

ESPs, including ISPs, should continue to be exempted from interstate carrier access charges as such charges currently are structured.^{41/}

50. For purposes of this proceeding, the core issue we clarify is that we have never held that by virtue of the ESP exemption, interstate ESPs are subject to state jurisdiction for any other purpose, including reciprocal compensation. Accordingly, there is no basis for some commenters' conclusion that the Commission's classification of ESPs as end users under the Part 69 regime in any way requires that ISPs be considered "local end users" or that Internet communications initiated through calls to ISPs be subject to reciprocal compensation.

51. Just as we have tentatively concluded that it would be inappropriate to subject ISPs to interstate access charges as they are currently structure, our current view, based on the record in this proceeding, is that it also would be inappropriate to provide for the recovery of the costs LECs incur to carry Internet communications that originate on the network facilities of another LEC within the same local area by subjecting such communications to the reciprocal compensation requirements. While this issue can be addressed in future proceedings, we believe it is helpful to state our current tentative views. We are concerned that extending the Section 251(b)(5) reciprocal compensation regime to such traffic could hinder the development of competition in the local exchange services market, could cause significant economic distortions in the still-evolving information services

^{41/} *Access Charge Reform*, Notice of Proposed Rulemaking, Third Report and Order and Notice of Inquiry, 11 FCC Rcd 21354 (1996).

industry, and create disincentives for investment and innovation in the underlying networks that support the Internet.

52. First, if reciprocal compensation applied to Internet communications that originate on the network facilities of one LEC, and traverse the network facilities of the LEC that serves the ISP, there appears to be a significant risk that competition among LECs to serve a large class of local customers -- heavy Internet users who access the Internet through an ISP -- could be reduced or eliminated. The record indicates that there currently are in excess of 24 million households that subscribe to ISPs and other consumer "online" services, and that the number of such subscribers is growing at an annual rate of 34 percent.^{42/}

53. In a system where the LEC that serves such a subscriber is required to pay reciprocal compensation to the LEC that serves the subscriber's chosen ISP, such payments could, under typical interconnection agreements, reach into the hundreds of dollars per subscriber, per year or even per month. CLECs, which have "no carrier of last resort" obligations, could simply refuse to serve subscribers who generate large reciprocal compensation outflows by remaining connected to the Internet for extended periods of time. Only the ILECs are required to serve such customers as a practical matter. In this environment, the ILECs would have no market-based opportunity to generate inbound reciprocal compensation payments that would offset the payments they must make to the CLECs. We do not believe that this is the competitive local exchange market that Congress envisioned in enacting the Telecommunications Act of 1996.

^{42/} *Interactive Services Report*, January 23, 1997 at 1 (citing online subscribership statistics as of December 31, 1997).

54. Second, if reciprocal compensation applied to Internet communications placed through an ISP, there is a significant risk that competition among LECs to provide local exchange service to ISPs would be distorted. Instead of competing on the basis of service quality, technological improvements, or other sound bases, CLECs could have artificial incentives to provide local exchange carrier to ISPs at uneconomic rates, and to establish or acquire their own ISP operations, simply to benefit from reciprocal compensation inflows.

55. The purpose of reciprocal compensation for local traffic is to ensure that a LEC is able to recover its actual costs of terminating local traffic that originates on another LEC's network.^{43/} We stress that while we conclude in this Order that reciprocal compensation pursuant to local interconnection agreements is an inappropriate way to compensate a LEC for carrying calls to the Internet that are placed through ISPs it serves, we stress our commitment rapidly to adopt an appropriate mechanism to ensure that LECs are duly compensated for such calls. We intend to initiate a rulemaking proceeding to implement such a mechanism on an expedited basis.

VII. Conclusion

56. We therefore conclude that calls to the Internet that are placed through an ISP are jurisdictionally interstate in nature. Because such calls are interstate and do not terminate on the network facilities of the LEC that provides local exchange service to the ISP, such

^{43/} Section 252(d)(2)(A)(i) of the Communications Act states that a State commission shall not consider the terms and conditions for reciprocal compensation just and reasonable unless they provide for the "recovery by each carrier of costs associated with transport and termination" of calls that originate on another carrier's network. 47 U.S.C. § 252(d)(2)(A)(i).

calls are not subject to reciprocal compensation under Section 251(b)(5) of the Communications Act. Further, this Commission has not required that such calls be subject to reciprocal compensation.

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MEMORANDUM

TO: Mr. Robert Blau

FROM: Albert Halprin
Melanie Haratunian

RE: FCC Authority to Issue Reciprocal Compensation Ruling

DATE: July 17, 1998

Pursuant to your request, this memorandum analyzes whether the Federal Communications Commission ("FCC" or "Commission") has the authority to proceed with plans to issue a ruling clarifying the reciprocal compensation provisions of Section 251(b)(5) of the Communications Act.^{1/} Specifically, we address whether the FCC can issue a reciprocal compensation declaratory ruling (or similar ruling) despite the fact that the Association for Local Telecommunications Services ("ALTS") recently withdrew its letter

^{1/} Section 251(b)(5) of the Communications Act requires all local exchange carriers ("LECs") "to establish reciprocal compensation arrangements for the transport and termination of telecommunications." Section 51.701(a) of the FCC Rules limited this obligation to "local telecommunications traffic." Section 51.701(b)(1), in instances of traffic exchange between LECs and non-Commercial Mobile Radio Service ("CMRS") providers, defines "local telecommunications traffic" as traffic that "originates and terminates within a local service area established by the state commission." Section 51.701 subsequently was vacated, except as applied to CMRS providers. *Iowa Utilities Board V. FCC*, 120 F.3d 753, 700-800 n. 21 (8th Cir. 1997), petition for cert. granted ("Eighth Circuit Opinion").

request for clarification on the issue ("ALTS Request").^{2/} As described more thoroughly below, since the Commission has the authority to issue a reciprocal compensation ruling on its own motion, the fact that the ALTS Request has been withdrawn is immaterial. Moreover, since all of the requisite requirements for issuing a declaratory ruling already have been met, it is proper for the FCC to rule on reciprocal compensation without seeking additional comment or taking any additional procedural steps.

I. ALTS' WITHDRAWAL HAS NO IMPACT ON THE FCC'S AUTHORITY TO ISSUE ITS RECIPROCAL COMPENSATION RULING AS PLANNED

There is ample legal support that it is within the Commission's jurisdiction to issue a reciprocal compensation ruling despite the withdrawal of the ALTS Request. Where the FCC has the authority to issue such a ruling either on its own motion or on the motion of an interested party, the FCC necessarily retains its independent authority to issue such a ruling even if the interested party subsequently withdraws its motion.^{3/}

The Commission clearly has the authority, on its own motion, to issue a declaratory ruling or otherwise clarify its rules, orders, and/or the Communications Act. For example, Section 1.2 of the FCC Rules expressly states that "[t]he Commission may, in accordance with section 5(d) of the Administrative Procedure Act on motion or on its own motion issue

^{2/} The ALTS Request, filed on June 20, 1997, requested expedited clarification of the FCC's rules regarding the rights of competitive local exchange carriers to receive reciprocal compensation pursuant to Section 251(b)(5) of the Communications Act for the transport and termination of traffic to CLEC subscribers that are information service providers.

^{3/} Even if ALTS had not withdrawn its Request, it is distinctly possible that the FCC would have dismissed the Request as procedurally defective. Section 1.2 of the FCC Rules requires that if an interested party seeks a declaratory ruling, it must file a motion. The ALTS Request merely is a letter that meets none of the requirements typically applicable to motions. *See, e.g.*, 47 C.F.R. § 1.727. As a consequence, if the FCC wanted to issue a reciprocal compensation declaratory ruling, it likely would have had to do so on its own motion, even if the ALTS Request had not been withdrawn.

a declaratory ruling terminating a controversy or removing uncertainty."^{4/} As the FCC expressly has stated, "[t]his Commission envisioned that the procedure [issuing a declaratory ruling pursuant to Section 1.2 of the FCC Rules] could be used to resolve . . . controversies among carriers relating to their rights or duties under the Communications Act, under this Commission's rules, or under prior Commission orders."^{5/} As demonstrated by the panoply of state court suits on the subject, there is ample uncertainty as well as controversy regarding the reciprocal compensation rights and duties pursuant to the Communications Act. The portion of the Eighth Circuit's Opinion vacating the FCC's reciprocal compensation rules adds further confusion to this area.^{6/}

^{4/} 47 C.F.R. § 1.2. Section 5(d) of the Administrative Procedure Act ("APA"), codified in 5 U.S.C. § 554(e), provides that "[t]he agency, with like effect as in the case with other orders, and in its sound discretion, may issue a declaratory order to terminate a controversy or remove uncertainty." Courts have interpreted the terms "declaratory order" used in Section 5(d) of the APA and "declaratory ruling" used in Section 1.2 of the FCC Rules to be interchangeable. *See, e.g., Wilson v. A.H. Belo Corp.*, 87 F.3d 393, 397 (9th Cir. 1996).

^{5/} *Public Service Commission of Maryland Petition for Declaratory Ruling Regarding Billing and Collection Services*, 4 FCC Rcd. 4000, 4004 (1989), *aff'd Public Service Comm'n of Maryland*, 909 F.2d 1510 (D.C. Cir. 1990).

^{6/} As discussed in Section II *infra*, the FCC already has met its obligations under Section 5(d) of the APA because the Public Notice gave adequate notice and an opportunity for interested parties to comment. In addition to its authority to issue declaratory rulings, the FCC also has general authority pursuant to Sections 4(i), 4(j), and 303(r) of the Communications Act to clarify, on its own motion, its rules and orders. *See, e.g., Amendment of the Commission's Rules to Establish Competitive Service Safeguards for Local Exchange Carrier Provision of Commercial Mobile Radio Services*, 12 FCC Rcd. 17983, 17985 (1997)(relying on Sections 4(i) and 303(r) as authority for the Commission to clarify, on its own motion, its *CMRS Safeguards Order*); *Replacement of Part 90 by Part 88 to Revise the Private Land Mobile Radio Services*, 11 FCC Rcd. 17676, 17789 and 17722 (1996) (relying on Sections 4(i) and 303(r) as authority for the Commission to clarify, on its own motion, its paging systems rules); *Amendment of Parts 21 and 74 of the Commission's Rules*, 10 FCC Rcd. 13821, 13833 and 13836 (relying on Sections 4(i), 4(j), and 303(r) as authority for the Commission to clarify, on its own motion, its unjust enrichment rules); *Corporate Ownership Reporting and Disclosure by Broadcast Licensees*, 58 Rad. Reg. 2d

(continued...)

Obviously, the Commission's clear authority to issue a ruling on its own motion is unaffected if an interested party subsequently withdraws its original request for such a ruling. Although our research disclosed no reported decision expressly addressing such a scenario, in an analogous situation, the D.C. Circuit ruled that an actual controversy exists for purposes of Section 1.2 of the FCC's Rules even if no interested party requested a declaratory ruling and thus that the Commission has authority to issue a declaratory ruling in the absence of such a request.⁷¹ In addition, there is FCC precedent for issuing a declaratory ruling, on its own motion, when the petition requesting such a ruling is deemed defective.⁸¹

There are also sound policy reasons why the Commission should issue the reciprocal compensation ruling as planned. The FCC, not interested parties, should control Commission dockets.⁹¹ Failing to issue its ruling as planned merely because ALTS

⁶¹(...continued)

(P&F) 604, paras. 51 and 72 (1985) (relying on Sections 4(i), 4(j), and 303 as authority for the Commission to clarify, on its own motion, its ownership interest rules); *Amendment of Part 73 of the Rules to Provide Procedures in the Event of a Personal Attack or Where A Station Editorializes as to Political Candidates*, 9 FCC 2d 539, 540 (1967) (relying on Sections 4(i), 4(j), and 303(r) as authority for the Commission to clarify, on its own motion, exemptions to its personal attack rules).

⁷¹ *Chisholm v. FCC*, 538 F.2d 349, 366 (D.C. Cir. 1976), *cert. denied*, 429 U.S. 890 (1976).

⁸¹ *See, e.g., Orth-O-Vision, Inc. Petition for Declaratory Ruling*, 69 FCC 2d 657 (1978).

⁹¹ We understand that some FCC staff members may be taking the position that since the FCC initiated a docketed proceeding, the docket continues to exist despite the ALTS withdrawal. Although that position makes sense from a practical point of view, our research did not uncover any FCC decision that expressly supported this position. Indeed, ample FCC precedent makes clear that assigning a docket number merely is a ministerial act without any independent legal significance. *See, e.g., Associated Press v. AT&T*, 18 FCC 2d 196 (1969) ("[Assigning a docket number] is a ministerial action in the strictest sense of the term. It involves no determination of any kind as to the merits . . . or as to whether a hearing will be required to determine the merits of the matters raised therein."); *Frances C.*

(continued...)

withdrew its Request would encourage a petitioner who foresees an unfavorable ruling to attempt to stymie FCC decisionmaking at the eleventh hour. This, in turn, unnecessarily would waste the FCC's time and efforts to analyze the issues and prepare a ruling as well as the interested parties' time, effort, and expenses to participate in the proceeding. Such an outcome is particularly egregious here, where interested parties and the FCC have invested a year of their time to address the issues raised in this proceeding. While an entity is free at any time to withdraw its request for declaratory ruling, the Commission has an independent obligation to ensure that entities under its jurisdiction comply with the Communications Act, the FCC's rules and orders.^{10/}

II. IT IS PROPER FOR THE FCC TO ISSUE ITS RULING WITHOUT SEEKING ADDITIONAL COMMENT OR TAKING ANY ADDITIONAL PROCEDURAL STEPS

Given its independent authority to issue a reciprocal compensation ruling, the FCC is not required, because of the ALTS withdrawal, to seek additional comment or take any additional procedural steps before issuing such a ruling. Applicable precedent makes clear that the Commission is deemed properly to exercise its authority to issue declaratory rulings

^{9/}(...continued)

Gaguine, 13 FCC 2d 184, 185 (1967) ("The assignment of a docket number is a purely clerical action."). However, where the request for FCC action is withdrawn after a docket number has been assigned, a public notice has been issued, pleadings from interested parties have been requested and provided, and the FCC has deliberated on the issues for a year, the proceeding has moved well beyond the assignment of docket stage and the FCC logically should be permitted to conclude the proceeding by issuing a declaratory ruling. This is particularly true where the FCC has authority to do so on its own motion.

^{10/} See, e.g., 47 U.S.C. § 208; *License Renewal Applications of Certain Suburban Broadcast Stations Serving the Washington, D.C. Market*, 77 FCC 2d 911 (1980) ("While a petitioner is free at any time to withdraw a petition to deny, this Commission has an independent obligation to assure itself that licensees are in compliance with its rules and regulations. Accordingly, while we will grant OHR's motion [to dismiss its petition], we have reviewed these stations' EEO performance on our own motion.")

under Section 1.2 of the FCC Rules and Section 5(d) of the APA if it gives notice and an opportunity for interested parties to comment before issuing such a ruling.^{11/} The FCC has already taken all such actions. The Public Notice in this proceeding already has provided interested parties with notice of the reciprocal compensation issues the Commission intends to address in its ruling.^{12/} The fact that these issues originally were framed by ALTS is immaterial. In fact, the ALTS Request only framed a portion of the issues in this proceeding. Whereas the ALTS Request was limited to reciprocal compensation rights with regard to information service providers subscribers, the FCC sought comment on such rights for enhanced service providers as well.^{13/}

In addition, the Public Notice already has afforded interested parties with an opportunity to file comments and reply comments. Indeed, the FCC extended the time period for filing reply comments, thereby increasing the opportunity for interested parties to participate in the proceeding.^{14/} At least 45 entities availed themselves of this opportunity by filing comments and/or reply comments in this proceeding. Withdrawal of the ALTS Request does not alter that opportunity. Moreover, since this proceeding has been pending

^{11/} See, e.g., *New York State Comm'n on Cable TV v. FCC*, 749 F.2d 804, 815 (D.C. Cir. 1984); *New York State Comm'n on Cable TV v. FCC*, 669 F.2d 58, 62 (2d Cir. 1982); *North Carolina Utilities Commission v. FCC*, 537 F.2d 787 (4th Cir.), cert. denied 429 U.S. 1027 (1976); *Chisholm v. FCC*, 538 F.2d at 365.

^{12/} *Pleading Cycle Established for Comments on Request by ALTS for Clarification of the Commission's Rules Regarding Reciprocal Compensation for Information Service Provider Traffic*, 12 FCC Rcd. 9715, Public Notice (released July 2, 1997).

^{13/} *Id.*

^{14/} *Request by ALTS for Clarification of the Commission's Rules Regarding Reciprocal Compensation for Information Service Provider Traffic*, 12 FCC Rcd. 10422, Order (released July 22, 1997).

for over a year, interested parties also have had ample opportunity to make any *ex parte* filings they deem necessary.

In particular, there is no legitimate reason to require interested parties to file additional comments in this proceeding merely because ALTS withdrew its Request. Since the record is relatively recent and there is no decisional changed circumstance that would properly impact an FCC decision in this area,^{15/} additional comments would be unnecessarily repetitive with the existing record and would delay Commission guidance on the important issue of reciprocal compensation. This is an extremely volatile issue for the communications industry with significant financial consequences. Delay will only prolong market confusion and the need for costly litigation. It is essential that the FCC act in a timely fashion and not allow gamesmanship on the part of one company unnecessarily to delay FCC resolution of this important issue.

* * *

Please let us know if we can provide any additional information or otherwise be of assistance.

^{15/} The extension of time for the reply comments in this proceeding was granted to allow all parties to take into account the implications, if any, of the Eighth Circuit Opinion. Thus, such implications already have been addressed in the record and do not constitute changed circumstances that warrant additional comments.

UCP

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Equity Research
Telecommunications Services
Wednesday, July 01, 1998

**Telecommunications
Services**
Long-term Rating: N/A
Short-term Rating: N/A
Risk: Above Average

CLEC INDUSTRY UPDATE

Company	Ticker	Price	Market Value	S-T/L-T Rating	Price Target
Electric Lightwave, Inc.	ELIX	\$11 1/16	\$574.483	Accumulate/Buy	N/A
e.spire Communications, Inc.	ESPI	\$22 9/16	\$1,311.650	Accumulate/Buy	N/A
GST Telecommunications, Inc.	GSTX	\$14 7/16	\$648.361	Accumulate/Buy	N/A
Intermedia Communications, Inc.	ICIX	\$41 15/16	\$2,639.025	Accumulate/Buy	\$50
ICG Communications, Inc.	ICGX	\$36 9/16	\$1,563.235	Buy/Buy	\$40
McLeodUSA, Inc.	MCLD	\$38 7/8	\$2,453.052	Buy/Buy	\$48
NEXTLINK Communications, Inc.	NXLK	\$37 7/8	\$2,294.000	Buy/Buy	\$40
Teleport Communications, Inc.	TCGI	\$54 1/4	\$9,287.250	Neutral/Accumulate	N/A
USN Communications, Inc.	USNC	\$8 7/8	\$158.125	Buy/Buy	\$23

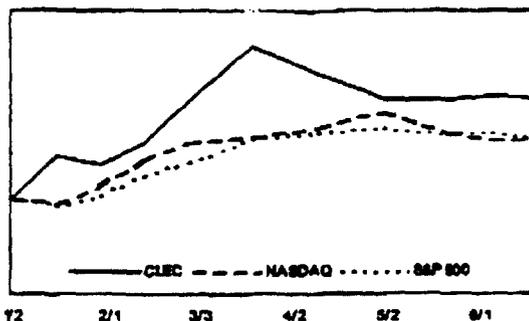
*Market Value in (000s)

SUMMARY OPINION

- We remain bullish on the Competitive Local Exchange Carrier (CLEC) Industry for both short- and long-term investment returns.
- Strong revenue growth, increased access line penetration and declining EBITDA losses are expected for 2Q98.
- We reiterate our short-term Buy ratings on shares of Intermedia Communications, Inc., ICG Communications, McLeodUSA, NEXTLINK Communications and USN Communications.

PRICE COMPARISON

- CLEC Index vs. NASDAQ vs. S&P 500 YTD Price Performance.



INDUSTRY HIGHLIGHTS

- Over 1.6 million installed access lines as of March 31, 1998, expected to exceed 2 million by June 30, 1998.
- 149 operational voice switches, connections to over 37,000 buildings, collocated in over 516 ILEC central offices, and access to over 1.1 fiber miles.
- Revenue in 1998 is estimated to exceed \$3.6 billion.

MARKET PERFORMANCE

- As of June 30, 1998, the year-to-date (YTD) return on our CLEC Index was 24% (YTD return S&P 500 is 16% and return on NASDAQ is 20%).
- Our CLEC Stock Index is worth over \$30 billion with ITC/Deltacom (up 155% YTD) and Metromedia Fiber Network (up 191% YTD) leading the group in price appreciation for 1998.
- During 2Q98, US LEC Corporation, Hyperion Telecommunications, and MGC Communications all raised initial public equity.

More Information Available Upon Request

ACCESS LINE STATISTICS

Our Access Line Statistics chart breaks down access lines into three different categories: on-net, hybrid and resale. In addition, we have restated access lines in order to reflect the different multipliers used by CLECs to report access lines. Access lines remain a key CLEC metric for predicting future revenue growth and gains in market penetration. On-net and hybrid access lines also provide indicators of network utilization and return on invested capital, while resold access lines provide potential network utilization once the lines are converted to CLEC network facilities. At the end of 1Q98, CLECs had installed over 1.6 million access lines (excluding MCLD acquired ILEC lines), resulting in a 2% penetration of the installed business access lines in the U.S. From 4Q97 to 1Q98, installed access lines increased by 445,540. For 2Q98, we expect this value to increase at similar levels to over 2 million installed access lines.

Definitions:

On-net Access Lines: Access lines connected to CLEC fiber and switches.

Hybrid Access Lines: Access lines connected to CLEC switches but transport facilities leased from other carriers.

Resale Access Lines: Total service resale access lines (TSR), lines that do not touch the CLEC network at any point.

THE TRUTH ABOUT RESALE...

...Almost every CLEC is doing it. On a reported basis, of the 1.6 million installed CLEC access lines, 50% are total service resale (TSR) lines. Of the CLECs in our chart, only Teleport Communications Group has no TSR access lines. Even though most CLECs are not discussing resale as a part of their market entry strategies, we think it is an important part of their business model and deserves some attention. First, we think it is important to take away the negative stigmatism surrounding resale. CLECs are reselling access lines for a number of different reasons. Many CLECs are pre-selling in markets before their facilities are operational. Pre-selling is a way to gain customers and start building up a sales force in a market while the CLEC installs its switches and/or fiber. In addition, very few CLECs are generating positive EBITDA (Earnings Before Interest Tax Depreciation and Amortization), so emphasis must remain on revenue, access line and network growth. The operating losses are driving many CLECs to resell in order to produce revenue and access line growth. A window of opportunity exists for CLECs to sell integrated data and voice services to commercial users before most of the larger competitors are able to offer the same services. Given a finite window of opportunity, we think it is important for CLECs to gain market share by selling integrated services to end users, through resale, hybrid and on-net facilities.

For the rest of 1998 we estimate that growth in hybrid and TSR lines will exceed on-net access line growth. As we approach the end of 1998, we expect increased automated provisioning will increase hybrid and on-net access line growth. Although many CLECs plan to convert the TSR lines to hybrid and/or on-net, the timing is often uncertain and the economics may not always justify converting customers due to their location from a Central Office or a CLEC switch. Although the CLECs have stated they plan to spend in excess of \$3.6 billion on capital expansions including switch installation, fiber deployment and collocating facilities in ILEC central offices the growth of TSR implies that resale is still the fastest method of market entry versus hybrid or on-net. Resale allows faster market penetration, revenue growth and access to customers, which are key factors to generating positive financial fundamentals.

CREATING VALUE

The CLECs have created tremendous value for investors over the past 12 months. Clearly the steady price appreciation has created significant public market value. At the beginning of 1997, nine public CLECs were worth about \$10 billion, today 18 public CLECs are worth over \$30 billion. In 18 months the CLECs have created a new public sub-sector of telecommunications services companies. Our chart of access lines

and network utilization for the quarter ending June 30, 1998 also supports the value they have created for businesses. The CLECs have installed over 149 voice switches, connected 37,000 buildings, built 21,000 fiber route miles and built over 1 million fiber miles. CLECs have also invested significant capital resources in expanding their high-speed data capabilities. CLEC network infrastructure will play a significant role in providing end-users with both higher quality voice and data services. By penetrating the business market, CLECs are filling a demand in the market place by providing high quality services, packaged data and voice offerings and better customer service. In addition, CLECs are amassing some of the most attractive small-to medium-sized business customers. Most importantly we feel CLECs are creating value by owning their customers. The value of a large base of low-churn multi-service customers is ultimately the most important asset of a CLEC. The financial returns gained from connecting customers to CLEC networks clearly provides the highest operating margins and greatest quality control of network services, but it also produces the slowest revenue and access line growth. A strategy that can balance the talents of management, efficiently deploy resources and generate market share gains will create significant value to investors regardless of the initial market entry strategy. We are moving away from focusing on the market entry strategy and focusing more on execution of the chosen business model. Over the past 12-months, CLEC business models have also evolved with increased emphasis on data and other enhanced services.

VALUATION METRICS

In our CLEC Standard Ratios chart we have compiled a number of metrics including: Total Enterprise Value (TEV)/1998E Revenue; TEV/Gross PPE; TEV/Access Line; Debt to Capital; 1998E Revenue/Employee; 1998E Revenue/Gross PPE; Avg. Monthly Revenue/Access Line; and Avg. Access Line/Customer. As of June 29, 1998, CLECs were valued at about 7.6x 1998E revenue, 4.3x Gross PPE and \$16,470 per access line. These valuation parameters are significantly lower than the average values for 4Q97. The factors driving down these valuation parameters are both the increased number of public CLECs and internal growth generated and estimated for 1998 versus 1997. As the CLECs evolve from start up companies to operational companies, we feel our valuation metrics will decline further. The rapid growth in revenue, network deployment and access line penetration is likely to outpace CLEC price appreciation.

Ratio	4Q97	1Q98	% Change
TEV/1998E Revenue	13.5x	7.6x	-44%
TEV/Gross PPE	5.1x	4.3x	-16%
TEV/Access Line	\$24,206	\$16,470	-32%

DIFFERENTIATING CLECS

Even though our CLEC Index has out-performed both the S&P 500 and the NASDAQ Composite, some CLECs have under-performed in 1998 relative to our CLEC Index and the broader market indices. In the table below, three of the CLECs (* next to the ticker) raised initial public equity in 1998. US LEC Corporation (ticker: CLEC) is the only CLEC that has issued initial public equity in 1998 that has out-performed our CLEC Index and the broader market indices with a YTD return of 39%.

Ticker	YTD Change
ELIX	-26%
*HYPT	-2%
*MGCX	-10%
TCGI	-2%
*USNC	-45%

* IPO in 1998

As the public CLEC sector grows, we expect investors to continue differentiating their business strategies, management teams and operating performance. Although we believe it will become increasingly important to differentiate the different CLECs, we believe that a number of market entry strategies will be successful. With 2Q98 results on the horizon, we expect greater differentiation between the CLECs in terms of operating performance and price appreciation. We remain bullish on shares of Intermedia Communications, Inc., ICG Communications, Inc., McLeodUSA, Inc., NEXTLINK Communications, Inc. and USN Communications, Inc.

A CLEC WITH A DIFFERENT MARKET ENTRY STRATEGY

We reiterate our Buy rating on shares of USN Communications, Inc. with a 12-month price target of \$23 per share. We initiated coverage on USN Communications in April 1998 and have not fundamentally changed our view on the positive upside for the shares. Since losing 45% of its market value from its IPO price of \$16 per share in February 1998, USN is significantly undervalued relative to its peers. USN has created significant value by hiring and training over 500 sales people and installing over 275,00 (2Q98E) resold access lines. Its total enterprise value to 1998E revenue is 1.2x. This value is significantly lower than any other CLEC. Its TEV per access line is \$1,165, also significantly less than industry averages.

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Equity Research
Telecommunications Services
Wednesday, July 01, 1998

Our CLEC index includes the following 18 Competitive Local Exchange Carriers:

Advanced Radio Telecom (ticker: ARTT)
US LEC Corporation (ticker: CLEC)
Electric Lightwave, Inc. (ticker: ELIX)
e.spire Communications, Inc. (ticker: ESP1)
GST Telecommunications, Inc. (ticker: GSTX)
Hyperion Telecommunications, Inc. (ticker: HYPT)
Intermedia Communications, Inc. (ticker: ICIX)
ICG Communications, Inc. (ticker: ICGX)
ITC^Deltacom, Inc. (ticker: ITCD)
McLeodUSA, Inc. (ticker: MCLD)
Metromedia Fiber Network, Inc. (ticker: MFNX)
MGC Communications, Inc. (ticker: MGCX)
NEXTLINK Communications, Inc. (ticker: NXLK)
Teleport Communications Group, Inc. (ticker: TCGI)
Teligent (ticker: TGNT)
RCN Communications, Inc. (RCNC)
USN Communications, Inc. (ticker: USNC)
Winstar Communications, Inc. (ticker: WCII)

*Our CLEC Index was created using market capitalization weightings for the 18 stocks listed above.

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Competitive Local Exchange Carrier (CLEC): Access Line Statistics

Values taken at March 30, 1998 unless otherwise noted

Ticker	CLEC	ELIX	ESPI	GBTX	ICIX	ICGX	MCLD*	MGCX	NKLR	TCGP**	USNC	WCF**	TOTAL
Reported Access Lines	75,536	41,270	57,633	44,646	220,587	186,156	313,900	20,924	72,634	325,874	225,962	118,000	1,701,522
On-net	N/A	26,828	9,331	15,838	-	54,909	-	N/A	13,405	293,287	-	6,525	420,220
Hybrid	N/A	14,445	9,331	23,908	64,058	44,110	99,200	N/A	53,618	32,587	-	6,525	347,782
Resold	N/A	1,201	38,971	5,900	156,529	87,137	214,700	N/A	5,811	-	225,962	72,500	807,811
*Restated Access Lines	12,589	29,587	57,633	30,000	182,152	186,156	313,900	N/A	72,634	325,874	225,962	118,000	1,552,667
On-Net	N/A	18,438	9,331	10,000	-	54,909	-	N/A	13,405	293,287	-	6,525	405,894
Hybrid	N/A	9,826	9,331	15,000	25,623	44,110	99,200	N/A	53,618	32,587	-	6,525	285,923
Resold	N/A	1,201	38,971	5,000	156,529	87,137	214,700	N/A	5,811	-	225,962	72,500	807,811
<i>percent difference</i>													
Reported vs Restated	-83%	-28%	0%	-33%	-17%	0%	0%	N/A	0%	0%	0%	0%	-8%
On-Net	N/A	-31%	0%	-37%	N/A	0%	N/A	N/A	0%	0%	N/A	0%	-3%
Hybrid	N/A	-31%	0%	-37%	-80%	0%	0%	N/A	0%	0%	N/A	0%	-15%
Resold	N/A	0%	0%	0%	0%	0%	0%	N/A	0%	N/A	0%	0%	0%
<i>percent total</i>													
Reported Access Lines	N/A	65%	18%	38%	0%	29%	0%	N/A	18%	90%	0%	8%	25%
On-net	N/A	35%	18%	53%	29%	24%	32%	N/A	74%	10%	0%	6%	20%
Hybrid	N/A	3%	68%	11%	71%	47%	68%	N/A	8%	0%	100%	63%	47%
*Restated Access Lines	N/A	62%	18%	33%	0%	29%	0%	N/A	18%	90%	0%	8%	28%
On-Net	N/A	34%	18%	50%	14%	24%	32%	N/A	74%	10%	0%	6%	19%
Hybrid	N/A	4%	68%	17%	86%	47%	68%	N/A	8%	0%	100%	63%	52%

Source: Company Reports and UCP estimates

*includes 99,700 CCI ILEC lines

**Restated to exclude long distance only access lines.

*Restated access lines reflect the removal of access line multipliers.

**data circuits - not switches.

UCP

Competitive Local Exchange Carrier (CLEC): Network Statistics

Values taken at March 30, 1998 unless otherwise noted

Ticker	CLEC	BLX	ESP	GSTX	ICX	ICGX	MCLD*	MGCX	NOLK	TCGI**	USNC	WCHI*	TOTAL
^A Restated Total Access Lines	12,589	29,667	57,833	30,000	182,152	188,158	313,900	N/A	72,834	325,874	225,962	118,000	1,552,667
^{**} Restated On-switch Access Lines	N/A	28,366	18,662	25,000	25,623	98,019	99,200	N/A	67,023	325,874	-	13,050	701,817
Voice Switches	4	5	17	14	19	20	N/A	3	14	38	N/A	19	149
Total Buildings Connected (TBC)	N/A	631	1,912	2,695	4,071	3,931	N/A	N/A	8,518	14,911	N/A	2,440	37,109
Route Miles	N/A	2,525	1,314	1,641	770	3,194	N/A	N/A	2,038	9,625	N/A	N/A	21,105
Fiber Miles	N/A	145,350	112,886	111,105	34,850	118,074	N/A	N/A	141,788	493,660	N/A	N/A	1,156,733
Central Offices Co-located	N/A	23	58	87	52	35	N/A	27	69	185	N/A	N/A	518
Markets Served	N/A	75	32	40	80	5	97	3	26	85	30	21	474
Data Switches	N/A	31	47	23	150	15	N/A	N/A	-	881	N/A	N/A	1,147
On-switch Access Line ratios													AVERAGE
On-switch Access Lines/Switch	N/A	5,873	1,098	1,788	1,349	4,951	N/A	N/A	4,787	8,578	N/A	687	4,710
On-switch Access Lines/TBC	N/A	45	10	8	6	25	N/A	N/A	10	22	N/A	5	19
On-switch Access Lines/Route Miles	N/A	11	14	15	33	31	N/A	N/A	33	34	N/A	N/A	33
On-switch Access Lines/Fiber Miles	N/A	0.20	0.17	0.23	0.74	0.84	N/A	N/A	0.47	0.66	N/A	N/A	0.61
On-switch Access Lines/CO	N/A	1,233	322	373	493	2,829	N/A	N/A	871	1,761	N/A	N/A	1,380
On-switch Access Lines/Markets	N/A	378	583	625	320	19,804	1,023	N/A	2,578	5,013	N/A	621	1,481

^ATotal restated access lines reflect the removal of access line multipliers from the reported installed lines.

^{**}Restated on-switch access lines reflect the removal of access line multipliers from hybrid and on-net access lines

UCP

Competitive Local Exchange Carrier (CLEC): Standard Ratios

(\$ in thousands except ratios & share prices)
Values taken as March 30, 1998 unless otherwise noted

Ratio	CLEC	ELR	EBP	GSIX	ER	ICR	WCLF	MGCR	NR/LK	TCGI	USRC	WCPI*	TOTAL
Recent Price	\$20.86	\$11.06	\$22.68	\$14.44	\$41.94	\$36.56	\$36.66	\$15.25	\$37.88	\$54.25	\$6.86	\$42.84	
Fully Diluted Shares Outstanding (000s)	26,426	49,683	65,965	44,716	83,400	44,664	62,648	16,828	62,000	174,000	22,000	37,279	869,444
Market Capitalization	\$551,732	\$549,640	\$1,489,011	\$645,667	\$2,659,838	\$1,633,023	\$2,335,428	\$253,666	\$2,348,250	\$9,439,500	\$195,350	\$1,609,646	\$23,800,512
Debt, Equivalents & Mkt. Securities	\$1,237	\$22,000	\$243,798	\$229,904	\$335,260	\$523,200	\$600,867	\$64,146	\$1,470,710	\$341,875	\$170,000	\$653,366	\$4,846,962
L-T Debt & Capital Leases	\$1,237	\$120,800	\$492,853	\$794,416	\$1,292,813	\$1,301,787	\$622,446	\$156,688	\$1,460,652	\$1,970,848	\$188,000	\$1,236,872	\$6,070,308
Shareholders' Equity	\$13,698	\$188,813	\$1,033,262	\$329,279	(\$184,863)	(\$348,064)	\$637,222	\$79,407	\$2,907	\$983,638	\$58,000	(\$148,652)	\$1,089,284
Total Enterprise Value (TEV)	\$465,784	\$477,648	\$1,738,188	\$1,299,961	\$4,614,391	\$2,411,819	\$2,787,271	\$316,188	\$2,367,962	\$10,168,811	\$293,288	\$1,864,296	\$20,823,656
1998E Revenue	\$55,000	\$97,015	\$141,653	\$168,724	\$748,200	\$572,277	\$609,830	\$165,000	\$130,543	\$743,574	\$223,433	\$180,800	\$3,865,348
Gross PPE	\$25,180	\$457,268	\$298,368	\$472,290	\$1,120,708	\$604,524	\$436,480	\$34,421	\$352,000	\$2,081,578	\$24,815	\$304,074	\$6,523,849
Employees	170	670	834	1,187	3,328	2,130	4,700	179	1,488	3,400	1,125	2,100	22,308
Direct Sales	30	86	220	253	520	196	181	19	308	760	500	400	3,488
Total access lines in service	76,536	41,270	67,633	44,846	220,587	188,156	313,800	20,824	73,834	325,874	225,862	18,000	1,701,522
On-net access lines	N/A	40,088	16,962	39,846	64,056	99,019	99,200	N/A	67,023	325,874	-	43,500	787,261
Resold access lines	N/A	1,201	39,971	6,000	166,828	97,137	214,700	N/A	5,811	-	225,862	72,500	907,811
Access line backlog	N/A	20,000	13,668	32,132	N/A	28,582	7,200	4,700	N/A	N/A	21,188	55,800	182,482
1998E Cap Ex	\$40,000	\$275,000	\$165,000	\$250,000	\$400,000	\$440,000	\$240,000	\$84,600	\$348,000	\$1,100,000	\$25,000	\$300,000	3,865,800

Ratio	CLEC	ELR	EBP	GSIX	ER	ICR	WCLF	MGCR	NR/LK	TCGI	USRC	WCPI*	AVERAGE
TEV/1998E Revenue	10.05	6.66	12.27	7.07	4.83	4.21	4.53	21.08	18.14	13.68	1.18	10.39	7.58
TEV/Gross PPE	21.97	1.42	6.82	2.64	3.23	2.97	6.29	9.18	6.73	4.86	10.57	8.63	4.30
TEV/Access Line	7.316	15.963	30.158	26.780	18.384	12.955	8.784	15.108	32.507	31.205	1.165	17.108	16.470
Debt to Capital	2.1%	3.7%	3.9%	3.9%	1.7%	1.7%	6.3%	9.6%	9.6%	8.2%	7.8%	11.4%	8.0%
1998E Revenue/Employee	\$323,829	\$144,798	\$189,847	\$145,438	\$224,752	\$182,836	\$129,368	\$83,799	\$97,087	\$218,508	\$198,807	\$80,806	\$165,656
1998E Revenue/Gross PPE	\$2.19	\$0.21	\$0.47	\$0.26	\$0.87	\$0.63	\$1.38	\$0.44	\$0.37	\$0.36	\$8.97	\$0.63	\$0.67
Revenue/Access Line	N/A	\$53	\$50	\$51	\$100	\$49	\$65	N/A	\$56	\$60	\$48	\$53	\$50
Avg. Access Line/Subscriber	351	34	6	16	17	10	6	N/A	11	N/A	9	20	13

Sources: Company Reports and UCP estimates
Price as of 6/30/98
*Includes 90,700 CCI IL EC lines
**access lines related to exclude long distance only access lines

UCP

Competitive Local Exchange Carrier (CLEC): Standard Ratios

(\$ in thousands except ratios & share price)
 Values taken at December 31, 1997 (unless otherwise noted)

Ticker	ELIX	ESPI	GSIX	KCIX	KCOX	MCLO	MXLK	TCGI	MCI	TOTAL
Avg 4Q97 Price	\$14.70	\$12.31	\$14.19	\$25.89	\$24.19	\$26.25	\$23.75	\$52.88	\$24.93	\$24.93
Fully Diluted Shares Outstanding (000s)	49,865	64,064	47,800	67,080	45,900	72,800	57,000	174,800	56,000	625,139
Market Capitalization	\$734,466	\$800,145	\$675,325	\$1,721,003	\$1,110,208	\$2,042,825	\$1,353,750	\$9,187,825	\$1,365,548	\$19,460,713
Cash, Equivalents & Mk. Securities	\$28,000	\$344,090	\$198,063	\$750,000	\$217,015	\$330,000	\$742,367	\$460,000	\$419,262	\$3,507,787
L-T Debt & Capital Leases	\$70,000	\$460,000	\$779,438	\$1,200,000	\$900,000	\$915,800	\$757,840	\$1,949,000	\$798,262	\$6,822,260
Shareholders Equity	\$213,000	\$965,212	\$97,654	(\$148,000)	(\$290,316)	\$590,000	\$69,460	\$1,031,000	(\$118,262)	\$1,167,463
Total Enterprise Value (TEV)	\$778,466	\$1,807,983	\$1,354,768	\$2,171,893	\$1,893,191	\$3,507,823	\$1,349,803	\$11,754,826	\$1,798,878	\$32,478,189
1997 Revenue	\$61,004	\$59,800	\$119,008	\$241,999	\$273,354	\$267,896	\$294,300	\$79,631	\$79,631	\$1,659,741
Gross PPE	404,000	215,383	433,878	\$46,815	740,000	265,500	263,000	1,006,730	324,468	4,421,665
Employees	673	803	1,100	2,056	2,218	4,500	1,327	3,058	1,479	17,316
Direct Sales	67	220	254	180	210	225	152	475	375	2,138
Total access lines in service	34,328	35,105	28,853	81,249	141,035	183,000	50,131	282,700	82,008	878,581
On-net access lines	33,182	8,272	27,899	51,082	68,348	-	45,131	254,430	41,000	525,152
Resold access lines	1,136	28,833	1,154	30,267	74,688	190,000	5,000	28,270	41,000	403,349
Access line pecking	N/A	8,476	20,171	N/A	37,435	N/A	5,813	N/A	38,000	187,895
1997 Cap Ex	\$127,000	\$130,000	\$214,500	\$270,000	\$270,000	\$160,000	\$147,000	\$501,000	\$227,000	\$2,036,500
1996E Cap Ex	\$275,000	\$165,000	\$245,000	\$400,000	\$440,000	\$190,000	\$340,000	\$1,100,000	\$309,000	\$3,455,000

Ticker	ELIX	ESPI	GSIX	KCIX	KCOX	MCLO	MXLK	TCGI	WCI	AVERAGE
TEV/1997 Revenue	12.74	13.88	10.66	8.76	6.19	10.93	23.78	19.78	21.81	19.64
TEV/Gross PPE	1.93	2.93	2.80	3.88	2.79	7.40	4.72	9.65	6.27	5.06
TEV/Access Line	22.678	21,990	43,821	26,888	12,005	16,169	27,309	34,441	21,378	24,208
Debt to Capital	25%	117%	101%	114%	186%	32%	32%	50%	118%	85%
1997 Revenue/Employee	\$108,604	\$73,474	\$108,189	\$120,573	\$123,188	\$58,530	\$43,380	\$181,588	\$63,841	\$98,970
1997 Revenue/Gross PPE	\$0.15	\$0.21	\$0.27	\$0.45	\$0.37	\$0.68	\$0.20	\$0.49	\$0.24	\$0.38
Revenue/Access Line	\$50	\$50	\$53	\$83	\$59	\$70	\$54	\$75	\$51	\$61
Avg. Access Line/Customer	28	7	15	17	19	6	9	N/A	14	14

Source: Company Reports and UCP estimates
 Avg. Price takes into the high and low for the 4Q97
 *MCLO CLEC access lines only
 CLECs included in our 1Q98 charts
 4Q97 US LEC access lines: 46,228
 4Q97 MGCLX access lines: 15,580
 4Q97 USAC access lines: 171,862