Testimony of

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October 19, 2005

"Video and Telecom Competition is Increasingly Vibrant and Here to Stay
& Recommendations on Telecom Reform Legislation"
Testimony of Scott Cleland
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Before the
Senate Subcommittee on Antitrust,
Competition Policy and Consumer Rights
Of
The United States Senate Committee on the Judiciary

Hearing on
"Video Competition in 2005
- More Consolidation or New Choices for Consumers?"

October 19, 2005

Thank you for the honor and opportunity to discuss the state of competition in the communications sector and for the request for insights into what this Subcommittee should consider in Congress' potential update of the 1996 Telecom Act.

I am Scott Cleland, Founder and CEO of Precursor, an independent investment research firm specializing in the technology, telecom and media sectors. In December of 2004, Institutional Investor Magazine, in its first national rankings of independent research firms, ranked Precursor #1 in Telecom and #3 in Technology research. Precursor has blazed a trail in the new specialty of Change Research, anticipating investment risk and opportunity from changes in technology, competition, regulation, and other external factors - for institutional investors. The positions presented here are my personal opinions and not those of Precursor or any other entity.

I. Video and Telecom Competition in 2005 is Increasingly Vibrant and Here to Stay:

State of Video and Telecom Competition: As both the video and telecom marketplaces are increasingly converging and inter-related, I am addressing the state of competition in both markets.

? Video Competition: This Subcommittee and Congress at large should be pleased with the fantastic success of the anti-monopoly thrust of both the 1992 Cable Act and the 1996 Telecom

Act. The facts are overwhelming that neither the cable industry nor the local phone business is a monopoly anymore and that competition in both the video and telecom marketplaces is increasingly vibrant and here to stay. For the vast majority of consumers in the vast majority of markets, consumers have substantial and increasing choice in both the video and telecom markets.

The success of bringing competition to the video marketplace has been exceptional. After only a decade, over 28 million Americans have exercised the new choice they have in the marketplace of a video provider other than cable, which Congress viewed as a monopoly in 1992. Now roughly 30% of Americans get their video from a non-cable provider. Even better, if any video provider acts in a manner that a consumer dislikes, virtually all Americans have the freedom and choice to tell their current video provider to "take a hike" and quite easily sign up with a direct competitor. Despite the large amount of past and pending consolidation, non-cable providers, DirecTV and Echostar are still the #2 and #4 largest video providers in the United States. Cable's competitors now have comparable market clout in programming and equipment markets that cable providers do. The speed and magnitude of this competitive transformation is remarkable. The facts scream for everyone to see that cable is not a monopoly.

Better yet, the real threat of competition cattle-prodded the cable industry to change its ways, to provide better service to its customers and provide customers better technology to get more products and services. The once-monopoly-cable industry has adapted to a competitive environment the old fashioned way, by investing to improve their product and service. Cable has invested about $90 billion in risk capital to build what is currently the best broadband consumer network in the Nation -- allowing cable to become the Nation's leader in providing broadband services to the American consumer. And cable's customer service has improved dramatically. Now a cable company, Cox, is the best telecom company in America according to JD Power. Surprising? It gets better. After over a decade of promises and false starts it appears that some telcos, like Verizon in particular, are finally getting serious about entering the video business.

? Telecom Competition: The same competitive market dynamic is playing out in the telecom space following Congress's 1992 expansion of wireless licenses through PCS spectrum auctions, the decision to have the National Science Foundation unleash and commercialize the Internet, and passage of the 1996 Telecom Act. Over the last decade, most of the large local telcos have lost between 15% - 20% of their phone lines to competitive substitution, plus ~10% to resellers. These companies are losing between 4.5% - 5.5% of lines per year. Americans now have the choice of three to five wireless providers to replace their local phone service and about 7% of Americans have already "cut the cord" and made that choice. Moreover, these providers are adding broadband wireless service in the coming year to further enhance the wireless value proposition relative to landline by enabling VoIP-like and other applications. Furthermore, in about one-third of America, Americans can choose their cable company for phone service and that will likely increase to at least two-thirds by 2006. In addition, VoIP providers are growing very rapidly. Vonage already has a million customers and Skype enjoys over fifty million users worldwide. And while still many dismiss the potential of Broadband over Powerlines (BPL) as a real technological substitute to DSL, cable modems and phone service, they have missed the dramatic technological developments in chips, modulation techniques, wireless, that have

completely transformed BPL technology from "wannabe" status to the real thing. Competition in telecom is increasingly vibrant and here to stay.

Important Caveats:

? Look forward, not backward. First, this Subcommittee and Congress should look forward, not backward and adapt antitrust vigilance and competition oversight to new and different kinds of potential anti-competitive behavior that remain or could emerge. The technological predicate of competition has changed with the advent of IP packet data, essentially enabling previously distinct technologies and industries to enter each others businesses. While IP packet data enables the potential for tremendous increase in competition, it likewise enables and creates new ways to behave anti-competitively. More competition does not mean there will not be bad actors or bad acts. Enforcement and antitrust will remain as relevant and important in the future, albeit differently and probably less frequently as the marketplace becomes more competitive and naturally self-correcting.

? Biggest remaining anti-competitive threats: Second, this Subcommittee and Congress should remain vigilant to predatory practices to deny access to critical facilities (like 911 access points) or some wholesale services with the intent to damage or harm a competitor's ability to compete. Predatory denial of access to networks, content, applications or devices without legitimate business reasons or with the intent to damage or harm a competitor's ability to compete, could be the biggest remaining threat to competition in the IP packet data era.

? Another risk to competition - non-disclosure of network use limitations: Non-disclosure of use limitations by network providers is a big risk to competition because markets assume and need good information so that consumers individually and collectively can exercise their free choice to switch providers based on what that provider will and will not allow a consumer to do. In a competitive and free market:
o Network providers must have the property right to ultimately control and manage their networks; and
o Consumers and businesses also have the right to have products and services marketed to them clearly, fairly, and truthfully so that they have the information to make wise and informed buying decisions.

? I believe the best way to ensure that the emerging consensus around "Net Neutrality" is achieved, is to rely on market forces with providers obligated to openly and fairly represent any restrictions their network may impose on users' freedom to access any legal content, application and device of their choice. If an informed consumer or business chooses to limit their freedom by knowingly buying a product or service that does so, in the presence of competitive choices, that's the essence of a free market. If consumers or business don't like it they can let their provider know individually or collectively and they can always take their business elsewhere. So as the market becomes more competitive in video and telecom, I recommend this subcommittee embrace market forces over regulation, be vigilant in antirust oversight and emphasize more enforcement of network use disclosure, fair representation, and truthful advertising. This is the free market approach that well serves businesses and consumers throughout much of the economy.

? Don't saddle tech software companies with legacy telecom regulation: One of the biggest dangers to the emergence of a lasting and vibrant competitive video and telecom marketplace is the FCC potentially burdening tech and software-based communications providers with legacy telecom regulation which applies to common carriers or legacy cable regulation which applies to incumbent cable providers. Regulations from the monopoly physical world have no business being applied to the competitive virtual world of IP. The FCC's well-intentioned effort to ensure that VoIP providers either provide 911 services or make clear to customers that they don't, was also apparently in response to anti-competitive pressure from some telcos who saw a competitive gain to be achieved by making it hard for VoIP providers to access their legacy-monopoly 911 facilities. The FCC needs to be vigilant against the siren song of legacy regulated providers, and not allow competitive unregulated businesses be pulled into the swamp of legacy telecom regulation.

? Outdated communications law inhibits market forces and consumer choice. The transition from monopoly to competition is largely but not entirely complete. Unfortunately for our Nation's consumers and businesses, video and telecom law is replete with entrenched and outdated law that is ultimately detrimental to consumers because it inhibits technology and market forces from supplying the consumer and business demands of the video and telecom marketplaces. Per the subcommittee's direction, in the appendix to this testimony, I will provide insights and recommendations on how the Judiciary Committee could look at the opportunity for Congressional reform of U.S. communications laws.

II. Current Issues: Bell Entry into Video; Adelphia Transaction; and Program Access:

Bell entry into video: After over a decade of hype, un-met promises and false starts, I believe the local telcos are finally serious about entering the video market. Much like it took the new DBS entrants for cable to become more competitive and invest in new infrastructure, it is taking the much broader cable offering of cable into telephony for local telcos to begin preparing to offer a competitive voice-data-video bundle of services. It is only the breadth and seriousness of the cable telephony/VoIP threat that is moving the telcos, because Cox has been a serious telephony threat for several years. The local telcos are probably five years behind cable in offering a voice-data-video bundle to as broad a swath of consumers as is cable. Of the large telcos:

? Verizon appears most serious about video. They have thousands of contractors deployed now in several cities laying fiber and they are in franchise negotiations with over 200 localities to offer video. They have a competitive program package to offer in their pilot markets like Keller, Texas. Verizon has chosen the most expensive infrastructure approach, fiber to the premises (FTTP). Costs and return on investment aside, FTTP has many advantages over SBC's Fiber to the Node approach:
o FTTP is a leap-frog attempt to end up on the other side with the best infrastructure just like cable leap-frogged DBS -- on data.
o FTTP enjoys more complete de-regulation than hybrid fiber-copper infrastructure like SBC.
o FTTP offers more potential for value-added services and operational savings.

? SBC appears the least serious about video. We have been questioning SBC's commitment to video because we have not seen much hard evidence that video is a true competitive priority

outside of their press releases. There has been little hard evidence that they are seriously spending or digging to fiber-ize for video a la Project Lightspeed. SBC has ended, slowed or changed its DBS reselling model no less than three times. And finally, SBC still is unique in its official stance that local telcos don't need a local franchise in order to offer video, and hence has not entered into negotiations with a single local franchise. I question SBC's seriousness about entering the video business because there is probably not a single local franchise that does not want to approve SBC's video entry. With effort and admittedly very serious time hassles, SBC like Verizon, could pursue a near certain negotiation outcome with local franchises. Instead, SBC is putting "all its video eggs in one basket", the hope for state or Federal relief from the local franchise obligation that has been the law of the land for nine years.

? Bell South is well prepared but under the radar. Bell South has been the most forward-looking and fiber-prepared of the Bells by far. Bell South already has more fiber closer its customers than SBC will have in a couple of years when it gets around to completing Project Lightspeed. Once again the facts speak loudest. By far the fiber-izing leader of the Bells, Bell South has almost half (46%) of its lines with either fiber to the curb (7%) or fiber deep in the network so the copper loop is short, <5,000 feet, (39%) which enables ADSL IPTV when IPTV software is ready for primetime in the next year or two. In 2004, BellSouth spent about 30% of its capital expenditures on fiber/broadband and plans to spend ~40% in 2005. In its understated but serious way, Bell South is prepared to enter video when it believes its chosen technology is ready. Unlike SBC and Verizon, which were clearly caught by surprise that they needed to get local video franchises, Bell South was well aware of the requirement for quite awhile. Bell South already has 20 local video franchises covering 1.4 million subscribers, which they will leverage first. They currently are not negotiating with any other local franchises.

? Qwest can only afford DBS resale. Investing heavily to offer fiber video to its customers just isn't in the cards for Qwest because they simply do not have the free cash flow or profit margin to be able to heavily invest in their infrastructure. Their lasting weak financial condition is a legacy of the bubble problems that left Qwest on the brink of bankruptcy in 2002.

Adephia Transaction: I do not see any anti-competitive concerns with the Adelphia transaction, and believe it actually helps consumers.
? First, this transaction carries out the Department of Justice's mandate in the 2002 AT&T Broadband consent decree to sever the substantial cross-ownership interest between the then #1 and #2 cable providers. While this transaction makes each marginally larger, it accomplishes a de-concentration of the market by ending the substantial multi-billion dollar cross ownership interest between Comcast and Time Warner.
? Second, this transaction will fully rescue the roughly five million U.S. subscribers to Adelphia from the nightmare of being served by a former criminal enterprise that is currently in bankruptcy protection. This transaction will bring these subscribers under reputable and highly-competent management which will be able to greatly increase the value proposition to these customers.
? I do not see how this transaction creates market power; it is a classic geographic extension of the market, not eliminating a competitor. The cable industry's clustering strategy is not anti-competitive, but competitive because it brings efficiencies and enables more effectiveness in infrastructure, overhead, logistics, advertising and customer service.

Program Access: In 1992, the program access law and rules were absolutely necessary and wise to level the playing field and allow new DBS entrants to emerge and challenge the incumbent cable monopoly. And the FCC was wise to extend Program Access rules in 2002. However, I believe the FCC will have a much harder time justifying their extension in 2007, because the factual predicate underlying the purpose of the rules has changed sufficiently to make the rules an un-necessary government intrusion in the marketplace to protect consumers. With #2 video provider DirecTV having nearly 15 million sets of "eyeballs" (subscribers) and owning popular Fox programming, NewsCorp is more than capable to take care of itself in any programming negotiation. Echostar with over 10 million subscribers is a market force as well. I believe in an increasingly competitive marketplace, it will be increasingly difficult to justify increasingly intrusive governmental intervention in the marketplace when the original purpose has been fulfilled.

III. Conclusion:

Thank you again for the opportunity to testify on the state of video competition. Video and telecom competition is increasingly growing, providing more choice for consumers and economic incentive to innovate and improve products and services. The advent of real competition between cable providers and local telcos will add to the competitive dynamic and benefits for consumers and businesses. Congress should look forward and not backward, and seriously consider a "clean slate" overhaul of communications laws in order to better bring the Nation together, and better promote economic growth, job creation, productivity, innovation and international competitiveness. Please see the Appendix for an elaboration of my views on pending telecom reform legislative efforts.

Appendix:

Requested Analysis and Recommendations on What the Senate Judiciary Subcommittee on Antitrust Could Consider when Congress Addresses Telecom Reform Legislation

"Current Telecom Reform Is Not Ambitious Enough;
Laws Must Adapt to a Competitive Marketplace

I. The Communications Legislation Problem:

U.S. communications laws are woefully out-of-date -- based on mid-20th century technological capabilities and business models, and on the factual predicate of legitimate concern about lack of true competition. Not only are U.S. communications laws based on depression-era technology models but also on a outdated and discredited approach that Government is better than markets in managing technology and economic tradeoffs. This Depression-era approach to technology and communications is depressing America's future and stunting America's potential economic growth, productivity and innovation.

The fact that U.S. communications laws have not kept pace with technology advances is creating real national problems:
? Impeding real and potential technology productivity, safety, and lifestyle-improving benefits for

consumers;
? Producing counter-productive and inefficient technology and economic decisions by consumers and businesses; and
? Undermining real and potential economic growth, productivity, innovation, and international competitiveness.

Current legislative efforts to reform telecom laws are surprisingly modest in scope. What is going on is a classic "industry fix" legislative dynamic which by definition are mostly "self-preserving" and disjointed; not "nation-serving" and purposeful. Consequently, I believe current "industry-fix" efforts are unlikely to generate consensus or be successful until the true purpose of the overhaul is based genuinely on:
? American consumer betterment: Fostering tech advances that substantially improve the utility and productivity of most Americans; and
? Economic growth, productivity, innovation and international competitiveness: rather than government conferring advantages or disadvantages on different industries.

U.S. Communications Laws are Badly in Need of Repurposing:
? From a market-power assumed, government-managed communications sector -- to a competition-assumed, minimally regulated marketplace with enforcement protections when necessary.
? From monopoly/oligopoly era where technologies, wires and spectrum were functionally separate and distinct -- to a competitive era where technologies, wires, and spectrum are interoperable and inter-changeable.
? From regulators choosing technologies and market outcomes -- to competitive forces, technologies, and consumer demand determining market outcomes.
? From Governmental mandates and management of market outcomes -- to a market forces approach emphasizing consumer and business freedoms and choice.
? From protecting consumers by legally and regulatory limiting technology -- to benefiting consumers from unfettered technology, competition and innovation.

U.S. Communications laws are limiting Americans' freedoms: U.S. Communications law and regulation is often counter-productive and restrictive - unnecessarily inhibiting Americans' from benefiting from true:
? Freedom from location: current geography-based law/regulation is replete with un-productive constraints on geography-independent IP packet-data technologies to specific locations;
? Freedom from functionality limitations: Current U.S. communications law and regulation is based on technology silos which un-productively limit technology convergence to single technology functions; and
? Freedom from technology and network limitations: Current U.S. communications law and industry-organized legislation unproductively limits efficiencies of I.P. packet data, any-to-any connectivity and personalization, by focusing on interconnection solely on companies rather than also people and devices.

II. A Communications Legislation Solution: New "Clean Slate" Techcom Legislation:

Need new "clean slate" techcom legislation: Congress should consider completely replacing legacy, technology-specific regulation of the 1934 Act, as amended, for telecom, broadcast,

cable, satellite and wireless, because the technological and monopoly/oligopoly predicate on which it is based is no longer the case and is woefully out of date and out of balance, favoring regulation over market forces. Congress should consider passage of technology-neutral legislation that:
? Embraces and harnesses technological innovation and market forces to meet consumer needs;
? Removes government from prospective market and technology decision making;
? Delegates oversight and enforcement of commercial interconnection negotiations and general industry disputes to a newly-created industry self-regulatory organization like SEC has with NASD;
? Ensures core public interest goals continue to be achieved with the minimum possible regulation: spectrum licensing and interference enforcement; antitrust and competition oversight; intellectual property: patents, copyrights; basic interconnection obligations, disability access, 911 access and law enforcement cooperation.

To succeed, reform legislation needs a powerful and consensus-building rationale: For a "clean slate" overhaul of communications law to ultimately be successful in updating communications laws for the 21st century, there needs to be a coherent and cohesive national policy that integrates:
? Consensus political principles of freedom and national unity;
? Free market economic principles;
? Homeland Security needs; and
? A forward-looking, market-driven technology vision

Proposed Preamble/Purpose for Communications Legislation Overhaul:
? Foster Americans' free and unfettered communications access to one another as communications technologies evolve in order to protect and enhance the United States':
o Political and social cohesion and unity;
o Homeland and national security; and
o Economic growth, job creation, productivity, innovation and international competitiveness.

The fundamental rationale behind this legislative purpose:
? Politically, is the constitutional First Amendment Right to Assemble;
? Economically and technologically, is Metcalfe's Law that "the value of a network scales as 2n where "n" is the # of persons connected to the network;" and
? Homeland Security-wise, is people are safer united in communication than isolated; e.g., 911, E-911, Emergency Broadcast System, spectrum for first responders, etc.

Freedom is the best new organizing principle for Communications Legislation overhaul: Promoting not just companies' freedoms, but also all Americans' rights to be interconnected as widely and freely as possible to others, the economy, and the world by ensuring Americans' inalienable Technology "Freedoms":
? Consumer 'Net Freedoms to:
o Access any legal content of their choice;
o Access any application of their choice; and
o Connect any device of their choice.
? Economic 'Net Freedoms of consumers and businesses:

o Freedom from location;
o Freedom from functionality limitations; and
o Freedom from technology and network limitations

Interconnection Solution: The core constant and unshakeable principle embedded in the 1934 and 1996 Act, and also the Internet, is the national value of Americans' free and unfettered access to one another. The 1934 Act mandated interconnection because AT&T successfully used denial of interconnection to monopolize telecom. At its core, Congress got the 1996 Act dead right in that for competition to be possible in communications, there had to be a mandated duty to interconnect and be interoperable. The Internet is the ultimate outgrowth of this principle -- facilitating universal interconnection of networks and people.

What's sorely needed is a better/less intrusive mechanism to oversee and enforce mandated interconnection than government setting all terms. Any legislative overhaul of the law should encourage commercial negotiations for interconnection, peering, and transit. An overhaul should also authorize:
? a self-regulatory organization overseen by the FCC (like the SEC relationship with the NASD) to be the arbitrator and enforcement arm for more contemporaneous and efficient resolution of interconnection and other disputes than the FCC or court can possibly achieve; and
? Authorize negotiating parameters that encourage commercial and non governmental action. Current law forces every dispute into regulation or in court, which is counterproductive, extremely inefficient and destructively slow.