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FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	**CC Docket No. 96-45**
Federal-State Joint Board on	)	
Universal Service	)	

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COMMENTS OF TIME WARNER COMMUNICATIONS HOLDINGS, INC.

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SUMMARY

Time Warner Communications Holdings, Inc. ("TW Comm") recommends that the Commission consider universal service issues in the broader contexts of cost definition and targeted needs. If those broader issues are resolved satisfactorily, other decisions on universal service support will flow naturally from those determinations.

As TW Comm emphasizes throughout its responses to the questions in the July 3, 1996 Public Notice, the current mechanisms for funding universal service must be revised. Any reliance on local exchange company ("LEC") reported costs will result in a skewed representation of the actual costs necessary to provide local exchange services. Older universal service support mechanisms such as DEM weighting are clearly obsolete, having outlived their original justifications.

TW Comm supports the adoption of a competitively neutral universal service funding mechanism, based on forward-looking, economic cost, to replace the existing high-cost fund. Adoption of such an approach will ensure that support is targeted and delivered efficiently, by reliance on affordability thresholds. TW Comm also continues to recommend that the Commission implement a competitive bidding mechanism, consistent with the requirements of the Communications Act, as means of minimizing required support levels. With adequate safeguards against collusion and the use of a proxy-based ceiling for

support in place, the benefits of a competitive bidding mechanism will far outweigh any administrative costs.

When considering the scope of universal service support for schools, libraries and rural health care providers, the Commission must require reconsideration of existing programs. Existing state programs that are incompatible with competition must be modified or, in the alternative, eliminated. Any federal support to schools and libraries should complement, rather than duplicate, state initiatives, but should be structured in a competitively neutral manner. The Commission should also consider that schools, libraries, and rural health care providers may obtain many of the telecommunications services at issue, such as Internet services, from alternative providers of telecommunications services, such as cable service providers. Some cable operators possess the potential to offer modem services to subscribers, including schools and libraries, at a lower cost than the incumbent local exchange company.

TW Comm also recommends that the Commission reassess existing assumptions regarding rural areas. For example, schools located in rural or insular areas will not necessarily incur more toll call costs when using Internet services than other schools simply because of their location. A rural school or library located near a large university may be able to access the Internet at relatively low cost. In addition, any universal service system must also consider the 1996 Act's provisions regarding rural telecommunications service providers and the possibility that these provisions could be used to limit competitive inroads in rural areas. If a carrier avails itself of the protections provided for in the 1996 Act, it should not also receive preferential treatment through the universal service mechanism.

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COMMENTS OF TIME WARNER COMMUNICATIONS HOLDINGS, INC.

Introduction

In response to the July 3, 1996 Public Notice issued by the Commission in the above-referenced proceeding,[1] Time Warner Communications Holdings, Inc.[2] ("TW Comm") welcomes the opportunity to submit further comment on specific issues relating to the March 8, 1996 Notice of Proposed Rulemaking[3] on the implementation of Section 254 of the 1996 Act.[4]

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1 The Commission solicited comments and reply comments on specific issues relating to the subjects previously noticed in this proceeding by Public Notice, DA 96-1078, released July 3, 1996.

2 Time Warner Communications Holdings, Inc. is a wholly-owned subsidiary of the Time Warner Entertainment Company, L.P.

3 In re Federal-State Joint Board on Universal Service, Notice of Proposed Rulemaking and Order Establishing Joint Board, CC Docket No. 96-45, FCC 96-93 (released March 8, 1996)("NPRM"). On April 12, 1996, TW Comm submitted comments in response to the NPRM.

4 Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996)(to be codified at 47 U.S.C. §§ 151 et seq.) (hereinafter "1996 Act").

Definitions Issues

1. Is it appropriate to assume that current rates for services included within the definition of universal service are affordable, despite variations among companies and service areas?

Yes. The high rate of acceptance of prevailing prices and the high rate of demand for basic access in effect today across all state jurisdictions confirm that the prevailing price levels and pricing policies for services included within the Commission's proposed definition of core services are indisputably within the affordability range. Despite variations among companies and service areas, the price of basic residential telephone service, expressed in real terms, actually has been declining steadily for many years. Specifically, since the completion of the residential Subscriber Line Charge ("SLC") transition in 1989, basic residential rates have decreased by approximately two percent annually through 1993.[5] At the same time, residential penetration rates have increased steadily.[6]

The absence of any direct linkage between price and demand for the overwhelming majority of the residential population suggests that even prices at the high end of the existing range are "affordable".[7] FCC tracking reports evince

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[5] FCC Common Carrier Bureau, Trends in Telephone Service, February 1995, Table 5.

[6] Id., Table 2.

[7] Residential exchange rates vary widely both within and across jurisdictions. Excluding extraordinary cases (such as those requiring special construction or in small, rural, independent local exchange company exchanges), the highest monthly rates for basic residential access/local flat-rate usage is in the $30 range Lande, James L., FCC Reference Book: Rates, Price Indexes, and Household Expenditures for Telephone Service, July 1993, Appendix 4.

that residential penetration rates have been virtually unaffected by such landmark events and policy initiatives as the break-up of the former Bell System, the introduction of customer-owned premises equipment and long-distance competition, and the transition to the current $3.50 recovery of residential local exchange costs through the federal SLC.[8] Thus, variations in penetration from state to state appears to be attributable to factors other than price.[9]

Nor is an increase in rates for services as a result of rate rebalancing likely to have an adverse effect on universal service because the evidence suggests that, with rebalancing, rates for services within the definition of universal service should remain "affordable".[10] The continuation of existing low-cost LifeLine services will act as a safety net for low-income consumers for whom telephone service is not affordable. For those consumers not receiving LifeLine assistance, any adjustment in the price of service as a result of rate restructuring would be unlikely to be of a magnitude that would cause any significant shift in the rate of subscribership. Experience has shown that a carefully considered rebalancing of rates with their underlying costs will not jeopardize achieving universal service goals by making rates unaffordable.

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[8] Id.

[9] Studies of the demand for basic residential exchange access have confirmed that this demand is highly price-inelastic. See, e.g., L.D. Taylor, Telecommunications Demand in Theory and Practice (Boston: Kluwer Academic Publishers, 1994), at 259.

[10] See Mass. D.P.U. 93-125, NYNEX, January 13, 1994, at 58.

Massachusetts' experience with rate rebalancing is instructive. The substantial rate rebalancing that took place in Massachusetts has not affected subscribership. In 1990, the Massachusetts Department of Public Utilities ("DPU") adopted a statewide rate rebalancing plan in which all residential dial tone line rates were to be increased to "target" cost-based levels, with intrastate (intraLATA) toll rates decreasing to a "target" non-distance-sensitive level of 5.5 cents per minute for day rate period calling.[11] Since then, as NYNEX moved rates for dial tone and usage towards cost in Massachusetts, there has been no statistically significant change in telephone service penetration rates in the years 1989 to 1992. The DPU concluded that Massachusetts' transition to cost-based rates did not affect universal service negatively:

> Because the transition to cost-based rates requires significant increases in traditionally underpriced residence exchange rates, the Department has carefully monitored the effects of the transition to ensure that it does not negatively impact universal service.
>
> * * *
>
> We also note that there has been no statistically significant change in the Massachusetts telephone service penetration rate in the years 1989 to 1992 . . . . Thus, we find that through 1992 the transition to cost-based rates has not negatively impacted universal service, and that the current proposed increase is unlikely to have an adverse impact on universal service.[12]

Thus, it is not only appropriate to assume that current rates for services included within the definition of universal service are

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[11] See Mass. D.P.U. 89-300, NYNEX, June 29, 1990.

[12] Mass. D.P.U. 93-125, NYNEX, January 13, 1994, at 57-58.

affordable but also that the rates for those services will remain affordable when rebalancing rates towards cost occurs.

2. **To what extent should non-rate factors, such as subscribership level, telephone expenditures as a percentage of income, cost of living, or local calling area size be considered in determining the affordability and reasonable comparability of rates?**

Theoretically, non-rate factors such as subscribership level, telephone expenditures as a percentage of income, cost of living and local calling area size could all be factored in to a determination of the affordability and reasonable comparability of rates. However, these are all factors intrinsic to the situation of an individual consumer or group of consumers, and indeed vary considerably among groups or the individual consumers themselves. Thus, the administrative burdens on carriers and regulators alike of considering such non-rate factors place significant limitations on the extent to which and, in fact, whether these non-rate factors should be taken into account. Therefore, before mandating that certain non-rate factors must be included in a determination of the affordability and reasonable comparability of rates, the Commission should carefully consider the following: (1) whether data reflecting these non-rate factors is readily available; (2) how difficult it will be to obtain any necessary additional data; and (3) the costs associated with gathering and processing the requisite data with respect to individual consumers or consumer groups.

To determine the affordability and reasonable comparability of rates - specifically, to determine the maximum rate that the average residential subscriber in any individual exchange would be required to pay - TW Comm recommends that the Commission rely on an affordability benchmark. The affordability benchmark would represent the upper end of the range of total charges for "local" services that individual residential subscribers within a given (state) jurisdiction would be expected to pay without any specific support. To establish the benchmark, affordability would be measured over a "basket" of services representing the average demand by residential subscribers in the jurisdiction.[13]

Measuring affordability over a "basket" of services representing the average demand by residential subscribers in a jurisdiction considers the relationship between affordability and the range of ancillary services demanded by customers. As such, "affordability" is not materially affected by rate structure differences among individual exchanges or local operating companies, or by subsequent revenue-neutral rate rebalancing that may occur. Rate rebalancing might, for example, affect the minimum monthly rate for a residential dial tone access line without any usage or vertical services; however, if dial tone line rates are increased and usage rates are correspondingly decreased, the price for the "basket" of services will not materially change.

After identifying the highest rate currently being charged by the dominant local exchange company ("LEC") for basic residential dial tone access, local usage, touch tone, vertical

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[13] Relying on the relevant jurisdiction's affordability benchmark, service would be "affordable" if it is at or below the highest rate level applicable for any exchange within the jurisdiction for which residential penetration is within five percentage points of the jurisdiction-wide average.

features, and intraLATA toll calling within a 40-mile radius,[14] corresponding evaluations of the total monthly bill would be made for individual exchanges that are considered to exhibit "high-cost" characteristics. For example, if the per-line cost of serving a particular exchange exceeds the benchmark rate, customers would be charged the benchmark rate and the excess would be drawn from the universal service fund. Only those exchanges where costs exceed the benchmark would be eligible for any universal service subsidy support

The affordability benchmark should be adjusted annually based on the Consumer Price Index. [If the Commission so chooses, it can take advantage of the availability of regional calculations of the Consumer Price Index, thereby making the adjustment more geographically targeted.] In addition, as competition develops and new technology is introduced, the prices for services in some individual exchanges may decrease. In those exchanges, cost reductions would bring some of the formerly high-cost areas closer to or perhaps below the affordability

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[14] Including "short distance" toll calls within the "basket" normalizes all areas with respect to differences in the geographic extent of local calling and captures the beneficial affects of rate rebalancing on remote, high-cost areas where toll calling tends to be highest. Within the United States, most calling areas extend 40 miles or less (although there are notable exceptions involving distances of 100 miles or more). In areas with extensive local calling (e.g., Atlanta, New York City, Denver, and Honolulu), there would be little or no "shorter distance" toll use within the basket. In contrast, where the local calling area is small (e.g., Los Angeles, San Francisco), a fairly large intraLATA "short distance" toll component would apply. If "short distance" toll charges are included, if the price for the basic dial tone line increases, it is often offset by substantial decreases in the toll service component of the monthly bill.

benchmark, thereby reducing the amount of required support, or removing them from eligibility for support altogether.

3. When making the "affordability" determination required by Section 254(i) of the Act, what are the advantages and disadvantages of using a specific national benchmark rate for core services in a proxy model?

As discussed in detail in its response to Item 2 above, TW Comm advocates the use of a jurisdictional, rather than a national, affordability benchmark in order to reach the affordability determination required by Section 254(i) of the 1996 Act. Specifically, TW Comm recommends that the affordability benchmark represent the upper end of the range of total charges for local services that individual residential subscribers in a state must pay without support. Service would thus be deemed affordable if the price is at or below the highest rate level applicable for any exchange within a given jurisdiction for which residential penetration is within five percentage points of the jurisdiction-wide average.

Adoption of TW Comm's recommendation that the "affordability" benchmark rate be determined on a state-by-state basis will best reflect local conditions and thus, will result in a more efficient distribution of funds than if a national benchmark is adopted. As proposed by TW Comm, an affordability benchmark established by jurisdiction recognizes the significant cost and demographic differences that exist among the states. Put simply, affordability determinations reached on a state level will more accurately reflect circumstances within a particular jurisdiction (i.e., household income, cost of living, local calling area size, telephone penetration, current rate levels and rate setting policies). An affordability benchmark that more accurately reflects the circumstances within a particular jurisdiction will, in turn, ensure that universal service support is targeted to those customers in areas where it is most needed.

The use of a national benchmark rate is undesirable because of its unknown, and possibly significant, effect on rates. For example, because rates vary widely between jurisdictions, one possible effect of setting the affordability benchmark at a national level is that rate shock may occur in some areas.

4. What are the effects on competition if a carrier is denied universal service support because it is technically infeasible for that carrier to provide one or more of the core services?

If core services are broadly defined for universal service purposes, it would increase the possibility that a competitive carrier might not be technically able to provide a constituent service on either a resale or a facilities basis. For these reasons, TW Comm recommends a narrow definition of core services. Such a definition of core services will not require a specific technology and thus, should not present unreasonable technical barriers to entry for new competitors. The following five "core" services enumerated in the NPRM should be designated as basic services for purposes of universal service support: (1) voice grade access to the public switched network, with the ability to place and receive calls;[15] (2) tone dialing; (3) single party service; (4) access to emergency services (911); and (5) access to operator services. TW Comm further recommends that it would be appropriate to include some base level of local usage within the definition of basic service as the ability to place local calls is equally, if not more, important than the ability to receive calls.[16] Relay services and a directory listing should also fall within the scope of the basic universal service definition.

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[15] Such access should include access to directory assistance and interexchange carriers.

[16] This does not imply that flat rate service is a universal service requirement. Measured service packages with certain call allowances would meet such a requirement.

If core services are narrowly defined as the 1996 Act implies, it is unlikely that it will be technically infeasible for service providers to provide one of the core services. It is reasonable to require a carrier to provide these core services to customers in order to qualify for universal service support. From a customer's perspective, it is extremely critical that a service provider furnish core services. Particularly during the transition period -- until a fully competitive market for core services develops -- any entity seeking universal service support should be obligated to provide at least the core services.

If the definition of core services is not narrowly defined as TW Comm recommends above, it is much more likely that competition will be affected negatively if a carrier is denied universal service support because it is technically infeasible for that carrier to provide the core services. This is further support for the conclusion that the NPRM properly excluded "advanced services" from universal service support because of their limited use by the broader public.[17] A core service will be a service that a substantial majority of other consumers would be willing to purchase at a reasonable price. Any expansion of the universal service concept mandated in a manner not consistent with actual consumer demand would be inefficient and would effectively require a subsidy to all customers irrespective of need, financial or otherwise.

If the Commission included advanced services as core services at this time, the size of the fund would expand,

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[17] See 1996 Act § 254(c)(1).

possibly damaging public support for all universal service support, as well as presenting technical barriers to market entry. As the market evolves and prices for advanced services are reduced by technological innovations and competitive forces, the Commission could consider expanding the set of core services to include advanced services that gain widespread acceptance and meet the requirements of Section 254(c)(1).

5. **<u>A number of commenters proposed various services to be included on the list of supported services, including access to directory assistance, emergency assistance, and advanced services. Although the delivery of these services may require a local loop, do loop costs accurately represent the actual cost of providing core services? To the extent that loop costs do not fully represent the costs associated with including a service in the definition of core services, identify and quantify other costs to be considered</u>.**

Although the delivery of core services does require use of the local loop, loop costs may not accurately represent the actual cost of providing core services. Arguably, the Commission should consider whether at least a portion of loop costs should be allocated to other telecommunications services such as interexchange services. TW Comm recommends that the actual cost of providing loop services should be determined by relying on proxy models and not by relying on incumbent LECs' book costs. TW Comm's position is explained in further detail below.

TW Comm advocates a universal service program that will allocate subsidies only after consideration of both the cost of serving an area (as measured objectively by a proxy) and the general economic need of subscribers in a given area. Thus, TW Comm's response to any question regarding whether the loop costs accurately represent the "actual cost" of providing core services on a universal basis is qualified by the manner in which those costs are measured. In no event is it appropriate or acceptable to rely on book costs of the incumbent local exchange carriers to define loop costs for purposes of determining universal service support requirements. TW Comm's suggested approach and also the difficulties associated with responding to the question of whether loop costs accurately represent the actual cost of providing core services are explained in more detail below.

Disbursement of the high-cost fund should directly correspond to the disparity between the general economic needs of subscribers in a certain area and the costs of providing the core services, as those costs are measured by a proxy methodology rather than based on a LEC's historical cost of providing service. An independent evaluation of whether an area truly merits high-cost support and the degree of high-cost support actually required to achieve universal service goals should be accomplished through a two-step process: (1) performance of an independent and objective analysis of the costs of an area based upon its physical characteristics and on that basis develop "cost proxies" to establish "normal" or "expected" cost levels for areas with the specified geographic and density attributes and (2) initiation of a bidding process to determine the "fair market value" of serving the area. If such an approach is adopted, the need to answer the question posed by Item 5 of the July 3, 1996 Public Notice becomes irrelevant.

Whether loop costs accurately represent the actual cost of providing core services frames the issue in terms of conventional telephone technology and thus tends to define the problem, at least in part, as related to LEC-reported costs. In turn, LEC-reported costs are based, at least in part, on LEC-created "cost of service" studies. It is unlikely that LEC-reported costs actually reflect the costs associated with an economically efficient service provider in a particular area.