

Testimony of

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Good afternoon. My name is Michael Capellas. I am the President and CEO of MCI. Thank you, Mr. Chairman and Members of the Committee, for giving me the opportunity to testify today about the changing structure of the telecommunications industry. Over the past five years, our industry has undergone a series of fundamental shifts - in technology and in the evolution of the marketplace, as well as in the legal and regulatory environment. The as yet untapped potential of the Internet guarantees even greater change in the future.

The combination of Verizon and MCI is a reflection of the need for both companies to re-position themselves in order to compete effectively to meet customer demands. The purpose and effect of the merger is to make the company a stronger competitor in what is and will remain an intensely competitive market. Residential, business and government customers will be the beneficiaries. Policymakers should encourage this marketplace evolution.

Introduction: A Technologist's Perspective

While I have been CEO of MCI for roughly the past two and a half years, I'd like to start by saying that I bring a different perspective to this discussion, having spent the past 30 years of my career in the computing industry before I arrived at MCI. I was previously CIO for two global Fortune 50 companies and CEO of Compaq and President of HP.

My life's projects include designing and developing systems, from using supercomputers to solve complex human genome problems to utilizing web analytics to better understand consumers and their online buying patterns. Why is this relevant to the telecommunications industry? As I like to say, there has been a computer on both ends of the communications network for a very long time.

I have spent my professional career as a customer of telecommunications services, as a developer who used the power of global networks to fuel innovation and productivity, and I believe in the power and promise of technology.

How is computing leading the structural changes within telecommunications?

First of all, there is a movement within computing towards standardization. Basic computer building blocks such as servers, storage and microprocessors are standard devices that are addresses on a network and can reside anywhere. Second, the rise of Internet commerce accelerated the adoption of software standards that enable different systems to talk to each other. At the same time, new tools like web services are allowing developers to write applications across different platforms.

Today, communications travel over the network in what we call "packets." There is no difference between a voice or data packet over the network. Whether you are making a voice call or purchasing an MP3 music file, it is all the same - a packet is a packet.

The Internet-driven standards that allow systems to talk to each other have redefined network requirements. Formerly, local, long distance and data traveled separate network paths. Now, there's a need for integrated, intelligent paths which can carry voice, data and streamed video without the developer or end-user needing to know or care how the path is developed.

One does not need to be a computer scientist to see this in everyday life. A "Blackberry" is a great example of a simple device that can instant message, make a phone call, get news or sports, or stream a video. It is called integrated communications. In more technical terms, we call it wireless broadband to an IP network. This ability to do integrated communications is becoming commonplace around the world and the path for future technology is clear. The only question is the pace of adoption and we may be behind the curve in this country.

Today, MCI is a leading global communications provider and operates the industry's most expansive global IP backbone. MCI develops the converged communications products and services that are the foundation for some of the most demanding applications in the world. We service major financial institutions, complex engineering and manufacturing centers, and provide complex solutions to more than seventy-five government agencies.

Many of these customers are the early adopters of new computing infrastructures and are led by the best and brightest technologists. These customers have some common requirements:

1. High reliability and security;
2. End-to-end global delivery;
3. Ease of adopting new applications; and
4. Low cost infrastructures.

At the heart of these requirements is the need to mesh local access with wireless capabilities and the core backbone networks. The core technology of the backbone of the future was largely incubated at MCI, in part due to the vision of the legendary Internet pioneer Vint Cerf, a 15-year veteran of MCI. It is known as Internet Protocol - or IP. In its simplest terms, IP allows applications from wireless email to video streaming to be rolled out without understanding or changing the core network elements underneath.

Broadband and Internet Adoption are Driving Technological Change

The momentum is clear: wireless and broadband connecting to IP is the wave of the future. On the broadband side, cable modem service and DSL offerings are being widely deployed. Some companies have started to rollout "next generation" broadband. Public and private entities are starting to deploy wireless "WiFi" networks. Newer and better wireless broadband technologies, such as "WiMax," offer great potential down the road.

Hand-in-hand with broadband is the move to IP. IP technology has led to a convergence of computing and communications, of voice and data, the first manifestation of which is Voice over IP technology ("VoIP"). The introduction of VoIP has led to the emergence of new and non-traditional providers of voice applications, such as the cable companies and VoIP providers such as Vonage. Peer-to-peer providers, such as Skype, have also started to provide voice applications.

But VoIP is only the tip of the digital iceberg, a precursor to what I call "Everything over IP," or "EoIP." Think of a future where you communicate not just with your voice over a telephone, but with new applications such as video e-mail and the realization of decades-old promise of "picture-phones." In short, IP makes old voice telephony seem as archaic as the telegraph. The rapid convergence of computing and communications has been remarkable.

The Telecommunications Marketplace Has Changed Dramatically

As the technology changes, customer expectations and acceptance of that technology changes. On the market front, we are already seeing a revolution in how we communicate. Wireless service has become a true substitute for traditional landline long distance service. Today, more than half of all long distance calls are made via wireless devices. The traditional distinctions between local and long distance have blurred considerably as providers offer products that give consumers unlimited local and long distance calling.

A growing number of consumers are abandoning traditional wireline companies altogether, in favor of wireless or cable companies or other non-traditional providers. This market trend toward new, non-traditional means of communication becomes more pronounced as each new generation comes on-line. E-mail and "instant messaging" have become significant substitutes for voice traffic. If you have ever watched a teenager do instant messaging, you can assume we are not far from peer-to-peer video as a way of life. Those who grew up on wireless phones and Internet-based access to music, movies and other forms of content will easily move away from traditional phone companies and purchase communications applications from a host of new companies.

Legal and Regulatory Changes are Causing Industry Restructuring

In addition to the technological and marketplace forces I've described, recent legal and regulatory changes have had a significant impact on the industry and, in particular, have hampered the ability of companies like MCI to compete for residential consumers:

? The decision last year by the federal court of appeals in Washington, D.C. in the Triennial Review Order case led the Federal Communications Commission (FCC) to issue new rules which dramatically affect the residential market. These rules contribute to the continuing decline in MCI's ability to serve residential customers who demand all-distance service. In particular, the FCC has significantly restricted so-called intramodal competition by curtailing the ability of competitive carriers to lease unbundled network elements from incumbent carriers to provide local service. These decisions fundamentally alter the underlying economics, forcing MCI and other companies to re-examine whether they can continue to address residential markets.

? Historically, MCI's primary residential sales vehicle has been outbound telemarketing. Federal legislation was enacted in 2003 that established a national Do-Not-Call registry and more than eighty-five million telephone numbers have since been registered. The net result is that MCI's use of the most cost-effective means of contacting potential new customers has been dramatically curtailed. In fact, more than half of all potential customers were removed from the reach of MCI's chief marketing channel.

We are already seeing intermodal competition begin to take place with cable companies investing heavily in their networks. Wireless companies, such as Sprint and Nextel, are moving to provide wireless broadband services. Power utilities are beginning to provide facilities-based broadband in some localities. The use of licensed and unlicensed spectrum to provide new, wireless broadband networks will be an area of great significance in the coming years. Emerging intermodal competition promises a continuing, robustly competitive marketplace.

MCI's Challenge

So where is MCI in this "perfect storm" of IP convergence, market evolution, and regulatory changes?

One of the first things MCI recognized was that, given all of these changes, it would be virtually impossible to sustain its traditional voice business based on circuit-switched technology, especially in the consumer market. As a result, we sought to de-emphasize the importance of our irreversibly declining consumer business and refocus the company on next-generation services for large business and government customers. Although it was the right thing to do, this was a wrenching change, given the fact that MCI played no small part in the creation of residential communications competition in the U.S.

As we transition away from our role in the consumer long distance business, our plan is to build on and leverage the strength of our IP network. In executing that plan, we have moved recently to expand our ability to provide network management and web hosting services, as well as network security applications.

MCI has also entered into an agreement with Verizon to combine our complementary strengths:

? MCI owns a state-of-the-art IP backbone network, but no significant "first mile" facilities or wireless. Verizon has extensive "first mile" facilities and is upgrading those facilities with state-of-the-art broadband technology. Verizon also owns a majority interest in Verizon Wireless.

? MCI has a large enterprise and government customer base that has remained loyal to us because we provide them with world-class products and service quality. Verizon, in contrast, has a much smaller presence in the enterprise markets but is very well-positioned in the consumer market.

The combined company will own a powerful end-to-end network that will permit it to launch a whole suite of innovative next-generation applications that will benefit residential, business and governmental customers.

Some have raised questions about whether the Verizon-MCI merger will significantly impact competition in the residential market. The answer to that question is plainly "No." The facts make incontrovertibly clear that MCI's consumer business is in a continuing and irreversible decline. Our consumer base will inevitably continue to shrink because the technological, market, and regulatory changes I've already described have converged to reshape the telecommunications landscape. Faced with the irreversible decline of our consumer business, MCI is trying only to manage that decline. The more significant competition for consumers will come from alternative technologies that the merger will not affect, like cable and wireless.

Some have also asked whether this combination will significantly reduce competition to provide Internet services. In short, it will not. The combination of the Internet assets of Verizon and MCI does not raise any competitive issues. MCI operates a global Internet transmission network or "backbone" that is comparable in size to those of several other firms that operate such networks, including AT&T, Sprint and Level 3. Verizon, by contrast, manages a much smaller Internet backbone that is located primarily in the northeastern U.S. and does not extend beyond our border. Thus, the combination of the two companies will not materially change the position of the merged company as a provider of Internet services.

Conclusion

Technological, marketplace and regulatory changes are the driving forces behind industry restructuring. Traditional notions of "long distance companies" or "local companies" have become obsolete in this evolving environment. One of the enduring strengths of our antitrust laws is that they recognize that markets are dynamic, not static.

The merger of MCI and Verizon is a reflection of these fundamental changes in the marketplace. The merger will not have an adverse effect on competition in any line of business. Quite the contrary: it will strengthen MCI's ability to compete and to continue to meet our customers' expectations. It is a beginning, an important part of a new and exciting era of competition in an expanding and converging "communications" world.

Thank you very much.