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Federal Communications Commission
Office of Secretary

April 1, 1997

Mr. William F. Caton
Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, DC 20554

Re: Ex Parte Presentation in CC Docket No. 96-45
Federal-State Joint Board on Universal Service;
CC Docket Nos. 96-262, 94-1, 91-213 Access Charge
Reform

Dear Secretary Caton:

On Tuesday, April 1, 1997, representatives of Time Warner Communications ("TWComm") met with Thomas Boasberg, Legal Advisor to Chairman Reed E. Hundt. Representing TWComm were Don Shepheard and Phil Verveer. Attached are two copies of the outline which describes the substance of TWComm's presentation and which was submitted at today's meeting.

Please let me know if you have any questions.

Sincerely,

Thomas Jones

Enclosures

cc: Thomas Boasberg

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KEY UNIVERSAL SERVICE and ACCESS REFORM ISSUES
For
TIME WARNER COMMUNICATIONS

The Universal Service and Access Reform proceedings address issues which are critical to the success of Time Warner Communications in the switched services and access markets...

A combination of FCC action which includes....

- Deregulation of ILEC prices on the basis of potential competition,
- Artificially reduced access prices, and
- High universal service support obligations without a competitively neutral surcharge,

....will place facilities-based competitors in an unacceptable margin squeeze. Under such conditions, Time Warner Communications would need to re-evaluate its business plan.

I. Universal Service

- Size of the Universal Service Fund
  - Consideration of affordability is <u>required</u> by the 1996 Telecom Act: "Quality services should be available at just, reasonable, and *affordable* rates."
  - The Joint Board concluded that "customer income level is a factor that should be examined when addressing affordability," and that "per capita income of a local or regional area, and not a national median, should be considered in determining affordability."
  - The impact of including income level thresholds in the determination of high-cost funding can be significant.
    - At a $20 revenue benchmark (i.e., the average revenue per line, considering basic service rates and discretionary services), Census Block Groups above the 70th percentile of income in each state account for approximately $4.5 billion, or 30% of high-cost fund requirements ($1.8 billion, or 25%, at a $30 revenue benchmark).
  - Should the federal fund provide a subsidy to communities where the median income is over $100,000? Can a cost of $50 be considered unaffordable for residents of these communities?

- Revenue Base for Contribution to USF
  - Basing USF, as structured, on interstate revenue only will tend to impact CLECs disproportionately to ILECs.
  - Revenue base for USF should be consistent with the scope of the funding.
    - Federal USF funded only by interstate revenue should support interstate services only. States must fund all other support requirements.
    - Equitable solution most consistent with the Act is a federal fund supporting both interstate and intrastate services, and funded by both interstate and intrastate revenues.

- Recovery of Carrier Contributions to Universal Service Fund
  - Only competitively neutral recovery mechanism is mandatory end-user surcharge. Simply incorporating USF contributions into carrier cost structure is <u>not</u> competitively neutral. ILECs will receive the bulk of USF distribution.
  - Captive consumers will end up paying a disproportionate share of USF costs.
  - Also, because ILECs will still have considerable areas/services with no competition, they can manipulate USF cost recovery to disadvantage new entrants.
  - Competitive companies do not pass "tax" increases that represent 10-15% of revenue to shareholders. Competitive markets, such as long-distance, tend to pass on such uniform cost increases to consumers.

II. Access Reform

- Market forces act more efficiently than regulatory prescription. TW Comm supports a market-based approach that allows facilities-based competition to develop. However, market approach put forward in NPRM deregulates ILEC prices and new services solely on the basis of the *potential* for competition.
  - Competition for switched access services is dependent upon a competitive market for local exchange services, now in its infancy.
  - No BOC has yet been able to demonstrate full compliance with Section 271 competitive checklist.
  - ILECs should be required to demonstrate the presence of substantial competition as a condition for any further pricing flexibility. Standards should be similar to those for AT&T.

- Regulatory prescription at TSLRIC could stifle the development of facilities-based competition.
  - IXC plan is to rely on resale and unbundled elements to build critical mass for facilities investment. There will be little, if any, product differentiation, and service quality can only be as good as the ILEC network being resold. IXCs plan to build critical mass by leveraging their long-distance customer base and their strong brand identity.

- In contrast, TW Comm plans to invest in facilities that provide lower cost, higher quality services.
  - TW Comm can build a network today that is more efficient than the ILEC's current cost structure. Over time, competition will force more efficiency into the ILEC cost structure and prices will move toward forward looking economic costs. At the same time TW Comm will establish an increasing customer base which will increase network utilization and reduce unit costs. Thus, TW Comm will be able to maintain competitive prices over time.
  - TW Comm cannot compete effectively, however, with prices prescriptively based on a hypothetical, least-cost competitor with a fully utilized network.
  - TW Comm cannot adopt the ATT/MCI resale strategy, as it has no established telecom customer base and no brand identification with telephony. TW Comm's competitive advantage is in the cost and quality of its network.
- Incumbent LECs should be given the *opportunity,* but not a *guarantee*, to recover historical costs.
  - ILECs should be permitted, to the extent allowed by the market, to recover historical costs of access rate elements to which those costs are reasonably attributed.
  - Guaranteed recovery through USF or other special recovery mechanisms is inconsistent with incentive regulation, and denies consumers the full benefits of competition.