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In this issue, In DC, lawmakers start long process to review possible regulation of VOIP and two key members of Congress announce legislation that could create a sweeping federal regulatory framework for Internet phone calls. The debate over taxing VOIP heats up. The FCC approved the spectrum swap deal with Nextel. AT&T continues its VOIP rollout in major markets. In Pennsylvania, the debate over UNE rate is far from settled as regulators at the PUC keep an eye on action in DC.

From the Papers

AT&T Corp. says it expects to have 1 million VOIP customers by the end of next year, while cable TV giant Comcast Corp. has said it anticipates offering the service to all its customers by the end of 2006."

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Stumbling blocks, uncertain regulation cloud future for Internet voice service.

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Washington politicians are about to kick off what will be a long and exhausting process aimed at deciding the future of phone calls made over the Internet.

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Legislation that could create a sweeping federal regulatory framework for Internet phone calls is introduced.

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F.C.C. approves plan to swap Nextel licenses for safety uses.

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The federal government, not the states, should regulate Internet phone services in order to protect investment and innovation, telecom industry and federal officials told Congress this week.

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Bloomberg: "The Treasury Department said it doesn't plan to tax telephone calls made over the Internet after a lawmaker asked for a clarification of a notice the government issued last week."

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Wholesale Access Rate Controversy Remains Unresolved

When on July 8 the Pennsylvania Public Utility Commission set the rates that Verizon charges competitors for network access; it acknowledged that its authority over the rates was restricted by recent events on the federal level. The clash of developments over the rates on the state and federal levels leave a murky picture as to the future of network access rates in the local phone arena.

“Given the fundamental shift in federal policy that has occurred, Pennsylvania must refocus its telecommunications strategy,” said Commissioner Glenn Thomas. “The Commonwealth has strived to develop a competitive model where UNEs, particularly UNE-P, comprised an integral part of telecommunications competition.”

In June, the U.S. Supreme refused to stop implementation of a lower court order declaring that the Federal Communications Commission (FCC) had no authority to set the rates that competitive carriers, or CLECs, must pay Verizon and other incumbent carriers (ILECs). The FCC then encouraged the phone companies to make deals for access outside the regulatory climate.

Verizon and other ILECs have long argued that the rates were below the cost for them to supply the service. The recent PUC decision hasn't changed that, according to Verizon officials.

“These below-cost wholesale rates hurt Pennsylvania’s ability to remain a leader in broadband deployment and seriously threaten investment in new technologies,” said James V. O’Rourke, president and CEO of Verizon Pennsylvania. “This decision requires our customers to subsidize our larger competitors, like AT&T and MCI, while taking investment capital away from the companies that are actually building networks in Pennsylvania.”

At the same time, Verizon said it will review the PUC’s final order before deciding on its next steps.

Thomas noted that Verizon has committed to the FCC that it will not unilaterally increase the wholesale price for UNE-P arrangements that are used to serve mass market consumers before November. Verizon also promised to provide wholesale customers at least 90 days notice of any future price change.

“The Commission has an opportunity and the obligation to assist in this smooth transition as well,” Thomas said. “We must be mindful that consumers are the most impacted by the very important and intricate policy decisions to be made in the months ahead.”

The recent PUC decision resulted from a November, 2002 order that established a methodology that Verizon was required to use to set the wholesale rates. A year later, the Commission voted to modify several variables in the formula, and it required Verizon to re-apply a variable called the forward-looking conversion factor. The most recent order reflects those changes.

Carriers Urge Congress to Enter Controversy over Granting of Airwaves

Verizon and other phone carriers are urging Congress to sidetrack an order by the Federal Communications Commission (FCC) that granted Nextel Communications new airwaves without an auction.

“Only Congress has the Constitutional authority to spend taxpayer dollars,” said Jeffrey Nelson, a spokesman for Verizon Wireless. “Has the FCC financed this project illegally by bypassing both Congress and the auction process?”

The Thursday, July 8 order stems from a Nextel proposal that it be given a new swath of airwaves since communications over its current spectrum were interfering with communications between law enforcement, fire response and other public safety functions. The proposal immediately raised protests from other phone carriers, which argued that new airwaves should not be made available without an auction.

Nextel will pay nearly \$2 billion for the airwave licenses, after it returns its current airwave licenses to public safety agencies and it covers the cost of returning thousands of police and fire radios. Still, other carriers maintain that the airwaves are worth nearly four times that price, since they are well-suited for high-speed wireless data services and far more valuable than the spectrum licenses Nextel is giving back.

“Taxpayers and first responders would have been far better served if the FCC had allowed the GAO and Congress to assess the legality of the Nextel spectrum grab before approving it,” Nelson said.

Verizon Not Required to Provide Web site Information on DSL Service

The Public Utility turned back a recommendation that required Verizon to provide more detailed information on its Web site concerning the availability of its high-speed DSL Internet Service.

The Commissioners had asked PUC staff to look into an order that Verizon provide the information. But the “recommendation exceeds a clarification of the order” Commissioner Kim Pizzingrilli said. The order dates back to September 17, 2003. Nothing in the order said that Verizon must make the information available on its Web site.

States Lose Most Recent MCI Fight

Although WorldCom emerged from bankruptcy more than two months ago as MCI, its legal battles continue in bankruptcy court in the Southern District of New York.

In this latest round, 14 states sought to disqualify MCI's auditors and tax advisers, KPMG, and disgorge tens of millions in fees the accounting firm received during bankruptcy proceedings. The states allege that KPMG advised MCI to implement an illegal tax strategy aimed at evading hundreds of millions of dollars in taxes owed to the states.

Bankruptcy Judge Arthur Gonzalez, who also presides over the Enron bankruptcy, soundly rejected the states' motion, calling the move to disqualify KPMG a "litigation tactic."

The underlying dispute arose from a restructuring strategy KPMG advised MCI to undertake in the late 1990s. One purpose of the effort, according to a January report issued by Bankruptcy Court Examiner Richard Thornburgh, was to minimize state taxes by as much as \$350 million.

The process involved licenses to MCI's subsidiaries, which then generated royalty fees in excess of \$20 billion. MCI's subsidiaries deducted the royalty charges, according to the examiner's report, and the corresponding income was transferred to states with lower tax consequences.

Thornburgh strongly criticized KPMG, claiming it "rendered improper tax advice" and "failed to disclose the risks" to MCI. The report concluded that if MCI is found liable for implementing KPMG's tax restructuring plan, it could sue KPMG to recover its penalties.

Upon the release of the report, MCI announced it had no plans to pursue claims against KPMG.

In mid-March, the states filed a motion to disqualify KPMG, arguing that it held an adverse interest to MCI and was not acting as a disinterested party - in other words, that it had a conflict of interest as MCI's auditor.

Gonzalez saw the timing of the states' motion as a ruse.

"It was only after the states decided that such a motion would advance their particular interests that they filed the disqualification motion," he wrote.

Looking back at the record, the judge found that the states were cognizant of the potential underlying grievances against KPMG as early as April 2003 and that at no point did they request the auditor's removal.

The delay in filing the motion, said Gonzalez in re WorldCom, spoke volumes of the states' motivation to pressure MCI during settlement discussions by potentially delaying its emergence from Chapter 11 bankruptcy through the eviction of its auditor. Such a removal would force MCI to find a replacement to issue a new audit for its 2003 financial statements, a process that would prolong its status in bankruptcy, the judge said.

"[T]he court finds by filing the disqualification motion, the states acted in connection with a litigation strategy that served their own pecuniary interest," said the judge. "Any argument by the states that they have pursued the disqualification of KPMG to protect the public interest 'rings hollow' in light of the fact that the very conflict they allege warrants disqualification was known to them for no less than ten months before they decided to file the disqualification motion."

Despite finding that the states acted with improper motives and were derelict in filing the motion, Gonzalez decided the motion on the merits "because of the seriousness of the allegations and their impact on [MCI] as well as KPMG."

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