BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Pricing Proceeding for Interconnection, Unbundled Elements, Transport and Termination, and Resale	)	**DOCKET NO. UT-960369**
In the Matter of the Pricing Proceeding for Interconnection, Unbundled Elements, Transport and Termination, and Resale for U S WEST COMMUNICATIONS, INC.	)	**DOCKET NO. UT-960370**
In the Matter of the Pricing Proceeding for Interconnection, Unbundled Elements, Transport and Termination, and Resale for GTE NORTHWEST INCORPORATED	)	**DOCKET NO. UT-960371**

RESPONSIVE DIRECT TESTIMONY OF

TERRY R. DYE

ON BEHALF OF

GTE NORTHWEST INCORPORATED

SUBJECT: PRICING POLICY

JANUARY 18, 2000

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND TITLE.

A. My name is Terry R. Dye. My business address is 600 Hidden Ridge Drive, Irving, Texas, 75015. I am employed by GTE Service Corporation as Manager - Pricing Policy and am representing GTE Northwest Incorporated ("GTE") in this proceeding.

Q. ARE YOU THE SAME TERRY DYE WHO PREVIOUSLY FILED DIRECT TESTIMONY IN THIS DOCKET?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR RESPONSIVE DIRECT TESTIMONY?

A. My testimony responds to the pricing proposals made in the direct testimonies of Commission Staff witness Thomas L. Spinks and AT&T witness Douglas Denney.

Q. ARE OTHER GTE WITNESSES ALSO SUBMITTING RESPONSIVE DIRECT TESTIMONY?

A. Yes. Rodney Langley addresses the significant administrative and system costs that would result from Mr. Spinks' deaveraging proposal. David G. Tucek describes several errors and deficiencies contained in the

deaveraging calculations of Mr. Denney and Mr. Spinks. He also describes the results of correcting those errors and deficiencies.

II. SUMMARY

Q. PLEASE SUMMARIZE YOUR RESPONSIVE DIRECT TESTIMONY.

A. My responsive testimony makes three principal points. First, I reiterate GTE's fundamental position that fair and efficient competition will not exist and will not be promoted if UNE rates are deaveraged in the absence of retail rate deaveraging and an explicit Universal Service Fund. To the contrary, deaveraging UNEs will only exacerbate rate arbitrage. GTE encourages the Commission to seek a waiver of the FCC's deaveraging rule until such time as retail rate deaveraging and Universal Service can be addressed.

Second, should the Commission nevertheless proceed to deaverage rates at this time in this case, it should reject the Staff and AT&T deaveraging proposals. They are based on erroneous and deficient methodologies and would exacerbate arbitrage opportunities. They would negatively impact the development of fair and efficient competition throughout Washington, and would instead harm consumers.

Assuming the Commission proceeds to deaverage UNE rates at this time,

it should deaverage only UNE loop rates. It should reject Staff's recommendation to also deaverage unbundled switching element rates. In addition, the Commission should not use AT&T's combined zone/combined rate approach. While the FCC's rules would allow using zone designations for multiple ILECs, the individual ILEC's deaveraged UNE rates must be company-specific, based on the company's costs for each zone applicable to it.

Third, GTE urges the Commission to adopt GTE's proposal set forth in my direct testimony. As noted there, GTE's proposal is based on COSTMOD results already of record, and produces loop rates for three density zones as follows:

	High Density	Medium Density	Low Density
2-Wire Unbundled Loop	$22.92	$22.49	$30.51

The Commission can, however adopt fewer than three zones for GTE and comply with the FCC's deaveraging rule (51.507(f)), because this rule requires only three zones per state, not three zones per ILEC.

III. DISCUSSION

A. UNE Rates Should Not be Deaveraged Until Retail Rates are

Deaveraged and an Explicit Universal Service Fund is Created

Q. WHAT SHOULD THE COMMISSION'S OBJECTIVE BE FOR DEAVERAGING?

A. The primary goal of deaveraging is the creation of UNE price sets that will facilitate the development of efficient competition.

AT&T witness Denney agrees:

> The purpose is to facilitate efficient competition by allowing the prices of unbundled network elements to more closely represent their underlying cost. (Denney Direct, page 5, lines 12-14)

So does MCI witness Cabe:

> ... since the goal of deaveraging is to promote the development of efficient competition, ... (Cabe Direct, page 9, lines 22-23)

As does Staff witness Spinks:

> Sending rational price signals to buyers promotes competition and efficient choice of technology. (Spinks Direct, page 7 & 8).

Q. WOULD THE DEAVERAGING OF UNE RATES WITHOUT DEAVERAGING RETAIL RATES AND ESTABLISHING AN EXPLICIT UNIVERSAL SERVICE FUND PROMOTE THE DEVELOPMENT OF EFFICIENT COMPETITION?

A. No. Deaveraging UNE rates in a vacuum would have the opposite effect -- it will further incent CLECs to target only urban, low-cost areas while

"redlining" rural areas by making them even more unattractive to serve. I explained this issue in detail in my direct testimony. In sum, UNE deaveraging, retail rate deaveraging, and universal service funding must be done at the same time.

Q. HAS THIS COMMISSION PREVIOUSLY RECOGNIZED THE NECESSITY TO IMPLEMENT A COMPETITIVELY NEUTRAL UNIVERSAL SERVICE SUPPORT MECHANISM TO ACHIEVE EFFICIENT COMPETITION?

A. Yes. In its report to the Washington State Legislature[1], the Commission stated: "The means to achieving fair competition is to replace the system of hidden subsidies to one of specific, predictable and sufficient supports for universal service."

Q. PLEASE EXPLAIN HOW DEAVERAGED UNE RATES ENHANCE THE CLEC'S ABILITY TO ARBITRAGE THE ILEC'S RETAIL RATES WHILE FURTHER STIFLING THE DEVELOPMENT OF A COMPETITIVE MARKETPLACE IN HIGH-COST AREAS?

A. In my direct testimony I presented a table (Table One) that computed the dollar amount (per-line per-month) that an inefficient CLEC would have as a "cushion" to compete with GTE in the provision of service to average

[1] Preserving and Advancing Universal Service In a Competitive Environment a Report to the Washington State Legislature, Prepared by the Washington Utilities and Transportation Commission, January, 1998.

residential and business customers. This cushion (or arbitrage) amount was computed as the difference between the prices the CLEC would pay to resell GTE's services and the amount the CLEC would pay GTE for the UNEs that would also replicate the services (based on ordered statewide average UNE rates). The ordered UNE rates[2] provide arbitrage capabilities to the CLEC that elects to use UNEs since they have been designed to be long-run cost-based rates while the resale rates are not cost-based[3] and continue to contain Universal Service support flows. To summarize the table in my direct testimony, the existing arbitrage amounts, based on a statewide average UNE loop rate of $23.94, are as follows:

Average GTE Residential Customer = $ 10.55 per month arbitrage

Average GTE Business Customer = $ 44.14 per month arbitrage

The deaveraging of UNE loop rates necessarily raises the cost to UNE purchasers in high-cost areas and lowers the costs in low-cost areas. This has a direct impact on a CLEC's incentives. If deaveraging causes the arbitrage amount to go negative in a given geographic area, then the CLEC will not enter that given market since it cannot compete with GTE's

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[2] Although not the topic of this proceeding, rational UNE rates would exhibit a degree of parity with associated retail rates. This would help eliminate any irrational arbitrage potential. As Staff witness Glenn Blackmon expressed in Phase I of this proceeding: "the objective should be to establish rough parity between wholesale or unbundled network element rates and corresponding retail rates for finished services."

[3] Although, in total and if purchased for all services, the resale rates would give the ILEC an opportunity to recover its total actual costs.

disoriented retail rates in that market area. Parity between the wholesale and retail rates is essential to the development of competition in such an area.

Q. HOW WOULD AT&T'S AND STAFF'S DEAVERAGING PROPOSALS IMPACT THIS ARBITRAGE OPPORTUNITY?

A. They would exacerbate them.

Q. PLEASE DESCRIBE THE ARBITRAGE IMPLICATIONS OF AT&T'S PROPOSAL.

A. Mr. Denney's proposed three zones and rates to be used by both GTE and U S WEST as follows: [4]

Zone 1 - $ 14.42

Zone 2 - $ 20.19

Zone 3 - $ 54.51

Assuming that the average business customer in each zone has usage characteristics similar to GTE's statewide average business customer, the change in a CLEC's revenue cushion (arbitrage amount) when competing with GTE would be as depicted in Table I below:

Table I
Effect of AT&T's UNE Proposal on Business Arbitrage Potentials

[4] Denney Direct Testimony, Attachment A.

Zone	Current Business Arbitrage Statewide UNE Loop Rate = $23.94 (a)	AT&T's Proposed Loop Rates (b)	Avg. Business Arbitrage/Line (c)=(a)+($23.94-(b))
1	$44.14	$14.42	$53.66 (Increased)
2	$44.14	$20.19	$47.89 (Increased)
3	$44.14	$54.51	$13.57 (Decreased)

AT&T's deaveraging proposal would leave significant rate arbitrage opportunities throughout GTE's serving territory for CLECs using UNEs and targeting business customers, and in fact increases those opportunities in Zones 1 and 2.

Table II addresses the arbitrage opportunities for residential customers. For the residential customer, deaveraging increases the incentives for CLECs to target Zones 1 and 2, while ensuring that competition will never develop in the high cost supported Zone 3.

Table II
Effect of AT&T's UNE Proposal on Residential Arbitrage Potentials

Zone	Current Residential Arbitrage Statewide UNE Loop Rate = $23.94 (a)	AT&T's Proposed Loop Rates (b)	Avg. Residential Arbitrage/Line (c)=(a)+($23.94-(b))
1	$10.55	$14.42	$20.07 (Increased)
2	$10.55	$20.19	$14.30 (Increased)
3	$10.55	$54.51	($20.02) (Redlined)

Q. WHAT IMPACT WOULD STAFF'S DEAVERAGING PROPOSAL HAVE ON ARBITRAGE OPPORTUNITIES?

A. Responsive Direct Exhibit TRD-1 to this testimony performs the same analysis using Staff witness Spinks' proposal for deaveraging GTE's UNE loop rate. Given that Mr. Spinks recommended a much lower level of deaveraging (80 rate level zones that incorporate zones based on distance from an ILEC's wire center), the degree of increased arbitrage potential is significant for selected residential and business customers and likewise the potential for redlining geographies / customer sets is also greatly increased.

In short, Mr. Spinks' proposal is not consistent with his belief, as stated on page 2 of his direct testimony, that deaveraging proposals should not confer any unfair competitive advantage or harm upon any carrier.

Q. SHOULD UNES EVER BE DEAVERAGED?

A. Yes, but only when the arbitrage problem is resolved. Efficient and competitive market price structures require that wholesale rates and retail rates exhibit a rational alignment. Fair, ubiquitous competition requires the implementation of a sufficient Universal Service support mechanism. That mechanism will allow facility-based competitors to compete with the incumbent LECs throughout the State of Washington. The mechanism will

also require the ILECs to rebalance their retail rates to reflect their underlying cost characteristics. A competitively-neutral Universal Service mechanism thus mandates the deaveraging of UNE rates to be consistent with Universal Service support flows and allowed retail rate structures. Retail rate levels, Universal Service support amounts, and wholesale rate levels must move in lockstep. If they do not, the characteristics of an unfair, inefficient market are created, which could only be considered to be harmful to the consumers of the State of Washington.

B. If the Commission Elects to Deaverage Rates, it Should Adopt GTE's Proposal. In the Alternative, the Commission Should Accept GTE's Adjustments to AT&T's Proposal

Q. WHAT PROPOSED DEAVERAGED RATES SHOULD THE COMMISSION ADOPT?

A. The Commission should adopt GTE's rates as presented in my Direct Testimony. Those proposed deaveraged rates were based on the results of COSTMOD already of record.

Q. IN YOUR DIRECT TESTIMONY YOU PROPOSED THREE ZONES AND RATES FOR GTE. AT&T PROPOSES THREE ZONES AND RATES FOR GTE AND U S WEST ON A COMBINED BASIS. WHAT DOES THE FCC'S RULE REQUIRE WITH REGARD TO THE NUMBER OF ZONES AND RATES?

A. The FCC's Rule 51.507(f) on the deaveraging of UNE rates only states that "State commissions shall establish different rates for elements in at least three defined geographic areas within the state to reflect geographic cost differences." There appears to be agreement on this point between GTE and AT&T.[5]

The FCC's rule does not specifically address the rates that are to apply, but the pricing guidelines of the Telecommunications Act of 1996 and sound regulatory policy provide that a given ILEC's rates must be based on that ILEC's own costs. Accordingly, in this case the Commission has made separate UNE cost determinations for GTE and U S WEST, set separate average UNE rates for each company, and directed that each company's deaveraged rates true up to its ordered average rate.

These requirements would allow the Commission to, for example, establish only three zones for the entire state, assign each GTE and U S WEST wire center to the appropriate zone, and then set the separate, company-specific deaveraged UNE rates for each zone.

Q. PLEASE COMMENT ON AT&T'S DEAVERAGING PROPOSAL.

A. GTE agrees with AT&T that, at this time, the number of zones for

[5] Denney Direct Testimony, page 2 lines 9-10.

deaveraging should be kept to a minimum, But GTE disagrees with AT&T's proposed mathematical procedures for developing deaveraged rates. As further discussed in the Responsive Testimony of GTE witness David Tucek, AT&T's approach will result in rates that do not reflect each company's ordered statewide average rates.

Q. HOW WOULD AT&T'S THREE ZONE DEAVERAGING PROPOSAL AFFECT GTE'S RECOVERY OF ITS COMMISSION-DETERMINED COSTS AND COMMISSION-ORDERED AVERAGE UNE RATE?

A. As further discussed by Mr. Tucek, AT&T's approach would result in rates that are not reflective of each company's costs and statewide average rates, as determined by the Commission in this case. Under AT&T's proposal, GTE would come up short, and U S WEST would reap a small windfall.

Q. PLEASE COMMENT ON STAFF'S DEAVERAGING PROPOSAL.

A. Mr. Spinks proposes to develop 80 rate zones for GTE and U S WEST based on distance from the ILECs' wire center. This proposal would be costly to administer (as discussed by Mr. Langley), is based on faulty methodology (as discussed by Mr. Tucek) and most certainly would not promote efficient competition while preserving Universal Service.

Mr. Spinks' proposal would create a UNE loop rate of $3.75 per month for all

UNE loops that are within one kilofoot of a wire center serving GTE's highest density areas. As shown in my Responsive Direct Exhibit TRD-1 (pages 1 and 3), that rate gives CLECs a revenue cushion (arbitrage potential after marketing expenses) of $64 per line per month for an average business line and $30 per line per month for an average residential line. At the same time, Mr. Spinks' proposal would also potentially increase the "redlining" of Washington's rural areas and customers in the low density areas.

If Mr. Spinks truly believes that UNE loop rates should be deaveraged based on their distance from a wire center, then he must also be aware that for an efficient competitive market to develop: (a) Universal Service support flows would have to be computed, paid, and administered at that same level and (b) the retail rates for services that do not come under the definition of "universal service" would also have to be deaveraged at that same level. One can easily comprehend how an 80-zone structure for non-supported services (e.g., a PBX trunk) would be an administrative nightmare.

Q. WOULD PRICES BASED ON LOOP LENGTH (I.E., DISTANCE FROM A WIRE CENTER) EVER BE A RATIONAL CONSIDERATION IN PRICING UNE LOOPS OR RETAIL SERVICES?

A. Loop length, per se, should never be used to justify rate deaveraging unless it is accompanied by significant differences in customer density within the

wire center's serving area. This condition is more likely to exist in rural wire center areas; but even then, the level of deaveraging should be limited to core-area versus non-core area and only implemented if the benefits from this deaveraging are likely to be greater than the administrative costs.

If the density characteristics are relatively homogeneous within a wire center's serving territory, then pricing based on loop length just results in another mechanism to facilitate rate arbitrage. What sense does it make for a CLEC to build its switch on the other side of town, self-provision its short loops, and pay short-loop prices to the ILEC for loops that would be long-loops to the CLEC? If density characteristics are relatively homogeneous, then what is of real concern in the setting of competitively efficient and neutral rates is the average cost in that homogeneous area. The arbitrary placement of a wire center should not make one customer more coveted than another identical customer in that homogeneous area.

Q. MR. SPINKS ALSO PROPOSES TO DEAVERAGE UNE SWITCHING RATES. DOES GTE AGREE WITH THIS PROPOSAL?

A. No. As I stated in my direct testimony, such deaveraging is not justified. Moreover, it is significant that the parties to this proceeding that would actually purchase UNEs have not proposed to deaverage UNE switching rates at this time. Although switching costs do vary based upon size of

switch and traffic volumes, the traffic sensitive cost levels (which, based on Mr. Spinks' rate proposal vary from $0.00139 to $0.00370 per minute of use) are not likely to result in any significant social gains due to price deaveraging. In other words, the end-user rates derived from these levels of costs are not likely to exhibit any significant degree of variation and thus are not likely to have any material impact on the demand for usage-related services.

IV. CONCLUSION

Q. PLEASE CONCLUDE AND SUMMARIZE YOUR RESPONSIVE DIRECT TESTIMONY.

A. The issues being investigated in this docket are vitally important, as they affect the nature and scope of all future competition for local telecommunications services throughout the State of Washington. The deaveraging of wholesale UNEs should not proceed prior to addressing the Universal Service support issues and deaveraging retail rates. If the Commission wishes to move forward with UNE deaveraging at this time, it should reject AT&T's and Staff's proposals, as they are based on erroneous and deficient methodologies and would exacerbate rate arbitrage opportunities, in violation of the policy of promoting fair and efficient competition in Washington.

Q. DOES THIS COMPLETE YOUR RESPONSIVE DIRECT TESTIMONY?

A. Yes.