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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion to Assess and Revise the New Regulatory Framework for Pacific Bell and Verizon California Incorporated.	**Rulemaking 01-09-001 (Filed September 6, 2001)**
Order Instituting Investigation on the Commission's Own Motion to Assess and Revise the New Regulatory Framework for Pacific Bell and Verizon California Incorporated.	**Investigation 01-09-002 (Filed September 6, 2001)**

MCI, INC.'S OPENING COMMENTS ON ASSIGNED COMMISSIONER AND ADMINISTRATIVE LAW JUDGE'S RULING INVITING COMMENTS REGARDING THE SCOPE AND SCHEDULE OF PHASES 3A AND 3B

MCI, Inc. ("MCI") respectfully submits its opening comments in response to the Assigned Commissioner and Administrative Law Judge's Ruling Inviting Comments Regarding the Scope and Schedule of Phases 3A and 3B of the above-referenced proceeding, dated October 15, 2004 ("Ruling").

I. INTRODUCTION AND SUMMARY

The Ruling seeks comments on two issues; 1) whether and how the scope of Phases 3A and 3B should be revised in light of the technological, regulatory, and market changes that have occurred since the scope of these phases was originally established and 2) whether phases 3A and 3B should be consolidated. MCI submits the following comments on the first issue. With respect to the second, MCI has no objection to a consolidation of phases 3A and 3B.

MCI appreciates the insight evidenced by the Ruling's invitation for comments on how technological, regulatory, and market changes over the past few years should affect the scope of this proceeding. MCI welcomes the opportunity to address this issue, for it

is critically important to the future of the telecommunications industry in California. There can be no question that profound changes in all aspects of the telecommunications landscape, developments occurring since the scope of Phase 3 of this review of the New Regulatory Framework ("NRF") was last considered and revised by the Commission,[1] warrant a more comprehensive and updated examination of the issues.

This proceeding is intended to provide the first comprehensive re-examination of the regulatory rules and policies that should be applied to the two largest incumbent local exchange carriers in California in several years. MCI anticipates that the dominant incumbent local exchange carriers, Verizon California Inc. ("Verizon") and Pacific Bell, Inc. ("SBC") (collectively "dominant ILECs"), will emphasize in their opening comments that significant technological, regulatory and market changes have occurred since the Commission originally established the scope of Phases 3A and 3B. MCI wholeheartedly agrees with this indisputable premise. The dominant ILECs will likely go on to argue that these developments justify the Commission's broadening or focusing of the issues in order to consider substantial further relaxation of its current scheme of regulation of the dominant ILECs. This theme was foreshadowed in a speech by Verizon's chairman and CEO, Ivan Seidenberg, last week. Mr. Seidenberg reportedly told an industry conference:

> Existing economic regulation should be reevaluated. We're no longer utilities. We no longer have protected markets. So in most cases, we should be taxed and governed by the same policies and rules that apply to other industries.[2]

[1] See *Assigned Commissioner's Ruling Revising the Schedule and Clarifying the Scope of Phase 3,* September 23, 2002.

[2] See Telecommunications Reports, Nov. 1, 2004, at 4.

MCI agrees that this sound policy direction is necessitated by recent technological, regulatory, and market developments in the telecommunications industry. These developments justify substantial relaxed regulation, but not just for the dominant ILECs. Economic regulation of traditional wireline carriers as pubic utilities should be reevaluated. Progressive regulatory reform is necessary now and, in light of these developments, needs be designed to truly "level the playing field" for all market participants -- not just for traditional dominant and non-dominant wireline telecommunications carriers, but also between them and non-traditional communications providers, such as cable companies, wireless, and Voice over Internet Protocol ("VoIP") providers.

MCI urges the Commission to ensure that all the interrelated ramifications of these dramatic changes in the industry and the way in which its market participants are regulated or *not regulated* are considered thoroughly, comprehensively, in proper context and in a manner that is balanced and fair to all stakeholders. Thus, as the Commission considers the relaxation or elimination of detailed pricing rules, service quality regulations, monitoring and reporting requirements, and the numerous other regulations that have been identified for review in Phase 3, it must make sure that these legacy rules are removed for all market participants, both incumbent ILECs and non-dominant wireline service providers alike, either in this docket or in other contemporaneous proceedings. In this proceeding, MCI will advocate "real deregulation." Real deregulation means that the underbrush of old, traditional regulation must be cleared away so that the market, not the regulator, picks winners and losers, ensuring that the unequal burden of outdated regulation is not perpetuated. Real deregulation will foster

more real competition. It also means that no one carrier can or should be protected by regulation.[3]

Two fundamental guiding principles underlie this new policy approach and need to be considered concurrently with the Commission's consideration of relaxed regulation for the dominant ILECs. Certainly the Commission needs to consider that any relaxation of the "burdens" of regulation on the dominant ILECs must apply *at least equally and concurrently* to all wireline telecommunications carriers that are currently subjected to the Commission's pervasive regulation. The Commission should ensure that competitive wireline telecommunications carriers which, unlike the dominant ILECs, possess no market power or other source of dominance in the California wireline telecommunications marketplace, are not disadvantaged by more burdensome regulation at the same time the Commission relaxes regulation of the dominant ILECs. But even more importantly, as we explain further below, symmetry of regulation or the concept of a level playing field needs to be considered in the context of all market participants, including those such as cable companies, wireless, and VoIP providers, not just the traditional wireline telecommunications companies that have historically been the focus of Commission regulation.[4]

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[3] Because this proceeding focuses on the regulation of retail services and the ILECs' participation in retail markets, MCI does not address here issues relating to the regulation of the wholesale provision of ILEC services and facilities, such as interconnection, resale and unbundling under Section 251 of the Telecommunications Act of 1996.

[4] The FCC has referred to such competitors as "intermodal," defined as "facilities or technologies other than those found in traditional telephone networks," including "traditional or new cable plant, wireless technologies (satellite, mobile, and fixed), power line (electric grid) technologies, or other technologies not rooted in traditional telephone networks." Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, *In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers* (CC Docket No. 01-338); Implementation of the Local Competition Provisions of the Telecommunications Act of 1996 (CC Docket No. 96-989); Deployment of Wireline Services Offering Advanced Telecommunications Capability (CC Docket No. 98-147), FCC No. 03-36, (rel. Aug. 21, 2003) (hereinafter, "*Triennial Review Order*" or "*TRO*"), at ¶ 97 n. 325.

In addition, it is equally important that the Commission concurrently address the remaining vestiges of regulatory protectionism or the "benefits" bestowed on the dominant ILECs under the Commission's existing scheme of regulation, which are no longer justified in the current competitive marketplace. The lingering vestiges of archaic rate base/rate of return regulation born in the days of the old Bell System monopoly and designed to protect dominant ILEC revenue streams, often under the guise of promoting "universal service," seriously tilt the playing field against competitive wireline telecommunications carriers and threaten to eliminate competition in traditional wireline local and long distance markets. The Commission needs to consider reform of the regulatory protections that substantially advantage the dominant ILECs at the same time it considers relaxation of the regulations that the ILECs will argue are a relative burden. Under "real deregulation," just as no carrier should be burdened by the old regulatory process, no carrier should be protected, and even subsidized, by traditional regulatory policy and programs.

With this background in mind, MCI presents additional questions in Section I below that should be addressed by parties in the context of this proceeding. Including these additional issues within the scope of the comments in this proceeding does not necessarily mean that relief on the broader issues can be accomplished in this proceeding. Insofar as this proceeding is intended to address the appropriate regulation of dominant ILECs subject to NRF, it may not be possible to grant similar relaxed regulation for non-NRF wireline carriers in this docket. If the Commission is not inclined to expand the scope of this proceeding to include broad-based, balanced regulatory reform for all wireline service providers, it should commit to consider comparable relief, i.e.,

symmetrical deregulatory action for all wireline carriers, in a separate proceeding conducted concurrently.

Similarly, reform of the current system of intrastate access charges in California is necessary to remove substantial subsidies that have been too long tolerated by the legacy regulatory regime, but are no longer appropriate in a more competitive market. This issue is the subject of a separate proceeding which, though long overdue, may not be able to be accommodated in this proceeding. Intrastate access reform, however, should be separately considered in parallel with this proceeding. In addition, the Commission has not yet commenced the review of its universal service program, which it originally intended would begin several years ago. The definition of universal service, its funding and administration in California need to be reexamined as well in light of the profound changes to the communications landscape we address in these comments.

Further, it may be that the record developed in this proceeding demonstrates that in order to fully advance real deregulation and truly accomplish the goal of a "level playing field," enabling legislation may be required. Nevertheless, consideration of these issues in comments is critical to a fair, balanced and thorough examination of how to reform regulation of the telecommunications industry in California to accommodate the realities of the modern communications landscape. At a minimum, parties should be permitted – indeed, encouraged -- to address in their comments in this proceeding what other Commission dockets or legislative initiatives need to be given equivalent priority in order to accomplish fair, balanced and appropriate deregulation.

II. THE SCOPE OF COMMENTS IN PHASES 3A AND 3B SHOULD INCLUDE CONSIDERATION OF RELAXING THE BURDENS OF REGULATION WHICH CURRENTLY FALL UNEQUALLY AND UNFAIRLY ON ALL TRADITIONAL WIRELINE TELECOMMUNICATIONS CARRIERS.

Twenty years after the breakup of the Bell System, the telecommunications industry is changing at a light-speed pace. The stand-alone long distance and stand-alone local consumer markets are eroding as the industry sees rate compression, and increasing substitution of wireless phones, Instant Messaging, pre-paid calling cards and e-mail.[5] Consumers are increasingly looking for bundles of services, not just local and long distance, but local, long distance, wireline, broadband, entertainment and more. The convergence of voice and data, and the rapid explosion of computer applications that use the Internet to transmit streaming audio and video, and enable two-way voice communications over the Internet (so-called "Voice over Internet Protocol" or "VoIP"), are rapidly contributing to the decline of the "traditional" voice market.

As a result of these technological and industry trends, traditional wireline carriers are now facing competition, not just among themselves and from wireless carriers, but from non-traditional carriers, such as cable companies, VoIP providers, and soon even voice applications offered by other providers such as ISPs. The emergence of new, non-traditional carriers necessitates some fundamental changes in state regulation.

Cable

In California, several "cable TV" companies have been certificated as competitive local exchange carriers, and have been able to attract very large numbers of mass market

[5] For example, by the end of 1999, the volume of e-mails in this country surpassed the pieces of mail handled by the U.S. Postal Service. See "Messaging Online," February 4, 2000, http://www.sims.berkely.edu/reasearch/projects/how-much-info/internet/emaildetails.html At the same time, it was estimated the number of e-mail accounts reached 225 million in the U.S. while the FCC reported that the number of end user telephone lines stood at 189 million. See "Newsbytes," April 5, 2000, http://www.cnn.com/TECH/computing/9904/05/fccphones.idg.

telephony customers. Cable telephony is no longer an emerging technology – it has arrived. Moreover, cable networks within the cable companies' franchised territories offer ubiquitous coverage in residential markets, and reach many small business customers, as well. It has been estimated that "six million small- to medium-sized businesses (SMB) are located within a few hundred feet of the local hybrid fiber/coaxial network . . . [w]ith the current cable infrastructure passing nearly 2.5 million SMBs today."[6]

Cox provides local telephone service to residential and business customers over its cable facilities in Los Angeles, Orange County and San Diego,[7] as well as other areas of the state. Having launched its telephone service in California in September 1997, Cox is now the third largest telephone service provider in the state, and one that is virtually unregulated.[8] Recently, Cox began offering unlimited local and long distance calling plans in all of its markets,[9] and now claims 30 percent residential market share in Orange County.[10]

Comcast (formerly AT&T Broadband) serves more than 3 million subscribers in California.[11] It has deployed circuit-switched cable telephony in the Bay Area,[12] plans to

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[6] J. Shim & R. Read, Credit Lyonnais Securities, *The U.S. Cable Industry – Act I* at 196 (Nov. 20, 2002).
[7] Soundi (New Paradigm Resources Group, CLEC Report 2003, Chapter 6 – Cox Communications, Inc. at 8-10 (17th ed, 2003).
[8] Cox Communications, Whitepaper: Preparing for the Promise of Voice-over Internet Protocol (VoIP) at 1 (Feb. 2003) .http://www.cox.com/PressRoom/supportdocuments/VOIDwhitepaper.pdf). Cox Press Release, Cox Digital Telephone Scores High in Customer Satisfaction; Research Shows 91% of Cox Digital Telephone Customers Would Recommend Cox Phone Service to a Friend (Aug. 14, 2001).
[9] Q3 2003 Cox Communications Inc. Earnings Conference Call – Final, FD (Fair Disclosure) Wire (Oct. 28, 2003).
[10] Cox, The Case for Cable Telephony at 2 (Oct. 2002), http://www.cox.com/PressRoom/supportdocuments/CaseCableTelephonyOctober2002.doc.
[11] Construction Begins on New Comcast Call Center in Sacramento Area, PR Newswire (June 10, 2003).
[12] Kagan World Media, Future of Cable Telephony at 12 (1st ed., 2003).

spend approximately $650 million upgrading its system by the end of 2004,[13] and already provides telephone service to over 500,000 subscribers in that region.[14]

Another company, RCN, offers bundled communications services. It has operational voice switches in Los Angeles and San Francisco, which it uses to provide local telephone service.[15] RCN's San Francisco system passes 90,000 homes, including portions of Burlingame, Dale City, Redwood City, San Mateo and South San Francisco.[16] RCN claims that it signs up "about 30 percent of its customers in...potential markets," which would translate to approximately 30,000 residential customers in the Bay Area.[17]

VoIP

Voice over Internet Protocol ("VoIP") applications have also arrived on the scene since the Commission first undertook this review of the NRF regime. The Commission has developed a substantial knowledge base about this new phenomenon in its pending inquiry into VoIP services, so our discussion of these applications here will be brief.[18]

Internet Protocol telephony service, such as that provided by Vonage – "the

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[13] J. Tessler, Comcast Begins Cable Takeover, Contra Costa Times (Feb. 13, 2003).
[14] AT&T Broadband , Investor Presentation at 18 (July 2001).
[15] New Paradigm Resources Group, CLEC Report 2003, Ch. 6 – RCN Corp. at 10-11 (17th ed. 2003).
[16] T. Wallack, RCN Looking Shaky, The San Francisco Chronicle (Nov. 22, 2003).
[17] Id.
[18] *O.I.I Re the Extent to Which the Public Utility Telephone Service Known as Voice over Internet Protocol Should Be Exempted from Regulatory Requirements*, I. 04-02-007. See MCI's April 5, 2004 comments in this proceeding, which addressed the myriad types of emerging IP-based voice applications. These "nontraditional" voice applications are burgeoning, properly not subject to traditional public utility regulation and, as a practical matter, immune from regulation. In addition to the newcomers addressed in the text, "traditional" cable TV companies, including, Cox, Time-Warner and Comcast all have indicated 2004 rollouts for their VOIP-based services. MCI is not in anyway suggesting that VoIP should be regulated. Regulators should refrain from asserting control over Internet applications such as VoIP and let the Internet develop unfettered as intended.

broadband phone company" is now offered broadly in California.[19] Vonage offers VoIP throughout large areas of California. For example, Vonage has acquired NXXs in 23 California area codes, including the San Francisco/Oakland/San Jose, Sacramento, Los Angeles, and San Diego metropolitan areas. According to Vonage CEO Jerry Citron, "Vonage is continuing with our strategic plan to rollout area codes to the top metropolitan areas on a regular basis while constantly introducing exciting advanced features that improve our customer's experience."[20]

Vonage provides phone service to customers over residential broadband Internet connections, such as cable modem service. Vonage claims to be the "fastest growing telephone company in the US," with more than 70,000 lines in 1,900 active rate centers in over 100 US markets. By the end of last year, it was adding 10,000 lines per month and transmitting more than 3 million calls per week over its VoIP network.[21] Vonage refers to itself as an "all-inclusive home phone service" that is "like the home phone service you have today - only better!"[22] It claims to be the "key to easy and affordable communications, by offering flat-rate calling plans that include all of the features, as well as many features not available from Verizon like online voicemail retrieval and area code selection."[23]

Entities such as Vonage, Skype and Pulver.com represent a radical departure from the kinds of telecommunications service providers that have existed in the past. Indeed, while they provide a communications capability to end users, there is significant doubt as to

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[19] See Vonage, Vonage DigitalVoice: The Broadband Phone Company, http://www.vonage.com/.
[20] Vonage Press Release, Vonage Rolls Out New Area Codes to San Francisco, San Jose and Surrounding Bay Area (Apr. 10, 2002).
[21] Vonage Press Release, Vonage Announces Private Label Agreement with CableAmerica (December 2, 2003)
[22] See http://www.vonage.com/learn_tour.php.
[23] Vonage Press Release, Vonage DigitalVoice Launches Service in Harrisburg, Pennsylvania (Mar. 7. 2003) (quoting Vonage chairman and CEO [illegible]).

whether they offer "telecommunications service," as defined in the Telecommunications Act. The fact that these entities are in no way subject to regulatory oversight by this Commission (and other regulatory bodies) is important to the agency's analysis of the regulatory framework that is appropriate (or not) for traditional wireline service providers.

Wireless

Rapid advancements in switching technology and microprocessors, combined with the removal of entry barriers (by increasing the amount of radio spectrum available) have contributed to the explosive growth of wireless services. Competition is flourishing in the commercial wireless marketplace. The FCC's 2004 annual Commercial Mobile Radio Service ("CMRS") competition report, documents that 97% of the U.S. population lives in a county with access to 3 or more competing carries, compared to 95% the previous year and 88% in 2000. The number of subscribers increased from 141.8 million to 160.6 million during a 12-month period through the end of 2003. The nationwide penetration rate stands at 54%. Table 2 in that report shows that the number of wireless subscribers in California grew to a whopping 20.4 million, up 16% over the 12-month period through the end of 2003.[24]

Over the years, the size of cell phones has shrunk from the size of a shoe box to a device that fits in a person's pocket. In addition, the features packed into the "phones" include everything from address books and games to cameras. The latest devices integrate telephone, camera, web and e-mail access, text messaging, and PDA functions in the same device – at a fraction of the cost of early cellular "telephones."

[24] "Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile

As a result of these developments, consumers have found wireless service not only to be comparable to traditional wireline service, but in some regards, even superior. There are many wireless carriers in California today that provide significant competition to traditional wireline carriers. Consumers increasingly use their cellular phones to place long distance and local calls, instead of wireline phones. This wireless displacement is due, in part, to the disparate intercarrier compensation regimes that place traditional wireline interexchange carriers at a material, unfair cost disadvantage relative to their unregulated wireless competitors.

Other wireless technologies have recently been accepted in growing numbers as persons link their computers using Wi-Fi "hot spots." An exciting new development, known as Wi-Max, offers the potential for high-throughput broadband connectivity over long distances, thereby further enhancing consumer choice. Of particular note, Wi-Max development is being fostered through the cooperative efforts of major firms, such as Intel, Siemens Mobile, Alcatel and others that are not traditionally associated with the provision of (or regulated as) telecommunications "utility" services.[25]

As one must conclude from the proliferation of nontraditional service providers that compete directly with traditional wireline carriers, telephony can no longer be thought of as traditional regulated "utility" services. Rather, policymakers need to see "communications" as a broader market in which many traditional and nontraditional players participate. Regulation imposed on traditional carriers -- while non-traditional

[25] See, for example, "Mayor Announces Wi-Fi plan for San Francisco," Reuters, November 22, 2004, 12:25 BST; Wi-Max World Trade Show, November 3, 2004, "Wi-Max for the Masses?;" Wi-Fi Technology Forum Press Release, November 3, 2004, "Study shows W-Fi Technology With Strong Growth; Security Remains Barrier Wireless LANs (Wi-Fi Networks) Go Maintstream is IT as Security Improves; VoWLAN Looks Promising."

carriers are virtually unregulated (and immune from state regulation as a "public utility") -- creates asymmetrical regulation. The differential regulatory treatment is discriminatory and artificially skews markets. Traditional wireline carriers, including those subject to NRF and nondominant competitive carriers like MCI, face substantial costs of regulation at the state level – rate regulation, certification requirements, change of control/merger approvals, reporting and tariffing requirements and service quality standards -- that non-traditional service providers like cable companies, wireless carriers and VoIP providers do not incur.

The current regulatory system has its origins in the era of monopoly "utilities," when plain black rotary-dial telephones were in vogue following the breakup of the Bell System 20 years ago. That system treats traditional wireline telecommunications providers like other public utilities and tries to draw a clear line between local and long distance services, interstate and intrastate wireline traffic, and the different technologies that are used to provide services that are for all intents and purposes substitutable and virtually indistinguishable. While competition has transformed the industry and ushered dramatic changes and innovation in technology, those market and technological changes have been shoe-horned into the old regulatory structure. Convergence and the proliferation of broadband services are ushering in a new era in communications, in which traditional carriers and nontraditional voice application providers compete for customers (both consumer and business). The lines between local and long distance, and intrastate and interstate jurisdiction, are becoming blurred and are of little or no significance in the marketplace. Regulated carriers compete head-to-head with non-regulated carriers for the same customers. These competitive forces from non-regulated

providers give policy makers no choice but to rethink how the industry is and should be regulated.

Traditional wireline providers, like MCI and those subject to NRF, are competing against the new kids on the block and are forced to provide services under completely different sets of rules. Under the current lopsided regulatory system, regulations choose the winners and losers in the marketplace – not consumers and end-users. Traditional carriers like MCI or the Bell companies are still bound by yesterday's regulatory requirements -- state certification, rate regulation, service quality standards, reporting and tariffing requirements. Wireless carriers and other "non traditional'' carriers are not subject to any of these requirements. The current system creates an "un-level'' playing field, where "traditional'' carriers like MCI and the Bell companies are bound by out-of-date requirements while wireless carriers and newer "non-traditional'' carriers remain largely unregulated and unfettered by unnecessary regulation.

In this proceeding the Commission has an opportunity to establish "real deregulation'' that is appropriate and balanced, by fixing an outmoded, broken regulatory system that hinders some service providers while protecting other businesses. Policy makers are not dealing with your Mother's or Father's telephone service anymore. Because the communications industry has dramatically changed – regulation of it needs to change too.

State requirements on traditional providers that do not provide any real consumer protection should be cleared away. Therefore, the Commission should broaden the scope of the comments in this proceeding to permit parties to address the following additional questions.

1. What Commission regulations governing the certification of wireline telecommunications companies are unjustified and need to be relaxed or rescinded in order to provide for more symmetrical regulation of traditional wireline and other nontraditional communications companies? Do any of these proposals for removing or relaxing regulations require legislation or action in other Commission proceedings?

2. What Commission regulations that impose reporting requirements on wireline telecommunications companies are unjustified and need to be relaxed or rescinded in order to provide for more symmetrical regulation of traditional wireline and other nontraditional communications companies? Do any of these proposals for removing or relaxing regulations require legislation or action in other Commission proceedings?

3. What Commission regulations governing the filing and service of tariffs by wireline telecommunications companies are unjustified and need to be relaxed or rescinded in order to provide for more symmetrical regulation of traditional wireline and other nontraditional communications companies? Do any of these proposals for removing or relaxing regulations require legislation or action in other Commission proceedings?

4. What Commission regulations governing rate regulation of retail service offerings by wireline telecommunications companies are unjustified and need to be relaxed or rescinded in order to provide for more symmetrical regulation of traditional wireline and other nontraditional communications companies? Do any of these proposals for removing or relaxing regulations require legislation or action in other Commission proceedings?

5. What Commission regulations governing review and approval of merger, change of control, financing or transfer of assets or stock by wireline telecommunications companies are unjustified and need to be relaxed or rescinded in order to provide for more symmetrical regulation of traditional wireline and other nontraditional communications companies? Do any of these proposals for removing or relaxing regulations require legislation or action in other Commission proceedings?

6. What Commission regulations imposing service quality standards and related reporting requirements on wireline telecommunications companies are unjustified and need to be relaxed or rescinded in order to provide for more symmetrical regulation of traditional wireline and other nontraditional communications companies? Do any of these proposals for removing or relaxing regulations require legislation or action in other Commission proceedings?

III. THE COMMISSION NEEDS TO PRIORITIZE AND CONSIDER CONCURRENTLY WITH THIS PROCEEDING ELIMINATION OF THE "UNEQUAL PROTECTION" OR OUTDATED AND UNJUSTIFIED BENEFITS BESTOWED ON THE DOMINANT ILECS BY THE CURRENT REGULATORY PARADIGM.

The purpose of this proceeding and the goal of those ILECs that are subject to NRF is to re-examine the regulatory framework applicable to their services and to modify it as appropriate in light of today's market realities. As explained above, it is clearly appropriate to remove the underbrush of traditional regulations where it is no longer necessary – for dominant ILECs as well as other wireline service providers.

At the same time the ILECs seek to escape the "burdens" of regulation in an increasingly competitive market, it is essential that they no longer be permitted to enjoy the "benefits" of the traditional regulatory regime that was designed in an era when monopoly utilities reigned. Those that seek to be treated, for regulatory purposes, as competitors, should experience what participants in competitive markets generally face – the fact that they are not the beneficiary or recipient of government-mandated or approved subsidy payment programs. Real deregulation means that those companies that seek to compete openly in the market free of regulatory constraints also forego the benefits and protections, including subsidy payments, of the legacy regulatory regime.

Traditional carriers are stuck with a hodgepodge of outmoded, irrational and subsidy-ridden intercarrier compensation systems that include fees such as access charges which are a relic of the breakup of the Bell system. Wireless carriers face a different hodgepodge of systems – but at a decided financial advantage. Interexchange carriers pay high intrastate (as well as interstate) access charges to originate and terminate long distance calls on ILEC networks. These high access charges are often justified in the

name of "universal service." Other non-regulated providers pay lower or different rates to ILECs for the same use of the same access facilities.

Traditional carriers are also forced to bear the burden of programs to support funding of universal service based on outmoded notions of universal service. But traditional notions of universal service no longer make sense in an era when voice applications are carried on non-traditional platforms and competition comes from non-traditional players.

MCI understands that Commission reform of the current intrastate universal service program and intrastate access charges are currently subjects beyond the scope of this proceeding. Nevertheless, MCI takes this opportunity to stress that the Commission needs to give priority to these matters. The Commission needs to act now in its current access charge proceeding, pending for over a year now,[26] to consider an issue with a decade long history of neglect at the Commission. It should immediately in Phase 1 of that proceeding eliminate the dominant ILECs' admittedly non-cost based network and transport interconnection charges (NIC and TIC). It should move quickly, immediately thereafter in the next phase of that proceeding to consider a further reduction of access charges to forward-looking economic cost. The Commission should also broaden its inquiry to address reform designed to rationalize and harmonize all intercarrier compensation schemes within its jurisdiction and eliminate the inequities and competitive market distortions they now cause. Access charges should be brought to the cost of completing a local call. Network interconnection and intercarrier compensation should be

[26] Order Instituting Rulemaking to Review Policies Concerning Intrastate Carrier Access Charges, Rulemaking 03-08-018; see Decision Granting Petition of AT&T Communications of California and Order Instituting Rulemaking to Review Policies Concerning Intrastate Carrier Access Charges, mailed on August 28, 2003.

rationalized, with particular attention given to the fact that in a converged world the jurisdictional nature of traffic flowing across networks is indistinguishable.

It is also time for the Commission to commence a long overdue review of its universal service program, in particular the Commission's California High Cost Fund B ("CHCF-B"). That fund has awarded some $900 million in grant monies to the state's largest dominant carriers, SBC and Verizon, in the past two fiscal years alone. Over the years, billions of dollars in payments from these funds have been earmarked for these large ILECs. The program has not been reviewed, nor has the appropriate sizing or administration of the fund been examined, since its inception in 1996.

A review of this outdated system of subsidies is critical now for a number of reasons in addition to the dramatic changes that have occurred in the technological and market environment in which both traditional wireline and non traditional communications companies compete. First, the subsidies were established based on old, obsolete ILEC cost studies. New Commission-approved TELRIC cost studies for the dominant ILECs' unbundled network elements are now or soon will be available that can be used to examine the cost reasonably needed to provide universal service in California. Second, simple population growth and demographic changes in California since 1996 justify a reexamination of the program. Finally, the CHCF-B is not being administered in a competitively neutral fashion to make the current subsidies available to competitive suppliers of local exchange service as was originally intended. While MCI does not agree with all of the recommendations and conclusions or necessarily the perspective

offered by the Commission's ORA in its recent report,[27] MCI emphatically agrees that the whole issue of the need for and structure of universal service funding in California is in dire need of Commission attention. It has never been comprehensively reviewed despite the fact that the Commission had mandated that a review of the program be conducted three years after it was established. The efficacy of the program has been called into question. Indeed, the manner in which funding is made available to an elite duo of large ILECs may actually impede the development of local competition because they are not being administered in a competitively neutral fashion. It is clear that the program is providing dominant ILECs with a significant source of steady funding that they can use to obtain a competitive advantage over other traditional wireline carriers.[28] In a competitive environment, there is no room for this form of subsidization of large market participants. Finally, nontraditional communications firms, such as cable and VoIP providers, completely escape the burdens imposed on companies and customers by the Commission's CHCF-B.

The current mechanisms in place to support "universal service" do not reflect the realities of today's telecommunications marketplace. Indeed, the entire concept of universal service needs to be redefined in light of today's market realities. Universal service programs should focus on protecting the customer – not protecting companies' revenue streams. The CHCF-B or its replacement should be concerned with customer needs and affordability. Moreover, in a competitive environment, the program should not be designed so as to direct government subsidies to a limited subset of market

[27] The Office of Ratepayer Advocates' Review of The California High Cost Fund B: A $500 Million Subsidy Program For Telephone Companies, released March 22, 2004.
[28] Id., "Executive Summary" at 1-2.

participants, indeed to firms that have no legitimate need for massive subsidies and can no longer justify their receipt of them. Universal service subsidies should be explicit and separately funded and administered in a competitively neutral manner. While California's CHCF-B is properly made explicit and separately supported, intrastate access charges have not been reduced to remove implicit subsidies that currently bloat intrastate access rates. Also, in light of the advent and growth of nontraditional communications competition the CHCF-B may not be structured in a competitively neutral fashion. It is certainly not being administered in a competitively neutral fashion, even among traditional wireline telecommunications companies.

IV. CONCLUSION

For all the foregoing reasons, MCI respectfully urges that the Commission broaden the scope of its inquiry in this proceeding to consider the specific questions set out in Section I of these comments. Economic regulation of traditional wireline carriers as public utilities should be reevaluated. The questions MCI proposes would permit the parties to comment on and justify relaxation of specific regulations which currently burden unequally all traditional wireline carriers, not just the dominant ILECs. In light of recent technological, regulatory, and market developments which have introduced increasing and virtually unregulated competition from nontraditional communications companies and technologies, consideration of these issues is critical to the competitive vitality of traditional wireline carriers in the new age of communications. If the Commission does not broaden the scope of this proceeding, MCI will continue to participate and offer the perspective of real deregulation as it relates to issues already within its scope. However, if the Commission chooses to proceed without changing the

scope of this proceeding, we strongly recommend that the Commission open and give priority to a concurrent proceeding to consider real deregulation that considers the realities of the current communications landscape.

At the same time, the Commission needs to focus on the hodgepodge of irrational subsidy mechanisms, both implicit and explicit, which currently exist and heavily tilt the playing field against competition and consumers in favor of the dominant ILECs. The Commission needs to prioritize and complete its pending access charge proceeding in a manner that immediately reduces the unjustified, excessive, anticompetitive intrastate access rates currently in effect in California. It can then move on quickly to consider broader reform to rationalize and unitize all intercarrier compensation within its jurisdiction. In addition, the Commission should immediately commence the overdue review of its universal service programs in California, in particular the CHCF-B, to reexamine the definition of universal service in the context of new market realities and ensure those programs are funded appropriately and administered in a competitively neutral fashion.

Respectfully submitted,

William C. Harrelson

Certified as a True Copy
of the Original Filed in Central Files.
CHIEF ADMINISTRATIVE LAW JUDGE,
PUBLIC UTILITIES COMMISSION
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November 4, 2004

CERTIFICATE OF SERVICE

I hereby certify that I have on this day served a copy of the

MCI, INC.'S OPENING COMMENTS ON ASSIGNED COMMISSIONER AND ADMINISTRATIVE LAW JUDGE'S RULING INVITING COMMENTS REGARDING THE SCOPE AND SCHEDULE OF PHASES 3A AND 3B

on all parties to R.01.09.001 by mailing a properly addressed copy by first-class mail with postage prepaid to each party named in the official service list.

Executed on November 4, 2004 at San Francisco, California.

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