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

POST-HEARING BRIEF OF GTE NORTHWEST INCORPORATED

PHASE III – DEAVERAGING

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GTE Northwest Incorporated ("GTE" or "Company"), by counsel and pursuant to the Commission's Confirmation of Briefing Schedule, dated March 7, 2000, hereby submits its Post-Hearing Brief.

I.Introduction

1. The Commission initiated this proceeding to fulfill its obligations under the Telecommunications Act of 1996. Phase I established the cost methodology and statewide average costs of unbundled network elements ("UNEs"). The Commission found it premature to deaverage UNE rates, stating that deaveraging should occur in the context of universal service reform and retail rate rebalancing. In Phase II, the Commission established statewide average rates for certain UNEs. However, the Commission found that it was required by Federal Communications Commission ("FCC") Rule 51.507(f) to establish geographically deaveraged rates. The Commission established

Phase III of this docket to fulfill this requirement using the costs and statewide average rates established in Phases I and II.

2. GTE recognizes and supports the fact that wholesale rates must be deaveraged. However, UNE rates should not be deaveraged in a vacuum, but must be deaveraged in the context of retail rate rebalancing and the maintenance of an explicit, sufficient, and portable universal service support mechanism. Because these issues are inextricably linked, GTE urges the Commission to seek a waiver of the FCC deaveraging rule until it can address these issues simultaneously.

3. In the absence of such a waiver, the Commission has several proposals from which to chose. All parties agree that the Commission need only deaverage the loop at this time. Moreover, most agree that three geographic zones – the minimum required per state under the FCC's rules – are sufficient. GTE submits three deaveraging proposals to the Commission that satisfy these goals in an economically efficient manner. GTE's preferred approach would be for the Commission to adopt the proposal set forth in the Rebuttal Testimony of its witness Terry R. Dye. These rates were developed by ranking GTE's wire centers from low to high cost – using GTE's cost estimates – and defining three zones based on obvious cost breaks.

4. AT&T Communications of the Pacific Northwest ("AT&T") proffers deaveraging proposals that are also based ranking wire centers by cost and defined zones allegedly based on cost breaks. AT&T developed deaveraged rates in three zones using cost proxy model estimates. AT&T developed an alternative proposal using GTE's cost estimates to produce deaveraged rates in four zones. The only major difference between AT&T's alternative proposal and that of GTE is where to draw the line between zones. GTE suggests a reasonable middle ground proposal by using AT&T's methodology with GTE's cost estimates, collapsing AT&T's Zones 1 and 2, and constraining the zones so that wire centers in the same exchange are in the same deaveraged zone.

Alternatively, the Commission could adopt GTE's modification of the AT&T proposal without constraining zones.

5. The Commission should reject Staff's distance-sensitive deaveraging proposal. Staff's proposal is based on a flawed methodology and supported by unreliable statistical analysis. Moreover, the systems modifications and administrative costs associated with implementing such a pricing scheme far outweigh any possible benefits.

II.Policy Considerations

A. The Commission Should Not Deaverage Rates In The Absence Of Retail Deaveraging And A Universal Service Fund.

6. In its Eighteenth Order on Reconsideration of the Commission's Ninth Report and Order in CC Docket No. 96-45 and CC Docket No. 96-98, the FCC lifted the stay of its rule requiring state commissions to establish at least three zones for deaveraging of UNEs and interconnection rates effective May 1, 2000. To deaverage wholesale rates without creating arbitrage opportunities and undermining investment incentives, states must simultaneously remove implicit support from local rates and establish explicit, portable intrastate universal service mechanisms. Washington will not be able to accomplish these objectives by the May 1st deadline, and therefore GTE urges the Commission to seek a waiver.

7. The FCC adopted a stay of the effective date of its deaveraging rule primarily because states must consider "in a coordinated manner the deaveraging issues that are arising in a variety of contexts affecting local competition." *Deaveraged Rate Zones for Unbundled Network Elements, Stay Order*, CC Docket No. 96-98, 14 FCC Rcd 8300 (re. May 7, 1999) ("Stay Order") ¶ 6. The FCC clearly intended for states to consider these issues in tandem:

> By linking the duration of the stay to the universal service proceeding,

> we afford the states and ourselves the opportunity to consider in a coordinated manner the deaveraging issues that are arising in a variety of contexts affecting local competition. We are considering in the universal service proceeding what level of geographic deaveraging to use in determining the universal service support available to non-rural LECs serving high-cost areas. ***States are confronting similar issues.*** In addition, in the access reform proceeding, we are continuing to assess rates of incumbent LECs. ***Applying different standards for, or degrees of, geographic deaveraging in different contexts might create arbitrage opportunities or distort entry incentives for new competitors***. Temporarily staying the effectiveness of section 51.507(f) will afford regulators the opportunity to consider the ramifications of deaveraging for the pricing of unbundled network elements, for universal service support in high cost areas, and for interstate access services.

Stay Order at ¶ 6 (emphasis added).

8. To encourage real competition and avoid increasing arbitrage opportunities, the Commission needs sufficient time to remove implicit support from local rates and develop explicit intrastate universal service mechanisms. Local competition for most residential customers and many geographic areas is currently constrained by implicit support contained in local rates. Washington currently relies on geographic rate averaging and above-cost business rates to subsidize high-cost residential rates, *i.e.*, business customers and low-cost residential customers pay more than the cost of their service so that high-cost customers can pay less than the cost of their service. As the Commission explained to the Washington Legislature last year, this system of implicit subsidies, including averaged retail prices, supports universal service within the state. The Commission concluded:

> It cost[s] more than $20.00 per month to provide basic service in many areas of Washington State. In some very remote areas, the actual cost of providing service can be $350.00 per month – an amount that is not affordable. In order to provide local service to a high-cost location at an affordable price, it is necessary to support that service with money from a source other than the customer's $20.00 per month payment. In Washington, we have used average pricing

> for decades to support the high-cost customer. Monopoly telecommunications providers have been permitted to charge an above-cost price in dense, urban areas in order to provide sufficient revenue to permit charging only the same average (and affordable) price to their customers in high-cost locations.[1]

Preserving and Advancing Universal Service in a Competitive Environment, A Report to the Washington State Legislature prepared by the Washington Utilities and Transportation Commission (Jan. 1998) ("USF Report 1") at 3; *See also Promoting Competition and Reforming Universal Service,* A Report to the Washington State Legislature Prepared by the Washington Utilities and Transportation Commission (Nov. 1998) ("USF Report 2") at 24.

9. Recognizing and taking advantage of the established and accepted implicit subsidy pricing, competitors have focused on serving business customers and low-cost residential customers, such as multi-dwelling unit residents. As competition has increased, particularly in the business market, intrastate implicit funding is being eaten away. The USF Reports recognized that fair and efficient competition is not possible in the presence of implicit subsidies, such as those embodied in retail rate averaging:

> Competition, if it is to be fair and even, cannot work when one company has the benefit of subsidies and another company does not. A new competitor cannot expect to sign up customers if it has to charge $50.00 per month for basic service while the incumbent, with a large base of low-cost customers in the city can still charge its rural customers only $20.00 for service. The same incumbent with the advantage in the country, however, will be at a disadvantage in the city if it has to charge all of its customers in urban areas more than the cost of service in order to support customers in rural areas. A new competitor in the city can price basic monthly service lower than the incumbent who must charge a little extra in order to keep the basic charge affordable for rural customers.

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[1] GTE does not agree with these Commission cost estimates, as they are significantly understated. Nevertheless, they illustrate the existence and extent of the implicit universal service supports in GTE's present rate structure.

USF Report 1 at 4; *see also* USF Report 2 at 24-25. As business and low-cost urban customers are lost to competitive local exchange carriers ("CLECs"), incumbent local exchange carriers ("ILECs"), such as GTE and U S WEST, no longer collect sufficient access, toll, and local service revenues to offset the cost of serving higher cost areas.

10. Rate averaging and implicit support also distort investment incentives for competitors, frustrating the development of facilities-based competition. CLECs are discouraged from building facilities in high-cost areas because they cannot compete with ILECs' artificially low rates. Further, uneconomic over-investment in low-cost areas (such as dense urban centers) is encouraged because of ILECs' artificially high rates. *See* USF Report 2 at 25.

11. Deaveraging UNE and interconnection rates without removing implicit support from retail rates would only exacerbate the current arbitrage opportunities and further discourage competition in high-cost areas. Exhibit 141T:9, 13 - 14 (Dye). When UNE and interconnection rates are deaveraged, it becomes even less expensive for CLECs to serve low-cost customers and more expensive to serve high-cost customers. Thus, CLECs will have an increased ability to cream-skim profitable customers from the ILEC, but will be further discouraged from competing for high-cost customers. This will, of course, further undermine intrastate implicit subsidies.

12. Even the advocates of uniform TELRIC pricing recognize the need to consider an ILEC's retail rate structure when establishing UNE rates. For example, William Baumol presents a methodology for establishing competitively neutral prices for accessing those network elements considered to be bottleneck facilities that takes into account the incumbent provider's retail rate structure. Exhibit 141T:14 (Dye); Exhibit 142. This is particularly enlightening since the FCC and others have relied on a previous affidavit co-authored by Professor Baumol in which he stated that "the appropriate forward-looking benchmark for pricing [UNEs] is the total service long run

incremental cost, or TSLRIC." Exhibit 141T:14 (Dye) (quoting Affidavit of William J. Baumol, Janusz A. Ordover, and Robert D. Willig ¶ 3, at 2, Implementation of the Local Competition Provisions in the Telecomms. Act of 1996, 11 F.C.C.R. 15,499 (1996) (No. 96-98)).[2] In his recent article, Professor Baumol demonstrates, using "The Level Playing Field Theorem," that uniform TELRIC UNE prices are not competitively neutral, and if adopted, will undermine productivity and efficiency by enabling less efficient firms to undercut suppliers that are more efficient in their use of resources. Exhibit 141T:15 (Dye), Exhibit 142:7. Dr. Baumol recommends that when retail rate structures contain support for universal service,

> to calculate the efficient price of a bottleneck service one need merely observe the final-product price currently charged by the owner of the bottleneck facility, and subtract from it the pertinent incremental cost.

13. This Commission has previously recognized the impact that piecemeal deaveraging can have on competitive neutrality. During Phase II of this proceeding, Commissioner Hemstad recognized a potential "market misallocation" if UNEs were deaveraged, but retail rates remained averaged: "[I]f the loop cost is deaveraged, but the ILEC must price retail services at an average, the CLEC will have a substantial opportunity for easy entry under the higher-priced umbrella for the retail price of the loop in urban areas." Exhibit 141T:11 (Dye) (quoting Tr. 2007 - 08 (Statement of Commissioner Hemstad)). Moreover, in its Universal Service docket, the Commission recognized that a universal service fund "is one of several necessary elements which must be in place to enable efficient entry into the market." *In the Matter of Determining Costs of Universal Service,* Docket No. UT-980311(a), Tenth Supplemental Order (Nov. 20, 1998) ("USF Order") at ¶ 28. The

[2] Following the release of the FCC's First Report and Order, the industry adopted the term "TSLRIC" to refer to the long-run incremental cost of a service, and "TELRIC" to refer to the long-run incremental cost of a particular network element. Exhibit 141T:14 (Dye Direct).

Commission recognized that in the absence of a USF, "competition in both high-cost and low-cost areas will be impeded and likely will not occur at all" because implicit supports will prevent CLECs from competition in high cost areas, and ILECs from responding to new entry in low-cost areas. *Id*. at ¶¶ 28 - 29.

14. To avoid these problems, Washington must, simultaneously with deaveraging of UNE and interconnection rates, replace the implicit support in local rates with explicit, sufficient, portable intrastate universal service funding that ensures affordable rates. Indeed, the Commission itself reported as much to the legislature:

> There is an interrelationship between universal service, UNE prices and the extent of competitive activity in Washington. A responsible approach requires that changes to universal service and UNE policy be considered together.

USF Report 2 at 98.

15. GTE recognizes the state legislative constraints this Commission faces in implementing an appropriate universal service fund mechanism simultaneously with wholesale UNE rate deaveraging. Because of these constraints, GTE recommends that the Commission seek a waiver of the May 1st deadline.

16. Several states are waiting to deaverage wholesale rates in the tandem with – or after – developing explicit universal service support. For example, Illinois, Minnesota, New Mexico, Ohio, and Oregon all have open proceedings on universal service issues, but have yet to implement an intrastate mechanism or adopt deaveraged UNE and interconnection rates. Although some states, such as California and Nebraska, already have intrastate funds, they are considering the nexus between retail rate issues and universal service during this year. However, states are finding that the complexity of the task will require time. For these reasons, the FCC has given states the opportunity

to file for a waiver from the May 1st deadline. Stay Order, ¶ 7. As previously stated, GTE recommends that the Commission seek a waiver from the FCC's deaveraging rule until it can address all relevant issues simultaneously.[3]

B. General Guidelines for Deaveraging

17. Generally, in establishing deaveraged wholesale rates, the Commission should rely on guidelines reflecting the following principles:

> Deaveraged rates should be based on variations in the underlying costs to provide the specific element;
>
> Deaveraged rates should include a reasonable allocation of common cost recovery;
>
> Deaveraged rates should be consistent with retail rate structures and levels (*i.e.*, eliminate the uneconomic arbitrage of the ILEC's rate structures);
>
> Deaveraged rates should provide the incentive for efficient competitive entry into all geographic markets for all customer sets; and,
>
> Deaveraged rates should allow the ILEC an opportunity to recover its actual costs.[4]

[3] The Oregon Public Utilities Commission has requested such a waiver. The Ohio and Idaho Commissions have submitted to the FCC statements in support of GTE's Petition for Reconsideration of the May 1st deadline.

[4] In its Seventeenth Supplemental Order in this docket, the Commission stated its belief that under the FCC's TELRIC pricing rules, it was prohibited from considering an ILEC's actual costs when pricing UNEs. However, as GTE explained in Phase II, prices based solely on TELRIC pricing violate the Act and the Constitution precisely because they do not allow the ILEC to recover its actual costs.

Exhibit 141T:6 - 7 (Dye).[5] Moreover, any decision regarding rate deaveraging must weigh the operational costs of deaveraging against the potential customer gains. *Id*. at 7.

C. The Commission Should Only Deaverage The Loop.

18. While Staff introduced a proposal to deaverage switching rates, all other parties agree that the Commission should only deaverage the loop at this time. *See* Exhibit 173T:24 (Tucek); Exhibit 1T:3 (Denney); Exhibit 61T:10 (Thompson); Exhibit 63T:7 (Thompson); Exhibit 301T:17 (Montgomery). While switching costs vary based upon the size of the switch and traffic volumes, the traffic sensitive cost levels are not likely to result in any significant social gains due to price deaveraging. Exhibit 143T:15 (Dye). End-user rates derived from these levels of costs are not likely to vary significantly, and thus are not likely to have any material impact on the demand for usage-related services. *Id*. at 15.

19. Based on the objections of all other parties, Staff has withdrawn its proposal to deaverage switching rates. Exhibit 260T:12 (Spinks); Tr. 2630 (Spinks). Moreover, the switching proposal introduced by Staff has been stricken from the record because it relied on data from the HAI 5.0a Model. Commission, therefore, should not adopt deaveraged switching rates in this proceeding.

[5] These deaveraging guidelines depend on the removal of implicit supports from retail rates.

D. The Commission Should Not Establish Distance-Sensitive Deaveraged Rates.

20. Distance-sensitive deaveraging would not promote efficient entry and competitive neutrality, but instead would greatly exacerbate the arbitrage opportunities already available to CLECs. *See generally* Exhibit 143T:13 - 14 (Dye). Loop length should never be used to justify rate deaveraging unless accompanied by significant differences in customer density within the wire

center's serving area. *Id*. at 14. If density characteristics are relatively homogeneous within a wire center's serving territory, then loop-length based pricing will facilitate even more rate arbitrage. *Id*. at 14. As discussed above, wholesale and retail rate structures should be compatible, but retail rates for most loop-based services are not based on distance factors.

21. Moreover, there is currently no way to estimate loop lengths with a degree of accuracy justifying distance-sensitive rates. Some CLECs suggest that the industry use available "off-the-shelf" software products measuring distance based on latitudes and longitudes or street addresses. Exhibit 301T:11 (Montgomery). These software applications, however, are unlikely to reflect true loop distance. See Exhibit 222T:5 (Langley/Casey)[6]; Exhibit 112T:6 (Brohl). Latitude and longitude software generally produces readings in airline mileage, which bears little relationship to facility loop length since loop facilities must follow a right-of-way. Exhibit 222T:5 (Langley/Casey); Tr. 2473 (Brohl).

22. Similarly, distance calculations using street addresses in a program such as Mapquest or Infospace.com will produce unreliable estimates of loop lengths. Proponents of the driving-distance approach fail to recognize that the distance calculation is geared to determining the shortest driving distance between two points. However, distribution and feeder plant is not designed to serve a specific customer, but all customers within the wire center. Tr. 2761 - 2762 (Montgomery). Consequently, the calculated driving distances will not correspond to actual loop length, resulting in an estimated cost that will not correspond to the actual cost of the loop. Indeed, because the distribution plant may follow a route away from the central office in order to intercept the feeder route, the driving distance and calculated costs may be understated. Tr. 2762 - 2763 (Montgomery);

[6] The pre-filed testimony submitted by GTE witness Rodney Langley was adopted at the hearing by Linda Casey.

Tr. 2435 (Brohl); Tr. 2702 (Statement of Commissioner Gillis). As illustrated by U S WEST witness Barbara Brohl, a single software product will not necessarily produce consistent distance calculations for the same address. Tr. 2433-2434 (Brohl). Furthermore, the ability of a street-address program to estimate distance depends on the address being pre-programmed into the system. Tr. 2479-2480 (Brohl). Such a program is likely unreliable for brand new customer locations or rural route addresses. *See* Tr. 2478-2480 (Brohl); Ex. 222T:5 (Langley/Casey). Similarly, this methodology is unreliable for campus-style building complexes. Exhibit 222T:5 (Langley/Casey).

23. Finally, as explained in Section VI, a distance-based deaveraging proposal would result in significant administrative costs for both the ILEC and the CLEC far outweighing any benefits.

E. Deaveraged GTE Rates Should Be Based On GTE's Cost Estimates.

24. The pricing guidelines of the Act and sound regulatory policy require that an ILEC's rates be based on that ILEC's own costs. Accordingly, the Commission made separate UNE cost determinations, established separate statewide average rates for GTE and U S WEST, and directed that each company's rate true-up to its ordered average. Moreover, GTE's cost estimates are the most accurate cost estimates on record in this proceeding. AT&T, Staff and the CLECs propose rates based on Hatfield Model 3.1 ("HM 3.1") estimates. However, these cost estimates are seriously flawed for a number of reasons.[7]

25. First, HM 3.1 does not accurately estimate the costs of small, less dense wire centers, primarily because HM 3.1 relies on Census Block Groups ("CBGs") to determine a wire center's serving area. Exhibit 173T:12 (Tucek); Tr. 2211 (Denney). CBGs can be very large, and do not correspond to GTE's serving areas, which affects the assignment of households, line counts and costs to individual wire centers. Exhibit 173T:12 (Tucek). As one moves away from urban population centers, CBGs become larger and less densely populated. As a consequence, a model that relies on CBGs will exhibit greater variability in costs with respect to small wire centers and to wire centers with relatively few lines per square mile. *Id*. In fact, the overall average error in HM 3.1's estimates of GTE's wire center serving areas is 215 percent; for U S WEST, the overall average error is 112 percent. *See* Exhibit 190. Moreover, for both companies, HM 3.1 tends to grossly *overestimate* the size of the serving area, particularly for small wire centers. *Id.* In Phase I, the Commission recognized this unacceptable variation between observed and modeled loop lengths resulting from

[7] AT&T did offer an alternative proposal based on GTE's cost estimates. As discussed below, this alternative proposal, as modified by GTE, is one of the second-best approaches the Commission could adopt.

the use of CBGs to model customer locations. Eighth Supplemental Order, ¶¶ 218 - 222.

26. Furthermore, HM 3.1 cost estimates bear no relationship to important cost drivers such as wire center line size, the size of the serving area, and the proportion of long loops. Exhibit 173T:13 - 17 (Tucek). These characteristics affect the average loop cost in a wire center. *Id*.; Tr. 2526 (Tucek). Any model that purports to estimate loop costs to the wire center level should show a relationship between its cost estimates and observable wire center characteristics for cost drivers. Tr. 2526 (Tucek). However, the visual and statistical analysis of the HM 3.1 cost estimates performed by GTE witness Tucek illustrates that little or no relationship exists between the HM 3.1 results and wire center line size, the size of the serving area, and the proportion of long loops. Exhibit 173T:14-17; Exhibit 176.

27. Both a visual and statistical analysis of the proposals relying upon HM 3.1 cost estimates for GTE illustrate an excessive amount of variation in the estimates for small and less dense wire centers. Exhibit 173T:2 (Tucek). Inaccurate wire center cost estimates skew the deaveraging process, particularly for GTE, which serves smaller and less dense wire centers than U S WEST. Exhibit *Id*. at 13. For these reasons, the Commission should use GTE's wire center cost estimates to deaverage GTE's UNE rates, and should use the GTE cost estimates presented by David Tucek in Exhibit 173T.

III.Deaveraging Proposals

A. GTE's Deaveraging Proposals

28. GTE recognizes that the Commission may decide not to seek a waiver of the May 1st deadline and implement deaveraging without simultaneously rebalancing retail rates and implementing an appropriate universal service fund mechanism. Without waiving its argument that

the Commission should not follow this approach, GTE offers several alternative deaveraging proposals that will mitigate market distortions caused by deaveraging UNE rates in a vacuum.

29. GTE recommends that the Commission adopt the deaveraging proposal put forth in the Rebuttal Testimony of Terry R. Dye and the Responsive Testominy of David G. Tucek, which produces 2-wire loop rates for three density zones as follows:

	Zone 1	**Zone 2**	**Zone 3**
Rate	$21.36	$31.52	$37.89
Percent of Lines	76.6%	20.3%	3.1%

Exhibit 173T:31 (Tucek).

30. GTE's proposed rates are based on the methodology proposed by Mr. Tucek in Exhibit 173T, using estimates of GTE's wire center costs developed from information contained in the Company's cost-study filing in Phase I and responses to Staff Data Request Nos. 6 and 7. Exhibit 173T:4, 26 - 29 (Tucek); Exhibit 179C; Tr. 2540, 2572 - 73 (Tucek). GTE adopted the AT&T methodology of stack-ranking the wire centers based on costs, low to high.

31. These cost estimates do not rely on Census Block Groups to model serving areas, but rather use the observed distribution of loop lengths in GTE's service territory. Exhibit 173T:4 (Tucek). Compared to the HM 3.1 data relied upon by the other parties, GTE's wire center costs exhibit a strong relationship to the wire center line size, the size of the serving area, and the proportion of long loops. *Id*. at 4, 29 - 30, Exhibit 177. GTE's methodology to define zones is based on obvious distinctions in GTE wire center costs, and is superior to the methodologies used by the other parties. By ranking the wire centers from low to high, based on the average cost per loop, obvious break points occur at $35 and $30 per loop. *See* Exhibit 173T:30 - 31(Tucek), Exhibit 178.

32. GTE also offers the Commission a reasonable compromise between its proposal and

AT&T's four zone alternative proposal using GTE's cost estimates outlined in Exhibit 4T. (Tr. 2497 (Dye)) Under this compromise approach, the Commission would collapse AT&T's Zones 1 and 2 to produce the following rates:

	Zone 1[1]	**Zone 2**	**Zone 3**
Rate	$17.46	$25.21	$32.36
Percent of Lines	38.0%	38.6%	23.4%

33. If the Commission adopts this approach, GTE recommends that the Commission constrain the zones so that all wire centers within the same exchange would be in the same zone – and consequently have the same rate.[8] This constraint would produce the following rates:

	Zone 1[2]	**Zone 2**	**Zone 3**
Rate	$19.02	$25.43	$32.40
Percent of Lines	42.1%	40.7%	17.3%

34. This constraint furthers the goals of competitive neutrality and rational rate design. Fifteen GTE exchanges consist of more than wire center, for which GTE is constrained by its retail tariffs to charge the same rate in each exchange. Tr. 2595 (Tucek). For example, the Kennewick exchange is composed of three wire centers, each of which has the same retail rate regardless of cost. *Id* at 2595-2596. Without this constraint, those wire centers would likely fall into different zones. *Id* at 2596. If GTE had to charge the same retail rate for each wire center, but had to offer different wholesale rates for each wire center, CLECs, whose retail rates are essentially unregulated, would enjoy more pricing flexibility than GTE within the Kennewick exchange. *Id*. Such a result would violate the principle of competitive neutrality.

35. Staff agrees that as a policy matter wire centers within the same exchange should be within the same zone. Tr. 2640 (Spinks). Furthermore, AT&T appears to agree that they would not

[8] Attachment A to this brief identifies the wire centers for each zone under GTE's prefered proposal and the two compromise approaches.

be prejudiced by this constraint, since it will not make a "huge difference." Tr. 2223 (Denney).

B. Other Parties' Proposals.

1. AT&T Proposals

36. AT&T made three deaveraging proposals for GTE, all of which use the same basic methodology. *See* Exhibit 4T:16 (Denney); Tr. 2216 (Denney).[9] Essentially, each proposal stacks GTE's wire center costs from lowest to highest and allegedly assigns wire centers to zones based on cost breaks. (Tr. 2217) (Denney). The following table summarizes the AT&T proposals:

Zone	AT&T Original Proposal	AT&T Original with GTE Corrections ("AT&T Corrected")	AT&T Alternative based on GTE cost estimates ("AT&T Alternative")
1	$15.21	$14.96	$15.44
2	$21.25	$20.61	$19.71
3	$58.91	$58.94	$25.21
4			$32.36

Exhibit 4T:16 (Denney).

[9] AT&T appears to have abandoned its proposal submitted in Exhibit 1T ("AT&T's First Proposal"), which recommended a combined rate for both U S WEST and GTE in each zone. *See* Exhibit 3T:2 n.1 (Denney); Exhibit 4T:11 - 12, 16 (Denney); Tr. 2216 (Denney). GTE witness David Tucek outlined several flaws in AT&T's First Proposal, including errors in identification of wire centers, a combined rate for both U S WSET and GTE per zone, a failure to tie back to the statewide average rates ordered in Phase II, and the use of HM 3.1 cost estimates rather than GTE cost estimates. *See* Exhibit 173T:5 - 17 (Tucek); Exhibit 174; Exhibit 176; Tr. 2203 (Denney).

a. AT&T's Original and Corrected Proposals

37. AT&T's deaveraging proposal presented in Exhibit 3T ("AT&T Original Proposal") contained several errors in identifying wire centers in GTE's Washington serving territory. First, AT&T proposed to deaverage loop costs in three wire centers that are no longer part of GTE's serving territory in Washington. Exhibit 173T:5 (Tucek). The proposal also omitted four GTE wire centers. *Id*. at 6. Finally, AT&T treated wire centers separately that should be combined because they constitute a single location for the purposes of deaveraging. *Id*. at 6. Acknowledging these errors, AT&T developed a corrected proposal based on the work papers of David Tucek (the "AT&T Corrected Proposal"). Exhibit 4T:12 - 13; Tr. 2216 - 17. Tr. 2217 (Denney). Accordingly the Commission should disregard the AT&T Original Proposal altogether, since in effect has been superseded by the AT&T Corrected Proposal.

38. The AT&T Corrected Proposal, however, is flawed. First, other than an objective of keeping a zone 1 rate below $16, there appears to be no logic to how AT&T defined its zones. *See* Exhibit 173T:11 - 12, Exhibit 175. AT&T witness Denney stated that he used $16 as a demarcation point between zones 1 and 2 because there was a three percent jump in costs in that range. (Tr. 2205) (Denney). However, Exhibit 2 outlining AT&T's wire center analysis does not support such a rationale. Indeed, Exhibit 2 shows a 1.1 percent difference between wire center costs at the demarcation point between zones 1 and 2. Tr. 2207 (Denney). However, a 1.3 percent cost increase occurs at the $18.13 range, and followed by a 2.4 percent cost increase at $18.57. Exhibit 2. Using Mr. Denney's approach, the demarcation point between Zones 1 and 2 would have been drawn more appropriately drawn at the $18 range. Instead, AT&T drew the line between Zones so as to produce a particular rate in Zone 1 for 31.29 percent of GTE's lines. Tr. 2207 - 08 (Denney).[10]

[10] Indeed under AT&T's original proposal, 94 percent of all GTE and U S WEST lines would (continued...)

39. In addition, AT&T's Corrected Proposal is flawed because it relies on HM 3.1 for wire center costs. For the reasons discussed in Section II, these cost estimates are not a reliable basis on which to rely for determining a cost-based deaveraging plan.

b. AT&T's Alternative Proposal

40. AT&T proffered an alternative deaveraging proposal using GTE's cost estimates from Exhibit 179C (the "AT&T Alternative Proposal"). Exhibit 4T:12, 16 (Denney). This proposal, however, increases the number of zones from 3 to 4 with no explanation or justification for doing so. Tr. 2220 (Denney). This is particularly inexplicable given AT&T's belief stated explicitly in direct testimony that 3 zones is sufficient at this time. Exhibit 1T:4 -5 (Denney); Tr. 2220 (Denney). This 4-zone approach results in 20 percent of GTE's lines falling within zone 1, and 18 percent within zone 2. Tr. 2220 - 21. The only possible reason for AT&T offering a 4-zone approach when using GTE's cost estimates is to again achieve its objective of a rate in zone 1 under $16.

41. Recognizing that the various proposals from the parties may require the Commission to look for a compromise position, GTE reviewed the AT&T Alternative Proposal and concluded that if AT&T had remained consistent in its Alternative Proposal with a 3-zone approach, the number of lines in zone 1 would have been 38%, which is remarkably similar to the 31% of GTE lines in zone 1 under the AT&T Corrected Proposal. Tr. 2221 (Denney). This is why GTE believes zones 1 and 2 in the Alternative Proposal should be combined, instead of arbitrarily creating 4 zones to artificially produce a sought-after zone 1 rate. Combining these zones and leaving AT&T's Alternative Proposal zones 3 and 4 as they are creates a fair and reasonable compromise deaveraging proposal.

(...continued)
fall within zones 1 and 2 (Tr. 2208) (Denney).

2. Staff's Proposals

a. Only One Staff Proposal Remains in the Record for GTE

42. During the course of this proceeding, Commission Staff developed six proposals for deaveraging GTE's UNE rates:

> Use of HAI Model 5.0a density zone ranges to provide deaveraged loop cost estimates for five zones, as well as a distance-sensitive rate structure within each of the zones for a total of 80 rate elements ("Staff Proposal One"); S*ee generally* Exhibit 251T (Spinks); Exhibit 260T:14; (Spinks);
>
> A modification to Staff Proposal One resulting in three deaveraged zones ("Staff Proposal Two"); S*ee generally* Exhibit 255T (Spinks); Exhibit 260T:14 (Spinks);
>
> An alternative to Staff Proposal Two based on HM 3.1 cost estimates ("Staff Proposal Three"); *See generally* Exhibit 255T (Spinks); Exhibit 260T:14 (Spinks);
>
> A distance-sensitive proposal based on HAI 5.0a cost estimates producing nine rate elements for GTE ("Staff Proposal Four") Exhibit 260T:15 (Spinks);
>
> A distance-sensitive proposal based on HM 3.1 cost estimates producing nine rate elements for GTE ("Staff Proposal Five") Exhibit 260T:15 (Spinks); and
>
> An errata to Staff Proposal Five proposed at the hearing ("Corrected Staff Proposal Five") Exhibit 261R.

43. In its Twenty First Supplemental Order, the Commission granted the joint motion of GTE and U S WEST to strike from the record all testimony and exhibits relying upon or referencing HAI 5.0a.[11] As a result, Staff Proposals One, Two and Four have been stricken from the record in their entirety. Staff proposals Three and Five, while purporting to rely on HM 3.1 cost estimates, are nevertheless tainted by HAI 5.0a data. Tr. 2622-2623 (Spinks). As Staff witness Spinks

[11] Attachment B to this brief provides a matrix of all references in pre-filed testimony and exhibits to HAI 5.0a that GTE believes the Commission should disregard pursuant to the Twenty First Supplemental Order.

admitted, he continued to use HAI 5.0a data for five wire centers within GTE's territory.[12] *Id.* at 2624; Tr. 2642 (Spinks). The cost estimates for these exchanges have likewise been stricken from the record, and therefore Staff Proposals Three and Five should be disregarded in their entirety.

44. At the eleventh hour, Staff offered its Corrected Staff Proposal through Exhibit 261R, which replaced the HAI 5.0a estimates contained in Staff Proposal Five.[13] This is the only staff proposal remaining before the Commission.

[12] These wire centers are Fairfield, Loomis, Malden, Thornton, and Stevens Pass.

[13] GTE objected to the admission of Exhibit 261R at the time it was offered and moved to strike the exhibit. Tr. 2626 - 2628. GTE renews its objection now. At the time Mr. Spinks prepared Staff Proposal Five in Exhibit 260T, he knew that GTE and U S WEST had filed a motion to strike all testimony and exhibits relying upon and referencing HAI 5.0a. Tr. 2620 (Spinks). Nevertheless, Mr. Spinks prepared Exhibit 260T using HAI5.0a data for five GTE exchanges. Tr.2623 (Spinks). Only when his was highlighted during the hearing when GTE distributed Attachment C to this brief did Staff offer its Corrected Proposal Five. Moreover, even in the Corrected Proposal Five, Staff simply ignores HM 3.1 data for one wire center and admits that HM 3.1 does not have data for several other GTE wire centers. Tr. 2624 (Spinks).

b. Staff's Corrected Proposal Five Should Not Be Adopted For GTE.[14]

45. Essentially, Staff statistically tested estimated wire center specific loop costs to determine the significance of a correlation between costs and density in different density zones. Staff then used statistical techniques to develop density-based cost deaveraging as a function of the density cost differences. As discussed in section VI, Staff's distance/density based deaveraging proposal is administratively impractical. Beyond its impractical rate design, however, Staff's deaveraging proposal relies on an unsound methodology.

46. First, Staff's proposed methodology is inconsistent with loop cost characteristics. The cost curve generated by Staff's methodology is continuous with respect to loop length, ignoring the widely known fact that at some point loop costs increase due to the need to install pair gain devices. Exhibit 173T:22 (Tucek), Tr. 2561 (Tucek), Tr. 2653 (Spinks). Additionally, U S WEST witness Carnall used Mr. Spinks' equation to randomly generate costs for individual loops and re-estimated the equation using the resulting average loop costs. Tr. 2416 (Carnall). This simulation of Mr. Spinks' proposal failed to produce the same equation. *Id*.

47. Second, Staff's proposal does not rely upon GTE's cost estimates, but instead upon cost estimates produced by HM 3.1. For the reasons discussed previously, these estimates are not reliable for developing a cost based deaveraging plan.

48. Third, Staff's proposal is based on an unsound statistical analysis. Staff's proposal relies explicitly on an estimated coefficient for average loop length in Mr. Spinks' regression analysis. Tr. 2543 (Tucek); Tr. 2407 (Carnall). However, Mr. Spinks' equation omitted several key variables that are important cost drivers for a wire center – line size, the number of wires served by

[14] These criticisms apply to all of Staff's deaveraging proposals.

the wire center, and the proportion of loops greater than 12 kilofeet.[15] Tr. 2543 (Tucek). As a result of this omission, the estimate is biased. *Id*. Consequently, the estimated average loop length values will not equal true values. *See* Tr. 2402 (Carnall). Coefficient estimates are biased if variables are left out of the regression model, unless the excluded variable is orthogonal – or independent – with respect to other variables. Tr. 2403 (Carnall). Orthogonal variables are only found in textbooks, unless one designs orthoganality into the sample. *Id*. Significantly, average loop length and the percentage of long loops are not orthogonal. Tr. 2407 (Carnall).

49. Additionally, because of the functional form of Staff's equation, the impact of this bias will vary exponentially with loop length. In other words, even if Staff's proposal was methodologically correct, the costs for the various loop lengths that Staff calculates using this biased coefficient will be distorted, and this distortion will change exponentially with the length of the loop. Therefore, Staff's methodology does not provide an accurate estimate of the true cost.[16] As Mr. Spinks admitted on the stand, re-scaling to an average will not remove the distortions caused in his deaveraging analysis. Tr. 2729 - 2730 (Spinks). This is because re-scaling, which is essentially a ratio calculation, retains the relative bias in Staff's methodology. *Id*.

50. Finally, Mr. Spinks included the logarithm of density as an independent variable in his equation, instead of including the logarithms of lines and area as separate variables. This is equivalent to constraining the coefficient of these two variables to be the same size.[17] Tr. 2409

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[15]As a loop extends beyond 12 kilofeet, its costs increase as a result of the need for a pair gain device, and the incremental costs associated with the right of way, preparing the site, and the central office terminal. Tr. 2561 (Tucek).

[16] Indeed, Mr. Spinks admitted that his coefficients are biased. Tr. 2692 (Spinks).

[17] Contrary to Dr. Gabel's suggestion during his cross of Dr. Carnall, the nature of this constraint is easily established: b x ln(Density) = b x ln(Lines/Area) = b x [ln(Lines) – ln(Area)] = b x ln(Lines) – b x ln(Area).

(Carnall). Based on information in the record it is easy to test whether this constraint is statistically warranted – it is not. Thus, even if the above problem of bias did not exist, Mr. Spinks' proposal should be rejected because the estimated equation was subjected to an unwarranted constraint on its parameter values.

3. Joint CLEC Proposals

51. On behalf of Advanced TelCom Group, Electric Lightwave, GST Telcom Washington, NewEdge Networks, and Nextlink Washington ("Joint CLECs"), William Page Montgomery presented deaveraging proposals that rely exclusively on the data and methodology used by Staff Witness Spinks. Consequently, Mr. Montgomery's proposal suffers from the same methodological flaws described above.

52. Beyond these flaws, however, the Joint CLEC proposals have been stricken from the record, and must be disregarded altogether. In his first deaveraging proposal, Mr. Montgomery modified Staff's Proposal One contained in Exhibit 251T to create a smaller number of deaveraged rates. Exhibit 301T: 8 - 10 (Montgomery). This proposal relied upon HAI 5.0a cost estimates, and consequently has been struck from the record by the Twenty-First Supplemental Order. Mr. Montgomery then developed a second deaveraging proposal based on the HM 3.1 data and methodology used by Staff to develop Staff Proposal Three ("CLEC Final Proposal"). Exhibit 303T:1 - 2 (Montgomery). As discussed above, Staff Proposal Three relied upon HAI 5.0a data for five GTE wire centers. Mr. Montgomery did not make any changes to the HAI 5.0a cost estimates used for the Fairfield, Loomis, Malden, Thorton, or Stevens Pass wire centers. Tr. 2804 (Montgomery). As a result of the Twenty-First Supplemental Order, these cost estimates, and the CLEC Final Proposal based on these cost estimates, have been stricken from the record.

IV.GTE's Proposal Is Consistent With The Commission's Prior Statements on Deaveraging.

53. In Phase I of this proceeding, Commission Staff argued that the questions of how and the extent to which UNE costs are calculated on a deaveraged basis should be addressed in the context of universal service reform, deaveraging retail prices, and the degree of competitive activity in the State of Washington. Eighth Supplemental Order, ¶ 271. Staff expressed a concern that if loop costs were deaveraged without a universal service fund mechanism in place to accommodate the cost shift, subscribers might be forced to leave the network. *Id*. The Commission agreed with the Staff's concerns, and found that the deaveraging of costs should not be determined within the scope of UT-960369, but rather within the context of universal service. Eighth Supplemental Order, ¶¶ 496, 511; Ninth Supplemental Order on Clarification, ¶ 73. The Commission reiterated this view in its USF Order:

> Recognizing the interrelated nature of each element, we believe that the development of sustainable competition requires us to maintain our policy that deaveraged UNEs should be implemented in the context of universal service reform, deaveraged retail prices, and the extent of competitive activity in Washington.

USF Order at ¶ 34. *See also* USF Report 2 at 24-25. The Commission should adhere to this view.

54. In Phase II, the Commission found that it was required by FCC Rule 51.507(f) to establish geographically deaveraged rates. Seventeenth Supplemental Order, ¶ 478. As a result of the FCC lifting the stay of its deaveraging rules, the Commission views itself bound to deaverage rates by May 1, 2000. Nineteenth Supplemental Order at 5 - 6. The Commission resigned itself to the fact that its "vision of contemporaneous occurrence has not come to pass," and expressed a preference to "comply with the FCC deadline than to face the compulsion to seek some variance and the uncertainty as to whether it would be granted." Twentieth Supplemental Order at page 2.

However, the Commission has never retreated from its express finding that deaveraging UNEs should occur in the context of universal service. If the Commission prefers not to seek a waiver of the FCC's deaveraging deadline, then it should adopt a UNE deaveraging proposal that minimizes the arbitrage opportunities that could occur in the absence of retail deaveraging and an explicit universal service fund. GTE's proposals accomplish this goal.

55. The Universal Service proceeding, UT-980311(a), the Commission estimated the cost of service at the wire center level, stating that "verifiable data, such as line counts and loop lengths, are unavailable at a finer level of granularity." Tenth Supplemental Order, ¶ 72. Such verifiable data is likewise absent from the record in this case. Staff claims that the Commission's concern over the lack of cost data below the wire center level can be overcome by its statistical evaluation of the relationship between costs, loop lengths, and wire center density. Tr. 2686 - 2687 (Spinks). However, as Dr. Gable's examination of Mr. Spinks illustrated, that statistical analysis is flawed. Tr. 2688 - 2693; Exhibit 404.

V.Implementation Issues

A. The Costs of Implementation Make Distance-Based Deaveraging Impractical.

56. The administrative costs and burdens associated with distance-sensitive deaveraged rates outweigh any benefits of such a pricing scheme. Such a rate structure would require significant modifications to ILEC operational support systems ("OSS"). For example, the ILECs' OSS do not currently maintain loop length data, and consequently would have to be modified to incorporate such data. Exhibit 221T:4 (Langley/Casey); Exhibit 111T:4 (Brohl). Moreover, the ILECs would have to develop procedures to inventory new customers and add associated loop data into the systems. Exhibit 221T:4 (Langley/Casey). Similarly, the ILECs would need to develop linkages between

inventory and billing OSS to assure the accurate and timely billing of services. Exhibit 111T:4 (Brohl). Any new systems requirements resulting from a distance-sensitive rate structure would need to be addressed in industry OSS forums. The telecommunications industry has a long-established platform — consisting of several forums —to ensure uniform standards for pre-ordering, ordering, and billing functions. Exhibit 221T:5 (Langley/Casey).

57. Moreover, a distance-sensitive rate structure would unnecessarily increase the burden on service representatives to process pre-ordering and ordering transactions. Exhibit 111T:7 (Brohl). Such processes cannot be automated without further systems modifications and associated costs. *Id.* Consequently, a distance-sensitive rate structure could decrease electronic flowthrough. *Id.* at 7-8. While it is too soon to determine the exact extent of the implementation costs associated with a distance-sensitive rate structure, high level estimates suggest they could run into the millions of dollars. *Id.*

58. The Joint CLECs' proposed dual-rate structure for distance-sensitive deaveraging is even more problematic. Mr. Montgomery suggests that CLECs be given a choice between an "average" loop rate per zone and loop rates deaveraged by distance. Ex. 301T:11 (Montgomery). Montgomery's second alternative involves a three step process in which (1) the ILECs would bill at an average rate for the first month, (2) the CLEC would determine the "actual" loop length, and (3) the CLEC would claim an offset to its bill at an end user and loop level. Exhibit 301T:11 (Montgomery).

59. This approach would result in substantial administrative costs relating to billing adjustments required to migrate from the first month's average bill to the distance-sensitive billing scheme. Exhibit 222T:4 (Langley/Casey). Similarly, ILECs would incur implementation costs to adjust individual CLEC account records to reflect the distance-sensitive rate. *Id.*

60. Under Mr. Montgomery's proposal, both the ILEC and the CLEC would incur costs to calculate loop costs. Mr. Montgomery concedes that each ILEC "would, of course, have the right to fully review the CLEC's calculations against the ILECs own data." Exhibit 301T:12 (Montgomery). In the absence of systems modifications, such validation would require the ILEC to duplicate the CLEC's manual loop-length calculation process and work through any resulting disputes. *See* Exhibit 112T:5 (Brohl).

61. Even AT&T and MCI find the Joint CLECs' alternatives difficult to administer. See Exhibit 4T:10 (Denney); Exhibit 33T:8-12 (Cabe); Tr. 2303 (Cabe). AT&T witness Denney explains that under a distance-sensitive proposal:

> [c]ustomers are not easily assigned to zones, since the zones are based upon a customer's distance from the wire center. The proposal assigns the responsibility of identifying a customer's distance from the wire center to the CLEC, with an incumbent's right to audit the CLEC's determination. A large CLEC with a substantial customer base would incur substantial costs in determining customer location and working with the incumbent on the review process.

Exhibit 4T:10-11 (Denney). Moreover, the CLECs find Montgomery's zone average option a "barrier to mobility." Exhibit 33T:11-12 (Cabe); Tr. 2303-2304 (Cabe); Exhibit 4T:11 (Denney).

62. Beyond these administrative problems, a distance-sensitive rate structure is impractical in light of the current inability of both ILECs and CLECs to accurately calculate loop lengths. *See* Section II(H). Considering the current inability of any company to accurately estimate loop lengths, any distance-based rate structure is bound to result in an increased number of billing disputes and associated administrative costs to both ILECs and CLECs. Exhibit 111T:4 (Brohl).

63. Even if the off-the-shelf systems for determining loop length suggested by the Joint CLECs were accurate – and there is no evidence in this record that they are – they would have to be integrated into the ILEC billing process. Tr. 2435 (Brohl). There is no good estimate in the record

of the time or cost involved in automating such a system into the ILEC systems. Tr. 2699-2700 (Spinks). Pending such automation, a manual look-up would be required by both the CLEC and ILEC. Tr. 2435 (Brohl). Moreover, these software systems are copyrighted, requiring ILECs and CLECs to pay licensing fees to use them to calculate loop lengths. Tr. 2788-89 (Montgomery); Tr. 2734 (Spinks).

64. In short, the proof offered in support of any distance-sensitive deaveraging proposal fails to establish that implementation is possible, accurate, reasonable, or cost-effective. Without this proof, any distance-sensitive deaveraging proposal should not be accepted.

B. The Commission Should Only Establish Three Deaveraged Zones For GTE.

65. In the absence of a universal service fund and retail rate rebalancing, the Commission should adopt a wholesale deaveraging proposal that minimizes the arbitrage opportunities resulting from a distortion between wholesale and retail rates. Tr. 2512-2513 (Dye). The fewer the zones, the smaller the distortion between averaged retail rates and deaveraged wholesale rates. *Id*. Consequently, until the Commission can address deaveraged UNE rates in tandem with retail rate rebalancing and implementation of a universal service fund, it should establish the minimum number of zones.

66. The FCC's deaveraging rule only requires a minimum of three geographic zones. CC Docket No. 96-98, No. 95-185 (rel. Aug. 8, 1996) at ¶ 765. Most parties agree that three deaveraged zones is a reasonable starting point at this time in Washington. Tr. 2220 (Denney); Exhibit 1T:4 (Denney); Exhibit 63T:4 (Thompson); Exhibit 141T:5 (Dye); Tr. 2728 (Spinks). Specifically, AT&T witness Denney suggests that

> [g]iven the state of competition in Washington, the inability to foresee the precise shape of competition in the near future, and the

> infancy of the deaveraging process at this time, three deaveraged zones is a practical place for the Commission to start.

Exhibit 1T:4 -5 (Denney).

67. Due to the pending May 1st deadline to deaverage UNE rates, the Commission was forced to deaverage rates based on the cost models filed in Phase I of this docket. Nineteenth Supplemental Order at 5. As a result, any rates established in this proceeding will likely be replaced after a more comprehensive consideration of up-to-date cost estimates. *Id*. at 5-6; Exhibit 141T:5 (Dye). Moreover, the Commission will need to re-examine its deaveraged UNE rates once it begins deaveraging retail rates and implementing a universal service fund. For these reasons, the Commission should adopt the least burdensome number of zones necessary to meet the FCC's deaveraging requirement. Furthermore, if after conducting a more comprehensive deaveraging proceeding the Commission should find that competition is best served by more than three zones, then it would be far easier to increase the number of zones than to decrease the number zones should the Commission find the reverse. Tr. 2586 - 2587 (Tucek).

68. Three deaveraged zones strike a reasonable balance between accurately capturing wire center costs and minimizing administrative costs. The record makes clear that the wire center cost estimates from Phase II are imperfect resulting in both positive and negative errors that will cancel each other out. Tr. 2585 (Tucek). As the number zones of increases, the benefits of positive errors offsetting negative errors decrease, leading to less accurate estimates of the average cost per zone. *Id*. Moreover, as the number of zones increases, the administrative costs to both CLECs and ILECs increase. Exhibit 3T:19 (Denney); Tr. 2727 - 2728 (Spinks). Beyond a certain point, the administrative costs outweigh the benefit of deaveraged rates that do not accurately reflect wire center costs. For these reasons, absent compelling evidence that more zones are required, the

Commission should only establish three deaveraged zones. The record of this proceeding contains no such evidence.

VI.Conclusion and Recommendation

69. Since it began implementing the Telecommunications Act of 1996, the Commission has recognized that universal service, UNE prices and retail rates are inextricably linked. Consequently, the Commission believed UNE rate deaveraging must be considered in the context of universal service support reform and retail rate rebalancing. The FCC also recognized this linkage, but believed states could address all three issues by May 1, 2000. Legislative and timing constraints prevent this Commission from achieving that goal. Such a circumstance was precisely why the FCC provided a waiver mechanism to the states. The Commission should avail itself of this option.

70. If the Commission instead chooses to move forward with UNE deaveraging, it must adopt a rate design that minimizes the distortion between retail and wholesale rates and arbitrage opportunities resulting from implicit support in an averaged retail rate structure. GTE has offered a proposal that achieves these goals, as well as a reasonable compromise approach with AT&T. These proposals deaverage UNE loop rates at the wire center level into three zones based on the best cost estimates currently available to the Commission. Moreover, GTE's proposals are easy to administer.

71. Staff and the Joint CLECs, on the other hand, would have the Commission deaverage UNE loop rates at the exchange level, creating a larger number of zones and distance-sensitive rates. These proposals are based on unsound methodology that cannot be statistically supported and consequently do not accurately reflect loop costs. Moreover, these distance-sensitive rates produce

administrative costs to both ILECs and CLECs that far outweigh any possible benefit to Washington consumers.

72. For all these reasons, the Commission should adopt GTE's deaveraging pricing analysis and methodology contained in the Responsive Testimony of David G. Tucek and the Rebuttal Testimony of Terry R. Dye. Alternatively, GTE requests that the Commission adopt its compromise proposal outlined herein.

Respectfully submitted,

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[17] Tr. 2221 - 2222 (Denney); Tr. 2595 (Tucek).

[17] Tr. 2595 (Tucek)