

April 27, 2010

**EX PARTE**

Ms. Marlene H. Dortch  
Secretary  
Federal Communications Commission  
Room TW-325  
445 12<sup>th</sup> Street, S.W.  
Washington D.C. 20554

**Re: WC Docket No. 06-122**

Dear Ms. Dortch:

tw telecom inc., by its attorneys, hereby files this letter to emphasize the urgent need to eliminate the harms caused by the selective application of universal service fund (“USF”) contribution obligations on providers of broadband Internet access that rely on leased telecommunications service inputs. This policy is irrational, it threatens efficient outcomes, and it should be addressed immediately by suspending any contribution obligations that may currently apply to telecommunications carriers that sell inputs to broadband Internet access providers. The Commission should then promptly adopt a new contribution mechanism that draws on a larger and more stable base of contributors than is the case under the current regime.

**1. The Current USF Contribution Regime Distorts Competition In The Broadband Internet Access Market.**

As explained in the National Broadband Plan, it is critical that the FCC reform the current USF contribution mechanism.<sup>1</sup> The Broadband Plan correctly points out that the current contribution system has imposed larger and larger contribution obligations on providers of end user telecommunications service while at the same time creating the incentive for providers of bundled services to underreport their assessable revenues. But it is critical that the Commission recognize that these are not the only reasons why the contribution mechanism must be reformed. Specifically, the rules governing USF contributions for telecommunications service inputs to downstream retail broadband Internet access services pose a serious and irrational threat to efficient competition in the broadband Internet access service market. Those rules are being interpreted by some, including the

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<sup>1</sup> See *Connecting America: The National Broadband Plan* 149 (Mar. 16, 2010), at [http://hraunfoss.fcc.gov/edocs\\_public/attachmatch/DOC-296935A1.pdf](http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-296935A1.pdf).

Universal Service Administrative Company (“USAC”), to impose, either directly or indirectly, USF contributions on broadband Internet access service providers that rely on leased telecommunications service inputs. At the same time, broadband Internet access service providers that rely on their own transmission facilities are exempt from either direct or indirect USF contribution obligations. This discriminatory treatment distorts market outcomes and threatens competition in some of the most important market segments -- including the small and medium business market segments.

These issues have come into sharp focus in the pleadings filed in response to TelePacific’s *Request for Review* of the USAC’s decision to levy USF contributions on retail revenues associated with the provision of broadband Internet access service. In the underlying decision at issue, the USAC appears to have determined that USF contributions apply to revenue associated with broadband Internet access services provided *via* leased DS1 loops.<sup>2</sup> This decision raises two important issues. First, TelePacific correctly argues that the USAC’s decision has no basis in law or sound policy. In the *Wireline Broadband Order*, the FCC held that USF contribution obligations do not apply to revenues earned from the provision of broadband Internet access service.<sup>3</sup> In particular, the FCC determined that broadband Internet access is not comprised of separate telecommunications service and information service offerings.<sup>4</sup> Rather, the FCC held that broadband Internet access is an integrated information service, which is provided *via* “telecommunications.”<sup>5</sup> Nor did the FCC exercise its

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<sup>2</sup> *U.S. Telepacific Corp. d/b/a TelePacific Communications Request for Review and Reversal of Universal Service Administrator Decision*, WC Dkt. No. 06-122 (filed Jan. 8, 2010) (“*Request for Review*”).

<sup>3</sup> *See, e.g.*, Letter of Andrew Lipman *et al.*, Counsel, TelePacific Comm., to Marlene H. Dortch, Secretary, FCC, WC Dkt. No. 06-122, at 1 (filed Feb. 1, 2010) (“*TelePacific Feb. 1 Letter*”) (“The question presented in the Request for Review is whether Telepacific has an obligation to contribute directly to [USF] when it provides a broadband internet access service. TelePacific has shown that because the Commission has classified such services as information services regardless of the underlying transmission technology, the answer to that question is no.”); Qwest Reply Comments, WC Dkt. No. 06-122, at 2 (Feb. 3, 2010) (“The Commission went to great lengths in the *Wireline Broadband Order* to make clear that under no circumstances is the transmission component of wireline broadband internet access service a ‘telecommunications service’ when it is provided to end users.”); Comptel Comments, WC Dkt. No. 06-122, at 2 (Jan. 29, 2010) (noting that in the *Wireline Broadband Order* “[t]he Commission has previously and decisively ruled that internet access services are information services and that providers of such service are not required to pay universal service contributions on the revenues from such services.”).

<sup>4</sup> *See Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities*, Report & Order and Notice of Proposed Rulemaking, 20 FCC Rcd. 14853, n.31 (2005) (“[W]e disagree with those commenters that argue that wireline broadband internet access service necessarily includes *both* an information service *and* a telecommunications service.”) (emphasis in original) (“*Wireline Broadband Order*”), *aff’d*, *Time Warner Telecom, Inc. v. FCC*, 507 F.3d 205 (3d Cir. 2007).

<sup>5</sup> *Id.* ¶ 14.

permissive authority to assess USF contributions on the “telecommunications” component of broadband Internet access service.<sup>6</sup> Revenues associated with broadband Internet access services are not therefore subject to USF contribution obligations.<sup>7</sup>

In excluding broadband Internet access service revenues from the USF contribution base, the FCC did not differentiate between (1) firms that provide such services *via* their own local transmission facilities and (2) firms that provide such services *via* local transmission facilities leased as telecommunications services from a wholesale provider. The exclusion of revenues from the provision of broadband Internet access services applies equally to both categories of service providers. This is sound policy. Requiring one but not the other competitor to contribute would skew efficient outcomes. Indeed, this very concern was part of the basis for the FCC’s holding in the *Wireline Broadband Order*, since the FCC sought to ensure identical regulatory treatment of incumbent LEC and cable company offerings. As the Commission explained, “we believe that we should regulate like services in a similar manner so that all potential investors in broadband network platforms, and not just a particular group of investors, are able to make market-based, rather than regulatory-driven, investment and deployment decisions.”<sup>8</sup> Identical treatment of incumbent LECs (which had in the past been required to include the telecommunications component of their broadband Internet access services in the USF contribution base)<sup>9</sup> and cable companies (which had not been required to do so) for purposes of universal service contribution obligations is obviously consistent with this policy. The same principle mandates that providers of broadband Internet access services *via* leased local transmission

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<sup>6</sup> See *id.* ¶ 112 (noting that the FCC may impose USF contribution obligations on broadband Internet access providers *in the future* pursuant to its permissive authority).

<sup>7</sup> See *id.* ¶ 113.

<sup>8</sup> *Id.* ¶ 45.

<sup>9</sup> The incumbent LECs’ obligation to include the telecommunications component of broadband Internet access services in the USF contribution base had been in place at least since the 2001 *CPE/Enhanced Services Bundling Order*. As the FCC explained in the 2002 *Wireline Broadband NPRM*, “[t]he Commission also has concluded that if a wireline telecommunications carrier offers wireline broadband Internet access to end-users for a single price, it must also contribute to universal service. In the *CPE/Enhanced Services Bundling Order*, the Commission addressed the question of ‘how to allocate revenues when telecommunications services and CPE/enhanced services are offered as a bundled package, for purposes of calculating a carrier’s universal service contribution.’ The Commission concluded that, for universal service contribution purposes, the carrier may elect to report revenues from the bundle based on the unbundled telecommunications service, or, if it cannot distinguish telecommunications service revenue from non-telecommunications service revenue, all revenues from the bundled offering.” *Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities; Universal Service Obligations of Broadband Providers*, Notice of Proposed Rulemaking, 17 FCC Rcd. 3019, ¶ 72 (2002) (citing *Interexchange, Exchange Access and Local Exchange Markets*, Report and Order, 16 FCC Rcd 7418, ¶¶ 48-51 (2001)).

facilities be subject to the same rules for USF contribution as firms that rely on their own local transmission facilities.

Second, the TelePacific *Request for Review* has also prompted extensive discussion in the record of the extent to which a telecommunications carrier must include in its USF contribution base revenues associated with telecommunications service inputs sold to broadband Internet access service providers.<sup>10</sup> Such revenues are, according to some, subject to USF contributions, an outcome that would allow the wholesale telecommunications carrier to seek to pass through the contribution to its broadband Internet access service provider customer.<sup>11</sup> Other parties have argued that this is not a correct reading of the law.<sup>12</sup> But regardless of which interpretation is the correct reading of the *current* law, there should be no doubt as to what the law *should* be. Imposing USF contributions on providers of telecommunications service inputs to broadband Internet access service and allowing the pass through of those contributions to broadband Internet access providers creates exactly the kind of regulatory distortion that the FCC sought to avoid in the *Wireline Broadband Order*. Make no mistake; as a practical matter, given the absence of competition in the provision of wholesale local

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<sup>10</sup> See *TelePacific Feb. 1 Letter* at 1 (“Assuming, arguendo, that the Commission agrees that there is no legal obligation for TelePacific, in offering these broadband internet access services, to contribute directly to USF, the logical second question is whether TelePacific must contribute to USF indirectly. The question therefore is whether the incumbent local exchange carriers...selling TelePacific T-1 special access circuits should be required to treat TelePacific as an end user if the Company uses the T-1 circuit solely to provide broadband internet access service.”).

<sup>11</sup> See AT&T Reply Comments, WC Dkt. No. 06-122, at 2 (filed Feb. 3, 2010) (“[I]f a facilities-based provider combines broadband transmission and internet access service, it is providing an interstate information service and owes no universal service contributions on the transmission component; if an ISP -- affiliated or unaffiliated -- obtains broadband transmission from another provider on a common carriage basis and combines it with internet access service, the transmission component is a telecommunications service and the underlying provider is permitted to recover its contribution costs associated with that telecommunications service from its end-user customer (i.e, the ISP)”).

<sup>12</sup> See *TelePacific Feb. 1 Letter* at 7 (noting that TelePacific already contributes to USF on the end-user “*telecommunications services*” that it provides using incumbent LEC inputs and, therefore, the incumbent LEC has no basis for imposing pass-through charges on TelePacific) (emphasis added); Letter of John J. Heitmann, Counsel, Coalition for Fairness and Restraint in USAC Fund Administration, WC Dkt. No. 06-122, at 4-5 (filed Feb. 19, 2009) (“CLECs purchase [special access inputs] under valid reseller certificates. Those certificates do not result in a minimum -- or a maximum -- contribution guarantee, but rather guaranteed that the CLECs is a contributor to the FUSF and that the CLEC contributes as required by Commission regulations. In some cases, the contribution is based on retail revenues much higher than the value of the special access input; in others, it may be the same value; in some, it may be less; and in the case of wireline broadband internet access, none at all...It would be virtually impossible for wholesale carriers...to collect reseller certificates and establish customer accounts based on the classification of each and every end user service that the CLEC provides at any given time.”).

transmission facilities, providers of broadband Internet access service that must rely on telecommunications service inputs purchased from a wholesaler have no choice but to pay a USF pass-through charge. Nor are the charges small. The most recent USF contribution factor is set at 15.3 percent. A pass-through charge therefore imposes a significant financial penalty on a subset of competitors in the market. That penalty applies to already-overpriced special access services. At the same time, the incumbent LECs are exempted from indirectly paying the USF penalty because they possess ubiquitous networks. Those networks are themselves an artifact of protected monopoly regulation. Thus, regulatory policy has conspired to ensure blatant discrimination against CLECs. As TelePacific observed, this approach is inconsistent with the requirement in Section 254 that USF contributions be equitable and nondiscriminatory.<sup>13</sup> Moreover, it is hard to imagine a policy more flatly inconsistent with the Commission's stated objective of ensuring that "all potential investors in broadband network platforms, and not just a particular group of investors, are able to make market-based, rather than regulatory-driven, investment and deployment decisions."<sup>14</sup>

In addition to the obvious consequence of disadvantaging competitors that must rely on leased telecommunications service inputs, imposing USF contributions on such inputs results in several other harmful consequences. For example, the effect of this distortion is likely to be greatest in the small and medium business sector, the very part of the economy that is likely to generate new jobs. Competitors that rely on leased inputs to provide broadband Internet access service are essential to competition in the small and medium business market because most cable companies do not effectively serve that market,<sup>15</sup> and CLECs that do serve that market generally must rely on leased local transmission facilities.<sup>16</sup> Thus, the effect of the USF pass through discussed herein is likely to be felt

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<sup>13</sup> See *TelePacific Feb. 1 Letter* at 2.

<sup>14</sup> See *New Edge Network Comments*, WC Dkt. No. 06-122, at 7 (filed Jan. 29, 2010) ("Foisting a 'tax' of up to 14.1% on only one type of provider of broadband internet access service, based solely upon the underlying facility input used to provide that service and not the type of service delivered, can hardly be considered technologically or competitively neutral as required by law. Moreover, subjecting only certain broadband internet access services to contribution...undermines the development of a comprehensive National Broadband Plan focused on the ubiquity and affordability of broadband services.").

<sup>15</sup> For example, in the recent order approving Comcast's acquisition of CIMCO, the FCC observed that Comcast generally does not serve medium businesses. See *Applications Filed for the Acquisition of Certain Assets of CIMCO Communications, Inc. by Comcast et al.*, Memorandum opinion and Order and Order on Reconsideration, FCC 10-41, ¶ 33 & n.99 (rel. Mar. 15, 2010).

<sup>16</sup> Most small and medium businesses do not demand more than a single DS3 of capacity. The FCC has held that competitors are generally unable to self-deploy loops to locations with such low levels of telecommunications demand. See *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Report & Order and Order on Remand and FNPRM, 18 FCC Rcd 16978, ¶ 320 (finding that "a single DS3 loop, generally, can not provide a sufficient revenue opportunity" to "recover the significant fixed and sunk construction costs of DS3 loops").

disproportionately by small and medium businesses. Retaining a policy with this effect is especially irrational at a time when Chairman Genachowski has emphasized the need to promote efficient deployment of broadband for small businesses.<sup>17</sup>

Furthermore, USF contributions for telecommunications service inputs likely result in higher contributions for rural service providers (and, indirectly, their customers) than for non-rural service providers. In the *Wireline Broadband Order*, FCC allowed carriers to offer “the transmission component of broadband Internet access service as a common carrier service.”<sup>18</sup> For example, a rural incumbent LEC might offer stand-alone broadband transmission service on a wholesale basis and “sell” this input to its broadband Internet access service provider affiliate. The FCC assumed that such arrangements would benefit rural carriers because treating broadband transmission as a telecommunications service enables rural incumbent LECs to include the costs of broadband facilities in NECA pooling subsidy mechanisms.<sup>19</sup> Unfortunately, such arrangements would cause the USF contribution requirements for telecommunications service inputs to apply disproportionately in the very rural areas in which affordable deployment of broadband service is most difficult to achieve.

## **2. The FCC Should Act Quickly To Eliminate The Distortions Caused By The Current USF Contribution Mechanism.**

For all of the foregoing reasons, the FCC should eliminate the distortions that appear to exist in the current USF contribution regime as soon as possible. It should do so in two steps. In step one, the FCC should suspend collection of USF contributions on telecommunications services sold as inputs to broadband Internet access service. As a result of such a suspension, if a wholesale telecommunications carrier receives a certification from a customer that the customer will use telecommunications services it purchases from the carrier to provide (1) broadband Internet access services, (2) telecommunications services or (3) a combination of these two services, then the revenues associated with the telecommunications services at issue would not be included in the wholesale telecommunications carrier’s USF contribution base. This result would eliminate the distortions described herein.

In step two, the FCC should adopt a new USF contribution mechanism. Any such new mechanism should, as suggested in the National Broadband Plan, increase the contribution base and

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<sup>17</sup> See Prepared Remarks of Chairman Julius Genachowski, FCC, *Broadband Field Hearing on Small Business* (Chicago, IL, Dec. 21, 2009), available at [http://hraunfoss.fcc.gov/edocs\\_public/attachmatch/DOC-295303A1.pdf](http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-295303A1.pdf).

<sup>18</sup> See *Wireline Broadband Order* ¶ 89.

<sup>19</sup> See *id.* at n.269 (“These associations, which represent rural incumbent LECs, indicate that their members may choose to offer some wireline broadband transmission on a common carrier basis even if we eliminate the *Computer Inquiry* requirements. These associations also explain that their members’ progress in deploying broadband in rural areas to date has been attributable to an ability to lower the costs of deployment through participation in the National Exchange Carrier Association, Inc.... pooling arrangements or other tariffed rate structures that reflect rate of return regulation.”).

reduce opportunities for firms to evade contribution obligations. It appears that the most appropriate means of achieving these objectives would be a numbers-based scheme similar to the one advocated by AT&T.<sup>20</sup> A numbers-based approach would accomplish the FCC's goal of competitive neutrality while minimizing administrative burdens.<sup>21</sup> Such a scheme would be fair, equitable, and would treat all providers of broadband Internet access in a like manner. Just as importantly, it would substantially reduce the need for USAC audits, in large part because a numbers-based approach would minimize, if not eliminate, the need for a CCR rule.<sup>22</sup>

Respectfully submitted,

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<sup>20</sup> See AT&T Petition for Immediate Commission Action to Reform Its Universal Service Contribution Methodology, WC Dkt. No. 06-122 (filed July 10, 2009) (“*AT&T Petition*”).

<sup>21</sup> However, the FCC must ensure that businesses are not required to bear a disproportionate universal service contribution burden. In other words, the relative business/residential contribution percentage must remain constant. For example, if a \$1 per residential number assessment means that 45 percent of the fund would be paid for by businesses, the FCC must ensure that this percentage remains the same over time. Therefore, if the size of the fund were to increase in a particular year by 10 percent, and the amount of assessable numbers remained the same, the per number contribution for residential customers should increase by 10 percent as well.

<sup>22</sup> See *AT&T Petition* at 17 (“Under today’s regime, auditors must scrutinize eight pages of revenue lines on the FCC Form 499-A, which providers populate based on instructions that are more than 35 single-spaced pages long, to ascertain whether a contributor has reported correctly its interstate telecommunications revenues. In performing these audits, auditors must perform the same complicated analyses as contributors as to whether a particular service is a telecommunications or an information service, interstate or intrastate, and, if it is a bundled offering, whether the contributor’s telecommunications/information service allocation was reasonable. By contrast, under the Numbers Proposal, auditors would simply review whether a contributor had accurately calculated its assessable numbers, and paid the correct per-number contribution into the fund.”).