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** BRIEF OF COMMISSION STAFF

I. INTRODUCTION

1 The Telecommunications Act of 1996, 47 U.S.C. §§ 151, et seq., requires that the rates for interconnection and unbundled network elements be "based on the cost . . . of providing the interconnection or network element." 47 U.S.C. § 252(d)(1)(A)(i). Recognizing that the cost of providing local telephone service varies by geographic area, the Federal Communications Commission (FCC) ordered states in 1996 to establish geographically deaveraged rates. See Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Report and Order, 11 FCC Rcd 15499 (1996), ¶¶ 765-66. The FCC's rule requiring geographic deaveraging, 47 C.F.R.

§51.507(f), provides, in part, that "State commissions shall establish different rates for elements in at least three defined geographic areas within the state to reflect geographic cost differences."

2 Because a number of parties appealed the FCC's pricing rules and the Eighth Circuit vacated those rules, many states, including Washington state, chose not to establish deaveraged rates. After the United States Supreme Court upheld the FCC's pricing rules in AT&T v. Iowa Utilities Board, 525 U.S. 366 (1999), the FCC stayed the effective date of its geographic deaveraging rule to allow states to come into compliance with the rule. On November 2, 1999, the FCC lifted its stay of the rule, requiring all states, by May 1, 2000, "to establish different rates for interconnection and UNEs in at least three geographic areas pursuant to section 51.507(f)." Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Ninth Report and Order and Eighteenth Order on Reconsideration, FCC 99-306, (Nov. 2, 1999) at ¶ 120.

3 Following the FCC's decision stay its deaveraging rule, the Commission determined that it should establish deaveraged prices for interconnection and unbundled network elements (UNEs). In the Matter of the Pricing Proceeding for Interconnection, Unbundled Elements, Transport and Termination, and Resale, et al., Docket Nos. UT-960369, UT-960370, UT-960371, 17th Supplemental Order: Interim Order Determining Prices; Notice of Prehearing Conference (Aug. 30, 1999) ¶ 482. To that end, the Commission initiated a Phase III proceeding in this docket, and requested parties to submit deaveraging proposals "that result in an average price for the loop that is equal to the statewide loop prices" established in the Commission's 17th Supplemental Order. Id. at ¶481.

4 In response to its request, the Commission has received a number of very different proposals from the parties to this proceeding: U S WEST Communications, Inc. (U S WEST), GTE Northwest, Incorporated (GTE), AT&T Communications of the Pacific Northwest, Inc. (AT&T), NEXTLINK Washington, Inc. (NEXTLINK) and other competitive local exchange companies (CLECs), and Commission Staff. While each proposal recommends the Commission deaverage rates for unbundled loops within the state, not every proposal would result in geographically deaveraged rates, or reflect the actual cost of providing interconnection and unbundled network elements, as required by the FCC.

5 In evaluating the merits of each party's proposal, the Commission must consider a number of policy considerations, as well as how to best implement the proposal. As will be discussed below, Staff's proposal in Exhibit 261R using H.M. 3.1 data, as modified in Tables 1 and 2, best promotes the interests of the Commission in encouraging efficient competition in local telephone service across the state--not just in low-cost urban areas, best reflects the costs of providing local telephone service, establishes defined geographic areas, and proposes a rate design that best incorporates these factors. Staff recommends the Commission adopt Staff's deaveraging proposal, including Staff's proposal for distance-sensitive pricing.

II. POLICY CONSIDERATIONS

6 Proposals to deaverage rates for unbundled local loops should implement the requirements of the Telecommunications Act that prices for UNEs be cost-based and access to UNE's be non-discriminatory. In establishing deaveraged rates pursuant to the

FCC's rule, the Commission must establish "at least three defined geographic areas" that "reflect geographic cost differences." 47 C.F.R. § 51.507(f). When setting these geographic zones, the Commission should consider not only the cost differences in providing service, but the factors of non-discriminatory access to UNEs, i.e., that deaveraging not confer any unfair competitive advantage or harm upon any carrier, efficient competition in the local exchange market, and a pricing structure that encourages competitors to serve not only the low-cost urban areas, but sends the appropriate signals to competitors for whether to lease UNEs or build their own facilities. See Cabe, Ex. 31T, at 5-8; Spinks, Ex. 251T, at 2, 6; Montgomery, Ex. 301, at 3. The pricing structure should not be overly complex or impose excessive administrative costs. Montgomery, Ex. 301, at 3, Spinks, Ex. 260T, at 2-3.

7 In promoting the policy of non-discriminatory access to UNEs, the Commission must ensure that incumbent local exchange carriers (ILECs) and CLECs face the same forward-looking cost for an ILEC's unbundled loop when providing service to the local customer. Otherwise, the ILEC may be able to engage in price discrimination between its retail customers and CLECs purchasing loops. See Cabe, Ex. 31T, at 5-6.

8 Generally, under an averaged-rate structure, if the loop price exceeds the loop cost, or the loop price is less than the cost of the loop, pricing distortions will occur that may result in the CLEC making inefficient choices of how to compete, by purchasing loops where it should build its own facilities and the reverse. See Cabe, Ex. 31T at 6-8. While deaveraging rates in a few zones, i.e., three, four or five, will not result in CLECs and ILECs facing the true cost of the loop (see Tr. Vol. 10, at 2351-52), deaveraging in a few

areas where the cost differences are the most significant will allow more efficient competition to begin in the local market.

9 Likewise, how the Commission deaverages rates will affect whether CLECs choose to serve customers outside of the low-cost, core urban areas. Witnesses in this proceeding generally agreed that the CLECs tend to first focus on providing service to businesses rather than residential customers and focus primarily on serving the downtown, urban areas where the cost of the loop tends to be the lowest. However, a primary goal of the Telecommunications Act, and of the Commission, is to encourage competition and choice to all customers, including those in rural, more high-cost areas of the state. Therefore, the Commission should strongly consider implementing a rate structure that encourages appropriate and efficient CLEC investment in all areas of the state.

10 U S WEST and GTE suggest that the Commission should not deaverage wholesale rates without a state universal service fund in place, or without deaveraging or rebalancing retail rates. See Thompson, Ex. 61T, at 5-9; see also Dye, Ex. 141T, at 8-17. While the Commission has recognized the importance of these considerations in prior orders, it is not necessary for the Commission to accomplish them all at the same time. Given the FCC's requirement that states establish deaveraged rates by May 1, 2000, and the Commission's current lack of statutory authority to establish a state universal service fund, the Commission cannot wait to deaverage rates, as the ILECs request. See Tr. Vol. 10, at 2370-71. Other states in which U S WEST provides local service have deaveraged wholesale rates without having a state universal service fund in place and without deaveraging retail rates. Id. at 2372-74, 2377-79. To the extent that the risk of arbitrage

exists, it is speculative at best. See Knowles, Ex. 281T, at 3-6; Montgomery, Ex. 303T, at 9-10; Spinks, Ex. 260T, at 11-12. Further, it is not clear that U S WEST or GTE will suffer immediate or actual harm if the Commission were to deaverage only wholesale rates at this time. See Tr. Vol. 10, at 2381-82. Even U S WEST recognizes that any harm the company might experience would not occur immediately. Id. at 2369-70.

III. STAFF'S DEAVERAGING PROPOSAL

A. Statement of Staff's Proposal:

11 While Staff has made several proposals for deaveraging the price of the loop in its pre-filed testimony, Staff recommends the Commission adopt Staff's final proposal presented in Exhibit 261R using data from the HM 3.1 model.[1] In this proposal, Staff recommends the Commission deaverage rates using a flat, density zone-based, rate structure, with four zones for U S WEST and three zones for GTE, where density is measured as the number of lines per square mile of serving area. Spinks, Ex. 260T, at 10; see also Ex. 261R. The zones consist of existing exchanges grouped by density. See Exs. 256, 259. Some of the exchanges include more than one wire center, whereas most of the exchanges in the smaller zones consist of only one wire center. See Tr. Vol. 12, at 2667-68. Staff suggests using four zones for U S WEST, given that U S WEST has exchanges or wire centers in a higher density range than GTE. See Tr. Vol. 12, at 2657. Staff's deaveraged rate

[1] While Staff initially proposed a deaveraged switch rate, Staff's final proposal no longer includes such a proposal.

proposals for U S WEST and GTE are contained in the following tables, derived from Exhibit 261R:[2]

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TABLE 1: U S WEST

ZONE:	>2550	650-2550	100-650	0-100
RATE:	$12.53	$15.87	$18.95	$42.41
Distance Band:				
0-12	$11.88	$14.02	$16.44	$35.43
12-24	$14.90	$17.58	$20.61	$44.42
>24	$16.25	$19.83	$23.66	$53.61

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TABLE 2: GTE

ZONE:	>650	50-650	0-50
RATE:	$16.50	$24.45	$66.96
Distance Band:			
0-12	$14.22	$21.15	$53.81
12-24	$18.09	$26.90	$68.43
>24	$19.84	$31.59	$84.62

14 The FCC rule requires not just deaveraged rate zones, but "defined geographic areas" that reflect cost differences. Staff chose to use density zones as the basis for determining deaveraged zones, as density is the primary driver of loop cost. Spinks, Ex. 260T, at 10. Staff interpreted the FCC's requirement to mean that the Commission must identify specific areas within the state that show significant cost variations, and that significance should be determined using statistical tests. See Spinks, Ex. 251T, at 2. Staff established its proposed density zones using the HAI cost model density zones as a starting point, as "Staff could not determine a unique set of geographic areas where costs differed significantly." Ex. 251T, at 3-4; see also Tr. Vol. 12, at 2631-32.

[2]Table 1 includes the corrected rates for density zone 100-650, as well as the correct density zone of 2550, not 2500, that Mr. Spinks noted during the hearing on March 1, 2000. See Tr. Vol. 12, at 2658, 2730-31.

15 Staff also proposes a distance-sensitive pricing structure, in which loop rates would be further deaveraged depending on the length of the loop. Staff and NEXTLINK witness Mr. Montgomery believe that distance-sensitive pricing is appropriate, as it reflects that loop length is one of the more important drivers of loop cost. Spinks, Ex. 260T, at 5-6, 7; Montgomery, Ex. 301, at 6. Distance-sensitive pricing will allow potential competitors to make more efficient technology choices in determining whether to serve customers using leased UNEs or building their own facilities. Spinks, Ex. 261T, at 6; Montgomery, Ex. 301, at 7. Further, distance-sensitive pricing may allow CLECs to begin penetrating the local market in more rural areas, beginning in the less costly areas and branching out once they establish operations. Spinks, Ex. 251T at 6; Knowles, Ex. 281T, at 8; see also Tr. Vol. 12, at 2705-2707, 2756-57.

B. Corrections Necessary as a Result of the Hearing:

16 During the hearing, the parties criticized Staff's flat-rate proposal and distance-sensitive pricing proposal. Parties charged that the flat-rate proposal was flawed due to use of exchanges rather than wire centers within density zones, the use of the HAI 5.0a model, and noted several numerical errors. Parties criticized Staff's distance-sensitive proposal as going too far, and argued that Staff's statistical analysis supporting the proposal was flawed.

17 Staff made a number of modifications to its earlier proposals to address the concerns of other parties. Thus, aside from a few minor numerical corrections to Exhibit 261R, Staff continues to recommend that the Commission adopt the flat-rate, density zone-based, proposal set forth in Exhibit 261R and Tables 1 and 2. While Staff believes its distance-

sensitive pricing proposal to be statistically valid and an adequate basis for setting a deaveraged rate for the loop, Staff recognizes that the Commission may wish to further explore how to best implement a distance-sensitive pricing structure. If the Commission does not adopt Staff's distance-sensitive proposal, Staff recommends that the Commission order distance-sensitive pricing as a part of its decision to deaverage rates, but identify a set time for implementation.

1. Flat-Rate Proposal:

18 First, after questions from U S WEST during the hearing, Staff witness Spinks corrected certain rates reflected in Ex. 261R under the HM 3.1 model for density-zone 100-650, and corrected the density zones for U S WEST to reflect that the high end is 2550 lines per square mile, not 2500. See Tr. Vol. 12, at 2658, 2730-31. These corrections to Exhibit 261R are noted in Table 1 above.

19 In pre-filed testimony and during the hearing, parties argued that exchanges are not an appropriate basis for geographic deaveraging, as each wire center within an exchange may not fall within the average density zone for the exchange. As Staff has recognized, some high-cost wire centers are included with low-cost wire centers if they are within the same exchange, and the averaging that results when using exchange level data will cause some distortion in the rate. See Tr. Vol. 12, at 2633-34.

20 Staff used the exchange as the basis for deaveraging rates in order to maintain consistency between the geographic level at which deaveraging and universal service funding are likely to take place, and because using the exchange was administratively simple and provided a contiguous geographic area in which people receive service at a common rate.

Spinks, Ex. 251T, at 4; see also Tr. Vol. 12, at 3632-33. However, Staff recognizes that basing deaveraging on wire centers will produce more economically efficient prices, and notes that its proposal in Ex. 261R could be recalculated using wire centers rather than exchanges. See Tr. Vol. 12, at 2719, 2725-27.

21 Third, GTE and U S WEST have opposed Staff's use of HAI model 5.0a data in its deaveraging proposals. In fact, the Commission has granted GTE and U S WEST's motion to strike references in the testimony and exhibits to HAI 5.0a data. GTE and U S WEST will undoubtedly object in their briefs to the Commission relying on any of Staff's proposals, and will likely assert that Staff's use of HAI 5.0a data permeates Staff's presentation and renders it fatally flawed. GTE plans to include with its brief a detailed list of references in testimony to the HAI 5.0a model. While Staff acknowledges that it did rely heavily on HAI 5.0a to develop its initial proposals, Staff asserts that it has revised its proposals so as not to rely on the results of HAI 5.0a. There is no need to strike Staff's testimony that discusses generally how Staff developed its proposal, nor is it necessary to strike Staff's final proposal.

22 Specifically, given the objection to the use of HAI 5.0a data, Staff witness Spinks submitted proposals in his rebuttal testimony, Exhibit 260T, using both HM 3.1 and HAI 5.0a data. In addition, when Mr. Spinks became aware that certain HAI 5.0a data were still present in his HM 3.1 proposal, he revised his proposal to exclude the data. This exhibit was admitted as Exhibit 261R. Under cross-examination, it became clear that there is still one data point in the GTE HM 3.1 flat-rate proposal using HAI 5.0a data - the data point for Stevens Pass. See Tr. Vol. 12, at 2623-25. If Staff's proposal were

recalculated without the Stevens Point data point, the resulting change in cost would not be significant.

23 U S WEST is likely to argue that the Commission should strike the portion of Exhibit 261R referring to Staff's deaveraging proposal for U S WEST using HM 3.1 data. Staff's response to Bench Request No. 1, admitted as Exhibit 401, states that "Due to a number of errors in the HM 3.1 model data for the U S WEST wire center areas, for purposes of classifying wire centers to the correct density zone and the regressions, wire center area data for U S WEST was obtained from the HAI 5.0a version of the model." It should be made clear, however, that the data used is not output from the model, but data inputted into the model. See Tr. Vol. 12, at 2737-38, 2806. To the extent that the Commission has stated that it will not rely on the results of the HAI 5.0a model, Staff has not done so. See Tr. Vol. 12, at 2817.

2. Distance-Sensitive Proposal:

24 GTE's witness Tucek, U S WEST's witness Carnall, and Dr. Gabel each questioned whether the estimation coefficients Staff used in regressions for its distance-sensitive proposal were biased. Staff acknowledges that there is some bias in the estimation coefficients. However, given that the Commission may never know the true costs of the loop, and given that the Commission will need to reconcile back to the statewide average rate that itself is a product of averaging, Staff's effort is a way to try to estimate what the cost is. While it is not a statistically perfect proposal, it is close enough to estimate cost and develop a distance-sensitive pricing proposal. See Tr. Vol. 12, at 2692-95.

25 U S WEST and GTE also question how easy a distance-sensitive pricing structure would be to administer and incorporate within their Operation Support System, or OSS. Although Staff recognizes that there are implementation and customer identification issues that remain to be determined, Staff believes the parties could resolve these issues in a workshop. See Tr. Vol. 12, at 2700-2701. Given the parties questions at hearing, and the Commission's concern over implementation and customer identification issues, Staff recommends, as Chairwoman Showalter suggested during the hearing, that the Commission find that distance-sensitive pricing is appropriate, set a certain schedule for implementation, and order the parties to work together to develop a proposal. See Tr. Vol. 12, at 2800-2801.

C. Summary of Proposal:

26 In summary, Staff proposes that the Commission, at the very least, adopt Staff's flat, density zone-based, rate deaveraging proposal based upon HM 3.1 data that organizes exchanges into the appropriate density zone. Staff recommends that the Commission use the density zones set forth in Exhibit 261R and above in Tables 1 and 2. These density zones reflect significant geographic cost differences between wire centers and exchanges.

27 Staff also recommends the Commission adopt the distance-sensitive pricing structure reflected in Tables 1 and 2. However, if the Commission does not believe that it can adopt a specific distance-sensitive pricing proposal at this time, Staff urges the Commission to follow the option (option two) proposed by Chairwoman Showalter during the hearings. See Tr. Vol. 12, at 2800-2801. Specifically, Staff recommends the Commission order that distance-sensitive pricing is appropriate, set a date for

implementing a distance-sensitive pricing structure, and require the parties to work together to develop a distance-sensitive pricing proposal.

D. Comparison with Other Proposals

28 Each party has a particularly different recommendation for how the Commission should accomplish deaveraging. Staff notes that AT&T's proposal and Staff's flat-rate proposal are the closest, and recommends use of Staff's proposal given the arbitrary nature of setting zones under AT&T's proposal.

1. AT&T

29 AT&T proposes to deaverage rates by setting zones based on wire center costs. Like Staff, AT&T relies on the HM 3.1 model to develop its proposal. Tr. Vol. 10, at 2211. While AT&T initially proposed a combined deaveraged rate for both U S WEST and GTE, AT&T's final proposal recommends three zones for U S WEST and proposes three alternatives for GTE, two three zone proposals and one with four zones. Denney, Ex. 4T, at 8, 11, 12, 16. MCI WorldCom, Inc. has not presented its own proposal and supports AT&T's proposal. See Cabe, Ex. 33T, at 13.

30 The primary flaw in AT&T's proposal is that defining each zone is quite arbitrary. AT&T's witness Denny asserts that he looked at the percentage change in cost between wire centers to determine the cutoffs. Tr. Vol. 10, at 2205. However, the cutoffs between zones were not determined by statistical significance, and only loosely comply with the FCC's requirement that the zones reflect geographic cost differences. In fact, Mr. Denny described how the Commission could choose to set the zones using his proposal, depending on the factors it deems important: "If they want an equal number of customers

in each zone, then you would choose different cutoffs than if you wanted to looked at a break in costs between the zones. If you wanted to assign a large number of customers in the low-cost zone, that would determine a different cutoff." Tr. Vol. 10, at 2206; see also Tr. Vol. 10, at 2239 ("There's nothing magical about 1.1 percent or 1.3 percent.").

31 The primary difference between AT&T's final proposal and Staff's final flat-rate proposal is the use of wire center cost rather than density zones to establish deaveraged zones. Tr. Vol. 12, at 2733-34. As Mr. Denney notes, the use of exchanges rather than wire centers does not really make that much difference in determining the cost differences. Tr. Vol. 10, at 2223. Staff believes that the use of density zones will result in a more geographically-based deaveraged zone than a pure wire center cost proposal. When only the wire center cost is used to define zones, an inordinate amount of subjective judgment must be used. The predefined density zones, on the other hand, offer a straightforward solution to the question of how zones should be developed for deaveraging UNE loops.

2. GTE

32 As with other parties, GTE has refined its proposal with each round of testimony, as well as during the hearing. GTE initially proposed to deaverage rates based on the use of density zones. See Tr. Vol. 11, at 2512. GTE's witness Dye provides GTE's final proposal, which proposes to use wire center cost as the basis for establishing deaveraged rates, and ranks the wire centers from lowest to highest cost. See Tr. Vol. 11, at 2591-2493. GTE's proposal differs from AT&T's proposal in three ways: AT&T's proposal relies on the HM 3.1 model and GTE's relies on its proprietary cost model; the two

parties disagree on where to draw the cutoffs between the zones; and AT&T's proposal includes four zones, while GTE's includes three. Tr. Vol. 11, at 2494, 2495, 2496.

33 GTE's proprietary cost model does not estimate specific wire center costs. GTE derived the wire center cost estimates from the aggregate GTE CostMod estimates, resulting in data with very little variation. GTE asserts that its proprietary model is preferable to HM 3.1 because there is less variation under GTE's model. However, this assertion is faulty. GTE has engaged in an apples-to-oranges-type of comparison. See Spinks, Ex. 260T, at 9. The loop distributions and density zone cost estimates in GTE's CostMod contained very little variation to begin with. Disaggregating such data will result in little variation, which does not prove the superiority of CostMod over HM 3.1. It simply proves the problems with the CostMod data. Id.

34 The Commission should reject GTE's proposal, as it is based on a cost of wire center basis, relies on wire center cost data derived from the company's proprietary cost model, and incorporates too many higher cost wire centers in the low-cost zone. For example, GTE's proposal appears to indicate that loops in Pullman are cheaper than loops in Everett. See Tr. Vol. 12, at 2725-26. Should the Commission choose to deaverage rates based on wire center costs, Staff recommends the Commission use AT&T's proposal, as it uses HM 3.1 data, and there is no problem of mixing low-cost and high-cost wire centers in the same zone. Id.

3. U S WEST

35 U S WEST proposes a "community-of-interest" method of deaveraging rates that supposedly reflects the local calling areas in which its retail customers currently fall. Tr.

Vol. 10, at 2339-40; 2344. U S WEST argues that this proposal best reflects the FCC's requirement to establish geographic zones, and is consistent with U S WEST's desire for consistency between its retail and wholesale rates. Tr. Vol. 10, at 2345. The primary flaw with U S WEST's proposal is that it combines truly high-cost and low-cost wire centers within the same zone, and effectively eliminates the advantages of deaveraging. See Cabe, Ex. 33T, at 3; Denney, Ex 4T, at 1-2, 5; Spinks, Ex. 255T, at 2-3. U S WEST's witness Thompson is correct that every party proposes an option for deaveraging that is based on averaging at some level. Tr. Vol. 10, at 2357-58. However, the true effect of U S WEST's proposal is to inflate the price of the loop in the low-cost, urban area, and underestimate the cost of the loop in more high-cost areas. Such a proposal will not allow for efficient competition in the local market, clearly a strategy that would benefit U S WEST over competing carriers.

36 Further, U S WEST's proprietary cost model does not use detailed geographic information on wire center and customer location relationships in developing loop investments, and therefore, cannot provide accurate estimates for specific wire centers. See Spinks, Ex. 255T, at 4. As described above, the proprietary cost models will overestimate the cost of the loop in the low-cost urban areas, and underestimate the cost in high-cost rural areas. The Commission should, therefore, reject U S WEST's proposal.

4. CLECs

37 NEXTLINK and other CLECs support a deaveraging proposal submitted by witness Montgomery that modifies Staff's distance-sensitive pricing approach to include two density zones, and seven distance-sensitive rate categories, resulting in 14 rates for each

company. See Montgomery, Ex. 301T, at 10, see also Ex. 302. Mr. Montgomery also recommends an "all or nothing" rule, in which he recommends the Commission require CLECs to permanently elect whether to use a flat-rated or distance-sensitive pricing structure, where CLECs that elect to use the distance-based pricing structure would assume the administrative costs for the rate structure. See Ex. 301T, at 11. The "all or nothing" proposal would seek to discourage CLECs from gaming the system by choosing distance-sensitive or flat-rate pricing depending on which would maximize profits. See Spinks, Ex. 260T, at 13-14.

38 Staff supports the use of distance-sensitive pricing, but recommends the Commission adopt the distance-sensitive pricing proposal Staff developed in response to Mr. Montgomery's testimony. See Spinks, Ex. 260T, at 12. In response to Mr. Montgomery's and other witness's testimony, Staff revised its proposal to use a much smaller number of zones and distance-sensitive bands. Id. at 13. Staff cannot support Mr. Montgomery's "all or nothing" proposal, but notes that the restriction is a step in the right direction. Id. Staff recommends that the Commission adopt a flat-rate structure or a distance-sensitive rate structure, but not both. As other parties have recognized during the hearing, this proceeding is really the first step in deaveraging, and the Commission may choose to further deaverage or revise its deaveraged rate structure after there is some experience under a deaveraged rate structure.

IV. CONSISTENCY OF STAFF'S PROPOSAL WITH PRIOR COMMISSION STATEMENTS ON DEAVERAGING AND IMPLICATIONS OF STAFF'S POSITION IN THE CURRENT PROCEEDING

39 In its Eighth Supplemental Order in this proceeding, the Commission stated that it chose not to deaverage interconnection and UNE rates, in part because of the Eighth Circuit's decision in Iowa Utilities Board v. AT&T, 120 F.3d 753 (8th Cir. 1997). See Pricing Proceeding, Docket Nos. UT-960369, UT-960370, UT-960371, Eighth Supplemental Order; Interim Order Establishing Costs for Determining Prices in Phase II; and Notice of Prehearing Conference (April 16, 1998), at ¶¶ 273-74. However, the Commission also agreed "with Commission Staff and the other parties who argue that it is more appropriate to consider this issue in the context of universal service reform, deaveraged retail prices, and the extent of competitive activity in Washington State." Id. at ¶ 274.

40 In its 17th Supplemental Order, the Commission stated that it would address deaveraging in Phase III of the proceeding, as the Eighth Circuit's order vacating the FCC rules had been overruled by the U.S. Supreme Court, and that the FCC had stayed the effect of its deaveraging rule. Pricing Proceeding, 17th Supplemental Order, at ¶¶ 477-78, 480. The Commission noted that, although the Commission had received evidence on the cost of providing service in different density zones, it chose, on Staff's recommendation, not to pursue deaveraging until a state universal service fund program had been established. Id. at ¶ 479.

41 Staff does not now advocate waiting to deaverage rates until a state universal service fund program has been developed, or until retail rates can be deaveraged. In Phase I of the proceeding, Staff recommended delaying deaveraging, but did not disfavor deaveraging

as questions during the hearing implied. See Tr. Vol. 12, at 2693. In Phase I, Staff was concerned about the impact of deaveraging in rural areas without the offsetting funding to produce comparable rates. While Staff remains concerned about this issue, Staff recommends the Commission proceed to deaverage rates. In part, the Commission has no choice but to pursue deaveraging given the FCC's order to lift the stay. Also, as Staff noted above in its discussion of policy considerations, Staff believes the ILECs concerns about arbitrage are speculative and overstated.

42 Since Phase 1 of this proceeding, Staff, like other parties, has looked at the data and considered what it believes to be the best approach to deaveraging. While a distance-sensitive approach may seem to be fairly "aggressive," it also appears to be the most economically efficient approach to deaveraging. In the Universal Service Proceeding, the Commission determined that "At this point in time, verifiable data such as line counts and loop lengths are unavailable at a fine level of granularity" than at the wire center level. In the Matter of Determining Costs for Universal Service, Docket No. UT-9809311(a), Tenth Supplemental Order; Order Establishing Costs (Nov. 20, 1998) at ¶ 71. However, Staff believes it has developed a finer level of granularity in proposing a distance-sensitive pricing structure. See Tr. Vol. 12, at 2686-87.

43 In paragraph 72 of the Commission's Order Establishing Universal Service Costs, the Commission noted that WITA proposes that rural companies be treated differently from non-rural companies, in that the FCC has determined that the proxy models should not be used to measure a rural company's forward looking cost of providing universal service, and has maintained existing levels of implicit support until at least January 2001. See Id.

at ¶ 72. Staff's distance-sensitive proposal may require a universal service plan similar to the core-fringe plan approved by the FCC for rural companies in Docket No. DA99-1844. ILEC universal service payments would be lower or non-existent in the lower cost urban areas of wire centers for rural ILECs.

V. IMPLEMENTATION ISSUES

A. Implementation:

44 The parties recognize that there are costs associated with implementing any deaveraged rate structure, whether it is a flat-rated or distance-sensitive structure. In particular, under any deaveraging proposal, CLECs and ILECS must be able to easily determine the zone into which a particular loop falls, and ILECs must incorporate the rate structure into their ordering and billing systems, i.e., the OSS system. See Tr. Vol. 10, at 2302-3. Thus, the Commission should seek to adopt a rate structure that is administratively simple and inexpensive to implement.

45 AT&T's witness Denney asserts that using a deaveraging approach based on wire centers rather than density zones will be easier to administer, as he is able to identify the wire center that serves a customer simply by knowing the customer's address. Tr. Vol. 10, at 2259-60. However, if Staff's proposal is recalculated using wire centers rather than exchanges, the CLECs and ILECs will still be able to easily identify the zone in which the customer falls, and thus the rate that applies. Even though Staff's proposal relies on density zones, it also relies on exchanges to set the zone rates for loops, and exchanges consist of wire centers.

46 Parties argue that the Commission should wait to implement Staff's distance-sensitive pricing proposal, as a number of implementation issues, including the use of the ILEC's OSS systems, customer identification, and estimating loop lengths, are not fully developed. Staff disagrees that these issues are so complex that they cannot be quickly implemented. Staff and CLEC witness Mr. Montgomery both suggest that online data bases, such as MapQuest, can be used to simplify the need to identify the actual distance of each loop. In addition, if the wire center or exchange is the basis for deaveraging, both CLECs and ILECs can easily determine the zone in which a customer is located by looking simply at the wire center data. However, Staff does not object to delaying implementation of a distance-sensitive price structure in order to work out the details. Staff and others have suggested that the parties should be able to develop a workable distance-sensitive rate structure, and determine implementation issues in a workshop, as parties have on other issues such as pole attachments. See Tr. Vol. 10, at 2302; see also Vol. 12, at 2700.

B. Number of Zones:

47 The FCC requires that state Commissions adopt at least three zones when deaveraging rates. See 47 C.F.R § 51.507(f). Most parties have presented flat-rate proposals that recommend the use of three or four zones. For example, Staff recommends the use of four zones for U S WEST given that U S WEST has more wire centers or exchanges in low-cost density zones. However, AT&T proposes four zones for GTE, rather than three, to reflect differences in cost in smaller wire centers. As the Commission uses more zones to deaverage rates, the rate structure will be more economically efficient, and the cost of

the loop (or wire center) will be more precise, i.e., less aggregated. See Tr. Vol. 10, at 2263, 2354. However, the more the rate is dissaggregated, for example, using a distance-sensitive rate structure, the costs of implementing the rate structure will increase. Tr. Vol. 10, at 2263. For that reason, Staff recommends the Commission implement a flat-rate structure with relatively few zones (three to four), and work toward a set date for implementing a distance-sensitive rate structure.

C. Cost and Cost-Recovery of Implementing a Distance-Sensitive Rate Structure:

48 Staff does not deny that there will be costs to both CLECs and ILECs associated with implementing a distance-sensitive rate structure. However, Staff seriously doubts the costs will be as high as U S WEST and GTE state in their pre-filed testimony. Those estimates are speculative and not based on any serious projections. See Spinks, Ex. 255T, at 3-4. In particular, these estimates are based on the perceived need to identify precise loop lengths for each service address. Id. Staff does not believe that would be necessary.

49 For example, as Staff noted during the hearing, there are certain wire centers where the length of every loop in the wire center is less than 12 kilofeet. Tr. Vol. 12, at 2702-3. If a distance-sensitive rate structure has a cutoff at 12 kilofeet, there is really no reason to identify the precise length of each loop to determine its price. In addition, the ILECs assume that CLECs will request a large number of loops, immediately. Testimony in the hearing indicated that the number of loops requested from the ILECs has been fairly low.

50 Given that the Commission is about to engage in an analysis of U S WEST's and GTE's OSS cost models, it seems appropriate for the Commission to request the parties to also discuss in that proceeding the impact of a distance-sensitive deaveraging proposal on the

cost of their OSS systems. Apart that from that proceeding, Staff recommends that, to the extent there are additional OSS costs due to a distance-sensitive deaveraging rate structure, that CLECs be required to pay the appropriate costs for the use of the system. However, Staff believes that it should not be too difficult for the parties to develop a system that minimizes the costs of identifying the distance of a particular loop, application of a particular rate, and billing for that rate.

VI. CONCLUSION/ RECOMMENDATIONS

51 Staff recommends the Commission, at the very least, adopt Staff's proposal set forth above in Tables 1 and 2 above to deaverage loop rates by establishing a flat, density zone-based, rate using either exchanges or wire centers. Staff also recommends the Commission adopt Staff's distance-sensitive pricing proposal. However, if the Commission chooses not to adopt Staff's distance-sensitive proposal, Staff recommends the Commission order distance-sensitive pricing, and set a date for implementation following workshops among the parties.

DATED this 28th of March, 2000.

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