

**BEFORE THE WASHINGTON  
UTILITIES AND TRANSPORTATION COMMISSION**

**IN THE MATTER OF THE PRICING )  
PROCEEDING FOR INTERCONNECTION, )  
UNBUNDLED ELEMENTS, TRANSPORT ) Docket Nos. UT-  
960369; UT-960370; )  
AND TERMINATION, AND RESALE ) UT-960371  
[FOR U S WEST COMMUNICATIONS, INC.] )  
[FOR GTE NORTHWEST INCORPORATED] )**

**EXHIBIT No. \_\_\_\_\_**

**TESTIMONY OF  
JERROLD L. THOMPSON  
ON BEHALF OF  
U S WEST COMMUNICATIONS**

**DECEMBER 15, 1999**

1 **Q. PLEASE STATE YOUR NAME, POSITION, EMPLOYER, AND**  
2 **BUSINESS ADDRESS.**

3 A. My name is Jerrold L. Thompson. I am employed by U S WEST as Executive  
4 Director – Service Cost Information. My business address is 1801 California St.,  
5 Denver, CO.

6 **Q. PLEASE REVIEW YOUR EDUCATION, WORK EXPERIENCE AND**  
7 **PRESENT RESPONSIBILITIES.**

8 A. My accounting experience includes 25 years of work in education, public accounting  
9 and in private industry. I have been employed in telecommunications for over 20 of  
10 those years. The majority of my experience is in the area of cost accounting in  
11 telecommunications. I have experience in telephone cost accounting as it relates to  
12 independent telephone companies and with U S WEST. I supervised the  
13 development and filing of many financial reports and cost studies that supported  
14 U S WEST's submissions before the 14 state jurisdictions of U S WEST and the  
15 FCC, including the reports known as the Automated Report Management  
16 Information System (ARMIS). I have provided expert accounting testimony in many  
17 proceedings in the majority of U S WEST's serving territory over the last 16 years.  
18 I have Master degrees in Business Administration and Taxation. I am a Certified  
19 Public Accountant licensed in Colorado and New Mexico. I belong to the AICPA  
20 and state CPA societies in Arizona, New Mexico, and Colorado.

21 My organization provides information, including expert testimony, on the cost of service  
22 for all products and services that U S WEST offers, including its traditional retail  
23 services and the more contemporary wholesale services.

24 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?**

25 A. Yes. I provided testimony in Docket No. UT-990300 which pertained to the  
26 Arbitration of an Interconnection Agreement with AirTouch Paging. In addition, I  
27 have provided testimony in numerous proceedings in Arizona, Colorado, Idaho,  
28 Minnesota, Montana, Nebraska, New Mexico, North Dakota, Utah, and Wyoming.

29 **Q. COULD YOU SUMMARIZE YOUR TESTIMONY?**

30 A. My testimony first provides background for the Washington Utilities and  
31 Transportation Commission's (WUTC or Commission) decisions that require  
32 U S WEST to file its UNE deaveraging proposal. The Commission's most recent  
33 decisions have indicated that UNE or "wholesale" deaveraging proceed without  
34 Commission initiated retail price deaveraging, or universal service funding.  
35 Previously, the Commission's decisions agreed with the idea that these three issues  
36 be addressed concurrently with one another. My testimony proposes a method of

1 UNE deaveraging that provides a reasonable and practical basis for the geographic  
2 deaveraging of both wholesale and retail rates.

3 The second part of my testimony describes U S WEST's proposal for UNE deaveraging.  
4 Because of the strong connection of wholesale rates to retail rates, the geographic  
5 deaveraging proposal contains several advantages for both wholesale and retail rates.  
6 This method of deaveraging is easy to understand and communicate to customers.  
7 It is consistent for groups of customers within similar geographic areas. It can be  
8 easily assigned to various customers for billing purposes, and it helps prevent  
9 harmful rate arbitrage.

10 BACKGROUND

11 **Q. WHAT DID THE WUTC'S 17<sup>TH</sup> SUPPLEMENTAL ORDER STATE**  
12 **ABOUT GEOGRAPHIC DEAVERAGING?**

13 A. In its August, 1999 Order the WUTC provided a historical perspective of the legal  
14 decisions at the U.S. Court of Appeals for the Eighth Circuit and the U. S. Supreme  
15 Court, along with the FCC's Stay Order for geographic deaveraging. The WUTC  
16 further stated:

17 [Para. 479] In previous Orders, we have taken the position that we did not  
18 want to order deaveraging until a state universal fund program had been  
19 established. In Phase I of this proceeding, the Commission received  
20 information on the cost of providing service in different density zones.  
21 Since the Commission decided, pursuant to Staff's recommendation, not to  
22 deaverage at this time, no deaveraged pricing recommendations were  
23 requested of the parties in Phase II. 8<sup>th</sup> ORDER at ¶¶274, 496.

24 [Para. 480] Given the recent Supreme Court ruling and the FCC stay Order  
25 concerning deaveraging, and the fact that no deaveraged pricing  
26 recommendations were submitted in the instant pricing phase of this  
27 proceeding, the Commission has decided to initiate a Phase III proceeding  
28 in which interested parties may submit proposals for deaveraging the  
29 statewide loop prices we establish in the instant Order.

30 [Para. 481] In the Phase III proceeding, the Commission will ask the parties  
31 to make deaveraged pricing proposals that result in an average price for the  
32 loop that is equal to the statewide loop prices we establish in the instant  
33 Order. The parties should not take this as an opportunity to re-argue the  
34 merits of the statewide loop prices we establish in the instant order. The  
35 Commission makes clear to the parties that in Phase III the statewide  
36 average loop price will not be at issue – the Commission will consider only  
37 the relative prices in different geographic zones contained in the  
38 deaveraging price proposals put forth by the parties.

**1 IN YOUR VIEW, WHAT POINTS IS THE COMMISSION EMPHASIZING IN**  
**2 THIS PART OF THE ORDER?**

**3** A. First, the Commission previously decided that deaveraging and universal service  
**4** were tied together and therefore determined that it should decide the two issues at the  
**5** same time. Since universal service was key to the Commission's decision, and  
**6** universal service is directly associated with a consumer perspective, (i.e., rates higher  
**7** than affordable levels leading to cancellation of service), retail rate deaveraging was  
**8** also tied to the Commission's previous decision. Second, because of the FCC's  
**9** mandate, the Commission appears to be moving ahead with UNE geographic  
**10** deaveraging without explicit consideration of universal service issues. Finally, the  
**11** Commission wants the parties to use the cost information which already is in the  
**12** record.

**13 Q. DID THE WUTC FURTHER COMMENT ON ITS REQUEST FOR**  
**14 DEAVERAGED UNE PRICES?**

**15** Yes, the last observation I made is reinforced by one of the Commission's latest orders,  
**16** (November, 1999). In its 19<sup>th</sup> Supplemental Order the Commission stated:

**17** "As noted above, the Commission clearly contemplates in its 18<sup>th</sup> ORDER  
**18** that Phase III will proceed upon the cost models and the evidence already  
**19** of record. Doing so permits an accelerated schedule to implement  
**20** deaveraged prices in a more timely manner, allows the Commission to  
**21** come to closure of this proceeding, and does not foreclose the development  
**22** of new prices in a future proceeding. The scope of Phase III deaveraging  
**23** will include consideration of UNEs and interconnection."

**24 IN ITS 17<sup>TH</sup> SUPPLEMENTAL ORDER THE COMMISSION REFERENCED**  
**25 ITS 8<sup>TH</sup> SUPPLEMENTAL ORDER, AND ITS RELIANCE UPON STAFF'S**  
**26 RECOMMENDATION. WHAT DID THE 8<sup>TH</sup> SUPPLEMENTAL ORDER SAY**  
**27 ABOUT DEAVERAGING UNES?**

**28** In its April 1998 Order the Commission stated:

**29** [Para. 271] Commission Staff contends that questions of how and the  
**30** extent to which network element costs are calculated on a deaveraged basis  
**31** should be addressed in the context of universal service reform, deaveraged  
**32** retail prices, and the extent of competitive activity in Washington State.  
**33** Staff is concerned that if loop costs were deaveraged without a universal  
**34** service fund mechanism in place to accommodate the cost shift, subscribers  
**35** might be forced to leave the network.

**36** The Commission concluded:

1 [Para. 274] We choose not to deaverage UNE and interconnection rates at  
2 this time. We agree with Commission Staff and the other parties who argue  
3 that it is more appropriate to consider this issue in the context of universal  
4 service reform, deaveraged retail prices, and the extent of competitive  
5 activity in Washington State.

6 **DOES THIS ORDER CONFIRM YOUR EARLIER OBSERVATIONS ABOUT**  
7 **THE CONNECTION BETWEEN DEAVERAGE UNE RATES, RETAIL**  
8 **DEAVERAGING, AND UNIVERSAL SERVICE?**

9 A. Yes. It is clear from this part of the order that the Commission believes there is a  
10 link between the three issues.

11 **Q. DOES PHASE III OF THIS CASE, AS ESTABLISHED BY THE**  
12 **COMMISSION, CONSIDER UNIVERSAL SERVICE REFORM?**

13 A. No. It is my understanding that the Commission has determined that it does not have  
14 the authority to establish a Universal Service Fund and would need legislation  
15 passed to enable such authority. Apparently, because of this inability, the  
16 Commission has not further addressed issues of universal service.

17 **Q. DOES THIS PHASE OF THE CASE, AS ESTABLISHED BY THE**  
18 **COMMISSION, CONSIDER THE DEAVERAGING OF RETAIL PRICES?**

19 A. No. As indicated above, the Commission's directive in this case did not address  
20 retail rate deaveraging.

21 **Q. HAS THE COMMISSION DESCRIBED REASONS WHY THERE ARE**  
22 **PUBLIC POLICY CONCERNS RELATED TO THE DEAVERAGING OF**  
23 **UNE RATES, THE DEAVERAGING OF RETAIL RATES, AND**  
24 **ESTABLISHING A UNIVERSAL SERVICE FUND?**

25 A. Yes, in the Commission's 10<sup>th</sup> Supplemental Order in Docket No. UT-980311(a), (In  
26 the Matter of Determining Costs for Universal Service), the Commission clearly  
27 addressed "the diminished ability of incumbents to average rates" as a factor  
28 affecting ILECs "ability to maintain low prices for high-cost services". Concerning  
29 the affect of deaveraging UNEs, the Commission wrote:

30 [Para. 5] Another element in the overall picture is the pricing of unbundled  
31 wholesale network elements, or UNEs. Incumbent local exchange  
32 companies (ILECs) are required under terms of the Telecom Act to  
33 unbundle their network and to provide the retail services on a wholesale  
34 basis to competitive companies (CLECs). The averaging of prices for those  
35 wholesale elements has offered the same kind of benefit for support of  
36 high-cost areas average cost pricing for retail telecommunications service

1 and it now presents an analogous vulnerability to competition and loss of  
2 implicit support.

3 [Para. 6] The quandary that is set upon us by all of the forces described  
4 above, driven by the competition that is mandated in both state and federal  
5 legislation, is the erosion of two of the main sources of implicit support for  
6 high cost service, averaged rates and access charges. (Footnote omitted).

7 [Para. 29] At the same time, the ILECs ability to compete with entrants in  
8 low cost areas should not be impeded by implicit support mechanisms. The  
9 record in this proceeding shows that, currently, high-cost areas receive  
10 implicit support from low-cost areas. The federal Telecom Act requires  
11 that support provided to high-cost customers be provided explicitly and in  
12 a competitively and technologically neutral manner. If competitive and  
13 technological neutrality is not established, the most efficient supplier will  
14 not serve customers.

15 [Para. 30] U S WEST, argues that the State USF law “requires that implicit  
16 sources of support for basic service in high cost areas be minimized, and  
17 explicit sources which are sufficient, specific, and technologically and  
18 competitively neutral, be maximized.” The Company points out that  
19 aggregating cost across an ILEC’s entire serving area perpetuates the  
20 implicit sources of support that exist in the current rate structures.

21 [Para. 31] Other parties note that the same logic also applies to wholesale  
22 rates. If unbundled network element rates continue to be averaged, the  
23 implicit support currently provided by low-cost areas will be perpetuated.

24 [Para. 32] The Commission agrees with this logic, and determines that if  
25 the Legislature authorizes the creation of an explicit universal service fund,  
26 the Commission will initiate a proceeding at the time of implementation in  
27 which it will consider simultaneously de-averaging the prices of retail  
28 services and unbundled network elements, and further reducing access  
29 charges.

30 **FROM THE COMMISSION’S ORDERS QUOTED ABOVE, IS IT CLEAR TO**  
31 **YOU THAT THE DEAVERAGING OF UNE RATES IS INEXTRICABLY**  
32 **LINKED WITH THE DEAVERAGING OF RETAIL RATES AND**  
33 **UNIVERSAL SERVICE FUNDING?**

34 Yes, it seems very clear that the WUTC believed that all three of these are strongly  
35 linked to each other. It is my view that the Commission simply stated a reality in the  
36 telecommunications industry today, that deaveraging of wholesale rates drives the  
37 deaveraging of retail rates which raises issues of universal service.

**1 IN YOUR VIEW, HAS THE COMMISSION RECENTLY INDICATED A  
2 CHANGE IN THEIR POSITION REGARDING THESE THREE ISSUES?**

3 As I read the Commission's 20<sup>th</sup> Supplemental Order, affirming the schedule for this  
4 proceeding, it did not express so much a change in position but rather a desire to  
5 "conclude the docket and move on", in its words. The Commission noted that some  
6 events have occurred differently than had been envisioned by the Commission earlier in  
7 this proceeding. However, the Commission did not indicate that coordination and  
8 linking of the wholesale and retail deaveraging was inconsistent with their current  
9 intentions.

**10 DOES U S WEST BELIEVE THAT THERE IS A STRONG LINKAGE  
11 BETWEEN WHOLESALE AND RETAIL DEAVERAGING?**

12 Yes. Deaveraging of wholesale rates without the deaveraging of retail rates is not  
13 consistent with the intent of Congress when it drafted the Telecommunications Act of  
14 1996. The intent of the Act is to provide competitive choices to all consumers,  
15 regardless of where they live in the state. Today, the majority of competition in  
16 Washington is in the urban business areas, not the rural high-cost areas of the state. This  
17 is not surprising because of the economic opportunity that the current averaged rate  
18 structure provides. U S WEST's retail rates are averaged statewide, urban low-cost areas  
19 have prices above their costs (these areas include recovery of costs for high-cost areas),  
20 and rural high-cost areas are priced below the cost of service in those areas (they receive  
21 the benefits from low-cost areas). This creates margin opportunities for the CLECs in  
22 urban business areas because U S WEST's urban rates, for example, are higher than the  
23 costs to provide the service. If the UNE prices are deaveraged, the UNE rates will be  
24 further reduced in low-cost urban areas, and increased in high-cost rural areas. This will  
25 mean that the margin opportunities will increase and further encourage competition in  
26 urban areas, with decreased incentives for competition in rural areas. Deaveraging  
27 wholesale rates without also deaveraging retail rates creates very unequal competitive  
28 choices for consumers in Washington.

**29 AT SOME POINT IN THE FUTURE IS U S WEST LIKELY TO FILE A  
30 PROPOSAL FOR THE DEAVERAGING OF ITS RETAIL RATES?**

31 Yes. Because of the reasons I have just explained, U S WEST will need to file a  
32 proposal for deaveraged retail rates sometime in the future. I would encourage the  
33 Commission to consider delaying the implementation of its decision to deaverage  
34 wholesale rates until such time as retail rates can be implemented to avoid further  
35 compounding the unequal balance of competitive choices in Washington.

36

1 DEAVERAGED COST INFORMATION

2 **Q. THE COMMISSION WAS VERY CLEAR IN THE WORDS QUOTED**  
3 **ABOVE THAT NEW COST INFORMATION WAS NOT APPROPRIATE**  
4 **FOR THIS PHASE OF THE CASE. ARE YOU PROVIDING NEW COST**  
5 **INFORMATION?**

6 A. No. In response to the Commission's Order, I am providing a proposal to  
7 geographically deaverage the unbundled loop price determined by the Commission.  
8 The information that is provided is the same as information provided earlier by  
9 U S WEST in this proceeding. The only difference is that the information has been  
10 deaveraged by groups of wire centers as follows: (1) Large communities, (2) Medium  
11 sized communities, and (3) all other communities.

12 **Q. WHAT COST STUDY INFORMATION ARE YOU PROVIDING?**

13 A. I am providing information derived from the U S WEST Regional Loop Cost  
14 Analysis Program (RLCAP), version 4.0, model run that forms the basis of the  
15 deaveraged costs utilizes the inputs and assumptions ordered by the Commission in  
16 Phase II.

17 **Q. IS U S WEST PROPOSING ANY GEOGRAPHIC DEAVERAGING OTHER**  
18 **THAN THE LOOP?**

19 A. No. Loop costs form a significant part of the total cost of unbundled network  
20 elements. Loop costs vary geographically due to the impact of distance from the  
21 serving central office and density of the serving area. Other UNEs costs, such as  
22 transport costs, that vary due to distance are already inherently geographically  
23 deaveraged with distance based rates. Switching costs do not vary significantly by  
24 geography.<sup>1</sup> Therefore, the only significant UNE left for geographic deaveraging is  
25 the loop.

26 **Q. HAVE OTHER STATE COMMISSIONS LIMITED DEAVERAGING TO**  
27 **THESE ELEMENTS?**

28 A. Yes. For example, the New Mexico Commission limited its geographic deaveraging  
29 to unbundled loop rates. In its Findings of Fact, Conclusions of Law and Order- 96-  
30 310-TC, the New Mexico Commission found that unbundled loop rates of \$17.75,  
31 \$20.30, and \$26.23 for 3 zones represented the appropriate level of geographic  
32 deaveraging for loops in New Mexico. Like the WUTC, the New Mexico  
33 Commission also had distance deaveraged transport rates.

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<sup>1</sup> Additionally, U S WEST is not aware of a method that could be used to geographically deaverage the switching cost ordered by the WUTC.



1 **Q. IS THE DEAVERAGING ORDERED BY THE NEW MEXICO**  
2 **COMMISSION CONSISTENT WITH THE COST INFORMATION YOU**  
3 **ARE PROVIDING IN THIS PROCEEDING?**

4 A. Yes. Geographic deaveraging of the loop cost as ordered by the New Mexico  
5 Commission is based on the same approach I provide in this testimony.

6 **Q. WHAT COMMUNITIES ARE INCLUDED IN THE THREE**  
7 **GEOGRAPHIC ZONES?**

8 A. Zone 1 includes the communities of Seattle, Tacoma, Vancouver, and Spokane.  
9 Zone 2 includes the communities of Bremerton, Bellingham, Yakima, and Olympia.  
10 Zone 3 includes all other communities served by U S WEST.

11 **Q. WHY WERE THESE COMMUNITIES SELECTED IN THESE**  
12 **GROUPINGS?**

13 A. The groupings of communities roughly equates to the Metropolitan Statistical Areas  
14 (MSAs) used by the Bureau of the Census. Some additional modifications were  
15 suggested by U S WEST's public policy staff in Washington to better match  
16 perceptions of communities of interest in Washington.

17 The MSA approach has been utilized numerous times by the FCC in recent decisions  
18 related to UNEs and interconnection. For example, MSAs were used to identify the  
19 first areas to receive permanent number portability. Recently<sup>2</sup>, the FCC used MSAs  
20 to identify areas for potential removal of the requirement to provide unbundled local  
21 switching. The MSA approach is understandable from a consumer perspective and  
22 is similar to traditional rate setting designs.

23 **ARE THERE ADVANTAGES OF MSA DEAVERAGING OVER OTHER**  
24 **TYPES OF DEAVERAGING?**

25 A. Yes. Because retail rates will be drawn toward the level of wholesale rate  
26 deaveraging, retail customer perspectives are essential in the selection of a  
27 deaveraging method. The first advantage of MSA deaveraging is that it minimizes  
28 the discrepancy in rates between customers within similar communities. Neighbors  
29 living across the street from one another have the same rates. Friends living in  
30 similar communities have the same rates. The MSA deaveraging method is  
31 understandable to consumers. This method provides for equitable rates based on the  
32 cost characteristics of the community where the customer lives. The second  
33 advantage is that this deaveraging methodology is fairly easy to administer.

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1 <sup>2</sup> Third Report and Order and Fourth Further Notice of Proposed Rulemaking, CC Docket No. 96-98,  
2 Released November 5, 1999.

1 Customer locations are not difficult or costly to identify. Next, there will not be large  
2 costs to implement billing and other changes. This deaveraging method is generally  
3 compatible with existing ILEC systems used to provision service, bill customers, and  
4 manage the network. Moreover, given that the deaveraging is intended to occur in  
5 a short timeframe, this methodology would be relatively simple to implement.

6 **Q. HOW WERE THE COSTS FOR THESE ZONES DETERMINED?**

7 A. The statewide average data was segregated into separate files according to the three  
8 zones. Three separate runs of RLCAP were made, one for each zone. I have  
9 attached summaries of this cost information in a confidential exhibit to this testimony  
10 (Exhibit JLT-1). Information of the investment cost for the unbundled loop was  
11 determined for each zone separately by RLCAP. The loop (feeder, distribution, and  
12 drop) investment was summed to achieve three levels of investment cost, one for  
13 each zone. Each zone investment was then compared to the statewide investment  
14 data that was used in the Commission ordered rate. A percentage was determined by  
15 dividing each zone investment by the statewide average investment. These  
16 percentages were multiplied by the statewide average unbundled loop price of \$18.16  
17 to determine the deaveraged price for each zone.

18 **Q. WHAT WERE THE RESULTS OF THESE CALCULATIONS?**

19 A. The investments and percentages of the statewide average for the three zones are:

20	Zone 1	\$ 740.15	92.2%
21	Zone 2	\$ 775.79	96.6%
22	Zone 3	\$1,230.36	153.2%
23	Statewide Average	\$ 803.08	

24 **Q. WHAT ARE THE RATES DETERMINED BY THIS INFORMATION?**

25 A. The deaveraged unbundled loop cost/rates are:

26	Zone 1	\$16.74
27	Zone 2	\$17.54
28	Zone 3	\$27.82
29	Statewide Average	\$18.16

**1 Q. WHAT IS YOUR RECOMMENDATION?**

2 A. I recommend that the Commission delay the implementation of the deaveraging of  
3 wholesale rates until retail rates can be deaveraged. Further, the deaveraging  
4 proposal I recommend allows for a simple and understandable level of unbundled  
5 loop prices. It meets the FCC's requirement of three geographic areas and is based  
6 on the statewide average cost determined by the Commission. I urge the  
7 Commission to accept these proposals.

**8 Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

9 A. Yes.