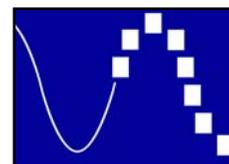


February 8, 2005

Senator Daniel Inouye
Senate Committee on Commerce, Science, and Transportation
508 Dirksen Senate Office Building
United States Senate
Washington, DC 20510



The VON Coalition

Dear Senator Inouye:

We are writing to urge your support for a petition for forbearance filed by Level 3 Communications with the Federal Communications Commission (WC Docket No. 03-266), which seeks to have the FCC confirm that access charges do not apply to communications between Internet Protocol (IP)-based end users and end users on the Public Switched Telephone Network (PSTN). We are also writing in response to a letter addressed to you by incumbent local exchange carrier (ILEC) trade associations dated February 3, 2005.

When the FCC created access charges over twenty years ago in the wake of the break-up of AT&T, it also exempted traffic between the PSTN and enhanced service providers (ESPs) under what was called the "ESP exemption." Pursuant to the ESP exemption, ESPs "may use incumbent LEC facilities to originate and terminate interstate calls," but ESPs are not required to pay access charges.¹ ESPs gain access to the PSTN by buying tariffed business services rather than paying per-minute access charges. During the past twenty years, the FCC has twice reaffirmed the ESP exemption, most recently in 1997, and has made clear that Internet access and IP-applications are information services that remain outside the access charge system.

The Internet and IP-based applications have flourished under this twenty-year-old policy, transforming every day life for Americans, at work and at home. This "hands off" approach has had demonstrable economic and social benefits: IP networks and IP applications (a) power the growth of businesses that no longer need physical offices, enabling telecommuting and flexible work arrangements, (b) allow Americans in the most isolated parts of the country to gain access to the information resources of our most populated centers, (c) allow Americans in all parts of the country to buy and sell goods and services in a global market, and (d) keep far-flung families connected, sharing pictures, stories and memories as if they were just down the street. These transformations are continuing, as technologists and entrepreneurs continue to develop more powerful applications, taking advantage of better and cheaper processing power, greater and cheaper storage capabilities, and faster and cheaper transmission speeds.

While the Internet has changed our economy and society over the past 10 years, IP-enabled voice applications are beginning to drive a virtuous cycle of investment and consumer benefits. IP-enabled voice applications such as Skype are allowing millions of individuals around the world to communicate at little or no cost over broadband connections without using the PSTN, simply by downloading software. Moreover, Skype has launched a service that allows these same Internet-based Skype users also to communicate, for a nominal fee, with individuals that use the PSTN. Other IP-enabled voice application providers are offering "all-you-can-eat" any distance residential communications packages at prices that are now as low as \$19.95 per month, with

¹ *In re: Access Charge Reform*, First Report and Order, 12 FCC Rcd. 15982, 16131-2 (¶341)(1997).

many features, some of which would not even be possible using the traditional PSTN. As a result of these new applications, more consumers are purchasing broadband connections in order to use these applications. And greater consumer demand for broadband supports further investment both in the broadband infrastructure, and in even newer and more innovative consumer applications.

By granting the Level 3 Petition, the FCC would keep this successful pro-consumer, pro-growth policy in place while the Congress and the Commission work to finalize and implement comprehensive reform of intercarrier compensation, including access charges. The Level 3 Petition is not a "gun-jumping" effort at "piecemeal" intercarrier compensation reform, but a request for a clarification of the rules-of-the-road for IP-enabled voice applications that will govern until Congress and/or the Commission complete comprehensive intercarrier compensation reform. Without such clarification, entrepreneurs and investors developing and bringing to market new IP-enabled voice applications will be left to guess at whether the FCC – or the many courts around the country – will ultimately conclude that access charges do or do not apply, either prospectively or retroactively. A continuation of the current regulatory uncertainty during the interim period prior to completion of comprehensive intercarrier compensation reform will only serve to reduce investment, slow the introduction of innovative new products and services – and their benefits – to consumers, and dampen the demand for broadband that these new innovative products and services will create.

If the FCC were to follow the path advocated by ILECs and apply access charges for the first time to IP applications that communicate with users on the PSTN, the results would be even more anti-consumer and anti-growth:

- Rates for innovative IP-enabled voice applications would go up;
- Innovation in and development of new IP-enabled voice applications would be curtailed;
- Consumer demand for broadband would be reduced, slowing the growth in broadband penetration, and thus stunting one of the policy objectives of the Congress when it enacted the Telecommunications Act of 1996.

There is no evidence of any compelling need for such a rate-raising, growth-sapping, innovation-reducing policy change. Historically, ILECs have always been quick to claim that every new technology or regulatory change – whether the deregulation of customer handsets and equipment, the introduction of long distance competition, or the granting of cellular licenses to anyone other than the incumbent local telephone company – will threaten universal service. In every case, market developments proved those claims to be vastly overblown. The same is true with respect to IP-enabled voice applications. Although IP-enabled voice application subscriptions are growing, they remain an exceedingly small proportion of overall PSTN connections – which now number over 300 million including both wireless and traditional wireline. Even with rapid growth, mass market IP-enabled voice applications are unlikely to exceed even a few percent of the market while Congress and the FCC complete intercarrier compensation reform. In fact, Level 3 has filed a study with the FCC showing that applying interstate access charges to IP-enabled voice applications will only marginally increase ILEC revenues in 2005 and 2006. In this environment, it seems ironic and shortsighted for the ILECs to now advocate that the FCC, after nearly 20 years of Internet pro-growth policy, reverse its course and apply access charges to IP-enabled voice applications.

February 8, 2005

In the first instance, as the ILEC associations acknowledge in their letter, the Level 3 Petition does not apply to any rural telephone company that remains subject to the 1996 Act's "rural exemption" from interconnection and unbundling requirements. Granting the Level 3 Petition would in no way preclude the FCC from adopting, in its existing IP-Enabled Services Rulemaking, a different interim intercarrier compensation mechanism for areas served by those exempt, rural LECs. There is no basis for assuming, as the ILEC associations do, that the FCC would be unsuccessful in sustaining such an interim and transitional regime for these areas, especially as the Commission works expeditiously to complete comprehensive intercarrier compensation reform.

Moreover, ILECs have continued to earn very healthy rates of return. For 2003 the price cap carriers, including all the RBOCs, reported the following interstate rates of return, all of which exceeded the FCC's prescribed rate of return of 11.25%:

- BellSouth, 21.93%
- Qwest, 23.03%
- SBC, 20.37%
- Verizon, 12.36%
- Sprint, 35.27%
- All others (including price cap LEC owned by AllTel, CenturyTel, Cincinnati Bell, Citizens, Iowa and Valor), 23.33%.

Finally, the construction of Section 251(b)(5) urged by the ILEC associations would wholly frustrate comprehensive intercarrier compensation reform. Section 251(b)(5) expressly addresses the "transport and termination of telecommunications," and, as the FCC has previously ruled, is not limited to "local" communications. Instead, the Act expressly, but only on a temporary basis, preserved the existing interstate and intrastate access charge rules (including the ESP exemption) in Section 251(g), but gave the FCC the express authority to supercede those rules. If, as the ILEC associations assert, Section 251(b)(5) only applies to "local" traffic, [] the Act would have no provision governing intercarrier compensation for intrastate access traffic in the event that the FCC superceded the existing regulations.

We therefore urge you to support the continuation of the FCC's pro-growth, pro-consumer, pro-innovation policies during the interim period while the FCC considers intercarrier compensation reform, and thus urge you to support the grant of the Level 3 Petition.

Sincerely,

The VON Coalition