Annex A:

VATM Written Testimony of September 7, 2000.

Testimony of
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On Behalf of

Verband der Anbieter von Telekommunikations- und Mehrwertdiensten e.V.

("VATM" a.k.a. The German Competitive Carrier Association)

Before the
Subcommittee on Telecommunications, Trade, and Consumer Protection
of the
Commerce Committee
United States House of Representatives

Foreign Government Ownership of American Telecommunications Companies

September 7, 2000

Summary

As recently as 1998, the U.S. telecommunications industry was enthusiastic about the prospects of entering the German market as a result of the WTO Basic Telecommunications Agreement. After a period of initial inroads into the former monopolistic German telecom sector, U.S.-backed competitive carriers have faced and continue to face increasingly difficult, and in many instances singularly burdensome, obstacles that prevent them from achieving competitive traction in Germany. In an effort to prop up the value of its investment, the German Government is highly protectionist of the state-owned and controlled incumbent Deutsche Telekom AG ("DTAG"), and seeks in many ways to micromanage and suppress competition.

Over the past several years, DTAG has not only striven to defend its traditional markets by unfair means, but also has blocked competitors from entering emerging markets such as DSL and advance wireless services. DTAG's anti-competitive actions are well-known, in particular its creation of artificial bottlenecks for interconnection; forcing competitors to accept burdensome interconnection rules; chronically exceeding provisioning intervals for collocation space; impeding billing and collection services; and pursuing a strategy of predatory pricing in emerging telecom markets. Yet, the German Federal Ministry of Economics and Technology (the "Ministry") and the German regulatory authority (the "RegTP") have generally adopted an overly passive and accommodating stand on DTAG's anti-competitive activities.

Therefore, our simply-stated message is that DTAG should be allowed to invest in the U.S. telecom market if it meets two conditions which will serve to help pry open the German market to competition. First, DTAG must make specific binding commitments to cease immediately all its anti-competitive practices. In this regard, DTAG should commit to timely publish and monitor its provisioning intervals on a monthly basis; to accept a state-of-the-art

ordering and benchmark system via electronic bonding as well as severe contractual penalties and other prompt and predictable enforcement action for provisioning lapses and service deficiencies; to make available its internal planning data for loop provisioning; and to significantly reduce its inflated fees for unbundled local loops. Second, DTAG's regulators must enforce these commitments vigorously, promptly and in a manner that displays no favoritism toward DTAG.

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Thank you Mr. Chairman and Members of the Subcommittee for inviting me to testify on this timely topic. As Vice Chairman of the Washington D.C. law firm Swidler Berlin Shereff Friedman, LLP, and head of the Firm's Telecommunications Practice Group, I have had extensive experience over the past two decades in assisting our competitive telecommunications clients enter previously foreclosed local and long distance markets in both the United States and abroad. In addition, as the former Senior Vice-President of Legal and Regulatory Affairs for MFS Communications, (at the time, the country's largest competitive local exchange carrier), I and my team obtained on behalf of MFSI Frankfurt Fiber Optic Network GmBH the first competitive carrier authorization ever issued in Germany.

I. Introduction

Last year, Germany generated over $45 billion in telecommunications services and represents the largest and most attractive market opportunity for competitive telecommunications carriers operating in Europe. Indeed, there are now several dozen telecommunications carriers – owned, controlled, financed and operated by U.S. firms – which are seeking to compete in Germany against the incumbent government-controlled carrier Deutsche Telekom AG ("DTAG"). I am here today on behalf of the German competitive carrier association: Verband der Anbieter von Telekommunikations- und Mehrwertdiensten e.V. ("VATM"), which is

comprised of a large number of these firms[1] who have experienced first hand the trials and tribulations faced when trying to establish a competitive foothold against DTAG. VATM is Germany's most significant competitive carriers' association, representing more than 50 telecommunications and multimedia companies which have entered the German market in competition with DTAG. Many of VATM's members are financed, operated or controlled by U.S. interests.

Our simply-stated message is that DTAG should be allowed to invest in the U.S. telecom market if it satisfies two preconditions which will serve to help pry open the German market to competition. First, DTAG must make specific binding commitments to cease immediately its anti-competitive activities such as artificially creating bottlenecks for interconnection; forcing competitors to accept burdensome interconnection rules; chronically exceeding provisioning intervals for collocation space; impeding billing and collection services; and pursuing a strategy of predatory pricing in emerging telecom markets. Second, DTAG's regulators and the relevant Ministries must commit to enforce these commitments vigorously, promptly and in a manner which displays no favoritism toward DTAG.

As recently as 1998, the U.S. telecommunications industry was enthusiastic about the prospects of entering the German market as a result of the WTO Basic Telecommunications Agreement. After a period of initial inroads into the former monopolistic German telecom sector, U.S.-backed competitive carriers have faced and continue to face increasingly difficult, and in many instances singularly burdensome, obstacles that prevent them from achieving competitive traction in Germany. In an effort to prop up the value of its investment, the German

[1] See Appendix 1 (VATM List of Members) attached hereto.

Government is highly protectionist of the state-owned and controlled incumbent DTAG, and seeks in many ways to micromanage and suppress competition.

In the face of announced acquisitions of U.S. telecommunications carriers by DTAG, these developments in Germany have rightfully caught the attention of key members of both the House and Senate, as well as the USTR and the FCC. While problems of anti-competitive practices may exist with government controlled telephone monopolies in certain other countries as well, my testimony focuses on my competitive carriers clients' particular experiences in Germany.

Over the past several years, DTAG has not only striven to defend its traditional markets by unfair means, but also has blocked competitors from entering emerging markets such as DSL and advance wireless services. DTAG's anti-competitive actions are well-known, in particular its predatory pricing tactics and its refusal to provide reasonable and timely interconnection. The USTR has been unsuccessfully seeking redress from the German Government for these types of practices for more than a year. It is particularly troubling that these anti-competitive practices have been accelerating over the last few months.

The German Federal Ministry of Economics and Technology (the "Ministry") and the German regulatory authority (the "RegTP") have generally adopted an overly passive and accommodating stand on issues such as DTAG's predatory pricing (e.g. voice telephony, DSL lines and Flat Rates for Online-Services) and price-squeeze tactics vis-à-vis competitors (in particular having extremely low retail prices while charging competitors high pre-product prices for the individual elements constituting those services in sectors such as interconnection, unbundled local loops and local access leased lines). The Ministry and the RegTP should instead be aggressively seeking to eliminate these barriers and, where appropriate, imposing stiff

penalties on DTAG – powers that the German government has under the German Telecommunications Act. On the contrary, the Ministry has recently announced that it intends to roll back several competitive safeguards previously implemented by the RegTP. For example, the Ministry stated that it will partially release DTAG from the current price control mechanism, which was initially adopted to encourage competition. The Ministry also artificially redefined smaller relevant geographic and product markets in order to make it easier for DTAG to escape dominant carrier regulation. In light of DTAG's continuing abuses of its market power, however, now is **not** the time to even be thinking of releasing DTAG from these important dominant carrier safeguards.

DTAG and their government appointed Directors have calculatedly and deliberately made it onerous and unduly expensive for U.S.-based carriers to invest in the German market. It is difficult enough to compete against a muscle-bound DTAG with all the advantages of a former monopoly. It is especially unfair when the German Government is not only ubiquitous on DTAG's side of the playing field, but is also the referee, umpire and official scorer. DTAG should shake off its bodyguard of Government investors, managers, and overly sympathetic regulators and compete fairly in the marketplace with privately owned competitors.

At a minimum, DTAG should make the following binding commitments to U.S. policy-makers that the German telecom market is open to fair competition. DTAG should commit to:

- timely publish and monitor its provisioning intervals on a monthly basis;
- accept a state-of-the-art ordering and benchmark system via electronic bonding as well as severe contractual penalties and other prompt and predictable enforcement action for provisioning lapses and service deficiencies; and
- make available its internal planning data for loop provisioning and significantly reduce the inflated fees for unbundled local loops.

If DTAG makes these commitments, and if the German regulators and Ministry represent to enforce these commitments, then DTAG should be allowed to invest in the U.S. telecom market.

II. Market Situation in Germany

1) Impact in Germany of the WTO Agreement on Basic Telecommunications

Only a few short years ago, the U.S. telecommunications industry was "wildly enthusiastic" about the successful conclusion of the negotiations resulting in the World Trade Organization's ("WTO") Fourth Protocol to the General Agreement on Trade in Services ("Basic Telecom Agreement") that entered into force on February 5, 1998.[2] At that time, U.S. negotiators committed to open the U.S. telecommunications markets to foreign carriers from WTO member countries, including carriers owned by foreign governments. U.S. carriers were enthusiastic about the prospects of entering the previously closed markets, particularly in Europe. Of all the countries announcing market-opening commitments, none generated as much excitement as Germany. As the largest telecom market in Continental Europe, Germany has been a magnet for many multinational companies, and the prospects that U.S. based and financed carriers could capture a part of this multinational telecom business in Germany were great considering these carriers' vast technical, marketing, and operational expertise and their valuable experience gained in the emerging U.S. competitive telecom market. Over the last several years, however, competition has not flourished as expected in Germany, and the benefits of the WTO Agreement have not materialized for U.S. based and financed carriers venturing into the German

[2] Shortly before the conclusion of the negotiations, the U.S. negotiators of the Basic Telecom Agreement were met at a briefing of U.S. industry with signs saying "wildly enthusiastic". *See* Laura B. Sherman, *"Wildly Enthusiastic" About the First Multilateral Agreement on Trade in Telecommunications Services*, 51 Fed. Comm. L.J. 61, 62 n. 6 (1998).

telecom marketplace. A large part of the blame can be attributed DTAG's anti-competitive activities and the German Government's refusal to take the necessary steps to reign in DTAG and enact and enforce laws that promote competition.

Detailed below is a snapshot of the state of competition in Germany, and a catalogue of problems encountered by U.S. based and financed carriers seeking to compete in that market. This list is not intended to be exhaustive, but merely sufficient to capture the essence of the difficulties competitive carriers face and how Germany has failed to live up to the commitments it made as part of the WTO Basic Telecom Agreement.

As the centerpiece of its WTO commitment, Germany agreed to provide to carriers from other WTO Member countries non-discriminatory access to and use of the German public telecommunications network. Germany also committed to abide by the principles found in the Reference Paper associated with the Basic Telecom Agreement.[3] Under the Reference Paper, Germany must provide interconnection with DTAG's network on an unbundled, non-discriminatory, cost-oriented and transparent basis, at any technically feasible point in the network. Germany also committed to make publicly available its licensing criteria and apply competitive safeguards when necessary to prevent anti-competitive conduct by DTAG. As demonstrated below, these commitments have not been fulfilled. Therefore, at the end of this statement is a list of specific commitments DTAG must make if Germany is to be truly open to competition as promised in its WTO commitments.

[3] *See Fourth Protocol to the General Agreement on Trade in Services* (WTO 1997), 36 I.L.M. 354 (1997).

2) DTAG's Overwhelming Market Share for Local Services Remains Unchallenged.

DTAG continues to dominate the German local services market. Given the current regulatory regime and lack of effective enforcement procedures to deter DTAG anti-competitive practices,[4] a customer switching to a competitive carrier encounters a complicated and expensive process. Therefore, it does not come as surprise that DTAG's market share on the local level is 97%.[5] A recent study on the liberalization of the German telecommunications market published by the renowned German think tank "Institut für Wirtschaft" /Cologne ("IWK") finds that:

(1) DTAG remains the *de facto* monopolist for local traffic.

(2) DTAG can readily cross-subsidize its local services because approximately 90% of the revenues generated by competitors in the long distance market flow back to DTAG in the form of excessive interconnection charges and billing and collection fees.

(3) For the short and medium term, competitive carriers must continue to rely on DTAG's network to reach end-users because it is prohibitively expensive in most cases for competitors to install their own lines to end-users. Alternative access technologies such as Wireless Local Loop ("WLL") or connections via television cables or energy lines, will not likely soon challenge DTAG's existing local infrastructure because they face high installation costs, and traffic volumes on the local level are expected to be relatively low.[6]

In the emerging DSL market, DTAG is attempting to foreclose competition from obtaining traction by adopting a parade of anti-competitive practices and through manipulation of its role as the dominant local service provider. These measures include setting self-serving standards which favor its own services and inherently disadvantage competitors. These practices also include leveraging its dominant market position by failing to provide necessary provisioning

[4] VATM Position Paper ("*VATM Report*"), p. 3, The VATM Report is attached hereto as Appendix 2.
[5] *Id.*

and operating support services to competitive DSL providers who must necessarily rely on DTAG unbundled loops, provisioning and service coordination. Similarly, DTAG frequently exercises its dominance to thwart competitors' attempts to provide Value Added Services such as entertainment services, weather forecasts and, most importantly, payments for Internet shopping via the telephone, by simply refusing to provide competitors billing services for e-commerce and innovative tariffs. For instance, selling movie tickets over the phone and charging them through DTAG's telephone bill is not possible if an alternative carrier operates the service platform.

III. The German Government Unfairly Protects DTAG

1) Intermingling of Interests Between the German Government, RegTP and DTAG

DTAG's anti-competitive practices are buttressed and in many instances sanctioned by the majority ownership and control exercised by the German Government. In numerous overt and subtle ways, the German Government seeks to fashion laws and policies to protect its significant investment in DTAG and keep competitors at leash.

In its annual report for 1999, DTAG candidly admits:

> "As long as the Federal Republic directly or indirectly controls the majority of Deutsche Telekom's shares, it will, like any majority shareholder in a German stock corporation, have the power to control most decisions taken at shareholders' meetings, including the appointment of all of the members of the Supervisory Board elected by the shareholders and the approval of the proposed dividend payments."[7]

In addition to its undisputed control at the shareholder level, DTAG's corporate structure ensures that the German Government exercises close supervision over DTAG's business. DTAG's Board of Management ("*Vorstand*") is controlled and directed by a Supervisory Board

[6] Klaus-Werner Schatz, *Liberalization in the telecommunications sector* (in German), IWK, publication 255 (1/2000).

("*Aufsichtsrat*") which consists to a large extent of representatives of the German Government and of the German trade unions. The Aufsichtsrat appoints, for instance, DTAG's top managers, determines the long-term goals of the Company and approves DTAG's general strategy and major transactions. Further, a significant share of DTAG's personnel consists of former government civil servants, who, with the support of their trade unions, endorse DTAG government ownership.

There also are a myriad of different ways for the Government to pave the way for DTAG indirectly. Many of the personnel in the regulatory authority overseeing the telecom sector, the RegTP, have been recruited directly from government officials of the former Federal Ministry of Posts and Telecommunications, whose primary mission used to be to supervise and protect the activities of the former Federal Post and Telecommunications Monopolies. The RegTP is supervised by the Federal Ministry of Economics and Technology (the "Ministry") and, consequently, vulnerable to political pressure. Therefore, competitive carriers have observed that in many instances – especially since the change in government in 1998 -- the RegTP has not been able and sometimes unwilling to take an aggressive stand, let alone initiate enforcement action, against DTAG.

2) German Ministry of Economics and Technology Interferes Directly to Protect DTAG.

In connection with its WTO commitments, Germany committed to establishing an independent regulatory body, the RegTP, to oversee the telecommunications market. Recent events, however, bring into question the full independence of the RegTP and consequently its ability to effectively regulate DTAG. So long as the German Government stands to gain

[7] DTAG 20-F filing with SEC for 1999, p. 68.

economically from its ownership and control of DTAG, the incentives will remain great for the German Government to enact rules and policies that favor DTAG vis-a-vis its competitors. For instance, it is a matter of concern that the Ministry recently released a Position Paper in which it announced that the RegTP "without undue delay" must refrain from reviewing DTAG's prices for domestic and international routes before they enter into force. The Ministry also mandated that business decisions by DTAG should "not more than necessary be restricted." The Ministry further reasoned that for business end-users, the prior approval procedure of DTAG's end-user prices must be abolished completely by 2002/2003 because new access technologies "bear the potential" for intensifying local competition on the local level.[8] Although competitors maintain that there is no support for these propositions, several DTAG petitions to remove prior RegTP price control are already pending before the RegTP.

This direct interference of the German Government into the day-to-day affairs of DTAG is inconsistent with the German Telecommunications Act and European law, under which the RegTP was intended to be established as an independent body (See Sec. 66 German Telecommunications Act). The Position Paper is a clear sign that the German Government intends to steer the telecommunications market into another direction, while overruling the well-established rules and competencies of the RegTP and the German Federal Cartel Office, both of which are under the supervision of the German courts.

3) Recent UMTS Auction Benefits DTAG Because of German Government Ownership.

The German Government also supports DTAG financially in many ways that impair competitors. Well beyond the aspirations of competitive carriers, DTAG has access to funds and

[8] Position Paper of the Federal Government on "*Competition on the Telecommunications and Post Markets*" (in

guarantees that allow it virtually unlimited financial freedom to expand its networks and operations in ways that its competitors cannot begin to even dream. According to DTAG's Annual Report for 1999,

> "Pursuant to applicable law, all liabilities of Deutsche Telekom outstanding as of January 2, 1995, the date of Deutsche Telekom's registration in the Commercial Register (Handelsregister), became guaranteed by the Federal Republic. This guarantee replaced the Federal Republic's obligations with respect to Deutsche Telekom's liabilities when it was a state-owned special asset. Liabilities incurred after January 2, 1995 are not guaranteed by the Federal Republic . . . As of December 31, 1999, EUR 31.8 billion of Deutsche Telekom's liabilities were guaranteed by the Federal Republic." [9]

DTAG's government financial backing indirectly has helped DTAG to succeed in the recent auctions for the German universal mobile telecommunications service (UMTS). This auction made international news as six companies bid nearly $50 billion for licenses to offer a new generation of wireless communications in Germany. In addition, each of the future operators is expected to invest approximately US$ 4 billion to rollout its UMTS network. It is unclear when or whether at all UMTS will become profitable and who will survive the stiff fight for market share. The amounts at stake are tremendous, however, and only those players with vast financial resources were able to participate.

Most privately-owned competitive companies simply could not afford to participate in the auctions. Government-owned companies such as DTAG, however, could participate because of their vast government-backed resources. In essence, these carriers have a government created safety net and therefore enjoy artificially inflated credit ratings. DTAG, for instance, holds a Standard & Poor's Single A rating. There is little dispute that DTAG will be able to raise the

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German), August 16, 2000, p. 4 to 6. (download available at www.bmwi.de)

[9] DTAG 20-F filing for 1999, p. 71 and 106.

funds for the UMTS world-record spectrum license fees. After the auction, the other consortia heavily criticized DTAG for unnecessarily inflating the bidding up by several billion dollars.

IV. Important Market Entrance Issues Remain Unresolved.

1) Exorbitant Administrative Fees Render Competitors' Entrance Difficult.

In a number of European countries, competitors finance the regulatory authority through fees that are split among the licensees. In Germany, the license fees are exorbitant and represent a clear barrier to entry. A national voice license costs US$ 1.6 million and a national infrastructure license costs US$ 5.6 million. Moreover, these fees must be paid up-front. Fees for regional or city licenses are also exorbitantly high. Due to this high hurdle for market entrance, of the 305 entities that hold German infrastructure or a voice licenses[10], many of them only cover small regions or individual cities.

The following chart published by the European Commission clearly demonstrates that German license fees are out of scale, compared to other EU Member States:

[10] RegTP Annual Report 1999, p. 12.

Survey of the European Commission on administrative fees (numbering/licensing) for the first year of operation (nationwide provision)

EU Member State	First Year Fees Voice (1) in Euro	First Year Fees Infrastructure (2) in Euro
Belgium	130,000	21,000
Denmark	295,000	0
Germany	**2,048,000**	**5,419,000**
Spain	143,000	17,000
France	366,000	800,000
Ireland	51,000	6,000
Italy	124,000	165,000
Luxembourg	290,000	20,000
Netherlands	58,000	2,000
Austria	0	5,000
Portugal	n.a.	20,000
Finland	342,000	0
Sweden	600	600
U.K.	18,000	64,000 max.

(1) Chart 38 of EU 5th Report (Fifth Report on the Implementation of the Telecommunications Regulatory Package, November 1999), Annex 4.3.3.1: Total fees for the first year of operation for nationwide provision of voice telephony services (numbering and licensing fees) , not including the operation of the network, for 1,000,000 telephone numbers and 1 International Signaling Point Code (ISPC), and 4 National Signaling Point Codes (NSPC).

(2) Chart 41 of EU 5th Report, Annex 4.3.3.2.

Accordingly, two U.S. competitive telecommunications associations have already filed formal complaints concerning the German licensing fees as part of the USTR's annual review of telecommunications trade agreements under Section 1377 of the Omnibus Trade and Competitiveness Act. In one industry report on Foreign Trade Barriers submitted to USTR, Germany's fee structure was listed as one reason to place Germany on the list of countries that

lack full or satisfactory implementation of commitments under the WTO Basic Telecommunications Agreement."[11]

2) Interconnection and Unbundled Local Loop Problems with DTAG

Equally egregious to the licensing fee barrier to entry are the myriad problems competitors face in obtaining access to essential facilities and interconnection. In virtually all instances, competitive carriers must rely on interconnection by DTAG to reach end-users. Alternative networks, such as WLL technologies, have yet to be implemented to provide an alternative to DTAG's ubiquitous network.

In its 2000 National Trade Estimate Report on Foreign Trade Barriers, the USTR stated:

> "The competitors to DTAG operated in considerable contractual uncertainty throughout 1999, after DTAG cancelled existing interconnection agreements in December 1999. On December 23, 1999, the German telecommunications regulatory agency (RegTP) finally approved new interconnection tariffs. These tariffs will remain valid until February 28, 2001. Competitors largely welcomed the rates, but noted that RegTP had still not ruled on a number of other important rate-related issues. In particular, DTAG has sought to impose numerous additional – and in the new entrants' view arbitrary and unsubstantiated charges for carrying competitor's traffic."[12]

One of the main reasons for the continuous struggle on interconnection issues between DTAG and its competitors in Germany (with dozens of complaints filed every year with the RegTP) is the fact that it is DTAG which still dictates unilaterally the rules and conditions for interconnection, not the RegTP – as it should be under EU law. The RegTP has yet to develop, together with all competitors and with the aim of truly well balanced non-discriminatory interconnection conditions, its own binding and fair Reference Interconnection Offer as required by EU law. Competitors have developed alternative draft interconnection agreements in an attempt to improve this long-lasting unsatisfactory situation in Germany. These draft

[11] USTR 2000 National Trade Estimate Report on Foreign Trade Barriers, at p. 118.

interconnection agreements, however, have in fact been ignored by DTAG during negotiations. Therefore, DTAG continues to force competitors to accept new interconnection rules and proposals or risk having their interconnection agreements terminated. The RegTP tolerates in principle this situation and only takes action, albeit in a modest way, if there are large injustices at stake.

USTR, in its on-going investigation of Germany under Section 1377, noted that interconnection is a key significant barrier to entry into the German market by competitive U.S. companies. As USTR noted, several new entrants reported that DTAG was not providing interconnection in a timely fashion, on terms and conditions and cost-oriented rates that are transparent and reasonable. For many U.S. competitive carriers seeking to do business in Germany, the interconnection difficulties are reaching the boiling point. Serious backlogs remain for obtaining from DTAG points of interconnection for competitors, particularly in bottleneck metropolitan areas.

VATM recently initiated a survey among its members that covers approximately 1,500 orders for collocation space under the Local Loop contract, placed by 15 different carriers. The results are as follows:

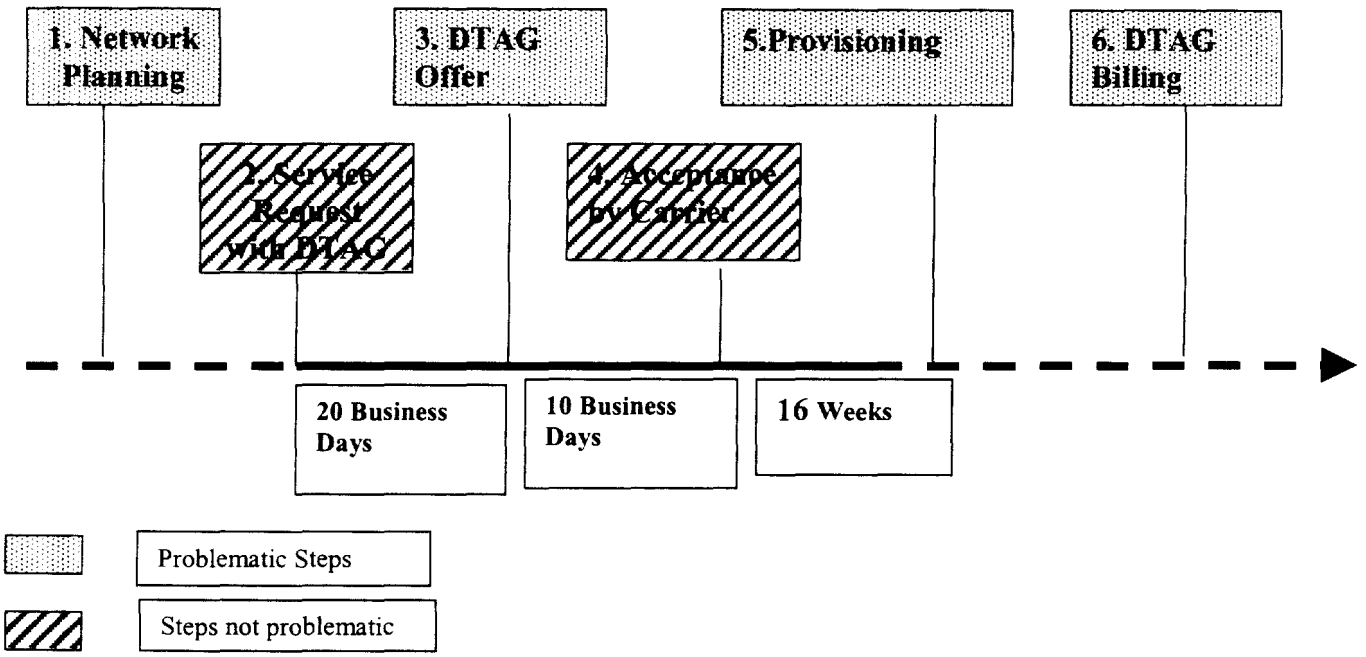
[12] *Id.* at p. 119.

1) Preparing an offer
(a) In **86.3 %** of all cases DTAG exceeds the stipulated interval for Preparing an Offer for collocation space (the interval is supposed to be 20 days according to the agreement between the Competitors and DTAG, approved by the RegTP)
(b) In **50.69 %** of the cases mentioned under (a) DTAG exceeds the interval for Preparing an Offer for collocation space by 250% (50 days or more).
2) Provisioning of collocation space
(a) In **77.02%** of all cases, DTAG does not comply with the provisioning intervals, which is 16 weeks from the receipt of the final order by DTAG.
(b) In **32.77 %** of all cases DTAG exceeded the stipulated interval for providing collocation space by **12 weeks** or more (more than **75%** of the stipulated time). This number is expected to increase because DTAG has not even processed many orders.
(c) In **171 cases**, DTAG did not provide the requested collocation space at all, particularly when DTAG's Central Office was located in an attractive commercial area. This is happening on an increasing basis.
(d) The situation of placing offers and the provision of collocation space is particularly burdensome in the metropolitan bottleneck areas Essen, Düsseldorf, Stuttgart, Munich, Hamburg, Cologne, Karlsruhe and Freiburg. In addition, competitors observe increasing serious provisioning delays with DTAG in smaller cities, such as Hagen, Gelsenkirchen and Krefeld.

VATM concludes:

"Even after the RegTP decision rendered on June 7, 2000, DTAG seriously obstructs competition on the local markets as the survey clearly demonstrates, not only in individual cases, but systematically by artificially created bottlenecks. In particular, new market entrants in the local markets suffer from DTAG's obstruction policy."

Figure: Ordering Process with DTAG



Due to the backlog in obtaining interconnection capacity from DTAG and pressure from the U.S. Government, the RegTP published last year a ranking scheme for processing competitors' orders. However, DTAG still refuses to make public information on the availability of interconnection lines for each point of interconnection and will not publish the ranking of each carrier for those lines. Consequently, competitive carriers cannot efficiently plan when interconnection and the ensuing number of lines will become available at a certain point of interconnection. Further, additional delays result from DTAG's deliberate strategy to retire relevant technical personnel and to outsource the provisioning of interconnection services to sub-contractors who are not familiar with DTAG's network.[13] Additional artificial obstacles, such as

[13] VATM Report at 3.

DTAG's refusal to let competitors share standard collocation space or to provide data on DTAG's network planning[14] exacerbate this situation.

In the Unbundled Local Loop ("ULL") sector, DTAG typically does whatever it can to delay the entrance of competitors. DTAG almost never delivers to new entrants within the stipulated timeframe the key prerequisite for establishing service, *i.e.* the collocation space at the Central Office. Consequently, competitors' network planning and deployment speed are significantly delayed. Problems with the delivery of unbundled loops also are commonplace, in particular if DTAG must visit the customer or transfer a customer's access number to complete the unbundling. For instance, DTAG's actual ULL contract does not contain binding provisioning intervals, so DTAG does not suffer any consequence for exceeding these intervals. In addition, switching of business customers during off-peak periods is only offered on a limited basis. Fortunately in one of these cases the RegTP did intervene. Last June, the RegTP imposed binding provisioning intervals on DTAG but unfortunately no penalties in case of non-fulfillment.

Finally, with regard to the quality standards that DTAG provides to its competitors, DTAG does not treat its subsidiaries and competitors on an equal footing. For instance, DTAG refuses to make automatic alternative overflow/emergency routing available to its competitors, while at the same time offering it to its subsidiaries.[15]

3) Restrictions on Billing and Collection Services by DTAG

DTAG, with the confirmation of the RegTP in the case of innovative Value Added Services (in particular, e-commerce), tries to impose such onerous requirements on its

[14] *Id.* at 4.
[15] *Id.*

competitors as to refuse for all intents and purposes to provide necessary billing and collection services. In its most recent offer, for instance, DTAG not only raises its charges for these services by up to 600%,[16] but also requires each individual competitor to submit to DTAG written direct debit authorizations individually for every single customer in order to be eligible for billing and collection services. If the authorizations are not submitted, DTAG charges the competitor a penalty for each customer. It is not only extremely burdensome to provide these written statements for up to 48 million German households, but also impossible to provide in those cases where a carrier does not have a nexus with their end-users, such as dial-around carriers and carriers with specific Value Added Services. In addition, as already mentioned, DTAG is not obliged, due to a recent regulatory decision, to provide billing and collection for innovative Value Added Services (e-commerce) of its competitors.

4) DTAG's Proposed New Network Structure is Unfairly Burdensome for Regional and National Competititve Carriers.

Currently, DTAG's interconnection tariffs are based on a 4-tier structure: "City", "Regional (50 km)", "Regional (200 km)", and "National". During the last year, the RegTP has studied a network element-based system for interconnection rates similar to the rate structure in other European countries ("local", "single transit", "double transit"). Yet, DTAG has submitted a proposal that, if adopted, will fundamentally change the interconnection regime in Germany, to the distinct disadvantage of competitive carriers. In particular, DTAG intends to impose a requirement of 1,000 local points of interconnection ("POI") on any competitive carrier that seeks local interconnection tariffs for the entire territory of Germany. If approved, this new model is expected to become effective in 2001. Due to the size of the "City" areas, a competitor is currently allowed to cover, for instance, the City of Berlin with only one POI and is eligible

[16] *Id.* at 2.

for "City" interconnection rates. Under DTAG's proposal, a competitor covering the same Berlin area would have to interconnect at 46 local POIs to reach all end-users at the local rate. Consequently, competitors are compelled to invest heavily into network planning to mirror DTAG's inefficient network and may be forced to write-off parts of their investment in infrastructure. Once again, this measure serves no useful purpose and is designed simply to raise the bar (and ensuing costs) for competitive providers. This is especially true for the many U.S. companies with nationwide activities in Germany that relied on the RegTP's ruling last year that they only needed a minimum of 23 POIs to cover Germany. These companies are now faced with the burden of making a huge new investment in POIs if they don't want to lose considerable ground. Under the new network-element based structure, these competitors would be severely punished for their streamlined national network structure on the basis of 23 POIs because DTAG would charge them the double tandem-tariff to terminate the calls. This extremely unfair situation was not at all foreseeable for them previously, and therefore makes obsolete their existing business cases.

In addition, the new network concept may inevitably lead to increasing predatory pricing by DTAG because the RegTP cannot use its unwritten principle that there should be a margin of at least 25 % between DTAG's end-user prices and the underlying costs of a competitive carrier (calculated by using only interconnection fees, no switches, no backbone, marketing, customer care, billing, etc.) necessary to provide the same services to its end-users.[17] The interconnection charges structured along network elements cannot be put into this oversimplified model anymore. A more sophisticated model will need to be developed.

[17] *Id.* at 8.

5) The RegTP's Regulatory Decisions Lack Transparency.

In contrast to the United States and most other European countries, there is considerably less transparency in the decision-making of the RegTP. The RegTP's website does not generally make the text of the RegTP's decisions available to the public. When tariff applications and decisions are made available to competitors, data is often heavily redacted to protect alleged "business secrets" of DTAG. This practice is considerably less open than the U.S. system or that of many European regimes where cost information of competitors is more readily available in order to determine whether access and other charges made by dominant carriers are in fact cost-based.

6) The RegTP's Regulatory Decisions Are Not Sufficiently Enforced.

As important as having clear industry standards and provisioning intervals is the ability to enforce these standards against incumbents swiftly and predictably. Experience in Germany with interconnection shows that the RegTP is extremely reticent about implementing a regulatory decision on this subject. Regulatory procedures are often long and burdensome, which lag naturally tends to benefit incumbents. Last June, the RegTP rendered a decision on some disputed ULL issues, such as splitting the costs for moving collocation space to another location and imposing binding provisioning intervals on DTAG for the delivery of ULL access. However, bowing to political pressure the RegTP refused a U.S. competitor's requests to impose automatic penalties on DTAG for violating the provisioning standards. In its decision, the RegTP – for the same reasons -- also refused to introduce a process that automatically monitors DTAG's provisioning intervals, similar to the systems used in Texas and New York, which would automatically calculate damages for under-performance of DTAG. With little explanation or

justification, the RegTP argued that implementing a benchmark system would be much too difficult and expensive.

Given the market inequality between DTAG and its competitors, and DTAG's incentive for delay, this process will not succeed on its own accord. In effect, if DTAG fails to meet the binding provisioning intervals for collocation space and lines, each competitor is forced to lodge individual complaints for every line or collocation space with the RegTP in order to challenge each particular delay. Otherwise, the competitor has to sue DTAG in court for each delay. This is not only burdensome and expensive, but also causes additional backlog and delay due to an overload on the regulator's docket. So far, the RegTP has not yet imposed significant penalties on DTAG.

Not content with the current regulatory situation, the Ministry seeks to further clip the RegTP's wings. As already mentioned the Ministry's Position Paper places even more restrictions on the ability of the RegTP to effectively regulate DTAG. The Paper determines that the RegTP should approve DTAG's prices "for at least one year" in order "to avoid unnecessary bureaucracy putting a burden on the market, in particular on DTAG."[18] Sadly, the RegTP appears to not recognize the need for changes in any of these policies in order to promote competition. The RegTP recently applauded DTAG's plans to acquire telecommunications companies in the United States because of the "background of the liberalized German telecommunications market"[19] in which U.S. carriers are investing. For these reasons, I am not sanguine that the German Government will take any action to increase competition in the German telecommunications market.

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[18] *Id.* at 10.

[19] Handelsblatt 07/25/00, Press Conference of RegTP President Scheurle.

V. DTAG's Anti-Competitive Behavior is not kept in Check by the Regulator.

As most recently evidenced in the Ministry's Position Paper, the RegTP, although established under German Telecommunications Act as an independent body, has come under increased pressure from the German Government to protect DTAG's interests and financial well being. As a result, even though the RegTP touts the "achievements" of liberalization of the German telecommunications market, its regulatory practices prove increasingly otherwise.

1) DTAG Is Not Prevented from Engaging in Cross-Subsidization.

In Germany, the Ministry has publicly declared that it wants to lift the long-standing *"ex ante"* price control in certain sub-markets, meaning the RegTP will no longer review DTAG's prices before they enter into force. This measure will almost certainly encourage DTAG to engage in below cost pricing for special customer groups, which will lead to a customer migration from the competitors back to DTAG. There is no control over DTAG's prices because the Ministry and the RegTP are not advocating accounting separation of DTAG to the extent that markets (both regional and products) under price control are separable from markets without price control. This is particularly true if the German market will be divided into several regional markets, as suggested in the Position Paper.[20] According to the Paper, DTAG may be released from the price control regime in several of these markets, even though it is within the purview of the German Cartel Office and the RegTP, not the Ministry, to determine the relevant markets. Without proper cross-subsidization control through separated accounts, this measure will allow DTAG to reinforce its dominant position in these markets. This is especially the case because DTAG has not been forced to compete through bifurcating its local network and other local and

[20] VATM Report at 5.

long distance services. Among other things, DTAG may be able to cross-subsidize its international business if it penetrates the U.S. market by imposing high access and local charges in Germany.

This behavior is encouraged by the RegTP's practice of determining price caps for DTAG's access charges. Currently, the RegTP only differentiates between residential and non-residential services, and curiously places international, national long distance, local and access services into the same basket. Consequently, DTAG is in the position to comply with the price cap by offering low rates for its long-distance and international services, where competition is emerging, and by keeping the prices for its local access services (where competition is embryonic) artificially high. The end customers using DTAG's local services, and the competitive carriers, will end up bearing the burden of this regulatory policy.

2) DTAG is Following a Strategy of Strategic Pricing in New Markets.

From a traditional point of view, strategic pricing prevents competitors from entering into a field because a dominant company can artificially keep prices low until the competitors are driven from the market, after which point the prices for the products concerned are raised. Over the past several years, the RegTP has not sufficiently discouraged behavior that has elements of strategic or predatory pricing. The most recent example is the RegTP's conditioned approval of a DTAG flat rate (making calls and surfing the Web on Sundays). Bowing to Government pressure, the RegTP approved this DTAG service over the strenuous protests of DTAG's competitors. Most recently, the RegTP did not seek to suspend DTAG's offer to provide DSL services to residential end-users for less than $5 a month. This price, in the view of many

competitors is clearly predatory and is much lower than in the United States where the DSL equipment is already significantly less expensive.

By engaging in this strategic pricing, DTAG seriously impairs competitors from entering the promising DSL market. It is true that strategic pricing may not work if a company is required to raise the prices for these specific products after a certain time period to finally cover its costs. However, a Party may decide to raise the prices for related products such as content if it has a dominant position in the means to access these products. Therefore consumers may pay less for access to the content, but much more for the content than in a competitive market situation without strategic pricing in the developmental phase of the market.

The following gives two concrete examples of DTAG's strategic pricing.

(a) The RegTP has allowed DTAG to provide a rebate to a customer who is already an ISDN customer and subscribes to the flat rate of DTAG's Internet provider "T-Online" (for $ 41 per month). The ISDN connection "AktivPlus" (including a 50% rebate for voice telephony) currently costs DM 54.88 (US$ 27) per month. In total, Internet via ISDN amounts to DM 133.88 (US$ 68). If the same customer subscribes to DTAG's new T-DSL service as of September 1, 2000, the customer will only be charged:

- DM 54.88 for the ISDN connection AktivPlus
- DM 14.89 (T-DSL)
- <u>DM 49 (Flatrate T-Online DSL)</u>

TOTAL: **DM 118.77 (US$ 55)** including the high speed and higher bandwidth of a DSL line.

(b) The RegTP recently issued an order permitting DTAG to introduce a flat rate XXL (DTAG's first flat rate offer) for a test period of 7 months beginning on June 1, 2000. This is good for Sundays and holidays only. Accordingly, DTAG's ISDN customers may choose to accept an increase in their monthly fee of DM 14.89 ($8) in order (without additional costs):

(1) To have unlimited surfing of the Internet via DTAG's provider T-Online; and

(2) To make unlimited telephone calls within Germany.

Further, customers may not be preselected to a competitor to use this service. Also, prior to this order DTAG was only permitted to charge for its services on a per-minute basis.

Competitors widely criticized this rate package unsuccessfully arguing that it materially increases the price squeeze between DTAG's interconnection charges (calculated on a per-minute-basis) and its end-user charges. Significantly, DTAG did not offer competitors comparable flat-rate services (such as interconnection) to enable them to offer their own flat rates. Competitors expect significant customer migration as a result of this pricing policy. The offer also blurs the line between DTAG's fees for voice telephony, where the RegTP's prior price approval is required, and Web communication, where this is not the case. It is already foreseeable that the XXL flat rate will lead to further congestion on DTAG's network because heavy users, who are no longer charged on a per-minute-basis, will remain connected to DTAG's network for the entire day. In addition, DTAG will be in the position to present bundled offers (for instance, combining voice and Internet services) which will undermine any efficient price control by the regulator.[21]

[21] *Id.* at 3.

3) DTAG Has No Outside Incentive to Open Its Local and Long Distance Markets

As the incumbent carrier for local, long distance and international services, there is not one line of the telecommunications business that DTAG does not dominate. DTAG already has telecommunications facilities in virtually every building in Germany, and has long-established relationships with most businesses. In contrast, in the United States the Bell Operating Companies ("BOCs") historically have been precluded from providing long distance service. Under Sections 251 and 271 of the 1996 Telecommunications Act, Congress was able to create a large incentive for BOCs to open their local markets, and provide interconnection and unbundled local loops, by making the BOCs entry into the long distance market conditioned on their complying with the regulations and safeguards needed to open the local markets. This is a powerful tool that the U.S. Government has for fostering competition. Unfortunately, the RegTP does not have such a competitive mechanism and there are few, if any, incentives for DTAG to affirmatively open their market. Therefore, it is even more critical that the RegTP be totally independent from the influences of the German Government, and can take an aggressive role regulating DTAG. So far, the RegTP has, after initial tough actions under another government, increasingly not been able to do so. As a result, DTAG continues to dominate the markets, succeeds in dominating new ones, and competition remains embryonic.

VI. Proposed EU Legislative Measures Will Not Change the Picture.

In many cases, gaps exist between national laws and EU laws as its Member States unequally interpret EU directives. The most recent EU proposed directives which intend to spur competition and close the "digital divide" with the United States generally will not take effect until the end of 2001 and have not yet passed the EU Parliament. Past experience has shown that

EU Directives are implemented quite unevenly within the Member States. In the aforementioned Position Paper, the Ministry already warned the EU that "the adoption of the additional legal standards in compliance with the development of competition must not be obstructed by EU law." The "principle of subsidiarity" (safeguarding the priority of national law over EU law) "must be strictly adhered to." The goal is that "the German legislator should have sufficient room for maneuvering to ensure the competitiveness of *German* [emphasis added] carriers on the European and global level. "[22] Therefore, one should not expect that pro-competitive missives from Brussels will improve the competitors' situation in Germany.

VII. Proposal.

In order to evaluate which measures the U.S. Government should adopt to encourage open market environments, the matter should be addressed on a country-by-country basis. In the case of Germany, DTAG's behavior as a whole has been anti-competitive, and the German Government's response has not been in congruence with its WTO obligations. Moreover, the competitive situation has actually worsened during the last year. Because DTAG's share price has plummeted by approximately 60% since the beginning of this year, there is mounting pressure from the political level public on the Federal Government to interfere with market and competitive forces to bolster DTAG's stock.

- In general, a key goal should be to ensure that U.S.-based and financed companies have an open market environment and the opportunity to compete, as set forth by the WTO agreements, particularly as to cost based interconnection and access to end users. The RegTP and the Ministry are obviously under political pressure to protect DTAG. However, there is

[22] *Id.* at 2.

no valid reason that a highly industrialized country with an advanced telecommunications regulatory regime like Germany should not be able to abide by the WTO standards. Therefore, DTAG can and should make the necessary commitments to change its anti-competitive practices in order to create an open environment and adequate opportunities for meaningful competition in Germany. In addition, regulators must actively enforce these commitments by DTAG. Provided that these commitments are made and enforced, the United States should allow DTAG to own U.S. telecommunications companies.

- Although the German regulatory authorities will take a primary role in enforcing DTAG's commitments as they relate to its actions in the German telecom market, U.S. regulatory authorities also should play a role. The U.S. Government has both expansive and flexible competencies in the sector of merger approvals. Merger approvals should be granted under the condition that the U.S. Government supervises the performance of DTAG and has the power to impose stiff penalties upon backsliding and failure to adhere to any commitments it makes. The following are the minimum commitments to the regulators that DTAG should make to ensure open competition in the German telecom market.

  1) DTAG must timely publish and monitor its internal and external provisioning intervals for all products it offers to competitors such as unbundled local loops, collocation space, interconnection lines, etc. (including all milestones, for instance the intervals for preparing the offer). The information should be published for each month by the end of the first week following that month.

  2) DTAG must accept considerable contractual penalties for provisioning lapses and other service deficiencies in their agreements with their competitors. Penalties for failure to

meet the benchmarks should be assessed in accordance with terms contained in the interconnection agreement. A pre-established matrix should be used and made publicly available to determine the penalty for failure to comply with a given benchmark.

3) DTAG must provide convincing evidence that it complies with the provisioning intervals by observing a benchmark of at least 98.5% of all orders (presenting the order collocation space, delivery of collocation space, reaction period for a loop order or interconnection port order, and delivery of the loop or the interconnection port order). Each order should be delivered free from defects. If DTAG falls below this benchmark during a certain month, DTAG must make good for this difference during the following month if it wants to avoid predetermined considerable penalties.

4) DTAG must make available its internal data which serves as DTAG's basis for loop provisioning to competitors so that both competitors and DTAG must commence discussions as soon as possible on how to streamline the process. The target deadline should be sufficiently in advance of the RegTP's review on DTAG's ULL charges by March 31, 2001. Electronic bonding, meaning a state-of-the-art online connection between DTAG and the competitors for ordering and monitoring of the competitors' orders, must be part of the process. The RegTP should review the ULL charges on the basis of the streamlined process. The goal is significant reduction of DTAG's inflated fees for unbundled loops.

VIII. Conclusion

DTAG and their government appointed managers have calculatedly and deliberately made it onerous for U.S.-based carriers to compete in the German market. DTAG should shake

off its bodyguard of Government investors and managers and compete fairly in the marketplace with privately owned competitors. Therefore, DTAG should be allowed to invest in the U.S. telecom market if it meets two conditions that will serve to help pry open the German market to competition. First, DTAG must make specific binding commitments to cease immediately all its anti-competitive practices. In this regard, DTAG should commit to timely publish and monitor its provisioning intervals on a monthly basis; to accept a state-of-the-art ordering and benchmark system via electronic bonding as well as severe contractual penalties and other prompt and predictable enforcement action for provisioning lapses and service deficiencies; to make available its internal planning data for loop provisioning; and to significantly reduce its inflated fees for unbundled local loops. Second, DTAG's regulators must enforce these commitments vigorously, promptly and in a manner that displays no favoritism toward DTAG.