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. _______________

REBUTTAL

TESTIMONY OF

JERROLD L. THOMPSON

ON BEHALF OF

U S WEST COMMUNICATIONS

February 7, 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 PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING?

A. Yes.

Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?

A. The purpose of this rebuttal testimony is to respond to the testimonies of Mr. Douglas Denney of AT&T, Mr. Rex Knowles of NEXTLINK Washington, Inc., and Mr. William Page Montgomery representing Advanced TelCom Group, Inc., Electric Lightwave, Inc., GST Telecom Washington, Inc., NewEdge Networks, Inc., and NEXTLINK Washington, Inc. .

TESTIMONY OF MR. DENNEY

Q. WHAT IS YOUR REACTION TO MR. DENNEY'S ARGUMENT THAT U S WEST'S DEAVERAGING PROPOSAL IS NOT "TRUE" DEAVERAGING?

A. The essence of Mr. Denney's argument is that because U S WEST's deaveraging proposal is not the same as AT&T's, it is not "true" deaveraging. The facts are that there is no requirement that geographic deaveraging be based upon wire center levels of cost. The FCC's Order and Rules for geographic deaveraging require the Commission to establish three cost related rate zones that are structured consistently with the manner in which the costs of providing the loop are incurred.

U S WEST's proposal meets these requirements. It proposes three zones. The zones reflect a level of geographic cost deaveraging. U S WEST's proposal has less difference between zones than either AT&T's three zone proposal or Staff's three zone proposal. The level it proposes is $2.00 to $2.50 higher in the most dense local calling areas, about $2 less in the medium density local calling areas, and $15 to $22 less in the lowest density local calling areas than AT&T's and Staff's three zone proposals. I have illustrated these proposals and the differences in Exhibit JLT-1.

The Commission should not be taken in by exaggerations that make it seem as though

U S WEST's proposal is significantly different than the other proposals, or that it does not comply with federal requirements, or that it has somehow missed the "truth" that lies within other proposals.

Q. MR. DENNEY AND OTHER PARTIES HAVE ASSERTED THAT U S WEST'S DEAVERAGING PROPOSAL IS NOT COST BASED. IS THE U S WEST DEAVERAGING PLAN COST-BASED?

A. Yes. FCC Rule 51.507(f) does not require unbundled network element wholesale rates to be set at a level equal to cost,[1] but requires "cost-related" zones. Rule 51.507 says:

> (f) State commissions shall establish different rates for elements in at least three defined geographic areas within the state to reflect geographic cost differences.
>
> (1) To establish geographically-deaveraged rates, state commissions may use existing density-related zone pricing plans described in § 69.123 of this chapter, **or other such cost-related zone plans established pursuant to state law.** (Emphasis added.)
>
> (2) In states not using such existing plans, state commissions must create a minimum of three cost-related rate zones.

U S WEST's proposal offers unbundled loops at lower prices in the low cost zones, and higher prices in the higher cost zones. Thus, U S WEST deaveraging plan contains cost-related zones, and is consistent with FCC Rule 51.507(f). It should be noted that in states where zone deaveraging plans currently exist, they are heavily influenced by community of interest considerations.

Q. MR. DENNEY TAKES ISSUE WITH U S WEST'S APPROACH OF CONSIDERING COMMUNITIES OF INTEREST IN ITS DEAVERAGING PROPOSAL. IS THERE SOMETHING WRONG WITH CONSIDERATION OF COMMUNITIES OF INTEREST?

A. There is nothing wrong with consideration of the consumer impact of the Commission's decision on geographic deaveraging, as long as the proposal meets the FCC's requirements. In fact, it could be argued that the Commission would be remiss if it did not consider the impact upon consumers in its decision. The consumer impact

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[1] Of course, it would be impossible to set prices for each loop at its cost, since unless all prices were set on an individual customer basis, there will always be average prices at some level, with some customers priced above cost, and some priced below cost.

assessment, as I discussed in my direct testimony, has to include the consumer's reaction to the inevitable deaveraging of retail rates. Because of the historical grouping of retail rates into communities of interest[2], it is likely that consumer's would have a basis of understanding the method of deaveraging. It is highly likely that this method would be more understandable by customers than a method that averaged central offices together into groups.

MR. DENNEY STATES THAT THE COMMUNITY OF INTEREST GROUPINGS PROPOSED BY U S WEST ARE "UNECONOMICAL AND WILL INHIBIT COMPETITION". DO YOU AGREE?

A. I do not agree. First, as I have illustrated in Exhibit JLT-1, there is not a significant difference in the deaveraging proposals of U S WEST, AT&T, and Staff in zones 1 and 2[3]. Two dollar differences are not significant in these proposals and certainly do not reflect rates that are uneconomical or would inhibit competition. On the other hand, rate proposals by AT&T and Staff for zone 3 may be considered as inhibiting competition in the rural areas of the state, especially given U S WEST's averaged retail rate structure. Loop rates of $40 to $50 per month may discourage UNE based competition in small towns in Washington.

Q. DOES MR. DENNEY PROVIDE DATA THAT SUPPORTS HIS NUMEROUS STATEMENTS ABOUT U S WEST'S REVENUES, MARGINS AND HIGHER PER LINE AMOUNTS IN RURAL AREAS?

A. No. On several occasions Mr. Denney has made guesses about how much higher revenues are in rural areas because of toll calling. He provides no factual data to support these guesses, nor is there data that has been supplied previously in this case that would support his theory. He has not calculated the impact of Extended Area plans in his theory, nor provided anything more than an unsupported observation that rural customers may make more toll calls than urban customers. Mr. Denney concludes that: " Thus, neither U S WEST or GTE have demonstrated that current revenues fail to recover costs in non-urban areas. The arguments to delay deaveraging are nothing more than an attempt to limit competition and protect current revenues that are in excess of forward-looking cost."[4] As I quoted this Commission in my direct testimony:

> At the same time, the ILECs ability to compete with entrants in low

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[2] Retail deaveraging based upon communities of interest was eliminated a few years ago in Washington, but still exists in the form of extended areas of local service.

[3] There is a large variation between U S WEST's zone 2 and Mr. Montgomery's average zone 2, but that is due in part to the fact that Mr. Montgomery's proposal only has 2 zones.

[4] Denney, January 18, 2000 testimony, p. 17.

> cost areas should not be impeded by implicit support mechanisms. The record in this proceeding shows that, currently, high-cost areas receive implicit support from low-cost areas. The federal Telecom Act requires that support provided to high-cost customers be provided explicitly and in a competitively and technologically neutral manner. If competitive and technological neutrality is not established, the most efficient supplier will not serve customers.[5]

Mr. Denney's arguments conflict with the findings of this Commission. As to the issue of implicit support from low-cost areas to high-cost areas, there is nothing for U S WEST or GTE to prove in this proceeding. His attack on U S WEST's proposal for the Commission to consider wholesale deaveraging concurrent with retail deaveraging as "an attempt to limit competition" is without merit and should be disregarded.

TESTIMONY OF MR. KNOWLES

Q. DOES THE U S WEST DEAVERAGING PLAN "IGNORE THE REQUIREMENTS OF THE ACT AND THE FCC RULES" AS CLAIMED BY MR. KNOWLES?

A. No. Mr. Knowles alleges that the U S WEST deaveraging plan "ignores the requirements of the Act and the FCC rules, either by refusing to geographically deaverage prices or indirectly by establishing prices with little variation from the statewide average rate established by the Commission."[6]

There is no basis for Mr. Knowles' claim. The U S WEST deaveraging plan does not "ignore" the Act and the FCC rules. First, the U S WEST plan does not "refuse to geographically deaverage prices." In fact, the U S WEST plan does geographically deaverage prices—into three deaveraged zones—in a manner that is entirely consistent with the Act and the FCC's rules. As I pointed out in my response testimony, the FCC stated in its First Report and Order that "three zones are presumptively sufficient to reflect geographic cost differences in setting rates for interconnection and unbundled elements…"[7]

Second, Mr. Knowles claims that the U S WEST somehow ignores the Act and the FCC rules because there is "little variation from the statewide average rate." This claim is wrong on two counts. First, the FCC rules do not specify that deaveraged rates must deviate from the state average cost by some minimum amount. Second,

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5 Thompson, December 15, 1999 testimony, p. 6.

6 Knowles response testimony, p. 3.

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

U S WEST's prices do deviate from the statewide average—ranging from $16.74 in zone 1 to $27.82 in zone 3—a significant variance. There is no basis for Mr. Knowles' claim that U S WEST's prices "cannot realistically even be called geographically deaveraged."[8].

Q. MR. KNOWLES CLAIMS THAT U S WEST'S CONCERNS ABOUT RETAIL RATES "DO NOT SURVIVE EVEN MINIMAL EXAMINATION."[9] PLEASE COMMENT.

A. Mr. Knowles dismisses U S WEST's concerns about the consistency of retail and wholesale rates. However, his discussion in this area is misguided and irrelevant. He argues that U S WEST appears to be generating "sufficient revenues from existing rates to earn (its) authorized rate of return" and that U S WEST desires the ability to reduce its rates for high capacity services. Mr. Knowles then concludes that "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."[10]

Mr. Knowles is missing the point. First, U S WEST is not claiming that geographic deaveraging will put universal service in danger. Instead, U S WEST has demonstrated that retail and wholesale rates should be deaveraged on a consistent basis—and that large discrepancies will lead to arbitrage, and the loss of implicit universal service subsidies. Second, whether U S WEST has sought rate reductions—or for that matter rate increases—in other services has nothing to do with geographic deaveraging. Mr. Knowles seems to be saying that since U S WEST appears to be making money, that any arbitrage or universal service concerns should simply be ignored. Such arguments should be ignored by the Commission.

Q. MR. KNOWLES CLAIMS THAT U S WEST IS ARGUING THAT GEOGRAPHIC DEAVERAGING WILL CREATE UNEQUAL COMPETITIVE CHOICES. PLEASE COMMENT.

A. U S WEST is not arguing that geographic deaveraging, in and of itself, will lead to unequal competitive choices for Washington consumers. However, if unbundled loop prices are deaveraged in a very significant manner (i.e., with very low prices in some zones and very high prices in other zones—such as the $6.16 to $75.83 spread recommended by Mr. Montgomery) and retail prices are not deaveraged, there can be little question that unequal competitive opportunities will exist, as I demonstrated in earlier testimony. Loops will only be purchased in the urban zones where low loop rates are in place and retail rates are relatively high—with rural zones left out of the

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[8] Knowles Response testimony, p. 7.

[9] Knowles Response testimony, p. 3.

[10] Knowles response testimony, p. 3.

picture. This is not the competitive landscape envisioned by Congress.

Q. MR. KNOWLES ARGUES THAT MARGINS ARE TOO SMALL TODAY IN URBAN AREAS, AND THAT LOOP PRICES IN THESE AREAS MUST BE SIGNIFICANTLY LOWER THAN THE STATE AVERAGE PRICE FOR COMPETITION TO FLOURISH. PLEASE COMMENT.

A. Mr. Knowles argues that unless loop prices in some areas are "significantly less than the statewide averaged recurring price CLECs will have a strong incentive not to use any ILEC unbundled loops, and effective competition will be unlikely to develop beyond the reach of CLEC's own networks."[11] Mr. Knowles provides an example (see Knowles response testimony, page 5) which purports to show that if state average loop prices are retained, competitive LECs will not be able to obtain the profit margin necessary to compete in urban areas, given current retail basic exchange rates.

This analysis is flawed in several respects. First of all, no party in this proceeding is proposing a state average loop price. In fact, U S WEST, and AT&T (and one of Staff's options) now propose a three zone deaveraging structure, and Mr. Montgomery proposes a 12 zone structure. If the Commission decides to go ahead with wholesale deaveraging, the issue in this proceeding is *which* deaveraging plan to adopt—not whether to adopt a deaveraging plan. Second, the analysis on page 5 of Mr. Knowles' testimony does not paint an accurate picture of the profit opportunities available to competitive LECs given the U S WEST deaveraging plan.

Q. PLEASE DESCRIBE THE FLAWS IN MR. KNOWLES' ANALYSIS.

A. According to Mr. Knowles' analysis, a competitive LEC must pay $38.73 for an unbundled loop, based on state average recurring and nonrecurring prices (amortized over three years). He argues that this cost to competitive LECs surpasses retail rates for residential basic exchange service ($16.97 including SLC and amortized nonrecurring prices) and business basic exchange service ($35.94 including SLC and amortized nonrecurring prices). Thus, he argues, competitive LECs have no margin opportunity.

This analysis is flawed in several respects. First, the actual calculations are not indicative of the real costs competitive LECs would incur. Mr. Knowles' analysis uses the statewide average unbundled loop price of $18.16. No party is arguing in this case that competitive LECs should pay a statewide average loop price in any geographic zone. U S WEST is proposing a $16.74 unbundled loop price in zone 1. In addition, his analysis assumes an amortized charge for cable unloading and bridged tap removal on each loop. This cost will not be incurred on most loops—it is only required if a

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[11] Knowles response testimony, p. 6.

competitive LEC requires digital service over a loop that currently contains load coils or bridged tap. Thus, even if all of Mr. Knowles' other assumptions (some of which are questionable) are retained, the deaveraged unbundled loop-related costs, with designated testing and an EICT, for a competitive LEC in zone 1 would be $24.77, not $38.73.

Mr. Knowles notes that there is no margin available for residence customers, since the unbundled loop price is greater than the residential basic exchange rate. This is true if one looks only at residential basic exchange service—which is priced below cost. In fact, U S WEST does not have a margin on this service either. However, when a competitive LEC enters the market, it will consider all potential customer revenues, which include not just the basic exchange rate, but also revenues from long distance, features, exchange access and other services. Based upon information previously in evidence in this docket[12], average monthly revenue per residential customer in Washington currently is over $30, and average monthly revenue per business customer in Washington is over $50. Of course revenues for a particular customer can be much greater, and one can assume competitive LECs will be targeting the highest revenue customers. Thus, Mr. Knowles' example does not, in any shape or form, reflect the actual margin opportunities available to competitive LECs. With the U S WEST deaveraging plan, competitive LECs will enjoy significant margin opportunities in urban areas—and in rural areas.

TESTIMONY OF MR. MONTGOMERY

Q. WHAT SORT OF DEAVERAGING PLAN IS RECOMMENDED BY MR. MONTGOMERY?

A. Mr. Montgomery proposes a deaveraging scheme with two overall zones (A and B) with six distance bands. Rates for U S WEST vary from $6.16 to $65.15. He argues that this plan incorporates cost differences caused by both density and loop length.

Q. HOW DOES MR. MONTGOMERY CHARACTERIZE THE U S WEST DEAVERAGING PLAN?

A. Mr. Montgomery claims that the U S WEST plan doesn't "involve cost differences" and uses an "artificial geographic definition like the MSAs"[13] Consistent with Mr. Knowles, he argues that the U S WEST plan does not provide enough of a spread between the high and low cost zones.

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[12] See WUTC information request 03-008.

[13] Montgomery response testimony, p. 5.

Q. DO YOU AGREE?

A. No. As I noted above, the U S WEST plan is entirely consistent with the FCC's deaveraging rules, and provides for lower rates in lower cost areas and higher rates in high cost areas. In addition, the MSA approach is hardly "artificial," but represents a reasonable deaveraging approach that considers both communities of interest and cost differences, as I explained in my direct and responsive direct testimony.

Q. MR. MONTGOMERY CLAIMS THAT THE U S WEST DEAVERAGING APPROACH CONSIDERS ONLY DENSITY AS A COST DRIVER. PLEASE COMMENT.

A. Mr. Montgomery argues that the U S WEST approach (and by inference, the AT&T approach), with its wire center-based zones, does not reflect cost causation, because it allegedly considers only density as a cost driver. He argues that loop distance is a more important cost driver, and proposes a loop distance-based deaveraging plan that allegedly better reflects this important cost driver.

It is certainly true that loop distance, along with density, is a major cost driver for loops—longer loops can cost significantly more than shorter loops. However, it is not correct to assume that a deaveraging plan that is based on deaveraging at the calling area level does not incorporate the cost impacts of loop length. In smaller, rural local calling areas with single wire centers, loop costs tend to be higher because of lower density, *and* because loops tend to be longer. In the U S WEST cost model, both of these factors lead to higher costs in smaller local calling areas, and this is reflected in its deaveraging proposal.

A deaveraging plan that offers different prices for loops *within* a wire center theoretically could better reflect cost differences. However, as I noted in my responsive direct testimony (and as discussed below), deaveraging at the sub-wire center level is significantly more complicated, would be expensive to implement in Washington and is not required in the three zone structure cited by the FCC.

Q. DOES MR. MONTGOMERY ARGUE THAT THE LACK OF SIGNIFICANT DEAVERAGING IS AN IMPEDIMENT TO COMPETITION?

A. Yes. Mr. Montgomery states that "the Commission should find that failure to deaverage loop UNE rates so as to reflect significant and real cost differences is an impediment to the development of local competition in Washington…"[14] He bases this argument on his assertion that in mid-year, 1999, unbundled loops in-use allegedly constituted less than one-tenth of one percent of U S WEST's switched retail lines.

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[14] Montgomery response testimony, pp. 7-8.

I have two comments regarding Mr. Montgomery's assertion. First, while unbundled loops remain a small percentage of U S WEST's retail basic exchange customers, the provision of unbundled loops is increasing rapidly—under the current averaged rate structure. By the end of 1999, there were approximately 6,000 unbundled loops in service, compared with approximately 200 at year end, 1998. This represents only 0.25% of retail basic exchange service, but a significant growth. Thus, average rates by themselves do not appear to be an impediment.

Second, Mr. Montgomery provides no evidence as to why competitive LECs purchase or do not purchase unbundled loops. Certainly there are many factors competitive LECs consider when deciding whether or not to purchase an unbundled loop; a competitive LEC decision cannot be solely attributed to whether or not loop prices are deaveraged, or by what amount they are deaveraged. In sum, Mr. Montgomery provides no evidence that the U S WEST deaveraging plan is an impediment to competition.

Q. MR. MONTGOMERY CLAIMS THAT HIS DEAVERAGING PLAN DOES NOT FAVOR ONE CLASS OF ILEC CUSTOMER. PLEASE COMMENT.

A. Mr. Montgomery claims that his proposal would have a similar impact on residential and business customers. While this is open to debate, it is clear that one class of customers would be harmed by his proposal—rural customers. With very high loop prices, and low retail prices, it is a virtual certainty that unbundled loops will not be purchased in rural areas—such as Zone "B" customers over 6,000 feet from the central office. Mr. Montgomery's plan benefits competitive LECs who plan to provide service in exclusively urban, low cost areas. It provides no benefit for rural customers in Washington.

Q. MR. MONTGOMERY ARGUES THAT HIS PLAN CAN BE IMPLEMENTED "WITHOUT MAJOR MODIFICATIONS TO THE ILEC'S SYSTEMS AND WITH MINIMAL ADDED COSTS TO THE INDUSTRY"[15] DO YOU AGREE?

A. No. Mr. Montgomery's plan is impractical, would be expensive to implement, and is fraught with problems for which he provides no solutions. First, Mr. Montgomery proposes an "all or nothing" rule, where a competitive LEC could choose whether to purchase loops based on an average price or based on a distance-deaveraged price. He argues that this "simplifies the deaveraging process," because some competitive LECs would purchase average loops that would not require a loop length measurement.

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15 Montgomery response testimony, p. 11.

I believe this proposal misses the mark in two respects. First, U S WEST would still need to develop systems to locate and bill customers if *any* loops are deaveraged on a distance basis in Washington. It does not simplify the process if *some* of the loops are sold on an average distance basis. The fact is, U S WEST's retail rate structure does not include deaveraging by distance, and all customers would have to be located and billed by zone, which is no simple task. Second, it makes no sense to deaverage by distance, and then provide competitive LECs with a choice of an averaged or deaveraged price. This would simply result in the purchase of deaveraged loops for competitive LECs serving customers at short distances, and the purchase of average loops for competitive LECs serving customers further from the office. While Mr. Montgomery states that a competitive LEC would have to choose the average or deaveraged rate schedule for all loops it purchases, this problem still exists. This does not represent deaveraging—it simply represents a rate reduction. The Commission should not sanction such an approach.

Q. HOW DOES MR. MONTGOMERY PROPOSE TO ADMINISTER THIS DEAVERAGING PROPOSAL?

A. Mr. Montgomery posits that:

> CLECs who did elect to utilize the distance based rates should have to assume some of the administration costs of the rate structure. For example, the ordering process and first month's ILEC bill for a loop UNE would reflect only the "A" or "B" zone rate elements. Thereafter, the CLEC could claim an offset against the average amount billed by the ILEC at the zone average rates by calculating the effective distances of the loop UNEs the CLEC was using.[16]

He then argues that an "off the shelf" software program could be used to measure distances based on latitudes and longitude, or street addresses. Using this method, a competitive LEC would "calculate the dollar effects of its distance priced loop UNE and apply an offset to its bill based upon the average priced UNE."[17]

Q. IS THIS A WORKABLE PROPOSAL?

A. No. This is an entirely unrealistic proposal that would result in massive confusion, high administrative costs for all carriers, and disputes between carriers. Mr. Montgomery has not considered the cost of processing adjustments, or the fact that an after the fact "billing by audit" process would result in numerous disputes. Mr. Montgomery also ignores the challenges inherent in locating customers. There is no "off the shelf" software that can assign customers to distance-based zones. As this

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16 Montgomery response testimony, p, 11.

17 Montgomery response testimony, p. 11.

Commission is no doubt aware, based on its prior analysis of the HAI Model and BCPM, it is no simple task to locate customers. In reality, if distance zones are established, U S WEST will have to locate all customers, and assign each customer location to a zone—before the plan is put in place.

One can only imagine the confusion involved with a plan that provides for an "after the fact" adjustment of the loop price based on the process proposed by Mr. Montgomery. Further, when a competitive LEC orders a loop, it needs to know what it will cost[18]. It cannot make decisions based on purchasing a loop with a "mystery price" to be determined later, based on a subsequent estimate of loop length. Quite simply, this proposal is a recipe for disaster from an administrative point of view.

Q. WHAT IS MR. MONTGOMERY'S POSITION REGARDING UNE DEAVERAGING AND UNIVERSAL SERVICE?

A. Mr. Montgomery dismisses U S WEST's concerns over universal service issues as a canard (defined in Webster's as "a false or unfounded story"). Mr. Montgomery essentially argues that, since U S WEST is allegedly in a "very robust financial condition which would require large general rate decreases under any previous form of rate regulation"[19] that universal service concerns are a non-issue.

Q. IS THIS A REASONABLE POSITION?

A. No. As I mentioned in my direct and direct responsive testimony, universal service, and the implicit subsidies between customers, is a very important issue that must be considered as unbundled loop rates are deaveraged. As wholesale UNE prices are deaveraged, retail rates will need to ultimately reflect the underlying wholesale rate structure. As UNE rates are deaveraged, and retail rates rise in high cost areas, universal service issues must be considered, as has been previously recognized by this Commission.

It is irresponsible for Mr. Montgomery to argue that universal service is a meaningless issue as long as a company is "making money." First, of all, Mr. Montgomery makes statements about the financial health of U S WEST, but does not provide any factual evidence to support his views. He implies that U S WEST is over-earning, and implies that any negative impacts from his deaveraging proposal would simply offset this surplus. Again, he provides no evidence to support his position. Finally, he essentially argues that U S WEST can make up for any harm through the implicit subsidies in current rates for all services. He fails to recognize the regulatory imperative to make such subsidies explicit, and he fails to address how the loss of implicit subsidies would be explicitly addressed.

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[18] For a CLEC perspective on this problem see the direct testimony of Mr. Denney, p. 6, lines 2-8.

[19] Montgomery response testimony, page 13.

Q. PLEASE ADDRESS MR. MONTGOMERY'S DISCUSSION OF ARBITRAGE.

A. Mr. Montgomery argues that "arbitrage is a normal market-clearing mechanism typical of many transactions"[20] He states further that U S WEST can adjust to this arbitrage opportunity "simply by adjusting their own retail prices."[21]

Mr. Montgomery is actually illustrating one of the major points U S WEST has made in this proceeding—that in the long run, wholesale and retail rates should be consistent. If wholesale rates are deaveraged using the plan proposed by Mr. Montgomery, there could be a significant long term shift in retail rates to eliminate this arbitrage. However, with the large spread in rates proposed by Mr. Montgomery, the prices for rural high cost customers would increase significantly. Mr. Montgomery provides no solution for this issue—he simply ignores it. In essence, he wants U S WEST to continue to pick up the subsidization of rural high cost customers, but proposes to eliminate the source of the subsidy.

Mr. Montgomery essentially argues that arbitrage is good—and that the Commission should allow gaming of the pricing structure in order to facilitate competitive entry. The Commission should reject this sort of self-serving logic, which is not in the best interests of Washington consumers

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

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[20] Montgomery response testimony, p. 14.

[21] Montgomery response testimony, p. 15.