An Open Letter to State Commissions

Dear Colleagues:

This week's important ruling by the Federal Communications Commission (FCC) regarding Vonage's Voice Over Internet Protocol (VoIP) service is yet another example of the need to overhaul completely our thinking about how communication services should be regulated... or not regulated...as the case may be. This ruling by the FCC and the expressed intent of the FCC to foster intermodal competition, calls for state regulators to approach the regulation of telecommunications or telecommunications-like services in a new way.

For many years now, MCI has been at the forefront of encouraging state involvement in telecommunications pricing and in molding the competitive landscape. States have laudably taken on this difficult architectural challenge. However, technology and markets are evolving more rapidly than anybody would have anticipated only a few years ago. Broadband investment occurred and we are now beginning to see the results of that investment in the form of various fiber to the home initiatives (both public and private), BPL, wireless, Wi-Max and various cable offerings. The impact of the "broadband revolution" is the convergence of voice and data, and the most immediate, but by no means the last, manifestation of that convergence is voice over Internet protocol (VoIP). Although the impact on many companies of these "disruptive technologies" has been painful, it has also forced all of us to take a hard look at the regulatory environment in which we serve consumers and begin the difficult job of determining whether the frameworks of the past fit the world of the future.

What has become increasingly apparent in the changing technological environment is that we must all... regulators and private firms alike...revisit our regulatory philosophy from the ground up. Just as the FCC has decided that various forms of broadband should be relieved of some levels of regulatory oversight, state and federal regulators must examine how they view all communications services and what level of regulation will best serve the needs of increased investment and innovation. As we collectively begin to recognize the national, if not global nature of our information and communication service infrastructure, we must begin the difficult task of deciding which aspects of regulation are integrally intertwined with public health, safety and consumer protection, and what regulation within this group should be managed at a national, as opposed to local, level.

Increasingly, you will be hearing from MCI that "Real Deregulation" begins with a bottoms up, or zero based, approach to state government involvement in these services. The Real Deregulation approach involves a re-examination of the interplay between federal regulation and state regulation in this changing world, and a review of state regulation to determine what is really necessary (and appropriate) in this new world in which companies like MCI operate. It is MCI's view that states should have less of a role in regulating retail telecommunications services and service providers. Simply put, convergence means that telecommunications can no longer be thought of as a traditional, state regulated utility any more. Attempts to keep such regulation on "traditional providers" such as MCI or the ILECS simply skew

the market place by creating an asymmetry of regulation.

This is not to say that states will have no role in the future of communications issues. In areas where competitive forces have not take hold and are not on the horizon - particularly in wholesale inputs in which the Bell companies maintain monopoly or near-monopoly control - regulation remains necessary to constrain the Bells' market power. But there are significant challenges ahead for state commissions as the industry completes the transition to a competitive and largely unregulated field.

One of the first challenges for the state PUCs and the FCC is to revamp our system of intercarrier compensation. The current intercarrier compensation mechanism is a hydra of different rates for different types of traffic in different jurisdictions. It is a non-sensical scheme that creates artificial competition and thereby skews the markets. On the Federal side, the Intercarrier Compensation Fund (ICF) proposal at the FCC is a first, good effort to recommend changes to our system of compensation that will attempt to place all providers on that long sought after "level playing field." However, efforts in these regards are still hampered by monopoly era notions of revenue neutrality. On the state side, states must come to grips with the fact that deregulation of telecommunications means that the access charges of incumbent carriers can and should no longer be protected. State PUCs have opportunities to tackle the access issue and eliminate the discriminatory pricing scheme for intrastate switched access services but are often dissuaded from doing so because of the political hot potato of "rate rebalancing." If regulators are to feel comfortable adapting new regulatory approaches such as retail rate flexibility and loosened regulation of filing requirements, incumbents must embrace the realities of what real competition means for their policy perspectives regarding access charges.

Universal service, like our system of access charges, needs to be reexamined in a competitive world. Current universal service funding mechanisms both at the state and federal level, are designed to protect carriers primarily (with the notion being that consumers are protected if carriers are protected). Those ideas of universal service must be revamped in a competitive world. Universal service should protect consumer needs first, not companies.

In the coming months, you will see MCI honing its business plan for a competitive environment that is all about broadband. MCI plans to rely on a variety of approaches to broadband, including its strategic partnerships with cable providers. MCI also recently announced a roll out of a substantial DSL program for its business customers. And MCI is a recognized leader in IP applications and systems integration. As MCI and others develop their broadband strategies, however, it is vital that the infrastructure necessary to compete globally is accessible to it. It is MCI's hope that this will be attained through the evolution of a satisfactory number of competitors who are willing to provide this infrastructure with ubiquitous reliability. If this competition does not develop and develop quickly, however, it is our hope that the Layers approach to regulation, increasingly being embraced by a broad range of business, academic and regulatory interests, will provide guidance as to how to ensure that networks are sufficiently open so that America's dream for broadband can be met.

State commissions have always been the court of first and last resort in protecting consumer interests in the telecommunications arena, and we do not believe that this will substantially change. The challenges of addressing consumer fraud, state access charge issues and of ensuring that a suitable transition to an end result that allows true competition and broadband deployment, will remain vital roles for the state. We look forward to working with the states to encourage the federal legislators and regulators to develop a framework that will bring the benefits of new technologies and services to all consumers.

The initial steps the FCC has taken this week in encouraging the development of and investment in broadband networks and the applications which ride on these networks hold the promise for a greater evolution of these technologies. Although much work still needs to be done to ensure that ALL IP-enabled networks are accessible and free of unnecessary regulation, MCI applauds the FCC's first step in this direction.

MCI commits to continuing its efforts to help these technologies drive the economic engine of this country and to working with our colleagues from the states in developing regulatory policies that protect the consumers' interests in acquiring and utilizing these services.

Sincerely,

Marsha A. Ward
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