

**REPORT: MCI TELECOM REGULATION OVERHAUL PROPOSAL IS
“FATALLY FLAWED,” DOES NOT ADDRESS CHALLENGES FACING INDUSTRY**

WASHINGTON, D.C.//July 13, 2004//A proposal advanced by MCI for revamping U.S. regulation for broadband and other services would lock in the worst elements of existing telecommunications rules and discourage new industry investment, according to eight experts writing in a new report from the New Millennium Research Council (NMRC). In describing the MCI plan as “fatally flawed,” the report authors also argue that it relies upon an overly simplistic view of the increasingly complex telecommunications sector and appears to be designed to protect the interests of certain industry participants, including MCI itself.

Entitled “*Free Ride: Deficiencies of the MCI ‘Layers’ Policy Model and the Need for Principles that Encourage Competition in the New IP World,*” the NMRC report concludes: “The authors of this report found that the network layers model was fatally flawed as a framework for new regulation or legislation. Many of the authors dismissed the MCI legislative proposal specifically because it does not provide a deregulatory path as envisioned by the Telecommunications Act of 1996. The authors conclude that the network layers model would be at cross-purposes with the Act’s goals of promoting broadband growth, creating competitive markets, and benefiting consumers. The authors recommend a light regulatory touch or voluntary adherence to industry created principles to balance competitive concerns, while at the same time providing incentives for investment and innovation. Regulatory reform is an important issue. The MCI layers approach highlights that. But it is an option which warrants a great deal more analysis and study.”

Under the MCI “layers” proposal, regulatory oversight would remain in place only for infrastructure companies such as incumbent local exchange carriers (ILECs) and cable companies -- but not for their competitors (including MCI), which would get access to the underlying infrastructure on a largely or entirely unregulated basis.

In his contribution, Braden Cox, technology counsel for the Competitive Enterprise Institute, noted: “On its face, the (MCI) layers model is a seductive analytical tool that improves upon the current lack of cohesiveness in telecom regulation. However, what is a superior analytical tool for network engineers is not necessarily good for network regulators. It is burdened with the same regulatory traps of current law – it retains too much faith in the capability of government regulators to beneficently intervene in the market.”

Stephen Pociask, president of TeleNomic Research, wrote that the MCI plan makes “transport services look like a commodity. What the proposal offers to fix, the compartmentalizing of industries, it breaks by compartmentalizing competitors into layers. The proposal places no value on economies of scope and vertical integration, ignoring network efficiencies that provide consumers low costs ... Effectively, the MCI proposal works to separate regulated and unregulated competitors, which would perpetuate regulations and protect companies that have not invested in telecommunications infrastructure.”

David McClure, president and CEO of the U.S. Internet Industry Association, pointed out: (1) the MCI model doesn’t accurately represent the Internet – the model is a gross simplification of the elements that make up the Internet, with no appropriate reference to how those layers interact or relate; (2) the model “criminalizes competition” by punishing success in the market; (3) the model fragments the Internet industry leaving it without cohesion and leadership needed for the Internet industry to grow, mature, and thrive, and (4) the model inhibits rural deployment of broadband by forcing providers to target dense urban areas.

Andrew Odlyzko, director of the Digital Technology Center at the University of Minnesota, argued that MCI's approach would be exceedingly complex and is unlikely to command any significant private sector consensus. He also warned that putting limits on business decision-making could drive up prices and limit customer choice. "Differential pricing, in which customers pay varying prices for what may be essentially the same goods or services, is at the heart of regulation ... This creates strong economic incentives for price discrimination, and against charging per byte or per packet. A physical layer service provider that charged just by the volume of traffic could not take advantage of the variation in willingness to pay. But it is the basic connectivity provider that has the high costs that are of greatest concern in discussions about deployment of broadband, at least for residential users."

Adam Thierer, director of telecommunications studies at the Cato Institute, asked: "Is today's Internet the only one we will ever know? ... Although 'layers' offer a fitting way of thinking about today's world, just as vertical silos made sense in the past, it could be the case that horizontal layers will not accurately describe the Internet, or Internets, of the future ... dumb pipes should not be mandated as the law of the land since there are good reasons to allow competition in network architectures between dumb and smart systems to see which consumers truly prefer. Perhaps the most important reason to reject dumb pipe mandates lies in the investment disincentives for both existing and potential infrastructure operators."

Wayne Brough, chief economist of Citizens for a Sound Economy, analyzed the MCI proposal as follows: "It offers little to ease the current regulatory impasse. In fact, the current problems that plague the telecommunications sector would persist, if not intensify, in a new regulatory model based on network layers. Perhaps the most troubling aspect of the layered approach outlined by MCI is the fact that it makes no effort to address problems imposed by the UNE-P[unbundled network element platform]...Rather than eliminating the UNE-P or revisiting the TELRIC [total element long-run incremental cost] pricing formula, it is viewed as 'an interesting blend of horizontal and vertical thinking' necessary for promoting intramodal competition ... Unfortunately, this approach would continue to impose regulatory impediments that inhibit critical infrastructure investment and limit growth in the telecommunications sector."

Glenn Woroch, executive director of the Center for Research on Telecommunications Policy at the University of California, noted: "Another drawback of imposing this engineering architecture on regulatory policy is that technology can change, and can do so quite quickly, while regulatory institutions are notoriously slow to react and to adjust."

James L. Gattuso, research fellow in regulatory policy at The Heritage Foundation, pointed out: "The (MCI) concept ... – at the theoretical level – is relatively uncontroversial... Yet, the idea – especially as elaborated upon by subsequent analysts – does have some very specific implications for policy ... The [MCI] policy proposals seem to assume that many providers, such as telephone companies have undue market power. But is this assumption warranted, given the number of competing providers offering this service? Moreover, do such conclusions flow from layering theory? Or does this simply re-hash long-standing debates over telephone competition in a new guise?"

For the full text of the NMRC report, go to <http://www.newmillenniumresearch.org> on the Web.

ABOUT NMRC

The New Millennium Research Council is composed of a network of policy experts who develop workable, real-world solutions to the issues and challenges confronting policymakers. Its work has focused primarily in the fields of telecommunications and technology. For more information, please visit: <http://www.newmillenniumresearch.org>.

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