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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

June 1, 1998

Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, NW
Room 222
Washington, DC 20554

Re: Erratum to TWComm's Reply Comments regarding Universal Service Support Methodology
CC Dkt. Nos. 96-45; 97-160
DA 98-715

Dear Secretary Salas:

Transmitted herewith, on behalf of Time Warner Communications Holdings Inc. ("TWComm"), are six copies of an erratum to its "Reply Comments of Time Warner Communications Holdings Inc." filed May 26, 1998 in CC Dkt. Nos. 96-45; 97-160; DA 98-715. Though all parties were served consistent with the requirements set forth in the applicable public notice[1] and FCC rules, the certificate of service list was inadvertently not filed along with the reply comments. This erratum is made to attach the certificate of service list to TWComm's reply comments.

If you have any questions concerning this letter or TWComm's reply comments, please contact the undersigned.

Sincerely,

Thomas Jones

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1 Common Carrier Bureau Seeks Comment on Proposals to Revise the Methodology for Determining Universal Service Support, FCC Public Notice, CC Dkt. Nos. 96-45; 97-160; DA 98-715 (rel. Apr. 15, 1998).

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BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the matter of	)	
Proposals to Revise the	)	
Methodology for Determining	)	CC Dkt Nos. 96-45; 97-160
Universal Service Support	)	DA 98-715

REPLY COMMENTS OF TIME WARNER COMMUNICATIONS HOLDINGS INC.

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ATTORNEYS FOR TIME WARNER
COMMUNICATIONS HOLDINGS INC.

May 29, 1998

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BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

In the matter of	)	
Proposals to Revise the	)	
Methodology for Determining	)	CC Dkt Nos. 96-45; 97-160
Universal Service Support	)	DA 98-715

REPLY COMMENTS OF TIME WARNER COMMUNICATIONS HOLDINGS INC.

Time Warner Communications Holdings Inc ("TWComm"), by its attorneys, hereby files its reply comments concerning proposals to revise the methodology for determining universal service support for non-rural carriers providing service to high-cost areas.

INTRODUCTION AND SUMMARY

Primarily in deference to the concerns expressed by certain state public utilities commissions, the Commission has undertaken to review proposals that would modify the May 8, 1997 Universal Service Order[1] in two major respects: (1) by raising the federal high-cost contribution from 25% of the amount determined under the Commission's high-cost methodology to a large percentage, as high as 75%, and (2) by replacing the nationwide revenue

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1 See Federal-State Joint Board on Universal Service, Report and Order, 12 FCC Rcd 8776 (1997) ("Universal Service First Report and Order").

benchmark with a nationwide average cost benchmark. However, the proposals that the Commission has received are not confined to these areas alone. Some proposals attempt to collaterally attack a broad array of matters that were fully considered and appropriately disposed of in the Commission's First Report and Order (perhaps most egregiously in trying to resuscitate the use of inflated, embedded costs as a basis for determining support levels).

The comments filed on May 15, 1998 reveal that despite some divergence of views, the Commission's May 8 Order continues to enjoy wide support. There is no reason to repeat the lengthy and resource-intensive process by which those decisions were reached. Instead, the Commission should be asking the following questions:

(1) are there any changed circumstances since the May 8 Order was adopted that would merit revisiting the policies adopted in that decision?

(2) has any new evidence been brought to light that calls into question the decisions in the May 8 Order?

TWComm respectfully suggests that the single most compelling circumstance that was not contemplated when the Commission adopted its Universal Service decision has been the slower-than-expected development of competition in the local exchange market and near-complete lack of competition for residential customers. The Commission's recent local competition survey shows that this

condition exists nationwide.[2] This circumstance was not contemplated by the Commission a year ago, nor by Congress in early 1996, when it mandated changes in the universal service funding mechanism as part of the Telecommunications Act of 1996. Moreover, as AT&T and MCI have appropriately commented, the financial strength of the non-rural ILECs in recent reporting periods confirms that the ability of these companies to serve all customers at affordable rates is not being jeopardized by the minimal levels of competition that have developed. As MCI demonstrates in Figure 1 of its Comments, ILEC interstate earnings have grown steadily and show no sign of weakening since Congress passed its pro-competitive mandate.[3]

After reviewing the comments of other parties, TWComm strongly supports postponing implementation of the new federal mechanism from the originally scheduled date of January 1, 1999.[4] Since the level of competition in the residential market is in no way jeopardizing affordable telephone service under the existing universal service mechanism, there is no imminent need for a new fund. A postponement would have the additional benefit of permitting the Commission to spend the additional time necessary to ensure the integrity of its forward-looking cost proxy model. The ILECs will likely protest such delay, suggesting that any

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2 The FCC has posted on its web site the incumbent LECs' responses to the Common Carrier Bureau's request for data on the level of local competition.

3 See Comments of MCI at 8.

4 See Comments of AT&T at 5.

postponement will endanger their survival. Before the Commission gives any credence to such complaints, the ILECs should be required to demonstrate that competition has caused a significant erosion of their earnings.

In addition, there is broad consensus that the Commission's policies should specifically aim to minimize the size of the universal service fund.[5] This is especially important under present conditions, in which the ILECs -- as the overwhelming providers of service -- would remain the overwhelming recipients of funds. TWComm is particularly concerned with the almost certain anticompetitive effects of a large fund that funnels most of its dollars to ILECs to support a service (primarily residential exchange service) for which competition is barely present. It is highly likely that, unless specifically constrained in their ratemaking practices by state and federal regulators, the ILECs will use much of these additional dollars to reduce prices for business services, in order to thwart

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5 See, e.g., Comments of MCI at 3; Comments of AT&T at 4-12; Comments of Ameritech at 6; Comments of Bell Atlantic at 2-3; Ad Hoc Working Group Proposal (submitted April 27, 1998) at 7. Ameritech is extremely pointed about the lack of need to expand existing federal universal service support. The Ameritech Comments start by observing (1) that "support has historically been directed to companies whose local rates are, more often than not, below the local rates of non-recipients" and (2) that universal service sometimes goes to companies "whose need for it may be questionable in light of the advanced state of their networks" (xDSL, all fiber, etc.). See Comments of Ameritech at 1-3. Ameritech concludes: "These facts clearly demonstrate that demands to expand federal high cost funding beyond current levels is premature -- at least until the states have taken a serious look at the intrastate aspects of universal service." Id. at 3.

competitive entry. This is so even though the extent to which (if at all) local business rates subsidize local residential rates has never been demonstrated. Thus, to the extent that the Commission considers modifications to the May 8 universal service framework, it should favor changes that minimize funding requirements and promote competitive neutrality.

Other aspects of the Commission's Universal Service decision -- such as the use of a national, revenue-based benchmark and the central determination that forward-looking, rather than embedded, costs should be the basis for universal service support -- are not specifically called into question by the limited growth in competition during the intervening period. In such areas, the Commission should strongly resist requests to reopen the debate over policies adopted within the comprehensive framework of its May 8 Order.

As to the proposal of the Ad Hoc Working Group, TWComm's review of the comments confirms its view that the proposal as it currently stands is unduly complex and its workings not fully understood. The proposal clearly has a substantial benefit to the Working Group states, but in light of the current state of competition, there has been no showing that the "cure" proposed by this subset of states is aimed at an actual deficiency in funding. The Commission should not embrace this or any other comprehensive revamping of the funding mechanism adopted in its May 1997 Order without compelling reasons and without further opportunity for public debate.

I. IMPLEMENTATION OF A NEW FEDERAL UNIVERSAL SERVICE SUPPORT MECHANISM THAT INCREASES THE PRESENT LEVEL OF FUNDING FOR NON-RURAL ILECS IS PREMATURE.

TWComm agrees with parties who urge the Commission to delay implementing a new (and expanded) universal service fund on January 1, 1999, and further agrees that the Commission is not under a legal mandate to implement a new mechanism by that particular date. First, as AT&T points out in strongest terms, under present competitive conditions, there is no indication that the existing funding of universal service is insufficient. Second, as Bell Atlantic argues, the statutory aspiration to make universal service support "explicit" does not need to result in a larger fund.[6] The evidence of ILEC earnings and the Commission's own local competition survey show that the pre-existing subsidies are in no way jeopardized.

Acting under the rubric of Section 254, the Commission adopted the framework for a universal service mechanism and, with it, a timetable that called for implementation of the new high-cost mechanism on January 1, 1999.[7] The statutory mandate for an explicit universal service funding mechanism is inextricably linked to assumptions that competition would eliminate the implicit subsidies to local exchange service. AT&T correctly summarizes this policy framework when it states, "Congress

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6 See Comments of Bell Atlantic at 12 ("The current amount of interstate high-cost universal service support is $1.7 billion [adding high-cost support, LTS, and DEM weighting], and the Act requires only this amount to be made explicit")

7 See Universal Service First Report and Order at ¶ 281.

understood . . . that under the Act new entrants would be able to offer competing services at cost-based rates, thus forcing incumbents to lower their prices and lose these sources of implicit subsidies. Section 254 therefore requires the Commission, working with the Joint Board, to establish explicit and competitively neutral mechanisms to replace the implicit subsidies that would be competed away by new entrants." AT&T goes on to argue that the Commission's decision to implement a new federal system of high cost support on a rapid timetable made sense, given the possibility that competition would materialize rapidly. However, since effective competition for residential customers has not yet occurred, the current timetable is out of synch with the Act and its objectives, and should not proceed without modification. Moreover, while Section 254 required the Commission to adopt a specific timeframe for implementing its universal service plan, nothing in the statute prevents the Commission from amending the original implementation schedule in light of unanticipated conditions that make a rush to the new funding mechanism not only unnecessary but potentially at odds with the Act's pro-competitive objectives.

Furthermore, good use can be made of the time from any such postponement. Because of the complexity of the cost proxy models and the wide-ranging views that the Commission's processes have accommodated, it is hardly surprising that the models are not yet complete. However, with no real pressure for a new fund, it is reasonable for the Commission to allot more time now to come up with a model that will serve the intended purposes at the future

time when such a model may actually be needed to determine high cost support.

II. THERE IS NO PRESENT NEED FOR THE FCC TO REVISE ITS DECISION TO FUND 25% OF THE UNIVERSAL SERVICE FUND REQUIREMENTS THROUGH INTERSTATE FUNDS.

TWComm does not oppose the decision to take a second look at the Commission's initial decision to fund 25% of the high-cost level determined using the cost proxy models. But while the relative contribution from interstate sources may need to change, there is no basis at this time to expand the absolute dollar amounts allocated to federal funds.[8]

Fundamentally, the states' concern about how they will recover 75% of the identified high-cost subsidy is integrally related to the size of the total support identified. When inflated universal service numbers are floated, it is no wonder that states are concerned about supporting a three-quarters share. Before agreeing to shift a greater portion of universal service support to the interstate jurisdiction, the Commission should ensure that it has minimized the total size of the fund, by such means as continuing to rely on a national revenue benchmark (as adopted in the May 1997 Order), assessing needs at the study area (or alternatively at the geographic level that corresponds with the level of UNE loop deaveraging), and forbearing from dispensing support to high-income CBGs. If the

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8 See, e.g., Comments of Ameritech at 4-5 (referencing Chairman Kennard's Principle 2 from his Address to the National Association of State Utility Consumer Advocates, February 9, 1998).

USF is appropriately sized, state USF requirements will be substantially lower and should not be out of reach for even predominately rural states such as those participating in the Ad Hoc Working Group. In any event, until the extent of rural funding requirements (including an assessment of the rural states' ability to pay for high cost programs) have been specifically quantified, it is premature to revisit the 25%/75% split. Indeed any such premature reassessment would be arbitrary and capricious.

III. THE COMMISSION SHOULD RETAIN A REVENUE-BASED BENCHMARK AND SHOULD REQUIRE ILECS TO RECOGNIZE ALL REVENUE SOURCES ASSOCIATED WITH THE PROVISION OF LOCAL EXCHANGE SERVICE

The Commission should not revisit its decision to adopt a revenue-based benchmark in light of the underlying rationale of its May 8 Order.[9] So long as the ILECs continue to have the revenue streams that have permitted them to offer basic local exchange service at affordable rates, there is simply no need for an external subsidy.[10] In attempting to resurrect debate over a cost- vs. revenue-based benchmark, the proponents of this approach are simply rehashing their old positions. In fact, nothing has happened to cause the Commission to reconsider or independently seek to revise its decision to use a nationwide revenue benchmark for determining universal service support.

In the exercise of their autonomous ratemaking functions, some states have taken actions that permit ILECs to appropriate

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9 See Universal Service First Report and Order at ¶¶ 257-267.

10 See Comments of MCI at 15-16, Comments of AT&T at 4-7.

for the exclusive benefit of shareholders certain revenues that otherwise would be available to support local service. For example, while a number of states have carefully preserved the subsidy from Yellow Pages profits to benefit the ILEC's local service,[11] others have permitted the ILEC to restructure or otherwise convert Yellow Pages into a business that profits the ILEC's shareholders alone. If a PUC or legislature in a particular state has chosen to permit the ILEC to remove the traditional subsidy to local exchange service from Yellow Pages profits, it cannot reasonably expect customers in another state to subsidize the shortfall associated with that decision. Thus, it is entirely reasonable to impute Yellow Pages profits, on a per-line basis, to the revenues of the ILEC for purposes of calculating the revenue benchmark. In fact, one of TWComm's concerns with the Working Group proposal is that it would mask the subsidy transfers between the states.

The merit of adopting a revenue benchmark that reflects revenues from those services that are inextricably linked to the basic dial tone was recently recognized by the Tennessee Public Service Commission as the following excerpt from its decision indicates:

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[11] Indeed, the only reason that the Bell Operating Companies continue to have their Yellow Pages businesses today is because the Court administering the proceedings on the Modified Final Judgment specifically ruled that the profits from Yellow Pages were an important source of subsidy to the local exchange carriers, which it did not want to disturb. See United States v AT&T, 552 F.Supp. 131, 194 (D.D.C. 1982).

> When competitors decide to provide service to residential customers in high cost areas, such competitors will offer a number of services to their residential customers (e.g.,local service, long distance, vertical features, etc.). For this reason, the Authority finds that the revenue benchmark used in calculating support for each wire center should be the average revenue per residential line for that wire center. The average revenue should be calculated using the following services: basic local service, toll, directory assistance, all vertical features, touch-tone, zone charges (intrastate/interstate), the interstate Subscriber Line Charge, and white page services. In addition, the subsidy provided by Yellow Page advertising should be included in the revenue benchmark.[12]

As the Tennessee Public Service Commission also found, Yellow Page revenues should continue to be included in any assessment of the need for universal service support:

> Since the divestiture of AT&T in 1984, regulators and the courts have recognized the importance of Yellow Pages in keeping local rates affordable and maintaining universal service. In *United States v. AT&T, 552 F. Supp. 131, 194 (USDC D.C. 1982)* the Court stated 'All those who have studied the issue agree that Yellow Pages provide a significant subsidy to local telephone rates...The loss of this large subsidy would have important consequences for the rates for local telephone service.'"[13]

TWComm also supports those parties who have taken the position that multiple thresholds and "super benchmarks" are inappropriate to ensure affordable universal service in exceptionally high-cost areas.[14] One such proposal is US West's "IHCAP" proposal which recommends the establishment of

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12 Interim Order on Phase I of Universal Service, before the Tennessee Regulatory Authority, Dkt. No. 9700888 at 36 (rel. May 20, 1998) (note omitted).

13 Id. at 36-37.

14 See, e.g., Comments of MCI at 5-6; Comments of AT&T at 15-17; Comments of Sprint at 9-10.

hierarchical benchmarks whereby the federal fund would (1) not provide support for forward-looking loop costs that are $30 or less, (2) provide support for 25% of the forward-looking loop cost between a "primary benchmark" of $30 and a "super benchmark" of $50, and (3) provide support for 100% of the forward-looking loop cost above the $50 super benchmark.[15] Although US West's proposal would target additional federal assistance to the highest cost loops, the proposal fails entirely to reflect the revenues associated with local exchange carriers' provision of local exchange service. As discussed, a complete examination of the need for high cost assistance for basic local exchange service cannot be made without an assessment of the revenues derived as a result of providing that service.

IV. TWCOMM'S PROPOSAL IS ONE OF SEVERAL THAT SEEKS TO SET REASONABLE LIMITS ON THE MAGNITUDE OF HIGH-COST SUPPORT, CONSISTENT WITH THE PRINCIPLES ESTABLISHED BY CONGRESS AND THE COMMISSION.

From the comments and proposals filed with the Commission, it is plain that the state commissions, IXCs, CLECs, and even some ILECs, (those serving states that make net contributions to federal funds) support the principle that federal support should be the minimum to achieve statutory goals and that a bloated federal service fund would disserve the public interest. TWComm strongly agrees with Ameritech, Bell Atlantic and others[16] that

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15 Comments of US West at 6.

16 See, e.g., Comments of Bell Atlantic at 2-3, Comments of Ameritech at 6; Comments of MCI at 18-19; Comments of AT&T at 4-12.

the Commission should reject out of hand those proposals that would result in a massive federal program, many times its current size. Particularly egregious are the BellSouth and GTE proposals, which are throw-backs to earlier ILEC positions that recommend sizing the fund to recover all of the "contribution" from interstate rates that exceed forward-looking cost. As MCI points out, the margin between the price and cost of access service simply cannot be equated with the subsidy necessary to preserve universal service in high-cost areas.[17] As several parties have observed,[18] the entire difference between the level at which prices for interstate access are presently set and the forward-looking cost of that access does not represent universal service support. Although some portion of that difference may provide federal universal service support, a substantial portion simply represents the difference between ILECs' embedded costs and their forward-looking costs. That latter component does not bear on the sizing or design of an interstate universal service fund. As Bell Atlantic points out, such costs represent the cost of providing access services, not the costs of universal service.[19]

TWComm also strongly urges the Commission to dismiss any suggestions (from SBC and others) that it should abandon its

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17 See Comments of MCI at 18-19; see also, Comments of Bell Atlantic at 13-14; Comments of AT&T at 20-21.

18 See Comments of MCI at 18-19; Comments of Bell Atlantic at 13-14; Comments of AT&T at 20-21.

19 See Comments of Bell Atlantic at 13.

focus on forward-looking cost proxy models in favor of "actual, booked" (embedded) costs. The FCC, in agreement with the Joint Board, has already rejected the use of embedded costs.[20] TWComm urges the FCC to move the debate forward rather than to re-open old and stale arguments that detract from the resolution of other unsettled matters concerning universal service funding.

On the other hand, the Commission should give careful consideration to the proposals and comments that seek to place legitimate constraints on the high-cost funding mechanism. NCTA[21] and others have previously pointed out that the size of the high-cost fund is dramatically increased by calculating support on a CBG basis, rather than based on a larger geographic area. In its comments, AT&T specifically recommends that support be calculated at the study area level. TWComm agrees that this modification would have a beneficial effect on the size of the fund and would not cause support to fall below a level sufficient to preserve universal service, at least until robust non-resale-based competition develops in the residential market. Moreover, a decision to calculate support at the study area level while effective competition is developing would not (as ILECs are likely to contend) result in support of inefficient entry.

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20 See Universal Service First Report and Order at ¶¶ 224-231.

21 See Baldwin, Susan M. and Lee L. Selwyn, The Cost of Universal Service: A Critical Assessment of the Benchmark Cost Model, April 1996, at 93-100 filed in CC Docket No. 96-45; see also, Baldwin, Susan M. and Lee L. Selwyn, Converging on a Cost Proxy Model for Primary Line Basic Residential Service, August 1996, at 111-115 filed in CC Docket No. 96-45.

Knowing that the Commission is prepared to implement support on a geographically deaveraged basis once competition has developed for residential customers would suffice to deter inefficient entry.

TWComm's proposal that the Commission should withhold high-cost support from high-income CBGs comes at the issue of an inflated fund from another direction. The mandate for affordable basic telephone service simply does not require that subsidies flow to customers who can afford cost-based rates, and TWComm's proposal presents a targeted way to achieve Congressional objectives more efficiently. TWComm recognizes that its proposal would add some administrative complexity to the Commission's high-cost mechanism, but is convinced that the additional burden would be more than offset by the elimination of funding not necessary to maintain affordable local service and by the benefits to customers and the industry that would result from a more efficient funding mechanism. Moreover, BellSouth's assertion[22] that the type of income data necessary to implement TWComm's proposal is not "readily available," and that TWComm has failed to explain how such data could be obtained is inaccurate. The source of the income data used by TWComm is publicly available data, routinely collected and reported by the Census Bureau and available in computer-readable format. This data source was explicitly and repeatedly cited in the paper prepared

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22 See Comments of BellSouth at 5 n.8.

for TWComm by Economics and Technology, Inc., which was attached to TWComm's proposal in this proceeding.

Nor are GTE's objections to TWComm's proposals any more supportable. First, GTE argues essentially that relative affordability should not be considered in distributing federal funds because affordability has never before been a consideration in high-cost subsidy programs.[23] GTE apparently believes that market inefficiencies created by flawed public policy should not be changed if they never been altered in the past. This position is of course absurd because it avoids meaningful discussion of exactly why the current system is flawed.

Moreover, GTE's assertion that TWComm's proposal rests on the unrealistic assumption that state rate structures would change in response to changes in federal funding is baseless and in any case a red herring. States have simply not faced the question of reduced federal funding for high-income areas, and there is therefore no way to know how they would respond to such a policy. In any case, the point is that the states must decide for themselves whether to subsidize high-income, high-cost areas. This should not be the FCC's responsibility in administering a statute that explicitly requires the FCC to consider affordability in setting federal subsidies.[24]

Finally, the Rural Telephone Coalition ("RTC") has made several attempts to discredit TWComm's proposal, but its

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[23] See Comments of GTE at 15-17.

[24] See 47 U.S.C. § 254(b)(1).

objections are baseless. RTC suggests that eliminating federal support to high-income, high-cost areas would violate a statutory requirement for "comparability" of rates between urban and rural areas. TWComm would point out that the comparability criterion is not a "requirement" but rather one of several criteria that the Commission is directed to consider and balance in designing its universal service mechanism, along with (and not with greater priority than) the criterion of affordability.

RTC also quibbles with use of BCM2 as the basis for the examples in the report supporting TWComm's proposal, on the grounds that this particular proxy model, according to RTC, has never been "validated or adopted as the measure of costs that will be funded."[25] But the choice of model does not affect the larger conclusion that a significant number of high-cost CBGs are populated by households that have the means to pay a cost-based rate for their basic telephone service.

Nor should the FCC give any credence to the RTC's argument that TWComm's proposal is unnecessary since "Section 254(j) indicates that Congress was satisfied with the existing low-income support mechanism."[26] TWComm's proposal is designed to ensure that subsidies *do not* apply to *high-income* consumers for whom service is affordable whereas the Lifeline and Link-Up programs (the second of which is not even mentioned in Section 254(j)) are designed to ensure that subsidies *do* apply where *low-*

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25 Comments of RTC at 22.

26 See Comments of RTC at 21 n. 18.

income subscribers cannot afford service. TWComm's policy concerns are therefore not satisfied by the existing Lifeline and Link-Up programs.

In sum, as GSA observes, TWComm's proposal would "focus support on households actually requiring financial assistance to obtain basic telecommunications services," is within the concept of "affordability" and is consistent with efficient economic policy.[27]

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[27] Comments of General Services Administration at 3-4.

CONCLUSION

The FCC should modify its universal service rules in accordance with the arguments made in these reply comments.

Respectfully submitted,

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Thomas Jones

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May 29, 1998

CERTIFICATE OF SERVICE

I, Catherine M. DeAngelis, do hereby certify that on this 29th day of May, 1998, copies of the foregoing "Reply Comments of Time Warner Communications Holdings Inc." were hand delivered or sent by First Class Mail, postage prepaid, to the following parties:

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