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JUN 2 - 1998
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

June 2, 1998

Magalie Roman Salas
Secretary
Federal Communications Commission
Washington DC 20554

Re: Universal Service Reform, CC Docket No. 96-45; Price Cap Performance Review, CC Docket No. 94-1; Access Charge Reform, CC Docket No. 96-262; Tariffs Implementing Access Charge Reform, CC Docket No. 97-250

Dear Ms. Salas:

On June 2, 1998, Jonathan B. Sallet, MCI's Chief Policy Counsel, and I met with Commissioner Michael Powell, Kyle Dixon, and Paul Jackson to discuss issues in the above-captioned dockets . Attached are the presentations that we used for our meeting.

Sincerely,

Mary L. Brown

Mary L. Brown

CC: Kyle Dixon
Paul Jackson

Implementation of Access Reform and Universal Service Orders - 2H98

May 27, 1998

Outstanding Issues

- **Universal Service**
  - Establishment of Contribution Factors - 2H98
  - Possible Flat Fee for Collection of Some/All Universal Service
  - MCI Declaratory Ruling on Collection of Universal Service

- **Access Charges**
  - Price Cap Reductions
  - Calculation of Access Flow Through
  - Emergency Petition to Establish Workable System/Tariff Investigation
  - Treatment of PICCs - 2H98

Universal Service - 2H98 Contributions

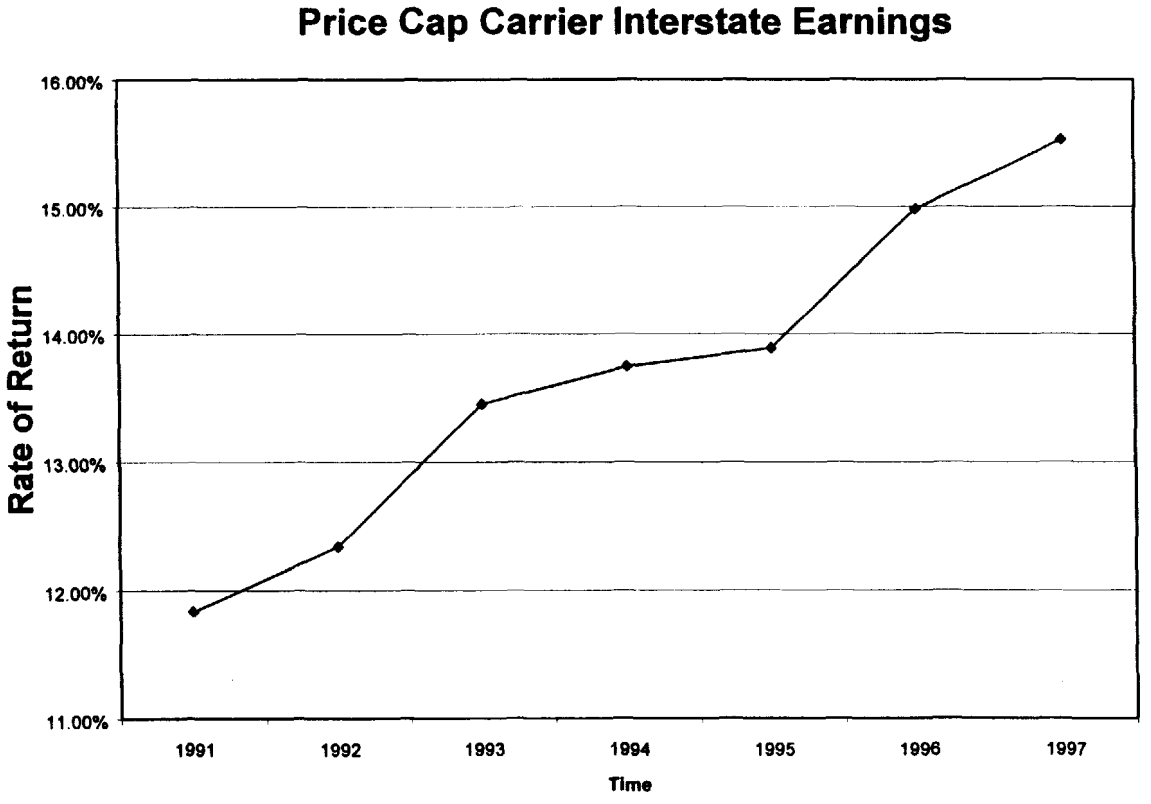
- **Timing**
  - MCI must file tariff on June 1, 1998 in order to implement new level of changes in July bills.
  - MCI will begin its recovery of USF from residential customers after foregoing $107 M in 1H98
  - MCI will assume full funding of S&L and RHC
- **Notice**
  - June 8 is last opportunity for change in Mass Market invoices in July
  - MCI was not able to give notice in June bills because FCC has not set contribution factors
  - MCI has never received notice from ILECs on the amount of USF it is being charged (subject of Emergency Petition)

By June 1, Resolve MCI Declaratory Ruling on Permissible USF Collection Methods

- **FCC, Not States, Should Interpret USF Order**
  - Florida: Show Cause Order Issued, June 8 MCI files Reply
  - Virginia: MCI filed motion for summary judgment May 22nd; VA SCC will file their opposition May 29th; MCI reply June 2nd
- **MCI Is Assessed on Total Revenue, Should Be Able to Assess Customers on Total Revenue**
- **IXCs Deserve Uniform Ruling Applied Uniformly**
  - Problem grows in July

True Access "Reform"Needed -- Rates Unreasonably High

FCC Should Establish Productivity Factor of At Least 8.5%, Reinitialized to 1995, Yielding About $1.8 Billion



Market-Based Access Reform Is A Myth -- No Downward Pressure on Rates

RBOC	Total Lines	Unbundled Network Elements	CLEC Market Share
AIT	20,612,210	68,134	0.33%
BEL	33,396,306	32,431	0.10%
BLS	23,153,182	8,448	0.04%
GTE	17,750,056	387	0.00%
SBC	33,487,936	13,940	0.04%
USW	16,121,235	340	0.00%
TOTAL	144,520,925	123,680	0.09%

Productivity Factor Should Increase to At Least 8.5%

- **Interstate-Only Productivity**
  - Reflects lower cost/min of interstate traffic (interstate more concentrated than local)
  - Fulfills Section 201 legal requirement that FCC set interstate prices on interstate costs
  - Higher, 8.5% factor based on experience & new data
    - 1997 Earnings at record 15.6%
    - ILEC pricing at cap
- **Failure To Go Back to 1995**
  - Suppresses LD demand, harming IXCs
  - Leaves access too high, harming LD rate payers…with no offsetting benefits
  - Gives ILECs time value of money
- **August Implementation Possible**

Access Charges -- Calculation of Access Flow Through

- **FCC Declares LD Industry Fully Competitive in 1995**
- **Interstate Prices Have Dropped Faster Than Access**

  "We see nothing to indicate that market forces will not compel IXCs to flow through access charge reductions"

  Price Cap Fourth Report & Order, May 7, 1997, Para 185

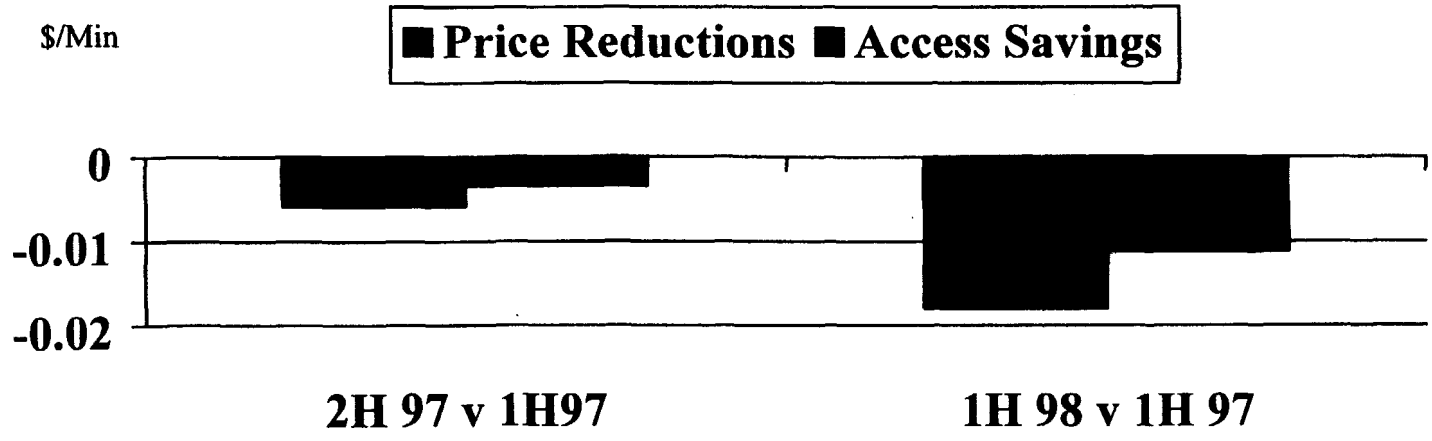
- **Proposed Data Collection Requests Revenue or Cost Data in 21 Categories**
  - Burdensome -- will cost millions to implement
  - Re-regulates LD Pricing
  - Fundamentally unfair to judge past actions by new rules
  - Quarterly reporting misunderstands and misrepresents retail environment.
  - Actual costs recaptures deficiency gains --even price caps for ILECs does not do this

MCI Passed Through Access Charge Reductions to End Users

Actions:

- $.05 on Sunday
- New Product
- 20% Cash Back for SB
- Customer Migration to Lower Rate Products
- Contract renegotiations

Access Savings	($756M)
Total Price Reductions	1,223
Extra Customer Savings	$467



FCC Must Rule on Issues Raised in MCI's Emergency Petition

- **Eliminate distinctions between primary and non-primary lines, or immediately prescribe a standardized, independently verifiable, definition of primary and non-primary;**
- **Hold the ILECs responsible for collection of PICC until such time as they can provide all necessary information to IXCs in advance of billing;**
- **Require the ILECs to provide auditable line count information, by telephone number, immediately;**
- **Standardize the date used by ILECs to decide which customers' PICCs are assigned to a particular IXC;**
- **Require ILECs to provide to each IXC the amount of USF pass through each IXC is receiving in its access bills every month.**

After Analyzing PICC Invoices Received, Over Half of Billings are Incomplete or Inaccurate

- 46% ($20.9M) of Invoice Charges Based on Missing or Incomplete LEC Information
- $1.8M of Complete Invoices Contain Incorrect Billing (MCI has Commissioned Independent Test Via Price Waterhouse)
- $1.4M In Discrepancies Found Between LEC Invoiced Data and MCI Customer Information

↓

- MCI Is Withholding $24M in PICC Payments Until End-To-End Audit Performed
- FCC Must act Immediately to Resolve PICC Implementation Flaws

6-Month Suspension of PICCs Would Be Misguided

- **$1.8b Shift To CCL Means Per Minute Access Rates Will Increase**

- **LD Rates Would have to be Raised, Wreaking Havoc With Consumers And Marketing**
  - MCI would incur unnecessary, substantial costs

MCI Report:
The Absence of Competition in Exchange Access Markets

Key Findings:

- **Competition Is Not Developing at a Pace That Could Place Competitive Pressure on ILEC Access Rates Any Time Soon**

- **By Any Measure, CLEC Market Share Is Approximately 1% of the Local Access Market**

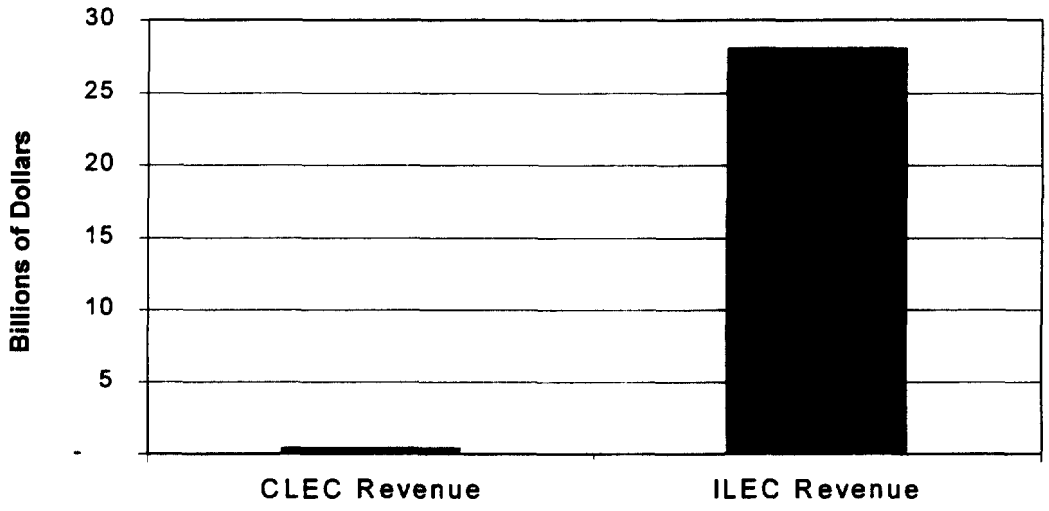
- **To Replicate the Price Cap ILECs' Local Exchange Network Built with Monopoly Funds Would Require $158 Billion of Investment by New Entrants**

CLECs Account for Approximately 1.4 % of Total Switched Access Revenues

ILEC and CLEC 1997 Access Revenues[1]

(Billions of dollars)	Switched Access	Special Access	Total Access
ILEC Revenue	28.0	5.90	33.90
CLEC Revenue	0.4	1.35	1.75
CLEC Percent	1.4%	18.6%	4.9%

1997 CLEC/ILEC Market Share by Switched Access Revenue



[1] ILEC data from 1998 Annual Report on Local Telecommunications Competition, 9th Edition, New Paradigm Resources Group, Inc, Chapter 4, Table 5, at 8. CLEC data from MCI market research.

RBOC Market Share of Switched Access Lines Is Approximately 99%

RBOC Market Share Based on Access Lines[2]

	1996	1997
AIT	99.40%	99.13%
BA	99.32%	98.99%
BS	99.45%	99.08%
SBC	99.56%	99.07%
USW	99.63%	99.00%

2 Based on MCI market research. MCI market data was obtained from government documents, industry reports, interviews with leading industry analysts, and MCI internal information. Sources included, but were not limited to: FCC data, International Data Corp, The Gartner Group, DataQuest, Frost & Sullivan, Bear Stearns, Prudential, Salomon Bros., Goldman Sachs, Connecticut Research & New Paradigm Group, CLEC public records, announcements and filings Annual Reports, 10K reports, and 10Q reports filed with the Securities & Exchange Commission.

ILEC Facilities Dwarf New Entrants' Facilities

ILEC/CLEC Transmission Facilities, 1996 [3]

ILEC	CLEC
12.3 million miles of fiber	1.3 million miles of fiber
1,300 million miles of copper	

ILEC/CLEC Switches[4]

ILEC	CLEC
23,661	1,311

* **Resale local exchange competition does not impart any pressure on the ILEC's access rates because with resale the underlying carrier keeps all access revenue generated by the resale carrier's end users.**

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[3] 1997 Statistics of Communications Common Carriers, Common Carrier Bureau, Federal Communications Commission, December 5, 1997, Table 12.

[4] ILEC based on 1996 ARMIS; LERG Data.

Less than 0.02% of All Buildings Are on CLEC Networks[5]

1997 CLEC Share of Commercial & Residential Buildings

	Business		Residential		Total	
	ILEC	CLEC	ILEC	CLEC	ILEC	CLEC
Number(millions)	4.6	0.015	112	-	116.5	0.015
Percent	99.67	0.33	100	-	99.99	0.013

1997 CLEC Share of Commercial & Residential Buildings, By Region

Region	ILEC Commercial Buildings	Total ILEC Households & Commercial Buildings	CLEC Percent of Commercial Buildings	CLEC Percent of Households & Commercial Buildings
Northeast	739,500	22,700,100	0.435%	0.014%
Midwest	1,161,780	27,696,060	0.164%	0.007%
South	1,785,000	41,989,320	0.335%	0.014%
West	983,280	24,280,080	0.464%	0.019%
Total	4,669,560	116,665,560	0.336%	0.013%

5 CLEC building data based on MCI market research, and represent buildings that take less than 30 days to provision. ILEC housing estimates based on U.S. Bureau of the Census, Estimates of Housing Units and Households of States: April 1, 1990 and July 1, 1996, Table 1 (ST-96-20T). ILEC commercial building information based on US Energy Information Administration, Department of Energy, Commercial Buildings Characteristics, 1995, Table 3. MCI increased the 1995 household and commercial building numbers by 2 percent, to represent a conservative estimate of growth since 1995.

ILEC-Provided Data Demonstrate that CLECs Serve Less than 0.09% of Access Lines in RBOC and GTE Territories[6]

CLEC Market Share by Unbundled Network Elements, March 1998

RBOC Region	Total Lines	Unbundled Network Elements	CLEC Market Share Through UNEs
AIT	20,612,210	68,134	0.33%
BEL	33,396,306	32,431	0.10%
BLS	23,153,182	8,448	0.04%
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TOTAL	144,520,925	123,680	0.09%

* As a measure of how insignificant the number of unbundled loops purchased by CLECs is, the RBOCs and GTE are expected to add 6 million access lines between 1997 and 1998.[7]

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6 On February 20, 1998, a limited number of large telephone companies were asked to complete--on a voluntary basis -- a short survey on the state of local competition at the end of 1997 for each state in which the company or affiliate (defined by direct or indirect ownership or control of a majority interest) serves as an incumbent local exchange carrier. ILEC UNE data in the following tables is compiled from the electronic survey responses from these ILECs, which the FCC received in March, 1998.

7 Earnings releases, Credit Suisse First Boston, March 11, 1998.

"Market Forces" Have Had No Impact on RBOC Pricing of Interstate Access Services

RBOC Pricing of Access Services as of 4/1/98[8]

RBOC	Trunking Basket	Traffic Sensitive Basket	Common Line Basket
Ameritech	5.7% Below Cap	**At Cap**	**At Cap**
Bell Atlantic	**At Cap**	**At Cap**	**At Cap**
BellSouth	**At Cap**	**At Cap**	**At Cap**
SBC	**At Cap**	**At Cap**	**At Cap**
PacBell	**At Cap**	**At Cap**	**At Cap**
Nevada Bell	6.1% Below Cap	**At Cap**	**At Cap**
US West	**At Cap**	**At Cap**	**At Cap**

* Even for interstate transport services, the services for which CLEC competition has been developing for nearly ten years, all the RBOCs except Ameritech and Nevada Bell are pricing at cap.

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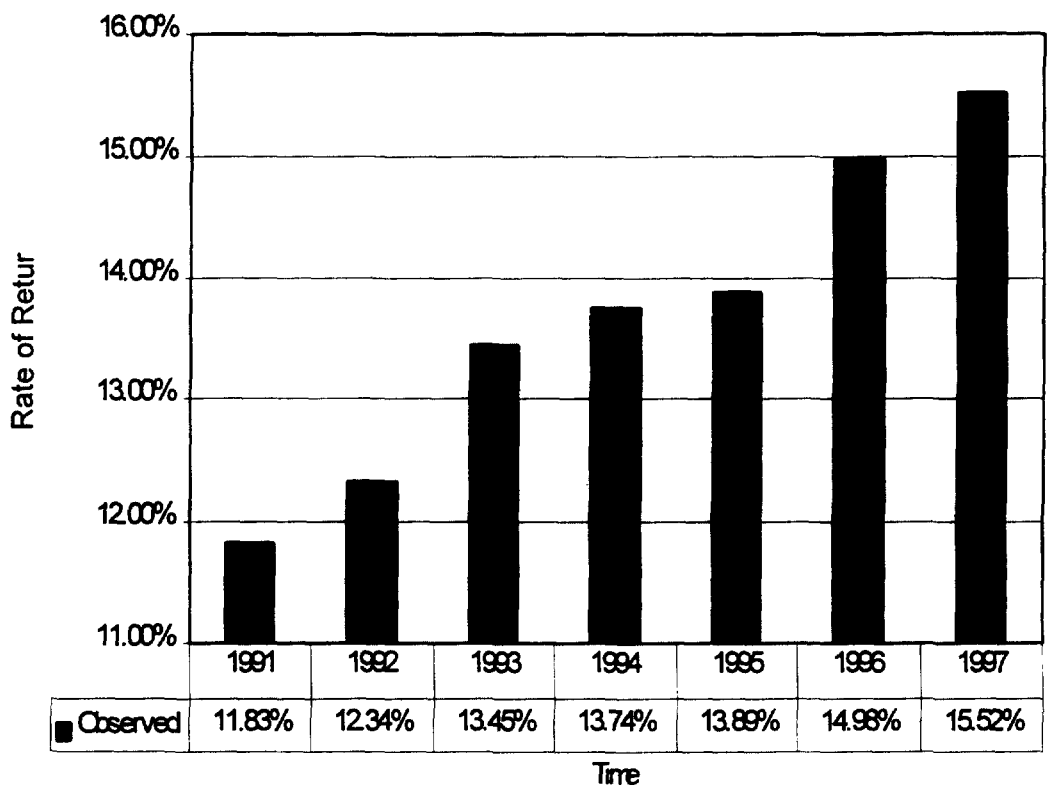
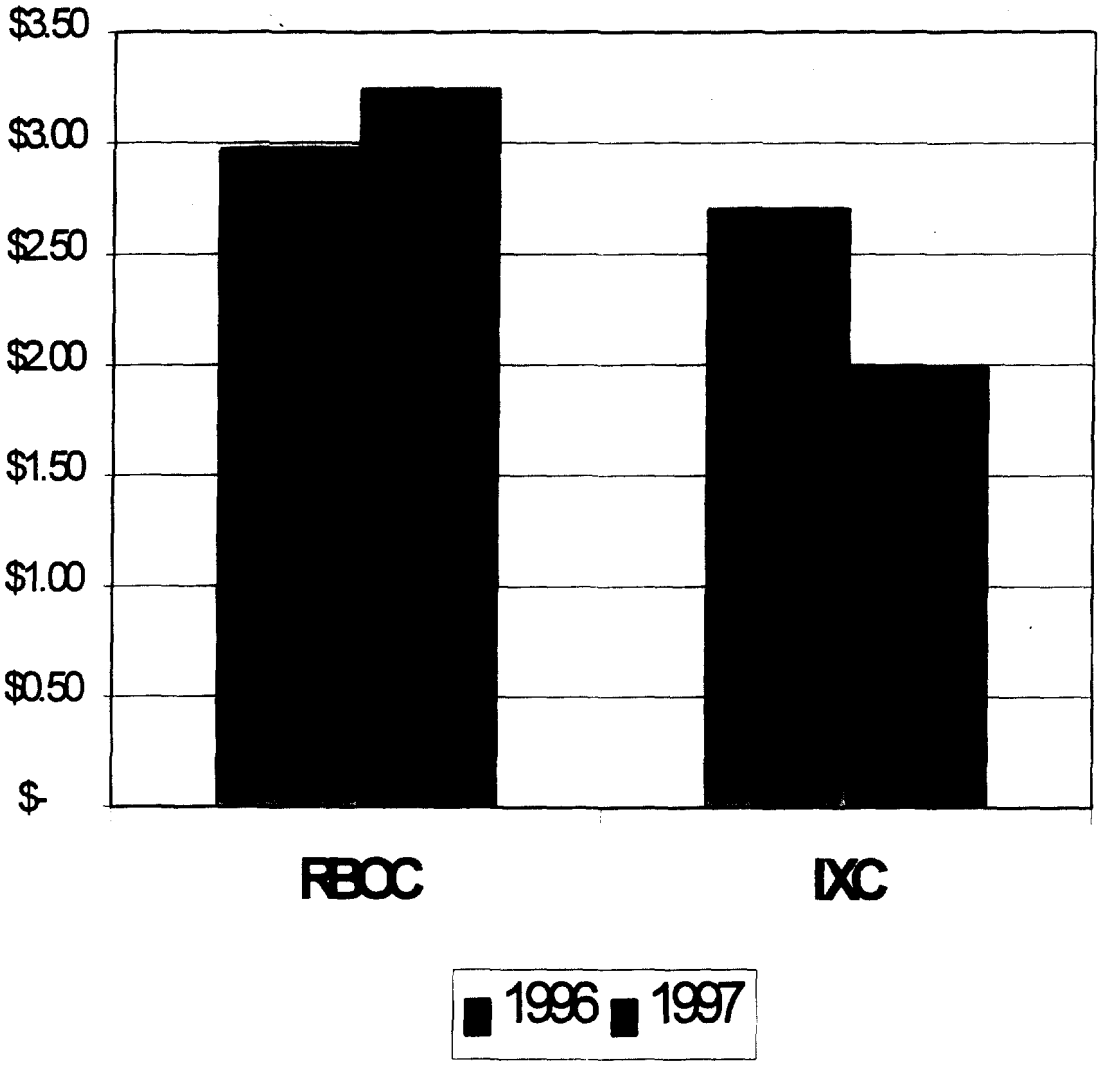
[8] Source: ILEC Tariff Review Plan Filings, April 1, 1998.

ILEC Profitability Has Not Been Negatively Impacted by CLEC Activities, or by the Commission's Decision to Increase the ILEC Productivity Factor to 6.5%

ILEC Earnings on Interstate Price Cap Services, 1991-1997



RBOC 1997 Earnings Grew 11.3% While IXCs' Earnings Decreased 11.2%



RBOC and GTE Monopoly Earning on Access Services Continue to Be Excessive

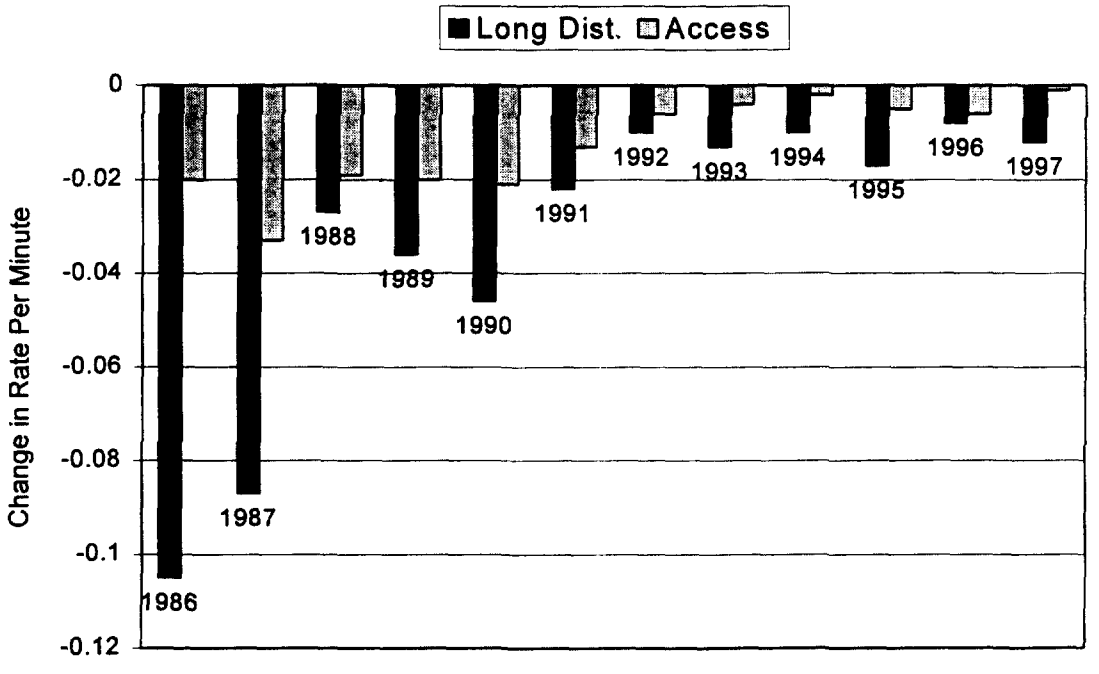
1996 RBOC & GTE Earnings [9]

1996 RBOC & GTE	Net Revenue	Operating Cash Flow	Operating Cash Flow Margin
Local	$45B	$9.8B	21.8%
Access	$27.6B	$19.2B	69.4%
IntraLATA Toll	$9.3B	$5.9B	63.2%

[9] Based on 1996 ARMIS data.

History Has Shown, Long Distance Carriers Continually Have Passed Through at Least the Amount of Access Reductions, If Not More, in Their Long Distance Rates

Change in Long Distance Average Revenue Per Minute and Average Access Rates Per Minute[10]



10 Data from Declaration of Robert E. Hall, In the Matter of Applications of WorldCom, Inc., for Transfer of Control of MCI Communications, CC Docket No. 97-211.

On July 1, 1998, the Commission Should:

1) **Increase Price Cap ILECs' Productivity Factor to 8.5% (yielding $460 incremental reduction)**

   - **ILEC choice of productivity factors between 1990 and 1996 show ILEC productivity of at least 8.5%.**

   - **Interstate total factor productivity studies Show an X-Factor of at least 8.5%.**

2) **Order Price Cap Adjustments to Reflect a Productivity Factor of at Least 8.5% since 1995 (yielding $1.8 billion incremental reductions)**