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1 **I. INTRODUCTION AND PURPOSE OF TESTIMONY**

2 **Q. PLEASE STATE YOUR NAME AND POSITION.**

3 A. My name is William L. Fitzsimmons. I am a Director at LECG; my business address is 2000  
4 Powell Street, Suite 600, Emeryville, CA 94608.

5 **Q. ARE YOU THE SAME WILLIAM L. FITZSIMMONS WHO FILED DIRECT**  
6 **TESTIMONY IN THIS DOCKET?**

7 A. Yes.

8 **WHAT IS THE PURPOSE AND STRUCTURE OF YOUR TESTIMONY?**

9 The purpose of my testimony is to reply to statements made in direct testimony by Rhythms and  
10 Covad witness Dr. Cabe. Section II reiterates and supports the FCC's directive that prices  
11 of unbundled network elements should include the recovery of a "reasonable measure" of  
12 common costs. Section III establishes the proper economic criteria for setting the price of  
13 the high-frequency spectrum unbundled network element.

14 **Q. WOULD YOU PLEASE SUMMARIZE YOUR TESTIMONY?**

15 A. Dr. Cabe and I agree that on a shared line there are no direct loop costs. This is because the  
16 costs of the loop are common to the two dedicated connections provided on a shared line.  
17 We also agree that there is no "correct" method for allocating joint, or in a broader sense,  
18 common costs to specific network elements. I disagree with Dr. Cabe, however, when he  
19 concludes that none of the loop costs that are common to the two dedicated connections on  
20 a shared line should be recovered from the price of the high-frequency spectrum unbundled  
21 network element. When a firm is required to lease unbundled elements at regulated prices,  
22 it is appropriate for regulators to recognize that these prices should include recovery of  
23 "reasonable" portions of joint and common costs. This principle was recognized by this  
24 Commission in previous cost proceedings, in which nearly \$2.00 dollars of common costs  
25 were included in the cost of a loop.

26 Dr. Cabe makes other statements that are contrary to the purpose of cost-based pricing of the  
27 high-frequency spectrum unbundled network element (UNE). He recognizes that a goal in  
28 setting UNE prices is to foster efficient competition and protect efficient competitors, but he  
29 does not propose a proper tool for protecting these competitors-. An accepted approach is  
30 to protect efficient competitors by removing the possibility that a regulated incumbent can  
31 use its market power to subject competitors to a price squeeze. This protection is achieved  
32 when the price of Qwest Corporation's (formerly known as U S WEST) MegaBit service is  
33 equal to or greater than the incremental cost of providing the service plus the portion of the  
34 common loop cost that is allocated to the high-frequency spectrum UNE. Instead of  
35 advocating the use of this accepted method for protecting efficient competitors, Dr. Cabe  
36 takes the inappropriate approach of recommending that this Commission should consider

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1 retail prices, even of services that do not cause the cost of the loop, as a basis for pricing the  
2 high-frequency spectrum unbundled element. This will not lead to a price for this UNE that  
3 will simulate conditions in a competitive marketplace.

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1 Dr. Cabe strays further from sound advice and the purpose of this proceeding when he  
2 recommends that, if the Commission allocates an amount of the common loop cost to the  
3 high-frequency spectrum UNE, it should also reduce the price of basic local service. His  
4 rationale is that, without this reduction, Qwest will double recover the cost of the loop. This  
5 recommendation is improper for several reasons. First, with the ongoing development of  
6 competition, Qwest is not even assured that it will “single recover” the cost of its loop  
7 network. Facilities-based competitors, including wireline, wireless, and cable providers, are  
8 winning customers who would otherwise have purchased loop-based services from Qwest;  
9 subsidies from business customers and high margin services, that were once earmarked to  
10 help fund below cost residential service, are increasingly at risk; and niche companies, such  
11 as Covad, are preparing to offer a full array of services across the high-frequency spectrum  
12 of the loop.

13 Second, on residential lines, Qwest is not recovering the cost of the line from the price of  
14 basic local service today. It is clearly not in the best interest of fostering efficient  
15 competition to lower the price of a service that is already below cost. There are myriad other  
16 imbalances in the relationships between Qwest’s costs and retail prices. Some of these  
17 imbalances have traditionally been looked on as sources of implicit subsidies to fund services  
18 that are priced below cost. These implicit subsidies are also looked on by competitors as low  
19 hanging fruit to fund entry and expansion, which means that these subsidies are not  
20 sustainable in a competitive market. This is an important concern that needs to be addressed.  
21 Singling out one imbalance and trying to fix it by lowering a price that is often below cost  
22 would be inappropriate. In summary, today’s retail prices, replete with sources and uses of  
23 subsidies, do not provide meaningful information for setting prices of unbundled network  
24 elements.

25 Finally, I urge this Commission to step back and think about what the DLECs are asking.  
26 They are asking you to force their competitor, Qwest, to give away, free of charge,  
27 productive assets that Qwest could otherwise use to provide its own DSL service. I contend  
28 that if representatives from Covad and Rhythms, or any other firm were to take this request  
29 to a firm that was not regulated, these representatives would be looked upon with incredulity.  
30 It is a matter of good economics and sound business practice that a competitive firm would  
31 not give away the high-frequency spectrum on its loops, especially to a competitor, without  
32 expecting something in return. At its core, the proposal that Qwest should not be  
33 compensated for its productive asset is inequitable and contrary to the spirit of competition.  
34 The following statement made by the Arbitrator in a recent line sharing proceeding in  
35 California supports this point:

36 “It is unreasonable for an ILEC to sell any product or service at a zero price.  
37 Whether or not the ILECs are already recovering the full cost of the loop, it

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1 would not be acceptable to require the ILEC to ‘give away’ any product or  
 2 service. Every product or service should make some nonzero contribution to  
 3 common costs...”<sup>1</sup>

4 **COST-BASED PRICES FOR UNBUNDLED NETWORK ELEMENTS SHOULD**  
 5 **INCLUDE A REASONABLE ALLOCATION OF COMMON COSTS**

6 **Q. DO YOU AGREE WITH DR. CABE THAT ON A SHARED LINE THE LOOP COSTS**  
 7 **ARE COMMON TO THE TWO DEDICATED CONNECTIONS TO THE END USER?**

8 A. Dr. Cabe and I agree that, on a shared line, the cost of the loop is jointly caused, or shared,  
 9 by the two dedicated connections that the loop provides. As Dr. Cabe points out, “the vast  
 10 majority of the cost of providing various portions of the loop bandwidth are joint or ‘shared’  
 11 costs.” [Cabe Direct, p. 10] This means that on a shared line, there are no separate direct  
 12 loop costs for the high or low-frequency spectrums. On a shared line, all loop costs are  
 13 common to the production of the two dedicated connections.

14 **Q. DO YOU AGREE WITH DR. CABE THAT THERE IS NO “CORRECT” METHOD**  
 15 **FOR ALLOCATING COMMON COSTS [CABE DIRECT, P. 10]?**

16 A. Dr. Cabe and I agree that there is no “correct” method for allocating joint costs to the high-  
 17 frequency spectrum UNE. As described in my direct testimony, high levels of common costs  
 18 make it difficult to determine a cost-based price, because common costs must be allocated  
 19 to network elements that share the costs, and often there is no definitive cost basis for this  
 20 allocation.

21 **Q. WHAT GUIDANCE DOES THE FCC PROVIDE REGARDING THE**  
 22 **ALLOCATIONS AND RECOVERY OF SHARED COSTS?**

23 A. In the First Report and Order, the FCC recognized that:

24 “Certain common costs are incurred in the provision of network  
 25 elements...some of these costs are common to only a subset of the elements  
 26 or services provided by incumbent LECs. Such costs shall be allocated to  
 27 that subset, and should then be allocated among the individual elements or  
 28 services in that subset, to the greatest possible extent...Because forward-  
 29 looking common costs are consistent with our forward-looking, economic  
 30 cost paradigm, a reasonable measure of such costs shall be included in the

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<sup>1</sup> Mattson, Burton W., Arbitrator, Administrative Law Judge, Final Arbitrator’s Report, before the Public Utilities Commission of the State of California, Rulemaking 93-04-003, Investigation 93-04-002, Interim Arbitration, Line Sharing Phase, May 26, 2000, p. 67.

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1 prices for interconnection and access to network elements.”<sup>2</sup>

2 It is clear that a reasonable portion of the shared loop cost should be allocated to the high-  
3 frequency spectrum UNE. The question before us is: How much of the \$18.16 of joint costs  
4 should a competitor pay if it wants to lease only the high-frequency spectrum?

5 **IN THE WASHINGTON PROCEEDING, HOW WERE NON-DIRECT COSTS**  
6 **ALLOCATED TO THE LOOP TO CREATE A COST BASIS FOR PRICING THE**  
7 **LOOP?**

8 Cost proceedings over the past several years established that the cost of unbundled elements should  
9 include a reasonable share of common costs. In Washington, the Commission averaged  
10 common costs (i.e. overhead) from three different cost models: the HAI model, RLCAP, and  
11 the BCPM. The result is that nearly two dollars of common costs are included in the  
12 statewide average loop cost and price of \$18.16 established by this Commission.

13 **PROPER ECONOMIC CRITERIA FOR SETTING THE PRICE OF THE**  
14 **UNBUNDLED NETWORK ELEMENT**

15 **Q. WHAT CRITERIA HAVE BEEN PUT FORTH IN THIS PROCEEDING FOR**  
16 **CONSIDERING THE PORTION OF THE SHARED LOOP TO ALLOCATE TO THE**  
17 **HIGH-FREQUENCY SPECTRUM UNE?**

18 **A.** Three types of criteria have been put forth in this proceeding for considering what portion  
19 of the joint loop cost should be allocated to the high-frequency UNE when setting the price  
20 for this UNE. The first two criteria are appropriate, and the third is not.

21 The first criterion, which I discuss in my direct testimony, is that the cost allocation should  
22 lead to a price that replicates a reasonable outcome in a competitive telecommunications  
23 market, since UNE prices are meant to assist in the transition to a competitive market.

24 The second criterion, supported by all parties in this proceeding, is that the cost allocation  
25 should foster and protect the development of efficient competition.

26 The third criterion, suggested by Dr. Cabe, is that this Commission should consider cost  
27 allocation and UNE pricing in the context of retail revenues and the overall financial  
28 positions of Qwest and competitors as they relate to all wholesale and retail revenues  
29 relative to costs.

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1 2 FCC 96-325, First Report and Order, Released August 8, 1996, CC Docket Nos. 96-98 and 95-  
2 185, Paragraph 694.

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1 The third criterion is inappropriate for setting the cost-based price for a UNE.

2 **WHY DO YOU MAINTAIN THAT UNE PRICES SHOULD REPLICATE A REASONABLE**  
 3 **OUTCOME FROM A COMPETITIVE MARKET?**

4 As noted by Dr. Cabe, a fundamental economic concept underlying the decision to transform local  
 5 telecommunications into a competitive market is that competition will provide the proper  
 6 incentives for more efficient investment and innovation. [Cabe Direct, p. 4] To achieve this  
 7 transformation, the FCC mandated that incumbent local exchange carriers make productive  
 8 assets available to competitors at prices that simulate competitive conditions. Under the  
 9 FCC concept, prices developed with this methodology will lead to efficient investment  
 10 decisions during the transition to competition. In its First Report and Order the FCC explains  
 11 its rationale as follows:

12 “Because a pricing methodology based on forward-looking costs simulates  
 13 the conditions in a competitive marketplace, it allows the requesting carrier  
 14 [of unbundled elements] to produce efficiently and compete effectively,  
 15 which should drive retail prices to their competitive levels.”<sup>3</sup>

16 In other words, to promote efficient investment, prices for unbundled elements are intended to replicate prices  
 17 that would prevail in a competitive telecommunications market. A price for the high-frequency spectrum UNE  
 18 that is out of sync with a price that would reasonably prevail in a competitive market will have a disruptive  
 19 impact on the ongoing transformation toward a competitive local telecommunications market in Washington.

20 **Q. IN A COMPETITIVE MARKET, WOULD YOU EXPECT THE PRICE OF THE**  
 21 **HIGH-FREQUENCY UNE TO INCLUDE SOME CONTRIBUTION TO THE JOINT**  
 22 **LOOP COST?**

23 **A.** Yes. The norm in a competitive market is that a product, service, or productive asset that is  
 24 in limited supply that has a positive demand also has a positive price. The expectation of a  
 25 positive price is even more pronounced when offering a productive asset for lease precludes  
 26 its use by the owner of the asset. In the case of the high-frequency spectrum UNE, leasing  
 27 the UNE to a competitor removes the ability of Qwest to provide xDSL service over the  
 28 high-frequency portion of the loop. In a competitive market, it is highly unlikely that any  
 29 rational provider would give up its ability to provide service using the high-frequency  
 30 spectrum on its loops without requiring compensation from the competitor that will use the  
 31 spectrum. The strong expectation is, therefore, that a competitive firm would charge a  
 32 positive price for the use of the high-frequency portion of the loop. In a competitive market,  
 33 companies such as Covad could not expect to get something of value for nothing.

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1 3 FCC 96-325, First Report and Order, Released August 8, 1996, CC Docket Nos. 96-98 and 95-  
 2 185, Paragraph 679.



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1 **Q. WILL ALLOCATING ANY OF THE LOOP COST TO THE HIGH-FREQUENCY**  
2 **UNE BE CONTRARY TO THE DEVELOPMENT OF EFFICIENT COMPETITION?**

3 A. No. Setting the price for this productive asset at a price that would be reasonable in a  
4 competitive market will not be contrary to the development of efficient competition. To the  
5 contrary, setting a price for this productive asset that would not occur in a competitive  
6 market, such as a price of zero, will disrupt the ongoing development of competition.

7 The correct tools for fostering efficient competition and protecting competitors are at hand.  
8 There are two classes of competitive local exchange carriers that will provide xDSL services  
9 using Qwest's loops. The first class of competitors includes the so-called "data" local  
10 exchange carriers (DLECs) that want to lease the high-frequency spectrum UNE only.<sup>4</sup>  
11 Preventing the possibility of a price squeeze provides the proper protection to this class of competitors. In my  
12 direct testimony I explain that a price squeeze involves the use of market power to reduce the margin between  
13 prevailing wholesale and retail prices to the point where the integrated seller has a substantial competitive  
14 advantage over retail competitors that are not integrated. [Fitzsimmons Direct, p. 25] In the context of this  
15 proceeding, guarding against the possibility of a price squeeze is achieved when the price for Qwest's Megabit  
16 service is equal to or greater than the incremental direct cost of providing the service plus the portion of the  
17 common loop cost that this Commission allocates to the high-frequency spectrum UNE. As explained by Qwest  
18 witness Jerold Thompson, the price of Qwest's Megabit service passes this test with fifty percent of the loop  
19 cost allocated to the high-frequency spectrum UNE. [Thompson Direct, pp. 10-11]

20 Because the broader class of competitive local exchange carriers (CLECs) lease the entire loop to provide a  
21 range of telecommunications services to their customers, the line sharing UNE is not required to foster efficient  
22 competition. Competitors entering and expanding across a broad range of services benefit from the fact that  
23 incumbent local exchange carriers, such as Qwest, are required by law to make several entry strategies  
24 available. CLECs are entering, expanding, and offering a full range of services using combinations of  
25 discounted resale of Qwest's retail services, unbundled elements priced at cost, and the installation of their own  
26 facilities. The ability to provide DSL service on leased or self-supplied loops makes entry even more attractive  
27 to facilities-based CLECs.

28 **Q. IN THE EFFORT TO FOSTER AND PROTECT THE DEVELOPMENT OF**  
29 **EFFICIENT COMPETITION, IS IT NECESSARY TO RECOGNIZE THAT NOT**  
30 **ALL COMPETITORS ARE USING QWEST'S FACILITIES?**

31 A. Yes. Dr. Cabe states that "DSL is an emerging technology with great promise for meeting  
32 the need for advanced telecommunications services," and he expresses concern that "prices,  
33 terms and conditions under which Washington ILECs offer the unbundled network  
34 elements...do not discourage competitive entry into this market." [Cabe Direct, p. 5] A  
35 fuller statement of the truth is that DSL is one of several technologies that are showing great  
36 promise for meeting the need for high-speed access. It is instructive to step back from the  
37 consideration of the dispute between Qwest and the DLECs over the price of the high-

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1 4 The term 'data' appears to be a misnomer, because, as noted in my direct testimony, Covad  
2 claims that it expects to use the high-frequency spectrum to provide voice services along with  
3 high-speed Internet access.

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1 frequency spectrum UNE and consider the impacts of this proceeding on other broadband  
2 Internet access competitors, such as broadband wireless and cable modem service providers.  
3 If this Commission sets an unreasonably low price for the high-frequency spectrum UNE,  
4 in an effort to assist DLECs, it may have a damaging impact on the otherwise beneficial  
5 development of alternative sources of broadband Internet access competition.

6 **Q. DR. CABE ADVOCATES ADDRESSING IMBALANCES BETWEEN WHOLESALE  
7 AND RETAIL PRICES; IS THIS PROCEEDING THE PROPER PLACE TO  
8 ADDRESS THIS ISSUE?**

9 A. This proceeding is not the proper place to examine the relationship between wholesale and  
10 retail prices. It is surely beyond the scope of this proceeding to consider the implications of  
11 wholesale prices on the overall corporate profits of Qwest and its competitors. When the  
12 price of the loop was set, it was based on the cost of the loop, not the retail price of the  
13 service that includes the dedicated connection or the retail revenues from all services that  
14 may or may not be provided on a given loop.

15 Qwest's residential basic local exchange customers pay \$12.50 per month, \$16.85 with the  
16 addition of the \$4.35 subscriber line charge. This is less than the statewide average  
17 unbundled loop price of \$18.16, and far less than the total economic cost of residential basic  
18 local exchange service, taking into account all of the cost elements beyond the local loop that  
19 are used to provide this service.

20 The current structure of retail prices is replete with implicit subsidies. It should be  
21 recognized, however, that these implicit subsidies create opportunities for competitors.  
22 Today, business customers subsidize residential customers, urban customers subsidize rural  
23 customers, and customers who use high margin services subsidize those who do not. It is not  
24 surprising that competitors target business customers in urban areas in an attempt to capture  
25 these subsidies. Resolving imbalances between retail prices and costs is an

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1 important concern. If assigning a portion of the loop cost to the high-frequency UNE results  
 2 in an imbalance between retail prices and costs, this Commission and Qwest should address  
 3 this at the proper time in the context of all retail price imbalances.

4 Furthermore, if this were a rate rebalancing proceeding, it would be incorrect to consider the  
 5 revenue from usage-based services in connection with the cost of the loop. It is well  
 6 recognized that other services, such as long distance usage, contribute revenues to cover the  
 7 cost of residential access lines. This does not mean, however, that long distance usage  
 8 causes the cost of the local loop any more than the number of auto trips made by customers  
 9 causes the cost of manufacturing the automobile. That is why a consumer who drives 3,000  
 10 miles a year pays the same price for a given automobile as a consumer who drives 30,000  
 11 miles a year. In this proceeding, we are attempting to provide a reasonable cost based price  
 12 for the high-frequency spectrum UNE. This is not a proceeding designed to rationalize retail  
 13 prices.

14 **Q. IN PREVIOUS COST PROCEEDINGS, DID THIS COMMISSION DETERMINE**  
 15 **THE COST-BASED PRICE OF THE UNBUNDLED LOOP RELATIVE TO THE**  
 16 **PRICES OF RETAIL SERVICES?**

17 A. No. The Commission determined the cost-based price of the unbundled loop based on the  
 18 cost of providing the loop, without reference to the prices of retail services. This is the  
 19 appropriate approach. In its First Report and Order, the FCC made it clear that the prices for  
 20 a UNE should be based on the element's TELRIC, plus a reasonable share of common costs.  
 21 In the Third Report and Order, the FCC states that "we must extend the TELRIC  
 22 methodology to this situation and adopt a reasonable method for dividing shared loop costs."<sup>5</sup>  
 23 Prices for an unbundled element should not be set based on the prices of retail services. With line sharing, the  
 24 loop can provide two dedicated connections to an end user. The fact remains, however, that the loop is caused  
 25 by the dedicated connections that it provides. The cost of a loop is caused by these dedicated connections, and  
 26 this should be the focus of this proceeding, not the retail prices of basic local service or other services. Retail  
 27 prices, which are replete with sources and uses of subsidies, do not provide meaningful information for setting  
 28 the prices of unbundled network elements.

29 **Q. WHAT PRICE DO YOU RECOMMEND THE COMMISSION ESTABLISH FOR**  
 30 **THE USE OF THE HIGH-FREQUENCY PORTION OF THE LOOP?**

31 A. None of the statements made by Dr. Cabe cause me to alter my position that there is no  
 32 meaningful evidence that more or less than fifty percent of the loop cost should be allocated  
 33 to the high-frequency spectrum UNE. [Fitzsimmons Direct, p. 4] There is no "correct"  
 34 allocation of common costs. It is necessary, therefore, to derive a "reasonable" allocation of  
 35 common costs. In the recently completed cost proceeding, this Commission adopted what  
 36 it deemed a reasonable method of allocating common costs to the UNEs. Now the

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1 <sup>5</sup> FCC 99-355, Third Report and Order in CC Docket No. 98-147, Released December 9, 1999,  
 2 Paragraph 138.

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1 Commission is faced with allocating a reasonable amount of common loop costs to the high-  
2 frequency spectrum UNE. This is a practical problem, much like the allocation of common  
3 costs to other UNEs was a practical problem. It is necessary to find a reasonable solution.

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1 There are two dedicated connections on a shared line, and there is no meaningful evidence that more  
2 or less than fifty percent of the loop cost should be allocated to either connection. The most  
3 reasonable solution is to allocate one-half of the loop cost to the high-frequency spectrum  
4 UNE. This represents a substantial discount from the full unbundled loop price.

5 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

6 **A. Yes.**