BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 010345-TP

In the Matter of

PETITION BY AT&T COMMUNICATIONS OF THE SOUTHERN STATES, INC., TCG SOUTH FLORIDA, AND MEDIAONE FLORIDA TELECOMMUNICATIONS, INC. FOR STRUCTURAL SEPARATION OF BELLSOUTH TELECOMMUNICATIONS, INC. INTO TWO DISTINCT WHOLESALE AND RETAIL CORPORATE SUBSIDIARIES.
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PROCEEDINGS: WORKSHOP

BEFORE: CHAIRMAN E. LEON JACOBS, JR.
COMMISSIONER J. TERRY DEASON
COMMISSIONER LILA A. JABER
COMMISSIONER BRAULIO L. BAEZ
COMMISSIONER MICHAEL A. PALECKI

DATE: Tuesday, July 31, 2001

TIME: Commenced at 8:30 a.m.
Concluded at 5:15 p.m.

PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: JANE FAUROT, RPR
Chief, Office of Hearing Reporter Services
FPSC Division of Commission Clerk and
Administrative Services
(850) 413-6732

IN ATTENDANCE: (As heretofore noted.)

I N D E X

P R O C E E D I N G S

COMMISSIONER DEASON: We need to get started. I would ask you to please take your places. We are going to try to stay on schedule as best we can today. Hopefully we won't be working until 6:00 again like we did yesterday.

Just for everyone's information, the Chairman will not be with us physically today, but I understand that he may be participating via telephone, but that it may be on an in-and-out basis. But the other Commissioners are here, and we are going to go ahead and begin. I believe the first scheduled presentation is IDS.

MR. KRAMER: Thank you very much. Good morning, everybody. I would like to thank the Commission for giving IDS this opportunity to discuss what I think is an enormous topic called structural separation. I'm not used to doing this, so I hope you don't mind if I read my notes.

My name is Keith Kramer. I am a Senior VP, and one of the four owners of IDS Telecom. We believe that the decision you are making concerning structural separation is a defining moment in the success or failure of the Telecom Act of '96. This is why I'm here. Understand I am neither trained nor experienced in addressing the PSC, but because of the experience of the past and the hope of the future, I feel compelled to do so.

First, let me tell you about IDS Telecom. We were founded in 1989 as an IXC, or a long distance company. Through the years we grew using Florida as our primary place of business. In 1999, because of the Telecom Act of '96, we decided to offer our base of small, medium-sized business customers local service.

Today my company employs over 280 Florida citizens. My employees work very, very hard and are at times under extreme pressure. They have families, and they depend upon me to ensure their livelihood and that is why I am here. My primary job at IDS was operations and business development. Now out of a sense of survival it is legal and regulatory, because without it IDS cannot survive.

As a long distance company, IDS had an untarnished history and a solid reputation. Our attrition rate annually is less than 2 percent. But as a local service provider using BellSouth's services this is no longer the case. Because of the massive problems caused by BellSouth, IDS has had no choice. And understand we tried everything we could with BellSouth to resolve our issues and our problems, and we felt compelled to file a complaint. On the advise of your staff and with all due respect, I will refrain from discussing anything that is specifically covered in my complaint.

But understand that my company, no question, is the best example and the reason for structural separation. If you wanted to discuss anticompetitive behavior, poor OSS, lack of parity, or just plain lousy service, I'm it.

I can really only discuss my experience from the ground level. I do appreciate all the esoteric testimony that you have heard, and I have learned a lot. But I live the problems on a day-by-day basis, so I figure that makes me an expert, and here are some of my qualifications. IDS is one of the first Florida-based companies to provide UNE-P service based on a 319 remand rate structure. In the past 11 months IDS has converted over 95,000 business lines with 80 percent of our customers based right here in Florida.

My customer is typically the small to medium-sized business with ten or more employees. Each owner of each business has the same responsibilities I do, and that is to supply a living for their employees. Now as a small ALEC, wishing as other ALECs and that is to grow and flourish, I expect, as Rodney Page from Access Integrated, to have a mutually beneficial relationship based on a good faith contract with BellSouth. Understand that IDS for years has provided long distance service to our customers.

Our underlying long distance network is provided by a number of long distance providers. It is not unusual to see two or three different LD salespeople in our lobby at any given day trying to get my service. They bid like the other guy on price and quality. But we are in a unique position. You see, they want my business.

But ALECs, including IDS, when we negotiate our interconnect agreement with BellSouth are clearly told this would not be the case. Up front I was told that the service offered in this contract are only minimally offered because they are mandated by law. The contract is and was clearly designed to protect BellSouth retail interest. And if the company could not come to terms with BellSouth on the agreement, both time and money precluded any attempt at arbitration. It's a kind of take it or leave it proposition. So once an agreement is signed under these types of circumstances, a CLEC realizes, like I do, that existence may solely depend upon regulatory agencies or commissions such as yours to enforce it. But at what price.

If you're a CLEC, what do you do and who do you turn to if for whatever reason BellSouth turns one of your customer's service off. Or for that matter, all of your customers service off. Let's say for an hour. Let's say for a day. How about two weeks. Your customer has DSL service with BellSouth and you provide them with their local service. BellSouth says that in order for you to maintain your DSL you must bring your service back to BellSouth. Or a customer decides to change locations. Eighty percent of the time his service will not be turned on when he moves. Or you ask BellSouth to roll out a truck to provide service to one of your customers, only to find out that the technician in that truck has an incentive to win the customer back to BellSouth.

I guarantee this Commission that of all the long distance providers I do business with none of the above has ever happened. And every long distance provider I do service with, or I do business with also has a retail division. The reason they perform this way is because they are not a monopoly and they all have their own separate networks. But understand in Florida BellSouth does not have the only wholesale network to which IDS or other ALECs can buy service from. There are others, and they want my business.

What is interesting is that one of the companies to which I am doing business with is approximately half the price on the very same UNEs that BellSouth says is at their cost or below. The only thing that this company can't provide is the UNE loop for that last mile. What happens if BellSouth for whatever reason decides not to connect my customers to this network.

But if BellSouth is structurally separated, what would happen? I suggest that BellSouth retail would seriously entertain buying services from a company that was 50 percent less than BellSouth wholesale. Second, wholesale business models are always more lucrative than straight business models, and BellSouth retail would no doubt be the largest consumer of a wide variety of cost-effective services and products that are offered by other wholesalers in order to stay competitive.

And it is the marketplace that could force BellSouth wholesale to reduce costs and improve services and introduce new products. I believe broadband would take off in flight. BellSouth has put the fear of God in the form of a threat that they would have to increase prices to their end users if they were to break up. Well, in 1983 AT&T used that exact same rhetoric. But in 1989 IDS was offering LD at 23 cents per minute and AT&T was offering it at 32 cents a minute. In 2001, IDS offers long distance at five cents a minute and AT&T offers long distance at seven cents a minute.

BellSouth would want any compromise that would prevent a full structural separation, because as a monopoly working in the free marketplace presents challenges they have never had to face before. Number one is BellSouth wholesale would start to have fierce competition with other very, very strong local network wholesale providers. Pricing to the end user would start to go down rapidly so that BellSouth retail could maintain their market share. But to maintain profits, BellSouth retail would have to shop the most cost-effective suppliers. The law of supply and demand now takes over. If structurally separated in Florida, competition would start to resurge and the Florida citizens would benefit.

I have developed my own business plans that have CLECs in a BellSouth structurally separated environment offering customers a free calling area which included the entire State of Florida. Now if you are BellSouth, this would scare your board of directors to death. How would they be able to compete? Well, the answer is, as with all big companies, they find a way. Otherwise, everyone would still be paying 32 cents a minute for long distance. Thank you very much.

COMMISSIONER DEASON: Thank you. Thank you for your brevity there.

Questions? Thank you for your presentation.

MS. LOGUE: Commissioners, the next presentation will be made by the American ISP Association, represented by Ms. Sue Ashdown.

COMMISSIONER JABER: Chairman Deason, while we wait for Ms. Ashdown to be ready, staff had asked -- actually brought to attention that we have Gennarro Jackson here, who I don't know if you know is leaving us this week to go back to FSU for classes. So I thought we would just take a second to congratulate him. He is over there on the right.

Gennarro is an accounting major at FSU. And I'm sure it breaks his heart to be leaving us this week and going back to our favorite university, even though I didn't go there.

COMMISSIONER DEASON: We all know that FSU is the University of Florida. We appreciate -- you were here on an internship, is that correct?

MR. JACKSON: Yes, sir. (Inaudible. Not at microphone.)

COMMISSIONER DEASON: Well, thank you. I'm sure it has been mutual. We have benefitted and hopefully you have benefitted by your experience, as well.

COMMISSIONER JABER: But would you come back?

MR. JACKSON: Yes.

COMMISSIONER JABER: Okay.

MS. ASHDOWN: Thank you very much for inviting me here today. I am very happy to see the Florida Commission taking such an active role in discussing the issues surrounding structural separation. By way of brief introduction of the American Internet Service Provider Association and myself to you, let me just tell you that I am an Internet service provider myself. I co-own an Internet service provider out west.

Very early on in doing business as an Internet service provider, I recognized that it was necessary to be involved in what was happening at our Public Service Commission, and that for us started when ISDN rates were being discussed at the Commission.

I recognized the effect that that had on my business and became involved with the Public Service Commission as well as in the political arena very early. And that is a somewhat unusual thing for an Internet service provider to do. And I recognized after several trips to Washington to express the small Internet service provider's point of view that there was no one really doing it on a consistent basis, and so I formed the American Internet Service Provider Association to do that.

The Internet Service Provider interest in structural separation has gone back quite some time. In a sense, our problems predated the problems that the CLECs experienced once they came into the market after the '96 Act. We were the original customers of the Bell monopolies, and large customers at that. And like any small business, we were looking to buy as many phone lines as we needed for our customers to reach us without encountering a busy signal.

So more than any other consumer group, I think, in the United States, the American Internet Service Providers are by virtue of the volume and the intensity of their telecom needs able to provide a unique perspective on this issue.

Telecom supply to any business is crucial, but to an Internet Service Provider it is more than crucial, it is like oxygen in the room. When your supply runs short and your customers encounter a busy signal and they flee to a provider that doesn't have them, you have lost the customer forever. If a customer calls a bank that hasn't got enough phone lines and they get a busy signal, they tend to keep trying the bank. They don't leave the bank for another bank immediately like they do in an Internet Service Provider's world.

The fact that the phone companies have been able to control our supply in the beginning was not that much of a problem. I think largely because the Bell monopolies had not woken up to the potential of the Internet, and so we were treated pretty much like any business. And our initial problems in supply had to do mainly with the fact that there are very few buildings that are able to accommodate the kind of exponential growth that we were experiencing.

However, once the Bells did wake up to the potential of the Internet and recognized that their customers were also their competitors, we started experiencing quite a few more problems in the supply line and in the pricing line. And supply and pricing are two issues that are well suited for a competitive solution. It was not uncommon after the Bells got into Internet service themselves to see them advertising that somehow because they controlled the phone lines their service was faster or closer to the source or somehow better. And BellSouth was particularly brazen in that regard, boosting you can count on us because we connect the Internet. As your telecommunications provider we own and operate the phone lines that most other Internet services rent.

So the CLEC industry couldn't have come along at a better time for Internet service providers due to the Bell conflict of interest in supplying us, quality of service becoming a crucial issue and it was even, I would say, a more important motivator than price behind our migration to the CLEC networks.

After DSL came along the environment changed yet again. Although we and the Bells and the CLECs had delivered a variety of high speed access solutions for our business customers for a number of years, those solutions were usually based on very costly frame relay delivery, and DSL had the potential to cut the cost of high speed delivery, broadening the market beyond the initial pool of business customers.

So broadband offerings over cable clearly spurred a competitive response from the phone companies who did not care to lose the revenue from those lucrative frame relay customers moving over to DSL, but they cared even less to lose them altogether due to the customers migration to the cable platform.

So determined not to miss out on broadband the way that they missed out on narrow band, the Bells rapidly set about doing two things. The first thing I call the Guccification (phonetic) of dry copper, because there is nothing really magical about the phone line that DSL is delivered over, but the first step for the phone companies was to take down the dry copper tariffs that allowed anybody to be able to buy that dry copper line at a cheap price.

A little bit of background on DSL. Burglar alarm companies used to use the plain copper lines. And typically how they would do it is they would wire a plain copper line between them and the customer premise. One pulse going down the line might indicate that a window is broken, another two pulses might indicate that a door was ajar. And as the Internet started pushing demand for lots of data, they recognized that a lot more data than one or two pulses at a time could go down these lines.

But if anybody could get their hands on the copper, that meant that anybody could provision a DSLAM anywhere. And, in fact, in the northeast there was a company called HarvardNet (phonetic) that started offering DSL long before the phone companies did. And how they did it was they installed DSLAMs at the back of grocery stores where these dry copper pairs were readily provisioned.

And incidentally, there are still Internet Service Providers around the country that I am aware of who are buying dry copper on the sly, bringing DSL to communities who would not otherwise have it, but they prefer naturally to remain quiet about it.

So now with the tariffs removed and the only way to buy a copper pair would be through the phone company, the only way to install DSL equipment was also with the phone company office. And for an Internet Service Provider that meant that most of us were locked out of the phone company's central office. In order for us to get a DSLAM into the phone company's central office, we would have to -- due to the 1996 Telecommunications Act -- register ourselves as regulated telecom carriers and most Internet service providers at this point in time were already familiar with the horror stories that their CLEC suppliers had encountered in getting interconnection with the Bell monopolies and chose to avoid it.

So, basically as an Internet service provider you have two choices; you could go -- if you had two choices, you could go through a competitor or you could go through the Bell monopoly to provide Internet access over DSL to your customers.

The second step in the Bells Guccification strategy was to submit tariffs to the FCC which the FCC sanctioned, which made it almost impossible for an Internet Service Provider to sell the service profitably. And they did this by means of outrageous and impossible quotas in order to get favorable pricing on the loops going out -- on these Guccified loops going out to the customers homes and businesses.

And although those tariffs have been refiled in BellSouth's case, the recent tariff punishes everyone equally by eliminating the quotas but increasing the minimum tariff price by $4 a month and completely without justification doubling the installation price by 220 percent from $50 to $110. In any case, these two -- this two-pronged strategy worked because now the Bells control 78 percent minimum of the DSL market and that is an unquestionable monopoly.

The Bell discrimination against the Internet Service Providers in the DSL product provides a very good illustration of the problem with Bell company integration with its Internet affiliate and why structural separation -- even the kind of structural separation that we have seen before that has gone away due to the sunset in the 1996 Act, the kind of structural separation that leaves us with accounting safeguards is not sufficient itself because when you have -- when you are relying on accounting safeguards to prevent discrimination you still have one CEO at the top who is straddling both sides of the fence reporting to one set of shareholders.

We decided that as Internet Service Providers we couldn't afford to ignore the DSL market. Broadband obviously wasn't going to go away, and we could not afford to be marginalized. So even though in the early days we were forced to pay $39 a loop for a DSL interconnection and the Bells were selling the DSL configured line, Internet access and tossing out free $200 modems to the customer for 39.95, leaving us an effective 95 cent profit margin, it was not a market that we could ignore and so we chose to go into the market and subsidize the money losing product with our other products.

For our 95 cents we ended up spending hours on the phone with Verizon, SBC, BellSouth, Qwest, tracking vanished orders, missed installations, incorrect installations, and on-going technical problems. And here is how DSL is particularly illustrative of the need to separate. DSL is in a sense half slave/half free. Half of the product comes from the phone company, half of it comes from the Internet Service Provider.

And so every time there is a problem on the line, whether it is caused by what the Internet Service Providers jokingly refer to as strategic incompetence, or it is just an act of God, or what, whenever there is a problem on the line, that provides an opportunity for the phone company to get involved in the interaction with the Internet Service Provider's customer and try to get them to migrate over to the Bell company Internet product.

Customers are frequently led to believe that the problems with the service originate with the Internet Service Provider when, in fact, they don't. And the disparagement of the independent Internet Service Provider by Bell company customer service representatives who are paid a commission on each DSL customer they win has been a hallmark of DSL deployment from 1998 to the present day.

The abominable service quality inferiority frankly that Internet Service Providers experienced encouraged them to come here to the Commission several months ago hoping to see the Commission take a stand on the staff recommendation to assert limited jurisdiction over the DSL product. And the staff here recognized, as the Kentucky Commission did, that the state does have a role in ensuring service quality, and without it Internet Service Providers as consumers and end users as consumers fail to see the benefits of high speed Internet access while the Bell monopolies hold it hostage to the lucrative frame relay market.

I came here actually for that hearing, and I thought it was very interesting to watch the Bell company attorneys who feared any sort of scrutiny of their service, clearly, and did their best to muddy the water. And I saw some really amazing claims that day including the claim that DSL had almost semi-mystical properties. Even the claim that when your phone line goes down your DSL connection stays up. This is, of course, impossible. Internet access comes down the very same copper wire that is governed by the state commission, whether it is narrow band or DSL refers to the frequency on the wire, nothing more, nothing less.

My initiation into the DSL market as an Internet service provider began with an experience that was, unfortunately, to be repeated countless times across the country. U.S. West had hooked up its own DSL customers, or its own DSL transport line while leaving ours sitting on the floor.

By the time we got our line provisioned, our customers were calling me asking why have I been put on a waiting list, the product has just barely been rolled out. Well, the answer was easy. While our line was dark, the phone company had filled up the DSLAM with its own customers and our turned up line did not have a DSLAM to connect to and we were at the phone company's mercy when it came to adding more DSLAMs.

Now, when were those DSLAMs going to be installed, we have no idea. The phone company knew. And the phone company, as I recall, insisted that its Internet affiliate was separate, and the Internet affiliate knew no more than we did. But the fact is that because of this half slave/half free nature of the product that I mentioned earlier, it didn't matter if the Internet affiliate had no more information about the product than we did. The phone company could advertise DSL. Remember that half of the product was a regulated product. The phone company could advertise DSL when it knew that new DSLAMs were coming in and the phone company affiliate would be the immediate beneficiary.

So if my only window into what was going on at the phone company was to open up the newspaper and see an ad showing that DSL was now available in the area, it's already too late for me. It's not too late for the phone company's affiliate, but it's too late for me.

On the scale of documentable problems for regulators, the denial of service, such as the phone company hooking up its own line and not ours, is a pretty easy one to track. But, frankly, once the line got turned up, even though it was too late, even though we had lost customers, the problem was more or less solved.

Again, the problems really got back to the issue of disparagement. And strange little service issues. Service issues like BellSouth configuring lines so that the modem would be greeted by a voice recording instead of a busy signal making it impossible for this on a dial-up service, not DSL, but problems that would make it impossible for a modem to automatically redial.

So when customers would call the phone company to say could you please take this feature off of my phone, they would be told, you know, we wouldn't have these problems if you would just go with BellSouth.net.

Back to DSL again, when the Bells control the line current regulation is still equipped to deal with this disparity. As an example if a customer moves and calls the phone company to shut off phone service at one location and turn it on at another, they are not calling the phone company to buy a product, but to make what is, in essence, a repair call. Yet the phone company treats the encounter as an opportunity to sell DSL.

Does the customer service representative record the time spent on this encounter or is it part of a formula that has been agreed to by regulators as an average percentage of customer service representatives' time to be billed back to the phone company by the -- back to the Internet affiliate by the phone company, I don't think it matters because there is nobody that can compete with that kind of built-in advantage.

In Qwest territory, the DSL network has been recently re-engineered, and now end users who want to change the speed of their DSL connection have to throw out their old DSL modem and purchase a new $200 modem from Qwest. You can only get the modem from Qwest, and --

COMMISSIONER DEASON: Excuse me for just a moment. I think we are having a little technical difficulty. There seems to be voices over the system. Apparently someone called in. If you will just be patient with us for just a moment.

You're okay now. Okay. The court reporter I could tell was showing a little consternation on her face there with the voices. You may proceed.

MS. ASHDOWN: Okay. As I was saying, in the Qwest territory they recently re-engineered the network. So if you want to change the speed of your DSL, you need to toss out your old modem. The only place you can get a new modem is from U.S. West or Qwest. The modem costs $200. Previously you could make speed changes on the existing modem. It seems to me that it is a fundamentally anticonsumer action.

But more than that it is anti-ISP. Because previously the Internet Service Providers could send their customers for a speed change to a safe harbor where they could be sure that their customers would not be pushed to move away from them and onto the Qwest network. But with this new re-engineering of the network, the safe harbor has been eliminated. And now in order for a customer to make the speed change in addition to buying their modem they need to contact the phone company and be subjected to marketing over there.

The problem for an Internet Service Provider in documenting these issues, for one thing it is the rare end user who documents the name of the phone company representative who disparaged the Internet Service Provider that they had chosen. And when -- in our experience when we have presented this documentation to regulators it is discounted by the Bells as an anomaly, this doesn't really happen, this is not our policy.

And we, as small businesses, have been expected to become the police force for all of these anticompetitive practices, which the Bell is insisting are statistically insignificant. Yet it is not us who presides over the information. It is not us recording the calls with the customer for quality control purposes. We don't monitor the records of disciplinary actions taken against phone company employees who deviate from regulator-approved scripts. We are not present inside the phone company when a phone line is incorrectly configured. And FCC opened network architecture reports are silent on the provisioning of DSL services for DSL end users as compared to the provisioning of DSL services for Bell company end users.

The DSL accounting issue alone has long been at the top of the list of LEC imponderables for Internet Service Providers. The Bells are going way beyond giving DSL service away by giving away free $200 modems and digital cameras, a package that if offered by the typical Internet Service Provider would require at least two years to break-even on. This goes beyond a question of economies of scale. It is a relevant question for regulators guarding against cross-subsidization. Yet in order for Internet Service Providers to gain the discovery privileges necessary to uncover the cross-subsidization they suspect, a complaint would need to be filed at the FCC and that brings me to the next point.

Several months ago when I came to that hearing here, the suggestions that were given to the Internet Service Providers to restore a fair competitive environment were the following; one, become a CLEC in order to install your own equipment in the phone company office. Two, lodge a complaint with the state commission and/or the FCC. Three, pursue state legislation to rectify the problem.

We have tried all three, and I will explain why they didn't help. First of all, aside from the fact that I can't imagine that regulators really want to see 7,000 ISPs join the ranks of the regulated, the entire DSL industry and the struggling CLEC industry provide an excellent case study of why interconnection under the present conditions is a nightmare best avoided by small entrepreneurs. The service quality issues that result in the death of a thousand cuts and are so difficult to address from a regulatory perspective exist equally for regulated carriers and nonregulated consumer ISPs.

Clearly the incentives that we imagined were going to exist in the 1996 Act lost some of their appeal for the incumbents. And although the Bells would like very much to more vertically integrate themselves, otherwise we wouldn't see legislation like Tauzin/Dingell on a congressional level, although they would very much like to vertically integrate themselves with long distance authority, they have come over the intervening years to realize that long distance is not worth sacrificing a local customer.

When I first became involved in telecom politics in my own state back in 1995, I remember the Bell company lobbyists constantly complaining we are the provider of last resort, we serve the customers nobody else wants to serve, the high cost customers, the hard to reach customers. I never hear that argument anymore.

And even though I have very little patience for the argument that service was being offered at below cost to consumers, it's clear by now that the added services like voice mail and Caller ID that are sold at quadruple digit profit percentages convinced me that even if you do accept the argument that local service at one time was a dog, it is not a dog any longer. And it is now the golden key to the customer's home. Long distance is a distant second in terms of appeal and becoming more distant all the time. So becoming a CLEC is clearly not an answer for an Internet Service Provider in today's world.

Filing a complaint --

COMMISSIONER DEASON: Let me interrupt you just a second.

MS. ASHDOWN: Yes.

COMMISSIONER DEASON: I didn't follow your point as to why becoming a CLEC is not a viable option. If local service is a lucrative business, and there are quadruple digit percentage mark-ups on services which are marketed to customers, a CLEC has that opportunity as well to market that to customers and get that quadruple percentage profit margin.

MS. ASHDOWN: In fact, I think that a CLEC would have to market those services in a bundle in order to get -- in order to make it profitable because the access charges I am told are very high for them.

COMMISSIONER DEASON: So I guess my question then, and I'm just trying to understand, if the CLEC community has the ability to market those services and get those profit margins and local service is not a dog, but is a true profit center, why is it that becoming a CLEC is not a viable option?

MS. ASHDOWN: Well, it's not a viable option for an Internet Service Provider because I think that an Internet

Service Provider is interested in providing Internet access to their customers, first of all. Getting into the voice business was not something I don't think that we had an interest in doing initially, I don't think it is something that we have an interest in doing now.

And I don't think that there is a need for 7,000 different voice companies, as well. I think that there are CLECs out there that do that job very well, and that we are happy to be customers of those CLECs when they can gain the interconnection that they need. So I don't think that the profitability of local voice service -- and I think, again, looking at the rough time the CLECs and the data LECs have had enforcing their rights to interconnect over the public switched phone network as a result of the 1996 Act have demonstrated that it is not an easy road for an Internet Service Provider to gain access to the phone company network even aside from whether they wanted to sell voice or not.

Filing the complaints. I have worked with a number of Internet Service Providers on two different complaints filed at two different state commissions. These were both regarding DSL deployment. And in Utah one of those complaints sits dormant thanks to a state law that says that proven anticompetitive abuses can only be dealt with by withdrawing the product completely from the market.

So to obtain justice we weren't allowed a remedy where future product sales could be suspended until the problems were worked out, it would just take it off the market away from everybody who had it and that was not an appropriate remedy for us, for the consumer, for anyone.

We were told here at this hearing a couple of months ago that Internet Service Providers didn't really necessarily need an attorney to file a complaint, they could come to the Commission on their own, they could go to the FCC on their own. After we failed to achieve justice at the Utah Commission, I went to the FCC. It is not something that I would do alone. I found myself in a room with another Bell company attorney, with four Bell company attorneys on the phone. And I did bring an attorney, but it is not a trivial matter to lodge a complaint.

And, in fact, at the FCC we only inquired about the possibility of it. And between our inquiries at the FCC and the complaint that we lodged at the Public Service Commission in Utah, the Utah Internet Service Providers were relieved of more than $40,000 with no tangible result.

In Kentucky the Igloo (phonetic) Internet services was more successful with the Kentucky Commission agreeing that BellSouth's actions had harmed the deployment of broadband in Kentucky. Yet in that case, as well, every one of the Commission's orders were ignored by BellSouth which imposed its own result, that new tariff that I mentioned earlier that punished everyone equally. And all without the cost justification that the Commission had asked for.

Finally, we tried one more time at the FCC, collecting the evidence that U.S. West was in violation of either Computer 2 or Computer 3 and we presented a request to the Regulatory Enforcement Bureau for enforcement basically of the regulations. And the FCC responded by calling U.S. West and asking which regulatory regime are you operating under, Computer 2 or Computer 3. U.S. West responded, well, we are under Computer 3. Even though on the record in the Qwest/U.S. West merger proceeding out west they said, well, we are operating under Computer 2.

So either way the FCC's response was simply to ask U.S. West to come into compliance with Computer 3 by posting network disclosures on the Internet. To this day those disclosures are inadequate, as are the disclosures of BellSouth, but the FCC considers itself to have sufficiently addressed the problem.

They did not respond to our proof of the conflicting statements on the issue, and I would add that conflicting statements on the issue are another convenient way for the Bells to muddy the waters. Here at the hearing several months ago we were told that BellSouth only deploys DSL through its separate affiliate BellSouth.net, yet before the Kentucky Commission prior to that BellSouth maintained that it deploys DSL and BellSouth.net only provides the services to BellSouth to make it possible.

I spend all this time talking to you about the Internet Service Provider experience with the regulatory process to illustrate an important point. Later this afternoon you are going to hear from the Bells and the Progress and Freedom Foundation that the whole idea of structural separation for the Bells is going entirely in the wrong direction, and that what is stifling DSL deployment in this country is the onerous regulation that forces the Bells to sell, not share, sell interconnection on their networks to their competitors, ISPs and CLECs alike. And the real answer is either to eliminate these regulations, which I am telling you that the Bells are ignoring anyway, or to put similarly useless regulations on cable.

I hope that some of the experiences I have mentioned today make it clear that the Bells are already operating in a virtually unregulated environment. That the emperor is wearing an invisible suit, and obfuscation about what the cable competitors can or cannot do does not change the abundant evidence that ISPs are not able to compete with their monopoly suppliers in this virtually unregulated environment and neither are the CLECs.

For the Internet Service Providers I am afraid it is already too late. The round of unaddressed anticompetitive Bell tactics that resulted in a 78 percent DSL monopoly has already taken its toll on many Internet Service Providers who have left the market, depriving of it the vibrant local competition it used to enjoy. Even if we were to decide this morning that we are going to address structural separation, we are going to move in that direction today, by the time the structure got in place, I think that it is going to be too late for -- it is already too late for many Internet Service Providers, and by the time it comes in place it may be too late for many more.

I would suggest that the time is now, however, even though it is too late for some of the small entrepreneurs who have left the market. Because if competition is something that we really care about, it is almost the only -- the only alternative we have left. Clearly diminished Internet service provider choice has already had an effect on consumers and consumers are being steered more toward a competitive environment dominated by a handful of national brands.

For Internet users this has implications beyond the traditional competitive issues that we look at like price and service quality. For Internet users it will ultimately have implications on the type of content people can access through their Internet connections.

As an Internet Service Provider responsible for offering a full range of service to my customers, I disagree with the contention that the local loop is not a natural monopoly because of the competition posed by wireless, cable, and satellite. Until any or all three of these can duplicate the ubiquitous availability and acceptable latency demonstrated by the public switched phone network on a drop-in basis for Internet use, the phone network rules.

And the fact that it is called the public switched telephone network should not be forgotten. It was the public that paid for and protected from the competition this ubiquitous system of wires quite unlike any other communications network in existence today. It is an asset that has been valued at nearly a trillion dollars, no wonder it hasn't been duplicated. And there should be no need to duplicate it if true interconnection can be achieved.

Yet what we have seen so far is only the faintest shadow of true interconnection and competition. We have seen a competitive industry that gave it its best and could not penetrate the Kremlin wall established by four monopolies whose anticompetitive efforts have been rewarded either with ignorance or with fines that were well within the cost of doing business.

The present regulatory structure cannot address this issue. It is not addressing this issue, and it is time to decide plain and simple if we want to create an environment that can truly level the playing field so competition can flourish, or if the tight oligopoly is sufficient to meet consumers' needs.

I submit that it is not meeting consumers' needs and it will not meet them until the Bell monopolies, Internet and retail divisions meet up with the rest of us outside the Kremlin Wall.

COMMISSIONER DEASON: I have a question.

MS. ASHDOWN: Yes.

COMMISSIONER DEASON: Can you go through for me for illustrative purposes, say there is a customer, she does not have Internet service but she wants Internet service. And it is a potential customer of one of your clients. What happens when that -- say that customer called one of your clients to subscribe to Internet service. What is the process that goes on and why is it unfair?

MS. ASHDOWN: Are you speaking of DSL service or narrow band service?

COMMISSIONER DEASON: DSL service.

MS. ASHDOWN: Okay. DSL service could vary depending on which Bell territory the Internet Service Provider were in. In my own territory, the customer would call the phone company to have their phone line reconfigured to get DSL.

CHAIRMAN DEASON: Now, would that customer not call you to begin with?

MS. ASHDOWN: They could call me to begin with, but they --

COMMISSIONER DEASON: And you would direct them call your local provider and get DSL service.

MS. ASHDOWN: Yes. They need to contact the phone company that controls the line coming into their premise to get the phone line reconditioned.

COMMISSIONER DEASON: Now, let me ask you a question. Why do you not go to the phone company on behalf of that customer and get that service? That is not permitted?

MS. ASHDOWN: I think that we do where we can, you know, the sheer volume and the fact that we are not paid for generating that additional business for the phone company suggests to me that it is appropriate for the phone company to take the order for their own customer. It is not appropriate for them to then leverage on --

COMMISSIONER DEASON: But then you open the door for them to market to that customer, oh, you are getting DSL service, would you like to subscribe to our Internet service.

MS. ASHDOWN: That's why I'm saying that structural separation is necessary, because apparently the temptation is irresistible for the phone company. The phone company should not be marketing on behalf of its Internet affiliate. In fact, in Verizon territory, as you will recall, where Bell Atlantic merged with GTE, that was part of their merger condition, was that the phone company was not going to be taking orders, soliciting orders for its Internet affiliate. Yet it is happening and there is going to be a complaint in Pennsylvania very shortly about that.

COMMISSIONER DEASON: Okay. Now there are no -- for BellSouth there are no FCC restrictions on that activity on the marketing?

MS. ASHDOWN: Just because there is not a merger condition like there was in the Verizon network doesn't suggest to me that -- it depends, again, on whether BellSouth -- and, again, the record is confused on whether BellSouth thinks that it is operating under Computer 2 or Computer 3.

If BellSouth is operating under Computer 3, then they can share employees and they can, you know, they can do all of that. If they are operating under Computer 2, they can't. If they are operating under Computer 3, however, they ought to be having full network disclosures on the web, and they don't have those. So this is what I mean when I say that we brought a complaint to the enforcement bureau of the FCC saying let's clarify this issue once and for all. Let's say what regulatory regime are you operating under. You don't get to pick and choose between regulatory regimes. And that was what was going on to the detriment of the Internet Service Providers' market.

COMMISSIONER DEASON: Let's get back to the example. A customer calls you and you tell her -- first of all, do you even know whether DSL is available to this customer when she calls?

MS. ASHDOWN: Well, that is an interesting question, because an Internet service -- Internet Service Providers all over the country have been telling me that they query the system to see if their customer is qualified. They get the answer back the customer is not qualified. Then lo and behold, the next day the customer gets a call from the Bell saying, you are qualified for DSL, how would you like, you know, can I bring it to you.

COMMISSIONER DEASON: Is that something that you can verify has happened?

MS. ASHDOWN: Yes.

COMMISSIONER DEASON: In BellSouth territory or U.S. West?

MS. ASHDOWN: I can verify that it has happened in SBC territory. I have proof that it has happened in SBC territory.

COMMISSIONER DEASON: So you have access to a database when you get a customer inquiry, you can query that database and then tell the customer whether he or she is in an area --

MS. ASHDOWN: I am told by the Internet Service Providers in BellSouth territory that the database is about 30 days old, the database that they are provided. So the database that the phone company employees are looking at, I don't know how fresh that is.

COMMISSIONER DEASON: Okay. Well, let's go back to our example. The customer calls you, you tell the customer contact your local company. And for the sake of argument let's say they contact BellSouth, and BellSouth says, yes, we can provide DSL service, and let's assume that they market their own ISP service, and the customer declines and says, no, I just want DSL service, I will pick my own Internet Service Provider. What happens after that? And say they -- first just tell me what happens at that scenario.

MS. ASHDOWN: First of all, let me say that in BellSouth territory that is unlikely to happen, that the Internet Service Provider is going to send the customer over to the phone company. The Internet Service Provider has bought the loop from the phone company, and they are probably going to take the order themselves. So, the problems that the Internet Service Provider in BellSouth territory and Verizon territory are going to experience at that point are mainly going to be provisioning problems. An order that is put into the system that disappears that you can't track down.

COMMISSIONER DEASON: Let's back up. I'm trying to understand. You are saying that most likely the ISP will enter the DSL order on behalf of the customer?

MS. ASHDOWN: In BellSouth and Verizon territory, not in Qwest territory. In Qwest territory it is more likely for the Internet Service Provider to turn them over to the phone company. But in Qwest territory the Internet Service Provider is not buying the loop out to the customer's home like the Internet Service Provider is obliged to do in Verizon, BellSouth, and SBC territory.

COMMISSIONER DEASON: All right. So you can obtain that DSL service on behalf of the customer, then do you package that to -- or does the local -- who pays the DSL service? Do you pay BellSouth for the DSL office on behalf of the customer?

MS. ASHDOWN: In BellSouth territory the Internet Service Provider pays BellSouth, yes.

COMMISSIONER DEASON: All right. What's wrong with that?

MS. ASHDOWN: What is wrong with that is that the loop is being sold to -- was being sold to the Internet Service Providers at $39 a month, unless they signed a volume commitment to purchase 40,000 lines. The average Internet Service Provider has 700 to 1,000 customers.

COMMISSIONER DEASON: Now, is that an FCC tariff?

MS. ASHDOWN: That was the original FCC tariff. The tariff that has now been refiled, now the maximum discount before was $29 for making a 40,000 line commitment. Now the volume quota has gone away, everybody pays $33 for the loop. Remember because you are an Internet Service Provider you are not getting that loop at a line shared cost. You have to buy the whole loop at $33 a loop. I think that is a very costly price.

COMMISSIONER DEASON: Line sharing is not available?

MS. ASHDOWN: Not if -- the only way you get line sharing is to put your own DSL equipment into the phone company office and you would need to become a CLEC to do that. So you are compelled to buy the entire line whether or not you want the voice portion of it.

COMMISSIONER DEASON: What does the customer have to pay if he or she subscribes to DSL service themselves without ISP service, just DSL? A customer calls BellSouth and says I want DSL service, what do they have to pay?

MS. ASHDOWN: Well, first of all, DSL service is useless without the Internet portion. There is no reason to configure a line without also getting the Internet portion. But if you called BellSouth and you wanted to get DSL service, I believe BellSouth -- you can ask BellSouth about this, but I believe BellSouth recently raised the price to $49 which includes the Internet service, the free $200 modem and the reconfigured phone line. Before that price was $39.95, while the Internet Service Providers were being compelled to buy loops at $39 apiece, so their margin was 95 cents.

COMMISSIONER DEASON: But now that is a package that BellSouth provides which includes ISP, correct?

MS. ASHDOWN: Yes. Yes.

COMMISSIONER DEASON: There is no offering out there -- a customer can't call up BellSouth and say I want DSL service and I do not want your Internet service. I will make arrangements with an independent Internet Service Provider.

MS. ASHDOWN: To my knowledge in BellSouth territory it would not be handled that way. The Internet Service Provider, the customer would have to call the Internet Service Provider to buy the DSL service if they wanted to go with an independent Internet Service Provider. And let me just add that that was, as I recall in the Kentucky Commission's case, one of the reasons that BellSouth looked to its FCC tariff as a superior tariff, saying that, well, see, you know, we did this for the Internet Service Providers.

The Internet Service Providers didn't like the kind of poaching that was going on in U.S. West territory and U.S. West/Qwest territory where our customers would call to have their line reconfigured and being told, you know, that ISP is not DSL capable, or you don't want to go with them, you know, you want to go with us for whatever reason. BellSouth insisted that its tariff was better.

But the fact was that when you are trying to compete against the kind of massive cross-subsidization that was clearly evident with BellSouth's DSL product, your customers are going to say why am I going to go with you? I'm going to have to pay $39 for the line with you and I'm going to have to pay another $19 for the Internet service, and I'm going to have to pay another $200 with the modem. I go with BellSouth I get the whole thing for 39.95. That in itself, you know, destroyed a lot of the Internet Service Provider's ability to compete, to get a foothold in the market. And I think it would be very hard to reverse at this point.

COMMISSIONER DEASON: Okay. Did the FCC approve that?

MS. ASHDOWN: The FCC approved the tariff over our objections, yes.

COMMISSIONER DEASON: The tariff which includes the whole package, the modem, the whole thing, is that FCC jurisdiction or not?

MS. ASHDOWN: Well, the Bells would like you to think that it is FCC jurisdiction. Whenever an Internet Service Provider tries to come to their local commission, they are told, ooh, you know, mystery, federal product here, Internet involved. Can't, you know, can't compute that locally, must go to Washington.

And, you know, if you don't see the Internet Service Providers here at the Commission very often, well, it's a thousand times less likely that you will see them in Washington. That's just, that's a burden of the small entrepreneur. The regulatory system is not working for the small entrepreneur.

COMMISSIONER DEASON: And it is your belief that if the company were structurally separated that the wholesale unit would have just as much incentive to be cooperative and provide service direct through and independent ISP as through the affiliate?

MS. ASHDOWN: If they were completely separate with completely separate boards of directors and completely separate entities, yes, I would say that they would have no incentive. But right now it's like this fake, you know, Chinese wall with regulatory safeguards that aren't working very well, that aren't being enforced. And I believe that, frankly, even if they were enforced it is not going to be enough, because it's just -- it's too overwhelming an incentive to try to move the people over to your -- to leverage the power that you have over the local loop.

COMMISSIONER DEASON: Now, you indicated that the manner in which it is marketed and the rates that apply to BellSouth's DSL and ISP service, the package that is being cross-subsidized, that is your belief, is there some numbers out there that --

MS. ASHDOWN: I very strongly suspect that it is, but without going to the expense of formal litigation through a formal complaint through the FCC, I don't have the discovery window, nor do I really frankly have the money to hire the cost experts to uncover the cross-subsidization that is going on. But I can tell you that the Internet Service Providers have told me if somebody can tell me how they are able to make money at that, how do they do it, we will go away, you know.

COMMISSIONER DEASON: So if it is not cross-subsidized and they are just more efficient than you and they can do that, well, then that is what the market is all about, correct?

MS. ASHDOWN: Exactly. But I think that what is going on here goes beyond economies of scale. It goes to the heart of the leveraging issue. You know, people say to me do Internet Service Providers have a future? I say Internet service providers are no worse or no better a small business than any other small business you can name. But it's not like the small Internet Service Providers against -- it's not like the small book stores against Barnes and Noble. It's not like the small independent hardware store against Home Depot. It's like right now with the DSL product in many senses -- because every time there is a repair problem, like the one that I mentioned with Qwest, because the product is married, you know, if the customer wants to change the speed, they have to go back to the phone company in Qwest territory to fix that.

If there is a problem on the DSL line even in BellSouth territory after the line is up and running, quite frequently the Internet Service Providers is going to have to do a three-way conference call to make sure that the blame is not wrongly assessed in their direction. And so the analogy, I think, it's not a perfect analogy, but the analogy is right now, you know, it is as though if you were -- if you wanted to buy a book, you were told you can go through any independent book seller you want, but you need to walk through Barnes and Noble first. You know, you have got to walk through Barnes and Noble on own your way, or you have got to walk through Home Depot on your way to the independent hardware stores out back.

And that is the conflict that we are looking at here. And it is unaddressable by regulation unless you completely separate the two. And then we will see. Economies of scale, fine. Let it rip.

COMMISSIONER PALECKI: You have previously mentioned a thought out policy on the part of the RBHCs, I think you used the words strategic incompetence?

MS. ASHDOWN: Yes, that is what the Internet Service Providers call it.

COMMISSIONER PALECKI: Do you believe that we really have a conscious policy on the part of the RBHCs, or is this really the failure of a poorly thought out regulatory policy wherein as regulators we are asking the RBHCs to act in a manner that is contrary to their best interest. We are actually asking them to help their competitors, and that that policy just is doomed for failure.

MS. ASHDOWN: Yes, I guess I would say that if the Bell were out on the outside with the rest of the competitors, if the regulatory structure were set up that way, then the Bell incentive to discriminate against their competitors would be removed.

COMMISSIONER PALECKI: But in operating your company, you know that -- well, I'm sure that you appreciate your loyal employees who are willing to go the extra mile to try to gain additional customers, who are always fighting for the interest of your company.

MS. ASHDOWN: Uh-huh.

COMMISSIONER PALECKI: Is it logical to think that a loyal, hard working RBHC employee is going to want to go the extra mile to fight to help a competitor take customers or potential customers away from their own employer?

MS. ASHDOWN: I don't expect that the phone company -- when a customer calls the phone company asking for the DSL product, that they will say go with Sue's company. I'm telling you she is the best in the market. I don't expect that.

But what I also don't expect is that they are going to say, don't go with her, she can't -- you know, she is not there 24 hours a day, or she is not even DSL capable. I don't expect that things that are completely untrue are going to be communicated in an effort to win customers for the Bell's affiliate so that that customer service representative can gain a commission.

And I can see why it happens. I mean, if every DSL customer had to come through my gate, it would be pretty difficult to stop. You know, pretty difficult to give them the policy you are going to treat everybody fairly and you are not going to -- you know, if somebody asks for Internet Service Provider X, hands off. You know, you won't make any money on that sale, you know, but that's the rule. I think it would be very unfair. But I think that if all of the DSL orders were coming through my company just like they are coming through the phone company, I might be the one with the DSL monopoly. That's why --

COMMISSIONER PALECKI: It would be difficult to resist at least trying to compete. I guess the problem is --

MS. ASHDOWN: I guess the problem I have with that statement is that trying to compete and unfair competition -- trying to compete and anticompetitive behavior are different things. And we have seen a lot of the latter.

COMMISSIONER PALECKI: Thank you.

COMMISSIONER JABER: Ms. Ashdown, I just have a couple of questions. The theme has been, I think, the last couple of days, whether it is an underlying theme or something that should be more blatant, is that the incentives that were built into the Telecommunications Act might not have been the appropriate incentives and, therefore, the Act isn't working.

So I am searching for a way to address this, if we choose to address it in an effective manner. And I hear you very loudly talk about the need to separate the company completely. And if we were to agree with you, the wholesale side you would advocate should be completely separate, new board, new employees. But the retail side to the degree it becomes a separate CLEC, my fear in taking that approach is that is just an opportunity for that retail arm of BellSouth to remonopolize and use the money that might come from a parent company to just become another facilities-based provider. And I don't see how that helps you. That facilities-based provider will be in it for the local service, the long distance service and the cross state service.

MS. ASHDOWN: Right.

COMMISSIONER JABER: So I just see it shifting from BellSouth, the company as we know it today, to a new BellSouth retail CLEC that might --

MS. ASHDOWN: I guess the reason that I see it differently is because my company buys about a million dollars a year in service from Excel Communications. Excel is also in the data market. Somehow Excel has been able to compete with us in a fair manner, not abusing its position. I'm not saying that would be the case forever, you know, things can certainly change.

But I think that what you see with the DSL product with them, with the Bells having such tight control over the --

that is, you know -- broadband is the way it's going. And if broadband is important, if it is important to get DSL out there, you know, I don't buy the argument that they have no incentive because they have to, you know, because they have to open up the network to other people.

COMMISSIONER JABER: But do you recognize that that new retail CLEC would start out at a competitive advantage.

MS. ASHDOWN: Not if the structural separation were done correctly. Not if they were put out there without the benefit of the brand name. Without -- you know, in a similar way to the way that AT&T was structurally separated.

COMMISSIONER JABER: Okay. So really what you would be asking for is a code of conduct and some mandates on that new company not to use the BellSouth name?

MS. ASHDOWN: Absolutely, yes.

COMMISSIONER JABER: And to participate in negotiations with the wholesale company at an arm's-length transaction.

MS. ASHDOWN: Exactly.

COMMISSIONER JABER: Can we accomplish that without structurally separating the company i.e., Pennsylvania?

MS. ASHDOWN: The arm's-length transaction used to be a part of the 1996 Act. And within the context of that legislation, a four-year sunset was put on that kind of arm's-length separation. We argued at the FCC to try to get them to extend the sunset, the FCC was unwilling to do so, and so now that has gone away. But I think that if you were to look at the shape of the DSL market last year when that provision of the '96 Act sunset, you would still see the same monopoly distortions that you see today.

So that says to me that regulations are only as good as the enforcement. And my experience has been that the enforcement that -- and it is nothing against regulators. You know, I don't want this to be seen as an anti-regulatory rant, because I understand the enormous pressures that you are under. And not having financial resources, not having staff resources, competing with private sector for staff resources, all of those things make the job very, very, difficult. But it has not worked in the past.

COMMISSIONER JABER: Let we tell you, Ms. Ashdown, the only pressure I'm feeling right now in this docket is to not create a new problem, to be very careful to -- I think it was one of the FCC Commissioners said structural separation is a solution looking for a problem. I don't know if that is correct or not, but I don't want us to develop a new problem.

So I'm looking for the most effective way to address your solution. And when you were talking about marketing and the problems you have seen with the customers having to communicate with the telephone companies, could that also be addressed in a very detailed code of conduct that limits the nature of the discussion to providing the loop for the purpose of interconnecting with the ISP?

MS. ASHDOWN: Well, certainly a code of conduct would go a long way. And, in fact, the Kentucky Internet Service Providers argued strenuously at their legislature for a code of conduct on BellSouth, which it, I might add, resisted vehemently saying that we are in a competitive market, we are not like the gas company trying to sell furnaces, we are not like the electric company trying to sell air conditioners. You know, we are faced with abundant competition, you know, we shouldn't be.

But I think a code conduct would go a long way. Of course, in my opinion, again, you are dealing with a natural monopoly. That is my opinion. Obviously my opinion is different from the MIT economist here yesterday. But the reason my opinion is different on that is because Internet service is not the same over satellite, it is not the same over cable, it is not the same over wireless as it is over the -- and until you have absolutely drop of the hat replaceability on any of those platforms for what you have got going on the DSL platform right now, they have got a monopoly.

And I fear that a code of conduct is a weak tool in dealing with monopoly anticompetitive behavior. And, frankly, I think that if structural separation does not happen here it will eventually happen through an antitrust action.

COMMISSIONER JABER: Okay. And then one final question. With respect to separation, the wholesale company, the complaints we have heard with respect to the system itself, the network system is that it is very old, not dependable, slow. Why would you envision that changing if BellSouth, an arm of BellSouth becomes strictly the wholesale side and absent some sort of directive from the Commission to update?

MS. ASHDOWN: I think it would require directives from the Commission to update. But, you know, the Bells have all been at their respective state legislatures arguing that they will update this network if they only get alternative regulation, or freedom from price caps, or freedom from rate -- you know, price caps or freedom from rate of return, that kind of thing. And the investment in the network hasn't happened.

It should have happened but, again, you have got to have enforcement. You have got to have somebody who remembers from year to year what they promised last year and is building into the legislation or the regulatory directive this is going to happen by this period of time or we are going to know why because the money is there and it is not being spent.

COMMISSIONER JABER: So if there was a directive from this Commission that BellSouth update its system, if codes of conduct were put in place to direct the method of communicating between the consumer and BellSouth, and this Commission enforced every step of the way you would be satisfied with that result?

MS. ASHDOWN: No, Commissioner, I wouldn't be satisfied. I'm not going to be satisfied until you see the full structural separation. But I would say that short of that, I mean, it's a step forward. I just don't think that -- I don't think that it fully addresses the problem.

COMMISSIONER JABER: Who should bear the cost of a full structural separation?

MS. ASHDOWN: I don't think I am the appropriate person to answer that question.

COMMISSIONER JABER: Thank you.

COMMISSIONER DEASON: Thank you.

MS. LOGUE: Commissioners, our next presentation will be by the Progress and Freedom Foundation represented by Mr. Randy May.

MR. MAY: Good morning, Commissioners, and thanks for having me come down and be allowed to participate from Washington this morning. My name is Randy May. I am a Senior Fellow and Director of Communications Policy with the Progress and Freedom Foundation in Washington, D.C. We are a 501(c)(3) research foundation, nonpartisan, tax exempt think tank, we call ourselves, in Washington. Our tag line is a research foundation that studies the public policy implications of the digital revolution. Everyone has to have kind of a sexy tag line, and that's ours.

I am going to use mostly this Power Point presentation just to guide me through, but feel free if you have questions at any time to stop and interrupt and that will be fine.

I think it is useful at the outset from my perspective just to set the context, and I think this is something on which I believe everyone here agrees regardless of which side they are on, or where they see their particular interest, and that is that both the 1996 Telecommunications Act and here in Florida, the legislation here, both envision that that will be competition in all telecommunications markets and that includes local, the local markets, as well.

Now I want to spend just a few moments looking at where we are at this point, post-1996. Some of these numbers you may, I'm sure, be familiar with, but I think it sets the context for what we are going to talk about. On this first slide these figures are from the report issued by the FCC in 2001, containing data through the end of last year, December 2000. We see that year over year from 1999 to 1999 the CLECs share jumped to 16.4 million local lines from 8.3 million lines. From January to December 2000 that is a 93 percent growth in market share. About 60 percent of the CLEC lines serve medium and large business, institutional, and government customers. And the CLEC share of residential and small business customer market grew 45 percent in the six-month period from June 2000 to December 2000.

The FCC report showed at least one CLEC was serving customers in 56 percent of the nations zip codes at the end of 2000 with 88 percent of the U.S. population residing in these zip codes. There were over 100 million wireless subscribers at year end 2000, that is this type of competition right here that I expect we all -- a lot of us have in our pockets this morning. CLECs provide 35 percent of their end user lines over their own local loop facilities. And the ILECs provided 5.3 million UNE loops at the end of 2000. That was an increase of 62 percent during the previous six months.

Just looking at it, another type of number. This is taken from the report of Doctor Robert Crandall, which was issued in June of this year, where he looked at data from SEC reports on the CLECs, and he found that the publicly traded CLECs reported revenues of $7.2 billion in the third quarter of 2000, a four-fold increase from the 1.7 billion reported for the first quarter of 1998. So you see that type of growth, as well.

On this next slide I just want to -- because I'm going to come back to it throughout the discussion today and maybe we will even have some questions, as well, but I want to focus on broadband, because broadband service is obviously important in an economic and social sense, I would say, to the well-being of the country, and that is true of Florida, as well. And remind me later, I just want to remind you to remind me if I don't do it to talk about the fact that there is really no -- there is not a DSL market, of course, as our previous speaker referred to several times there. There may be a broadband market, in fact, I would say there is, and that consists of a number of different ways that one receives broadband. But it really throws the whole discussion off course if you start talking about a DSL market.

But on this slide at this point I would just like to quote from the FCC's report last September. Obviously on all of these numbers, as you know, and this will be true when I get to Florida, as well, there is a lag, but it makes the point that we want to make. Here the FCC said in September in our second 706 report, these are reports that are required by Congress to look at the broadband marketplace, "We found significant growth in advanced services provided to residential and small business customers by LECs between 1998 and 1999.

In recent years industry investment in infrastructure to support high speed services has increased dramatically driven in part by the rapidly rising demand for such services. Service providers are deploying a variety of networks that rely on different network architectures and transmission paths, including copper wire, cable, terrestrial wireless, radio spectrum, satellite radio spectrum, or a combination of these and other media to provide high speed services. In the coming years analyst predict rapid growth in subscribership of high speed services provided using each of these technologies." That is from the FCC.

I guess this actually is a good time to remind you that there is no -- that there really is no such thing as a DSL market, that is just one particular mode of providing broadband service. And as you probably know, the most recent numbers show that in terms of the broadband marketplace today 70 percent of people receive their broadband service from cable modems and 30 percent from DSL.

COMMISSIONER DEASON: Well, how do you respond to the previous speaker's assessment that DSL basically is a class by itself, that it is basically a monopoly service. That's what I understood her to say.

MR. MAY: Yes. I mean, I heard her say those words, but I don't understand it. Just as, I mean, the FCC has never treated it that way, as well. It's a way of -- it's a technology, and I wouldn't classify markets based on what technology happens to be used to provide a service in the market. I would look at the substitutability of the services --

COMMISSIONER DEASON: Well, you know, you have got transportation, and there is a 2001 Chevy Impala and then there is a horse and wagon. They both provide transportation, but one would say that they are not in the same market. I'm trying to understand --

MR. MAY: One might. But economists don't look at it, I think, that way. I mean, if we are you looking at communications one might say that you have got telephones and then you have got carrier pigeons, but most people wouldn't say they are in the same marketplace. We are talking about the high speed market. I mean, it is really a difference between a narrow band, you know, a traditional telephone service and a high speed, high capacity bandwidth service that enables you to do things with that communications capacity that you can't do with a narrow band capacity, you know, in terms of video and --

COMMISSIONER DEASON: So you are saying that cable, satellite, wireless are all interchangeable on an equal basis with DSL service?

MR. MAY: Cable -- well, I'm not saying -- yes, I'm saying that that is the view that they -- there is a great deal of interchangeability now as we speak. Some obviously have some different characteristics, some or more or less so. But the way you look at the market is in terms of also the potential competition. Obviously right at the moment as we speak, cable service and DSL service, I think, are more interchangeable from the consumer's point of view and in more places than satellite service.

It happens that where I live I have a choice. I mean, it just -- and not everyone does at the moment, but I have a choice between satellite service, a cable service, and a DSL service. And from my perspective they are basically -- they are basically -- I mean, I consider the cable and the DSL service essentially interchangeable. The satellite, I haven't thoroughly investigated it, I think that is one way down, you know, downloading now and not as fast uploading.

COMMISSIONER JABER: Mr. May, I have never looked at them as being interchangeable. Tell me if I am incorrect in my thought here. I view the market as being the market for Internet. It is the provision of Internet that is the market.

MR. MAY: Internet access, right.

COMMISSIONER JABER: That's right, Internet access. And the way you choose to get that is the technology. And DSL is the technology that the phone companies have chosen and there are other technologies, satellite, wireless, and cable, absolutely. And to me the difference is between a Concord and flying Delta when Comair and Delta are on strike perhaps.

MR. MAY: Which one is the Concord and which one is Delta?

COMMISSIONER JABER: Well, DSL would be the Delta/Com -- what is their affiliate, Comair? So I see it as a difference in technologies, but I don't see the technologies as being the market.

MR. MAY: I don't, either. I mean, I think that is what I said or tried to say at the beginning, that you don't define the market by the technology that is being used to deliver a service. The way you look at the market is whether the services are comparable from the point of view of a consumer. So you definitely don't -- you didn't define the market by the technology.

In fact, in the Communications Act, in Section 706, there is a specific direction, of course, and I understand you are the state commission, but that section actually, I believe applied to both the federal and state level is to look at advanced services as the way it was put in that context regardless of technology. So you are absolutely correct.

COMMISSIONER JABER: Okay. What complicates it, though, for companies that have to rely on DSL is that there is a level of regulation for phone companies.

MR. MAY: Sure.

COMMISSIONER JABER: And it is those phone companies that have to provide DSL. That is what complicates it.

MR. MAY: It does. Let me go on, I mean, all of this, of course, relates to then how you regulate and what your choices are. I mean, I have in mind your question, and if I can actually proceed we are going to get to that, I think quickly. Because that is an important discussion to have, I agree.

Well, the next slide is just more data showing -- I guess actually I have switched here to the Florida experience.

I looked at your 2000, December 2000 competition report. At the Progress and Freedom Foundation we have done some work looking at other states and how competition has developed in those states, frankly, and this is not intended to be a definitive statistical analysis, but my impression is that competition in Florida is developing quite nicely as I assume that you know compared with or in relation to some other -- in some other states. And so that is from your report.

Well, I guess one thing I would point out on this slide, you can see that the FCC report showed that at the end of last year you had -- the CLECs had 6.1 percent of the market as of June 30th. And the FCC showed in December 2000 the Florida CLECs had 8 percent of the market. So those numbers -- and served over one million local lines here in Florida. Again that is from the FCC. It looks to me like those numbers are basically consistent.

According to the FCC at the end of last year you had the highest percentage of zip codes with seven or more CLECs of any state in the country. You had more wireless subscribers on an absolute basis than any other state. And in your own report you found that only one of the state's 67 counties had fewer than three wireless providers with some having up to six.

So, when I looked at your report the conclusion that I drew is that, in fact, you know, we are never as far along as we might like to be in some other context, but things in terms of local competition are developing quite nicely here in Florida. And, in fact, just quoting from your report that seemed to be your conclusion, as well, if you look at those statements. The bottom line is that based on the data collected for the preparation of this report, it is apparent that the ALECs view Florida as an attractive market.

COMMISSIONER PALECKI: Let me ask you how do you respond to the nationally recognized commentators, several who have recently stated that local competition in telecommunications is doomed for failure. They cite the number of ALECs that have gone under over the last year or two. Basically, what I'm hearing from several commentators that as long as the traditional regulatory approach of requiring the RHBCs to assist the competitors by providing operational support, installation, maintenance in a manner that actually can reduce the RHBCs revenues and in a manner that is contrary to their self-interest is doomed for failure. How do you respond to those commentators?

MR. MAY: Well, you know, you are looking at another commentator. You have got commentators all over the place. But, you know, the answer is, in large part, the numbers that I'm showing you which would show you that competition is developing. I mean, you have done a study at the end of the year 2000, the FCC has done one, and finds that, in fact, competition is doing pretty well.

Another way of answering you is that I agree on the one hand with Ms. Ashdown, that she said in response to one of your questions that, you know, I think it was the Chairman perhaps asking her about why the ISPs don't get into the CLEC business, and I think she said there is not a need for 9,000 CLECs, I think was her response. And that is probably true in terms of the way economists would look at it.

In Reed Hundt's book, you know, the former FCC Chairman, he more or less bragged that -- I think he would probably agree that it was bragging that because of his interpretations of the '96 Communications Act that he had been responsible, or the Commission under his leadership, he had been responsible for creating 350 new CLECs, you know, that came into being as a result of those policies which had largely to do with the sharing of facilities, which I want to get to.

And, you know, my response is does anyone think that there really were going to be in that market 300 CLECs. And is it your job as a regulator to try and figure out how many CLECs you want to consider your policy successful? I don't think that is the way --

COMMISSIONER PALECKI: Well, the issue isn't really the number of CLECs, as I see it, but the amount of competition in number of customers. And when we see a level of competition of 6 to 8 percent, do we really have the good results of competition, and that is downward pressure on rates and an increased level of service. At 6 to 8 percent we are not seeing that, are we?

MR. MAY: I think you are beginning to see it, but I think you will see more. I don't think we are doing badly for where we are at this point in time after the '96 Act. As I will say, I think we can do much better if we follow different policies that are even more deregulatory. And, you know, that is what I would like to say to you. But I don't think we are -- you know, I think when you look at the experience in other industries that have been deregulated like the airlines or other ones, you know, a lot of the initial competitors that came in, of course, were not survivors. I don't think that is the way competition works, and I don't think it is your job really to try and manage it that way.

I'm not getting this to move. You can see how much Power Point experience I have. I'm trying to move this to the next line.

Well, that's where I want to go, because this -- ultimately what I think confronts you in a fundamental sense, and here is what I think we are going to be talking about, are talking about today and this is what from a telecommunications point of view actually I think is actually on your job sheet, as enticing or as unenticing as it may be.

There are two competing visions of today in terms of how to regulate telecommunications, and there is a choice between the two. And the first vision is the one held by a lot of the commentators that were just referred to who are bemoaning the fact that some of the CLECs have gone under in financial distress, and that is that telecommunications remains essentially a natural monopoly and the question you face is how to shape regulation in the future to ensure the proverbial level playing field and guarantee, quote, open access of essential facilities.

Vision two, which is actually the one that I share, is that telecommunications is rapidly becoming a natural competitive market. The question is how to transition to a deregulatory framework and what regulations to leave in place for remaining pockets of monopoly based largely on antitrust principles. And I think that is the choice you face.

It is clear to me, and I don't think there should be any mistake about it, the proposals to create a structurally separate LoopCo assume that the local loop is an essential facility in a monopoly antitrust sense for the indefinite future. And I know in the petition that was filed that is before you there was frequent citation to the Pennsylvania proceeding and the break up that had been at that time ordered by the Pennsylvania Commission.

But as you know, in the final Pennsylvania order the Commission backed away from the full structural approach. And I think when -- this quotation, I think, is instructive about the continued regulatory oversight that would be required. The Pennsylvania Commission said, "The parties have convincingly argued that even with the implementation of structural separation of Verizon's wholesale and retail arms, no less regulatory oversight than that currently prevailing will be required to ensure compliance."

And then the Commission also said, "Pennsylvania consumers will benefit more from the expeditious implementation of functional separation of Verizon's wholesale and retail divisions set forth herein, with the attached safeguards outlined below, than they would from physical structural separation resulting in the likelihood of additional and prolonged litigation and regulatory micromanagement which even the competitors do not view as a successful formula for bringing telephone local competition."

Having shown you what the Pennsylvania Commission said, though, and said that, what I would say is that it is clear to me that even the so-called non-structural safeguards that the Pennsylvania Commission left in place and the code and conduct and so forth are far too regulatory. And, in fact, ultimately impede the development of the type of competition that I think you would hope to see here in Florida.

Because the fundamental truth of the matter is that excessive regulation destroys the incentives of both the ILECs and CLECs to invest in new facilities and innovative services.

I think that Fred Kahn in his recent book put it well. He said, "By employing with TELRIC something like traditional prescribed rates of depreciation and return for the pricing of unbundled network elements, the FCC effectively assumes that the ILECs will for the most part remain monopoly suppliers of those components -- an assumption clearly contradicted by its assertion about the preference of CLECs for using their own facilities."

I think that when the Supreme Court in the Iowa Utility Board's case remanded the FCC's initial local competition order on the basis that the Commission had put no limitations on its mandatory sharing policies and sent that case back. I thought that Justice Breyer's concurrence in that case also put it well, and was pretty wise coming from a Supreme Court Justice. Breyer said, "Nor can one guarantee --" he was arguing really that the FCC had gone way too far in its mandatory sharing policies. He said, "Nor can one guarantee that firms will undertake the investment necessary to produce complex technological innovations knowing any competitive advantage deriving from those innovations will be dissipated by the sharing requirement. It is in the unshared, not the shared portion of the enterprise that meaningful competition likely would emerge. Rules that force firms to share every resource or element of a business would create not competition, but pervasive regulation, for the regulators, not the marketplace would set the relevant terms."

COMMISSIONER PALECKI: I would like to talk about this particular slide. I agree completely with Justice Breyer's statement. Could you -- where it uses word competitive advantage substitute the word revenues. Would that still be a truthful statement? The way I see this is that an RBHC, knowing that any revenues deriving from these innovations will be dissipated by the sharing requirement, takes a great deal of motivation away from the RBHCs to make these innovations.

MR. MAY: Yes, I agree, Commissioner. I think that that is generally true. It would take a lot of motivation away from me if I were required to do it, so I think that is true.

COMMISSIONER PALECKI: Isn't this really a double-edged sword, though? I think this right here is the strongest argument in favor of structural separation. And I think almost every ALEC commentator that we have heard would probably agree with this statement, but would say that this is the reason that we need structural separation because requiring the sharing on the part of the RBHCs has just not worked.

The RBHCs are motivated to compete, they are motivated to succeed, to make profits. And because of those motivations they are not willing to help their competitors. That is a perverse incentive. It just isn't going to work. And I think that the CLECs would argue that this point is the strongest argument for structural separation.

MR. MAY: Well, I'm not sure I always follow their arguments, but really what I do know is this. Ultimately I think the vision of the federal act and the state act is that you will have competition. And that ultimately for that competition to be meaningful it ultimately requires facilities-based competition. And there is more slides, we can get to that.

But you are not going to have competition really when the competition is based on resale facilities. What you are going to always have is managed regulation. Because what that implies -- I mean, the structural separation proposals, you always hear the ILECs -- excuse me, the CLECs say that if we had this structural separation then we would be able to treat the retail Bell affiliate just like, you know, any other -- then we will be able to treat that affiliate like any other retail competitor. And I think this was going to some of your questions, Commissioner Jaber. Then we will have competition. Well, you were questioning whether then you would even have real competition.

But the real issue is actually not on the retail side, but what do they envision then for the LoopCo that remains. And, of course, what they envision and, in fact, I think this was just made clear by Ms. Ashdown, and I don't think anyone disputes that this is their position, that the local loop is really a natural monopoly. And that it is your job, and that is why you are here, to continue to regulate that local loop. And that is what structural separation implies, frankly.

But an important point to understand is -- and here I don't think Breyer, I think if Justice Breyer was standing here he wouldn't distinguish between structural separation and extreme forms of unstructural separation or maybe none. I mean, you can have a continuum of regulation. All of what you are talking about is regulation.

So, the point is the extent -- what Justice Breyer is talking about, and the point that I really want to emphasize is that the issue is in order -- if you require excessive regulation, whether it is in the form of structural separation or excessive non-structural separation, especially by requiring excessive mandatory sharing of facilities, you are going to deter facilities and investment. That is what you ultimately, that is what your policy should be, the promotion of facilities investment so that you will have competition among the telephone companies, some CLECs.

You have some facilities-based CLECs that are, in fact, thriving. You have got the cable companies. Before I left just yesterday, I pulled out something from Telecommunications Reports, July 27, 2001. I think this is the daily edition where Cox was just -- the headline is cable telephony helps drive revenue increase at Cox. The bottom line is that Cox has 344,000 subscribers to its local telephone service and 14.5 percent penetration rate in areas in which the service is offered. That is the type of competition that you want.

You know, Reid Hunt when he talked about having created 300 telephone companies, we are not going to have 300 telephone companies competing in the local marketplace in any way that means anything in terms of adding consumer value and consumer welfare. The way we are going to get that is if we have companies that control in large part or at least most part, not necessarily entirely, but their own facilities so they can control their own costs and then you will have competition.

COMMISSIONER PALECKI: Is the capital investment needed for the facilities for a CLEC to gain entry in traditional telephone markets too great? What I see is that the CLECs that have invested in plant are usually niche market types of companies. And I keep hearing that the capital investment required to get into the traditional local telephone business is much greater than any CLEC could ever afford.

MR. MAY: There was a heck of a lot of money raised on Wall Street by any CLEC that had a business plan, particularly one that put Internet in its business plan someplace. But could you switch to slide 18 for a minute.

Here is one CLEC, Royce Holland is the head of Allegiance, one of the CLECs which is actually doing pretty well. And he has said, he said it in a different context, in different ways, but this was from this past February. He said UNE-P pricing levels, quote, "Could well be too low, which makes it more difficult for efficient facilities-based CLECs to compete." He is talking about for CLECs that want to build a business on a long-term sustainable basis, it is very hard for them to compete with the 360 CLECs that might be able to get into the business on the basis of artificially low, you know, prices based on TELRIC and the sharing requirements.

So you really, you have a choice between fundamentally these two visions. One in which ultimately and on a long-term basis will require you to be in the business of really regulatory management, micromanagement of telecommunications, or one that puts you more on the path of taking you out of that business with the idea that ultimately there is going to be competition and, you know, that is the choice you face every day here.

On this same point that I have been discussing, you know, and I think this is -- hopefully we can all come to some agreement on this, because it is central, but here is the FCC's way of saying it. Of course, it has said it over and over again, because facilities-based competitors are less dependent than other new entrants on incumbents networks, they have the greatest ability and incentive to offer innovative technologies and service options to consumers. And then then FCC Commissioner, now Chairman, of course, back in 1999, I thought that he put this same thing in a colorful way. He said, "A fundamental premise of competition and markets is that you are supposed to get your own cow. Competition policies should focus on the benefits and harms to consumers, not the effect on firms." Chairman Powell said that was just a precept that he thought flowed from the 10th commandment about not coveting thy neighbor's ox, I guess he had in mind.

Others who have remarked in the same way about why facilities-based competition is so crucial, Bob Sachs just a couple of weeks ago, the head of the National Cable and Telecommunications Association said that local telephone companies are most likely to come in the form of facilities-based competition over broadband cable networks rather than through the resale of incumbent services or the purchase of unbundled network elements. There at the bottom you can see Mr. Holland, again, making the same point as a CLEC, as the CEO of a CLEC.

On the point about the -- since I just cited the head of the National Cable Television Association, Mr. Sachs, let me just point out, I just got a letter July 18th from Dan Brenner (phonetic), who is the Senior Vice-president, Law and Regulatory Policy of the National Cable and Telecommunications

Association. All of these associations are changing their names, as you know, and he sent me an enclosure which was a report from Morgan Stanley Dean Witter, and in his cover letter he says, "The table on Page 10 provides some significant numbers on the availability of cable modem and DSL service. The bottom two lines of the table indicate that by the end of this year Morgan Stanley estimates that 77 percent of households past will have cable modem service available to it and nearly 50 percent of qualified DSL homes will have DSL service available. By the end of the 2004 the study indicates that 92 percent of cable homes past will have the modem service available to it, and 80 percent of qualified DSL homes will have DSL service available."

Again, it shows the projection by the cable folks that things are moving quite nicely in this broadband market, which, of course, is the market that is so important that we ought to be focusing on. And it shows how silly it is to talk about a DSL market as if there were such a thing.

Okay, let's skip over Justice Breyer, again. On 24, that is just a slide that shows the tremendous amount of investment to upgrade the infrastructure that will be needed on the telco side -- this relates to the telco and not cable or other infrastructures -- in terms of the investment that is required to provide broadband. You know, there are a bunch of estimates, but they tend to be in the 200 billion give or take

50 or $100 billion range.

On 25, this is, as you probably know, SBC decided to pull back from its deployment in Illinois of broadband services as part of its Project Pronto when the Illinois Commission required it to essentially share its broadband service, and Ed Whitacre, this is his statement that the Illinois Commission decision requiring SBC to unbundle and lease at TELRIC prices its broadband network, quote, "Has made it economically impossible for SBC to recover the cost of deploying and operating the new DSL service in Illinois."

Now, on the next slide we have got someone else who also understands how much investment is required to bring broadband service to the American public, and that is Mr. Armstrong, the Chairman and CEO of AT&T. And he put it this way, "No company will invest billions of dollars to become a facilities-based broadband service provider if competitors who have not invested a penny of capital nor have taken an ounce of risk can come along and get a free ride on the investment and risk of others." That was Mr. Armstrong when he was arguing against the proposals at the FCC which are still pending, by the way, of course, to require the cable companies to make available the capacity on their cable systems through the so-called open access policies.

And one thing that I want to emphasize is that, we at the Progress and Freedom Foundation, or I guess more importantly myself, because we don't always agree on everything. But, you know, I have argued and we filed comments at the FCC arguing that the cable companies should not be required to -- the FCC should not adopt any type of mandatory open access requirement. Of course, by another name that is just another type of forced sharing.

Some of the telephone companies, as you know, some of the ILECs have argued that if, you know, we continue to be regulated as we are at the present time and with the traditional public utility types of requirements, then in order to level the playing field, then at least the cable companies should be, you know, subjected to some of those same types of requirements. Again, the requirements are make available, you know, X amount of capacity, blah, blah, blah, at a certain price.

I believe very firmly that that is the wrong policy. We have argued the cable companies should not be subjected to that type of regulation. And I have argued that regardless of when the telephone -- when the regulators get around to reducing and relaxing the requirements on the incumbent telephone companies.

Shortly after Mr. Armstrong made the statement that I showed you, I thought that Chairman Kennard put it really quite well when he said, "It is easy to say --" and this gets to the nub, really, of what we are talking about and what I have been trying to say, and I thought he said it pretty eloquently. "It is easy to say that the government should write a regulation, to say that as a broad statement of principle that a cable operator shall not discriminate against unaffiliated Internet Service Providers on the cable platform. It is quite another to write that rule, to make it real and then to enforce it. You have to define what discrimination means. You have to define the terms and conditions of access. You have issues of pricing that inevitably get drawn into these issues of non-discrimination. You have to coalesce around a pricing model that makes sense so you can ensure non-discrimination. I have been there on the telephone side and it would be wrong to just pick up this whole morass of regulation and dump it on the cable pipe."

Well, as I have said, he was absolutely right about that. Chairman Kennard and the Commission under his leadership, unfortunately did not go far enough to really begin to relax and eliminate the traditional public utility type regulation on the incumbent telephone company's provision of broadband services. I mean, it seems to me when you recognize it is wrong to dump that whole morass of regulation on the cable pipe, at the same time you are issuing the reports that I cited to you earlier in Section 706 and otherwise making speeches and so forth about the fact that what we have is a competitive broadband market with different facilities, infrastructures competing with each other. At the same time you are doing that there is a little bit of a disconnect about not going ahead and proceeding, really I would say a pace to deregulate at least the broadband, broadband side of the equation.

I mean, at PFF very early on we developed shortly after the 1996 Act what we called our containment philosophy in which we really suggested, and I think this could have been done consistent with the '96 Act, but that would get us probably into long legal discussions that we don't have time for today. But that, you know, the regulator should have drawn a line between narrow band and broadband services, which frankly and honestly over a long period of time I understand even that line, that line would not be sustainable on a long-term basis, but you have to get from here to there if you have the right vision.

And what the regulators should have done was not -- we should have deregulated the -- should have deregulated the ILEC provision of broadband services. You know, again, the consumer welfare ultimately is not going to be dependent. I understand how many times that Ms. Ashdown referred to small businesses, and, you know, we are all in favor of small businesses when they can compete efficiently. And I understand that. But ultimately what you need to think about is whether you are moving towards a facilities-based environment in which you have facilities-based businesses as much as possible, and not whether they are small, you know, or large businesses.

COMMISSIONER JABER: Mr. May, I think Ms. Ashdown made a very good analogy to calling DSL part-free, part-slave in the sense that it is tied by definition, it is a technology tied to the local phone company.

Short of structural separation, is there a way as you say to partial, or to deregulate DSL provisioning? Assuming, of course, I accept the notion that it is regulated.

MR. MAY: Assuming that you accept the notion that it is regulated. Because I was going to say if it is part-slave, part-free, you know, which may be a good characterization of its present state, then you can free it or subject it to more slavery. And I would free it.

But I'm not sure I understand even the nature of the question in the sense that to me ultimately, again, it doesn't matter -- no one, I don't think anyone here is really talking about, when they talk about structural separation, maybe I'm wrong, but I don't think they are talking about requiring the incumbent to really divest and have completely separate ownership of this affiliate. I mean, in a sense that it would not be common ownership.

Because if you did it completely and absolutely, which I don't think would be a good thing for efficiency reasons, but presumably if you did that, you know, so that you had divestiture -- I mean, structural separation, as I said before, is really on a continuum just to me another -- I mean, it's hard to understand what that means in the context. It is just extreme regulation.

But if you actually had a divestiture, you know, what would that really mean is would you then -- presumably the LoopCo that was left wouldn't have any incentives at all, would it, to discriminate against the former affiliate, former part of the Bell company that was now divested. Its incentives would be to treat everyone alike at that point, if that is what you wanted really to do.

Now, you would have all the transactional costs and, you know, in Pennsylvania they claimed a billion dollars and so forth, you would have a lot of transactional cost and we couldn't agree on exactly -- I don't know what they are precisely. But one thing you probably don't hear people saying that are advocating that is then you would deregulate, that after you had done that, would you deregulate the wholesale part of the company that is remaining? It wouldn't have those -- it wouldn't have any incentives to discriminate. Would you deregulate the wholesale company at that point? I mean, that is the key issue.

Now, I don't think -- I think you should let companies make that decision themselves. You know, maybe some company at some time -- once in awhile I see the CLECs say that, you know, in some situations some company came along and they decided voluntarily to separate themselves, you know. And that's fine when a company does that, when it tries it figure out the efficiencies that are lost or gained from doing that.

But the ultimate issue is not going to be how are you going to regulate the retail company, but whether you are moving to an environment in which you are going to have -- where you are not regulating forever. I know we have to get from here to there in a certain way, but where you are not regulating the LoopCo. But you don't hear anyone talking about when you have this divestiture that at the same time you should -- they are not going to have a non-discrimination -- they wouldn't have an incentive to discriminate. Well, in theory I think the first thing -- I mean, the only way that type of thing would make any sense is if you would immediately say at the same time, well, now we don't need anymore -- now we don't need all of these rules about non-discrimination, right, and sharing, you wouldn't need them.

COMMISSIONER PALECKI: Let me ask you a related question. I agree with you that forced sharing of facilities is not working. I also agree with you that companies are unlikely to take risks and make large investments if they are forced to share the fruits of their risk and investments.

MR. MAY: Could I just say one thing, and I'm sorry to interrupt, I apologize. Because I said -- I wanted to make this clear. When I say it is not working, the reason I started my presentation as I did, it was not to the say that nothing, that we haven't made some progress under the current regime. I would rather look at it and think about it in terms of where we are now and what works best, you know, from here forward in terms of where you are, rather than going back and saying, you know, could we have done this or that. Because I showed that in my view -- I mean, maybe we disagree about how much competition that is, but I think we have made a lot of progress.

COMMISSIONER PALECKI: I thought I heard that forced sharing was pervasive. I didn't get the impression that you really thought forced sharing was a good thing.

MR. MAY: And there is too much of it. I'm just trying to be forward-looking here rather than casting backwards.

COMMISSIONER PALECKI: And I guess the point I'm trying to get at is it seems that some of the arguments that you are making also support the argument for structural separation. And let's say we went to a structural separation scheme where we have forced sharing of existing facilities by the RBHC wholesale provider. I think you have called it the LoopCo. No forced sharing of new investment by the RBHC CLEC company or any other CLEC. Head-on-head competition, all the investment and risk would be only for the profit of that particular company. Wouldn't that scheme work?

MR. MAY: No. It is completely contrary to the vision of where you ought to be going, because you said -- you just said, Commissioner, you wouldn't have any forced sharing with the RBHC CLEC. As I was explaining to Commissioner Jaber, that is not the issue. The issue is whether you envision that you are going to need to continue to regulate for the indefinite future what we can call the LoopCo because it remains a monopoly, essentially an essential facility and whether, you know, that is what you envision. I don't envision that at all. I don't think that is what the Telecommunications Act of '96 envisions or even your own statute. Let me just --

COMMISSIONER PALECKI: But under that scheme wouldn't we see investment in new facilities, wouldn't there be a great deal of motivation on the part of all of the CLECs, including the newly created CLEC --

MR. MAY: No, of course not.

COMMISSIONER PALECKI: -- to invest in their own facilities?

MR. MAY: No, you wouldn't, except to the extent that you deregulated the LoopCo. Because the implication of what you are saying, and I think this is what you are saying, is that you will continue to regulate the price of the input that the LoopCo makes available to the CLECs, including the RBHC

CLEC, but all other CLECs, is that correct?

COMMISSIONER PALECKI: Correct.

MR. MAY: And as long as you are doing that, and let's say you do it under a pricing scheme called TELRIC, which is the current regime, and maybe there will be another name, but if you are -- as long as you are doing that at a price, if the idea is that you have to regulate that price in order to make sure that the number of CLECs, you know, a certain number of CLECs survive in the marketplace, or how are you going to know, why do you want to regulate that price when you have -- when you have an increasingly competitive environment in terms of the infrastructure that is going to be used to develop these 21st Century services?

I mean, whether or not -- the basic answer is, as I showed on a number of those slides, as long as you are regulating the LoopCo at TELRIC prices and under non-discrimination rules, then the incentives of the CLECs themselves are diminished in terms of going out and constructing their own facilities. I mean, why would they do it if they can get that input from the RBHC at a price that is cheaper, lower than what they could do it themselves.

And if it is not cheaper or lower, it is only because you are trying to figure out as the regulator, and I spent a decade or so of my life before state commissions, you know, challenging Bell cost witnesses, so I know what those rate proceedings are like, and one thing I know is that no one ever agreed on, and obviously couldn't and wouldn't on what the real cost is, but that is what your question implies that you want to do. Because there is no incentive to go out and build facilities if you can get them from LoopCo at the regulated TELRIC price. That is what Justice Breyer was saying, that is what Royce Holland was saying.

COMMISSIONER PALECKI: I thought I saw somewhere in your presentation the fact that the final loop was a concept that is -- that new technology will eliminate the need for reliance on the RBHCs for the final loop. So won't there eventually become the time when that wholesale provider is maybe not even needed under your argument?

MR. MAY: Well, absolutely, and the time is getting close, and that's why it doesn't make any sense to be talking about going through this structural separation hullabaloo, because, you know, the time is near. I have here -- if I cannot lose my mike --

COMMISSIONER JABER: Your point is that structural separation might, in fact, take away the signal to the market or an incentive to the market to create and encourage new technologies, other technologies?

MR. MAY: Exactly. That's a great way of saying it, another way of saying it. I mean, that is a good one, is that it is certainly giving a signal to the market that you, as a

Commission, have chosen choice number one concerning a continued path for the indefinite future of regulation. Can you go to Slide 33. That you have chosen choice number one rather than choice number two. And that is a bad signal for the market in terms of whether to invest in new facilities.

Because when you do that, you want to capture -- I think this is what the Commissioner was saying earlier -- you want to be able to capture the opportunities, the revenues from your investment. You don't want to have to share them away. I mean, that is what Justice Breyer was saying. I mean, to make this point as well in terms of where we are, I mean, you are exactly right. The whole -- I mean, it's important -- we haven't said it very much today and that is my fault, but understand we are talking about technologies here that are quite dynamic.

I mean, I think Ms. Ashdown gave an illustration about walking through a Barnes and Noble to a book store in the back or something. It doesn't quite compute with the nature of these very dynamic technologies that we are talking about. Here on July -- can you go to 31. While you are doing that, I will just quote from -- here is Michael Armstrong, again, from AT&T on July 24th. "We want investors to see that AT&T broadband is not just the nation's largest cable TV company, but the leading provider of integrated residential" -- note residential -- "broadband services."

I mean, what you have to think about -- ought to think about is the competition that is developing, and quite nicely and rapidly among these competing technologies. Look at the next slide. You probably read about Microsoft. I mean, we have all read more than we may wish to have read recently about Microsoft, but the article in the New York Times on June 12th had this to say, "Microsoft is preparing to include --" well, basically to make a long story short, the next version of XP is going to have another -- some advanced software for offering Internet telephony.

And one of the analysts quoted in the article, Mr. Isenberg, I thought put it succinctly. He said, "Microsoft is going to suck the value out of the telecommunications companies." You know, I don't know whether that is -- I mean, I'm not smart enough to know actually whether they are, but I wouldn't want to bet against Microsoft doing that.

But I think the important point is, really, for you as regulators is on a going-forward basis in terms of what we know is happening in the marketplace and the technology, is not to put yourself in the position either of thinking that you necessarily know for sure whether it is going to be -- whether the cable companies, or Microsoft, or, you know, these wireless phones, that we know who is going to suck the value out of today's incumbents.

I mean, I think what really is important is that you opt for that second choice, you know, one in which you are moving towards a deregulatory framework that is applicable to all of the telecommunications providers.

COMMISSIONER DEASON: Are you concluded?

MR. MAY: That's all I have.

COMMISSIONER DEASON: Very good. Any final questions?

MR. MAY: Thank you very much.

COMMISSIONER DEASON: Thank you, Mr. May.

COMMISSIONER PALECKI: Thank you.

COMMISSIONER DEASON: We will take a break at this time and we will reconvene at 11:05.

(Recess.)

COMMISSIONER DEASON: I would ask you to take your places. We will reconvene the workshop.

Ms. Caswell, you may proceed.

MS. CASWELL: Verizon has three speakers today, but before I introduce them I would like to emphasize that this is not just a BellSouth issue we are discussing in this workshop. This is instead a defining moment in terms of Florida's telecommunications policy.

AT&T's petition presents the Commission with a choice of two fundamentally different regulatory models, and Mr. May raised this theme in his presentation. Under the first model, the Commission will continue to shepherd the transition to full local competition through a market-based approach. This is the model underlying the market opening measures adopted by the U.S. Congress in 1996 and by the Florida Legislature in 1995. It is the model that has led the FCC to affirm the determination of state regulators in New York, Connecticut, Texas, Kansas, Oklahoma, and Massachusetts that local markets are irreversibly open to competition with all the consumer benefits typically associated with such competition.

Indeed, it is the model that led Pennsylvania to reject structural separation and then to approve Verizon's 271 application just three months later. It is a model that works.

The second model, the one the CLECs urge opts instead for heavy-handed government micromanagement that assures the local loop that will indefinitely remain a monopoly. This approach would negate all the work the Commission and its staff have done in UNE, collocation, and OSS proceedings among others. As you recall, the CLECs prompted the Commission to initiate all these proceedings. Now apparently they don't like the results, so they have asked for a radical change in direction, one that you don't have the authority to take, as we discussed yesterday.

We are here today to talk about why you shouldn't consider structural separation even if you had the authority to the do so. You have now heard from all the CLEC speakers, and probably the most striking impression of their collective presentations was the lack of any specifics about the alleged problems they are experiencing. As BellSouth pointed out in its motion to dismiss, AT&T's petition was devoid of any facts in support of its claims. And its amended petition was, too. So we expected that surely AT&T would bring someone to address that point and to prove to you that a problem exists.

Certainly you couldn't be expected to open an extremely expensive and protracted proceeding to consider structural separation without some convincing evidence of an extremely serious problem. But what we heard from the CLECs, once again, were vague generalities, some anecdotes from other states, complaints about the FCC not having gone far enough in opening up the ILECs' networks, and complaints about the CLECs' inability to get any more funding.

The only conclusion to be drawn here is that there is no problem, at least not a problem of the ILECs making. It's not the ILECs fault that the capital markets have dried up for some CLECs, many of which did not have realistic business plans in the first place. And imposing structural separation on BellSouth won't solve the CLECs problems and certainly won't help consumers. It is preposterous to believe that you can break up a multi-billion dollar company and retain the same cost structure. What would, in fact, happen as you will hear today from the speakers, is that both wholesale and retail rates would go up as a result of structural separation.

What the CLECs will tell you, of course, is that they need you to open a proceeding so they can give you all the details of BellSouth's anticompetitive abuses. But given the importance of this workshop proceeding to the disposition of -- to the Commission's disposition of AT&T's petition, don't you think they would have come forward with some hard facts showing a problem so serious that it warrants an extreme remedy like structural separation?

They had a lot of impressive lawyers and consultants, but no one with any specifics about real problems in Florida that would justify structural separation. There are no such problems. Florida's markets are open to competition.

As Mr. May told you, 39 percent of Florida's zip codes have seven or more CLECs, while the national average is 9 percent. In Verizon's service area, competitors have about 35 switches, collocation everywhere, and massive amounts of fiber in all the right places to obtain all the most lucrative customers. And I'm sure the situation in BellSouth's territory is much the same. The federal act and Florida's telecommunication law have created the open market conditions that they are supposed to.

Our speakers today and BellSouth's speakers will give you all the information you need to understand why structural separation is not necessary and why you should give no serious consideration to AT&T's petition. Our first speaker today is

Mr. Dan Whelan, who is the President and CEO of Verizon Pennsylvania. Mr. Whelan will give you a firsthand account of the Pennsylvania Commission's evaluation and rejection of structural separation.

Our second speaker, Mr. John Malone, is President and CEO of the Eastern Management Group, a consulting firm that supplies services to communications companies world-wide. Before forming the group in 1979, Mr. Malone spent ten years at AT&T developing corporate strategy and managing sales and marketing organizations throughout the U.S. Mr. Malone will explain why structural separation would harm consumers, the state's economy, the ILECs and even the CLECs themselves.

Mr. David Leach is Verizon's last speaker. Mr. Leach now leads the telecommunications practice at the D.C. law firm of Dewey Ballantine. He spent 17 years on the staff of the U.S. Congress and was closely involved in all efforts to rewrite the Telecoms Act since 1977. Mr. Leach will explain why the CLEC structural separation proposal is inconsistent with the Act. And with that I will turn the floor over to Mr. Whelan.

COMMISSIONER DEASON: Apparently the microphone is not working.

MR. WHELAN: I think it is on now. I am here to talk about Pennsylvania. You have heard a lot over the last day and a half about what has happened in Pennsylvania, and I would like to clarify some of the things.

First of all, the Pennsylvania Commission conducted an extensive, protracted two and a half to three-year investigation of structural separation, as well as a number of other issues. That process, as evident from just the length of time, consumed tremendous amount of resources of the Commission, the Commission staff, the Commissioners themselves, and the proponents and opponents of the various issues of structural separation itself.

In terms of Commissioner input, the Commissioners themselves individually spent time in workshops like this, spent time in trying to research several negotiated settlements through that three-year process. There were actually three attempts by the Commission to put forth something called term sheets, which constituted a compromise of issues of a number of parties. None of those term sheets, I might add, included structural separation.

After initially concluding in September of 1999 that structural separation had merit, but at the same time concluding that the Commission lacked the necessary evidentiary base to move forward with full structural separation without a very detailed analysis of the cost, benefits, and the manner with which it was achieved, it nonetheless voted that at least preliminarily it would proceed to move Verizon Pennsylvania into a structurally separated organization.

We appealed, Verizon appealed, as did a number of other parties appealed the Commission decision, and in the course of that appeal Verizon and the Commission reached yet one more settlement. That settlement did not include structural separation. The settlement was opposed in the intermediate court in Pennsylvania successfully as beyond the jurisdiction to consider at that point in time because of a quirk of Pennsylvania appellate practice.

But in issuing that settlement the four Commissioners that were then sitting unanimously said that the settlement that had been achieved, which did not include structural separation, was more than adequate to move the marketplace forward.

In any event, as a result of the Commonwealth court's decision both on the settlement that had been reached and the substantive underlying issues, the Commission commenced another proceeding that concluded by a Commission order that was adopted on March 22nd and entered on April 2nd, which in the first instance adopted the already agreed-upon structural separation that Verizon and Bell Atlantic and GTE had agreed to with the FCC for purposes of the GTE/Bell Atlantic merger that was the sole portion of the order that did anything with respect to structural separation. Everything else was left to a functional separation of the wholesale and retail units.

Functional separation was a term of art that was defined in the underlying global proceedings that covered three years. That functional separation was the manner in which Verizon had been operating before, during, and after the global order and before, during, and after the structural separation order that was entered on April 11th.

Significantly, in reaching its conclusion not to move forward with structural separation, the Commission determined that it was difficult to determine in advance the best or most efficient market structure, that structural separation would be costly, although they didn't reach any conclusion as to what the exact cost would be, and that contrary to the preliminary decision in September of '99 that structural separation would not yield a decrease in regulatory oversight, it would actually add to the benefits, much as you were suggesting, Commissioner Jaber, that the burden doesn't go away.

Additional burdens are created. You still need a UNE docket. You still need a collocation docket. You probably will need a cost allocation docket. You still need the various collaboratives that were referred to yesterday in terms of an electronic loop collaborative, a DSLAM collaborative, and other collaboratives as technology changes and the demand by the CLEC community for additional functionality in the network rise.

You still need a code of conduct. You still need service standards. Except now you need two service standards unless you are going to deregulate both sides of the separated entities. You still need, I believe, a performance plan and you probably still need performance metrics and performance penalties. So from your standpoint, your burden doesn't go away, your burden grows.

I think, though, that in addition to the burdens that are on you, you have to understand and consider the harms that are going to occur, one, to BellSouth or Verizon, and the harms that are going to occur that are going to act to the detriment of consumers.

In the first instance, as was being discussed with Mr. May, I have a very hard time as the operator of a local telephone company, which coincidently has about 7 million lines, so we are a little bit bigger than BellSouth in Florida, substantially larger than Verizon in Florida. In that environment where I am the only presumed network supplier, a presumption which I challenge, I have little incentive to invest. I have little incentive to upgrade my network unless you assume that I am forced to upgrade my network in order to compete with the other networks that are being constructed and that are already out there, be they a cable network or the various networks that I don't know Florida, but I would be very surprised if there aren't multiple networks in Miami, multiple networks in Tampa as there are in Philadelphia and Pittsburg.

COMMISSIONER JABER: Could I interrupt you for just a second on that point.

MR. WHELAN: Sure.

COMMISSIONER JABER: There is some merit to the notion of recognizing that DSL is just one technology among the many technologies used to provide Internet. And if the ILEC had a separate wholesale company, even if the Commission didn't direct that wholesale company to upgrade its systems, it would be forced to do it because the market then would dictate that the ILEC do it just to compete with all of the other technologies that are faster, more efficient.

MR. WHELAN: I think that is a fundamental flaw -- I agree with that statement, but I think that is a fundamental flaw in the logic of going to structural separation in the first instance.

COMMISSIONER JABER: Why? I think that was actually one of the strongest arguments.

MR. WHELAN: Well, if there are multiple suppliers of service out there and the representative from IDS this morning specifically stated that she or some of her clients spend a million dollars a year with XO Communication. XO Communication, at least in my experience in Pennsylvania, is a fully integrated end-to-end supplier. They supply both local telephone service, they supply Internet access via DSL, and other higher bandwidth than DSL.

So you have got a situation where we know from the statements this morning that at least in some portions of

Florida you have got contrary or competitive suppliers of facilities-based carriage in the context of Miami, Orlando, Tampa, I would suspect. I don't know, but I suspect that each of those large metropolitan areas have competing networks, and integrated competing networks.

And you would be relegating one supplier, BellSouth, Verizon, to have no, no entry into a marketplace other than through as a mere wholesaler. In that situation, you are competing, you have -- as the quote from Justice Breyer, you have got no incentive to make such investment except in those area -- at the very most except in those areas where you have competing networks.

That leads you to a situation where there are not competing networks, at least at present in the more rural portions of Florida you are left with a single supplier. That single supplier will have very little incentive to upgrade those networks as it would have if it could realize the benefits, at least in part, of the retail services that it would tend to offer over that network. It is a very, very dangerous strategy. It is a very, very dangerous strategy.

But putting aside those big global kinds of issues in terms of capital deployment, you have this huge, I think, huge potential for very sharply increased rates. Both on the wholesale side, on the retail side. I have been through one divestiture in 1984. I managed, I was practicing law at the time, I managed the divestiture case in 1984 in Pennsylvania. That was a very -- and I'm sure you had the same experience here, if you have staffers here that were on the Commission at that time, it was a very, very contentious, very, very difficult process with lingering service problems that continued well after 1984.

But from a consumer perspective today in Pennsylvania, five to ten percent of the calls into our service center are for calls to long distance carriers that people still don't understand yet who their actual provider is. So that confusion factor is going to be very, very significant under any of the scenarios that have been presented over the last day and a half.

But more importantly I think is that whatever the costs are, you know that again and again in merger after merger, synergy savings are defined when two companies merge. I don't know what the state of the law here is in Florida, but in Pennsylvania we had to go through a process, the savings had to be quantified in the GTE merger, they had to be quantified in the NYNEX merger.

Well, if there are synergy savings from a merger, I think it follows that there are diseconomies from the separation. And those diseconomies, if you choose as the Pennsylvania Commission chose not to accept our number, if there are not 800 million of one-time expenses and $300 million of on-going expenses, on-going inefficiencies, if it is half of that the impact on Pennsylvania ratepayers would have been somewhere in the 2-1/2 to $3 range per month.

And I go back to my experience in the divestiture case in 1984. Rates rose in 1984 dollars by roughly $400 million a year. Some of that was -- some of that was recovered through access charges, but a significant portion fell to the residential consumer. I tried to -- last night I tried to contact somebody to quantify what that number was, and I can only go by my recollection, but it was somewhere around $2. I don't know how $2 goes over in Florida, but $2 was a big battle in Pennsylvania back in 1984. So there is that aspect of it.

COMMISSIONER PALECKI: Let me ask you a question about that.

MR. WHELAN: Sure.

COMMISSIONER PALECKI: Didn't divestiture eventually work to create a competitive environment in which we had pressure, downward pressure on rates.

MR. WHELAN: Yes.

COMMISSIONER PALECKI: So we had a situation where somebody had to bite the bullet and say, yes, it's going to cause a short-term increase in expenses to the ratepayers, but we recognize that there is a long-term benefit.

MR. WHELAN: Well, I agree with you that the toll mark is substantially more competitive today than it was in

1984 and there are rate reductions. But it is interesting to me, anyway, that when you hear five cents a minute or seven cents a minute, the last time I checked the FCC reports the average revenue per minute by AT&T was something approaching 20 cents a minute on the toll side. So there is still substantial, I will call it, lack of competition on the toll side.

I agree with your premise, however, but the question for you is do you end up with a more competitive marketplace if you constrain one supplier, Verizon or BellSouth, one supplier to nothing more than a wholesale operation. Do you end up with true competition. And I say looking at, again, I can only rely on my Pennsylvania experience, I compete in Philadelphia, which 25 percent of my lines are in Philadelphia and Pittsburg, within the city limits of those two cities. I compete with Comcast Cable, who is offering services that they market right now through an affinity program with the Philadelphia Chamber of Commerce. I compete with them. They are a wholly integrated supplier, completely vertically integrated using their own facilities.

Now, how do I compete? Why do I invest as a LoopCo, as a wholesale company in order to compete against them? I need some incentive to roll out new investment. And the incentive isn't there if by definition I'm only going to get incremental cost. But to the extent that somehow this is seen as a way of getting UNE rates at some kind of a level without all the noise that I will admit is in the equation in terms of integrating with the CLECs, the fact is you are going to be forced to first do a cost allocation between the two companies.

Secondly, you are going to have to look to the accounting results, not the forward-looking incremental cost of UNE rates at that point in time, because the constitution trumps the statute. And you have got to give us -- you would have to give that loop company a constitutional rate of return. I think you all know that since everybody has been arguing for forward-looking incremental cost, everybody on the competitive side, you know that the accounting costs are going to be higher. So, by raising the UNE rates, I think you would have to ask yourself does that help or hurt competition.

Number two is you then have the situation, I think you would have no choice if you truly want to get the competitive marketplace on the residential side and on the retail company, those rates for every service would have to rise to the imputed cost or the actual cost at that point in time that retail was experiencing. So I don't know what your residential are rates in Florida, I would suspect they are in the $15 range.

(Telephone interruption.)

COMMISSIONER DEASON: Wait just a moment. I think we are going to address the problem. You may proceed.

MR. WHELAN: Again, I don't know what your UNE rates are, but if you assume a substantial increase in your UNE rates, I think by definition you have to assume a rather substantial increase on your residential and business dial tone line rates. I think the other -- getting back to the Pennsylvania decision, I think the other fact that substantially moved the Pennsylvania Commission off the concept of structural operation was the competitive inroads that the competitors were gaining, making in Pennsylvania despite structural operation.

The FCC report that was referenced earlier by Mr. May, in Pennsylvania at the end of 2000 by the FCC's report there were a million competitive lines in Pennsylvania. Shortly before, about six months before, or nine months before that report was released, the PUC issued a report to the Pennsylvania legislature in terms of the active telephone numbers that CLECs had in use in Pennsylvania as of October of '99, and that was 1.4 million customers, 1.4 million active telephone lines. That represents that the quantification by the FCC was roughly 10 percent at the end of 2000. If I recall, the quantification for Florida was 8 percent at the same point in time.

Significantly, when New York, Verizon New York gained FCC approval, just shortly before they gained FCC approval in December of 2000 -- December of '99, excuse me. December of

2000. '99. December of '99, the New York Commission found that market penetration by the competitors was 8.9 percent. Now, what has happened in New York since then? A recent report just issued yesterday by the New York Commission said that as of the end of last year 21 percent of the local service lines were being provided by competitors in New York of which 52 percent of those were to residential customers.

What caused that entry, what caused that dramatic change from roughly 9 percent to roughly 21 percent overall? It was the threat provided by the entry by Verizon New York into the long distance market in New York. The net effect was primarily MCI, MCI entered big time shortly before it came obvious that New York was going to get relief, Verizon New York would get relief. They dramatically increased their marketing to local customers through the base that they hold and the relationship they have with their long distance customers. And they grabbed market share.

The same thing has happened in Pennsylvania. We filed in June the 271 application with the FCC. In October, starting in October of last year, I have been losing to competitors roughly 40,000 residential lines per month each and every month since October of '99; 40,000 residential lines constitute one percent market share. But coming back to the point of --

COMMISSIONER JABER: What have you gained in DSL customers?

MR. WHELAN: DSL, we have just over 200,000 customers. Just about 200,000 customers.

COMMISSIONER JABER: And that is an increase from 1999?

MR. WHELAN: Oh, it is a substantial increase. Now, on that point, the good news is, and I will paraphrase the VP of Operations of New York, Larry Babbeo (phonetic), the good news is I have 200,000 DSL customers. The bad new is they all call me on Saturday afternoon with problems on the line. The fact is DSL is a very, very difficult installation. It is a complicated installation. You're trying to take what is essentially a voice network, a voice designed analog network and transform it into a digital network.

Part of the problem, as I'm sure you are aware, is at least in Pennsylvania we have been actively placing fiber since 1994 into the feeder and distribution plant when we reached accommodation with the state legislature and with the PUC to modernize the network. DSL doesn't work today over fiber unless you start putting the DSLAMs out into the remote terminals. So, DSL is a very, very difficult installation.

We are having problems when we provision our own customers directly. The problems are experienced by the ISP, the information service providers when they are acting as the agent for the customer in the securing of a DSL line. It is a start-up technology. In many ways it's like you and I, or I won't denigrate you, its like me trying to program my VCR. It's a hard installation. It is a very, very hard installation.

COMMISSIONER JABER: It would be okay for you to include me.

MR. WHELAN: It's that constantly blinking light that says 12:00 o'clock that gets me so frustrated. But the point of all of this is, as Mr. May suggested, there are going to be resellers in the marketplace that simply resell the services of others. But there are also going to be large integrated end-to-end suppliers in the marketplace. The latter will ultimately drive the marketplace.

And in terms of the fallout in the marketplace that has occurred, I would ask you to look at your history in the marketplace, in the long distance marketplace. In 1983 and '84, in anticipation of divestiture, hundreds of resellers entered the marketplace. Hundreds of long distance resellers entered the marketplace. What has happened to those hundreds of resellers? There are still a number of them out there. But they have consolidated, they have moved the facilities carriage, they have been acquired, their customer base has been acquired usually by facilities-based carriers.

Are there still niche resellers out there? Yes, there are. Are the people that drive the marketplace those niche resellers? No, it is the head-to-head facilities competition that exists.

Furthering the decision that the Pennsylvania Commission made, ten weeks, approximately ten weeks after they reached the conclusion on structural separation, they concluded that the market was adequately opened, that we were fully compliant with the 14-point checklist, and they filed a report with the Federal Communications Commission that the market was adequately, irretrievably, irreversibly open to competition despite the lack of structural separation.

And I might add that AT&T in the interim between the first decision and the -- that is the structural separation decision of March 22nd and the June 6th determination that we were checklist compliant, AT&T sought to clarify the Commission's definition of structural separation that it would require Verizon Pennsylvania to pass all its retail orders through the same interfaces as the CLECs. And the Commission -- and, again, in a 5-to-0 vote said, no, that is not what they meant by structural separation.

That is an aside, and I only mention it because it was brought up yesterday that if you are not going to do structural separation at least require the ILEC to pass the orders through the order interface systems of the incumbent company.

COMMISSIONER PALECKI: Can you tell us some of the key points about the Pennsylvania settlement?

MR. WHELAN: Yes. The settlement was a public -- the settlement at the -- I cannot go into the details of the proposed settlements of the three, what are called the three term sheets in the global case, that is the ones that predated the decision ordering structural separation because there was a confidentiality agreement among the parties and among the Commissioners.

But the settlement that was reached in the context of the appellate process was a public document. And that settlement said no structural separation, functional separation only. A code of conduct that was going to be revised with no definition of the revision, but there would be a process to revise it, that there would be certain added levels of penalties for nonperformance under the Pennsylvania performance plan. There was a creation of a consumer education fund. The agreement to a universal service fund that would last -- that is an intrastate universal service fund that would last a couple of years. And there was a temporary reduction in the most rural areas of Pennsylvania on the UNE rates. There were other provisions, but they are the ones that occur to me right now.

COMMISSIONER PALECKI: And how does the functional separation component of that settlement work?

MR. WHELAN: The functional separation component would require that all orders that come in from the CLECs would come in through a separate channel, which we call a TSOC, and I can't recall what that acronym stands for. Telecommunications industry service order center.

COMMISSIONER PALECKI: Would that include your own orders?

MR. WHELAN: No. The orders -- if you can picture a series of main frame boxes that have the legacy systems, the legacy software systems. Our service reps would take the orders that would flow directly into those legacy systems, and the legacy systems would then either mechanically, automatically, or with human intervention then get the order worked.

On the CLEC side, the CLEC systems would come into an interface system, the interface system would then hit the back office legacy systems, and then it would be worked by the people, our own people on the operation side. But the order taking, the pricing, the competitive intelligence that you gain through that is in a separate, separate organizational line that I never see, for example, that goes up and moves up toward -- and it only comes together in New York at an operational senior VP level.

COMMISSIONER PALECKI: Has the implementation of that program already started?

MR. WHELAN: The implementation actually predated,

predated the global proceeding. And we constantly defined the manner in which we were operating then through this separate organizational line. We defined that as functional separation. That was the only definition of functional separation in the docket.

Protecting the competitor in that situation is a very, very, extensive penalty plan. A very, very, extensive performance metric plan. In Pennsylvania the metrics had to be reported monthly by CLEC by subgeographical levels, six geographic areas in the state. And penalties are paid if the metrics are not met. That is similar in design, although the actual plan is different, but it is similar in design to the performance plans and the penalty plans that have been approved by the state commissions in Massachusetts, in New York, in Texas, Oklahoma, and Kansas.

COMMISSIONER PALECKI: Do you find that the program is working and have you received any feedback from the CLECs as to what they think of the plan?

MR. WHELAN: Well, the CLECs, like we have heard here today, had presented both in the global proceeding and in the proceedings before the state commission on the 271 application presented anecdotal evidence. That anecdotal evidence was rebutted by statistical evidence. We and they cannot run the business on anecdotes. I don't believe you, as a Commission, can run and manage the regulatory responsibilities that you have on an anecdotal basis. So I will use one example in the case.

Two CLECs were complaining vehemently about the adequacy of directory listings. That their white page directory listings were not, one, either being inserted or, two, when inserted were inserted in an inaccurate way. The examples that they came up with of inaccuracies were Daniel J. Whelan where the J was lower case, or there was no period after the J, living in Bethlehem City as opposed to Bethlehem in Pennsylvania. There were some obvious errors. There were some errors that were their fault, there were some errors that were our fault. The net of that was that depending on the book that you were looking at, the accuracy of the book was 96 to 98 percent.

So when you start to squirrel down and peel back some of these complaints, they range from, one, inapplicable, to they are on the side of the CLECs, there is a category it is very hard to say whose fault they are, and there is a category clearly we are at fault. That is in the nature of a volume business.

But when you look at the -- I don't know if you plan to have a third market test in Florida, but third party test of systems and how the systems are working. If you are going to do that, I would like to let you know what you are getting in for. KPMG performed the test in Pennsylvania. The Commission decided who would do it in Pennsylvania. They picked KPMG because of their expertise out of New York. That test cost Verizon of Pennsylvania $51 million. $51 million. At the end of the day, KPMG decided that we had gotten an A to A+; 92 percent of the various metrics and the various test points that they had, and they had thousands of test points, that we had all but 8 percent of them, 7 to 8 percent of them. And of the 7 to 8 percent that they had tested that we didn't pass, they had declared, KPMG declared them immaterial to a competitive marketplace. Sort of in the nice to have category. A car with a sunroof perhaps that we heard the car analogy earlier today.

So, the fact is you have got means at your disposal to assure parity. And that parity goes a long way to, I think, relieving many of the concerns or should go a long way to relieving many of the concerns of the competitors. I think one fact that I have always found somewhat useful in this debate, others have disagreed with it, but I presume in Florida as in Pennsylvania, the long distance suppliers compete with the local telephone company in the intraLATA market and compete on more or less an equal footing.

The same arguments in terms of equality of treatment, the same arguments about discrimination, the same arguments about dirty tricks you would expect to see in that long distance market, in the intraLATA long distance market. Again, I can't speak to any experience in Florida. But in the 15 years in Pennsylvania where I was competing head-to-head with AT&T and MCI, I'm not aware of one complaint of unfair inadequate treatment. And long distance, as you know as well as I, was a tremendous revenue stream even after divestiture on the intraLATA market.

COMMISSIONER PALECKI: But isn't there a really big difference where we have intraLATA long distance competitors that are competing head-on-head, none of them are dependent upon the other long distance competitor for assistance, sharing, or help, whereas in the local market, we have a situation where we are forcing the RBHCs through regulatory command and control to provide operations, installation, maintenance, assistance to competitors who are competing to take away a part of the RBHCs' market share not to the economic best interest of the RBHC.

And I guess that is the problem I'm having with the traditional command and control regulatory scheme we have seen thus far throughout this country, is we are asking an existing potential competitor to help the competitors that are the new competitors. And I'm not sure that that will ever work.

MR. WHELAN: Well, I think over the long-term, I think you don't want to move to a facilities-based carriage form of competition, but you can't get there by constraining one supplier to a narrow niche and the narrow niche being the wholesale market.

But continuing my analogy with respect to long distance, when a long distance carrier wants to initiate a customer relationship and that customer then wants to initiate a call through that long distance from -- what is intraLATA here -- from Tampa to Sarasota. That rides over the local facilities, it rides over the trunking facilities from the end office to the point of presence of the interexchange carrier, it then rides over that carrier's interoffice facilities, in many cases those interoffice facilities are leased from the incumbent company, and then at the terminating end the same thing happens.

So in many ways it is very analogous to what is happening in a shared arrangement. It is shared in the sense that the rates are set by you all as to what all of those pieceparts cost, and they have the choice of either building their own, buying from another competing carrier, or utilizing the end-to-end services of Verizon, in that case Verizon, or BellSouth. And you have the information, I don't. You have to tell me, aren't there multiple networks, end-to-end networks in Miami? In the 1999 annual reports of AT&T and MCI, I forget the -- when you break it down which had a little bit more, but I do remember the sum. They had 33 million voice grade equivalent local access lines reported in their 1999 annual report. That has to have grown since then.

They are lines that we never see over a network that we don't control or provide any service to. So, I guess the end result is, one, I don't see why you would want to constrain a significant investor to just running a railroad and not having any cars on the railroad and not having any -- determining whether you wanted any freezer cars on the railroad, just running the railroad. I just don't see why any investor would invest in a company that was so relegated. That's number one.

COMMISSIONER JABER: What would constrain them, what would restrict them, for example, from investing in wireless technologies or satellite technologies? I would think that a stand-alone BellSouth wholesale company would actually be able to have more leverage and attract venture capital from new sources?

MR. WHELAN: Well, and maybe I am misunderstanding what the proposal is. But the proposal, as I understand it, is to -- as it was in Pennsylvania -- to divorce the two companies, leave the network company with a number of subproducts, but one basic product, the provision of the railroad from Point A to Point B.

COMMISSIONER JABER: Right. But the only regulatory part that we would care about, I suppose, if we accepted the notion that it should be a separate company, would be the loop provider, the LoopCo as it has been referenced. There isn't anything that would prohibit the stand-alone wholesale company from investing in other technologies. We wouldn't interfere in the satellite, wireless, even investing in cable.

MR. WHELAN: Well, wireless is already separate. Cable, I would think that if you went through the split what would happen is that NetCo would wither on the vine. Retailco would start to build its own network. That's what would happen. So what you have is you have got a bunch of -- if you adopt the alternative proposal, the sort of the middle ground proposal which actually was also proposed in Pennsylvania by the Office of Consumer Advocate, in my mind that is the worst of all worlds. Because you end up with a legacy customer sitting there, and the example was given yesterday I believe by you, Commissioner, that said you mean I'm a 20-year customer of BellSouth and I move across the street and I can't have BellSouth. It gets worse than that. And this was addressed in Pennsylvania.

I'm a 20-year customer of BellSouth and I have one line and I want to order a second line. Is that second line with the legacy customer or with the new company. I want to order a feature. I don't have Caller ID on that line. Is that with or without. It gets very, very complicated when more and more large companies, like ourselves, are looking toward being an end-to-end supplier on a very broad range of services. We just don't have the -- we are just too large to revert to a niche player. We are just too large. The investments that you are talking about, you saw the $200 billion that are necessary to get from Point A to Point B with a broadband network. You don't get a $200 billion investment with a regulated return of whatever you are calling out these days as a regulated return. You just can't get there. That number I believe is just about accurate because we are spending -- in Verizon in total, we are spending about 17 or $18 billion, one billion of which is in Pennsylvania.

To put it in perspective, again, I have no idea what the Florida numbers are. In Pennsylvania in the year 2000, Verizon Pennsylvania, not including the piece of GTE that we merged with, that billion dollars was 50 percent -- it should be 100 percent higher than the total state capital budget of that year. The total state capital budget was in the $450 million range, we were just over a billion dollars. That is the kind of money that you are talking about. You don't get investments like that for a 10 percent, or 11 percent, or a 12 percent, if you would even give Verizon or BellSouth a 12 or 13 percent return. Not when you are confronting an integrated supplier like a Comcast, or an Adelphia, or for that matter an XO Communication.

COMMISSIONER PALECKI: What is your motivation or incentive to make the Pennsylvania settlement work? And I ask that question with the recognition that Verizon is being ordered through command and control regulation to help its competitors in a manner that is not necessarily in Verizon's best economic interest. So why is Verizon going to make that plan work?

MR. WHELAN: I think there are two reasons for that. Number one is we have heard -- I heard the debate or the commentary earlier this morning that long distance isn't worth very much anymore, long distance voice. The fact is the bar of interLATA participation by the Regional Bells restricts us from participating not only in the voice interLATA market, but the data interLATA market. You are simply not in the communications business today if you do not have voice and data.

Secondly, from our standpoint the long distance market remains on the voice side largely attractive. The rough rule of thumb that we have used in Pennsylvania vis-a-vis AT&T and MCI, that for every customer on the long distance side I gain, they have to gain two customers on the local side. And that is because the profit stream on long distance remains extremely lucrative for MCI and AT&T despite the cost -- excuse me, the price pressures that competition has created for them. So, we have got this huge pot of money out there that we are hoping to get after.

We realize that we can't participate in a true broadband marketplace unless we have interLATA relief. So we need that relief. And absent relief from the FCC, which we are not going to get unless we are providing closely regulated service at parity, or better than parity, that license, one, in the first instance will never be granted, and, secondly, once granted if we retreat and somehow slide back we will lose that license. And prior to losing that license we will have substantial fines.

I think the fundamental premise that troubles me is in the absence of any broad scale information that says that we are acting in an illegal conspiratorial way to foster such an extreme remedy -- I mean, the remedy that you are talking about is the Microsoft remedy, to divide a company. That is such an extreme remedy, that should be taken only after a very, very, very, very, strong showing of very, very, unlawful conduct. None of which has happened.

But in the bottom line, I come back to the proof is in the pudding. New York, Massachusetts, Connecticut, Kansas, Oklahoma, Texas, and hopefully in September Pennsylvania have all passed through the eye of the FCC's very, very narrow needle saying that the market is fully open to competition without this draconian measure of structural separation. And what has happened in each one of those markets? Each one of those marketplaces have seen a dramatic upsurge in competition, a dramatic upsurge in market share shift. New York being the preeminent example of 21 percent market share.

Doctor Bradford yesterday testified that he more or less uses as a litmus test a 10 percent figure. That once you get to a 10 percent market share loss, things are working. You know, he is pretty confident that the market is working fairly well. Those were his words. Well, you were at 8 percent under the FCC's view as of December of 2000. Where are you now? My guess is you are probably a little bit closer to 10 percent. And to take this risky step that clearly is going to add to your regulatory burdens, clearly is going to create tremendous confusion in the marketplace, is clearly going to add to the rate pressures on the residential side, most particularly in the most rural portions of your state. I think that is a step I would take very, very reluctantly. Very, very reluctantly.

COMMISSIONER DEASON: Are you finished?

MR. WHELAN: Anything else?

COMMISSIONER JABER: I have one question on the cost accounting. Perhaps I didn't understand what you were trying to say, but you cautioned us in separating wholesale from retail. You said there would be some costs, an automatic increase and perhaps an adjustment, a regulatory adjustment to account for that cost.

MR. WHELAN: I think there is an initial layer of cost allocation that you would have to do and then there would be a subsequent layer of cost allegation that you would have to do for many of the reasons that I talked about already, but I will try and detail them. To split the company in two, you are going to have to split buildings, people, trucks, desks, equipment, because there are some computers, there is computer equipment that go with one and go with another. Software systems, some of which are integrated software systems. And in the Pennsylvania model that is the biggest series of costs. You are separating, your separating software systems that are integrated software systems, so whole new systems have to be created largely on both, probably on both sides of the equation.

COMMISSIONER JABER: And some of the older equipment wouldn't have to be separated.

MR. WHELAN: Yes.

COMMISSIONER JABER: So then isn't the reverse of that statement also correct that we would also need to recognize that some of that expense has already been recovered through a rate of return regulation that is well over with when you transfer that older equipment to a new retail arm?

MR. WHELAN: Well, no, as a point of fact under the uniform systems of accounts no equipment is fully depreciated until the equipment is actually retired. So there is some book value related to that equipment. So you have got that, you have got that initial cost allocation, and that -- excuse me, that initial one equipment allocation followed by cost allocation questions of a variety that is identical to the cost allocations that occurred at the time of divestiture back in

1984, and that consumed to a large measure the debate that circulated then.

COMMISSIONER JABER: So are you saying we would have to go through that sort of proceeding before separation would occur to determine what has been depreciated?

MR. WHELAN: It's not just a depreciation question. Take, for example -- I would revert to 1984. The debate in 1984 was the Office of Consumer Advocate in Pennsylvania wanted as much cost as possible to go to AT&T. Irrespective of -- I will denigrate a friend -- irrespective of whether there was any rhyme or reason to the cost going over there. And the value of that is he recognized that if he didn't do that there wouldn't be sufficient revenues on what was left of Bell of Pennsylvania at that time to get to a constitutional rate of return.

So, there was a constant battle to shift costs to AT&T. The CLECs will have the same incentive. They will argue dump as much cost over to that retail company as possible in order to constrain the UNE rates. So that is the first cost allocation battle that you have. That battle was a very, very lengthy and very, very bitter battle in the divestiture scenario.

But then you have a second layer of cost allocation if you went to full structural separation. That cost allocation will result from the following: LoopCo will have to compete with XO Communication, a fully integrated supplier in Miami, Orlando, Tampa, and St. Petersburg, and those other places also have to compete with whoever the cable supplier is down here. I guess TCI is a player in big Florida. Will have to compete with those companies primarily in those urban and suburban and perhaps exurban areas around those cities. What will NetCo and LoopCo want to do? They will try and allocate as much of the construction costs, as much of the costs that they can legitimately send to the rural areas in order to minimize their cost structure in the urban areas when they are competing against XO and others.

So you will have that debate and that on-going debate because the XO Communications, the other network suppliers will then be in here arguing that BellSouth or Verizon in Tampa is seriously understating their cost in density cell one, in the most densely populated areas in order to unfairly compete with that other NetCo. I just don't see why you lose any problems. You gain an awful lot of problems. Even by Doctor Bradford's testimony you are within one or two percentage points of having something that he would define as an actively competitive marketplace. I say you are already at an actively competitive marketplace, and I would look to the eight or nine jurisdictions that have already approved 271 applications, look at how competition takes off in those marketplaces immediately before 271 entry, and then look at how they all have parity results. Look at the network performances of New York, of Texas, and other jurisdictions after entry has occurred.

COMMISSIONER PALECKI: And one further question. Under the Pennsylvania settlement, how will Verizon motivate its loyal, hardworking employees to provide excellent service in operations, installation, maintenance to the CLECs, or do we simply have a situation where we are going to continue to see lackadaisical response and continued problems forever?

MR. WHELAN: Number one, Verizon has, before a code of conduct was ever mentioned in a regulatory scheme, we have our own internal code of conduct. That internal code of conduct, we all review it annually, we all sign that we have reviewed it, we all sign that we -- not just me, all the way down to the newest installer -- that they have read and understand what that code of conduct is. A substantial portion of which is that we will not disparage the product and services of other parties.

We have had incidents where -- I won't say renegade, but overly enthusiastic employees have violated that code of conduct. And we have done everything up to and including discharge them for failure to abide by it. The fact is when the initial code of conduct was set by the Pennsylvania Commission we looked at that code of conduct, juxtaposed it to our existing code of conduct, and said, "What is different here?" We couldn't find anything different.

So, again, I can't speak for any other company except for Verizon Pennsylvania, and we think we have that incentive. We don't like to be fined. We don't like to pay penalties. We don't like to pay big penalties, we don't like to pay little penalties. Because we value our good name and we value the negative goodwill that is created when a newspaper reported that Verizon is fined $100,000 or several million dollars.

COMMISSIONER PALECKI: So penalties can provide an economic incentive to motivate your company and your employees to take action to help your competitors?

MR. WHELAN: Yes. To help our competitor to the extent required by law.

COMMISSIONER PALECKI: Which is to help them actually achieve the ability to take your customers away from you.

MR. WHELAN: Yes. The answer to that question is yes. AT&T, until they sold Lucent Technology, was the largest customer of Verizon Pennsylvania, the largest competitor of Verizon Pennsylvania, and the largest supplier to Bell of Pennsylvania. So we found that situation workable. AT&T never filed a complaint at the FCC, never complained about -- you know, they complained about rates, but they never complained in terms of filing levels of complaints about the level of service to Pennsylvania.

And that situation existed until the sale of Lucent. Which if memory serves me was '95 or '96. So that was ten years experience. We compete head-to-head in Pennsylvania -- and, again, I would suspect the same situation exists in Florida. We compete with a number of suppliers of broadband pipes, T-1s and above. Those T-1 pipes, we compete in a number of fashions. We compete head-to-head with customers, with competitors, facility-to-facility. We compete with competitors that buy our facilities at access rates. We compete with them. And to my knowledge there has never been any complaint about unfair dealing.

COMMISSIONER JABER: Are all regulatory penalties reported on your annual report to the stockholders?

MR. WHELAN: I don't know the answer to that, Commissioner.

COMMISSIONER JABER: I'm sure we are going to take a lunch break in a short while. I would like to know if all of the penalties are reported on your annual report. And if not all, is there a threshold amount.

THE WITNESS: I honestly don't know the answer, but we can try and find out at the lunch hour. Or if not during the lunch hour afterwards, and get back to you on that.

COMMISSIONER DEASON: Thank you, sir.

MR. WHELAN: Thank you.

COMMISSIONER DEASON: We will have the next presentation.

MS. LOGUE: Commissioners, the next presenter on behalf of Verizon is Mr. John F. Malone, President and CEO of the Eastern Management Group.

MR. MALONE: Good day, Commissioners. I find it a great privilege to have an opportunity to come back again and speak with each of you. I had a delightful experience two months ago, and we had a chance to talk about competitive local exchange carriers and difficulties and successes they may be having in Florida.

We are going to talk about a different subject today. And we are going to talk about it from my perspective as a management consultant, head of a company that has 400 clients worldwide, including ALECs, IXCs, ILECs, manufacturers, software companies.

I was having dinner last Wednesday evening in Washington with a client of mine. He is the CEO of one of the ten largest ALECs in the United States. They have got operations throughout Florida. Part of our conversation moved over to the subject of structural separation. And he knew I was coming here to talk. And he said, I am not part of the petition to require structural separation in Florida, even though it is one of our largest bases of operations. He said I'm not in favor of it because structural separation is not good for consumers. And he said, and I started this company to do good for people that I might serve, and this is not one way to do it. He said, I don't want you to think I like the Bells.

I don't like the Bells at all. But this isn't the way for me to run my business.

A couple of months ago during a piece of research and consulting work that our firm was involved in, we had a conversation with the chief operating officer of one of the ten largest ALECs in the United States, also with operations here in Florida, part of the conversation did drift over to the subject of structural separation. The chief operating officer indicated during the conversation that I don't want to see structural separation beset our company. And when we questioned him as to why, because there was a lot going on with structural separation at the time, he said it has taken us five years to get to a point where initially 100 percent of our roaters (phonetic) were rejected, and then we learned the systems and the practices and the procedures of interfacing with the ILEC. We have gotten to know the management and the personnel. And he said, and frankly, I'm just not willing to go back with structural separation and risk all of that again. He said I have really got to stay focused on turning a profit in this company, that is the only way that we are going to be successful.

So I find myself here as a consultant talking to you about structural separation. And if there is structural separation here in Florida, and you are going to make your own decision on that, and if you rule in favor of it then you will decide exactly what form it ought to take. But no matter what one might do relative to structural separation, if it is done consultants are going to be brought in to help the network company, the NetCo, or the wholesale company get itself established. And whether it is our firm or one of hundreds of other management consulting firms, I would like to try and help you understand exactly what process the consultants are going to go through as they provide counsel. Because under any and all circumstances if structural separation does take hold, the consultants are going to work to help each of the companies or any company that retains them to be as successful as they possibly can in the market. And so let's kind of look at the marketplace here.

What I have done is I have taken a look at the Florida market for purposes of our discussion. And here in Florida what we find is we find that according to NPRG, which is one source that people go to to find out who is out in the marketplace, NPRG says that there are 61 ALECs operating in the State of Florida. Operating, not just licensed, but operating in the State of Florida. In each jurisdiction there is one ILEC, as well. So there is 62 potential customers for the wholesale company to be going after. And the revenues that the wholesale company will get from these 62 businesses are going to bubble up from the consumers and businesses in the State of Florida. And according to Census Bureau reports, we have got

15.9 million consumers in the State of Florida and 421,000 nonfarm businesses. So that is the market.

Now, one, as a consultant, has to say to themselves is this a good market, and what are the opportunities here for the wholesale company. And so what we have attempted to do is to take a look at what the foundation is in this marketplace, that is what a consultant would do initially, just see how real this market is. And what we have done is we have taken a look first off at what is the situation like in the consumer portion of the market.

Now, I have heard a lot of anecdotes that say that ALECs really don't want to sell to the consumer. So two weeks ago, in getting ready for this discussion, we decided to test whether or not ALECs would be interested in selling to the consumers in Florida. Out of 61 ALECs, we talked with 30. Now here is what we did. I took one of the younger people on my staff, and I said get the addresses for these 30 ALECs in Florida, for the towns that they operate in, and place a call to the town. And when someone answers the phone, this is an ALEC now, indicate I am moving from New Jersey to Florida. Anyone would appreciate that, why not. And tell the person that you are talking to that you are moving and you need phone service. What you need is basic service, one extension line in the bedroom, $25 a month of long distance service. And then place the order.

At the end of the study, which only took a day and a half, what she reported back was that 28 of the 30 ALECs that had been contacted indicated that they would not provide service to her even though she had indicated that she was moving right down the road from where they were located. So, when we start to test the Florida foundation of the business, what we find right away is that the ALECs are not interested in selling to the residence customers in the State of Florida. Now, why is that? It's very simple reasons, and we have talked about it before the last time we got together. The average business customer that the ALEC goes after is a business that has revenues in excess of $1,000 a month.

COMMISSIONER JABER: Mr. Malone, in all fairness, is it that they will not sell telephone service, or they are not in that area, or they don't believe they can provide it in the time that the customer has requested? I look at your list, Intermedia -- someone needs to correct me if I'm wrong, but I thought Intermedia did provide residential service, for example. So it's not that 28 of these 30 will not. In all fairness there might be situations and circumstances that this chart doesn't point out to us, correct?

MR. MALONE: I have to respectfully disagree with that. In some of the areas we found that companies would provide local service. As you can see, for example, Grande Communications or Grande will not provide it at their location in Florida, but they will provide it in the State of Texas. In all cases what we did in the course of this small little survey was to indicate that the individual, the employee was going to move down the block from the ALEC's operation in either Tampa, or Miami, or whatever city they were located in. And these were the responses.

Now, it was not that maybe at a future point in time, or if we had the facilities, or you are asking for too many services. Those kinds of qualifiers, Commissioner, just didn't get mentioned. These were the answers. Sometimes they weren't even as friendly as a no. But that's okay. Those were the responses that we had gotten.

I think that what I like about it is that that little piece of work is replicable. And so anyone can go through the same exercise, provide the same phone numbers, the same data and one could do it all over again. And I would conclude come up with exactly the same result.

Now, businesses, that is where the ALECs want to focus because the revenue that they look for is $1,000 a month to $10,000 a month. Now, obviously they want businesses with more than that, but a lot of those people have already converted to dealing with ALECs. They don't want to sell to the residence customers because the residence customers are generating about $50 a month. And as we have talked about before, the cost of marketing to a residence customer is high.

Numbers of about $500 per customer to sign them up are not outrageous. If.

You have cell service, cellular telephone service and you went down to Circuit City to get it, whatever company you got it from, whether it was Verizon, or Voice Stream, or one of those companies probably paid Circuit City $350 just to pass that order. So $500 is a reasonable number to expect if someone is going to sell into the residence market. Or business market, for that matter. About the same cost for marketing to either of them. And with $50 revenue coming back to the ALEC, you are looking at about five to eight years to start to really recover your investment in having secured that consumer. So people are just not too interested.

Now, what we have, therefore, is we have 61 ALECs who are happy to sell to business and we have one ILEC, who is more that happy to sell to the business, and the ILEC selling to residence customers, as well. All right. Now, so where is the market that people are going to go to here. This is the great State of Florida, and when I take a look at the marketplace in Florida, we have concentrated here on where are the businesses and where are the densest resident populations. And the businesses are marked off on the chart in pink.

There are seven very dense business areas in the State of Florida. The blue pools that surround each of the pink areas, and sometimes there are blue pools without pink areas, are areas of dense residential population. The ALECs are going to be very interested in the pink areas, as will be the ILEC. My sense would be that if there are 62 potential customers for the wholesale company, that what we will see occurring is that there will be great attention paid by the wholesale companies on the pink areas because there are so many customers that are out there. And very likely service will be great. The businesses in those pink cities, who are ultimately the beneficiaries of the telephone service provided by the ALECs and the ILEC, those businesses will probably have great, great service. They will probably have lots of new offers.

Now, once you go beyond those large cities, the ALECs are not interested in the consumer market, so now we are down into the pools where there is only one ILEC who is operating. But they are dense pools. But my sense is that because there is really only one massive customer in each of the pools, now there are some other ALECs that are hanging there, but not the numbers of them.

And then out in the white areas where we have a paucity of business and lack of density and consumers, we will find very little ALEC interest because they are not selling to consumers and the ILEC is there. So now what we have -- now what we have is we have a situation where the wholesale company has to make an assessment of exactly how they are going to serve the market.

Now, as a consultant, and this is just going to be one formula that a consultant might advise, but it is not one that one would discount out of pocket, the objective of the wholesale company is going to be to maximize shareholder return. You are going to be advised and we will develop strategies to sell to the broadest base of well-financed ALECs so that they can pay their bills. Focus on the major cities, and then on the tactics, as I indicated just a moment ago, make very large investments in these cities in order to allow for the provisioning of new services and also to allow the wholesale company to lower their operating costs.

Outside the major cities where there are not a lot of potential customers for the wholesale company, reduce the capital expenditure, reduce the operating expenses as much as possible, assume a risk diverse posture for new consumer services. And I want to stop on that and talk about it for a bit. Because the wholesale company is going to need to make sure that if they make investments in the network that there will ultimately be consumers or businesses to absorb those and be willing to pay.

If the consumer marketplace, the residential customer is spending $50 per month, and in a state like Florida where 19 percent of the population is retirees, it is going to be advisable for the wholesale company to be very, very cautious before they launch investments into these outlying areas. Risk diverse posture, and I will say it, but I don't think you would see it talked about in public forums, and that is milk the base.

COMMISSIONER PALECKI: Could I ask you a question?

MR. MALONE: Please.

COMMISSIONER PALECKI: Turning back to your previous slide where you showed the business centers. Under our current regulatory scheme, which is designed to introduce competition, aren't we seeing the exact same thing occurring as was depicted on your previous slide, and aren't we seeing pretty much the same strategies on the part of the RBHCs to minimize investment in the more rural areas? I mean, won't that continue under either scheme?

MR. MALONE: Well, it may. But in today's environment the wholesale company and the retail company are all converged in the ILEC today. In the new environment -- and so what you have is a situation where the costs in the wholesale company and the revenues from the retail side are all put together and bubble up to one shareholder, or one group of shareholders.

My counsel would be that even in that situation which is what you have today, you want to maximize the profit that you return to the shareholders. In the newer structure that might be implemented where there are now two entities and there is a real concentrated laser-like focus on the wholesale company, my counsel would still be to concentrate expressly on return to the shareholders, but then I would probably go some steps further.

With the wholesale company as a consultant I would probably counsel them to over time either short-term or longer term find those areas where the -- those geographical areas where the profit is less, and if cutting back doesn't accomplish what you are looking to do for the shareholders, perhaps entertain vacating markets, as well.

I think that there are certain inefficiencies that occur in a telephone company today because one is not mandated to step back, take a look at the whole business, and to say what changes should we make globally in this company. There is a lot that goes on in a BellSouth, a lot that goes on in a Verizon, and to take and put the whole business under the microscope is not something that one undertakes lightly. It is not often done. Pieces of it are. Consultants like myself do very well as companies in all industries look at pieces of their business.

But we may be about to take the wholesale side and be forced to put it all under the microscope at once. Because the ILECs will probably say, look, setting up a wholesale company is going to require an awful lot of intelligence and a lot of manpower, and it is going to require a lot of people who are accustomed to changing businesses all the time. So we are going to turn to the outside, and that is going to happen in all the cases. And to turn to the outside and let someone else look at it, and it is going to be a big project. Thing of the big dig like Boston. It is going to be that large.

And what you are going to find is you are going to find with the microscope turned on maybe the result, Commissioner, is no different than if they turned the line on today for everything, but this piece will go under the microscope. It will be carefully looked at. Costs will be slashed, and a consultant will have to advise companies under a new environment, especially if wholesale is not under your regulation, look for places to cut costs. Be as pragmatic as possible to return to the shareholders.

And if one of the options were -- and I don't know that it is, but if one of the options were vacate market, start looking at unproductive markets to go into, then the company will have to decide whether or not they take the consultants advice on that at all. But the consultant will look to do the right thing for the shareholders. So you may be right. My sense is that under today's environment, though, just in summary no one is going to put the entire company under the microscope. Far too expensive. It takes too many ergs (phonetic), it's just not going to happen.

Now, we are looking at what one might say, as a strategy consultant -- now if you will just click to the next one. This is Florida. This is a new cut on Florida. It is broken down principally by geography into three different categories. I am persuaded that in the far left column, which is seven cities, things will be really great. The ALECs will like it, the wholesale company will figure out a way to serve that market, there will probably be a lot of new technologies, there will be new services.

As we start to move towards the right, the cities in the center column were principally found in those pools that we saw before on one of the other charts surrounding the dots. The cities with the pools have a lot of consumers, they will probably get better service because there is a lot of consumer density. However, the revenue stream for the consumer is still going to be only roughly $50 per family. And without a lot of ALECs in the marketplace to sell to the consumer, investments will go in those areas into the businesses if there are good ALECs there. And then in the far right-hand column I think things could deteriorate.

Now, is that my counsel to someone? No, that isn't my counsel to someone. What I am suggesting is this is probably an effect that we will find. The far left side I would strongly urge someone to look carefully at making very good investments because there are a lot of potential ALECs out there to service.

COMMISSIONER PALECKI: What you are saying here I think would also hold true if we just ignore the issue of structural separation and we look at a movement from a purely regulated environment to a purely competitive environment. The competition is going to focus on the major metropolitan areas. And I think what I hear you saying is we are going to continue to need regulation in order to ensure that the rural areas continue to receive reliable telecommunication service.

MR. MALONE: Well, you may conclude that yourself. I'm not here to counsel you as to what decision to make relative to deregulating a telephone company. You are going to have to make that call yourself. If you were to totally deregulate a telephone company so that they could vacate market, so that they could treat it anyway they want, yes, you would probably find something that would look like this, as well.

But in today's environment, the telephone company is regulated, they can't unplug from areas, there is oversight, as well. Are the facilities in the larger cities better than the facilities in the smaller towns? I don't know if that is the case or not. Some of the smaller towns that are just building up very, very quickly may have pretty good facilities because there is a great demand for services, people have to drag new cables out, they put fiber in in some of the cities where there is older establishments. The town here in Tallahassee, there are a lot of older copper, things along those lines. Maybe infrastructure isn't quite as good. But essentially your argument is well made, and regulation --

COMMISSIONER PALECKI: My question to you is that under our current directive from both the federal and state governments we are being told to move towards greater competition in local markets. And I think that with the move towards greater competition this is the result we are going to achieve whether or not we look at the issue of structural separation. And it is only in continuing to have command and control regulation that we are going to see continued reliable service in places like on your far right side of your chart, like Crestview and Chipley and DeFuniak Springs. We will always need some regulation in order to ensure service in the very rural areas.

MR. MALONE: I really wish that I were qualified to comment on the necessity of that. That is not the area of my practice, Commissioner. I work with companies to help them understand how to make profit, how to pursue markets. On the regulatory side, there are experts in that area, people who have spoken today and yesterday. But I am a management consultant, and so to provide you with guidance on whether this situation is suitable rationale for keeping regulation or not keeping regulation, it exceeds the scope of my expertise. But thank you for thinking that I could.

COMMISSIONER JABER: Commissioner Deason, I guess you don't get service, unless I'm missing something.

COMMISSIONER DEASON: Well, I was just thinking, you know, where I come from the cities in the far right, they are considered pretty large places. Where I come from is not even listed, so I guess we may not have telephone service in the future.

MR. MALONE: Well, and I don't know.

COMMISSIONER JABER: Neither will Sanford, I suppose.

MR. MALONE: I think we have gotten all the areas of the state. We might have stretched out a couple more columns. If you are in one of the right ones, then you are in a pretty large town. If we had added seven or eight more columns you would have probably felt pretty good to be in the third column. People are all the way down in the eighth column. But we have broken it out, we have broken it out that way.

Now, a couple of people have talked about costs of breaking up a telephone company. I'm not here to talk about the cost to break the company up, but I can say a few words on it. And whether you think these words are helpful in your appreciation of what the impact might be on consumers here in the state, I am going to say those words because I believe that there will be some costs that are going to be incurred.

But what I did in attempting to look at some costs is I performed a simple exercise by looking at past mergers. My sense is that if a merger of two companies -- or my sense is if a merger of two companies will allow each of these businesses to save some monies when they come together, then it occurs to me that a separation of a company into two may cause some costs to be incurred. And so I thought this might be an interesting exercise, to peel the onion back and see what that might look like. And so I did that.

If you could turn the slide. And so what you see here is someone who is obviously a lot more famous than I has put together what he thinks the benefits are that might accrue from merging companies, and so I just put that up there for your review. We looked at six announced mergers. Now, I say announced mergers, some of these took effect, one did not, one is a work in process right now.

And the interest that we had was to take a look at what kind of economies of scale one might expect from a merger. And Bell Atlantic had expected that if they could merge with NYNEX a few years ago they would save 2.6 percent of the combined mergers revenues. Now, it's all the same revenues, but we just looked for an amount that might be saved. And we did the same all the way down the line. And then we distilled out the telephone companies.

And MCI never completed the merger with Sprint, that was abandoned, but the other three were. And as we took a look at the amount of savings that companies expected they might receive, the median average of that was just 4.0 some odd percent. So our sense was that if a merger might cause a 4.0 percent savings in roughly costs to the business, might diseconomies of scales of a comparable size be incurred if you take two companies apart.

COMMISSIONER PALECKI: Have those economies of scale been borne out through actual experience?

MR. MALONE: Well, I think that is an excellent question, Commissioner, and I don't know what the answer to that is. They may have and they may not have. We didn't pursue that line of research. What we did do is we attempted just to come up here with an idea to present. We do believe that there are diseconomies, and I'm going to talk about some of those. But to the extent that they are -- whether they are 4 percent or less or more, I don't know. But it is a great question.

Now, if we have got some diseconomies, and they can be any number you would like, we took a look to try and get some understanding as to what might the diseconomies be and where might they fall. And we know a lot about telephone companies. We know how to set up a telephone company business. I probably think we could run one.

And so what we did is we took a look at all of the areas of a telephone company where we thought there would be higher cost and we broke it out by function. This building here is actually a telephone company. It looks more like a prison to me, but nonetheless. And what we decided was that separating a company into two parts would cause some diseconomies due to lack of scale, which translates into higher costs for both the network company, we call NetCo, and the retail company, which we call ServeCo. And it is fairly easy to appreciate why there would be some costs, if you start just by saying, well, we are going to need two presidents here.

Yesterday there was a speaker who said you need two presidents, and then the speaker went on to say, oh, and two buildings. Well, there is more than two presidents and two buildings. You are going to need some other things. And we have identified here four areas where we know from our experience in creating phone companies and helping to run phone companies those are areas where you are going to find costs. How much cost, incremental cost is there, I can't tell you. You will have to assign your own value to that.

Now, this without the attractive building looks at all of the areas. Now not just the four areas where there would be greater costs, but it shows other areas blown out where there would be lesser costs. Some of the ones with the circles are not painted in at all. I think the cost would be de minimis. I don't think it would cost a heck of a lot of money to put together under corporate planning the vision and mission. We might do that at lunch today. But there are costs incurred in what we conclude to be 47 different areas of the business.

Now, these costs, whatever they are, even if they are a dollar, those costs are going to be get passed on to someone. My sense as a consultant is that these costs are going to get passed on to the consumer. Probably not to the business customer. Now remember they get passed on to the perhaps ALEC and the ILEC, right, who in turn translates them down to the consumer. But the ALECs are probably going to experience less of the costs because they don't deal with the consumer. The ILEC will possibly get more of them. And my sense is that they will probably get driven down to the consumer.

Next chart. Here is why. We know, and you have heard over the last two days that ALECs like to build-out their own facilities. You saw a quote from Royce Holland, another speaker you had today talking about the reason we don't like UNE-Ps is because we build our own facilities, if you recall that. It may have been the last speaker or the speaker before. Here is AT&T talking about facilities. You heard another speaker this morning from Progress and Freedom Foundation quoting AT&T saying we must have our own facilities.

So here is the rub here for the wholesale company. The wholesale company has got 61 ALEC customers just as long as they don't trifle with them, because the ALECs have a motivation here to want to get their own facilities in place. A very simple reason why they would want to have their own facilities. Cross all ALECs in the United States that are publicly held where there is a lot more data on them for us to examine. Gross margins for an ALEC that owns their own facilities are in the upper 30 percent. Gross margins from an ALEC who don't own any of their facilities in the lower 30 percent. People want to build their facilities, if they can get the capital in order to do it.

So the wholesale company doesn't want to trifle with these ALECs who may be very fragile. What you do is trifle with the ILEC, the retail company, who has got to grin and bear it, especially if they can't build their own facilities, or principally if they can't build their own facilities. And then let them pass it off onto the consumer, because the consumer isn't going to go anywhere either.

So whatever the amount of money is to structurally separate a company into two, even if it is a dollar, I would argue that the consumers are probably going to see more of that cost passed on to them. Or at least one will try to get them to pass it along. Now, this may not play out that way, but it would be certainly something that the companies would have to seriously consider.

COMMISSIONER JABER: Mr. Malone, am I understanding you correctly that you don't know what the cost for Verizon would be, for example, of splitting up a company like Verizon?

MR. MALONE: No, I have no idea whatsoever.

COMMISSIONER JABER: So on what information, then, did you base these estimates? How were you able to shade in portions --

MR. MALONE: I based the estimates because we do know what it would take in each of these areas to set up a separate company. We know that there is a lot of effort that is going to be put into redoing interfaces for the OSSs. We know that there is going to be a lot of effort invested in IT systems for the second company, because they are not just going to be able to port all the IT systems over from the first company. So we know that there will be a lot of costs associated in some areas. But in terms of how much they are, Commissioner, we haven't taken a look at that. I think that would be a rather formidable exercise. Someone will do it, but we haven't done it. And our experience in putting together the circles really comes from our experience working for 20 years and myself over 30 years in this industry.

Now, I would like to take a look at the next chart. I'm not a believer that structural separation is going to be good for the consumers of the State of Florida, and I also don't believe that structural separation is going to be in the best interest of the ALECs in the State of Florida. But I'm not here in loco parentis, and they speak for themselves, but I will tell you as a consultant, and I have a lot of ALEC clients, here is my assessment of the situation as it relates to ALECs in the State of Florida.

I think it is going to take awhile to get the new operations up and running at the wholesale company. So the ALEC, I mentioned at the beginning of my presentation who had said, gosh, it took us five years to get to our position, I don't want to have to go back. I don't know how long it is going to take in order to return to the status quo in operations once you break the companies apart, but I think a year would be a conservative estimate, and it could be longer. There is a lot of different reasons why. You can see next to the checkmarks, knew this, knew that, knew the other thing, all the way down the line. On day one of the cut over there will be problems.

The facilities build-out may slow down substantially in the State of Florida. I think one thing you are going to find is that if you split the companies there will be more ALECs coming into the state. And so if you feel that the state needs more ALECs, you have got 61 now, you have got 36 in the City of Tampa already, although a city like Tampa can only support about five. If one were to conclude, though, look, more ALECs are not really all that bad because maybe some of them would move off into the residential areas, putting in a structural separation is going to attract more ALECs.

Now, the ones that you are going to attract are not going to be facilities-based, they will be ones who will be selling the same services that the ILEC will be selling through their retail arm. Because now there is great incentive just to acquire the facilities from the telephone company and then resell them. So my sense is facilities build-out could slow in the state. It may not slow to a tickle, it should slow down somewhat. And newer services or services from newer providers certainly, I think, are going to start to look very much alike.

Wall Street I don't think is going to be thrilled with the move, but then again I don't speak for Wall Street, either. More CLECs in Florida is not what Wall Street is announcing it wants. Wall Street is talking in terms of the market may improve when there are fewer ALECs in the marketplace. And if ALECs already don't have enough problems to deal with, and let's stipulate that the ALECs now are on a great path to improving management, improving the financial position of the companies, improving the back offices of the companies. If they are on a good tack to doing that today, and let's stipulate that they are, I'm not sure that is the case, but it may be, if they are on a good tack Wall Street we all know is still very disappointed with what they see. And I don't believe that anything that is going to complicate the process that may set us back even 12 months in terms of setting up new interfaces and the like, one thing Wall Street doesn't have is a sense of humor, and I don't feel that this is going to be received very well by Wall Street at all.

COMMISSIONER PALECKI: Now, every ALEC that we have heard from in this workshop thus far has come out in favor of structural separation. How do you square this slide with what we have been hearing for the last two days from the ALECs?

MR. MALONE: Commissioner, I can't. I have heard every -- I have been here for the entire two days. I have heard everybody. I have listened attentively, and I do understand that all of the people who have spoken and others who have appended their names to CompTel's position, all are saying structural separation is a good idea.

I would have just two comments. Number one, they don't speak for the universe, although I guess they speak for a large bit of it. They don't speak for the universe because I related two anecdotes, conversations with top people, one a CEO and one a COO of top ten ALECs both with operations in your state, who aren't thrilled by the prospect. I would have that comment, so it's not the universe of them.

And, secondly, I would be real careful what I would wish for here if I were an ALEC. There isn't an ALEC who spoke who would say, in my opinion, this is going to be perfectly seamless, on day one we will never see a hiccup. It's just not going to happen. I spent ten years working for AT&T. I know what happens when you start to work around or try and work on changing drastically the structure of the business, and it's not pretty. And this is not going to be as pretty as people may think it is.

What it does do, what it does do, I can see some motivation. What it does do is this runs the prospect of putting a stick in the spokes of the ILEC business. It is particularly disruptive as they have to split their business, reassign their management, try and get their arms around their business. It will stall the ILEC business for quite some period of time.

And so for a competitor who is not in business to keep the ILEC in business, there is some, you know, nice parts about pushing for structural separation because you get to make life difficult. However, however, this is not going to be easy and it's not going to be pretty. It's just the way it is going to be.

But I heard everybody and I respect their comments. And I'm not here as an apologist for the ILECs. Sure, I've got ILEC clients. I've got IXC clients, and CLEC/ALEC clients, as well. And they are nontrivial clients. They contribute mass amounts of money to our business. But as a consultant I do what I think is best for them in providing my counsel. Whether they take it or not, that is their decision.

And the very last piece is regulatory uncertainty. I'm not qualified to talk about the regulatory uncertainty, because I wasn't qualified to answer your question before when you talked about what you, as regulators, should do. I just think that is another issue. That concludes my prepared comments.

COMMISSIONER DEASON: Thank you very much.

MR. MALONE: You are very welcome.

COMMISSIONER DEASON: Is Ms. Caswell still here? You have one more presenter?

MS. CASWELL: Yes, sir.

COMMISSIONER DEASON: Well, hold on just a second. I think you started your presentation at around 11:15 and you were allocated an hour and a half, you should have been finished with all of your presenters some 25 minutes ago. We are way behind schedule.

MS. CASWELL: (Inaudible, not at microphone.)

COMMISSIONER DEASON: Ten minutes? Okay. After ten minutes we can turn the microphones off, right?

MS. CASWELL: Yes. Thank you.

COMMISSIONER DEASON: Okay.

MR. LEACH: Is this on? Okay. I apologize. First, I think as was said yesterday, one of the dangerous things about going at this point in the program is redundancy. The second is I'm afraid with this body mike on you may hear my stomach growling, and for that I apologize.

Thank you for giving me this opportunity to appear before you today. My name is David Leach. I am the communications industry advisor in the Washington office of

Dewey Ballantine, a large New York law firm. In that capacity I head the communications practice group. I'm sorry, I'm trying to rush and tripping all over myself.

COMMISSIONER DEASON: I appreciate that. But we have a court reporter and she is tired and hungry, too. So take mercy on her and --

MR. LEACH: And on myself, if that is all right. Prior to joining Dewey Ballantine, I served in a variety of capacities in the U.S. House of Representatives as follows; from 1977 to 1981 I was on the staff of then Representative Timothy Worth, Colorado; legislative assistant, administrative assistant, legislative director.

In 1981, Worth was elected Chairman of the Telecommunications Subcommittee, and so I joined that staff until 1985. In 1988, Chairman of the House Commerce Committee, John Dingell called and asked me to come back. I served for him from 1988 to 1994 on the majority staff of the House Commerce Committee. And then from 1995 to 1997 on the minority staff.

Over that 20-year period I was involved in every effort to update the nation's telecommunications laws which culminated in the enactment of the Telecommunications Act of 1996. I have been retained by Verizon to discuss with you the inconsistency of structural separation with the '96 Act from the perspective of someone who was directly and personally involved. Although Verizon has retained me for this purpose, the presentation and any conclusions I have drawn are my own.

It's funny, this didn't use to happen to me while I worked for Dingle, because I could say any outrageous thing I wanted to and people would believe it. I'm going to skip over the history of the drafting of the '96 Act, what was in the House bill and what was in the Senate bill, and simply cut to the chase in the interest of time.

You have now before you a petition that would require BellSouth to split itself into wholesale and retail entities and then to divest a portion at least of that retail entity as a separate corporation. From a variety of perspectives this proposal would not only fail to benefit the public, but would visit substantial harm upon the public.

The proposal, of course, is not knew. It has its roots in the so-called Rochester plan, which was first proposed in 1993. It was considered and reject by the Congress when the '96 Act was being drafted. It should likewise be rejected by the FPSC. As one of the drafters of the '96 Act, I was well aware of the Rochester plan, as were my counterparts in both the House and the Senate.

During the course of drafting HR 1555, the House bill, we had extensive discussions about the wisdom of requiring ALECs to split themselves along wholesale and retail lines. Now, you don't have to just take my word for it, former

FCC Commissioner William Kennard stated in response to whether a structural separation policy should be adopted, quote, Congress had an opportunity to adopt a wholesale/retail distinction --

COMMISSIONER DEASON: Sir, I'm sorry, just slow down a little bit, okay. I will give you a few extra minutes.

MR. LEACH: All right.

COMMISSIONER DEASON: Okay.

MR. LEACH: Congress had an opportunity to adopt a wholesale/retail distinction, but chose not to. That is not the way the Telecom Act was set up. As evidenced by the refusal of Congress to include structural separation in the bill, we rejected this approach for the following reasons. First, because doing so would impose significant disruptions without any demonstrable benefits to the public. While the competitors to the ILEC may benefit from hobbling their competitors, the public most certainly is worse off than it would be with the market opening provisions that were contained in the '96 Act.

Many of the presenters yesterday implicitly acknowledged that structural separation would increase prices. Mr. Page probably came the closest when he discussed changing the quote, wholesale/retail power balance, close quote, and conceded in the absence of retail, wholesale rates will go up.

This is a matter of relatively simple economics.

While the reasons that we rejected a wholesale/retail split remain valid here in Florida, there are other reasons for the Commission to reject this proposal, as well. Perhaps most importantly this approach has been superseded by the market opening mechanisms contained in the '96 Act. Whatever validity structural separation may have had in the 1993/1994 context has been overtaken by the enactment of Sections 251 and 252 of the Communications Act, which require ILECs to unbundle their networks, negotiate with their competitors over the terms and conditions of interconnection.

Sections 251 and 252 were drafted to impose interconnection requirements on integrated ILECs. These requirements will not fit in a separate subsidiary environment. Neither does the requirement that ILECs offer resale services at wholesale discount from retail rates. Look also to Section 254, universal service provisions. Again, crafted with the expectation that you were dealing with integrated ILECs and how money would flow to support the universal service obligations to which a Commissioner referred earlier.

I would like to digress from my prepared statement at this point to say yesterday we heard a lot of discussion about the proper alignment of interests. And that proper alignment of interests was all from the perspective of the competitors. What we need to look to as well, what we attempted to do in the '96 Act was not only align interests with the competitors, but also align interests with the consumers.

And if you go back to the previous presentation, the list of cities which you acknowledged were not small towns that could very well be worse off, those are the people you have to worry about. And unless the carriers' interests are also aligned with providing service to those consumers, they are going to be left in the dark while the densely populated seven areas that he enumerated receives improved service.

Attempting to graft a separate subsidiary requirement onto the requirements of the federal statute will only open up Pandora's Box. I am going to go off script again. Yesterday Mr. Lackey referred to the Florida Statute and how his reading of that indicates that the Commission will no longer have jurisdiction over what has been referred to now as LoopCo. Your jurisdiction under Sections 251 and 252 hinges on the definition of what constitutes an incumbent local exchange carrier.

When you turn to the definitions in the law, an ILEC is defined as a carrier that is a member of the National Exchange Carrier Association. It makes a reference to the FCC's regulations. You turn then to the FCC's regs and it defines what constitutes a member in NECA.

Now, I am not confident as a matter of law that if you divest the retail subsidiary, LoopCo becomes the underlying carrier, but no longer a carrier offering service to the public, that they are any longer eligible for membership in NECA. And so your jurisdiction under 251 and 252 may disappear just as quickly as it would under the Florida Statute.

Finally, adopting this approach would stop competition in its tracks. The progress that has been made in opening up local markets to competition would be frozen, while the market attempt to determine whether the old business models will continue to make sense in the new environment.

Commissioner Jaber yesterday asked Mr. Meros about whether or not there will be a delay as a result of imposing structural separation requirements. Of course there will be. There will be delays as employees are assigned to one company or the other. Every truck, every piece of equipment, in fact, every single asset will have to be reviewed, assigned and accounted for. And that is just the beginning.

Then there will be delays borne of confusion as consumers learn, probably unhappily, to adapt to the new world. And finally there will come regulatory delays as new questions are raised about whether the split was done properly or fairly. Make no mistake about it, as long as the sign on your doorway reads "open for business" there will be a line there every morning.

Finally, Congress wrote the '96 Act to impose a uniform set of requirements that open local markets to competition while maintaining the high quality and affordable telephone service to which all Americans have access. Adopting a wholesale resale approach would disrupt this uniformity to the disadvantage of Florida consumers.

Let me address one final issue. Yesterday Mr. Morrissey encouraged you to adopt structural separation in order to avoid monopolization of the next level of service, DSL. Mr. Johnson referred to DSL as an indicator of market failure, the canary in the mine shaft I think was his phrase.

As Mr. May did earlier, let me remind you that DSL is but one of four technologies used to offer high speed Internet access. While the other three, cable modem service, wireless, and satellites are not subject to your jurisdiction, they are all nonetheless competitors for customers. And of the four, DSL has only 25 percent of the market. The cable industry, led by AT&T, the largest cable company in the world, has a market share of more than 70 percent. Please don't be misled by AT&T's crocodile tears about monopolization. They are a bluff and should be dismissed as such.

Congress wisely rejected proposals to impose a wholesale/retail split on ILECs out of concerns that doing so would raise subscriber rates and because of the disruption it would cause. These reasons are as valid today as they were when the 1996 Act was being drafted. Moreover, turning back the clock on market opening mechanisms established by Congress would freeze competition in its tracks. It is our hope that you reject this proposal, just as Congress rejected it, and stick with the market opening approach enacted in 1996.

I apologize for the length of my statement and will be happy to answer any questions.

COMMISSIONER PALECKI: I have just one question. Is competition under the '96 Act working in Florida, and specifically do you believe a 5 to 8 percent market share to the competitors will result in the favorable effects of competition, that is downward pressure on rates and an increased level of service? And, if not, what advice would you give this Commission if we would like to see a greater level of competition?

MR. LEACH: Are you sure you want to ask that question before lunch? Is it working the way as expected. I think our hope when we were drafting the bill was to time limit the FCC's ability to write regulations by imposing strict time limitations on them. So, for example, the bill was enacted in February 1996, they had to come out with their interconnection order in August, August 6th. And we thought it would be maybe 120 pages. Well, you saw the size of that thing. And then that was just the beginning. They have put it out for further comment and further rulemaking and so on.

So the regulatory landscape has never stood still, and as long as that is in flux, people are going to hedge their investment decisions and question whether or not there is enough stability there for them to make a projection about what the market is going to look like. So I think the FCC's activities have delayed the advent of competition.

Secondly, the whole issue of offering UNEs was not -- it was designed to jump start competition. We knew there were residential networks out there, the cable networks, but they didn't have everything they would need to be full service providers. They didn't have switches, for example. And so how can you jump start the cable competition to telephone company provision of voice telephony? You make the switch or the trunking facilities available to them on a UNE basis.

It was never intended to subsidize competitive entry. They were intended to pay market rates, but only as a bridge over time till such time as they could deploy their own facilities. That has not happened under the FCC's rules. Instead you have got TELRIC prices that effectively subsidize entry, which was not the intention at all.

In terms of, you know, is the market in Florida competitive, you don't create instant networks with a glass of water and a little powder. It's going to take a time for people to build facilities. Wireless networks are going to be made available more rapidly than wireline networks, but everybody is going to take a look at the regulatory and the financial landscape first before they turn the first spade full of earth.

I guess my recommendation to you is, and this goes back to the comment I made as long as you hang your "open for business" sign on the front door you are going to find a line there in the morning. As long as people know that they can come in here and argue with you about the terms and condition of offering service, they are going to be better off than if they actually go out and invest the money and offer the service.

The '96 Act framework is there. I think as has been demonstrated in Texas and New York and in Massachusetts and the other cities where once the competitive spur has been applied, then you have got vigorous competition. And this is just the beginning. We are still looking at wireless networks that haven't been fully deployed. You know, there is plenty more out there, but it's a question of getting -- pardon me, this comes from an old Democrat -- getting the regulators out of the way, letting the providers offer consumers the service and allow the consumers to make their choice. That was a long answer, I'm sorry.

COMMISSIONER PALECKI: It was a long question.

COMMISSIONER DEASON: Thank you.

MR. LEACH: Thank you very much.

COMMISSIONER DEASON: We will recess for lunch. We will reconvene at 2:15.

(Lunch recess.)

STATE OF FLORIDA)

: CERTIFICATE OF REPORTER

COUNTY OF LEON)

I, JANE FAUROT, RPR, Chief, Office of Hearing Reporter Services, FPSC Division of Commission Clerk and Administrative Services, do hereby certify that the foregoing proceeding was heard at the time and place herein stated.

IT IS FURTHER CERTIFIED that I stenographically reported the said proceedings; that the same has been transcribed under my direct supervision; and that this transcript constitutes a true transcription of my notes of said proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorney or counsel connected with the action, nor am I financially interested in the action.

DATED THIS 13th day of August, 2001.

JANE FAUROT, RPR
Chief, Office of Hearing Reporter Services
FPSC Division of Commission Clerk and
Administrative Services
(850) 413-6732