discriminate against CLECs and make it more difficult for CLECs to access previously negotiated or arbitrated agreements, thereby delaying the availability to consumers of competitive alternatives.[14/]

In short, absent a credible, articulable, and substantial reason to the contrary—the heavy burden of which lies with the LEC—individual terms of a negotiated agreement should be available to any requesting CLEC. This issue is particularly important to WinStar, because (as discussed herein) the state-of-the-art 38 GHz wireless technology employed by WinStar differs (in form but not substance) from the technology employed by wireline CLECs. LECs must not be able to utilize this difference as an excuse to delay or prevent WinStar from obtaining interconnection terms that are available to other competitors. At a minimum, it is critical that a LEC should be required to make a negotiated or arbitrated interconnection arrangement available to a subsequent competitor, and the LEC should be required to adjust the arrangement to account for differences in technology employed by the new entrant, without revising material terms of the arrangement.

[14/] In general, no two carriers in the telecommunications market are exactly alike. The diversity among market participants is extraordinary and reflects the great number of technologies currently in service in the telecommunications market. With respect to the basics of interconnection, however, the extent of such diversity is more perceived than real. WinStar recognizes that in theory, and in certain limited circumstances, the costs of extending an agreement to a new carrier, with substantially different underlying technological needs, may entail different or additional costs not foreseen by the original parties that negotiated the agreement. This is not, however, the case with respect to WinStar's wireless technology (as previously discussed). The Commission should assign the incumbent LEC the heavy burden of proving that a new carrier is substantially different from the original parties to an agreement, and only after the incumbent LEC in the first instance has made each of the items in the pre-existing agreement available to the new carrier. Otherwise, an incumbent LEC could use alleged technological differences to create barriers to market entry, thereby effectively foreclosing the expansion of competition for a significant period of time.

VI. BILL AND KEEP IS AN APPROPRIATE METHOD OF RECIPROCAL COMPENSATION (NPRM, ¶¶ 239-43)

Section 252 provides the pricing standards for interconnection and network elements and for transport and termination of traffic. With regard to transport and termination of traffic, § 252 provides generally that carriers should recover the approximate costs of transporting and terminating calls that originate on another carrier's network; *however*, this provision is not to be construed to preclude arrangements that offset costs, including "arrangements that waive mutual recovery (such as bill-and-keep arrangements). . . ." 1996 Act, § 252(d)(2)(B)(i). The Commission has sought comment on whether this provision "authorizes the states or the Commission to authorize bill and keep arrangements." (NPRM at ¶243.)

Clearly, under the explicit terms of the Act, both the Commission and state commissions have the authority to impose bill and keep arrangements on LECs and CLECs, and nothing in the Act can even arguably forbid either the Commission or state PSCs from ordering LECs and CLECs to exchange traffic on a bill and keep basis.

Certain LECs have suggested that § 252(d)(2)(B)(i) merely authorizes state commissions to approve negotiated agreements that contain bill and keep arrangements. This position is flatly contrary to the plain reading of the Act. The simple and uncontrovertible fact is that nothing in the Act prohibits the Commission and state PSCs from mandating arrangements that waive mutual recovery of costs. As the Commission correctly observes, the language in this subsection is not necessary to authorize state commissions to approve negotiated arrangements that include bill and keep (*see* NPRM at ¶ 243), because in the absence of § 252(d) nothing in § 252(e)(2) (which governs approval of negotiated agreements) would prohibit a state commission from approving bill and keep arrangements.

A. The Commission Should Mandate Bill and Keep Arrangements for Terminating Compensation on a Trial Basis (NPRM, ¶¶ 239-43)

WinStar supports bill and keep as an appropriate compensation arrangement for a trial period of 36 months. Bill and keep has several advantages over other methods of cost recovery. As the Commission has recognized in this proceeding, bill and keep is administratively simple, eliminating the need for tracking and billing local traffic between carriers. This promotes the immediate introduction of competition for local services that is called for by the Act. Other forms of cost recovery call for the LEC to provide information concerning its costs for terminating traffic, and thus are susceptible to manipulation by the LEC, because neither new entrants such as WinStar, nor state or federal regulators, have the resources to investigate these issues thoroughly or in a timely manner.

Just as importantly, scrupulous review of cost data is particularly time consuming and thus necessarily delays the introduction of services by new entrants. Moreover, it is contrary to the spirit of § 252(d)(2)(B)(i), which provides that neither the Commission nor state PSCs are authorized to engage in "rate regulation proceedings to establish with particularity the additional costs of transporting or terminating calls, or to require carriers to maintain records with respect to the additional costs of such calls." If the Commission and state PSCs are precluded from engaging in proceedings which determine "with particularity" the LECs' costs of terminating traffic, and if neither regulators nor CLECs are capable of assessing LEC data regarding costs, it would seem that, absent proof that traffic terminating ratios will be significantly out of balance, bill and keep is a reasonable accommodation between LEC and CLEC interests.

In the NPRM the Commission proposes to limit bill and keep to situations where transport and termination costs of carriers are roughly equal and traffic is near to being in balance or where actual transport and termination costs are very low. (NPRM at ¶ 243.) WinStar believes that this is premature. The CLEC industry is very young, and only a handful of CLECs are currently switching local traffic, despite having sought to enter into effective arrangements to do so for two or more years. Data sufficient to determine the existence of traffic ratios cannot be effectively gathered without some form of trial period, during which the marketplace is given a chance to develop and provide meaningful (non-aberrational) information concerning traffic balance ratios.[15] During the period proposed by WinStar, data regarding traffic balances and service costs could be collected to determine whether bill and keep arrangements treat parties fairly and should be continued into the future. As the Commission has noted in detail (NPRM at ¶ 40), a number of state commissions have ordered the use of bill and keep on an interim basis.[16] Accordingly,

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[15] Despite presumptions that CLECs would terminate significantly greater traffic on the LEC networks than the other way around, initial traffic results—such as those involving MFS and NYNEX in New York, and City Signal (Brooks Fiber) and Ameritech in Michigan—indicate that incumbent LECs are terminating far more traffic to the few currently operating CLECs than vice-versa. Moreover, studies of EAS traffic (which often is cited as a reasonable proxy for how LEC/CLEC traffic patterns will develop), such as that by the staff of the Washington Utilities and Transportation Commission, show that historically such traffic has been roughly in balance. Although it is unclear whether this is a long-term trend, WinStar nevertheless believes the better policy is to allow sufficient time for the facts to make themselves clear, as many state commissions already have recognized.

[16] *See, e.g., Re City Signal, Inc.*, 159 P.U.R.4th 532, 547-48 (Mich. P.S.C. 1995) (ordering that bill and keep will be used when the balance of traffic in either direction is within 5%); *In re:*
(continued...)

WinStar recommends that the Commission impose bill and keep on a 36 month trial basis. After such time, the Commission should allow parties to provide it with information regarding traffic termination ratios. Then, based upon this statistical information, the Commission should adopt reasonable cost-recovery rules which reflect actual experience. These rules could include permanent adoption of bill and keep.

B. If the Commission Establishes Bill and Keep Arrangements Between CMRS Providers and LECs in CC Docket No. 95-185, It Must Clarify that All Local Exchange Carriers May Transport CMRS Traffic and Interconnect to LECs (For the Purpose of Terminating CMRS Traffic) Under the Same Bill and Keep Arrangements (NPRM, ¶¶ 166-69; 195; 230)

WinStar believes that the Commission has authority to impose bill and keep arrangements between LECs and CMRS providers. WinStar supports instituting such bill and keep relationships and is encouraged by the Commission's proposal in the CMRS Notice of Proposed Rulemaking

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16/ (...continued)
McLeod Telemanagement, Inc., 160 P.U.R.4th 473, 480-81 (Iowa Util.Bd. 1995) (ordering the use of bill and keep on an interim basis, pending the filing of adequate cost studies); *Washington Utilities and Transportation Commission v. US West Communications, Inc.*, Docket Nos. UT-941464, *et al.*, at 29-31 (Wash. Util. Trans. Comm. Oct. 31, 1995) (ordering the use of bill and keep on an interim basis, pending the filing of adequate cost studies) (hereinafter *Washington Interconnection Order*); *Regulations for Local Telecommunications Providers*, Rule 1220-4-8-10(3)(a) (Tenn. Div. Pub. Util. 1995) (adopting bill and keep for one year); *In the Matter of the Application of Electric Lightwave, Inc. for a Certificate of Authority to Provide Telecommunications Services in Oregon*, Order No. 96-021 (Ore. P.U.C. 1996) (ordering bill and keep for 24 months); *Re Competition for Local Exchange Service*, 163 P.U.R.4th 155, 174-175 (Cal. P.U.C. 1995) (adopting bill and keep for one year); *Re Rules for Telecommunications Interconnection and Unbundling*, Docket No. R-0000-96-001, Decision No. 59483 (Az. Corp. Comm. 1996) (proposing rules requiring carriers to exchange traffic on a bill and keep basis for 36 months); *In the Matter of the Complaint of Time Warner AxS of Ohio, L.P. and Time Warner Communications of Ohio*, L.P., Case No. 96-66-TP-CSS (Oh. P.U.C. 1996) (ordering bill and keep on an interim basis).

to implement a form of bill and keep for CMRS providers and LECs.[17] WinStar urges the Commission, in promulgating rules regarding bill and keep between LECs and CMRS providers, to clarify that when a CLEC transports traffic of a CMRS provider to the end office or tandem of the LEC, it must be allowed to terminate the CMRS traffic under the same bill and keep arrangements applicable to CMRS providers.

Although the basic proposition—that a CMRS provider should be able to utilize the transport provider of its choice and that this choice should not affect the CMRS nature of the traffic—seems obvious on its face, WinStar already has encountered resistance in the marketplace. Because WinStar will provide both switched local services and dedicated transport to a variety of customers (including CMRS providers), WinStar has been informed that, unless and until bill and keep is adopted for CMRS traffic, it will have to set up separate collocation arrangements in order to terminate CMRS traffic to the public switched network. Obviously this is technically unnecessary and economically inefficient, and is simply an attempt to penalize CMRS providers seeking to utilize WinStar where WinStar is the most efficient transport provider. Nonetheless, to eliminate baseless claims of this sort, WinStar requests that the Commission clarify this matter.

C. Transport and Traffic Termination Rates Must Be Symmetrical (NPRM, ¶¶ 235-38)

Regardless of the actual reciprocal compensation method used, the Act clearly compels that the rates be equal and symmetrical. In other words, the Commission's rules must clarify that

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[17] *Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers; Equal Access and Interconnection Obligations Pertaining to Commercial Mobile Radio Service Providers,* Notice of Proposed Rulemaking, CC Docket No. 95-185, FCC No. 95-505 at ¶¶ 62, 65 (released Jan. 11, 1996) ("CMRS NPRM").

CLECs are authorized to charge an incumbent LEC call termination and transport rates equal to those the incumbent LEC charges to terminate and transport the calls of CLECs.

Section 252(d)(2)(A)(ii) of the Act provides that a state commission shall not consider traffic transport and termination rates to be just and reasonable unless such rates are "mutual and reciprocal." This language would be wholly unnecessary if Congress intended that separate traffic transport and termination rates should be implemented based on each carrier's individual costs. Significantly, § 251(d)(2)(A)(i), which sets forth the pricing standard for interconnection and access to network elements, does not require mutuality or reciprocity. To construe the pricing standard for traffic transport and termination to allow nonsymmetrical rates would read the "mutual and reciprocal" language out of the statute. Moreover, unlike subsection (d)(2)(A)(i), which provides simply that interconnection and network element pricing be based on cost, subsection (d)(2)(A)(ii) requires that transport and termination rates be based on "a reasonable approximation of the additional costs" to terminate calls. The "reasonable approximation" qualification is necessary to remove any doubt that traffic termination rates must be equal even though both carriers' costs may not be identical.

It is frequently presumed that, at least initially, a new entrant may terminate a larger percentage of its traffic on the incumbent LEC's network than the incumbent LEC will terminate on its network (although, as discussed above, the actual number of minutes exchanged likely will be in balance or may even be higher for the incumbent LEC than the CLEC). If this were the case, any disparity in reciprocal compensation rates would have a far greater financial impact on the new entrant than the incumbent carrier. In order to avoid placing new entrants at a severe competitive disadvantage, WinStar submits that it is critical for the Commission to require states to impose symmetrical rates.[18] In fact, the Commission should make this pricing principle a priority.

Nonsymmetrical, cost-based compensation schemes would have the perverse effect of penalizing new entrants for deploying state-of-the-art technology. In the vast majority of cases, a new entrant's incremental cost to terminate traffic will be lower than the incumbent LEC's in significant part because it will use a more efficient network technology and topology. Under a nonsymmetrical reciprocal compensation arrangement, however, the incumbent LEC, rather than the new entrant, will reap the benefits of these lower costs. Indeed, a more efficient new entrant would be handicapped financially whether it originates or terminates a call. First, it will be forced to absorb the costs of the incumbent LEC's less efficient network by paying higher termination rates. Second, it will be forced to pass the cost savings from its own more efficient network to the less efficient LEC by charging lower termination rates. As a result, despite having the less efficient, more costly network, the incumbent LEC will enjoy a significant competitive advantage over its more efficient competitors. Nor will the incumbent have any incentive to increase the efficiency of its own operations as long as it is free to charge higher traffic termination rates than its competitors. Reciprocal compensation rate symmetry is absolutely necessary to preserve the competitive opportunities new entrants will bring to the table and to prevent incumbent LECs from shifting their costs on to their competitors.

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[18] This symmetry must apply regardless of whether traffic is terminated at an end office, tandem or meet point.

Regulatory policy should encourage all market participants to provide services in the most efficient manner possible in order to maximize consumer benefits. Therefore, the pricing principles that the Commission adopts should neither reward inefficiency nor penalize efficiency. It is not enough for the Commission to remain neutral on the rate symmetry issue. It must adopt a national pricing principle that affirmatively requires states to implement equal and reciprocal call termination and transport rates.

Comments Continue on Next Page☞

VII. PRICING OF INTERCONNECTION AND UNBUNDLED NETWORK ELEMENTS UNDER § 252(d)(1) OF THE ACT (NPRM, ¶¶ 117-57)

WinStar wholeheartedly supports the Commission's tentative conclusion that § 251(d)(1) of the Act mandates that it establish pricing principles that will be binding on the states in setting rates in arbitration proceedings and in reviewing RBOC statements of generally available terms and conditions. (NPRM at ¶ 118.) By directing the Commission to adopt regulations to implement the requirements of § 251, Congress clearly intended that the Commission formulate standards for determining whether interconnection and unbundled network element rates are just and reasonable. As new entrants negotiate interconnection and access to network elements with incumbent LECs, pricing issues are likely to be the among the most contentious. National pricing principles will work to facilitate (and hopefully accelerate) the negotiation and arbitration process and avoid the potential for states to adopt inconsistent interpretations of the § 252 pricing standards. Such principles will be especially critical to the prompt resolution of interconnection and network element pricing issues in the more than 30 states that have not yet promulgated generic rules or even instituted proceedings to address local exchange competition. (NPRM at ¶28, n.43.) Public utility commissions in virtually all states likely will be hard pressed to meet the tight statutory deadlines for completing arbitrations or reviewing RBOC statements of generally available terms and conditions without the benefit of federal guidance. Establishment of national pricing standards also will ease the administrative burden on the Commission when it is called upon to review or arbitrate agreements pursuant to § 252(e)(5).

A. Rates for Interconnection and Unbundled Network Elements Must Not Include Contribution (NPRM, ¶ 121)

Under § 252(d)(1), Congress has determined that interconnection and network element rates will be deemed just and reasonable only if they are nondiscriminatory and cost-based (without reference to a rate of return or other rate-based proceeding). Congress also has determined that such rates may, but need not, include a reasonable profit. In setting national pricing principles, the Commission should instruct state commissions that rates for interconnection and network elements must be capped at total service long run incremental cost ("TSLRIC") with no mark-up for contribution to overhead or joint and common costs. Rates set at TSLRIC would incorporate a "reasonable profit," as authorized by Congress, in the form of the cost of capital or cost of money factor included in the TSLRIC calculation.

In a competitive marketplace, each carrier should recover its overhead and joint and common costs through its retail rates, not through "wholesale" rates for essential competitive inputs. As monopoly providers, incumbent LECs have been able to set contribution at arbitrary levels for various services. Because their retail rate structures are already designed to recoup their total costs and generate a profit, the Commission should prohibit any markup on the rates for interconnection and network elements that competitors must use as essential inputs in providing their own telecommunications services. In the event that an incumbent LEC's market prices for retail service offerings do not afford full recovery of joint, common and overhead costs, those costs may have to be written down. They should not, however, be recovered in the rates competitors pay for essential inputs.

Permitting incumbent LECs to include a markup for contribution would have several adverse and anticompetitive consequences. First, it would reinforce the incumbent LEC's ability to charge excessive rates for interconnection and other essential inputs, which competitors cannot reasonably obtain from any other source, in order to create a price squeeze that would severely constrain the opportunity for new entrants to offer competitively priced services. Second, it will force new entrants to charge retail rates that not only include their own joint, common and overhead costs, but also those of the incumbent, thereby precluding customers from realizing the full benefits of CLECs' more efficient operations. Third, it will eliminate any incentive for incumbent LECs to minimize or readjust their own cost structures and maximize the efficiency of their own operations. Finally, by its very nature, "contribution" is an extraordinarily malleable concept, which makes it particularly subject to potential abuse.

For competition to work, incumbent LECs and new entrants alike must have the capability to compete in the retail market on terms that reflect the overall relative efficiencies of their operations, including the efficiencies reflected in their joint, common and overhead costs. If incumbent LECs are authorized to shift some of those costs to new entrants, they will have the ability to artificially suppress the retail prices against which the new entrants must compete. Such an outcome would surely impair the development of economically efficient competition.[19]

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[19] In § 254 of the Act, Congress has prohibited carriers from using noncompetitive services to subsidize competitive services and from recovering more than a reasonable share of their joint and common costs through universal service funding mechanisms. These prohibitions are fully consistent with the theory that incumbent LECs should recover their joint and common costs through the retail rates they charge end users, rather than the rates they charge competitors for essential inputs.

The pricing principles that the Commission adopts for states to apply must reflect the fundamental premise that basic interconnection elements are a public good and should be priced accordingly. Capping rates at TSLRIC will satisfy the pricing standard of § 252, allow competitive carriers to participate in the market on economically reasonable and even-handed terms and ensure efficient entry and utilization of the telecommunications infrastructure.

As the Commission noted, a number of states, including Michigan[20/] and Oregon,[21/] in recent years have implemented long run incremental cost methodologies for determining the costs of providing local exchange network components and access. WinStar submits that reference to such state models would be an appropriate starting point for developing a national model.

B. Proxy-Based Ceilings Are Needed to Control the Pricing of Interconnection and Unbundled Network Elements on an Interim Basis until TSLRIC-Based Pricing Can Be Implemented over the Long-Term (NPRM, ¶¶ 124-25)

Unfortunately, the adoption of a TSLRIC pricing standard is not the end of the road, but rather only the beginning. Incumbent LECs still must perform the cost studies that will yield the data against which the reasonableness of their rates can be judged. Such studies tend to be both time-consuming and subject to manipulation because the incumbent LECs have exclusive control of basic cost data. As a result, and as several states already have recognized, there is tremendous potential for incumbent LECs to delay the process, game the system and inappropriately shift or

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20/ *Re A Methodology to Determine Long Run Incremental Cost*, 156 P.U.R. 4th 1 (Mich. P.S.C. 1994).

21/ *Re Cost of Providing Telecommunications Services*, UM-351, Order No. 94-1056, 1994 WL 412859 (Ore. P.U.C. 1994).

allocate costs.[22] Until accurate costs studies are available and have been approved, WinStar recommends that the Commission use proxy-based ceilings to prevent anticompetitive abuses in establishing rates for interconnection and network elements in the first instance.

1. *The Commission Should Use Interconnection Agreements between Affiliated LECs or, Alternatively, Incumbent and Independent LECs, as a Proxy-Based Ceiling (NPRM, ¶ 138)*

Of the three proxy-rate alternatives suggested by the Commission, only one should be given serious consideration as an interim substitute for TSLRIC rates. WinStar believes that the interconnection and network element rates used in existing agreements between RBOC affiliates serving neighboring states is the best proxy solution. WinStar is referring to the interconnection arrangements for the exchange of local traffic between, for example, Bell Atlantic-Maryland and Bell Atlantic-Virginia. Using the rates contained in RBOC affiliate agreements would alleviate the Commission's very legitimate concern that existing interconnection agreements between incumbent LECs and other local service providers, such as neighboring independents, CMRS providers or new entrants, may reflect the vastly unequal bargaining power of the interconnecting parties. Because RBOC affiliates have cooperative, co-carrier relationships and do not compete with one another, WinStar submits that the pricing in these agreements very likely approximates the true cost of the services rendered. Such an approach would be consistent with the intent of § 251(c), which requires incumbent LECs to provide interconnection to requesting carriers that is at least equal in quality to that provided by the LEC to itself or to any subsidiary or affiliate at rates, terms and conditions that are just, reasonable and non-discriminatory.

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[22] *See, e.g., Washington Interconnection Order, supra*, at 89.

A second best option would be to use the rates in existing interconnection agreements between incumbent LECs and independent LECs serving contiguous areas. There are, however, practical difficulties with this approach. For example, in some jurisdictions, such as Washington, D.C., there are no independent telephone companies. In other jurisdictions, such as Ohio, there are numerous independents. If the rates in the various interconnection agreements vary, how would the proxy-ceiling be selected? Without knowing the details of the interconnection arrangements on a state by state basis, the Commission may inadvertently authorize the adoption of rate ceilings that would place new entrants at a significant competitive disadvantage.

That being said, existing interconnection agreements between incumbent LECs and neighboring independents do have the distinct advantage of having been negotiated by parties who were not competing for customers. Accordingly, there was no overt incentive for price-gouging at the time the rates were set. Although these agreements may not include rates for all interconnection services and network elements that competitive entrants may need, they generally provide for:

1) bill and keep mutual compensation;
2) White and Yellow Pages listings at nominal or no cost;
3) access to directory assistance and other databases at nominal cost;
4) the opportunity for mid-span interconnection at the option of the parties; and
5) meet-point billing arrangements.

At least as to these services, the rates in the existing agreements could serve as adequate proxy-based ceilings.

Unlike the agreements between non-competing incumbent LECs, existing agreements between incumbent LECs and CMRS providers or other new entrants are likely to be the product of the vastly unequal bargaining positions the carriers occupy. As a result, there is no assurance that the rates accurately reflect costs. Because of the danger that incumbent LECs may be unwilling even to consider rates that fall below the proxy ceiling in interconnection negotiations, the Commission should not use the rates contained in these agreements as a proxy ceiling. In any event, to the extent that any of these agreements remain viable in the wake of the Act, it may be possible for new entrants to access their rates in the very near future because § 252(a)(1) of the Act requires incumbent LECs to submit interconnection agreements negotiated before February 8, 1996 to state commissions for approval. Once approved, the rates, terms and conditions of the agreements must be made available to other requesting carriers on a nondiscriminatory basis under § 252(i). *See* Section V, *supra*.

2. *The Bench Mark Costing Model's Technological Bias Makes It a Poor Proxy-Based Ceiling (NPRM, ¶ 137)*

For the reasons stated in its Comments in the Universal Service proceeding, which are incorporated herein by reference,[23] WinStar opposes the use of any model, such as the Benchmark Costing Model ("BCM"), that is predicated solely on wireline technology. The BCM is not technology neutral and, as such, perpetuates reliance on costs incurred through the use of network architectures, which, by comparison to WinStar's wireless fiber network, are inefficient.

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[23] *See* comments and reply comments of Winstar Communications, Inc. filed pursuant to the Notice of Proposed Rulemaking in *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45 (released March 8, 1996).

The proliferation of fixed-point-to-point wireless transport in the local exchange market may reduce the market value of the incumbent LEC's wireline services. But the incumbent's possession of essential inputs—such as the local loop—ensures that it can price services above their market value. If the proxy-based ceiling is set according to wireline technology, nothing would constrain the incumbent LEC from artificially and dramatically inflating the prices of its inefficient transport.

3. *An Access Charge Regime Cannot Be Used as a Proxy-Based Ceiling Without Introducing the Possibility of Subjecting New Entrants To a Price Squeeze (NPRM, ¶¶ 139-41)*

WinStar unequivocally opposes the use of interstate or intrastate switched access charges as a proxy-based ceiling for local switching. Because switched access rates contain inordinate amounts of contribution and generally far exceed the cost of terminating a local call, such a rate ceiling would unquestionably violate the § 252(d) pricing standard. Moreover, numerous state commissions have devoted tremendous time and resources to consideration of the use of switched access charges as a compensation mechanism for local interconnection arrangements. Those commissions have uniformly found that switched access rates are an inappropriate surrogate for local switching because their use would create the untenable situation of forcing new entrants to pay wholesale compensation rates that exceed the retail market rates for local calls.[24/] As a result

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24/ *See, e.g., Illinois Bell Telephone Company, Proposed Introduction Of A Trial Of Ameritech's Customers First Plan In Illinois*, Docket No. 94-0096, *et al.*, at 97 (Ill. Comm. Comm'n 1995); *Re Establish Nondiscriminatory Rates, Terms and Conditions For Interconnection Involving Local Exchange Companies*, Docket No. 950985-TP, 1996 WL 159638 (Fla. P.S.C. 1996); *In the Matter of the Application of Electric Lightwave, Inc. for a Certificate of Authority to Provide Telecommunications Services in Oregon*, Order No. 96-021, at 57 (Ore. P.S.C. 1996); (continued...)

of this potential for a price squeeze, no state has adopted and retained access charges as the basis for interconnection. This Commission's proposal to require state commissions to use switched access charges as a rate ceiling would represent a giant step backward in the effort to open the local exchange market to competition.

The Commission also must recognize that using switched access charges as a rate ceiling may create the incentive for new entrants to target their marketing efforts at customers with predominantly in-bound traffic in an effort to counteract the anticompetitive consequences of the price squeeze. Such a marketing strategy would ensure that the new entrant collected more in interconnection charges than it paid, thereby enabling it to keep its local service rates to customers at competitive levels. While this type of distorted marketing strategy may benefit the individual new entrant in the short term, it would jeopardize the long-term prospects for robust competition in the local exchange market. The public interest would be ill-served by the implementation of proxy-rates that would make it economically unattractive for competitive carriers to serve the vast majority of customers having more balanced traffic patterns.

Even if part or all of the carrier common line and transport interconnection charges were excluded from the incumbent LECs' switched access charges, the resulting rates still would be too high to serve as a proxy-ceiling. In many jurisdictions, intrastate switched access charges include a universal service rate element. Allowing recovery of universal service costs through implicit

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24/ (...continued)
Washington Utilities and Transportation Comm'n v. U.S. West Communications, Inc., Sixth Supplemental Order, Docket Nos. UT-941464, *et al., at* 33, 35 (Wash.Util.Trans.Comm. Dec. 27, 1995); *In the Matter of the Application of MFS Intelenet of Maryland, Inc.*, Case No. 8584, Phase II, 1995 WL 848272 at *25 (Md. P.S.C. 1995).

subsidies built into interconnection and network access rates would be contrary to the express language of § 254(e), which states that universal service support must be explicit.

4. *There Is No Need for the Commission to Establish Price Floors (NPRM, ¶ 143)*

Setting long term interconnection and network element rates at TSLRIC should avoid the need for the Commission to adopt price floors. As long as incumbent LECs are allowed to recover their incremental costs in the rates they charge their competitors, they are not subject to any confiscatory regulatory action.

C. Other Issues Related to Proxy-Based Ceilings (NPRM, ¶¶ 144-48)

1. *Factoring Historical or Embedded Costs into the Determination of Cost-Based Rates under § 252(d)(1) Is Impermissible (NPRM, ¶ 144)*

Section 252(d)(1) of the Act expressly forbids state commissions from approving rates that include historical or embedded costs. Accordingly, the Commission may not establish pricing principles that take such costs into account. WinStar vigorously disagrees with the Commission's suggestion that, even though the plain language of § 252(d)(1)(A)(i) specifically prohibits setting rates in the context of a "rate-of-return or other rate-based proceeding," Congress may have left room for the Commission or the states to incorporate quasi-rate-of-return pricing principles in determining costs. (NPRM at ¶144.) It is clear that Congress disfavored rate-based methodologies because of their well-known inability to incent efficient behavior. The Commission is on infirm legal footing in attempting to underwrite the historical investments of incumbent LECs through the rates charged to competitors for interconnection and network elements. Allowing state commissions to include historical or embedded costs as they set cost-based prices under § 252(d)(1) would transfer to new entrants all of the burdens of inefficient incumbent LECs. This would both sacrifice the benefits of the efficiencies that new entrants will bring to the market and eliminate any incentive for incumbent LECs to become more efficient. The language in § 252(d)(1)(A)(i) cannot be read so narrowly as to eviscerate Congress's decision to prohibit use of rate-of-return pricing methodologies.

Moreover, the Commission must not ignore the growing trend for states to implement incentive-based regulation of incumbent LECs as an alternative to traditional rate-of-return regulation, in most cases at the aggressive urging of incumbent LECs themselves.[25/] Incumbents opting for incentive-based regulation forego the right to claim entitlement to recovery of historical costs, embedded costs or revenue requirements in exchange for the flexibility to price their services to meet competition. Incentive regulation recognizes that the advent of competition should spur incumbent LECs to increase the efficiency of their operations, develop innovative products and focus more on services and price. While incumbent LECs may lose some potential contribution to the recovery of their historic and embedded costs when they lose customers to competitors, those losses are likely to be more than offset by the overall growth in business they will enjoy if they move aggressively to meet the competitive challenge. In light of the strong movement of the states away from rate-of-return regulation, it would be truly anomalous—and

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25/ *See, e.g.,* Conn. Gen. Stat. Ann. §§ 16-247a, 16-247k (West 1994) (Connecticut); Fla. Stat. Ann. § 364.051 (West 1995) (Florida); Ga. Code Ann. § 46-5-161 *et seq.* (1995) (Georgia); Ill. Ann. Stat. ch. 220 § 5/13-506.1 (Smith-Hurd 1992) (Illinois); Md. Code Ann., Public Service Commission Law, § 69 (1995) (Maryland); Mich. Comp. Laws Ann. § 484.2304 (West 1995) (Michigan); Ohio Rev. Code Ann. §§ 4927.03, 4927.04 (Baldwin 1989); 30 Pa. Cons. Stat. Ann. § 3001 *et seq.* (1993) (Pennsylvania); Tex. Rev. Civ. Stat. Ann. art. 1446C-0, §§ 3.351 *et seq.* (West 1995) (Texas); Wash. Rev. Code Ann. § 80.36.135 (West 1989) (Washington).

harmful to competition—for the Commission to turn the clock back by adopting pricing principles that would require states to reinstate rate-of-return costing methodologies.

The Commission has asked for comment on the "empirical magnitude of the differences between the historical costs incurred by incumbent LECs (or historical revenue streams) and the forward-looking LRIC of the services and facilities they will be providing pursuant to section 251." It also seeks to quantify the amount of the differential that can be attributed to universal service support flows. (NPRM at ¶ 144.) Although WinStar is not in a position to identify the magnitude of the difference or the portion that can be attributed to universal service support, it submits that the Commission should not even address this issue. As discussed more fully below, § 254(k) of the Act precludes the inclusion of implicit universal support subsidies in the rates an incumbent LEC charges its competitors.

Even as they scramble to take advantage of various forms of incentive-based and alternative regulation, it its likely that incumbent LECs also will argue disingenuously that it is unfair to deny them recovery of the historical costs incurred to serve the public. But the Commission should bear in mind that any alleged unfairness is more than offset by the huge competitive advantages the incumbent LECs will continue to maintain in the local exchange market as a result of nearly a century of government-sanctioned monopoly. At the very minimum, these advantages include their long-standing relationships with virtually all residential and business customers in their service areas as well as their capability to reach all customers with ubiquitous networks that traditionally have been funded principally by captive ratepayers. In addition, unlike new entrants, incumbent LECs will not be dependent on competitors for essential monopoly inputs necessary to provide service.

2. *Rates for Interconnection and Unbundled Network Elements Should Not Include Universal Service Subsidies (NPRM, ¶ 145)*

Under no circumstances should the Commission authorize or permit states to include universal service costs or subsidies in the rates for interconnection, network elements or collocation. As WinStar demonstrated in its Comments in the Universal Service Proceeding,[26/] which it incorporates here by reference, §§ 254(d) and 254(e) of the Act mandate that universal service support be recovered in an explicit, competitively-neutral manner from all providers of telecommunications services. State universal service programs that incorporate implicit subsidies into rates for interconnection or unbundled network elements, such as the "pay or play" scheme in New York, are not consistent with the competitively-neutral funding mechanism contemplated by the Act. In addition to the fact that such programs do not require all telecommunications carriers to contribute on an equitable and nondiscriminatory basis, they do not qualify as "specific, predictable and sufficient mechanisms" to preserve and advance universal service.

Allowing incumbent LECs to recover universal service support through interconnection and network element rates also would run afoul of the requirement of § 254(e) that a carrier receiving universal service support use that support only for the provision, maintenance and upgrading of facilities and services for which the support was intended. Until such facilities and services and the carriers providing them are identified, there is no basis for the Commission to

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26/ *See* n. 23, *supra*.

authorize all LECs to impose universal service charges on competitive carriers through the charges for essential inputs.

3. *The Efficient Component Pricing Rule Must Be Rejected (NPRM, ¶¶ 147-48)*

WinStar strongly supports the Commission's tentative conclusion to prohibit states from using the so-called Efficient Component Pricing Rule ("ECPR") to set prices for interconnection and access to network elements. The Commission correctly recognizes that the ECPR is a "make-the-incumbent-LEC-whole device" that will foreclose the possibility for consumers to reap the benefits of a competitive marketplace.[27/] Use of the ECPR would allow incumbent LECs to recover from competitors the profits that they would otherwise lose when a customer elects to take service from a different provider. In directing that rates for interconnection and network elements be cost-based so as to encourage the development of competition, Congress could not possibly have intended that recoverable costs include such "lost opportunity" costs.

Although the incumbent LECs have advocated the use of the ECPR in numerous state local competition proceedings, they have thus far failed to convince *any* commission that a mechanism that completely insulates them from the financial impact of competitive entry would serve the public interest. Precluding states from using the ECPR in setting rates will avoid the necessity of relitigating the issue in the remaining states.

27/ WinStar fully concurs with the Commission's analysis that "[u]nder the ECPR, competitive entry does not drive prices toward competitive levels, because it permits the incumbent carrier to recover its full opportunity costs, including any monopoly profits." NPRM at ¶ 147.

CONCLUSION

For the foregoing reasons, WinStar respectfully requests that the Commission adopt rules consistent with the principles discussed herein.

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EXHIBIT A

Photographs with Descriptions of WinStar's 38 GHz Transmission Equipment