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

PHASE III RESPONSE TESTIMONY

OF

REX KNOWLES

NEXTLINK WASHINGTON, INC.

January 18, 2000

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

A. My name is Rex Knowles. I am a Director Regulatory and External Affairs for NEXTLINK, 111 East Broadway, Suite 1000, Salt Lake City, Utah 84111.

Q. ARE YOU THE SAME REX KNOWLES WHO TESTIFIED IN PHASE II OF THIS PROCEEDING?

A. Yes, I am, and I continue to testify on behalf of NEXTLINK Washington, Inc. ("NEXTLINK ").

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN PHASE III?

A. The purpose of my testimony is to provide a business perspective on the geographic deaveraging proposals and testimony submitted by U S WEST Communications, Inc. ("U S WEST"), GTE Northwest Incorporated ("GTE"), and Commission Staff. The incumbent local exchange company ("ILEC") proposals do not represent legitimate geographic deaveraging, in sharp contrast to Staff's proposal. NEXTLINK's concern with Staff's proposal, however, is that it could be difficult to implement. Accordingly, NEXTLINK supports the modifications to Staff's proposal in the responsive testimony submitted by William Page Montgomery.

Q. HOW SHOULD THE COMMISSION EVALUATE EACH OF THE GEOGRAPHIC DEAVERAGING PROPOSALS THAT HAS BEEN SUBMITTED?

A. The Commission should analyze the proposals using two areas of inquiry. First, the Commission should determine which proposal best reflects geographic cost differences between providing unbundled loops in at least three different areas. Both the Telecommunications Act of 1996 ("Act") requires that unbundled network element prices be based on cost, and FCC Rule 507 further requires that the Commission establish such prices in a minimum of three cost-related zones. In paragraph 765 of its *Local Competition Order*, the FCC further stated, "A state may establish more than three zones where cost differences in geographic regions are such that it finds that additional zones are needed to adequately reflect the costs of interconnection and access to unbundled network elements."

The other area of inquiry is implementation. Compliance with appropriate costing requirements should be the primary focus of the Commission's inquiry, but Commission Staff's proposal to geographically deaverage loop prices into 150 zones to better reflect cost differences resulting from loop length also necessitates consideration of how to implement deaveraging proposals. Geographically deaveraged prices must reflect the cost of providing unbundled network elements, but implementation of that pricing scheme should not significantly increase those costs. Both the ILECs and competitors thus should be able to determine the appropriate price of a loop without incurring unnecessary time and expense. In other words, the benefits of the geographically deaveraged pricing should outweigh the cost to implement it.

Q. SHOULDN'T POLICY CONCERNS ALSO PLAY A ROLE IN ADOPTING A PROPOSAL FOR GEOGRAPHIC DEAVERAGING?

A. Yes, but only a supporting role. The ILECs devote the vast majority of their testimony to their policy concerns, claiming that deaveraging unbundled loop rates without also deaveraging retail rates will negatively impact universal service and the development of local exchange competition. The ILECs request that the Commission rely on these concerns and ignore the requirements of the Act and FCC rules, either directly by refusing to geographically deaverage prices or indirectly by establishing prices with little variation from the statewide averaged rate established by the Commission.

Not only have Congress and the FCC already made the policy determination that UNE prices must be based on cost without any regard for retail service rates, but the ILECs' alleged concerns do not survive even minimal examination. Neither U S WEST nor GTE has ever claimed in this proceeding that they do not generate sufficient revenues from existing rates to earn their authorized rates of return while fully funding their universal service obligations. To the contrary, GTE recently agreed in the context of its proposed merger with Bell Atlantic to *reduce* its rates for regulated services to achieve a net annual revenue reduction in Washington of $30 million. U S WEST recently requested and received competitive classification for its high capacity services and has proposed legislation that would establish existing rates as price caps, the point of both of which is to enable the company to selectively *reduce* its retail rates. U S WEST and GTE cannot credibly claim that geographically deaveraged loop prices will reduce their revenues to the point of posing any danger to universal service when the ILECs are already voluntarily reducing or seeking to reduce their retail rates.

Q. WHAT ABOUT CONCERNS THAT GEOGRAPHIC DEAVERAGING WILL SKEW THE DEVELOPMENT OF LOCAL EXCHANGE COMPETITION?

A. Cost-based geographic deaveraging will encourage competition, not create unequal competitive choices as the ILECs contend. U S WEST and GTE would have the Commission believe that as a result of geographic deaveraging, "the margin opportunities will increase and further encourage competition in urban areas, with decreased incentives for competition in rural areas." Testimony of Jerrold L. Thompson at 8; *see* Testimony of Terry R. Dye at 13-14. The statewide averaged prices the Commission has established in Phase II of this proceeding, however, have effectively eliminated "margin opportunities" in the provision of basic local exchange service using ILEC unbundled loops, and only cost-based geographic deaveraging will encourage CLECs to serve customers using unbundled loops anywhere in Washington.

A facilities-based CLEC that wants to use an unbundled loop from U S WEST or GTE to provide service to its end-user customer must pay more than the monthly recurring charge for the loop. The CLEC also must pay a recurring Expanded Interconnection Channel

Termination ("EICT") or cross-connect charge for the facility that connects the loop to the CLEC's collocated equipment. In addition, the CLEC must pay nonrecurring charges to the ILEC to provision that loop – including testing and coordinated transfer of the loop to the CLEC's network so that the customer will not be out of service – and any necessary loop conditioning, such as load coil and bridged tap removal. Based on U S WEST's compliance filing in Phase II, the CLEC would have to pay the following amounts per month (assuming that the non-recurring charges are amortized over a conservative time period of three years):

<u>U S WEST Loop Charges</u>

Statewide averaged recurring	$18.16
Expanded Interconnection Channel Term.	$ 2.12 (from GTE collocation tariff)
Installation with designated testing	$ 4.52 ($162.81/36)
Disconnect	$ .45 ($16.33/36)
Cable unloading	$ 8.45 ($304.12/36)
Bridged Tap Removal	$ 4.09 ($147.37/36)
OSS Maintenance (2)	$ .20 (3.60/36 x 2)
OSS Development (2)	$ .74 ($13.29/36 x 2)
Total	**$38.73**

The $38.73 that a CLEC must pay U S WEST for an unbundled loop exceeds U S WEST's retail rates for residential exchange service ($16.97, including Subscriber Line Charge ("SLC") and amortized nonrecurring charge ("NRC") of $35) and basic business exchange service ($35.94, including SLC and NRC of $50). Even without line conditioning, the CLEC must pay U S WEST a total of $26.19 – which still exceeds the residential retail rate and approaches the business retail rate – without even considering charges for collocation in the U S WEST central office that serves the loop and the CLEC's own network and retailing costs.

Similarly for GTE, the statewide averaged loop prices that CLECs must pay based on GTE's compliance filing ($51.27 – or $38.73 without line conditioning) approach or exceed GTE's retail rates (including SLC and amortized NRC) for residential ($17.86) and business ($47.11) service, without consideration of collocation or CLEC network and retail costs:

<u>GTE Loop Prices</u>

Statewide averaged recurring	$23.94	
Cross-connect	$ 2.12	(from GTE collocation tariff)
Engineered Service Order	$ 6.41	($230.70/36)
Central Office Connect	$ .38	($13.61/36)
Outside Facility Connect	$ 2.45	($88.06/36)
Disconnect	$ .37	($13.19/36)
Hot-Cut Coordinated Conversion	$ .80	($28.94/36)
Central Office Connect	$ 1.19	($42.83/36)
Outside Facility Connect	$ 1.07	($38.34/36)
Cable unloading	$ 8.45	($304.12/36)
Bridged Tap Removal	$ 4.09	($147.37/36)

Total	**$51.27**

The only legitimate policy issue presented by geographic deaveraging in this proceeding, therefore, is whether the Commission wants to foster the development of local exchange competition – other than wholly facilities-based competition – *anywhere* in Washington. Unless the Commission adopts cost-based loop prices, at least some of which are significantly less than the statewide averaged recurring price, CLECs will have a strong economic incentive not to use any ILEC unbundled loops, and effective competition will be unlikely to develop beyond the reach of CLECs' own networks.

Q. DOES EITHER THE U S WEST OR GTE PROPOSED PRICES SATISFY THE CRITERIA FOR EVALUATING GEOGRAPHIC DEAVERAGING PROPOSALS YOU HAVE PROPOSED?

A. No. Neither the U S WEST proposal nor the GTE proposal satisfies the first and most important requirement that rates adequately reflect geographic cost differences. The exhibits to Mr. Spinks' testimony illustrate the vast differences between loop costs in various wire centers and distances, ranging from as little as $3.63 to as much as $218.65. U S WEST and GTE, however, propose prices for their high and medium density zones that vary less than $1.50 from the statewide average rate, while the price each proposes for their low density zone is less than $10 higher than the statewide average. Consistent with their positions that the Commission should not geographically deaverage loop prices at all, U S WEST and GTE propose prices that cannot realistically even be called geographically deaveraged.

Q. WHAT ABOUT COMMISSION STAFF'S PROPOSAL?

A. Although I have not independently analyzed Mr. Spinks' calculations, Commission staff appears to have done a thorough job of considering geographic cost differences and developing a proposal that complies with both the letter and the spirit of the Act and FCC requirements for cost-based rates. My concern with Staff's proposal, however, is with implementation of rates based on the number of distance sensitive bands within each zone. The level of disaggregation in Staff's proposal more accurately reflects geographic cost differences, but the time, effort, and uncertainty both ILECs and CLECs would incur to determine the applicable rate for each loop could outweigh the benefits of prices that more accurately reflect the underlying costs.

NEXTLINK, however, supports the concept in Staff's testimony that geographically deaveraged prices should be distance sensitive. Not only does Mr. Spinks' analysis demonstrate that costs vary significantly by distance from the central office, but distance sensitive prices make affordable loops available in locations other than the large metropolitan areas of Seattle, Bellevue, and Tacoma. NEXTLINK, for example, operates in Spokane, which is in the next to lowest density zone in Staff's analysis, even though it is one of the largest cities in the state. Staff has calculated the averaged rate for that zone as $19.93, which is almost two dollars higher than the statewide average of $18.16 and would likely make unbundled loops in Spokane prohibitively expensive. Adjusting that rate according to the customer's distance from the serving central office, however, would give NEXTLINK and other CLECs a more realistic opportunity to use unbundled loops to provide service at least to some customers in Spokane, Olympia, and other lower density areas.

Q. HOW DOES NEXTLINK RECOMMEND THAT THE COMMISSION ESTABLISH GEOGRAPHICALLY DEAVERAGED LOOP PRICES?

A. NEXTLINK supports the modification to Staff's proposal in William Page Montgomery's testimony that NEXTLINK is jointly sponsoring with other CLECs. Mr. Montgomery has reduced the number of distance bands to a level that will enable the ILECs and CLECs to determine applicable loop prices with a minimum of cost that will not outweigh the benefit of more affordable, cost-based loop rates. NEXTLINK is willing to work with the ILECs and other CLECs to develop an efficient and mutually acceptable method of determining loop lengths, and is also willing, as Mr. Montgomery proposes, to be primarily responsible for determining the length of the loops it orders, subject to ILEC confirmation. Accordingly, NEXTLINK recommends that the Commission adopt the joint CLEC proposal presented by Mr. Montgomery.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes, it does.