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 Phase III**
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 Phase III**
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**

POST-HEARING BRIEF OF

RHYTHMS LINKS, INC. AND TRACER

MARCH 28, 2000

I. INTRODUCTION

1. This case involves the adoption of geographically deaveraged unbundled loop rates to comply with the FCC's mandate that states deaverage unbundled network elements ("UNEs") into at least three cost-based zones by May 1, 2000. Rhythms Links, Inc. ("Rhythms") and the Washington Telecommunications Ratepayers Association for Cost-based and Equitable Rates ("TRACER") recommend that the Commission establish five cost-based zones for U S West Communications, Inc. ("U S West") and five cost-based zones for GTE Northwest Incorporated ("GTE"). These zones should be determined by grouping together wire centers with similar costs. This proposal would conform with the FCC's rules and mandate, and it would promote the purpose of deaveraging, namely, the promotion of efficient competition.

2. Rhythms and TRACER respectfully submit the following brief in support of their deaveraging proposal.

II. POLICY CONSIDERATIONS

3. In its First Report and Order, issued August 8, 1996 ("Local Competition Order"), the FCC concluded that prices for interconnection and unbundled elements must be deaveraged to satisfy the requirement of the Telecommunications Act of 1996 that prices be cost-based.[1] The FCC determined that geographically deaveraged rates more closely reflect the cost of providing UNEs and

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[1] First Report and Order at para. 764.

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directed the states to establish a minimum of three zones.[2] This deaveraging requirement contained in FCC Rule 51.507(f) will become effective May 1, 2000.

4. The basic policy rationale for deaveraging the prices of UNEs is to ensure that competitive local exchange carriers ("CLECs") will face the same forward-looking costs when providing service using an incumbent local exchange carrier's ("ILEC's") facilities as the ILECs do when providing service to their own customers. As explained by MCI Worldcom's ("MCI") witness, Dr. Richard Cabe, "[o]nly by setting prices as closely as possible to the actual cost of providing service is it possible to assure CLECs the non-discriminatory access that the Act requires. Thus, geographic deaveraging is essential to promote the robustly competitive local exchange market that was the Act's promise." Cabe Direct, Ex. 31T, at 5, lines 12-16.

5. As further explained by Dr. Cabe, deaveraging, particularly of the unbundled loop, is necessary to correct the distorted pricing signals created by averaged UNE prices. Particularly in urban areas the divergence between price and cost may very well have delayed the development of competition to the detriment of Washington consumers. *Id.* at 6, line 21 through 7, line 2. This flows from the fact that a new entrant that relies on UNEs to enter the local exchange market depends heavily on non-discriminatory pricing in order to compete effectively with the ILEC. Thus, UNE prices that are not cost-based will distort competition between the ILEC and new entrants. *Id.* at 7, lines 2-9.

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[2] *Id.* at para. 765.

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6. Highly averaged prices result in significant distortions whenever there is significant geographic variation in the cost of providing UNEs. In such circumstances, the price will invariably be below or above the forward-looking cost of the UNEs. Where cost is below the averaged price, the resulting discrimination acts to either prevent a new entrant from using UNEs to compete on equal terms with the ILEC or it gives a distorted pricing signal to the CLEC, causing it to deploy redundant facilities where it is inefficient to do so. Where cost is above the averaged price, there is an artificial incentive for the new entrant to rely on UNEs instead of building its own facilities, which may be more efficient than the ILEC's. *Id.* at 7, line 13 through 8, line 15.

7. It follows that the deaveraging of prices into zones should be based purely on cost variations among the zones. Application of any criteria other than cost will reduce the precision with which the zones reflect cost variations. Cabe Rebuttal, Ex.33T, at 2, lines 7-12.

8. Rhythms and TRACER agree with Dr. Cabe that deaveraging should be accomplished to the greatest practical level of detail after consideration of administrative costs, and recognizing that deaveraging is likely to proceed in increments, with the present effort being just a first step in the process. Cabe Direct, Ex.31T at 2, lines 15-18. Stated another way, additional detail in deaveraging rates should be adopted so long as the cost of the additional detail is justified by the benefits of more detailed deaveraging. The benefits of additional detail are the benefits that arise from faster and more efficient development of competition. The limits of desirable deaveraging are a function of a particular plan's ability to allow efficient transactions in UNEs without burdening those transactions with an unwieldy rate structure. *Id.* at 9, line 17 through 10, line 8.

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9. In the context of this case, the appropriate level of detail for deaveraging of the loop is the wire center. This is because the level of detail at which reliable loop cost information is available from the cost models used in this case is the wire center. Indeed, in paragraph 72 of its Tenth Supplemental Order Establishing Costs, Docket No. UT-980311(a), the Commission stated: "The Commission has estimated the cost of service for each wire center. At this point in time, verifiable data such as line counts and loop lengths are unavailable at a finer level of granularity."

10. The aggregation of wire centers into zones is inherently a matter of judgment. Cabe Rebuttal, Ex.33T at 5, lines 6-9. Given that the purpose of deaveraging is to facilitate the development of efficient competition, zones should be constructed so as to promote that goal. As stated by AT&T Communications of the Pacific Northwest's ("AT&T") witness, Doug Denney, "[t]he most practical way to deaverage is to combine areas with similar costs into zones. The best way to do this is to group wire centers with similar costs into at least three cost based zones. Denney Direct, Ex.1T at 5, lines 4-6. Further, as stated by Dr. Cabe, the "concern about distorting the development of competition is most urgent in high density areas where competition is likely to develop soonest, and particularly where CLECs are most likely to consider the alternative of building their own facilities. For this reason, zones should be delineated in such a way as to accurately reflect cost variation, especially at the lower cost, higher density end of the spectrum." Cabe Direct, Ex.31T at 6, lines 1-6. That is not to say that deaveraging to accurately reflect cost differences in the lower density, higher cost areas is not important. However, finer levels of deaveraging in those areas can

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proceed over time as more experience with deaveraging is gained and once a state universal service program is implemented.

III. RHYTHMS' AND TRACER'S PROPOSAL

a. Statement of Proposal

11. Consistent with the policy considerations discussed above, Rhythms and TRACER recommend that the Commission establish five zones for U S West and five zones for GTE based upon the wire center cost calculations prepared by AT&T's witness, Doug Denney. The zone calculations are based upon updated line counts, as requested. Tr. 2255. This proposal, which is supported by AT&T, MCI, and the CLEC participants, would best further the objective of fostering the development of efficient competition because it reflects a reasonable definition of zones based strictly on cost differences among wire centers.

12. Specifically, the two-wire unbundled loop rates for the proposed U S West zones are as follows:

Zone 1	Zone 2	Zone 3	Zone 4	Zone 5
$8.35	$13.66	$15.48	$17.28	$26.64

13. The two-wire unbundled loop rates for the proposed GTE zones are as follows:

Zone 1	Zone 2	Zone 3	Zone 4	Zone 5
$14.96	$16.74	$20.11	$23.36	$49.85

14. A detailed chart showing the wire center name, CLLI code, total lines, adjusted cost, the applicable zone, and certain information is attached to this brief as Attachment A.

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b. Changes from Hearing Position

15. Because Rhythms and TRACER did not have a witness to present their position at the hearing, this subsection is not applicable. However, the recommendation is based upon the work of Mr. Denney and does vary from the one presented by AT&T at the hearing. The differences are explained in AT&T's brief.

c. Summary of Proposal

16. As discussed above, the zone proposals for U S West and GTE are based on cost estimates by wire center. As discussed by Mr. Denney in his direct testimony, ideally the wire center costs would be created using the cost model selected by the Commission in Phase I of this case. However, since the Commission did not select a single model, the cost estimates by wire center were generated by using HM 3.1 with Commission prescribed inputs. A factor was applied so that the average cost generated by using HM 3.1 would equal the company specific cost averages determined by the Commission. Further, while theoretically any model that can produce costs by wire center could be used, the HM 3.1 model is the only one in this case that can easily be used for this purpose. Denney Direct, Ex.1T at 8, line 19 through 9, line 5.[3]

17. The advantages of this proposal are that significant cost differences are captured between wire centers in the state, it is easy to implement, and customers are easily identified with their zone. The disadvantage is that prices are deaveraged into only five zones for U S West and into

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[3] The BCPM model is also capable of producing cost estimates at the wire center level. However, because the BCPM model does not directly estimate an unbundled loop cost (Denney Rebuttal, Ex.3T at 5, line 2), and because there is a high correlation between HM 3.1 and BCPM (Denney Direct, Ex.1T at 9, fn. 8), it is reasonable to use only the HM 3.1 for purposes of this proceeding.

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only five zones for GTE, although it would be easy for the Commission to further subdivide any of the zones established at any time in the future that it felt it desirable to do so.

d. Comparison with Other Proposals

1. U S West

18. U S West proposes zones based on an arbitrary "community of interest" standard, rather than on cost differences. Its method groups low and high cost wire centers together, essentially averaging costs. According to U S West's witness, Mr. Jerrold Thompson, because retail rates will be drawn toward the level of wholesale rates, one of the avowed purposes of the U S West approach is to minimize the discrepancy in rates between customers within similar communities. Thompson Direct, Ex.61T at 11, lines 20-24.

19. U S West first assigns wire centers to zones and then calculates cost using its RLCAP model. Finally, it applies a factor to the results to maintain the averaged loop cost ordered by the Commission. Denney Rebuttal, Ex.3T at 5, line 10 through 6, line 2. The result is that unbundled loop prices in the least cost areas are significantly above cost. *Id.* at 6, lines 16-17. As stated by Mr. Denney: "The wire center zone assignments proposed by U S WEST (based on "communities of interest") are much less homogeneous in cost than those proposed by AT&T (based solely on cost characteristics). By pursuing this strategy, U S WEST inflates the price in the lowest cost zone and effectively inhibits competition by setting above-cost loop rates." *Id.* at 9, lines 14-18.

20. In sum, U S West does not propose zones based on cost but on other, non-cost considerations. Further, its proposal does not really deaverage loop rates based on cost at all as

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required by the FCC's rules. It should not be followed by the Commission in this case.

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2. GTE

21. GTE's original proposal used density as a proxy for cost, rather than use cost directly. This is because GTE's loop cost model cannot produce wire center-specific costs. As pointed out by Mr. Denney, GTE effectively proposed only two zones, and those showed very little deaveraging. *Id.* at 10, lines 14-20.

22. GTE subsequently proposed grouping together wire centers with similar costs. However, it proposed only a minimal level of deaveraging with 76% of GTE's customers in the low-cost zone. In effect, then, GTE fails to deaverage for the vast majority of its market. Denney Surrebuttal, Ex. 4T at 14, lines 1-6; Tucek Responsive Direct, Ex.173T at 31; Dye Direct, Ex.141T at 17, line 5.

23. GTE also offered a compromise between its proposal and AT&T's four zone proposal using GTE's cost estimates that was described in Mr. Denney's Surrebuttal, Ex.4T. Tr. 2497. Essentially GTE proposes to combine the first two zones proposed by AT&T, once again masking cost differences in the low cost areas. Further, GTE proposed an additional constraint that would require all wire centers in the same exchange to be placed in the same zone, driving up the price for an unbundled loop in the low cost areas even more.

24. Both U S West's and GTE's deaveraging proposals would inhibit competition by pricing an unbundled loop well above cost in low-cost areas. The result is that CLECs relying on unbundled elements to provide service in dense areas would face significantly higher costs than would U S West and GTE. Because U S West and GTE would always be able to price their retail

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services below a CLEC's and still earn a profit, CLECs could effectively be excluded from the market. Denney Surrebuttal, Ex.4T at 3, lines 13-18. Further, to the extent there may be facilities-based entry into that part of the market, that entry might be inefficient because distorted pricing signals would be sent.

25. According to Mr. Denney, it is unlikely that U S West and GTE would face increased competition in the areas where prices are below cost because of the economies of scale prevalent in the telecommunications market. Because of these economies of scale, entry is likely to occur first where the greatest number of potentially profitable customers are located. *Id.* at 5, lines 2-7. Those areas are the most dense parts of the state, not the areas with few customers. In the low density areas, it will be harder for an entrant to build a sufficient customer base to gain the cost advantages associated with economies of scale. The result of the U S West and GTE proposals, then, is that there will be little, if any, competition in either urban or rural areas.

3. Commission Staff

26. The Commission Staff's proposal assigns exchanges, which may be comprised of one or more wire centers, into density zones. It then groups the density zones with similar costs into cost-based zones. To this point the Staff's approach is relatively easy to administer, and it is easy to identify customers with their zones. Although the approach captures cost differences between exchange areas, it loses the differences between wire centers located within exchange areas. Tr. 2633-34.

27. The Staff also proposes creating distance-sensitive deaveraged loop rates

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within each zone. Spinks Direct, Ex.251T at 6-7. While loop length is certainly a significant determinant of cost, a number of questions were raised about the reliability of the loop data below the wire center level[4], the complexity of the resulting proposal, and the costs of implementation. Rhythms and TRACER credit the effort by the Staff's witness, Thomas Spinks, to develop a distance-sensitive proposal; however, it appears that because of the complexity of the task and the remaining uncertainties regarding the difficulties of implementing the proposal, further study is warranted before distance-sensitive loop rates are implemented.

28. Although Mr. Page Montgomery also recommended a modified form of distance-sensitive loop prices on behalf of a number of CLECs, Rhythms and TRACER understand that those CLECs are now recommending that the Commission adopt the same zone proposal recommended here.

IV. THE PROPOSAL IS CONSISTENT WITH THE COMMISSION'S PRIOR STATEMENTS ON DEAVERAGING AND THE IMPLICATIONS OF RHYTHMS' AND TRACER'S POSITION IN THE CURRENT PROCEEDING

29. The Commission has asked the parties to address the question of whether their respective proposals are consistent with the Commission's prior statements on deaveraging and the implications of their positions for the current proceeding. Rhythms and TRACER respectfully

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4 As noted above, the Commission has specifically noted in paragraph 72 of its 10th Supplemental Order, Docket No. UT-980311(a): "The Commission has estimated the cost of service for each wire center. At this point in time, verifiable data such as line counts and loop lengths are unavailable at a finer level of granularity."

submit that their proposal is consistent with the Commission's prior statements in prior orders as those orders are read together.

30. In its 8th Supplemental Order in this docket, UT-960369, at paragraph 274, the Commission stated: "We choose not to deaverage UNE and interconnection rates at this time. We agree 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." However, in paragraphs 477 through 482 of its 17th Supplemental Order in this docket, the Commission acknowledged the effect of the U. S. Supreme Court's opinion upholding the FCC's pricing rules and of the FCC's stay order relating to deaveraging. In paragraph 480, the Commission stated: "Given the Supreme Court ruling and the FCC stay Order concerning deaveraging, and the fact that no deaveraged pricing recommendations were submitted in the instant pricing phase of this proceeding, the Commission has decided to initiate a Phase III proceeding in which interested parties may submit proposals for deaveraging the statewide loop prices we establish in the instant Order." The Commission then ordered that parties make deaveraged pricing proposals that result in the same average price for the loop determined by the Commission in Phase II of this case.

31. In paragraph 72 of its 10th Supplemental Order in Docket No. UT-980311(a), the Commission stated that it had estimated the cost of service for each wire center. In doing so, it specifically noted that, at this time, verifiable data such as line counts and loop lengths are unavailable at finer level of granularity than the wire center level. Thus, in both Docket No. UT-

960369, the UNE cost case, and Docket No. UT-980311(a), the universal service proceeding, the Commission determined that costs should be determined at the wire center level, at least at this time.

32. The deaveraging proposal recommended by Rhythms, TRACER, AT&T, MCI, and the other CLECs is consistent with these prior Commission orders. As discussed above, it is based on wire center costs and results in an average price for the loop that is equal to the statewide loop prices established by the Commission in its 17th Supplemental Order in this docket.

33. The deaveraging proposal is also consistent with the Commission's support for rural USF deaveraging. Although some cost-based deaveraging of rural loop prices is proposed now, there is clearly an opportunity to easily subdivide the recommended zones further once a state universal service program can be implemented. The deaveraging proposal presented here is intended as a flexible first step. It can easily be adapted for further cost-based deaveraging when the Commission determines it is advisable to do so.

V. GENERAL CONSIDERATIONS

34. Both U S West and GTE argue that geographic deaveraging of loop prices creates an immediate need for retail price deaveraging. U S West argues deaveraging the loop prices without deaveraging retail rates will create margin opportunities for CLECs in urban areas.

35. Rhythms and TRACER disagree that retail rate deaveraging must proceed in conjunction with loop rate deaveraging. There are a number of reasons for this. First, in all but two wire centers in U S West's territory, the proposed deaveraged loop rates would be higher than the rates currently in effect.

36. Second, the effect of deaveraging will only be to allow CLECs to face the same forward-looking costs that the ILECs do, and under the law of this state, U S West and GTE have the right to respond to competition in a number of ways. They can reduce prices without prior approval of the Commission. RCW 80.04.130(1). They can offer customer-specific contracts in instances of competitive necessity. RCW 80.36.150. They can obtain both upward and downward pricing flexibility in areas where there is effective competition. RCW 80.36.330. And, in Docket No. UT-950200, the Commission has granted U S West the right to offer all retail services under banded rate tariffs; the company only needs to file the appropriate tariff.

37. Third, as pointed out by Dr. Cabe, wholesale deaveraging does not create an immediate need for retail deaveraging. Only if wholesale deaveraging results in the development of significant competition would an ILEC be forced to seek reductions in prices in low cost areas. When such competition is nascent, there is no need for retail deaveraging. Cabe Rebuttal, Ex.33T at 12, lines 10-13. At this point there remain significant impediments to competition in local markets, including the inadequacy of the ILECs' Operations Support Systems ("OSS"), wholesale service quality problems, and collocation limitations. Geographically deaveraging loop prices alone cannot be expected to result in a significant increase in the amount of competition overnight.

38. Finally, it is not obvious that retail rates must be deaveraged to the same extent that unbundled loop rates are. There may be many reasons why carriers would want to maintain a simpler retail rate structure, including the avoidance of customer confusion, simplicity for marketing purposes, offering bundles of services, and simplicity for administrative and billing purposes. The

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whole trend for simplification of rate structures for long distance and wireless services should serve as a signal here.

39. The Commission simply need not feel compelled to solve a problem that does not yet exist. There is time to consider the complex issues surrounding retail rate deaveraging; they need not complicate the issues of unbundled loop deaveraging at issue in this case.

VI. IMPLEMENTATION ISSUES

40. As noted above, the deaveraging proposal recommended by Rhythms, TRACER, AT&T, MCI, and the other CLECs would be easy to implement. It is not overly complex, unlike the proposals to implement distance sensitive pricing for loops.

41. Because of the potential complexities associated with implementing a distance-sensitive pricing structure, Rhythms and TRACER respectfully submit that further study is needed before such a deaveraging scheme is ordered by the Commission. Certainly one of the issues that would have to be addressed is how the costs of implementing such a rate structure should be recovered.

VII. CONCLUSION/RECOMMENDATIONS

42. For the reasons stated above, Rhythms and TRACER respectfully recommend that the Commission adopt their deaveraging proposal, which would establish five cost-based zones for U S West and five cost-based zones for GTE. These zones would be determined by grouping together wire centers with similar costs. If the Commission decides at some time in the future that

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(206) 623-4711

further deaveraging is desirable, the recommended structure could easily be adapted by subdividing one or more of the zones recommended here.

Respectfully submitted this 28th day of March 2000.

ATER WYNNE LLP

By ________________________________
Arthur A. Butler, WSBA #04678
Attorneys for Rhythms Links, Inc. and TRACER

Douglas Hsiao
Rhythms Links, Inc.