competitors that use unbundled elements under section 251 once they are authorized to provide in-region interLATA service. Only BOCs are subject to special restrictions in the 1996 Act to ensure that their entry into the in-region interLATA market does not have an adverse impact on competition. We conclude that this additional trigger date after which BOCs may not continue to receive access charges from purchasers of unbundled local switching is consistent with this Congressional design.

725. We have selected June 30, 1997 as an ultimate end date for this transitional mechanism to coincide with the effective date for LEC annual access tariffs, and because we believe it is imperative that this transitional requirement be limited in duration. We can conceive of no circumstances under which the requirement that certain entrants pay the CCLC or a portion of the TIC on calls carried over unbundled network elements would be extended further. The fact that access or universal service reform have not been completed by that date would not be a sufficient justification, nor would any actual or asserted harm to the financial status of the incumbent LECs. By June 30, 1997, the industry will have had sufficient time to plan for and adjust to potential revenue shifts that may result from competitive entry. Thus, the economic impact of our decision on competitive local service providers, including those that are small entities, should be minimized.[1739]

726. We believe that we have ample legal authority to implement this temporary transitional measure, and we find that this approach is consistent with the letter and spirit of the 1996 Act. We recognize that the CCLC and TIC have not been developed in accordance with the pricing standards of section 252(d)(1), and that to comply with the 1996 Act, the rates that states establish for interconnection and unbundled network elements may not include non-cost-based amounts or subsidies. The 1934 and 1996 Acts do, however, give us legal authority to determine, for policy reasons, that users of LEC facilities should pay certain access charges for a period of time.[1740] Section 4(i) of the 1934 Act authorizes the Commission to "perform any and all acts . . . not inconsistent with this Act, as may be necessary in the execution of its functions."[1741] Given the extraordinary upheaval in the industry's structure set in motion by the 1996 Act, and the specific concerns described above, we believe that a temporary mechanism is necessary in order to ensure that the policy goals underlying the access charge system and the Communications Act itself are not undermined. Further, we believe section 251(g) of the 1996 Act lends support to our decision. As discussed above, section 251(g) does not require that incumbent LECs continue to receive access charge revenues when telecommunications carriers use unbundled incumbent

[1739] *See* Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

[1740] *See, e.g., New England Tel. and Tel. Co. v. FCC,* 826 F.2d 1101 (D.C. Cir 1987); *North American Telecommunications Association v. FCC,* 772 F.2d (7th Cir. 1085); *Lincoln Tel. and Tel. Co. v. FCC,* 659 F.2d (D.C. Cir. 1989).

[1741] 47 U.S.C. § 4(i).

LEC network elements to originate and terminate interstate traffic. That section does, however, provide evidence of Congressional recognition of the potential tension between existing interconnection obligations, such as access charges, and the new methods of interconnection mandated by section 251, and therefore supports our decision to create a limited-duration mechanism to address this tension.

727. The decision of the court in *CompTel v. FCC* to remand our decision to adopt the TIC is not inconsistent with this approach. The Court's concern stemmed, in part, from the inclusion of a portion of the interstate tandem switching revenue requirement in the TIC. We have excluded from the charges that purchasers of unbundled local switching must pay a percentage of the TIC that, at a minimum, includes these allocated tandem switching revenues from the transitional charges that incumbent LECs may assess on IXCs.[1742] Furthermore, the Court directed the Commission to develop a cost-based transport rate structure, or to explain why it chose not to do so.[1743] We intend to fulfill this obligation in the forthcoming access reform proceeding. The charge equal to 75 percent of the TIC will be applied only as an interim measure for a brief, clearly-identified period, until that restructuring of access charges is completed. The court expressly acknowledged that the 1996 Act would have implications for the access charge system.[1744] For the reasons described above, we conclude that these effects necessitate temporary application of a portion of the TIC to entrants that win end user customers from LECs, and that purchase the local switch as an unbundled element to originate and terminate interstate and intrastate toll traffic for such end users. In the access reform proceeding, we intend to determine the appropriate disposition for these revenues. Until we have had the opportunity to do so, however, we permit incumbent LECs to recover a transitional charge equal to 75 percent of the TIC under the limited circumstances described herein.

728. The interim mechanism we establish here differs from the waiver relief we have previously granted to NYNEX and Ameritech to permit them to recover certain interstate access charge revenues through "bulk billing" of revenues to all interstate switched access customers.[1745] Those orders responded to waiver requests filed prior to the passage of the 1996 Act. Our responsibility in those proceedings was to determine whether special circumstances existed, and

[1742] As discussed above, we estimate that the tandem switching, SS7, and other costs associated with transport facilities now recovered through the TIC likely do not exceed 25% of the TIC for most incumbent LECs.

[1743] *Competitive Telecommunications Association v. FCC*, No. 96-1168 at 26-27.

[1744] *Id.* at 12-13.

[1745] *See The NYNEX Tel. Cos. Petition for Waiver, Transition Plan to Preserve Universal Service in a Competitive Environment*, Memorandum Opinion and Order, 10 FCC Rcd 7445 (1995), *reconsideration pending* (*NYNEX USPP Order*); *Ameritech Operating Companies Petition for a Declaratory Ruling and Related Waivers to Establish a New Regulatory Model for the Ameritech Region*, Order, FCC 96-58 (released Feb. 15, 1996) (*Ameritech Customers First Order*).

whether the specific relief requested better served the public interest than continued application of our general rules. By constrast, the action we take today addresses industry-wide issues that arise from the new regime put into place by section 251 of the 1996 Act, which allows states to establish unbundled network element rates that recover the full unseparated cost of elements. Our response to the Ameritech and NYNEX waiver petitions does not, simply because those petitions also concerned access charge recovery, constrain our decision in this proceeding.

729. It would be unreasonable to provide such a transitional mechanism on the federal level, but to deny similar authority to the states. Therefore, states may continue existing explicit universal service support mechanisms based on intrastate access charges for an interim period of a similar brief, clearly-defined length. During that period, unless decided otherwise by the state, incumbent LECs may continue to recover such revenues from purchasers of unbundled local switching elements that use those elements to originate or terminate intrastate toll calls for end user customers they win from incumbent LECs. States may terminate these mechanisms at any time. We define mechanisms based on intrastate access charges as those mechanisms that require purchasers of intrastate access services from incumbent LECs to pay non-cost-based charges for those access services on the basis of their intrastate access minutes of use.

730. We do not intend, however, that such a transitional mechanism eviscerate the requirements of sections 252 and 254, which, as we have stated, prohibit funding of universal service subsidies through rates for interconnection and unbundled network elements. Mechanisms such as New York's "pay or play" system, which would impose intrastate access charges on non-access services rather than allowing incumbent LECs to recover non-cost-based revenues from purchasers of access services, may not be included in this interim system. Such a result is justified because state "pay or play" mechanisms do not at present constitute a significant revenue stream to incumbent LECs, and therefore elimination of this mechanism is unlikely, in the short term, to have significant detrimental effects on universal service support.

731. These state mechanisms must end on the earlier of: (1) June 30, 1997; or (2) if the incumbent LEC that receives the transitional access charge revenues is a BOC, the date on which that BOC is authorized under section 271 of the 1996 Act to offer in-region interLATA service. With one exception, the analysis provided above as to the rationale for the end dates for the transitional interstate access charge mechanism applies here as well. Because our access reform proceeding focuses on federal charges, and because the full extent of the section 254 universal service mechanism remains to be determined in that proceeding, intrastate access charge-based universal service support mechanisms should not now be required to terminate upon the completion of those proceedings.

732. As with our decision to permit incumbent LECs to continue to receive certain interstate access charge revenues from some purchasers of unbundled local switching for a limited period of time, we believe our decision to allow states to preserve certain intrastate universal service support mechanisms based on access charges is within our authority under section

251(d)(1) of the 1996 Act, and section 4(i) of the 1934 Act. Moreover, although section 251(g) does not directly refer to intrastate access charge mechanisms, it would be incongruous to conclude that Congress was concerned about the effects of potential disruption to the interstate access charge system, but had no such concerns about the effects on analogous intrastate mechanisms.

(c) Fifth Amendment Issues

733. We conclude that our decision that prices for incumbent LECs' unbundled elements and interconnection offerings be based on forward-looking economic cost does not violate the incumbent LECs' rights under the Fifth Amendment of the Constitution. The Supreme Court has recognized that public utilities owned and operated by private investors, even though their assets are employed in the public interest to provide consumers with service, may assert their rights under the Takings Clause of the Fifth Amendment.[1746] In applying the Takings Clause to rate setting for public utilities, the Court has stated that "[t]he guiding principle has been that the Constitution protects utilities from being limited to a charge for their property serving the public which is so 'unjust' as to be confiscatory."[1747]

734. The Supreme Court has held that the determination of whether a rate is confiscatory depends on whether that rate is just and reasonable, and not on what methodology is used.[1748] In *Federal Power Comm'n v. Hope Natural Gas Co.*, the Court upheld the Federal Power Commission's order that required the company to make a large reduction in wholesale gas rates. The commission based its determination of a reasonable rate of return on a plant valuation determined by using a historical cost methodology that was only half as large as the company's own valuation based on forward-looking reproduction costs. In its decision, the Court set forth the governing legal standard for determining whether a rate is constitutional:

> Under the statutory standard of "just and reasonable" it is the result reached not the method employed that is controlling. It is not the theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. The fact that the

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[1746] The Fifth Amendment provides that, "private property [shall not] be taken for public use, without just compensation." U.S. Const. amend. V. *See Duquesne Light Co. v. Barasch*, 488 U.S. 299, 307 (1989) (*Duquesne*).

[1747] *Duquesne*, 488 U.S. at 307 (*citing Covington & Lexington Turnpike Road Co. v. Sandford*, 164 U.S. 578, 597 (1896)).

[1748] *Hope Natural Gas*, 320 U.S. at 602-603; *see also Duquesne; In re Permian Basin Area Rate Cases*, 390 U.S. 747 (1968); *Federal Power Commission v. Memphis Light, Gas & Water Division*, 411 U.S. 458 (1973); *Jersey Central Power & Light v. FERC*, 810 F.2d 1168 (D.C. Cir. 1987).

method employed to reach that result may contain infirmities is not then important.[1749]

735. The Court went on to explain that, in determining whether a rate is reasonable, the regulatory body must balance the interests of both the investor and consumer.[1750] "From the investor or company point of view, it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business . . . . [T]he return on the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks."[1751]

736. Under sections 251(c)(2) and (3) of the 1996 Act, incumbent LECs must establish rates for interconnection and unbundled elements that are just and reasonable.[1752] In adopting the rules that govern those rates, under *Hope Natural Gas* we must consider whether the end result of incumbent LEC rates is just and reasonable. Incumbent LECs argue that establishing a rate structure that does not permit recovery of historical or embedded costs is confiscatory. We disagree. As stated above, the Court has consistently held since *Hope Natural Gas* that it is the end result, not the method used to achieve that result, that is the issue to be addressed.[1753] Indeed, the Court has found that the "fixing of prices, like other applications of the police power, may reduce the value of the property which is being regulated. But the fact that the value is reduced does not mean that the regulation is invalid."[1754] Moreover, the Court has upheld as reasonable changes in ratemaking methodology when the change resulted in the exclusion of historical costs prudently incurred.[1755] Thus, the mere fact that an incumbent LEC may not be able to set rates that will allow it to recover a particular cost incurred in establishing its regulated network does not, in and of itself, result in confiscation.

737. Moreover, *Hope Natural Gas* requires only that the end result of our overall regulatory framework provides LECs a reasonable opportunity to recover a return on their

[1749] *Hope Natural Gas*, 320 U.S. at 602.

[1750] *Id.*

[1751] *Id.* at 603.

[1752] 47 U.S.C. § 251(c)(2) and (3).

[1753] *See, e.g.*, *Duquesne*, 488 U.S. at 310; *Hope Natural Gas*, 320 U.S. at 602.

[1754] *Hope Natural Gas*, 320 U.S. at 601.

[1755] *Duquesne*, 488 U.S. at 301-302.

investment. In other words, incumbent LECs' overall rates must be considered, including the revenues for other services under our jurisdiction.[1756]

738. In this proceeding, we are establishing pricing rules that should produce rates for monopoly elements and services that approximate what the incumbent LECs would be able to charge if there were a competitive market for such offerings. We believe that a forward-looking economic cost methodology enables incumbent LECs to recover a fair return on their investment, *i.e.*, just and reasonable rates. The record does not compel a contrary conclusion. No incumbent LEC has provided persuasive evidence that prices based on a forward-looking economic cost methodology would have a significant impact on its "financial integrity." We further note that at least one federal appellate court has held incremental cost-based pricing constitutional.[1757]

739. Incumbent LECs may seek relief from the Commission's pricing methodology if they provide specific information to show that the pricing methodology, as applied to them, will result in confiscatory rates. We also do not completely foreclose the possibility that incumbent LECs will be afforded an opportunity to recover, to some extent, their embedded costs through a mechanism separate from rates for interconnection and unbundled network elements. As stated above, we intend to explore this issue in detail in our upcoming access reform proceeding.

740. GTE argues that the proper standard to review our ratemaking methodology is the just compensation standard generally reserved for takings of property. This is in effect a contention that the 1996 Act's physical collocation and unbundled network facility requirements constitute physical occupation of their property that should be deemed a taking and that must be subject to "just compensation." Assuming for the sake of argument that the physical collocation and unbundled facilities requirements do result in a taking, we nevertheless find that the ratemaking methodology we have adopted satisfies the just compensation standard. Just compensation is normally measured by the fair market value of the property subject to the taking.[1758] Just compensation is not, however, intended to permit recovery of monopoly rents.[1759] The just and reasonable rate standard of TELRIC plus a reasonable allocation of the joint and

[1756] However, we may not consider incumbent LECs' revenue derived from services not under our jurisdiction. *Smith v. Ill. Bell*, 282 U.S. 133 (1930).

[1757] *Metropolitan Transp. Auth. v. Interstate Commerce Commission*, 792 F.2d 287, 297 (2d Cir.), *cert. denied*, 479 U.S. 1017 (1986).

[1758] *See, e.g.*, *United States v. Miller*, 317 U.S. 369, 374 (1943) (holding that just compensation can readily be set by ascertaining the property's fair market value, *i.e.*, "what a willing buyer would pay in cash to a willing seller").

[1759] *See, e.g.*, *Lord Mfg. Co. v. United States*, 84 F.Supp. 748, 755-56 (Ct.Cl. 1949), *citing United States v. Cors*, 337 U.S. 325, 334 (1949).

common costs of providing network elements that we are adopting attempts to replicate, with respect to bottleneck monopoly elements, the rates that would be charged in a competitive market,[1760] and, we believe, is entirely consistent with the just compensation standard. Indeed, a similar rate methodology based on incremental costs has been found to satisfy the just compensation requirement.[1761] For these reasons, we conclude that, even if the 1996 Act's physical collocation and unbundled network facility requirements constitute a taking, a forward-looking economic cost methodology satisfies the Constitution's just compensation standard.

3. Rate Structure Rules

a. General Rate Structure Rules

(1) Background

741. In addition to applying our economic pricing methodology to determine the rate level of a specific element or interconnection, the state must also determine the appropriate rate structure. We discuss in this section general principles for analyzing rate structure questions, such as in what circumstances charges should be flat-rated or usage sensitive and in what circumstances they should be recurring or non-recurring. These rate structure rules will apply as well if a state sets rates based on default proxies discussed in Section VII.C.2 below, where we also discuss the appropriate rate structure for specific network elements. Network providers incur costs in providing two broad categories of facilities, dedicated and shared. Dedicated facilities are those that are used by a single party -- either an end user or an interconnecting network. Shared facilities are those used by multiple parties. In the NPRM, we proposed that costs should be recovered in a manner that reflects the way they are incurred.[1762] We also sought comment on whether we should require states to provide for recovery of dedicated facility costs on a flat-rated basis, or at a minimum, require LECs to offer a flat-rate option.[1763]

[1760] *Compare Policy and Rules Concerning Rates for Dominant Carriers*, Further Notice of Proposed Rulemaking, CC Docket No. 87-313, 3 FCC Rcd 3195, 3200-01 (1988).

[1761] *Metropolitan Transp. Auth. v. Interstate Commerce Commission*, 792 F.2d at 297.

[1762] NPRM at para. 150.

[1763] *Id.* at para. 152.

(2) **Comments**

742. Parties from all sectors of the telecommunications industry agree that costs should be recovered in a manner that reflects the way they are incurred.[1764] Lincoln states that using an approach that varies with capacity, without taking into account the utilization of shared facilities, would not allow small and mid-sized LECs to recover their total costs, because they lack economies of scale and scope.[1765] No commenters take issue with that principle or the principle that the costs of dedicated facilities should be recovered through flat rates. A wide variety of parties proposed that the Commission adopt such a rule.[1766] BellSouth, however, opposes rigid rate structure rules, and contends they could be detrimental if they preclude alternative structures to which parties are willing to agree.[1767]

(3) **Discussion**

743. We conclude, as a general rule, that incumbent LECs' rates for interconnection and unbundled elements must recover costs in a manner that reflects the way they are incurred. This will conform to the 1996 Act's requirement that rates be cost-based, ensure requesting carriers have the right incentives to construct and use public network facilities efficiently, and prevent incumbent LECs from inefficiently raising costs in order to deter entry. We note that this conclusion should facilitate competition on a reasonable and efficient basis by all firms in the industry by establishing prices for interconnection and unbundled elements based on costs similar to those incurred by the incumbents, which may be expected to reduce the regulatory burdens and economic impact of our decision for many parties, including both small entities seeking to enter the local exchange markets and small incumbent LECs.[1768] We also adopt some more specific rules that follow from this general rule.

744. First, we require that the charges for dedicated facilities be flat-rated, including, but not limited to, charges for unbundled loops, dedicated transport, interconnection, and collocation. These charges should be assessed for fixed periods, such as a month. We are requiring flat-rated

[1764] *See, e.g.*, AT&T comments at 67; GSA/DoD comments at 10; Kentucky Commission comments at 5; Lincoln Tel. comments at 17; Sprint comments at 62; Texas Public Utility Counsel comments at 36; USTA comments at 57; LDDS comments at 57; NEXTLINK comments at 30 (generally supporting rate structures that reflect off-peak costs); Washington Commission comments at 24.

[1765] Lincoln Tel. comments at 17.

[1766] *See, e.g.*, Florida Commission comments at 31; GSA/DoD comments at 10; MFS comments at 61-63; Ohio Consumers' Counsel comments at 30; Telecommunications Resellers Ass'n comments at 42.

[1767] BellSouth comments at 57-58.

[1768] *See* Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

charges for dedicated facilities. Usage-based charges for dedicated facilities would give purchasers of access to network elements an uneconomic incentive to reduce their traffic volumes. Moreover, purchasers of access to network elements with low volumes of traffic would pay below-cost prices, and therefore have an incentive to add lines that they would not add if they had to pay the full cost. As stated in the NPRM, a flat-rated charge is most efficient for dedicated facilities, because it ensures that a customer will pay the full cost of the facility, and no more. It ensures that an entrant will, for example, purchase the exclusive right to use additional loops only if the entrant believes that the benefits of the additional loops will exceed its costs. It also ensures that the entrant will not face an additional (and non-cost-based) usage charge.

745. Second, if we apply our general rule that costs should be recovered in a manner that reflects the way they are incurred, then recurring costs must be recovered through recurring charges, rather than through a nonrecurring charge. A recurring cost is one incurred periodically over time. A LEC may not recover recurring costs such as income taxes, maintenance expenses, and administrative expenses through a nonrecurring charge because these are costs that are incurred in connection with the asset over time. For example, we determine that maintenance expenses relating to the local loop must be recovered through the recurring loop charge, rather than through a nonrecurring charge imposed upon the entrant.

746. We find that recovering a recurring cost through a nonrecurring charge would be unjust and unreasonable because it is unlikely that incumbent LECs will be able to calculate properly the present value of recurring costs. To calculate properly the present value of recurring costs, an incumbent LEC would have to project accurately the duration, level, and frequency of the recurring costs and estimate properly its overall cost of capital. We find that, in practice, the present value of the recurring costs cannot be calculated with sufficient accuracy to warrant up-front recovery of these costs because incumbent LECs lack sufficient experience with the provision of interconnection and unbundled rate elements. Without sufficient experience, incumbent LECs are unable to project the length of time that an average entrant would interconnect with, or take an unbundled element from, the incumbent LEC, or how expenses associated with interconnection and unbundled rate elements would change over time. In contrast, a recurring charge for a recurring cost would ensure that a customer is only charged for the costs the entrant incurs while that entrant is taking interconnection service or unbundled rate elements from the incumbent LEC. Moreover, when costs associated with the interconnection and particular unbundled rate elements change, the incumbent LEC can make appropriate adjustments to the charges at the time such cost changes occur.

747. Accordingly, we find that imposing nonrecurring charges for recurring costs could pose a barrier to entry because these charges may be excessive, reflecting costs that may (1) not actually occur; (2) be incurred later than predicted; (3) not be incurred for as long as predicted; (4) be incurred at a level that is lower than predicted; (5) be incurred less frequently than predicted; and (6) be discounted to the present using a cost of capital that is too low.

748. Notwithstanding the foregoing, where recurring costs are *de minimis*, we will permit incumbent LECs to recover such costs through nonrecurring charges. We find that recurring costs are *de minimis* where the costs of administering the recurring charge would be excessive in relation to the amount of the recurring costs.

749. Third, states may, but need not, require incumbent LECs in an arbitrated agreement to recover nonrecurring costs, costs that are incurred only once, through recurring charges over a reasonable period of time. The recovery of such nonrecurring costs through recurring charges is a common practice for telecommunications services. Construction of an interconnector's physical collocation cage is an example of a nonrecurring cost. We find that states may, where reasonable, require an incumbent LEC to recover construction costs for an interconnector's physical collocation cage as a recurring charge over a reasonable period of time in lieu of a nonrecurring charge. This arrangement would decrease the size of the entrant's initial capital outlay, thereby reducing financial barriers to entry. At the same time, any such reasonable arrangement would ensure that incumbent LECs are fully compensated for their nonrecurring costs.

750. We require, however, that state commissions take steps to ensure that incumbent LECs do not recover nonrecurring costs twice and that nonrecurring charges are imposed equitably among entrants. A state commission may, for example, decide to permit incumbent LECs to charge the initial entrants the full amount of costs incurred for shared facilities for physical collocation service, even if future entrants may benefit. A state commission may, however, require subsequent entrants, who take physical collocation service in the same central office and receive benefits as a result of costs for shared facilities, to pay the incumbent LEC for their proportionate share of those costs, less depreciation (if an asset is involved). Under this approach, the state commission could require the incumbent LEC to provide the initial entrants *pro rata* refunds, reflecting the full amount of the charges collected from the subsequent entrants. Alternatively, a state commission may decide to permit incumbent LECs to charge initial entrants a proportionate fraction of the costs incurred, based on a reasonable estimate of the total demand by entrants for the particular interconnection service or unbundled rate elements.

751. In addition, state commissions must ensure that nonrecurring charges imposed by incumbent LECs are equitably allocated among entrants where such charges are imposed on one entrant for the use of an asset and another entrant uses the asset after the first entrant abandons the asset. For example, when an entrant pays a nonrecurring charge for construction of a physical collocation cage and the entrant discontinues occupying the cage before the end of the economic life of the cage, a state commission could require that the initial entrant receive a *pro rata* refund from the incumbent LEC for the undepreciated value of the cage in the event that a subsequent entrant takes physical collocation service and uses the asset. Under this approach, the state commission could require that the subsequent entrant pay the incumbent LEC a nonrecurring charge equal to the remaining unamortized value of the cage and the initial entrant will receive a

credit from the incumbent LEC equal to the unamortized value of the cage at the time the subsequent entrant takes service and utilizes the cage.

752. BellSouth's concern that rate structure rules could preclude mutually agreeable alternative structures is misplaced. The rate structure rules we adopt here apply only to rates imposed by the states in arbitration among the parties and to state review of BOC statements of generally available terms. Our rules do not restrict parties from agreeing to alternative rate structures. On the contrary, our intent, following the clear pro-negotiation spirit of the 1996 Act, is for parties to use the backdrop of state arbitrations conducted under our rules, to negotiate more efficient, mutually agreeable arrangements, subject, of course, to the antitrust laws[1769] and to the 1996 Act's requirements that voluntarily negotiated agreements not unreasonably discriminate against third parties.[1770]

b. Additional Rate Structure Rules for Shared Facilities

(1) Background

753. In the NPRM, we stated our belief that the costs of shared facilities should be recovered in a manner that efficiently apportions costs among users that share the facility. The NPRM noted that, for shared facilities, it may be efficient to set prices using any of the following: a usage-sensitive charge; a usage-sensitive charge for peak-time usage and a lower charge for off-peak usage; or a flat charge for the peak capacity that an interconnector wishes to pay for and use as though that portion of the facility were dedicated to the interconnector.[1771]

(2) Comments

754. USTA argues that shared facilities are more reasonably priced on a usage-sensitive basis.[1772] The Florida Commission and Telecommunications Resellers Association both contend that a variety of charges may be appropriate for shared facilities.[1773] Telecommunications Resellers Association further argues that the Commission should "require, where practicable, that LECs offer a flat-rated option with respect to common facilities and bear the burden of justifying

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[1769] Sherman Antitrust Act, 15 U.S.C. §§ 1 *et seq.*

[1770] *E.g.*, 47 U.S.C. § 252(e)(2)(A)(i).

[1771] NPRM at para. 151.

[1772] USTA comments at 57; *see also* Lincoln Tel. comments at 17; Sprint comments at 62; NTIA reply at 33-34.

[1773] Florida Commission comments at 31; Telecommunications Resellers Ass'n comments at 42.

instances in which they allege that such an option is not workable."[1774] AT&T makes a similar proposal, arguing that rates should generally be non-usage sensitive except where a usage-based charge is clearly required.[1775] Lincoln Tel. argues that costs of shared facilities should be apportioned among users of the shared facility and that a capacity approach that does not account for utilization of shared facilities would prevent small and mid-sized LECs from recovering their costs as they lack economies of scale.[1776]

(3) Discussion

755. The costs of shared facilities including, but not limited to, much of local switching, tandem switching, transmission facilities between the end office and the tandem switch, and signaling, should be recovered in a manner that efficiently apportions costs among users. Because the cost of capacity is determined by the volume of traffic that the facilities are able to handle during peak load periods, we believe, as a matter of economic theory, that if usage-sensitive rates are used, then somewhat higher rates should apply to peak period traffic, with lower rates for non-peak usage. The peak load price would be designed to recover at least the cost of the incremental network capacity added to carry peak period traffic. Pricing traffic during peak periods based on the cost of the incremental capacity needed to handle additional traffic would be economically efficient because additional traffic would be placed on the network if and only if the user or interconnecting network is willing to pay the cost of the incremental network capacity required to handle this additional traffic. Such pricing would ensure that a call made during the peak period generates enough revenue to cover the cost of the facilities expansion it requires, and would thus give carriers an incentive to expand and develop the network efficiently. In contrast, off-peak traffic imposes relatively little additional cost because it does not require any incremental capacity to be added to base plant, and consequently, the price for carrying off-peak traffic should be lower.

756. We recognize, however, that there are practical problems associated with a peak-sensitive pricing system. For example, different parts of a given provider's network may experience peak traffic volumes at different times (*e.g.*, business districts may experience their peak period between 10:00 and 11:00 a.m., while suburban areas may have their peak periods between 7:00 and 8:00 p.m.) Moreover, peak periods may change over time. For instance, growth in Internet usage may create new peak periods in the late evening. Further, charging different prices for calls made during different parts of the day may cause some customers to shift their calling to the less expensive time periods, which could shift the peak or create new peaks.

[1774] Telecommunications Resellers Ass'n comments at 42.

[1775] AT&T comments at 67.

[1776] *See* Lincoln Tel. comments at 17.

Thus, to design an efficient peak-sensitive pricing system requires detailed knowledge of both the structure of costs as well as demand.

757. We conclude that the practical problems associated with peak-sensitive pricing make it inappropriate for us to require states to impose such a rate structure for unbundled local switching or other shared facilities whose costs vary with capacity. Because we believe that such a structure may be the most economically efficient, however, we do not prohibit states from imposing peak-sensitive pricing. We also expect that parties may be able to negotiate agreements with peak/off-peak differences if the benefits of such distinctions are sufficiently high. We conclude that states may use either usage-sensitive rates or flat capacity-based rates for shared facilities, if a state finds that such rates reasonably reflect the costs imposed by the various users. States may consider for guidance rate structures developed in competitive markets for shared facilities. We note that our decisions in this section may benefit small entity entrants in local exchange and exchange access markets by minimizing the extent to which purchasers of interconnection and unbundled access pay rates that diverge from the costs of those facilities and services.[1777]

c. Geographic/Class-of-Service Averaging

(1) Background

758. In the NPRM, we asked about the appropriate level of aggregation for rates for interconnection and access to unbundled elements. We noted that geographic averaging is simple to administer and prevents unreasonable or unlawful rate differences but, where averaging covers high and low cost areas, it could distort competitors' decisions whether to lease unbundled elements or build their own facilities. We sought comment on the geographic deaveraging of interconnection and unbundled element rates by zone, LATA, or other area.[1778]

759. We also inquired about disaggregation by class of service. We questioned whether business and residential loops, or loops deployed using different technologies should be charged different rates, and how large a differential should be allowed.[1779]

[1777] *See* Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

[1778] NPRM at para. 133.

[1779] *Id.*

(2) Comments

760. *Geographic Deaveraging.* Commenters generally agreed that rates for interconnection and unbundled elements should be geographically deaveraged where there are significant cost variations.[1780] Many parties assert that there are large geographic variations in the costs of providing these services and elements.[1781] Many commenters argue that rates for interconnection and unbundled elements must be geographically deaveraged in order to meet the cost-based requirements of sections 251 and 252.[1782] Teleport maintains, however, that most geographic or class-of-service classifications have arisen from marketing or regulatory considerations and have no basis in cost causation.[1783] The Ad Hoc Telecommunications Users Committee fears the "balkanization of [incumbent] LECs' markets" and would only allow geographic deaveraging where incumbent LECs could demonstrate significant regional variation in their non-common costs.[1784] It claims that excessive pricing flexibility would encourage the recovery of common costs to be shifted from competitive markets to less competitive markets.[1785] Finally, MFS would have us require geographic averaging to deter anticompetitive, strategic pricing by incumbent LECs.[1786]

761. *Extent of Deaveraging.* Cincinnati Bell, Lincoln Tel., and MECA would place no limits on the degree of deaveraging that would be permitted.[1787] MCI and Sprint advocate deaveraging based on the population density in specified geographic areas or zones.[1788] AT&T

[1780] *See, e.g.*, Connecticut Commission comments at 13-14; N. Economides comments at 3; Maine Commission, *et al.* comments at 19. *Cf.* Colorado Commission comments at 41; Ohio Consumers' Counsel comments at 27-28 (deaveraging should be left to states); Pennsylvania Commission comments at 31 (noting industry movement towards deaveraging); Texas Commission at 24 (Commission should defer geographic deaveraging and rate rebalancing to universal service proceeding).

[1781] *See, e.g.*, Cincinnati Bell comments at 27; Lincoln Tel. comments at 14; Maine Commission, *et al.* comments at 27-28; Sprint comments at 50-51.

[1782] AT&T comments at 60.

[1783] Teleport comments at 48.

[1784] Ad Hoc Telecommunications Users Committee comments at 47.

[1785] *Id.*

[1786] MFS comments at 55-56.

[1787] *See, e.g.*, Cincinnati Bell comments at 27; Lincoln Tel. comments at 14; MECA comments at 46.

[1788] MCI comments at 68; Sprint comments at 50; *see also* MFS comments at 55-57.

also advocates zone density deaveraging and would have us require at least six zones.[1789] MFS proposes that prices could be averaged over several possible areas, with state-wide averaging being the maximum geographic area. To address concerns that widespread averaging may force low cost areas to subsidize high cost areas, MFS suggests that exchanges be assigned to a small number of cost bands based on access line density, but that rates be set at the state-wide average cost of the exchanges assigned to each zone.[1790] GST generally favors a level of disaggregation that would mitigate incumbent LEC administrative expenses, but would require loop components such as drops to be deaveraged and priced at LRIC.[1791]

762. *Opposition to National Rule.* Many state commissions seek flexibility to determine the degree of deaveraging and argue that this issue should be left to the states.[1792] Several favor deaveraging wherever the benefits exceed the administrative costs.[1793] The Connecticut Commission has already allowed SNET to create four cost categories based on density.[1794] The Michigan Commission would deaverage rates for interconnection and access to unbundled elements only where competitive entry warrants such flexibility, subject to a TSLRIC floor constraint.[1795] Michigan Commission further states that there may also be non-competitive situations that warrant rate deaveraging, such as when a service has wide cost variances, when averaging may reduce subscription levels, or when deaveraging could provide more accurate market signals due to cost variation.[1796]

763. *Class-of-Service Deaveraging.* In contrast to the general support by parties for geographic deaveraging, only one party supports class-of-service deaveraging.[1797] That party, the Ohio Consumers' Counsel, argues that permitting intercategory restrictions on unbundled elements

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[1789] AT&T comments at 67.

[1790] MFS comments at 55-56.

[1791] GST comments at 30.

[1792] *See, e.g.*, Colorado Commission comments at 41; Connecticut Commission comments at 13-14; Maine Commission, *et al.* comments at 19-21; Michigan Commission comments at 15; Texas Commission comments at 24; *see also* Ohio Consumers' Counsel comments at 27-28; California Commission reply at 18.

[1793] *See, e.g.*, Connecticut Commission comments at 13-14; Indiana Commission comments at 24; Mass. Commission comments at 11 n.5.

[1794] Connecticut Commission comments at 13-14.

[1795] Michigan Commission comments at 15-16.

[1796] *Id.*

[1797] Ohio Consumers' Counsel comments at 27-28.

would be consistent with intercategory restrictions on resale, such as prohibitions against reselling residential services to business customers, which are permitted under the 1996 Act.[1798] Many parties argue that incumbent LECs should not be able to charge different rates for interconnection or unbundled elements based on the class of service being provided with the elements or the class of customer purchasing or using the interconnection or unbundled elements.[1799] According to most commenters, the 1996 Act's requirement that rates for interconnection and unbundled elements be cost-based generally precludes class-of-service rate differences, unless the costs of provision vary significantly across classes.[1800] Sprint adds that there is no cost justification for rates to differ when unbundled elements are used for business customers instead of residential customers. Sprint also argues that requiring different rates for newer, less-expensive elements would give entrants the incentive to avoid serving customers connected to older, more-expensive plant, which would leave incumbent LECs at systematic cost disadvantages.[1801]

(3) Discussion

764. *Geographic Deaveraging.* The 1996 Act mandates that rates for interconnection and unbundled elements be "based on the cost . . . of providing the interconnection of network elements." [1802] We agree with most parties that deaveraged rates more closely reflect the actual costs of providing interconnection and unbundled elements. Thus, we conclude that rates for interconnection and unbundled elements must be geographically deaveraged.

765. The record reflects that at least two states have implemented geographically-deaveraged rate zones.[1803] These rate zone pricing systems have generally included a minimum of three zones. In the *Expanded Interconnection* proceeding, the Commission also permitted LECs to implement a three zone structure.[1804] We conclude that three zones are presumptively sufficient

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[1798] *Id.*

[1799] *See, e.g.*, Koch comments at 3; GST comments at 30; Mass. Commission comments at 11; MFS comments at 56-57; Sprint comments at 50; Teleport comments at 48.

[1800] *See, e.g.*, Citizens comments at 18; Mass. Commission comments at 11; MFS comments at 56-57.

[1801] Sprint comments at 51.

[1802] 47 U.S.C. § 252(d)(1)(a)(i).

[1803] Connecticut Commission comments at 13; Illinois Commission comments at Attachment C (Illinois Commerce Commission Order), p.54, 60-61.

[1804] *Expanded Interconnection with Local Telephone Company Facilities and Amendment of the Part 69 Allocation of General Support Facility Costs*, CC Docket Nos. 91-141 and 92-222, Report and Order and Notice of Proposed Rulemaking, 7 FCC Rcd 7369, 7454-57 (1992) (*Expanded Interconnection Order*); Second Report and Order and Third Notice of Proposed Rulemaking, 8 FCC Rcd 7374, 7426-29 (1993). LEC central offices in to reflect geographic cost differences in setting rates for interconnection and unbundled elements, and that states may, but need not, use these existing density-related rate zones. Where such systems are not in existence, states shall create a minimum of three cost-related rate zones to implement deaveraged rates for interconnection and unbundled elements. A state may establish more than three zones where cost differences in geographic regions are such that it finds that additional zones are needed to adequately reflect the costs of interconnection and access to unbundled elements.

766. *Class-of-Service Deaveraging.* The record leads us to the opposite conclusion for class-of-service deaveraging. Under the 1996 Act, wholesale rates for resold services will be based on retail rates less avoided costs. Rates for interconnection and access to unbundled elements, however, are to be based on costs. We conclude that the pricing standard for interconnection and unbundled elements prohibits deaveraging that is not cost based. Interconnection and unbundled elements are intermediate services provided by incumbent LECs to other telecommunications carriers, and there is no evidence that the cost of providing these intermediate services varies with the class of service the telecommunications carrier is providing to its end-user customers. We conclude that states may not impose class-of-service deaveraging on rates for interconnection and unbundled elements. We disagree with the Ohio Consumers' Counsel's position that the 1996 Act's explicit permission of class-of-service deaveraging of resold services implies that class-of-service deaveraging should be permitted for interconnection and unbundled elements. Finally, we note that these decisions concerning averaging may be expected to lead to increased competition and a more efficient allocation of resources, which should benefit the entire industry, including small entities and small incumbent LECs.[1805]

C. Default Proxy Ceilings and Ranges

767. As previously discussed, we strongly encourage state commissions, as a general rule, to set arbitrated rates for interconnection and access to unbundled network elements pursuant to the forward-looking, economic cost pricing methodology we adopt in this Order. Such rates would approximate levels charged in a competitive market, would be economically efficient, and would be based on the forward-looking, economic cost of providing interconnection and unbundled elements. We recognize, however, that, in some cases, it may not be possible for carriers to prepare, or the state commission to review, economic cost studies within the statutory time frame for arbitration and thus here first address situations in which a state has not approved a cost study. States that do not complete their review of a forward-looking economic cost study within the statutory time periods but must render pricing decisions, will be able to establish interim arbitrated rates based on the proxies we provide in this Order. A proxy approach might

areas with the highest traffic densities were assigned to Zone 1; offices in areas with intermediate degrees of density were assigned to Zone 2; and offices in areas with the lowest density were assigned to Zone 3.

[1805] *See* Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

provide a faster, administratively simpler, and less costly approach to establishing prices on an interim basis than a detailed forward-looking cost study.

768. The default proxies we establish will, in most cases, serve as presumptive ceilings. States may set prices below those ceilings if the record before them supports a lower price. States should provide a reasoned basis for selecting a particular default price. In one case, for local switching, the default proxy is a range within which a state may set prices.

769. States that set prices based upon the default proxies must also require the parties to update the prices in the interconnection agreement on a going-forward basis, either after the state conducts or approves an economic study according to the cost-based pricing methodology or pursuant to any revision of the default proxy. We believe generic economic cost models,[1806] in principle, best comport with the preferred economic cost approach described previously, and we intend to examine further such models by the first quarter of 1997 to determine whether any of those models, with any appropriate modifications, could serve as better default proxies. Any updated price would take effect beginning at the time of the completed and approved study or the application of the revised default proxy.

770. Second, if a state has approved or conducted an economic cost study, prior to this Order, that complies with the methodology we adopt in this Order, the state may continue to apply the resulting rate even when not consistent with our default proxies. There must, however, be a factual record, including the cost study, sufficient for purposes of review after notice and opportunity for the affected parties to participate.

771. Finally, while we provide for the use by states of default proxies, we recognize that certain states that are unable to utilize an economic cost study may wish to obtain the benefits of setting rates pursuant to such a study for its residents. The Commission will therefore entertain requests by states to review an economic cost study, to assist the state in conducting or reviewing such a study, or to conduct such a study.

1. Use of Proxies Generally

a. Background

772. In the NPRM, we discussed the possibility of setting certain outside limits for interconnection and unbundled element rates, in particular, by the use of proxies. We invited parties to comment on whether the use of certain proxies to set outer boundaries on the prices for interconnection and unbundled elements would be consistent with the pricing principles of the 1996 Act. Specifically, in the NPRM, we asked parties to comment on the benefits of various types of proxies: (1) generic cost studies, such as the Benchmark Cost Model and the Hatfield

[1806] *See* Section VII.C.3. *infra*.

models;[1807] (2) some measure of nationally-averaged cost data;[1808] (3) rates in existing interconnection and unbundling arrangements between incumbent LECs and other providers of local service, such as neighboring incumbent LECs, CMRS providers, or other entrants in the same service area;[1809] (4) a subset of the incumbent LECs' existing interstate access rates, charged for interconnection with IXCs and other access customers, or an intrastate equivalent;[1810] (5) use of the interstate prices established in the *ONA* proceeding for unbundled features and functions of the local switch as ceilings for the same unbundled elements under section 251;[1811] and (6) any other administratively simple methods for establishing a ceiling for interconnection and unbundled network element rates.[1812] As a counterpart to ceilings, we also sought comment on whether it would be necessary or appropriate for us to establish floors for interconnection and unbundled element prices.[1813]

b. Comments

773. *Proxies Generally.* A number of parties offer general support for the use of cost proxies to establish upper limits on the rates that incumbent LECs may charge for interconnection and unbundled elements.[1814] Ad Hoc Telecommunications Users Committee cautions, however, that using a proxy approach does not eliminate the need for detailed analysis of the cost methodologies and cost inputs upon which the proxy is based.[1815] In addition, USTA contends that the Commission should establish a presumptive framework using targets based on pricing proxies, from which the states would be permitted to depart based on individual circumstances.[1816]

[1807] NPRM at para. 137; *see infra*, Section VII.C.3, discussing generic cost models.

[1808] NPRM at para. 137.

[1809] *Id.* at para. 138.

[1810] *Id.* at paras. 139-140.

[1811] *Id.* at para. 140.

[1812] *Id.* at para. 141.

[1813] *Id.* at para. 143.

[1814] *See, e.g.*, GSA/DoD comments at 8; Cox comments at 31, reply at 30; WinStar comments at 31; NEXTLINK comments at 27-28; Texas Public Utility Counsel Comments at 28-33; NCTA comments at Attachment A (Declaration of Bruce M. Owen), pp.5-6, reply at 18-19; *see also* USTA comments at 50 ("may be a feasible way to establish presumptively valid rates for some unbundled elements").

[1815] Ad Hoc Telecommunications Users Committee comments at 48-49.

[1816] USTA reply at 19, 28; *see also* Washington Commission comments at 27.

774. Incumbent LECs and AT&T generally oppose the use of proxies.[1817] They argue that a national proxy methodology for all network elements is inappropriate because it would not reflect cost-based rates,[1818] may restrict competitive entry,[1819] does not allow for variations among the states,[1820] and is inconsistent with the 1996 Act's mandate of economic costing.[1821] Several commenters contend that the use of proxies could harm small and mid-sized incumbent LECs if such proxies are developed from larger geographic and demographic scales.[1822] In addition, Ameritech opposes the use of proxies for those states that have already adopted cost methodologies and urges the Commission to limit application of such proxies to states that have not yet adopted appropriate cost and pricing methodologies.[1823]

775. *Floors and Ceilings.* Several commenters oppose adoption of a federal floor and ceiling for the rates of interconnection and access to unbundled elements.[1824] They argue generally that such an approach is inferior to a prescription of a specific methodology because it results in rates that are not cost-based and therefore inconsistent with the statute, provides an incentive to incumbent LECs to price inefficiently at the maximum, and removes incentives for upgrading network technology.[1825] Moreover, any such price ceiling would have to be set as high as the reasonable price for the highest cost company or be challenged as confiscatory when higher

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[1817] *See, e.g.*, AT&T comments at 52-53; Bell Atlantic comments at 39; Cincinnati Bell comments at 27; Frontier comments at 22-23; LDDS comments at 65 n.66; Lincoln Tel. comments at 15-16.

[1818] *See, e.g.*, ALTS comments at 37; AT&T comments at 53; NYNEX comments at 53; Lincoln Tel. comments at 15-16; Texas Statewide Telephone Cooperative comments at 14; Rural Tel. Coalition comments at 22; Washington Independent Tel. Ass'n comments at 6.

[1819] *E.g.*, Cincinnati Bell comments at 28; AT&T comments at 53.

[1820] *See, e.g.*, Bell Atlantic comments at 39; Rural Tel. Coalition comments at 22; Wyoming Commission comments at 31; Alaska Commission comments at 2-3.

[1821] *See, e.g.*, ALTS comments at 35; Time Warner comments at 54-55; Washington Independent Tel. Ass'n comments at 6-7; Ohio Commission comments at 50.

[1822] *See, e.g.*, Cincinnati Bell comments at 28; Colorado Independent Tel. Ass'n comments at 4; Illinois Ind. Ass'n comments at 5; Lincoln Tel. comments at 17; Matanuska Tel. comments at 4; Rural Tel. Coalition comments at 22, 28-29; SBA comments at 16; TDS comments at 22.

[1823] Ameritech comments at 61.

[1824] *See, e.g.*, Frontier comments at 22; Lincoln Tel. comments at 14-15; MECA comments at 47; Pennsylvania Commission comments at 31; Telecommunications Resellers Ass'n comments at 41.

[1825] *See, e.g.*, NYNEX comments at 57; Frontier comments at 22-23; Lincoln Tel. comments at 14-15; AT&T comments at 52-53; TDS comments at 22.

cost LECs are unable to recover their costs.[1826] In addition, the Texas Public Utility Counsel notes that floors impair the ability of competition to reveal how low costs really are.[1827]

776. Many parties agree, however, that if the Commission establishes pricing guidelines it should use an "outer bounds" pricing approach or require pricing within a zone of reasonableness.[1828] Others support an "outer bounds" if the Commission ensures that states will have sufficient leeway to accommodate state-specific situations,[1829] and the range of reasonableness is not so circumscribed as to reduce the range to the equivalent of a price point.[1830] They argue that establishing separate floors and ceilings enables the Commission to set absolute boundaries that frame the debate with the incumbent LEC concerning relevant costs and prices during negotiations and ultimately arbitration, while giving states flexibility to address state-specific costing issues.[1831] Parties assert that calculation of a perfectly correct, single price is impossible and that cost boundaries allow states to choose an acceptable pricing result with a range of reasonable rates.[1832] Several parties agree that the Commission should establish a presumptive rate ceiling, and that rates exceeding the ceiling should be presumed unlawful.[1833] USTA contends that, if the Commission adopts rate ceilings, such ceilings should indicate levels above which rates must be further justified.[1834] Ameritech maintains that floors should be used only as a benchmark below which rates may not be set in order to guard against cross-subsidization and predatory pricing.[1835]

[1826] Oregon Commission comments at 29-30; *see also* GVNW comments at 38-39.

[1827] Texas Public Utility Counsel comments at 33.

[1828] *See, e.g.*, Ad Hoc Telecommunications Users Committee comments at 48; BellSouth comments at 55; Cox comments at 24; GSA/DoD comments at 8; NEXTLINK comments at 27-28; SBC comments at 93; USTA comments at 38; WinStar comments at 31; NCTA reply at 18.

[1829] *See, e.g.*, Kentucky Commission comments at 5; Ohio Consumers' Counsel comments at 29; Puerto Rico Tel. comments at 10-11; Washington Commission comments at 26.

[1830] *See, e.g.*, BellSouth comments at 55.

[1831] *See, e.g.*, GSA/DoD comments at 8; Cox comments at 24, reply at 30-31; NEXTLINK comments at 27-28.

[1832] *See, e.g.*, Rural Tel. Coalition comments at 30.

[1833] *See, e.g.*, ACSI comments at 56; Bell Atlantic comments at 39-40; Cincinnati Bell comments at 27, 30; MCI comments at 60; PacTel comments at 73-74; Texas Public Utility Counsel comments at 28-29.

[1834] USTA comments at 50.

[1835] Ameritech comments at 73; *see also* GSA/DoD comments at 8; Ohio Consumers' Counsel comments at 28; TDS comments at 20.

777. *Generic Cost Models.* Several generic forward-looking cost models were introduced into the record. These are discussed in Section VII.C.3. below.

778. *Nationally-Averaged Costs.* Although a few commenters support the use of nationally-averaged costs as a proxy to establish the rates for interconnection and unbundled network elements,[1836] many more parties oppose the use of such nationally-averaged cost data.[1837] These parties argue that nationally-averaged data ignore geographically divergent factors and the interests of small or rural LECs, do not account for variance of cost between incumbent LECs, and do not reflect the true cost of the service.[1838] No nationally-averaged cost studies were introduced into the record.

779. *Existing Interconnection Agreements.* Generally, commenters oppose the use of rates in existing interconnection agreements as a proxy-based ceiling for interconnection and unbundled element rates.[1839] These parties argue that, because the agreements are the subject of the negotiation between two carriers with their own particular characteristics and needs, such agreements are likely to be inconsistent and not cost-based, may not be based on the pricing standards codified at 252(d), and the services covered by these agreements may not be those that entrants need to purchase.[1840] A few parties express qualified support for a proxy based on the rates in existing interconnection agreements between incumbent LECs, arguing that such rates have already been scrutinized and determined to be just and reasonable.[1841] WinStar cautions that the Commission should not use the rates contained in the existing interconnection agreements

[1836] *See, e.g.*, MECA comments at 47; PacTel comments at 74; Sprint comments at 55; *see also* ACSI comments at 56.

[1837] *See, e.g.*, Ad Hoc Telecommunications Users Committee comments at 49-50; Bay Springs, *et al.* comments at 17; Cincinnati Bell comments at 28; Colorado Independent. Tel. Ass'n comments at 4; Florida Commission comments at 29; Illinois Independent Tel. Ass'n comments at 5-6; Lincoln Tel. comments at 15-16; Telecommunications Resellers Ass'n comments at 41.

[1838] *See, e.g.*, Ad Hoc Telecommunications Users Committee comments at 49; Bay Springs, *et al.* comments at 17; Cincinnati Bell comments at 28; GVNW comments at 31-38.

[1839] *See, e.g.*, ACSI comments at 58; Ad Hoc Telecommunications Users comments at 52; Cincinnati Bell comments at 28-29; Colorado Commission comments at 43; Florida Commission comments at 30; MCI comments at 70; Telecommunications Resellers Ass'n comments at 41.

[1840] *See, e.g.*, Ad Hoc Telecommunications Users Committee comments at 52; Florida Commission comments at 30; Telecommunications Resellers Ass'n comments at 41; Time Warner comments at 55.

[1841] *See, e.g.*, Bell Atlantic comments at 39-40; Ohio Consumers' Counsel comments at 28-29; PacTel reply at 34-35; Pennsylvania Commission comments at 31; Texas Commission comments at 24-25; WinStar comments at 32.

between incumbent LECs and CMRS providers or other new entrants as a proxy ceiling because they were negotiated by parties with unequal bargaining power.[1842]

780. *Interstate Access.* A number of parties support the use of a proxy based on existing interstate access charges, claiming that it is easy to apply, based on cost, and would be self-correcting as the access reform and universal service proceedings remove subsidies from access rates.[1843] ALLTEL further maintains that if access charges are used, there should be no requirement for small and mid-sized LECs to produce cost studies that could hamper their interconnection negotiations.[1844] USTA further argues that such proxies are important to all LECs, but are especially important for rural, small, and mid-sized LECs subject to the two percent waiver process, who should not be subjected to the burden of producing expensive and time-consuming cost studies.[1845] Several parties note that some access charges may need to be adjusted or converted to reflect the characteristics of particular unbundled service offerings.[1846] Others oppose the development of a proxy-based ceiling derived from existing interstate access rates, because access charges are based on historical, rather than economic, costs, and contain inordinate amounts of contribution.[1847] These commenters note that setting rates for other elements that could not be derived from access rates would involve application of different proxies,[1848] and the intrastate and interstate rates associated with common lines are applied in different ways to different categories and classes of customers.[1849] NYNEX argues access charges were designed for a different purpose than interconnection and unbundled elements and therefore would be inappropriate proxies.[1850]

1842 WinStar comments at 34; *see also* Telecommunications Resellers Ass'n comments at 41; ACSI comments at 58.

1843 *See, e.g.*, ALLTEL comments at 10-11; Bell Atlantic comments at 39-40, 56; BellSouth comments at 56; Cincinnati Bell comments at 29; SBC comments at 94; USTA comments at 54, reply at 28.

1844 ALLTEL comments at 11.

1845 USTA reply at 27-28.

1846 *See, e.g.*, Cincinnati Bell at 30; SBC comments at 95; USTA comments at 54.

1847 *See, e.g.*, ACSI comments at 58; Ad Hoc Telecommunications Users Committee comments at 52-53; Colorado Commission comments at 43; Frontier comments at 23; Lincoln Tel. comments at 15-16; MCI comments at 70; MFS comments at 57 n.66.

1848 *See, e.g.*, Ad Hoc Telecommunications Users Committee comments at 52-53.

1849 *See, e.g.*, NYNEX comments at 59-60.

1850 NYNEX comments at 58-59.

781. In addition, several parties assert that a proxy based on access charges should include all or part of the CCLC or TIC, because otherwise it would be impossible to determine whether an appropriate amount of joint and common costs would be recovered, and IXCs would be able to reconstruct access through unbundled elements priced less than access.[1851] GVNW argues that the TIC is particularly important for small LECs that are not allowed to charge a rate that more accurately reflects their tandem switched transport costs.[1852] On the other hand, several commenters argue that the CCLC and TIC should be excluded,[1853] and WinStar further maintains that, even without those elements, access charge rates would still be too high to serve as a proxy ceiling.[1854]

c. Discussion

782. We adopt, in the section below, default proxies for particular network elements. We believe that these default proxies generally will result in reasonable price ceilings or price ranges and, for administrative and practical reasons, will be beneficial to the states in conducting initial rate arbitrations, especially in the time period prior to completion of a cost study. The proxies we adopt are designed to approximate prices that will enable competitors to enter the local exchange market swiftly and efficiently and will constrain the incumbent LECs' ability to preclude efficient entry by manipulating the allocation of common costs among services and elements. States that utilize the default proxies we establish to set prices in an arbitration should revise those prices on a going-forward basis when they are able to utilize the preferred economic costing methodology we describe in Section VII.B.2.a. above, or if we subsequently adopt new proxies.[1855]

783. We have considered the economic impact of the adoption of default proxy ceilings and ranges on small entities, including new entrants and small incumbent LECs.[1856] The adoption of proxies for interim arbitrated rates should minimize regulatory burdens on the parties to arbitration, including small entities seeking to enter the local exchange markets and small incumbent LECs, by permitting states to implement the 1996 Act more quickly and facilitating

[1851] *See, e.g.*, Cincinnati Bell comments at 29; NYNEX comments at 59; Texas Commission comments at 25; USTA comments at 51-53.

[1852] GVNW comments at 39.

[1853] *See, e.g.*, Sprint comments at 58; Texas Public Utility Counsel comments at 30-32; WinStar comments at 36-37.

[1854] WinStar comments at 36-37.

[1855] *See infra*, Section VII.C.3., discussing generic cost models.

[1856] *See* Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

competition on a reasonable and efficient basis by all firms in the industry. We therefore believe that the adoption of default proxy ranges and ceilings advances the pro-competitive goals of the 1996 Act. We also note that certain small incumbent LECs are not subject to our rules under section 251(f)(1) of the 1996 Act, unless otherwise determined by a state commission, and certain other small incumbent LECs may seek relief from their state commissions from our rules under section 251(f)(2) of the 1996 Act.[1857]

784. The proxies that we establish represent the price ceiling or price ranges for the particular element on an averaged basis. In Section VII.B.3.c. above, we required that rates be set on a geographically-deaveraged basis. Consequently, states utilizing the proxies shall set rates such that the average rate for the particular element in a study area does not exceed the applicable proxy ceiling or lie outside the proxy range.

785. We reject the use of rates in interconnection agreements that predate the 1996 Act as a proxy-based ceiling for interconnection and unbundled element rates.[1858] These existing interconnection agreements were not reached in a competitive market environment. Further, such agreements may reflect the divergent bargaining power of the parties to the agreement, various public policy initiatives to advance rural telephone service, or non-monetary *quid pro quos* often found in voluntarily negotiated business arrangements that may be difficult to quantify. There is little basis for us to conclude that rates in these interconnection agreements reflect the forward-looking, incremental cost of interconnection and unbundled network elements. Prices in agreements reached since the 1996 Act are more likely than prior agreements to provide useful information about forward-looking costs, which together with other information may be useful in establishing proxies.

786. In the NPRM, we also raised the issue of using some measure of nationally-averaged cost data as a proxy.[1859] No such study has been submitted into the record in this proceeding.

[1857] 47 U.S.C. § 251(f).

[1858] *See* discussion *supra*, Section III.C., concerning the applicability of section 252 to preexisting agreements.

[1859] NPRM at para. 137.