

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Pricing Proceeding for) DOCKET NO. UT-960369
Interconnection, Unbundled Element,
Transport and Termination, and Resale)
.....)
In the Matter of the Pricing Proceeding for)
Interconnection, Unbundled Elements,
Transport and Termination, and Resale for) DOCKET NO. UT-960370
)
U S WEST COMMUNICATIONS, INC.)
.....)
DOCKET NO. UT-960371
In the Matter of the Pricing Proceeding for)
Interconnection, Unbundled Elements,
Transport and Termination, and Resale for)
)
TWENTY-FOURTH
SUPPLEMENTAL ORDER
)
ORDER REJECTING TARIFFS;
GTE NORTHWEST INCORPORATED) AUTHORIZING REILING
.....)

Synopsis: In this order, the Commission rejects proposals for the deaveraged wholesale price of unbundled loops that USWC and GTE offered. The Commission directs USWC and GTE to refile tariffs in accordance with the provisions of this order, providing for five rate zones for each company, based on wire-center costs.

TABLE OF CONTENTS

I. PROCEDURAL HISTORY 2
 A. Hearings 2
 B. Parties 3

II. INTRODUCTION 3

III. RATE PROPOSALS AND CRITICISMS 5
 A. Rates That are a Function of Distance 5
 1. Commission Staff and Joint CLECs 5
 2. Implementation Costs 6
 B. Commission Staff’s Flat-Rate Proposal 9
 C. U S WEST’s Proposal 9
 D. GTE’s Rate Proposal 11
 1. Request for Delay 11
 2. GTE Preferred Proposal 11
 3. GTE Compromise Proposal 12
 4. Critique of GTE’s Proposals 12
 E. AT&T and MCI Worldcom’s Proposal 13

IV. COMMISSION DISCUSSION AND DECISIONS 15
 A. Unit of Granularity—the Exchange or the Wire Center 15
 B. Commission Decision Regarding Distance Sensitive Rates 16
 C. Rate Proposals 17
 D. Conclusion 21

V. FINDINGS OF FACT 21

VI. CONCLUSIONS OF LAW 22

VII. O R D E R 23

I. PROCEDURAL HISTORY

A. Hearings

1 The Commission heard this matter pursuant to due and proper notice to all interested persons in Olympia, Washington on February 28, 2000, through March 1, 2000, before Chairwoman Marilyn Showalter, Commissioners Richard Hemstad and William R. Gillis and Administrative Law Judge C. Robert Wallis.

B. Parties

- 2 U S WEST Communications, Inc., appeared by Lisa A. Anderl, attorney, Seattle; GTE-NW appeared by W. Jeffery Edwards and Jennifer McClellan, Richmond, Virginia; Washington Telecommunications Ratepayers Association for Cost-based and Equitable Rates ("TRACER") appeared by Stephen J. Kennedy, attorney, Seattle; MCI Worldcom appeared by Ann Hopfenbeck, attorney, Denver, Colorado; AT&T appeared by Susan Proctor, attorney, Denver, Colorado; Nextlink Washington, Electric Lightwave, Inc., Advanced Telcom, Inc., New Edge Networks, Inc. and GST Telecom appeared by Gregory Kopta, attorney, Seattle; Washington Independent Telephone Association appeared by Richard A. Finnigan, attorney, Olympia; and the Commission Staff appeared by Sally G. Johnston and Ann Rendahl, assistant attorneys general, Olympia.

II. Introduction

- 3 This proceeding began over three years ago with the Commission's decision to pursue unbundling of network elements, interconnection, and wholesale prices for telecommunications services. The Commission recognized that in a more deregulated environment, rate averaging that helped to support the tariff structure of the past might be in tension with increased competition. That tension could result from the realities of market incentives: potential competitors could be drawn to low-cost areas (generally high-volume, high-density locations) where the averaged rate of the incumbent would provide a high margin, and could have fewer market incentives to enter high-cost areas where the incumbent's existing averaged rates would be well below cost. In passing the 1996 Telecommunication Act, Congress concluded that the benefits from competition outweighed the potential disruptions to the existing retail pricing structure. Therefore, we are obligated under the Act and Federal Communications Commission pricing rules to implement a rate structure in which the price of the unbundled loop is deaveraged.
- 4 This proceeding is an outgrowth of a number of arbitration cases that were conducted by the Commission pursuant to the passage of the 1996 Telecommunications Act (Act). The Telecommunications Act established a procedure whereby the Commission serves as an arbitrator for disputes that may arise between an incumbent and a competitive local exchange telecommunications carrier. Act §252(b). Due to the compressed time schedule established by the Act, the Commission determined that permanent resolution of certain issues that arose during the arbitration hearings should be resolved through this generic proceeding.
- 5 Consolidated dockets began with an exhaustive review of cost models in an effort to determine the cost of providing network elements and the costs that were avoided when an incumbent provided retail services at a wholesale discount. In Phase I the Commission relied on a number of models to estimate the cost of network elements and the retail costs that are avoided in a wholesale environment. We deferred to Phase II a determination of how the common costs of an incumbent should be measured and

reflected in the price of unbundled network elements. In Phases I and II we also gave consideration to such matters as the costs associated with collocation, connection and disconnection orders, and the recovery of operational support system costs. Finally, in Phase III, this phase, we establish the pricing structure and levels for the deaveraging of the unbundled loop.

6 The Commission has also reviewed "compliance filings" that the parties submitted pursuant to specific Commission instructions and will address those by separate order.

7 A few matters remain for later decision, largely as a result of Federal action. The Commission has begun Docket No. UT-003013 to resolve those matters.

8 In this phase of this proceeding, the Commission's principal task is to determine the proper tariff structure for implementing the geographic deaveraging of loop costs of incumbent local exchange companies GTE of the Northwest, Inc. (GTE-NW or GTE) and U S WEST Communications, Inc. (USWC or US WEST). In this proceeding we consider the desirable "granularity" of loop rates, or the degree to which averaging should continue to be permitted. This undertaking is mandated by section 51.507(f) of the Federal Communications Commissions pricing rules. Section 51.507(f) requires state commissions to establish at least three geographic rate zones for unbundled network elements and interconnection. Our deaveraged rates in this order are designed so that the average price for the loop is equal to the statewide loop prices that we established in Phase II. These average prices are \$23.94 for U S WEST and \$18.16 for GTE.

9 In the discussion below, the Commission reviews its prior rulings on deaveraging and the parties' various rate proposals. The Commission then makes its ruling on geographic deaveraging of wholesale loop rates based upon the evidence presented.

10 The Commission asked the parties to brief the extent to which their proposals were consistent with prior statements the Commission had made concerning the deaveraging issue. In this section of the Order we present a brief review of Commission rulings on deaveraging emanating from this "Generic Cost" Docket, UT-960369.¹

11 The Commission first addressed the deaveraging of UNE rates and interconnection prices in April 1998. At that time the Eighth Circuit Court had stayed the FCC's rule which required deaveraging. The Commission stated in the Eighth Supplemental Order² in this docket that it agreed with Staff that deaveraging of UNE and interconnection rates should be considered "in the context of universal service reform, deaveraged retail prices, and the

¹For convenience we will refer to the consolidated dockets under the lowest number of the three dockets, UT-960369.

²References to orders without a docket number will refer to orders in this docket.

extent of competitive activity in Washington State." *Eighth Supp. Ord., para. 274.*³

- 12 In January 1999 the United States Supreme Court upheld the Federal Communications Commission's (FCC) deaveraging rule, 47 C.F.R. §51.507(f). In paragraphs 477 through 482 of its 17th Supplemental Order, 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 submit proposals to deaverage rates that would result in the same average price for the loop determined by the Commission in Phase II.

III. RATE PROPOSALS AND CRITICISMS

- 13 In this section of the Order we summarize the various pricing proposals and critiques that were made in this proceeding.

A. Rates That are a Function of Distance

1. *Commission Staff and Joint CLECs*

- 14 The Commission Staff initially proposed a distance-sensitive pricing structure in which rates based upon exchange areas, by zone, would be further deaveraged depending on the length of the loop. Staff witness Thomas Spinks and the Joint CLECs⁴ witness Page Montgomery state that distance-sensitive pricing is appropriate, as it reflects that loop length is one of the more important drivers of loop cost. Staff and the Joint CLECs note that distance-sensitive pricing will allow potential competitors to make more efficient technology choices in determining whether to serve customers by using leased UNEs or by building their own facilities. Further, distance-sensitive pricing may allow CLECs to begin penetrating the local market in more rural areas by enabling them first to provide

³ Staff does not now advocate waiting to deaverage rates until a state universal service fund program has been developed, or until retail rates can be deaveraged. In Phase I, Staff was concerned about the impact of deaveraging in rural areas without the offsetting funding to produce comparable rates. While Staff remains concerned about this issue, Staff recommends that the Commission proceed to deaverage rates. Staff finds the ILECs' concerns about arbitrage to be "speculative and overstated." *Staff's Brief at para. 10 and 41.*

⁴ Advanced TelCom Group, Electric Lightwave, GST Telcom Washington, NewEdge Networks, and Nextlink Washington.

service to customers located close to the central office and then to branch out once they establish operations.

- 15 A number of concerns were raised about Staff's and the Joint CLECs' distance-based rate proposals. Both of those proposals rest on a regression analysis that was submitted by Commission witness Spinks. Mr. Spinks submitted a regression analysis in which the average cost per wire center was the dependent variable and the number of lines per square mile and the average length of a loop were the independent variables. Parties objected to Staff's proposal, contending that the data used in the study are partly from a model that is not part of the record in this proceeding, that the regression estimates are biased,⁵ and that it would be costly to implement a distance-based tariff.
- 16 GTE and U S WEST filed testimony in which their witnesses challenged the soundness of Mr. Spinks's regression analysis. For example, GTE faulted Staff for using a smooth cost function. According to GTE, the cost function actually has a kink at the point where a digital line carrier is substituted for copper feeder cables.
- 17 Staff concedes that there are problems with its analysis:

Staff acknowledges that there is some bias in the estimation coefficients. However, given that the Commission may never know the true costs of the loop, and given that the Commission will need to reconcile any derived costs back to meet the statewide average rate that itself is a product of averaging, Staff's effort is a way to try to estimate what the cost is. While it is not a statistically perfect proposal, it is close enough to estimate cost and develop a distance-sensitive pricing proposal. See Tr. Vol. 12, at 2692-95.

Staff Brief at para. 24.

2. Implementation Costs

- 18 The ILECs contend that the administrative costs and burdens associated with distance-sensitive deaveraged rates outweigh any benefits that might arise from implementing this type of rate structure. The ILECs go on to argue that a distance-sensitive rate structure would require significant modifications to the ILECs' 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. Furthermore, parties argued that distance calculations using street addresses in a driving-map-based program such as Mapquest will produce unreliable estimates of loop lengths. GTE adds that because initially the determination of the distance-sensitive rates would be done manually, the cost of processing orders would be increased, and this in turn would raise

⁵ A coefficient is biased if the expected value of the estimated parameter does not equal the true value of the parameter.

the non-recurring charge for UNE loops.

19 Rhythms and TRACER support setting rates on a wire-center basis, in part because of the "potential complexities associated with implementing a distance-sensitive pricing structure." They add that before a distance-sensitive pricing structure is adopted, the Commission will need to determine how the implementation costs would be recovered. *Rhythms/TRACER Brief at para. 41.*⁶

20 AT&T/MCI believe that it would be cumbersome and potentially expensive to identify the distance between the end-user and the wire center. AT&T/MCI witness Denney expressed a concern that because this process would not, initially, be done electronically, it would significantly raise the cost of establishing a new customer. He said that a manual lookup would be especially problematic if a CLEC uses UNEs to serve a large share of the market. Mr. Denney noted that in New York, AT&T is serving a large number of customers using the UNE platform. Mr. Denney is concerned that the manual distance look-up would be costly to implement, due to the large volume of connections. Therefore, AT&T/MCI support using zones based on cost differences among wire centers.

21 The Joint CLECs continue to support the principle of distance-sensitive rates but . . . are concerned that implementation of distance-sensitive rates based on the record developed to date would delay the availability of geographic deaveraging, and that imposition of the statewide averaged rates the Commission previously established in this docket would have a severe chilling effect on CLECs ability to use ILEC unbundled loops. See Ex. 281T (NEXTLINK Knowles Response) at 4-6.

Nextlink Brief at para. 11.

22 Commission Staff disagrees that these issues are so complex that they cannot be quickly implemented.

However, Staff does not object to delaying implementation of a distance-sensitive price structure in order to work out the details. Staff and others have suggested that the parties should be able to develop a workable distance-sensitive rate structure, and determine implementation issues in a workshop, as parties have on other issues such as pole attachments. See Tr. Vol. 10, at 2302; see also Vol. 12, at 2700.

Staff Brief at para. 46.

⁶ This Commission previously found that the cost of modifying the ILECs' operational support systems is recoverable from the CLECs. *17th Supplemental Order at para. 98-101*. Based on this decision, it would appear that any implementation costs related to distance-sensitive pricing are costs that would chargeable to the CLECs.

- 23 Staff also suggests that if a distance-sensitive rate structure is not adopted at this time, only three or four flat rate zones be used on an interim basis. Staff is concerned that, without this limit, if a distance-sensitive rate structure is subsequently adopted, there will be so many rate elements that implementing the tariff will be costly.
- 24 Because the Commission will be considering the ILECs' OSS studies in docket UT-003013, Staff and the CLECs recommend that the Commission "request the parties to also discuss in that proceeding the impact of a distance-sensitive deaveraging proposal on the cost of their OSS systems." *Staff Brief at para. 50 (quote) and CLEC's Brief at para. 40.*
- 25 Finally, Staff asks that the Commission order distance-sensitive pricing and "set a date for implementation following workshops among the parties." *Staff Brief at para. 51.* The CLECs have made a similar request. The CLECs

urge the Commission to adopt the concept of distance-sensitive loop rates and require that the parties address the necessary cost and implementation issues in the new generic cost proceeding, Docket No. UT-003013, to enable the Commission to adopt and implement distance-sensitive geographically deaveraged loop rates as a result of that docket.

CLECs' Brief at para. 12.

- 26 The CLECs' proposal was strongly supported by witness Page Montgomery, who argued that if the Commission adopts the concept of distance-sensitive rates in principle, the ILECs would be compelled to begin altering their operational support systems so that distance measurements could be reported by their computer systems. Mr. Montgomery went on to argue that if no set implementation date is established, the matter will be "ignore[d]..because everybody's busy for the time being. But it's also in the specific interest of those who like the status quo to make sure that it's put off longer and longer and longer." Mr. Montgomery noted that if the Commission accepts the idea and orders implementation, the ILECs will be compelled to "go out and solve the problems." *Tr. Vol. 12, 2801-03.*

B. Commission Staff's Flat-Rate Proposal

- 27 Staff also proposed a flat-rate pricing structure, using density as the basis for determining deaveraged zones. For its flat-rate proposal, "staff recommends the Commission adopt Staff's final proposal presented in Exhibit 261R using data from the HM 3.1 model. In this proposal, Staff recommends the Commission deaverage rates using a flat, density zone-based, rate structure, with four zones for U S WEST and three zones for GTE, where density is measured as the number of lines per square mile of serving area." *Staff Brief, para. 11.*

28 In developing its methodology Staff notes that "[t]he FCC rule requires not just deaveraged rate zones, but "defined geographic areas" that reflect cost differences." *Id.*, *para. 14*. Staff chose density zones as the basis for deaveraging because it felt that density is the primary driver of loop cost and it interpreted the FCC requirement ". . . to mean that the Commission must identify specific areas within the state that show significant cost variations, and that significance should be determined using statistical tests." *Id.*, *para. 14*. In establishing its density zones Staff states that it used the HM cost model density zones as a starting point and used exchanges as the basis for deaveraging rates. *Id.*, *para. 14 and 20*. Staff states that it chose to use exchanges "...in order to maintain consistency between the geographic level at which deaveraging and universal service funding are likely to take place, and because using the exchange was administratively simple and provided a contiguous geographic area in which people receive service at a common rate." *Id.*, *para. 20*. Staff has recognized, however, that basing deaveraging on wire centers produces more economically efficient prices and notes that its proposal, presented in Exhibit 261R, can be recalculated using wire centers. *Id.*, *para. 20*.

29 Commission Staff goes on to assert that, based on objections received to its use of HAI 5.0a data, Staff has revised its proposals so that they do not, with one exception, rely on HAI 5.0a data. The one exception noted by Staff is the Stevens Point data point in Staff's flat-rate proposal for GTE. *Id.*, *para. 21 and 22*. Staff notes that it did utilize wire-center area data from HAI 5.0a for calculating U S WEST densities. Staff goes on to assert that this should not be a problem, as this is not an output of the HAI 5.0a model, but is geographical data that is utilized by the model as an *input*.

C. U S WEST's Proposal

30 U S WEST proposes deaveraging its unbundled loops into three zones "[u]sing a community-of-interest approach," (*USWC Brief*, *p. 9*) which groups the loops into the following three zones: (1) large communities (Seattle, Tacoma, Vancouver, and Spokane); (2) medium sized communities (Bremerton, Bellingham, Yakima, and Olympia); and (3) all other communities. U S WEST states that these groupings were based on the Metropolitan Statistical Areas (MSAs) used by the Census Bureau. *Id.*, *p. 9*. The Company goes on to argue that there is precedent for this methodology in that "MSAs have been used by the FCC to identify areas for the initial deployment of permanent number portability and to identify areas for potential removal of the requirement to provide unbundled network switching." *Id.*, *p. 9*.

31 U S WEST used the following methodology in arriving at its cost estimates (*Ex. 61-T at p. 12*):

The statewide average data was segregated into separate files according to the three zones. Three separate runs of RLCAP were made, one for each zone. . . . Information of the investment cost for the unbundled loop was determined for each zone separately by RLCAP. The loop

(feeder, distribution, and drop) investment was summed to achieve three levels of investment cost, one for each zone. Each zone investment was then compared to the statewide investment data that was used in the Commission ordered rate. A percentage was determined by dividing each zone investment by the statewide average investment. These percentages were multiplied by the statewide average unbundled loop price of \$18.16 to determine the deaveraged price for each zone.

- 32 It should be noted that the RLCAP runs referred to were runs using RLCAP 4.0, not RLCAP 3.5, which was the model originally filed in this docket. U S WEST believes that use of the RLCAP 4.0 model is justified because: (1) Investment from this version of the model was used in Phase II of this docket to establish the four wire loop cost; (2) This version of the model is being used “to distribute relative costs among zones to deaverage the prices set in earlier dockets,” not to re-argue the loop prices; and (3) No party has objected to U S WEST’s using this version of the model. *Id.*, p. 10.
- 33 AT&T/MCI assert that U S WEST’s approach is backward, because it first assigns wire centers to zones, based on an arbitrary "community of interest" methodology, and then calculates UNE loop cost for those zones using RLCAP, which is not capable of calculating cost on a wire center basis. *AT&T/MCI Brief*, pp. 8-9. Parties contend that this methodology has problems because it groups low- and high-cost wire centers within the same zone, effectively eliminating the effects of deaveraging, and because it minimizes the significant cost differences that can exist within, and between, communities.⁷ This problem is highlighted by AT&T/MCI, who state that

[t]he deviation in U S WEST’s wire center costs in the low-cost zone is 5 times greater than the deviation based on AT&T’s proposed zone assignments. The medium cost zone for U S WEST has more than twice the deviation than the costs resulting from AT&T’s zone assignment. U S WEST’s high-cost zone also has a greater variance than AT&T’s zone assignment.

Id., p. 9. AT&T/MCI go on to point out that the inclusion of high-cost wire centers in low-cost zones distorts UNE loop rates upward.⁸

⁷*Brief of AT&T and MCI WorldCom*, p. 8. See also, *Brief of Rhythms Links, Inc. and TRACER* at para. 18-19, and *Brief of Staff* at para. 35.

⁸ *Id.*, p. 9. See also *Brief of Rhythms Links, Inc. and TRACER* at para. 19 which states that U S WEST’s strategy inflates the price in the lowest cost zone and effectively inhibits competition by setting above-cost loop rates.

D. GTE's Rate Proposal

1. Request for Delay

- 34 GTE advocates that the Commission not order deaveraging at this time. Rather, it urges that UNE deaveraging should be implemented contemporaneously with USF reform and retail rate rebalancing.
- 35 The Commission has previously rejected GTE's and U S WEST's request to delay the deaveraging of the UNE loop prices. *Twentieth Supplemental Order, UT-960369, December 9, 1999, p. 2.* We do so again here. GTE provided no new argument on this issue. We reaffirm our prior decision.
- 36 GTE adds that if the Commission feels compelled to proceed with UNE deaveraging, "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 Brief at para. 54.*
- 37 GTE offers two proposals for the Commission's consideration, their preferred proposal and what they refer to as a compromise proposal.

2. GTE Preferred Proposal

- 38 GTE's preferred proposal is the deaveraging proposal contained in the Rebuttal Testimony of Terry R. Dye and the Responsive Testimony of David G. Tucek. GTE notes that its methodology is that proposed by Mr. Tucek in Exhibit 173T. It uses estimates of the Company's wire center costs developed from the Company's cost-study filing in Phase I and from its responses to Staff Data Request Nos. 6 and 7. *GTE Brief, para. 30.* GTE goes on to state that it adopted AT&T's "methodology of stack-ranking the wire centers based on costs, low to high." *Id., para. 30.*
- 39 GTE states that it modeled serving areas based on the observed distribution of loop lengths in the Company's service territory. This methodology was followed because, the Company avers, its "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., para. 31.* GTE goes on to assert that, because its methodology defines zones based on ". . .obvious distinctions in GTE wire center costs . . .," its methodology is superior to the methodologies utilized by the other parties. *Id., para. 31.*

3. GTE Compromise Proposal

- 40 GTE 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, citing Tr. 2497. GTE says, "Under this compromise approach, the Commission would collapse AT&T's Zones 1 and 2" (*GTE Brief, para. 32*) and would "constrain the zones so that all

wire centers within the same exchange would be in the same zone -- and consequently have the same rate." *Id.*, para. 33. The Company asserts that this constraint is necessary to further the goals of competitive neutrality and rational rate design in that fifteen GTE exchanges consist of more than one wire center and that, under its current tariffs, the Company must charge the same rate in each exchange. The Company is concerned that, without this restraint, there is a strong likelihood that wire centers located in the same exchange will fall into different density zones. Should this occur, GTE points out, it would offer CLECs greater pricing flexibility than GTE would enjoy, because the Company, under its tariffs, would have to charge the same retail rate for each wire center, regardless of what density zone it was in, while being forced to offer different wholesale rates. *Id.*, para. 34.

41 GTE goes on to assert that Staff has agreed that "as a policy matter wire centers within the same exchange should be within the same zone" and that AT&T also appears to agree that this constraint would not be a problem for it. *Id.*, para. 35.

4. Critique of GTE's Proposals

42 The principal objection to GTE's preferred proposal is that it only proposes a minimal level of deaveraging. Seventy-six percent of its customers would fall into the low-cost zone. This, in effect, would mean that the vast majority of GTE's market would not be deaveraged at all. *Brief of Rhythms Links, Inc. and TRACER*, para. 22; *Brief of AT&T and MCI Worldcom*, p. 10. Staff points out that a flaw with GTE's proposal is its reliance on the Company's proprietary cost model, which does not estimate specific wire-center costs, instead deriving those costs from aggregate GTE CostMod estimates. *Brief of Staff*, para. 32-33. Staff goes on to point out that one of the problems with GTE's methodology is that there is very little variation in the data output. *Id.*, para. 33.

43 Regarding GTE's compromise proposal, AT&T/MCI assert that GTE's proposal to combine the two lowest-cost zones keeps the loop rates in these zones high, produces small variances in high-cost exchanges, and likely understates cost differences. *Brief of AT&T and MCI Worldcom*, p. 10; *Brief of Rhythms Links, Inc. and TRACER*, para. 23. TRACER/Rhythms further assert that GTE's suggested constraint requiring all wire centers in the same exchange to be placed in the same zone would drive up unbundled loop prices in low-cost areas. *Brief of Rhythms Links, Inc. and TRACER*, para. 23.

E. AT&T and MCI Worldcom's Proposal

44 At the hearing, AT&T and MCI presented a four-zone proposal. In briefing to the Commission after the close of the hearing, however, they proposed a five-zone deaveraging of each ILEC's prices. The other CLECs and TRACER all supported the proposal.

45 USWC and GTE objected to the presentation and moved to strike the briefs in which it was contained. The Commission ruled that it was not evidence, but a position of the proponents based on evidence discussed by the witnesses and subjected to cross examination at the

hearing.⁹

46 AT&T/MCI argue that their

"proposed prices have been developed, as described in the testimony of AT&T's witness, Mr. Denney. Ex. 1-T, at 8-10; Ex. 2; T. 2271. First, he generated the cost estimates by wire center using HM 3.1, with Commission-prescribed inputs for GTE and for U S WEST (separately). Next, he applied a factor to equalize the average cost utilizing HM 3.1 with the company-specific overall averages determined by the Commission. Second, he sorted the results for each company from lowest cost to highest cost wire center. Finally, he grouped the wire centers into five zones, with each zone being as homogeneous as possible."

AT&T and MCI Worldcom Brief, p. 5. The Companies contend that five zones were chosen because "[t]he record demonstrates that the greater the number of zones, the more accurately costs can be reflected." *Id.*, p. 6.

47 AT&T/MCI state that wire centers having similar cost characteristics should be grouped into zones. The Companies argue that cost should be the determining factor for this grouping, and that the use of any other criterion, such as exchange membership or communities of interest, would diminish the precision with which the resulting zones reflect variation in cost.

48 AT&T/MCI assert that they prepared the cost estimates for U S WEST using the most recent line counts and that the corrections suggested by GTE witness Tucek were incorporated into the proposals.

49 While the other CLECs and TRACER have joined in support of AT&T/MCI's deaveraging proposal, they recommend strongly that this proposal be considered as only an interim step in establishing geographically deaveraged loop rates. The other CLECs recommend that the Commission adopt the concept of distance-sensitive deaveraging of UNE loop rates in the order, conclude the current proceeding, and direct the parties to address the cost and implementation issues of distance-sensitive deaveraging in a new cost docket. *Brief of CLECs, para. 20*. TRACER points out that while Staff's approach "...captures cost differences between exchange areas, it loses the differences between wire centers located within exchange areas." *Brief of Rhythms Links, Inc. and TRACER, para. 26*.

50 U S WEST asserts that the five-zone joint proposal put forward by AT&T and the CLECs is self-serving and devoid of any consideration that it might have on retail rates. *Reply Brief of U S WEST, Phase III, Docket Nos. UT-960369, UT-960370, and UT-960371, p. 3*. U S WEST goes on to assert that a key claim of the CLECs in advancing the five-zone proposal that of homogeneity within zones is flawed. As evidence of this, U S WEST points out that

⁹A portion of the proposal was based on information not received in evidence. That issue is addressed below.

“the Seattle local calling area contains four of the CLECs’ five zones (Zones 1, 2, 3, and 5), with unbundled loop prices ranging from \$8.35 to \$26.64.” *Id.*, p. 4. U S WEST charges that this lack of homogeneity will, it is sure, be reflected in the retail rates and will be confusing to consumers.

51 U S WEST further contends that another flaw in the CLECs’ proposal is that zone 1 contains only two wire centers. The Company asserts its belief that this condition is not indicative of geographical deaveraging and fails to meet the threshold for economic pricing credibility.

52 U S WEST also points out that “[t]he proposal to implement five zones is not supported by any testimony or evidence on this record and should be rejected on that basis alone.” *Id.*, p. 4-6. U S WEST states that the transcript reference provided by AT&T in support of the five zones is not particularly helpful as an explanation of AT&T’s decision to advocate for this proposal. U S WEST asserts that this reference merely cites Mr. Denney’s statement that more zones lead to greater precision in cost estimates, a position that U S WEST states he held when he went on to recommend using only three zones.

53 GTE’s criticisms of the five-zone joint proposal put forward by AT&T and the CLECs echo those of U S WEST. In addition, GTE asserts that, because the CLEC’s five-zone proposal results in four out of the five zones having a range of costs that fall below the ordered statewide average, the proposal “. . . does not produce a set of deaveraged rates that track the actual cost of providing the loop.” *Responsive Post-Hearing Brief of GTE Northwest Incorporated*, p. 2.

54 GTE goes on to assert that the CLEC’s proposal does not address the issue of “. . . whether the choice of underlying cost estimates matters to the establishment of deaveraged rates.” *Id.*, p. 4. The Company contends that a comparison of the CLECs’ five-zone proposal using HM 3.1 costs with the same proposal using GTE’s cost estimates indicates that deaveraged rates change substantially when the underlying cost estimates are changed.

55 GTE further argues that, because the Commission has previously stated that wholesale deaveraging is a prelude to retail rate deaveraging, any deaveraging proposal must turn an eye toward the impact of such a proposal on retail rates. The Company states that, under the CLEC’s proposal, “. . . two-thirds (ten out of fifteen) of GTE’s multiple wire center exchanges are split among different zones, which would result in customers within the same exchange having different rates.” *Id.*, p. 5. This, the Company asserts, would cause much confusion among customers.

IV. COMMISSION DISCUSSION AND DECISIONS

A. Unit of Granularity—the Exchange or the Wire Center

56 In Docket UT-980311, the universal service investigatory docket, the Commission estimated

the cost of providing universal service to high-cost areas. Our calculation, which was undertaken for a report for submission to the Legislature, aggregated costs at the exchange level.¹⁰ At this time, the Legislature has not authorized us to establish a state universal service fund. Consequently, there *is* no preferred unit of state universal service support to which a deaveraging unit must or should conform.

- 57 Commission Staff used the exchange as the basis for deaveraging rates in order to maintain consistency with the geographic level at which Staff asserts universal service funding is likely to take place, and because using the exchange is administratively simple and provides a contiguous geographic area in which people receive service at a common rate. *Spinks, Ex. 251T, at 4; see also Tr. Vol. 12, at 3632-33.* However, Staff recognizes that basing deaveraging on wire centers will produce more economically efficient wholesale prices. The CLECs support deaveraging at the wire center level.
- 58 GTE and U S WEST also support establishing rates at a more aggregate level than the wire center. U S WEST supports using the community of interest for deaveraging, and GTE advocates rates based on exchange costs.
- 59 Using exchange-center data for UNEs is neither consistent nor inconsistent with the Commission's use of exchanges to estimate universal service costs in Docket No. UT-980311. The Commission used exchanges in part because support would likely be provided to carriers that provide service in an entire exchange. Carriers do not qualify for federal universal service support if they only provide service in a limited portion of an exchange.
- 60 In Docket No. UT-980311, we estimated the cost of providing service in each exchange. Our estimate of the level of support was done by comparing revenues and cost data at the exchange level. When we made this calculation, we did not aggregate the exchanges into zones. In this proceeding, all parties have supported some measure of aggregation. Parties have supported aggregating either wire centers or exchanges into rate zones. Due to this aggregation, none of the rate proposals can fruitfully be characterized as consistent or inconsistent with our USF calculations in 980311.¹¹

¹⁰Our 1998 Universal Service Fund (USF) exercise was undertaken as a formal adjudication. It yielded the best information and the best analysis available on the topic at the time. The Commission acknowledged in its Order, however, that the results of the proceeding would be reviewed before implementation even after legislative approval. The legislature has not accepted the report. We cannot say, therefore, that a new review would find the exchange level appropriate for purposes of defining the level of USF support. We look to the issue in this docket only for purposes of this docket.

¹¹Furthermore, because the Legislature has not authorized the Commission to establish a universal service fund, the method for determining support has not been resolved.

61 With regard to establishing the price of loops, establishing rates that reflect variations in wire-center costs better aligns rates with costs. The use of wire centers would, therefore, better conform to section 252(d)(1)(a) of the Act, which requires that UNEs be based on the cost of service. Accordingly, the Commission has decided that the wire center, rather than the exchange, is the appropriate unit for building rate zones.

B. Commission Decision Regarding Distance Sensitive Rates

62 Staff and the Joint CLECs initially proposed the adoption of distance-sensitive loop rates. These parties argued that distance-sensitive pricing is appropriate, as it reflects that loop length is one of the more important drivers of loop cost. Subsequently these parties advocated that the Commission adopt the *concept* of distance-sensitive pricing in this proceeding, but not specify any rate levels.

63 The data analysis presented by staff in support of a distance-sensitive rate structure is significantly flawed, with all parties agreeing that the estimated coefficients used in that analysis are biased. As to the point raised by Mr. Montgomery -- that if we adopt the *concept*, the ILECs will be compelled to begin to modify their operational support systems -- we find ourselves in agreement with him as far as his argument goes, but the evidence presented in this docket has not convinced us that the cost of implementing this system exceeds the benefits to be gained from doing so.

64 Accordingly, the Commission is of the opinion that it would not be wise to adopt a distance-sensitive rate structure at this time. Nor does the Commission find the evidence presented concerning distance-sensitive rate structures to be compelling enough to cause the Commission to adopt the *concept* of distance-sensitive rates at this time.

65 Any party wishing to do so may present further evidence on this topic in Docket UT-003013. Along these lines, the Commission notes that there is an industry working group that is currently studying targeting universal service funds (USF) support to high-cost areas and that its work might provide suggestions on how to establish distance-sensitive UNE rates.

66 Due to GTE's and U S WEST's interest in providing xDSL services, the carriers have an internal need to determine the loop distance between a central office and an end-user. We do require GTE and U S WEST to file by November 1, 2000, a report with the Commission detailing the modifications, if any, that are being made to their operational support systems to support distance measurements. We require GTE and U S WEST each to provide us with a report that (a) details how the company will prospectively make these distance calculations; (b) the date by which modifications, if any, are likely to be implemented to their operational support systems in order to automate or partially automate the distance calculation; and (c) the budgeted cost for the modifications identified in (b).

C. Rate Proposals

- 67 For the setting of UNE loop rates, the Commission adopts the concept of the five zones proposed by AT&T/MCI, the other CLECs, and TRACER. As described below, we adopt their proposed rate levels for GTE, but not for U S WEST.
- 68 U S WEST criticizes the CLEC/TRACER proposal for a lack of homogeneity within exchanges. It bases its argument on the proposition that eventually retail rates will move to reflect the wholesale prices set in this docket. Its concern is that persons within an exchange who are served by different wire centers -- perhaps neighbors -- would then pay different rates for their service. U S WEST provides no citation to the 1996 Telecommunications Act that would suggest that the UNE loop rates should be designed to provide some measure of conformity with retail rates. On the other hand, section 252(d)(1)(a) of the Act clearly requires UNE prices to be based on the cost of service. We find that costs -- established at the wire center level -- are a reasonable basis for establishing the zone rates. Further, there must be "line-drawing" somewhere, with those on one side of the line under different provisions than those on the other side of the line. The lines should be drawn suitable to the purposes they are serving.
- 69 U S WEST asserts that "[p]robably the most egregious example of the self-serving nature of the CLECs' proposal is the fact that zone 1 only contains two wire centers. A two-wire center zone is simply not [original emphasis] geographic deaveraging." *US WEST Reply Brief, p. 4*. Obviously, any party with a commercial interest in this proceeding, such as AT&T, or for that matter U S WEST, will sponsor proposals beneficial to its interests. But the fact that a proposal is self-serving is not a good reason to dismiss an idea. The test is whether the proposal makes sense when viewed through the filters of the public interest as well as the goals and mandates of the pertinent statutes.
- 70 GTE raises a more substantive objection to including only two wire centers in a zone. GTE argues that "by proffering an unsupported increase in the number of zones, the CLECs' proposal reduces the netting of positive and negative errors in the individual wire center cost estimates." *GTE's Responsive Brief, p. 2*.
- 71 GTE is correct that an increase in the number of zones reduces the netting of positive and negative errors. On the other hand, averaging also results in the establishment of an average rate that does not reflect the variations in the cost of service. The FCC clearly adopted geographic deaveraging so rates could be established that reflect the underlying cost of providing service. By mandating deaveraging, the FCC opted to reduce the netting of positive and negative errors and instead increase the precision that results from geographic deaveraging. Based on our review of the record, we find that a three- or four-zone structure would not result in UNE loop rates that sufficiently reflect the variation in costs that exist at different wire centers. The addition of a fifth zone is necessary to adequately reflect the underlying cost providing unbundled loops in each zone.
- 72 GTE has also faulted AT&T's proposal because the rates in four of the five zones for each company are below the ordered statewide averages for the company. GTE contends that by

"cramm[ing] four of the five zones into the range of costs falling below the ordered statewide average...the CLECs' five-zone proposal does not produce a set of deaveraged rates that track the actual cost of providing the loop." *GTE Responsive Brief*, p. 2.

- 73 According to AT&T/MCI, 72% and 81% of the U S WEST and GTE lines, respectively, fall into the first four zones under the AT&T proposal. *AT&T/MCI Post-Hearing Brief, March 28, 2000*, pp. 4-5. The fact that a majority of the line costs are less than the state-wide average merely reflects that the distribution of costs is not symmetrical. One would not expect costs to be symmetrical. Cost functions are often skewed to the right because the lower tail of the distribution is censored at zero. That is, a wire center cannot have a negative cost per line. On the other hand, the cost per line in a wire center can be significantly greater than the average. The five-zone rate proposal merely highlights the fact of record that a limited number of high-cost wire centers have a disproportionate effect on the average cost of service.
- 74 U S WEST contends that the proposal to implement five zones is "not supported in any testimony or evidence on this record and should be rejected on that basis alone." *Id.*, p. 4-6. We disagree. First, as pointed out by the CLECs, the issue of what might be the appropriate number of density zones -- and the means of defining zones -- was explored at some length during the proceedings.
- 75 Furthermore, this proceeding is not an arbitration-style proceeding in which we are obligated to adopt the last-best offer of a party. The Commission has the legal right and the obligation to adopt a rate proposal that best fulfills the requirements of section 252(d)(1)(a) of the Act. Based on the evidence presented in this proceeding, we conclude that the five-zone rate proposal provides the appropriate balance at this time among the objectives of cost-based rates, the need reasonably to minimize implementation costs, and the ability of the available proxy model to estimate the relative cost of different wire centers. Parties are of course free to sponsor alternative rate structures in Docket UT-003013.¹²
- 76 The CLECs' five-zone rate proposal is based on Confidential Replacement 2C attached to AT&T's Brief (Exhibit "R2C"). GTE's cost estimates, contained in the replacement exhibit, contain the same values that were discussed during the hearings. *AT&T/MCI, Response to U S WEST's and GTE's motion to Strike CLEC briefs, April 10, 2000*. The costs for U S WEST's wire centers, however, are different from the costs filed in Exhibit 2C on the record. U S WEST and GTE state that consequently, U S WEST "has no way of verifying these calculations." *Joint Motion to Strike CLEC Briefs*, para. 6.
- 77 AT&T/MCI state that U S WEST's cost estimates were obtained from the HM 3.1 model after adjusting the model for the Commission-prescribed inputs and based on "the most

¹²The Commission is interested in seeing how the HCPN model, developed in conjunction with the FCC, compares with other models.

recent line counts submitted by U S WEST.” These companies point out that the bench asked that the HM run for U S WEST be provided as Bench Request Number 6. *AT&T/MCI Brief, March 28, 2000, p. 5, citing to Transcript 2255.*

78 U S WEST responds that AT&T/MCI never provided the response to Bench Request Number 6 and that the record “certainly does not appear to authorize the production of a new exhibit attached to the closing brief.” U S WEST further adds that the line counts appear to be based on data from 1995, rather than data provided by the Company in response to discovery requests. *Joint Motion to Strike CLEC Briefs, para. 6. note 2.*

79 AT&T and MCI reply that “Exhibit 2C reflects wire center costs for each of the ILECs generated by Hatfield 3.1 using actual updated line counts received from USWC at the direction of the Commission...” However, they do not identify the data source for the “actual updated line counts.” *AT&T/MCI, Response to U S WEST’s and GTE’s motion to Strike CLEC briefs, April 10, 2000.*

80 Because AT&T/MCI failed to provide a timely response to the bench request, and because we are uncertain about the source of the line count used for the U S WEST run of the Hatfield Model, we agree with US WEST and GTE and determine that cost estimates associated with replacement Exhibit 2-C cannot be used to deaverage US WEST’s UNE loop prices. On the other hand, with respect to GTE, replacement Exhibit 2-C uses only cost data that was available during the hearing. Therefore we rule that it should be used to determine GTE’s rates.

81 The UNE loop costs adopted by the Commission are set forth in the tables below:

Approved GTE UNE Loop Costs		
Zone	Price	Percentage of Lines
1	\$14.96	28.88%
2	\$16.74	23.93%
3	\$20.11	9.78%
4	\$23.36	18.88%
5	\$49.85	18.52%

Approved US West UNE Loop Costs		
Zone	Price	Percentage of Lines
1	\$ 7.50	5.52%
2	\$ 13.89	19.65%
3	\$ 15.73	20.62%
4	\$ 17.78	20.85%
5	\$ 24.18	33.36%

- 82 For U S WEST we have used the input data from the Eighth Supplemental Order to generate wire-center estimates, and in turn, to establish deaveraged rates. The appendix provides a listing of the zone classification for each of the wire centers.
- 83 The wire-center cost data was generated by HM 3.1. GTE has pointed out that the deaveraged rate levels are not independent of the selected cost model. *GTE Responsive Post-Hearing Brief, April 14, 2000, p. 4.* We previously determined that this phase of this proceeding would rely on the models previously approved, rather than accept evidence of different models. We repeat that decision and state that, contrary to GTE's assertion, it does produce acceptable results. For the limited purpose of deaveraging, we find the Hatfield Model to be a superior analytical tool than the alternative, the ILECs' cost models. The Hatfield Model was designed to reflect variations in cable installation costs depending on line density, terrain, and other factors not directly modeled by either GTE's or U S WEST's cost models.¹³ Furthermore, the Hatfield Model is comparatively open and designed to develop wire-center-specific cost estimates. We are aware of the limitations and faults in the Hatfield model but, for the purpose of deaveraging, we have concluded, and we continue to believe, that it provides more useful wire-center-specific cost estimates than the ILECs' proprietary models and that the estimates it produces are fully adequate for our purpose here.
- 84 Approximately 20% of U S WEST's lines fall into each of Zones 2 through 4. We have placed a smaller number of lines in Zone 1 because there is a striking difference in the cost of providing an unbundled loop between the wire centers in Zone 1 and the costs in the next zone. Finally, a large number of lines fall into Zone 5. In order to reduce the administrative costs of implementing the plan, and to recognize the variability of estimates at the higher end, we have not broken down Zone 5 into additional zones.

¹³GTE argues that its cost model does a superior job relative to the Hatfield Model of reflecting the relationship between cost estimates and important cost drivers. GTE's comparison is seriously flawed because its statistical analysis has not controlled for variables that are explicitly included in the Hatfield Model, such as soil type and variations in installation costs due to differences in line density.

D. Conclusion

85 The Commission adopts five-zone geographic deaveraging structures for the wholesale loop rates for U S WEST Communications, Inc., and General Telephone of the Northwest, Inc. as shown in this Order.

86 Having stated above our findings and conclusions as to each of the matters in this docket, the Commission now sets out a summary of the findings and conclusions. The individual findings and conclusions made above are included herein by this reference.

V. FINDINGS OF FACT

87 1. U S WEST Communications, Inc. and General Telephone of the Northwest, Inc. are privately owned, wire-based providers of local exchange telecommunications service to the public for compensation within the state of Washington.

88 2. The Commission is an agency of the State of Washington vested by statute with the authority to regulate the rates and conditions of service of telecommunications companies within the state and to implement state responsibilities under the federal Telecommunications Act of 1996.

89 3. The Commission has in prior orders in this docket determined the average wholesale cost of loops within the state. It has also determined for purposes of this docket that geographic deaveraging required under Section 252(d)(1)(a) of the Act will be based on the previously determined average loop cost and on the cost models found appropriate on the record of this docket.

90 4. A five-zone deaveraged loop rate structure best balances for the present the objectives of cost-based rates, the need to minimize reasonably the costs of implementation of deaveraged rates, and the ability of the available proxy models to estimate the relative costs of different wire centers.

91 5. In the absence of agreed, updated figures of record as to line counts, the line counts established in the Eighth Supplemental Order for U S WEST constitute reliable information that is satisfactory for the purposes of this order in calculating the proper rate per line and in defining the boundaries between zones.

92 6. The proposals filed by U S WEST and GTE do not meet the practical requirements for geographically deaveraged rates within the state of Washington.

93 7. The rates set out in the tables in para. 81 above, the boundaries, and the wire-center groupings set out in Appendices A and B for U S WEST and GTE, respectively, are the proper wholesale UNE rates for geographically deaveraged loops of the respective companies

in the state of Washington.

VI. CONCLUSIONS OF LAW

- 94 1. The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of this proceeding and the parties to the proceeding.
- 95 2. The geographically deaveraged loop rate structure and rates set out at paragraph 81 in the body of this order and the rate zones set out in Appendices A and B, to apply to the unbundled loop rates of U S WEST Communications, Inc. and General Telephone of the Northwest, Inc. best meet the legal and the practical needs for deaveraging of the Companies' rates in the state of Washington for purposes of this proceeding.
- 96 3. The rate deaveraging proposals of US WEST and GTE should be rejected.
- 97 4. The Commission requires US WEST and GTE to file tariffs reflecting the deaveraged loop rate structure and rates set forth in the body of this order and in Appendices A and B of this order, with appropriate timing and administrative review requirements.

VII. ORDER

- 98 1. The Commission adopts the geographically deaveraged unbundled loop rate structures and rates set out in Appendices A and B, attached to this order and incorporated within this paragraph as though set forth herein, as the proper structure and rates for U S WEST Communications and GTE of the Northwest, Inc., respectively.
- 99 2. U S WEST Communications must adopt the rate structure for unbundled loops within the state of Washington set out in Appendix A and the rates set out in para. 81 of this Order by means of a tariff to be filed no more than six business days following the date this order is served.
- 100 3. General Telephone of the Northwest, Inc. must adopt the rate structure and rates for unbundled loops within the state of Washington set out in Appendix B and the rates set out in para. 81 of this Order by means of a tariff to be filed no more than six business days following the date this order is served.
- 101 4. The tariffs filed hereunder must be submitted with an inserted effective date of five business days following the date of their submission to allow the Commission to verify that the tariffs properly reflect the requirements of this Order.
- 102 5. The Commission retains jurisdiction to implement the terms of this and prior orders in this

docket.

Dated and effective at Olympia, Washington this ___ day of May, 2000.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

MARILYN SHOWALTER, Chairwoman

RICHARD HEMSTAD, Commissioner

WILLIAM R. GILLIS, Commissioner