

# Heading For Federal Pre-Emption

State and Federal Regulators Will Continue to Push for Federalization of VoIP Rules

By Steven S. Ross ■ *Editor, Broadband Properties Magazine*

Most attendees at this year's Fall VON (Voice Over Networks) conference in Boston heard a crystal-clear message from all levels of government and officials of all political stripes: The infant VoIP business will be regulated mainly at the federal level, despite the issues still to be addressed and mixed signals sent this year by Congress, the courts, the FCC and state bodies. The national press showed up for FCC Chairman Michael K. Powell's early-morning talk and press conference, but missed the context by ignoring panels of federal legislative staffers and state regulators who, somewhat surprisingly, said about the same thing while raising those issues.

Federalizing VoIP regulation would boost the infant industry by keeping regulatory fees low and by making it easier for small VoIP providers to compete in all states without having to gear up for a regulatory filing and hearing in each one. There were about 1 million VoIP lines installed by late summer. With companies offering free equipment that attaches to a subscriber's broadband modem or router (typically cable or DSL right now) and unlimited calling within the US for as little as \$19.95 a month, business is booming.

Powell has been criticized in the past three years for not pushing for federal preemption. A bill in Congress to do the same thing, sponsored by Senator John Sununu (R, NH) also stalled. Three dozen state utility commissions have



Videophone from Packet8 VoIP service. \$300 street price (\$500 a pair) after rebates; video VoIP service is \$29.95 a month.

opened dockets on regulating VoIP as well.

Said Powell, "We cannot avoid this question any longer. To hold that packets flying across national and indeed international digital networks should be subject to state commission economic regulatory authority is to dumb down the Internet to match the limited vision of government officials. That would be a tragedy." He promised FCC action by January 20.

The FCC is hardly unanimous, and probably never will be as long as Commissioner Michael Copps holds a seat.

Jessica Rosenworcel, legal advisor to Copps, said "the cable and DSL duopoly has all but 1.3 percent of the broadband market so the FCC is concerned about bottlenecks and access to the last mile. Access has been eroding, fiber is off the unbundling radar."

A panel of Congressional staffers (Democrats James Assey, minority counsel of the Senate Commerce Committee, and Colin Crowell, minority counsel for the House Subcommittee on Telecommunications and the Internet, along with Republican Howard Waltzman, chief counsel for telecommunications

on the House Committee on Energy and Commerce) noted that the basis for the 1996 Telecommunications act is that voice, video, data would be on the networks so they would all be treated alike. Now there is a move to split them up as if they were distinct. But every VoIP offering is already integrated with e-mail, voicemail and calling features! So although the 1996 act will be revisited, big changes are unlikely.

Powell admitted that states would have to regulate consumer fraud aspects of an industry well known for slamming and cramming. In addition, he said, there has to be provision for 911 emergency service on VoIP lines, as more and more subscribers use VoIP for their only phone connection.

Sununu, who also spoke at the conference, admitted that his bill had foundered over those issues, and that “politically, we know we have to support rural phone service. I’m a realist.” That means there will be at least a small federal tax on VoIP to pay for rural subsidies. Sununu promised a revised bill addressing those issues early in 2005.

#### States Look to the FCC

Some state utilities commissions – most notably New York, California, and Minnesota -- have argued that since VoIP service is “functionally equivalent” to conventional Plain Old Telephone Service, the states should regulate and tax it the same way. Federal courts have put a hold on those actions, waiting for the FCC to move.

Listening to state regulators at the conference – their panels were on before Powell spoke – made it clear that state utilities commissions had almost uniformly acted to “regulate” VoIP only because traditional telephone providers had asked them to open hearing dockets. That’s an automatic right in almost all states.

The state regulators insisted that they want to regulate VoIP lightly if at all, but their panel showed that the devil is in the details – and all the details have to be worked out before a federal pre-emp-

tion will occur. Thus, Powell’s hopes for a pre-January 20 decision may be misplaced, even if a vote in favor by Capps is not needed.

The congressional staffers say Congress is waiting to see what the FCC comes up with. One issue for them: The FCC has a long lag time between complaint and action. State utilities commissions tend to react more quickly.

Susan Kennedy, one of the more conservative members of the California Public Utilities Commission, said that for now “it is important that states be preempted by the [federal government], because 50 states’ ideas would damage the industry. In the future, there is a strong state role. There are arbitration issues that can stay state. 911 is national. Do all VoIPs have to provide 911? No,

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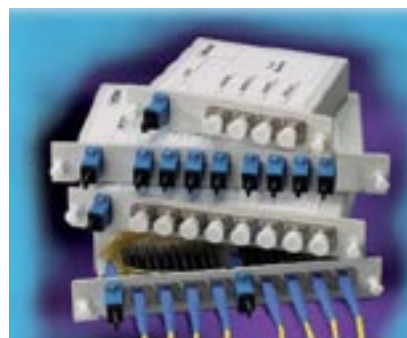
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*New Hampshire Senator John Sununu after his talk at VON 2004.*

but there should be a universal service fund contribution and the states administer these programs.”

Greg Sopkin, chairman of the Colorado Public Utilities Commission, said, he agreed with Kennedy, “Because the intelligence is moving to the edges. Even calls to neighbors may bounce off servers in different states. Colorado has 327 pages of regulation. Could a startup do that for every state? That would be a massive barrier to entry. Also, it is hard to imagine that VoIP can have monopoly power.”

Sopkin also said that at the state level “We need after-the-fact enforcement against bad actors. My analogy is like car dealers. Every state has an auto dealer board, fines, can withdraw authorities to sell cars. Cars have intermodal competition, like bikes and buses. All have high paid lobbyists. I’m not aware of any state that regulates the rates of car dealers. We may have 3-day lemon laws, but no delivery date rules.”

Replied Kennedy, “In California, the response might be “we’d better regulate those car dealers.” She said she voted against the “the 255 page consumer

bill of rights” approved in California this year. “It expands monopoly regulations,” she said. “Companies even have to respond to ANYONE, not just customers, in three days! It should be thrown out by the courts.”

Stan Wise, president of the National Association of Regulatory Utility Commissioners (NARUC) and a commissioner on Georgia’s PUC, noted “regardless of the diversity of views here on this panel, we want competition.”

#### **That New York Action**

Robert Mayer, director of the Office of Telecommunications, NY PSC, explained the Vonage order this way: “We did get a complaint from Frontier Corp saying Vonage is a phone company and we concluded that as a matter of state law that they are subject to regulation and the state is compelled to express interest in 911, public safety, and so forth. The US District court asked Vonage to participate voluntarily in 911 in NY in December, and issued a temporary injunction. Mayer also said “The issues of service quality, safety, etc., are still important to states. So hands-off does not

hold water for us. Before we issued [our findings], I said I’m concerned about [big players like] Verizon and AT&T announcing VoIP but not Vonage which at the time had maybe 10,000 customers in New York.”

“In New York, we said to Vonage that we want to talk to them, and told them they would not be under the same level of regulations as Verizon,” said Mayer. “We clearly understand our role should be limited, but Verizon and Time Warner have market power and we may not have consumer protection.... We said to them file a tariff, get a CPN [Certificate of Public Necessity], which preserves our ability to regulate if we have to. We only want an option to intervene if they abuse the process, to help consumers. We have done this against resellers. But we have no beef with Vonage now.”

Sopkin was worried. “As token nut case, let me disagree with the notion that all regulators will have a light touch. California said these folks are all telephone services, subject to all regulation, and there are always future commissions that will be able to do anything they want, absent federal regulation/pre-emption. This is the first regulatory escape from [urban/rural] cross-subsidies and regulators do not want to see that system collapse. Colorado was smart enough to deregulate wireless, the most hyper competitive business, 97 percent of us citizens have a choice of three providers.”

Even Wise said, “Social subsidies offend me as a conservative, but how do we exit to avoid huge price spikes for rural users, so give us the exit strategy. In Georgia we unbundled the natural gas industry, which impacted the low income folks, and we are still paying for it eight years later.”

#### **The Terrorism Issue**

Mayer added another issue to the pile, saying “We also need network reliability in the New York City area for JP Morgan, Citibank, etc., so we regulators have to come in there and make sure.”

That produced an argument. Tom

Welch, chairman of Maine's PUC, said "Time-Warner does not have market power in NY. We as regulators ought to figure that out. See how long they have Chase as a customer! I favor [federal] pre-emption."

Mayer replied that the issue of reliability goes beyond a certain company's customers, because many providers use the same network and a defect in one could bring the whole system down, as it has in electricity transmission. "New York has a network reliability issue. The New York [Federal Reserve Bank] Clearing House, securities industry, and so forth, have come very aggressively to say they support network reliability, route diversity. They do NOT believe the market will provide this!"

He also played the terrorism card: "Following 9/11 we had a catastrophic telecommunications issue, and the outage was very short. Large financial institutions needed route info and so forth. Verizon is the incumbent carrier so most routes exited to them only, not other carriers. But customers have to bear the full cost of knowing how their networks are routed."

Welch said the role for states in VoIP "will be whatever the FCC tells us it is. I think of VoIP as two tin cans on a string -- we don't need to regulate. As state regulators, is there a market failure we have to resolve? Regulations have to be in response to the market not providing a particular set of needed services. If it is perceived as within the box of the provider services, we should stick to consumer protection, billing disputes, 911. FCC should ask only that they be the provider of last resort."

He noted that in Maine, VoIP is regulated because "somebody talking to someone else over wire," is the definition the legislators have given us."

Kennedy said that California issues "a certificate of public needs and we have denied them where companies have a history of slamming and cramming in other states. Feds are not going to take the consumer complaints, so states must."

"What is a provider of last resort?" Kennedy asked. "Today's rules are meaningless, we have to figure out what these things are, and we should administer [with that in mind]. Universal service has to be solved at both the federal and the state level. There has to be some logic about who can be brought into universal

service fund. AOL? I don't want to draw them in."

There is also the issue of the 1994 Communications Assistance to Law Enforcement Access Act (CALEA). Compliance for telcos requires an infrastructure giving the FBI the access, at the flip of a switch, to "call content"

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(conversations) and “call data” ( who dialed what when). Said Welch, “no one wants to sell a service that works with CALEA, so there is no market solution, so the feds have to impose their will.”

### Trouble for CLECs

VoIP feeds on bandwidth and access to it. Staci Pies, VP for Governmental and Regulatory Affairs for ISP and VoIP provider PointOne, said her company “has strong opinions about how the physical facilities should be regulated, for the last mile. Duopoly is not competition. I live in second largest city in Maryland and only just got DSL 6-9 months ago so there isn't a lot of competition out there.”

Melissa Newman, VP at Qwest, asked “How much fiber would any carrier put into the ground if they had to sell to their competitors at below cost? So there are costs to unbundling. Companies must recognize returns on their investment. Quest will negotiate with CLECs if the price is right but the FCC mandated prices for new technologies too low.”

Who loses? The CLECs (Competitive Local Exchange Carriers) feels threatened by willingness of regulators to allow Verizon, Qwest and others to control the fiber they are bringing into homes and small businesses. Many CLECs have soft switching but not transmission facilities. They depend on access to unbundled bandwidth.

Rosenworcel said the “last four years’ erosion of competition has not been good for users and small business users.”

Pies said PointOne, as an ISP and a VoIP provider, purchases bandwidth from CLECs but “the FCC is unclear about what kinds of packets can flow; ILECS (Incumbent Local Exchange Carriers, usually the phone companies) are refusing to sell to us because voice packets may not be able to travel over local trunks, but FCC has not ruled, and the ILEC, who control the last mile is balking.

Right now the VoIP [business] is

a smaller source of revenue. We don't want to become a CLEC, but rates for our customers would be lower if we did become a CLEC. Many CLECs still have very high access revenues and no one wants to let go of a revenue stream.”

Jim Geiger, CEO of Cbeyond Communications and chairman of the Association for Local Telecommunications Services (ALTS) Executive Committee, worried “without CLECs in the mix there will be a cozy duopoly of the cable providers and Bell [regional operating] companies in the residential markets.”

ALTS is leading trade association representing facilities-based local telecommunications competition. ATLS members primarily target small and medium businesses. They depend on availability of last-mile facilities in the form of unbundled loops and transport. The small business market is not served by cable and companies providing service to small businesses do not want to get sucked into arguments on this. Said Geiger, “Beware of Bell/cable ‘parity’ argu-

ments that seek to remove all regulations from the Bell networks. Cable investors like me invested with the understanding this would not happen; cable built their own networks in a less regulated environment.

At the moment Verizon's investment in fiber does not seem to be displacing the CLECs. Instead, it is drawing investment into the fiber industry overall. But investors are beginning to see no great long-term CLEC growth potential, several attendees said. Thus, they are having trouble raising funds to expand their operations. Said one: “I'm a CLEC for 12 years. Our problem is what are we going to do; we are in sunset period, CLECs need to find an alternative. We are trying to combine with facilities. There is not a dime for investment for CLECs right now.” ♦

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