasis there over the next couple of years. So when I said reinventing itself, that’s what I was referring to.

MS. COX: Yeah. I would definitely agree with that. At least from a global standpoint, a lot of things that are happening in the paging industry. For example, the industry in China, you know, the government has been really restructuring that whole organization and the carriers that handle paging. And that has caused a bit of a slowdown over there in addition to a lot of the economic things that are happening.

So in addition to kind of the reinvention, there have been some economic and other factors out there that have impacted the slowdown.

But the two way side. The advance messaging is seeing, you know, very strong growth and, as Jay said, you know, for the personal messaging side there has, you know, been strong growth there, too.

MR. CATLOW: I agree with my colleagues, I guess. I don’t see a clear picture of what Jay didn’t really talk about is that middle ground, which is not all the way up at the high end, but probably wants something more than numeric.

The devices are out there, but the growth is relatively flat. We service that market. We have a very good market, a million and half paging only customers. It has a growth rate to it. It isn’t at the growth rate of digital cellular and at the affordable level, probably right above that, you know, teenager with a $5.95 a month service, at that affordable level, we need some influx of new services and products that can be brought on to the infrastructure at a minimum amount of cost.

I think that some folks are working on that. The demand is there, but it's like any other market that’s at that plateau of maturity. Most of those users probably don’t really know what it is they want next and you’re in a cycle of trying to both figure that out and then invest in the platform for it.

But I agree at both of the other ends. I think we’re seeing a direction. They have good low cost service, family type service. A lot of times we’ll equip in our stores an entire family with pagers when they come in. The high end service, people—well, maybe that’s symmetrical. They want to be able to go both ways. And that end is totally elastic with digital—with PCS and digital cellular and then that part in the middle is where we need to work on. And I don’t have any real solutions.

MR. WILLIAMS: We have a question back here.

MALE VOICE: A couple related. I believe that that works. Is there any hope of—(inaudible) —cover the free technology that we can use—(several sentences inaudible)?
MS. COX: Well, as far as on the coverage side, I think you’re certainly seeing the advent of a lot of multi-mode, multi-band products that are starting to enter the market to cover a lot of the coverage and make the coverage broader, particularly in light of all the different technologies and bands that are out there and in use within the US market.

So I think that over time is going to help and, you know—and we’re working on the display issues as well. I think our newer products have bigger and better displays and Motorola has also been a—always been a proponent of the light omitting, you know, display, which I think is much more visible to the users and easier to use.

MR. KITCHEN: On the coverage issue, I just remind everybody as far as PCS is concerned, the new digital service, it’s only three, three and a half years old. So I think we’ve done a remarkable job of getting the coverage out there today to 84 percent of the population, but there are holes that need to be filled in. I think the industry is working to correct that.

MR. CATLOW: And I would just add to what Jay says, our direct customer research and our experience is exactly that. We do not turn up—when we go to our clear path digital service, we do not turn that up until we can give the same kind of coverage without holes in the same area that people are used to their analog because the first thing we find out is if they don’t have that, they’re not happy with it because that’s exactly what they expect and they’ve been brought up to expect that. And we often get return customers who go to carriers who aren’t making that kind of coverage.

MR. WILLIAMS: We got time for one more question here. Right here.

MALE VOICE: What do you think the?

MR. KITCHEN: Yeah, what do you think.

MR. SUGRUE: We should probably ask to set odds. I don’t know the answer to that. It’s tee upped in an NPRM. Current spectrum cap is 45 megahertz per carrier out of a total of—I think it’s 180 megahertz for PCS and cellular together.

It’s one issue that has split the industry somewhat. I think when Jay picks this up he’ll explain why it would be a bad idea. If there were a CTAA representative here they’d explain why it would be a good idea.

It’s something we need to look at as to whether it’s—was it a necessary thing for an introductory period that should be phased out or given that this is a—this is a funny market in which the government controls access to the market. It’s a competitive—a worthwhile competitive market, but you just can’t come into it without getting a government license to enter.

So it—the characteristics of a market like that in economic terms are a little bit different than I think you’re typical market and I think we’ll need to look at that.

MR. KITCHEN: Tom’s absolutely right. It is a device of issue. PCIA’s position has been established that one is that perhaps lifting the cap is appropriate, but not now. It’s a timing issue.

We need to make sure that there is sufficient competition in the marketplace, so that we don’t lose the competitive advantage created in the past. And without the caps we’d be very concerned about immediate consolidations that would, in effect, reduce competition.

We’re very deregulatory in nature, but to deregulate at this time may—for example, there were enough consolidations that it forced the Commission to think back or think again their regulations, it could actually be a regulatory move. And so it’s a very delicate balance there.

MR. WILLIAMS: With that, I think I’m going to thank the panel very much.

FCC CHAIRMAN’S OUTLOOK

MR. CLELAND: One thing I know, in speaking with Chairman Kennard, is one of his highest priorities is promoting bandwidth to all American consumers so that everybody can enjoy the fruits of the Internet phenomenon.

As an aside, I would like to take this time to formally congratulate Chairman Kennard on his fantastic and huge victory before the Supreme Court in January. That decision restored the FCC’s broad jurisdiction over Telecom policy in the United States.

I don’t know if you read in the papers, when Chairman Kennard heard about this, he was home sick with the flu. When he heard it, it was like getting an elixir. He felt better immediately. If you thought Chairman Kennard was happy, you have no idea how happy the FCC was.

You have to realize that the FCC turned 65 this year. As a 65 year old, you know, they essentially got a dose of jurisdictional Viagra. Some of you
people that followed this Eighth Circuit Court decision, the Eighth Circuit essentially tried to put the FCC out to pasture. They wanted them out to pasture behind the fence that was hog tight, horse high and bull strong.

The Supreme Court decision was a very strong affirmation of the FCC's authority. I'd like to give Chairman Kennard this plaque which is really a prescription. It's called the Supreme Court prescription. The Rx is jurisdictional viagra. And the instructions are, take one capsule whenever jurisdiction is challenged; be sure to have a rationale basis; and also, do not take in combination with no political support.

We'd like to give this to you. I'd also like to say that there's refills as needed. They should call Dr. Chevron Deference at Chris Wright's phone number, 418-1700. A lot of congratulations also go to Chris Wright. People don't understand; this is a big deal.

Chairman Kennard was general counsel of the FCC during this time, so he did the legal work and thought he was right. It turned out that he was right. Chris Wright argued before the Supreme Court. This is a very big win. We'd like to introduce you and also give you this present. Thank you.

Please welcome Chairman Bill Kennard.

CHAIRMAN KENNARD: Thanks a lot, Scott. I appreciate that introduction. I will never forget when I came into the office the day after the Supreme Court ruled and I saw the headline of Scott's newsletter on January 27th, the headline was "Supreme Court Gives FCC Viagra." But I'll tell you what I thought about when I saw that, Scott.

Scott, as many of you may know, is a prominent Republican. And when I read that headline, I thought to myself, what is it with Republicans and Viagra these days. You've got Scott Cleland and Bob Dole. You all have some kind of obsession here or some kind of a problem.

Well, we all know that Scott's newsletter is a staple for those of us who follow telecommunications policy in the marketplace. And in that pithy Cleland way, he tends to sum up pretty much all you need to know about this dynamic industry. I want to thank Scott for inviting me here today and welcome you all to Washington.

Also, I wanted to acknowledge the three people who have actually been running the FCC for the past six years. I looked around this room today and realized that there are two former and one current FCC Chief of Staff in this room, Blair Lavin, who I worked with when I was general counsel under Reed and Blair, and John Nakahata, who was my first chief of staff when I was chairman of the FCC. I still am chairman of the FCC, I think, although I have a reauthorization hearing next week. My second and final chief of staff, Kathy Brown, is also here today. And I also notice Rachelle Chong, who was also running the FCC for part of the last six years.

One day here in Washington, one of the most important officials in our government, someone who was responsible for technology, innovation and new ideas surveyed the whole technological landscape and made this statement. He said, everything that can be invented already has been invented. This was a man named Charles Dahl who was head of the U.S. Patent Office. And the year was 1899, exactly 100 years ago.

It occurred to me when I read that statement that sometimes people in Washington get it wrong, which shouldn't come as a shock to many of you who follow Washington from afar. But, then again, who among us could have predicted the future, particularly in the telecom business, and I don't mean forecasting what will happen over the next 100 years. I mean forecasting what will happen in a few years. Just think of what has happened over our own lives in communication.

It seems to me that even people who are well known who are making bold predictions and usually getting them right often get them wrong. Bill Gates is a smart guy, right. In fact, this year the FCC relocated our headquarters office to a building called The Portals in Southwest Washington, D.C. As soon as I moved into The Portals Building, I looked up the word portals in the dictionary. In Latin, it means gates. I thought to myself, God, this guy is good. I mean, this guy is really good.

But even Bill Gates doesn't get it right all the time. In fact, in 1981, Bill Gates said, when talking about the demand for PCs that 640 kilobits could be just about as much as anyone would need.

McKenzie and Company, the management consultants, these are smart guys, too. Bill Gates probably pays these guys hundreds of thousands of dollars for their advice. In the early 80s they
predicted that by the year 2000 there would be 900,000 cellular telephones in use in the United States. This year there are 70 million cellular telephones in use in the United States. Most of those phones are small enough to fit in my suit pocket. Today that service costs about 40 percent less than it did just three years ago. Of course, I should note that McKenzie made this now infamous prediction long before my predecessor, Reed Hunt, joined that particular firm.

Blair, would you make sure that Reed knows I said that about him? Thank you.

Imagine the changes we’ve seen just in our own lives. We grew up with black and white television. Now, we have not only color television but all the cable networks. In fact, the cable networks today are getting more audience than the big three networks combined, what used to be the big three. They’re watching in color. People have closed captioning. Soon we’ll have high definition and digital multicasting. The picture is clearer than anyone has ever imagined from a home television set.

In the phone business we’re seeing competition like we’ve never seen before, particularly in long distance. I grew up in a time in this country when choice in telephone service meant, in my neighborhood, whether you had a phone or you didn’t have a phone. Today, of course, choice in long distance means you can choose from over 600 long distance carriers and you can pick any number of pricing plans that can be customized to your particular needs.

But as all of you know, and as Scott alluded to earlier, the most important, stunning, paradigm shifting development in communications in the last 10 years is the Internet, possibly over the last 100 years in this country. We know that the Internet is changing every facet of communications in this country. It’s changing the traditional media. Radio and TV, even the telephone, almost every facet of our lives is being changed by this technology.

From shopping to trading stocks to how you all value companies, whether on phone lines, over cable wire, through the airwaves, millions of people’s lives are changing as they go online and, in part, because of the spectrum that we in government have made available. In the coming years we’ll have even more ways to access the Internet, via satellite and via third generation wireless.

All this is happening, and it’s still hard to believe that the Internet is still just in its infancy. It’s just a baby and all this is already happening. As we enter this network future, this new economy powered by information zipping along the web, I think it’s useful to understand how we got here, how the Internet came to be.

This is an important year because 30 years ago this year, it will be 30 years in October, researchers at Stanford and UCLA decided that it was time to test what was then the ARPANET, which was the forerunner for the Internet. 30 years ago they sent the very first e-mail message ever sent in the United States. And this first message was not something as profound as the first message that Morse sent when he developed the telegraph where he said something profound. I think he said, “what hath God wrought.”

Or Alexander Graham Bell, he said something actually very practical when he said, using the first telephone of the United States, “Watson, come here, I need you.” But the first word ever sent by e-mail was a single word, two letters, “L,” “O”. The reason for this was simple. They were trying to type “log-in” and the thing crashed. I don’t know about you but I’m still having this problem. I had it this morning when I was writing this speech. I had a little problem with my computer.

But even though this momentous, historic occasion in the development of the Internet was essentially a blooper, there’s an important lesson here. First, think about who was involved in that first e-mail message. Academics. Not a government regulator, not an agency but students and scholars working at two universities. Of course the ARPANET was seeded with government money. But the development of it and the development of the Internet was done by people working at our nation’s universities and labs and even in garages, private homes, people with big ideas and dreams and people who were willing to take some risks to develop new ideas and to build a better future.

I believe that these fertile fields of innovation in Silicon Valley and Boston and Denver, close by here in Northern Virginia, and around the country bloomed because of the open entrepreneurial nature of the Internet, the chaotic nature of the Internet. Nobody owns it. Nobody has the control over its language. No one owns the proprietary language that makes the Internet work. The basic standards for the Internet are basically de-
developed in the marketplace in an open process where everybody can participate.

Once these ground rules are established in this open process, anybody can develop a new application or a new service using this basic Internet protocol platform. It's becoming a universal language, a universal language of innovation in communications here and around the world. It's a worldwide web.

Perhaps the most significant Internet development so far was developed after the Internet protocol itself. It rode on top of the Internet protocol, if you will, and now we're seeing all these new applications like Internet radio and Internet voice, streaming video, all based on this single universal platform.

I think that there are two things that are most responsible for this explosion of growth in the Internet. First, this tradition of openness that I've talked about. Second, the fact that the Internet is unregulated. In fact, the Internet grew so fast that regulators couldn't have regulated it even if they wanted to because it was moving so fast. That's a good thing.

Two weeks ago the FCC made a decision that addressed the payment of reciprocal compensation for Internet bound traffic. In plain English, this means that our decision dealt with the way that different telephone companies pay each other for connecting your call to the Internet. With this decision, it's clear that the FCC and the FCC alone has jurisdiction over the Internet. It means that no state can impose long distance charges and the FCC won't impose these charges either.

I want to say this as clearly as I can. I've said it before, I'll say it again, and I'll probably say it as long as I'm chairman of the FCC. That is, as long as I'm chairman of the Federal Communications Commission, this agency will not regulate the Internet. I say that because, unfortunately, there's some people, for whatever reason that are always trying to rile up Internet users by saying that the FCC is going to take all of the old telephone regulations that have been built up over the 65 year history of this agency and just dump it onto the Internet. It's not going to happen.

But I know these rumors fly around every once in a while. These rumors get on the Internet that the big bad FCC is going to impose all this regulation on the Internet. I know this painfully be-

cause every so often when one of these rumors flares up, I get literally about 600 e-mail messages a day by people who are telling me to keep my hands off the Internet.

Let me tell you, the language in these e-mails is not very delicate. In fact, if the FCC ever did get authority to regulate indecency over the Internet, it wouldn't be hard to find violators of these rules. We're not going to do that. But these messages come right into the inner sanctum of my office and they are not delicate, believe me.

These rumors do persist from time to time and we find ourselves having to sort of beat them down. And it occurs to me that if you believe everything that you read on the Internet, then you think that Elvis is alive and well and selling blue suede shoes on e-bay somewhere, because there is a lot of false information about just what the FCC is doing vis-a-vis the Internet.

It's unfortunate because these are scare tactics. A lot of the American public has become dependent on the Internet in their daily lives. It's unfortunate that we're bringing all this fear and uncertainty to this growing marketplace. Anybody who knows anything about the Internet knows that its fundamental strength is its freedom.

And anybody who knows anything about me and what I've tried to accomplish at the FCC over the last couple years is that I am fundamentally committed to creating a telecommunications marketplace that is driven by competition, free of unnecessary regulation that allows a robust competitive marketplace to grow. This is one of the most important priorities of the FCC right now and I think we all recognize that we have to have a competitive marketplace for these innovations to continue and for these economic opportunities that result from innovation progress.

Let me say it once again as clearly as I can. This FCC is not going to regulate the Internet.

Let me say one more thing about this recent reciprocal compensation order. The philosophy of this order is important because it not only allows us to let competition flourish on the Internet, it also takes us closer to a more competitive open telecommunications marketplace that Congress clearly intended when they wrote the Telecommunications Act.

This is a market where the relationships are defined by entrepreneurs and executives negotiating in the marketplace and not by regulatory offi-
cials. You all invest much more than I do. I expect that you would be much more comfortable putting your money in companies who control their own destiny, who make business decisions based on contract and not on government regulation.

This is fundamental, because for all Americans to access the wonders of new technologies, like high speed Internet access, we need to make this transaction from a regulated monopoly command and control marketplace to a more robust competitive marketplace. That's really the theory of this reciprocal compensation decision, because we decided that we wanted companies to make these decisions about how they terminate traffic and who gets paid based on decisions that they make in the marketplace as opposed to what we tell them to do, because we think that fundamentally that will bring more predictability to the marketplace.

I suspect it's easier for you to make decisions if you know what the incentives of the companies are and know that those companies are free to make those decisions in the marketplace than to try to crystal ball what five people at the FCC are going to decide. That predictability means more stability, more investment, more innovation, more jobs and more opportunities for the country.

Stability, that's the key. That's the chain reaction, in my view, to a fueling investment in growth. That's why I was so pleased that the United States Supreme Court this January gave the FCC a ringing endorsement of our procompetition policies in the local phone marketplace. To paraphrase Winston Churchill, this decision is not the end. It's not the beginning of the end. It's the end of the beginning. We have a lot more work to do. But I believe that with this decision we ended what was the first phase of the implementation of the Telecom Act. It was a phase unfortunately dominated by lawyers and litigation.

We're moving now into a second phase which will be dominated by consumers and competition shaping this marketplace. It's a time, I believe, when competitors can take their efforts out of the courtroom and back into the marketplace where those efforts belong. It is time to move on and get on with it.

The court did leave a bit of unfinished business for us to do. The court asked the FCC to take another look at one issue, and only one issue, really, and that is which elements of the incumbent's local phone system must be made available to competitors.

As I said before, I understand what uncertainty can do for investors and for the marketplace and what that in turn can do to the flow of capital needed to develop these technologies in the marketplace. That's why, after the decision came down, we got together at the FCC and decided that the most important thing that we can do right now is try to bring more stability to this marketplace.

I asked the FCC staff to get together with all the regional Bell companies and GTE and to get these companies to agree to fulfill their current obligations to provide unbundled network elements while the FCC undertakes a reexamination of this limited part of our rule in response to the court. I'm very happy and pleased that these companies were cooperative and they agreed that they would honor their existing interconnection agreements.

Beyond that, we established a mechanism to resolve in the marketplace some of the uncertainties that arose in the wake of that particular aspect of the decision. We designated a senior level person at the FCC, Bob Atkinson, a very accomplished lawyer in Telcom to work with incumbents and the new entrants so that disputes, when they flare up, can be resolved quickly and easily, or at least we'll know whether we've got a resolution that we can adopt early or whether we're going to have a more extended dispute.

I'm pleased to say that it's working, not only the work that Bob has been doing with the competitors and the incumbents, but also the other mechanism we put in place, what we call our "rocket docket," a recognition that we've got to change the philosophy of enforcement at the FCC. If this marketplace is going to work and these rules are going to work, we've got to enforce them quickly and fairly.

In the meantime, while we have these enforcement efforts in place, we're taking another look at the list of network elements that need to be made available to competitors under the law. And while we take another look at this list, let me say one thing about this process because I need to resolve some confusion out there in the marketplace.

One thing is very clear about this process. The local loop has got to be on that list of unbundled
network elements that must be available. The local loop, that copper wire that goes from the central office to your home or business, is not just the last mile. It is the most important mile because we all know that it's that route into the marketplace for competitors and it's that route from the Internet into your home, into your home PC. The local loop has got to be at the very top of that list of unbundled network elements that must and will be made available to competitors.

Another thing about competition, in order to make competition work and in order to make that loop valuable, you've got to get to it. You've got to get into the central office. The ability of competitors to collocate to the incumbent's network is absolutely crucial. Without a portable and speedy collocation, competitors can't get to the loop that is so essential to competition.

In these three years since the passage of the Act, we have learned about collocation. At next week's FCC meeting, we will revise and update our collocation rules to make them work even better.

It's been 100 years since Charles Dahl said that everything that can be invented has been invented. It's been 100 years full of inventions and advances that would have been blown Mr. Dahl's mind. 100 years later it's easy, I guess, for us to poke fun at poor Mr. Dahl, God rest his soul. I hope that 100 years from now no one is going to reread my speeches or your newsletter, okay, and poking fun at the predictions that we made. But I don't think that will happen.

I really don't, because I think that one of the things that we all learned who work in this field of telecommunications is that we all learn pretty early on that you have to be humble when you make predictions about what's going to happen in this marketplace. You all know this.

We all recognize that the innovations of the next century will be as mind-boggling and revolutionary as those of the past century, if not much, much more. With an Internet that is open, new ideas will bubble to the surface, new innovations. It will come from places that we would have never expected.

With a marketplace open to all competitors, this innovation will flourish and hard working Americans will have more choices in these increasingly important technologies and more choices and lower prices.

More than that, all Americans, and I do mean all Americans, will be able to tap into the opportunities that these wires and web pages provide, an unlimited front of information, the endless ways to communicate with people around the world and the high paying jobs of the information age.

That is what you are investing in when you place your money into these new companies and some old companies. That is what drives me and the men and women at the FCC every day when we do our work, because the bottom line is, at the end, the biggest and most important profit that we all reap from this is what we can develop and bring to the American public.

Thank you all very much.

SUBSIDY REFORM II

MR. BROGAN: For those who don't know me I'm Pat Brogan. I am an Associate with the Legg Mason Precursor Group.

We're now going to delve into the issue of the universal service system and its complex web of both exquisite subsidies in Federal and State universal service funds and cross subsidies that are hidden in regulated rates.

The subsidy served a valuable policy goal of expanding the region value of the telephone network and enhancing consumer welfare. But wise investors should be concerned with phone subsidies. Well, the answer, not to oversimplify it, is that subsidies have real economic consequences. Not just because they have a direct bottom line impact on those who pay and receive support, but also because subsidies and competition are inextricably interrelated.

Through subsidy policies and competition policies, federal and state regulators can have a great deal of influence over carriers' costs, rates and revenues and they can effect incentives for competitive entry in any particular market segment. For example, the recent Supreme Court interconnection decision gives FCC broad authority to regulate the cost of local entry and state and federal universal service policies that regulate incumbent rates effect how carriers compete with each other in various local telephone and exchange access markets.

The FCC's universal service and access charge rules are due to become effective around the first of July. Any reform to the existing subsidies and
rate structures have the potential, intended or not, to alter existing economic incentives of consumers and carriers. To determine the impact, investors need to keep an eye on the interplay among costs, rates and economic incentives. Of course, investors also have to keep an eye on the politics of subsidy reform, which are as complex and dynamic as the economics and it's the politics that will drive the outcome of the process.

We're very fortunate today to have an outstanding panel of individuals who have been highly influential in the subsidy reform process.

We have Russell Frisby, President of the Competitive Telecommunications Association, which just recently merged with America's Carriers Telecommunications Association. Mr. Frisby is also a former Chairman of the Maryland Public Service Commission.

Julia Johnson is currently a Commissioner with the Florida Public Service Commission, where she recently finished a two year term as Chairman. Commissioner Johnson also serves as a State Chair on the Federal-State Joint Board on universal service.

Roy Neel is President of the United States Telephone Association, which represents the interests of over 1,200 local exchange carriers, the companies that are charged with providing universal telephone service.

And Susan Ness is Commissioner with the Federal Communications Commission and Chair of the Federal-State Joint Board on universal service.

I'd like to thank each of you for taking the time to be with us. I look forward to hearing all of your insights on what is going on and what we can expect in universal service reform. We are going to begin with Commissioner Ness and then we're going to continue with Mr. Frisby, Commissioner Johnson and Mr. Neel.

I'll turn it over to you, Commissioner Ness.

COMMISSIONER NESS: Thank you very much and I want to also thank this very large and enthusiastic audience for listening to a discussion on the technicalities of universal service immediately following a luncheon. This is not a good idea.

But in any event, the storm that we had a little bit earlier this week reminded me a little bit of universal service telephone regime. There's a certain splendor to a snow storm. The idea of basically having this beautiful blanket of white, quiet, all across the region. It was just magnificent to see. Similarly, universal service, the notion that every American ought to have access to affordable telecommunication services is a very important goal.

And then, of course, there's driving in Washington DC during a snow storm with traffic tie-ups and slush and blocked cars. It's a little bit like trying to trudge through universal service reform. There are so many inconsistent pieces and complications and issues that it makes it a challenge for anyone to get through. But being an optimist, I'm quite confident that we'll be able to see the beautiful snow on the lawns and over the mountain tops as we complete this process. But in the meantime, there certainly is a lot of sludge associated with it.

Universal service is one of the three pillars of the Telecom Act together with private sector competition and deregulation. The system today is really a crazy quilt of implicit and explicit subsidies above the federal and state levels. The federal jurisdiction pays for about a quarter of the cost of a local loop; 75 percent of the cost is borne by the states or on the state side in the intrastate side.

And the price to the consumer of residential lines is supported by, for example, the price of business lines, vertical services such as call-waiting, intrastate toll calls and these rates are all set by the state commissions. On the federal side, 25 percent of the loop cost is borne by subscriber line charge, what are called pixies, a flat charge that is paid by the intra-exchange carrier and per minute charges that the IXC, the interstate carrier, charges the consumer.

In addition, all carriers provide intrastate service and they contribute to a universal service fund. That fund is about somewhere between $1.3 and $1.6 billion. It goes largely to small carriers—rural carriers with less than 200,000 lines. Another approximately $250 million goes to large carriers, such as the Bell operating companies and GTE, that serve high cost areas. And about half of that amount that I mentioned, included within the $250 million, actually goes to Puerto Rico—the Puerto Rico telephone company. And it's been the discussion about that—the large carriers, the high cost fund, that has really occupied our time and the time of the Joint Board.

There are several different types of universal service. We keep thinking about the high cost fund because that's, right now, the area that we've
been focused on. But, in addition to that, we provided for low income consumers through two programs that are administered in the states. We have advanced services for schools and libraries that is being funded at about $1.3 billion to connect schools and libraries to the information superhighway. And we also have advanced services for rural health care providers.

There is sort of a balance with all of these services. We often times think of the high cost fund as benefiting the rural States, but at the same time a lot of the low income funding, which again is very, very important for low income consumers, benefits largely the urban areas. And schools and libraries really benefit both rural, as well as urban areas of the country.

So the Act, Congress really provided for all areas of the United States to reap the benefits of universal service and that's something that we all need to remember as we have these discussions.

The ‘96 Act required the FCC to establish a Federal-State Joint Board to try to design a high cost—well universal service funding regimen including a high cost funding regime that provides for comparable and affordable rates. Today rates are averaged over large areas and so what you have is a line in a low cost area that may be charged more for that line than is necessary supporting a line in a high cost area where they charge to the consumer is considerably less than the actual cost of providing that service.

That’s fine when you don’t have local competition. But when you start to have local competition coming into play, Congress wanted us to redesign, make explicit certain funding sources, regimes that were implicit subsidies. In other words, come up with a system that was fair and comparably charged for all.

In contemplation of competition coming into play, Congress wanted us to redesign, make explicit certain funding sources, regimes that were implicit subsidies. In other words, come up with a system that was fair and comparably charged for all.

Again, one of the main things people need to understand that most of this is the responsibility of the states. It’s not at the Federal level. State regulators, not the FCC, decide the pricing for local telephone service. They control the pricing for local business lines, the vertical services that I mentioned before, the interstate access, interstate toll—intrastate toll rather. And much of what is being done today to make residential service affordable involves trying to squeeze out these implicit subsidies.

There was a strong sentiment in the Federal-State Joint Board that the FCC should leave it to the state regulators to decide when and to what extent these intrastate implicit subsidies would be replaced with explicit subsidies. There was also a strong sentiment that the Federal mechanism should operate on the assumption that the states will continue to manage their share of the responsibility, either again through these implicit subsidies as they do today or through new and more explicit forms of high cost support. And a number of states are working with their state legislatures to put in place universal service funding mechanisms on the intrastate side.

There’s also a recognition that some states may need some degree of additional Federal support to pick up some of the burden that’s currently being carried through these intrastate mechanisms. But there was no support for shifting what had been primarily a state matter into primarily a Federal matter.

There was also a general agreement that the FCC’s responsibility to ascertain what portion of intrastate access represents high cost support and then to convert that to an explicit subsidy. Once again, those comments apply to large carriers that are serving predominantly rural areas.

The situation is a little bit different with the smaller carriers. I’m talking, once again, about those carriers that have fewer than 200,000 access lines. There is less of a basis for implicit intrastate support because these smaller companies typically don’t have a Seattle or a Denver or an Albuquerque to throw off support for the higher cost areas.

So there the Federal support mechanisms already pick up a substantially higher share of the load and what the Commission had said in the last go-around and again, the universal service Joint Board recently said, we’re not going to touch the smaller carriers at this point in time until we know precisely what regime is going to be workable for the large carriers. We’re going to get that piece in place and then we’ll turn to finalizing any
changes that might take place with respect to the smaller carriers. But we wanted to make sure they have very different economics attached to that provision and service in these high costs areas. We wanted to make sure that they were well cared for and we wanted to make sure that they were protected for the foreseeable future.

An issue that’s very important to me is universal service portability. By that I mean basically if you change carriers the support that attaches to that line would then go to a new carrier and this is going to be the only way in which we will see competition arrive in some of the higher cost areas. So that new entrant, you want to compete and they can provide service perhaps a little bit less expensively, would continue to receive the universal service that had previously been paid to the incumbent carrier. How to work all of those details out is still under discussion, but it is an area of concern.

Finally for me, I’m very concerned that we make technology neutral, that we make sure that if wireless services, for example, can serve an area—a high cost area less expensively, then—and more efficiently than a wireline system, that we not inadvertently discourage the migration to wireless communications by virtue of an existing regime.

So as we look at universal service, we want to make sure that we have mechanisms in place that are technology neutral, that would encourage the ability of other technologies, often times owned by the same companies that are currently serving, to come in and use these technologies to provide additional service for the public.

So, in conclusion, we hope to work our way through this universal service together with a revision of access charges to get a regime that is predictable, provides a comparability of rates, is portable so that consumers have choice, is forward looking to encourage efficient competition, and takes into account the rapidly changing technology in the marketplace.

We expect to find our way through this snow-storm so that we can all reap the benefits of an efficient and fair universal service system. Right now there’s an often lot of slush and debris in the road, but we will get there.

Thank you very much.

MR. BROGAN: Thank you, Commissioner Ness. Mr. Frisby.

MR. FRISBY: Thanks, Brad. It’s a pleasure to be here. Actually after the storm, it’s a pleasure to be anywhere, but it is a pleasure to be here.

As is mentioned, I am President of the Competitive Telecommunications Association or CompTel/ACTA as we are known. We like to call ourselves the Big Tent of the competitive industry in that our membership includes long distance carriers, competitive local exchange companies, internet companies and resellers.

We, like the competitive industry, have been growing at a tremendous rate. Last year we grew by about 43 percent. We now have 315 members and really 190 of those are carriers. So if you folks are 1,200, I think we are at 16 percent and growing.

Our membership is linked by a vision of a telecommunications market in which customers have free choice of a number of services provided by a variety of carriers of all sizes and shapes, and these carriers of all sizes and shapes providing service through many, many different means.

Now, explicit in this vision is the notion that all subsidies must by explicit and that there must be structures in place to thwart the use of monopoly power. And I’m referring to the monopoly of the last mile, which I think Chairman Kennard talked about. It is critical that that monopoly be broken.

Now, in the context of subsidies, it is important to remember that competitors are payers and not recipients of the subsidies. In fact, they’re in the same situation as my home state of Maryland, which was a payer’s State. In Maryland’s case under the old system, we would pay maybe $15 or $20 million out to other States and territories, including Micronesia and we would not get anything back, but at that level it doesn’t really matter.

But now we’re talking about expanded subsidies. We’re talking about, you get a billion here, a billion there and pretty soon you got real money. Now, we’re at the real money stage and that’s why we’re all here.

Our concern as competitors is that as payers is that subsidies don’t work. Subsidies distort competition. They distort the provision of service. They send the wrong price signals. And if we’re really committed to local competition, we must make all subsidies explicit.

Now, not only must they be explicit, a number of them must be reduced and abolished. I re-
member when I was at the Maryland Commission. We reduced intrastate access charges by 30 percent and required the reduction to be passed through to consumers. No big deal. It happened. It was done. The end of the world didn’t come. Intrastate service continued in Maryland. It can be done. There’s a lot of funny money in this system.

Now, what do competitors want? I think six things. First of all, all subsides must be explicit, reduced or abolished.

Secondly, the universal service fund must be targeted to those individuals in areas where needed. Also, it must be as small as possible. This should not be seen as the last gold rush of the 20th Century.

Third, the universal service fund should be portable. It should based on the cost of the least cost provider. For instance, if wireless can actually provide services more cheaply than wireline, why should the subsidy be based on the wireline cost. In line with that, it should be technologically neutral.

Fourth, recognize that whether you’re talking about the universal service charge, whether you’re talking about SLCs and the whole range of subsides, you’re basically talking about a tax which is imposed on telecommunications providers. Like a tax, the providers should be able to pass it through and governments should not dictate how this is to be passed through.

Now, this is particularly important with regard to small and medium size carriers because a number of these carriers do not have the back office, cannot absorb the cost to comply with government requirements saying you’ve got to document this, you’ve got to document that. Because there’s a notion going all around in Washington that somehow this will all be okay because of access charge reductions.

While some of the larger carriers may have actually received access charge reductions, a lot of the small and medium sized carriers either have not received the reductions or if you compare what they’ve received in access charge reductions to the additional tandem costs, which have been imposed on them, they’re actually paying more. So there is nothing to pass through.

That gets us to the fifth point, access charges. They really should remove the cost. You know, there’s got to be a transition. This is probably not something that can be done overnight, but the access charges must move to thwart cost.

And, six, back to the universal service fund. I think we only need one fund. We don’t need a federal fund and fifty different state funds because there is too much danger of mischief, and we’re already seeing some state funds which are far larger than they need to be and we think if you have a multitude of funds you’re going to just impose additional costs on competition. The real loser in this is the customer because remember we’re doing this because we’ve decided correctly that if you want to have customers receive a variety of services, a variety of cost efficient services, you have to have competition. And to have competition, you need to have a competitive environment.

Finally, just a couple of observations. Now, the conventional wisdom is always that competition in the business market means that you need to subsidize residential. But I suggest that the facts may be different and that the residential market as a whole for most ILECs—and there are some exceptions. But the residential market, as a whole for most ILECs, is, in fact, profitable.

Recognize that the real subsidy is not necessarily from business to residential, but in the residential from the high toll, high enhanced service users. the call waiting users. For instance, in Maryland call waiting is priced 300 percent over cost. But from those customers to the residential customers who just have dial tone, I think that’s the real subsidy. So it’s not necessarily business competition situation.

Secondly, with regard to the notion that competition will force rates down in low cost areas and cause rates to increase in high cost areas, I think the Jury is still out on that for the simple reason that to have both residential and small business competition, you need to be able to access those markets via the platform and that just hasn’t happened yet. So we don’t know what the end result will be.

Finally, the notion is that competitors will somehow go after only the good customers and therefore leaving the ILECs with the bad customers. But if you look at IXC market the competition has been for all residential customers and if you look at what MCI is doing in New York, again, it’s for all residential customers because you have to do mass marketing. In a mass marketing context you
deal with the people who walk up. You don’t differentiate between the good and the bad customers.

But at this point, I’ll stop and just go back to where I started that is critical over the next period of time that we deal with the subsidy issue. We make subsidies explicit, where we feel that the subsidies are necessary and where they’re not necessary we should either reduce them or abolish them.

Thank you very much.

MR. BROGAN: Thank you. Commissioner Johnson.

COMMISSIONER JOHNSON: Certainly. A couple of things up front. I wanted to talk about three issues in the context of subsidies; universal service, both the Federal Fund and funds on a state level, access reform which I think both individuals that spoke before me touched upon, and rate deaveraging.

I’ll go first to the universal service on the Federal level for nonrural providers, which is actually interesting that Mr. Frisby, my former colleague, said that States shouldn’t have their own universal service fund.

MR. FRISBY: We don’t have one in Maryland.

COMMISSIONER JOHNSON: Yet. I guess where you stand depends on where you sit or vice versa. And I’m still a regulator. Yes, I’m one of those. Anal retentive. Got to watch what’s happening. Protect my rate peer kind of people.

So with that backdrop in mind—and let me set the mood a little bit more. When we talk about these subsidies and what we’re going to do, understandably I’m guilty, I’m one of those regulators, that over time we’ve always, for purposes of universal service—I think Patrick said political reasons—we’ve determined that local rates should stay low and those have been subsidized by other services; access, higher long distance rates, long distance companies paying high access fees to Mr. Neel’s—the folks that he represents, in order to keep a system that allowed rates to remain affordable.

Now, part of that analysis, I have a lot of companies that come to speak to me regarding universal service inter and intrastate universal service funds. In the State of Florida we don’t have an intrastate fund yet, either. And often times it’s interesting because they’ll say to me, Julia, you don’t understand, you have to do something about these subsidies because the subsidies are just killing competition and that 30 percent of the customers subsidize 70 percent of the customers and therefore, you need to act so we can open up these markets. Or 25 percent of the customers subsidize 75 percent of the customers. And often times we hear those kind of comments.

Well, from a regulator’s standpoint, you get mixed feelings about that. And more importantly, from an elected official’s standpoint, when you understand that if you reverse this subsidy mechanism or schemes or methodologies, then three out of the four of your voters in the short term may be worse off.

So this, on its face, isn’t necessary seen as a good thing. But I think that the Federal Act, as well as the State Act, says but we have to open the markets. So they make regulators, like myself, into David Copperfields. We’re trying to open up markets and we’re trying to also keep rates low and affordable.

I think that sitting on the Joint Board and having the opportunity to serve with Commissioner Ness and the other state and federal colleagues, that our original recommendation that we made several months ago is a step in the right direction. I think the first thing that we did was to say that no state will be made any worse off.

I got a lot of reaction from that and a lot of people said well, why do you do that. That doesn’t make economic sense. Well, it does make political sense. When you’ve made a promise to Congress that you would, indeed, try to keep rates affordable and try to, indeed, have a system that parties will not be made worse off. So that was the first step.

But we also tried to set a methodology or recommendation in place that would keep the fund small or keep the fund reasonable so that it wouldn’t die. The states, like Florida and Maryland, wouldn’t have contributions to such a degree that their rate payers are really, really filling the burden of a huge universal service fund. But we wanted to make sure that it would provide the kind of support that would, indeed, make it such that we have a system that will fulfill the obligations of universal service.

In order to do that, we did a couple of things, And just picking up on some of the points that Commissioner Ness made, we determined that we would use, for purposes of measure, costs that
were about 150 to 155 percent above the national average and that states would have their own revenue thresholds, that is to suggest if there is sufficient revenues within the state to take care of some of the problem or to help with respect to the universal service problem, that that would also be factored in.

In our recommendation, in my mind we abolished the necessity for the 75/25 split. That is the Feds only funding 25 percent of the fund and States funding 75 percent of the fund. Finally, on the inter/intrastate revenues, which revenues would be used.

We determined that—and sort of indicative, that inter/intrastate revenues is probably the right way to go, but because this fund will probably be small, interstate revenues—and because there's a case out there pending as to which revenues could be assessed, that it was probably best in the instance of a small fund to have interstate revenues.

But that whole analysis was for the big companies and not the rural companies. There is a rural task force that is looking at whether or not there should be a forward looking price model for rural companies. And let me digress for just a moment because I know from the State of Florida and as a Joint Board member we will look carefully at that particular issue.

In the State of Florida we had to do some cost models for purposes of our Legislature and issue some reports. For the large companies, we were requested to use forward looking, most efficient kind of cost analyses. For the small companies, we had the opportunity to use an embedded cost analysis. And the interesting thing was that the embedded cost analysis, the actual book cost analysis, led to lower costs than the proxy models did.

For some of our small companies, the actual cost was like $50 and the model would have given you $75. If we had a cost bench mark of $40, then you have a $35 subsidy and what would that do for universal service? Well, perhaps it would help because the incumbent company would get $35, cost of $50 and be able to charge $15. Whereas, the CLEC would, in turn, still have $75 cost. They would get the subsidy, but then they would have a $40 charge for their cost.

It is those kind of odd anomalies that we'd like to look at to determine whether or not those models actually work and are suited for the small companies. In some instances, the results for the small companies were just the opposite.

So when you're trying to establish a fund, perhaps, the forward looking model is right on point, perhaps, for the larger companies. But for the small companies, we need to look at that more closely to make sure that we can provide them with the kind of structure that will work as we move towards a competitive market. And I'll touch briefly on two other issues because I see that I'm running out of time.

With respect to access reduction, I thought that USTA's proposal in the context of the universal service docket was interesting in that they suggested that what we could do would be to remove quite a bit of the subsidy that we all admit—or the access as priced above cost. You would say it is not a subsidy towards universal service. He would say it is a subsidy.

But whatever that extra dollars might be, USTA proposed that we move that into a universal service fund and that we require access to be reduced. And the information that they provided stated that overall customer's bills would go down and that we could be the David Copperfields and that that was the right way to go, would be reducing access, putting in a universal service, rates would go down, customers would be happier after all.

I know that's something that the FCC is pursuing and the one thing that the Joint Board asks is that to the extent that the FCC says that there is subsidy in access, that the Joint Board have the opportunity—universal service subsidy in access, that the Joint Board have an opportunity to speak to that issue.

And finally on the issue of deaveraging, certainly given the Supreme Court decision the deaveraging issue is quite appropriately teed up and I know that the FCC will have to make a determination as to the applicability or when their rules will go into effect.

I don't think that States are afraid of the concept of deaveraging, it's just the impact and when that should be implemented. Looking at Florida, I can't say that deaveraging on its face is a bad thing and I don't even know how detrimental it would be to our rates. Looking at an area like Miami, say the rates—average rates may be $10 in that particular area. And if you were to deaverage, that probably wouldn't do that much to
Miami. The rates may go down to $9, $9.50. But in the Everglades, the rates would go up to $25.

And that's the issue and that's the rub. How do we handle that? And what does that actually do? If the $9.50 didn't bring in competition, but the $25 just set up a situation where competition would never occur, how does that help?

The only thing that we did with respect to deaveraging from the State prospective was to determine that we did need to go forward and have the authority to set up a universal service fund if it was necessary and if some anomalies occur that would cause the local companies to lose revenues too quickly when they are still the carriers of last resort.

And with that I will end my comments and look forward to your questions.

MR. BROGAN: Thank you, Commissioner Johnson. Mr. Neel, it's your turn.

MR. NEEL: Thanks. There are obviously some things we agree on. There are a lot of things that my—Russell and I clearly disagree on. But one of the interesting questions is why we're even having this discussion. It's been more than three years since the passage of the '96 Act and we still don't have a universal service plan in place. Three years.

We had a proceeding designed early on to blow open the open market to advantage new competitors to put them in business and it's been largely successful. In fact, wildly successful. We have over 5,000 interconnection agreements; either negotiated or arbitrated. Any CLEC or IXC can get into the local market and do its business, especially for those customers that it wants to go after.

Companies have been extremely successful in pursuing high volume, high capacity business customers. All you got to do is look at their claims to Wall Street as to how well they're doing and how to open those markets.

The debate is really about local residential service. It's fairly simple. The IXCs, in particular, the AT&T/TCI, MCI/WorldCom Enterprise—you sort of think of them as one company in this respect—have a great deal. Everyone should have that kind of deal. They have massive market power due to capitalization. They have zero regulation. They've been deregulated virtually entirely by the Commission. They have virtually no market barriers to participate in the markets they choose to play in. They are largely ignoring the residential market. And they have totally ignored, and in fact, in almost a blatant way, have indicated they have no interest in serving the rural and low income marketplace.

It's pretty clear that these companies have chosen to redline rural and low income America and will continue to do so and will continue to do so with virtually no regulation. We don't think they should be regulated, frankly, in these areas. We think there should be deregulatory parity to let all the companies play.

The Act was pretty clear. It said that there should be deregulation. We've had virtually no deregulation on the part of the industry that is most regulated, the local exchange industry. The Act called for local competition. We have it. It called, by the way, for new competition in long distance. We don't have it yet. The bar keeps getting moved.

There was nothing in the Act that said access charges should be reduced. Michael Armstrong charges, and basically reaffirmed by Russell, that the access charges are a tax. Ignore the purpose of access charges, which are largely to keep residential rates affordable. That's exactly what they are.

These companies have basically said to rural America, to hell with you, and it doesn't appear that that is hurting them at all. They continue to have no intervention in the way they do their business. So something else has to happen here.

As Commissioner Johnson suggested, we have a plan that would reduce access charges, would help fund universal service, would make these charges explicit. We all agree that they should be explicit, but we're not hopeful that that's going to happen. That takes some political courage. We're not hopeful that that's going to happen.

We think access charges should be reduced to spur competition. We think those access charge reductions should flow through to consumers that have it. Access charges have been reduced by $12 billion and no more than half of that has flowed through to consumers. AT&T just announced an increase on its basic long distance customers. These companies have great deals.

We want to be just more like Mike. Our industry just wants to have this kind of virtual nonregulation as well. What we're doing is disadvantaging consumers who don't have access to these competitive services and any universal service fund.
We spent a lot of time talking about how a fund would be structured. Any universal service fund that is put in place by the FCC and the Joint Board is not going to take care of the problem. It's a fraction of the problem.

The rest of these subsidies come from the areas that Commissioner Ness outlined; from access, from business users, as Russell said from higher volume residential users. Those are going to be eroded by virtue of competition.

So what's the net effect of that going to be? Either local residential rates in rural, hard to serve areas are going to go through the ceiling? That's not likely to happen soon because Commissioner Johnson and her colleagues are not going to allow it to happen, if possible.

Investment in rural areas, in low income areas, will dwindle. That will happen. That absolutely will happen. These companies will have no choice. And where will these new competitors be? They will be in the metropolitan areas. They'll be in the affluent parts of the market. That's the way it should be. That's the way smart business people make their decisions and that's what will happen.

The call here should be for a rationale market based on economics and not micro-management and not access regulation. For some reason the Commission can't let go. The spirit of this Act was to deregulate. It requires a little bit of risk taking, but the vision is deregulation.

At this point the only companies that will be looked to provide universal service are the traditional incumbent local exchange companies. It's a fact.

Russell's members, AT&T/TCI, MCI/WorldCom, are not going to go into these areas. They're simply not going to do it. It's bad business for them in their view.

So at a certain point it has to be accepted that the incumbent companies are going to be there to provide this service. They're the only ones that can do it. They're the only ones that are going to extend these new technologies, build this information superhighway out into these areas as everyone wanted. As the FCC wants, as the administration wants, the President, the Vice President and everyone.

But who is going to do it? It's not going to be AT&T, MCI, TCI, WorldCom. It's going to be the incumbent local exchange provider. You can't have it both ways. We can't have this shell game continue.

So as Commissioner Johnson pointed out, we have a plan that would make these subsidies explicit, would further lower access charges, would fund the universal service fund to the maximum that we think we can do, would preserve funding for schools and libraries and do this in a way that is pro-competitive. We hope that it is a system that's technologically neutral and that is competitively neutral. But we're not, frankly, encouraged by what we've seen so far and the delay has gone far too long.

We hope you can meet the July deadline. If not, we're just going to continue and have distortions in the marketplace and consumers that are disadvantaged.

Thank you.

MR. BROGAN: Thank you. First, Mr. Frisby would like to respond to Mr. Neel.

MR. FRISBY: Yeah. Roy and I clearly live in different worlds.

Let me get first things first. Yes, our members wants to serve everybody. We'd love to serve the residential markets, but the ILECs won't let us in. They won't provide us a platform necessary.

Now, let's deal with facts. USTA numbers, not CompTel numbers. Forty percent of the lines that the competitors have—now these are resale lines because we can't get many other lines. But 40 percent of the resale lines, and these are USTA numbers, are residential. And you talk about we're not going into rural? Go to Iowa. Go to McCleod. Eight percent of the market, forty percent of those are residential.

First of all, I would like to point out that we have members other than AT&T, MCI/WorldCom and others, but MCI/WorldCom, look at what it's doing in New York. It is going into residential. The reason it was able to go into residential now is because it got a deal on a platform.

State communications resale are out of southeast. It is going into residential markets in South Carolina, North Carolina, Georgia. It's happening. Also, let's focus on broadband. Let's look at companies like Covad, e.sprise, who are out there competing, trying to get in the market.

And let's look at the history of competition and I suggest that when you look at that history, what you'll find is that broadband is being brought by the competitors and what you have is ILECs trying
to play catch-up and trying to react to competitors. They can't lead the way because it makes too many T-Is obsolete. So let's focus on the real world.

MR. NEEL: Well, Russell, they can't get in there because the FCC won't allow it and you know that. The rules don't allow that. Both the interLATA rules and the data rules don't allow that. And if all those members of yours are doing so great, what are you complaining about. They're out there in the market. They're selling services. Making money. People are investing in them, hope they get bought out and their stocks go through the roof.

MR. FRISBY: Well, first of all —
MR. NEEL: I'd be celebrating.
MR. FRISBY: We could do better if you would let us in. Let us have the platform.
MR. NEEL: You are in. Every state has an arbitration proceeding that allows you to get the deal that you either want or one that is within the state's rules. You've got no barriers whatsoever.
MR. FRISBY: Stop filing litigation. Stop filing litigation everywhere. I mean, this has been tied up for years based on RBOC litigation. Let's be real, Roy.
MR. BROGAN: But I do want to allow some time for Q and A. I would like to —
MR. NEEL: Russell, you slut.
MR. FRISBY: Wait until he finds out that a lot of his members have joined CompTel.
COMMISSIONER JOHNSON: Pat, we get this all the time as a regulator.
MR. BROGAN: Right in the middle. Okay. Let me kick off the first question and see if I can frame this well.

This morning Reed Hundt predicted that access charges would be wiped out as a source of implicit support for local networks and universal service within five years.

My question to each of the panelists, and feel free to address any or part of this question, but I'm interested in how imminent is the threat to access charges and other implicit subsidies in state regulated rates in terms of how fast and how far those subsidies are likely to be eroded? And what is the best solution in your view or what is the most important next policy step and what are the political problems with that policy solution?
MR. FRISBY: Well, I'll kick off and we can go down. I think access charges can't be maintained in a competitive environment because what you have is the development of the internet, IP and the ISPs don't pay access charges. And if you impose access charges on the internet, I think you seriously impact, if not destroy, the Internet, which is what we don't want. It gets the Chairman into the regulation of the internet that he doesn't want.

So therefore technology has moved beyond access charges. So I think we have to ration them down to cost as soon as possible.

COMMISSIONER JOHNSON: I'll follow up. I think Russell is right and despite their fighting, I don't think either side would disagree, nor would the regulator—we admit that access is above cost and that it needs to go down.

The question is how fast and how do we get around the rate shock issue. As a regulator, and I'm sure that Commissioner Ness would say the same, the rate shock issue is a big issue for consumers. When you have these acts out there, whether it's on the State and the Federal level, and they're both promising that competition will bring choice and lower prices, we've got to figure out a way to do that. Certainly, under the analysis that if access goes down the long distance market is competitive. Rates will go down. Bills will go down. That is something that we're hopeful and that we'd like to see.

On the State level looking at intrastate access, we are, I think, being driven by the Federal interstate access reductions and I think that that's a good thing. But I do also recognize the debate occurring in my legislature right now is what should we do and how does this impact the local exchange companies because they are the carriers of last resort.

But the question is being asked on both sides. How does it impact them and should we care? Is it just additional profits or is it something that they need to sustain the carrier of last resort obligations?

But directionally, as a State regulator, I do believe that access must continue to go down and if not by the courage of politician and regulators, it will be because technology will make the regime that we've currently set up obsolete.

MR. NEEL: Well, I think we all believe that access is going to go down. Access charges should reflect cost and a reasonable return plus whatever
it takes to keep universal service affordable. And that's where much of the dispute is, I think.

It is interesting to me always that the ghost Reed Hundt just will not die. But the issue is really who is going to pay for it. Those reductions should go directly to support universal service and that's the rub.

The IXCs, both Russell's members and AT&T/TCI, MCI/WorldCom company, want those to go—they want them to go in their pocket where they've gone before. They want them to enhance their profits. They don't really care anything about residential telephone customers and they want that money to go in their pocket. The regulators need to look at that shell game for what it is, make sure that those reductions go to support real universal service.

COMMISSIONER NESS: One comment that Russell made I want to address very quickly, and that is the notion that because so many ISPs are providing service that there is a deficit going to universal service.

We did a study on that in conjunction to a report that we filed with Congress last year and we found much to our delight that as a practical matter, ISP's lease capacity from Russell's members, from Telecom carriers and those Telecom carriers are paying into universal service and the universal service dollars were going up, not down. Now, that may not be sustainable over the long term. We do need to address the situation. It is a compelling question. But, nonetheless, at this stage of the game that is not an issue.

Yes, access charges will be going down and should be going down and I think on the Federal level we ought to be talking about deaveraging of the rates that we charge on the interstate side of the fence as well as States focusing on deaveraging the rates that are charged on the intrastate side. When you match up the actual cost with the actual lines, you're going to have a much better competitive situation.

All of these pieces have to come together in a regime that makes sense and we're trying to work with all of the players to accomplish that mission.

COMMISSIONER JOHNSON: Let me follow up on just one important point as we talk about access reductions in the context of regulation where the FCC on the Federal level or the states on the state level mandate some percentage reduction. In our instance, the legislature would have to state the percentage by which intrastate access can go down.

An important aspect of that, in order for the customers to see true benefit, will be the flow through provisions and states have been having some difficulty insuring that that benefit will roll down to the low volume user.

Certainly I know Russell would state that we should stay out of that game. That regulators should not get involved in those kind of flow through mechanisms. But just from a public policy standpoint, to the extent that we say that there should be benefits to all Americans with respect to universal service and with respect to the transition into competitive markets, as a regulator we're looking for some real commitment and we're looking for some real flow through for those low volume users. Particularly, because a lot of the surcharges that may result as a result of universal service are showing up on those local bills and to the extent that those customers are receiving no relief from access reductions, then it makes it very difficult for the American consumer to buy into this, particularly the low volume consumers.

So I know that in the State of Florida, we're all looking at ways to insure that, yes, as access goes down can we insure that those benefits are passed through. A lot of people would say, well, you're in a competitive market. It will happen. It will happen for certain classes of customers, but we would like to have a way to insure that it can happen and be shared for all customers.

COMMISSIONER NESS: Indeed, what Roy is talking about with his plan would place a very substantial percentage fee on the bill of every consumer. And that is something that we have to look at very, very carefully and worry about.

MR. NEEL: Let me just say, with all due respect, that any increase that would come as a result of the USTA plan would be nominal. But frankly, this approach is what the Congress intended, that these subsidies become explicit. And I think that one way or the other, either through a decision on universal service or through challenges in the Court, they must become explicit. And whether that's a noted surcharge on end-users or some other mechanism, it has to happen.

We can't have it both ways it seems to me. We can't drive access through the floor, make up for it in no way, not allow these companies to recover their costs and in the end have no impact on any-
It seems like that there are too many people who just want this to be a free lunch and it can't be.

MR. BROGAN: Okay. Are there any questions from out in the audience? Yes.

FEMALE VOICE: It sure seems to me that —

COMMISSIONER NESS: Could you go to a microphone?

MR. NEEL: Microphone — there's a microphone in the aisle.

FEMALE VOICE: It would seem to me that really without knowing the exact degree to which every customer of Telecom services are above or below cost you end up with the situation where you have the potential for cherry picking and a situation in which some people are getting — I assume if you have a preponderance of low cost customers, they're basically getting implicit subsidies in the form of part of your access charges, but without having any obligation to serve, you know, rural customer, et cetera. And it's hard to see how you would get over that without really knowing exactly — be able to pinpoint every customer's degree of high or lost cost exactly.

John Sidgmore sorts of floats this theory a fair amount, but what if you took the local telcos and sort of separated them into two bytes and you had one byte that did nothing but own the copper loop and that would be completely regulated and then everything else wouldn't be.

And I was wondering if you thought that was just sort of a crazy idea or how you would go about solving that issue?

MR. FRISBY: Well, I can say, at least with regard to that issue, we're on record — I think LCI filed a petition a while back to that effect and we're on record in support of that and I will note that, at least on the electricity side, that's what the regulator is looking at, separating the transmission piece from the generation piece. So that's — that's an idea which keeps bubbling to the surface.

MR. NEEL: Well, it is irrelevant. Somebody still has to pay for the maintenance of that loop. Do we really want to isolate a business, a lot of business that is inherently inefficient. I mean, nobody is suggesting to AT&T or to one of Russell's members that they have to divest themselves. They're looking to integrate their services in a converged marketplace in a way that is most efficient and use their capital in a way that makes most sense.

It is nonsense to apply that kind of logic only on the local carriers.

FEMALE VOICE: (Question is inaudible.)

MR. NEEL: That is the — the comeback was that then you wouldn't have the issue of what's subsidizing what. That should be an irrelevant issue as well. When markets are deemed competitive by Commissioner Johnson's State, Florida, or by the Commission, then it shouldn't matter what your costs are or what — or how your costs — subsidizing costs. It shouldn't matter if a local market is deemed competitive.

So why subject these companies to rules that you would never subject AT&T/TCI to or MCI/WorldCom. It makes no sense whatsoever. What you want is a minimally regulated industry that — whose players are allowed to invest their capital in the most common sensible way.

All these schemes are just further micro-management of an industry that needs to be unleashed and have its investment potential unleashed. We're never going to get to the information superhighway that the Vice President has envisioned for years unless we do that. It's just not going to happen. We're going to continue the digital divide. We're going to continue this redlining because it makes real good business sense for those new competitors.

MR. BROGAN: Are there any more questions from the audience? Yes, sir.

MALE VOICE: I have a question and you should know that I'm an ILEC and I represent a rural — a small rural Telco.

I can say that our local service rates do not cover nearly 50 percent of what it costs us to provide the service. So, Mr. Frisby, respectfully, I'm not sure where you get your numbers.

I'd like to know, no one wants to talk about raising local service to the true cost. I think, a lot of this can be solved pretty easily if access can come down if, in a competitive environment, we get local service costs to where they need to be. But it's like, your crazy cousin Eddie. Nobody wants to talk about it. You know, he's like kept in a back corner.

When are politicians and regulators going to find the intestinal fortitude to really address the local service issue? I would just like to know that.

MR. FRISBY: I think that's a very difficult question and a good question. I guess, quite frankly,
my comments were more directed not at the small rural companies, which are an entirely different environment, but from the larger company situation. We've been, as an organization, very supportive of continuing the support for small rural companies because, again, that's very much of a different environment.

But before you get there you—ultimately in a competitive situation we do have to look at rates and see where they go because there's this notion that—and it's—I saw—one of your footnotes, Roy asked—if you're going to do this—like $24 billion, I think that was the amount of support you thought the industry needed if you made some of the proposals—implemented some of your proposals.

Now, before you do that, I think we need to look at not only costs, but revenues. For instance, in your case I understand your situation, but I submit that for a lot of the larger companies once you look at not their cost—their loop cost, but their revenues per line, which you include your access charges, you include your various enhanced services, you have—for the larger companies you have a different result. We need to look at that.

We need to look at the price cap companies and a lot of these price cap companies are in over earning situations. So before we talk about raising local rates for the larger companies, I think we need to do some rate reviews. We've got the FCC audit, which appears that there's $5 billion worth of equipment missing and that's interstate. Who knows what's happening on the intrastate side. Again, it is a discussion we need to have, but we need to have it in the broader context and particular the larger companies. Should their rates be going up or going down? In fact, the CFA did some studies which make the argument, for the larger companies, the rates should be going down. We shouldn't be talking about going up.

MR. BROGAN: Would anyone else on the panel like to address the question? Sure.

COMMISSIONER JOHNSON: I'll just address that briefly. It's not just about intestinal fortitude, although I was one of the main ones that said when you know that, you know, three of the four user are being subsidized, that's something that's hard to contend with. But it's also about a fundamental notion of universal service and making sure that rates are affordable to everyone. That's something that our telecommunications system is founded upon and I think we all take that very seriously.

When we look at costs and whether things are priced above or below costs, you do have to look at cost allocation and I think that's what Russell was speaking to, as to you can't just bifurcate one small section and say, oh, that piece of this service is being—is below cost. You have to look at the entire service. And those are the kind of things that I think regulators are doing.

But I would be the first to admit that that is a hard pill to swallow for a lot of reasons because you tell people that you're going into competitive markets and competition means lower prices and you can't just jack up their rates. And you're still dealing with a system where we'll trying to open up markets. They aren't completely open and people don't have a lot of choice.

So to allow rates to just be arbitrarily increased in this kind of an environment probably isn't the best thing to do. But your points are well taken and with respect to the small companies I think there are some extraordinary things that we will need to do as we look at universal service and what kind of system should be used in those truly high cost areas.

For instance, representing the amount of universal service that is supporting that line so that the consumer at the bottom will pay what the consumer has been paying in the past, but it will become abundantly clear that the line has support and that's, you know, certainly something that's worth playing around with.

MR. NEEL: Just very briefly. The obsession with ILEC costs is just one more example of the kind of Jurassic regulation that we have. Nobody is looking at the cost of the new competitors even though they're being urged to go into these markets. It's absurd. We're going to hold onto these cost allocations and these irrelevant, unnecessary audits that—under price caps which make no sense when we ought to be able to get out there—ought to be able to get out there and open up all of these markets.

If the regulators and others were as obsessed with opening up the data markets and the long distance markets to really start moving services and facilities out there where everybody wants them as opposed to this obsession with costs of the incumbent carrier and excessive regulation,
then we may be ultimately realizing this vision that was embodied in the act.

COMMISSIONER JOHNSON: Excuse me, Roy, but aren’t you saying, however, when you say that you need to be able to recoup everything that’s in access that you’re saying that that is the embedded cost to providing the service and then it’s reasonable to look at what is in that cost?

MR. NEEL: Well, under the system we have now you have no choice but to look at the net cost. I agree with that. And we have intense disputes about what it costs to provide universal service.

The IXCs suggest there’s virtually no cost above the actual cost of the connection. But we ought to be, at least, moving toward a deregulated environment where the examination of costs become irrelevant as marketplaces are open.

MR. FRISBY: I think it’s important to recognize, though, the initial question, which was raising the dreaded “R” phrase, rate rebalancing. And my point is, and I maintain it vehemently, that you can’t talk about rate rebalancing without first looking at the ILEC—underlying ILEC costs and you can’t get there without looking at costs.

COMMISSIONER NESS: Doesn’t this sound like a snowstorm to you?

MR. BROGAN: Yes, sir.

MALE VOICE: You said earlier that one of the objectives was to provide affordable service to residents, but it seems like you’re assuming that residents can’t afford to pay the actual cost, but there’s probably a lot of residents who live in rural states that can. Why not go to a need based subsidy?

COMMISSIONER NESS: Talk to Congress. The Statute does not envision that they need based and, indeed, the concept, as I mentioned a little bit earlier, there is a piece of universal service that is need based. But the basic concept for a high cost fund was on the notion that everyone ought to have comparable, affordable universal service. And that is what we’re endeavoring to do because everyone in the United States benefits when all Americans have access to telephone service. That is the underlying principle and it’s served us well for many years.

COMMISSIONER JOHNSON: And so you raise an interesting point. One of the things that our legislature asks us to do with the State of Florida was to go out and hold public hearings and determine—we did some cost studies and those kind of things. But what truly was affordable.

Our recommendation back to the legislature we did state that customers could afford, generally, the rates to go up $1 to $5. But we also had information in the record that talked about the returns of the companies and teed up, even if you were to increase rates, did that mean competition would occur?

I don’t know what the legislature is going to do, but in that recommendation we did acknowledge—and it wasn’t just based upon these public hearings and people testifying, but it was some empirical work that one of the universities had conducted that suggested that perhaps customers could afford to pay more.

Throughout those public hearings, customers stated that they thought they were getting a good deal for their bucks. Certainly, you have those classes of customers, low income individuals and different sectors that would be disproportionately impacted, but the masses, we concluded, could afford to pay more.

Does that mean that the legislature will then take that report and increase rates? I don’t think so. But we, at least, teed up the issues.

MR. FRISBY: I think that you’ve touched a very interesting dilemma we have and in Telecommunications we usually face dilemmas as opposed to problems which are easily solvable. But if—in a State like Maryland, telephone costs are lower than you would have in some of the midwest and rural states. But the cost of living is higher, the poverty rate is higher. But that isn’t balanced in that determination of universal service support.

So that’s why I think at a minimum, since we can’t do that kind of balancing, we have to error on the side of the small fund, recognizing that for every $100 million Maryland sends westward that’s going to impact upon four people in Baltimore City. It doesn’t reflect a much higher cost of living in Baltimore than impute.

So, you know, it’s a very complex situation. There are probably no satisfying answers to this situation.

MR. NEEL: I think I can—oh.

MR. BROGAN: No more questions. Sorry about that. Thank you. Very good. That was—thank you very much. That was very good.