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. _____

RESPONSIVE DIRECT

TESTIMONY OF

JERROLD L. THOMPSON

ON BEHALF OF

U S WEST COMMUNICATIONS

JANUARY 18, 2000

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

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

Q. HAVE YOU FILED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes.

Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?

A. The purpose of this testimony is to respond to the direct testimony of Thomas Spinks of the staff of the Washington Utilities and Transportation Commission, Douglas Denney of AT&T, and Terry Dye of GTE.

Q. WHAT ARE THE DEAVERAGING PROPOSALS THAT WERE SUBMITTED TO THE COMMISSION?

A. There are four deaveraging proposals that have been submitted for Commission consideration:

U S WEST's Loop Deaveraging with 3 Zones based on density of existing service areas and the statewide average loop cost determined by the Commission.

AT&T's Loop Deaveraging with 3 Zones based on wire center average costs and the statewide average loop cost determined by the Commission.

GTE's Loop Deaveraging with 3 Zones based on wire center density and the statewide average loop cost determined by the Commission.

Staff's Loop Deaveraging with up to 80 Zones[1] based on wire center density, distance and the statewide average loop cost determined by the Commission; and switching deaveraged costs based upon wire center density.

[1] Mr. Spinks proposes four wire center groups with sixteen different distance zones for US WEST, (four times sixteen equals 64 effective zones), for GTE he proposes five wire center groups with sixteen different distance zones, or 80 effective zones.

ARE THERE SIMILARITIES BETWEEN THE PROPOSALS OF THE INDUSTRY MEMBERS?

Yes. First, although all four of the proposals assume some level of geographic averaging, the industry proposals have several similarities, and all three are strikingly dissimilar to staff's proposal. Both U S WEST's proposal and GTE's proposal approach the issue from the perspective of a current provider of retail services that is implementing a new geographic wholesale rate and structure. As I discussed in my Direct testimony, an important element of the Commission's decision for wholesale geographic deaveraging is to create the appropriate relationship between retail and wholesale prices, or what has been termed "competitive neutrality". AT&T's deaveraging proposal approaches the issue from the perspective of a new entrant that has little concern for the problems of an existing highly averaged retail price structure, but rather focuses on the opportunities of a lower urban loop rate. However, in spite of the differences in perspective, all three industry participants propose deaveraging with three zones[2].

Second, the range of the industry members proposed loop rates are more alike than the range proposed by staff.

U S WEST	Zone 1 $16.74	Zone 2 $17.54	Zone 3 $27.82
GTE	Zone 1 $22.92	Zone 2 $22.49	Zone 3 $30.51
AT&T	Zone 1 $14.42	Zone 2 $20.19	Zone 3 $54.51
Staff	For U S WEST	Range of $3.63 to $75.52	
	For GTE	Range of $3.75 to $218.65	

Third, all three industry members reference the importance of a deaveraging scheme that considers the cost of implementation and their proposals reflect that belief. My direct testimony discusses the advantage of U S WEST's proposal in the low implementation costs and relative speed of implementation.[3] GTE's witness Dye recommends a guideline for the Commission that weighs "the operational costs of deaveraging against the potential consumer gains".[4] AT&T's witness recommends that "(t)he desire of CLECs to have a multitude of zones should be tempered with the practicality, implementation and the current state of competition in Washington. It

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[2] AT&T notes that it does not oppose more than three zones, Denney Direct, footnote 3.

[3] See Jerrold L. Thompson Direct Testimony, page 12, lines 3 through 9.

[4] See Terry R. Dye Direct Testimony, page 7, lines 11 through 12.

would be burdensome to the Commission, ILECs and CLECs to have to track the prices in 20 zones if UNE purchases are only occurring in two zones."[5] Staff's proposal is not developed from this practical perspective, although Mr. Spinks does acknowledge that his proposal may "create undue administrative burdens and cost." [6]

Finally, the three industry member's proposals were limited to the deaveraging of the loop. No other Unbundled Network Element (UNE) was proposed for deaveraging. Staff proposed a method of deaveraging switching costs in addition to the loop.

DOES THE FCC'S ORDER REQUIRE MORE THAN THREE AREAS OF DEAVERAGING?

No. In its First Report and Order, the FCC stated "We conclude that three zones are presumptively sufficient to reflect geographic cost differences in setting rates for interconnection and unbundled elements…"[7] This decision was affirmed by the FCC's Order lifting its Stay where three zones continued to be the minimum.[8] Because the minimum number of geographic areas chosen by the FCC was three even though some parties recommended greater deaveraging, the FCC implied that less deaveraging was appropriate at this time. It determined that three zones were "sufficient" to comply with the provisions of the Telecom Act.

HOW HAVE OTHER US WEST STATES DEAVERAGED UNBUNDLED NETWORK ELEMENTS?

Four states in U S WEST's territory have deaveraged loop costs. The Colorado and Wyoming Commissions each ordered 4 zones. The New Mexico and Utah Commissions each ordered 3 zones. All of the other states that are currently in investigations in compliance with the FCC Order are considering methods that propose three to four zones.

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[5] See Douglas Denney Direct Testimony, page 4, lines 9 through 11.

[6] See Thomas L. Spinks Direct Testimony, page 8.

[7] CC Docket No. 96-98, No. 95-185, Released August 8, 1996, para. 765.

[8] Whether three zones is the absolute minimum is unclear due to paragraph 7 of the FCC's Stay Order that states " Finally, we recognize the possibility that the three-zone rule may not be appropriate in all states. In some states, for instance, it may be that local circumstances dictate the establishment of only two deaveraged rate zones. We intend to address such situations on a case-by-case basis. States may file waiver requests with the Commission seeking relief from the general rule in light of their particular facts and circumstances."

IS STAFF'S DEAVERAGING PROPOSAL PRACTICAL?

No. As described in the testimony of Ms. Brohl, Mr. Spinks' proposal is impractical and very costly. In order to implement his kilofoot proposal, the distance of loop from the central office to the customer location must be known. Consistent with the development of the average UNE loop cost, this is not the airline distance as "the crow flies", but the route distance of the feeder and the distribution plant for each potential unbundled loop. U S WEST asked in interrogatories for an explanation of the methodology staff used to map addresses to the assigned geographic zones. Staff responded that "Mr. Spinks has not mapped addresses to assigned geographic zones, nor does he believe such an exercise is necessary to identify customer locations."[9] In response to another request, staff responded that "the only mapping that is necessary is to map census blocks to wire centers because databases already exist that map addresses to census blocks. Manual lookups of addresses to census blocks may be necessary from time-to-time."[10]

In order to implement Mr. Spinks' proposal, U S WEST needs to know the actual distance from the central office to the customer for each unbundled loop in order to identify the appropriate kilofoot distance and therefore the rate. As Ms. Brohl describes in her testimony, U S WEST would have to develop this information. Even if databases were available that map addresses to census blocks as Mr. Spinks suggests, given the large areas often included in census block boundaries[11], kilofoot distances of the actual loop length would still be unknown. Neither Mr. Spinks' testimony nor his responses to interrogatories has provided information that indicates how the actual rates could be determined. This is a critical omission.

> In addition, if the data were available, as Ms. Brohl explains, it would need to be included into ordering and billing systems to be usable. This process can be very tedious and complex. Several years ago, the Colorado Commission ordered that retail rates should be deaveraged into a metro "base rate area" and three distance based zones outside of the metro area. Implementation of this structure took three years to perfect. In the end, many customer locations were identified by employees driving through the service areas and manually marking addresses on maps. This was a very expensive and time consuming effort, but one that ultimately was required to accurately identify customer addresses to the <u>four</u> zones ordered by the Commission. Without clear and proven alternative methods to identify customers

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[9] Response to USWC Request No. 7.

[10] Response to USWC Request No. 10.

[11] U.S. Census Bureau defines "census block" as follows: "The smallest entity for which the Census Bureau collects and tabulates decennial census information; bounded on all sides by visible and nonvisible features shown on Census Bureau maps."

with deaveraged zones, staff's deaveraging proposal could face these same difficulties, but increased by the significantly larger number of zones.

Recovery of the costs of the customer identification in Colorado was ultimately a responsibility assigned to U S WEST's Colorado customers. The costs of implementing staff's proposal in Washington should be recovered from CLECs operating in Washington, thereby increasing the CLECs cost of business.[12] As discussed by Mr. Denney of AT&T, CLECs would want accurate information not just for billing, but also for planning and competitive bidding, and would likely oppose U S WEST's recovery of necessary implementation expenses.[13]

U S WEST's proposal for deaveraging considers the practical issues of implementation in that it uses existing groupings of wire centers that are used for local calling areas or similar communities. Its proposal does not require the identification of customers to new geographic areas, nor does it impose additional costs to the CLECs.

SHOULD THE COMMISSION ACCEPT STAFF'S PROPOSAL FOR DEAVERAGED SWITCHING RATES?

No, for several reasons. First, Staff's proposal for deaveraged switching rates appears to be derived from an analysis of data used by the Hatfield Model. Staff has manipulated this data and has run some statistical analyses on this data. Dr. Carnall provides testimony on staff's statistical methods so I will not comment on that. I will note however, that the underlying data used by Mr. Spinks was rejected by the Commission.[14] Staff's deaveraged switching cost analysis begins with the direct cost per switch identified by the HAI Model 5.0. In its Eighth Supplemental Order the Commission rejected the use of comparable costs. Staff's analysis has used this data and has not supported reasons why the data is any better than when it was submitted by AT&T earlier in the case. The Commission should not seriously consider data in this part of the proceeding that it has flatly rejected in an earlier part of the proceeding.

Secondly, the cost of switching in a location depends upon the configuration of the switch. For example, CLECs often have one switch that serves an entire state. The

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12 Since no other state is considering such a radical deaveraging proposal, the system costs to implement staff's plan could not be shared across U S WEST states as would be done with company wide system changes.

13 Denney Direct, page 6.

14 The WUTC rejected switching cost estimates and models submitted by AT&T, GTE and U S WEST, and determined its own cost per line of $150.

switching costs for this configuration do not vary geographically. Likewise, the cost of switching can vary by manufacturer and for functionality of the switch, but these cost variations are not due to geography.

Finally, Staff's switching cost deaveraging appears to be basically an analysis of fixed costs spread over the number of lines served by a switch. Where the number of lines served by the switch are small, the fixed cost per line is higher. Where the number of lines served by the switch are large, the fixed cost per line is lower. This is not geographic deaveraging. Two switches with the same cost serving the same number of lines will have the same cost per line regardless of where the switch is located. Staff's analysis is nothing more than the observation noted by the Commission that "The investment per line generally declines as the number of lines on the switch increases. This occurs because the getting started cost of a switch is shared with a larger number of customers."[15] While the Commission acknowledged this phenomenon, it found that a single switching cost per line was reasonable. Since there is only a single switching cost per line, for all lines in Washington, all geographic areas, there is no basis for geographic deaveraging of switching.

Q. AT&T HAS PROPOSED A THREE ZONE DEAVERAGING PROPOSAL. SHOULD THE COMMISSION ADOPT THIS PROPOSAL?

No. AT&T proposes a wire-center based deaveraging approach, with wire centers aggregated into three groups based on the average loop costs within each wire center. The wire centers with the lowest average loop cost are included in zone 1, and the wire centers with the highest average loop costs are included in zone 3. All other "medium cost" wire centers are included in zone 2. This results in a mix of the three types of wire centers included in contiguous traditional local calling areas. For example, all three zones are present in the Tacoma and Spokane communities. Solely because customers are served from a particular central office, loops serving these customers can have any of the three types of wholesale rates, ranging from $14.42 to $54.51 per month. As I have discussed in my direct testimony, retail rates will, of necessity, migrate toward the level of deaveraging of wholesale rates. In order for balanced competition to occur, some of U S WEST's retail rates will need to be reduced and some rates will need to increase in proportion to the wholesale rate. If AT&T's proposal were to be adopted by the Commission, retail rates that reflected this hodge-podge of wholesale deaveraging could leave customers confused and irritated. Neighbors could have significantly different rates, simply by the fact of which central office they received their service from[16]. Explanations of how their rates were determined from theoretical cost models

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[15] Eighth Supplemental Order, paragraph 309.

[16] For example, under AT&T's plan, customers in Tacoma Greenfield are in zone 1, customers in Tacoma Juniper are in zone 2, and customers in Tacoma Fort Lewis are in zone 3.

will not satisfy their questions.

As the Commission is aware, the Telecom Act provided three ways for new entrants seeking to compete in the provision of local exchange services: total service resale, purchase of UNEs from the incumbent, and facilities-based entry. Under AT&T's deaveraging proposal, monthly loop rates in Seattle would be $14.42 and monthly loop rates in Othello would be $54.51. It is far more likely that AT&T is more interested in the UNE rate in Seattle than the UNE rate in Othello. This is true because AT&T can provide service in Othello, if it chose that option, by purchasing the total service at a discount from the geographically averaged retail rate[17] and avoiding the $54.51 charge. This arbitrage opportunity has been discussed previously, but its importance cannot be overstated.

> Alternatively, U S WEST's proposal deaverages costs into groups that are more understandable to the consumer. Consumers in adjacent areas will have similar rates. Rates will not vary dramatically along arbitrary wire center boundaries. It has always been the policy of commissions to use communities of interest as one criteria for establishing retail rates. This approach stems from the need to have an understandable rate structure which customers can accept. Rates that vary dramatically along adjacent wire center boundaries will not promote consumer confidence. Neighbors in identical neighborhoods could have significantly different rates based solely on where the wire center boundaries were set. Community of interest has always been a reasonable means of promoting customer acceptance of rates. AT&T has provided no evidence which supports abandoning this principle now.

WHAT IS YOUR RECOMMENDATION TO THE COMMISSION?

Because deaveraging proposals have some level of averaging implicit in them, and because the FCC knowingly allowed deaveraging at only three levels, there must be other considerations that the Commission should include in their decision than simply the number of zones. The additional elements I recommend are that the Commission give weight to the fact that retail rates are not currently set with regard to geographical cost variations. Low cost areas have rates that recover the low costs and provide support for areas with high costs. When this structure exists and wholesale rates are deaveraged, competition is distorted. Deaveraged retail rates may require universal service fund support that is not currently available in Washington. In addition, consideration should be given to the practical issues of implementation. These elements suggest the need for a cautious approach to wholesale deaveraging.

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[17] Flat residence is $12.50 per month, discounted to $10.66 for resale. Flat business is $26.89 per month, discounted to $22.94 for resale.

The Commission has determined that it needs to investigate its obligation to deaveraging UNEs. If the Commission decides that it must deaverage UNEs at this time, I would recommend that it reject the proposals of staff and AT&T and adopt U S WEST's proposal for its service areas because of its consideration of implementation and the relationship of retail rates to wholesale deaveraging.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.