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BEFORE THE ARIZONA CORPORATION COMMISSION

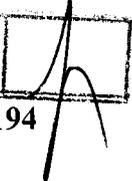
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ARIZONA CORPORATION COMMISSION  
REGULATORY CONTROL

Arizona Corporation Commission  
**DOCKETED**

APR 24 2000

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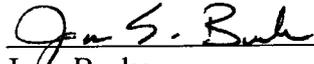
IN THE MATTER OF INVESTIGATION )  
INTO U S WEST COMMUNICATIONS, )  
INC.'S COMPLIANCE WITH CERTAIN )  
WHOLESALE PRICING REQUIREMENTS )  
FOR UNBUNDLED NETWORK )  
ELEMENTS AND RESALE DISCOUNTS )

DOCKET NO. T-00000A-00-0194  
NEXTLINK ARIZONA, INC.'S  
NOTICE OF FILING DIRECT  
TESTIMONY OF REX KNOWLES

NEXTLINK Arizona, Inc. hereby files the Direct Testimony of Rex Knowles  
in the above-referenced matter. A copy of which is attached to this notice.

Respectfully submitted this 24<sup>th</sup> day of April, 2000.

NEXTLINK ARIZONA, INC.

  
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## CERTIFICATE OF SERVICE

I hereby certify that the original and 10 copies of the Notice of Filing Direct Testimony of Rex Knowles, Docket No. T-00000A-00-0194, were hand-delivered on this 24<sup>th</sup> day of April, 2000, to:

Arizona Corporation Commission  
Docket Control - Utilities Division  
1200 West Washington Street  
Phoenix, AZ 85007

and a true and correct copy was sent via United States Mail, postage prepaid on this 24<sup>th</sup> day of April, 2000, to:

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BEFORE THE  
ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF INVESTIGATION INTO )  
U S WEST COMMUNICATIONS, INC.'S ) DOCKET NO. T-00000A-00-0194  
COMPLIANCE WITH CERTAIN WHOLESAL )  
PRICING REQUIREMENTS FOR UNBUNDLED )  
NETWORK ELEMENTS AND RESALE )  
DISCOUNTS )

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**DIRECT TESTIMONY**  
  
**OF**  
  
**REX KNOWLES**  
  
**NEXTLINK ARIZONA, INC.**

**April 24, 2000**

1           **Q.     PLEASE STATE YOUR NAME, EMPLOYER, AND BUSINESS ADDRESS.**

2           A.     My name is Rex Knowles. I am a Vice President Regulatory for NEXTLINK, 111 East  
3                 Broadway, Suite 1000, Salt Lake City, Utah 84111.

4

5           **Q.     PLEASE IDENTIFY AND DESCRIBE THE PARTY ON WHOSE BEHALF YOU**  
6                 **ARE TESTIFYING.**

7

8           A.     I am testifying on behalf of NEXTLINK Arizona, Inc. ("NEXTLINK"), a competitive  
9                 local exchange company ("CLEC") that provides facilities-based local and long distance  
10                telecommunications services in Arizona in competition with U S WEST  
11                Communications, Inc. ("U S WEST").

12

13           **Q.     WHAT ARE YOUR RESPONSIBILITIES?**

14

15           A.     I am responsible for all regulatory, legislative, municipal, and incumbent local exchange  
16                 carrier ("ILEC") initiatives on behalf of NEXTLINK and other affiliates in several  
17                 western states, including Arizona and other states in the U S WEST region.

18

19           **Q.     WHAT IS YOUR BUSINESS AND EDUCATION BACKGROUND?**

20

21           A.     I graduated from Portland State University in Portland, Oregon, with a degree in Business  
22                 Administration/Finance Law in 1989. I was employed by United Telephone of the  
23                 Northwest from 1989 to 1993 as a regulatory staff assistant and product manager  
24                 responsible for incremental cost studies and creation and implementation of extended  
                  area service ("EAS") and 911. From 1993 to 1996, I was employed by Central Telephone

1 of Nevada as manager of revenue planning and research and was responsible for  
2 supervising cost study preparation and developing and implementing regulatory reform,  
3 including opening the local exchange market to competition and alternative forms of  
4 regulation for ILECs. I joined the NEXTLINK organization in the Spring of 1996.  
5

6 **Q. HAVE YOU PREVIOUSLY TESTIFIED IN OTHER REGULATORY**  
7 **PROCEEDINGS?**

8  
9 A. Yes, I have provided testimony on costing, pricing, and policy issues in various  
10 proceedings before the Utah Public Service Commission and the Washington Utilities  
11 and Transportation Commission.  
12

13 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

14  
15 A. The purpose of my testimony is to provide a business perspective on the need for  
16 geographic deaveraging. I have reviewed proposals made by U S WEST in other states  
17 for the manner in which loop rates should be deaveraged. These proposals do not  
18 represent legitimate geographic deaveraging. In contrast, the proposal made by AT&T in  
19 testimony submitted by Douglas Denney does meet the requirements of the  
20 Telecommunications Act of 1996 ("Act") and also makes sense for Arizona consumers.  
21  
22 For this reason, NEXTLINK supports AT&T's proposed approach to geographic  
23 deaveraging.  
24

1           **Q.    HOW SHOULD THE COMMISSION EVALUATE THE GEOGRAPHIC**  
2           **DEAVERAGING PROPOSALS SUBMITTED IN THIS PROCEEDING?**

3  
4           A.    The Commission should analyze the proposals using two areas of inquiry. First, the  
5           Commission should determine which proposal best reflects geographic cost differences  
6           between providing unbundled loops in at least three different areas. The Act requires that  
7           unbundled network element prices be based on cost, and FCC Rule 507 further requires  
8           that the Commission establish such prices in a minimum of three cost-related zones.  
9           Moreover, as provided in paragraph 765 of its *Local Competition Order*, “A state may  
10          establish more than three zones where cost differences in geographic regions are such that  
11          it finds that additional zones are needed to adequately reflect the costs of interconnection  
12          and access to unbundled network elements.” NEXTLINK believes that it is appropriate  
13          to establish more than three zones in Arizona to reflect more accurately the costs  
14          associated with providing unbundled loops across the state. Mr. Denney’s testimony  
15          proposes five zones. NEXTLINK supports that proposal.

16  
17          The other area of inquiry for the Commission is implementation. While compliance with  
18          appropriate costing requirements should be the primary focus of the Commission’s  
19          inquiry, the cost of implementing deaveraging proposals is also important. In other  
20          words, the benefits of the geographically deaveraged pricing should outweigh the cost to  
21          implement it. For example, an unnecessarily complex deaveraging proposal could force  
22          both U S WEST and competitors to incur significant time and expense in determining the  
23          appropriate price of a particular loop. The proposal made by Mr. Denney in his

1 testimony is simple and relatively easy to administer. NEXTLINK supports that proposal  
2 for this reason as well.

3  
4 **Q. SHOULDN'T POLICY CONCERNS ALSO PLAY A ROLE IN ADOPTING A**  
5 **PROPOSAL FOR GEOGRAPHIC DEEVERAGING?**

6  
7 A. Yes, but only a supporting role. The Commission's primary policy concern should be  
8 whether the geographic deaveraged loop rates it establishes will foster or inhibit the  
9 development of effective local exchange competition in Arizona. The availability of  
10 unbundled loops at appropriate geographically deaveraged cost-based rates is critical to  
11 that policy objective. Congress, the FCC, and this Commission have all recognized that  
12 broad-based alternatives to the local service provided by U S WEST will not develop  
13 unless competitors can use portions of U S WEST's network on the same terms and  
14 conditions that U S WEST makes use of its network.

15  
16 NEXTLINK, for example, is a facilities-based company that has deployed its own switch  
17 and network facilities. NEXTLINK, however, has not duplicated the size and scope of  
18 U S WEST's network in Arizona, and could not hope to do so in the foreseeable future.  
19 Thus, while NEXTLINK serves some customers using only its own network facilities,  
20 NEXTLINK cannot offer service to customers throughout a particular service territory  
21 without access to unbundled loops that can be combined with its own facilities.

22 NEXTLINK obtains such access through collocating the necessary equipment in U S  
23 WEST's central offices and connecting that equipment with the rest of NEXTLINK's

1 network. NEXTLINK thus can potentially offer service to all customers served out of a  
2 central office in which NEXTLINK has collocated by using unbundled loops, rather than  
3 being limited to serving only those customers located on, or in close proximity to,  
4 NEXTLINK's own facilities.

5  
6 NEXTLINK or any other CLEC, however, cannot use U S WEST unbundled loops if the  
7 rates U S WEST charges approach or exceed the retail rates of the service the loop is used  
8 to provide. CLECs incur not only the cost of the loop itself, but costs for collocation and  
9 the equipment to be collocated, as well as other network, administrative, and retailing  
10 costs. CLECs cannot economically use unbundled loops if CLECs cannot recover the  
11 costs to provide service using that loop through the CLEC's retail rates, which generally  
12 can be no higher than U S WEST's retail rates. Similarly, U S WEST increases its  
13 already daunting competitive advantage as the incumbent monopoly provider if it can  
14 charge more to a CLEC to use an unbundled loop than it "charges" itself.

15  
16  
17 **Q. HOW DOES GEOGRAPHIC DEAVERAGING OF UNBUNDLED LOOP RATES**  
18 **ADDRESS THESE CONCERNS?**

19  
20 A. The statewide averaged loop rate the Commission previously established approaches or  
21 exceeds the retail rates for basic local exchange service, as well as the costs U S WEST  
22 incurs to provide loops in most of its Arizona exchanges. A CLEC cannot recover the  
23 \$21.98 loop price along with its other costs when the retail rate for local residential

1 service is \$13.18 (even with the addition of the \$3.50 Subscriber Line Charge (“SLC”)).  
2 The statewide averaged loop rate also exceeds the basic business rate of \$17.43 (\$20.93,  
3 including the SLC), without any consideration of CLECs’ need to recover their other  
4 costs, which quickly approach or exceed the revenues the CLEC can expect to generate  
5 by matching U S WEST’s existing rates from most small and mid-sized business  
6 customers. As Mr. Denney’s calculations demonstrate, moreover, U S WEST currently  
7 charges CLECs far more for the use of a loop in urban and suburban areas than the costs  
8 U S WEST incurs to provide that loop. Appropriate geographic deaveraging of  
9 unbundled loop rates, therefore, would more accurately reflect the costs of providing  
10 unbundled loops and would enable CLECs economically to use unbundled loops in at  
11 least a portion of the state.

12  
13 U S WEST’s own figures demonstrate the need for loop rates that more accurately reflect  
14 the underlying costs. According to testimony U S WEST filed in connection with the  
15 proposed merger between its parent company and Qwest Communications, U S WEST  
16 currently provides 8,265 unbundled loops in Arizona, which represents less than 0.3% of  
17 the nearly 3 million access lines U S WEST serves in this state. Other factors, such as  
18 service quality and availability, likely contribute to the exceedingly low number of  
19 unbundled loops CLECs obtain from U S WEST, but the current statewide averaged price  
20 is undeniably a major reason that CLECs generally are not using unbundled loops to  
21 provide local service in Arizona.

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**Q. SHOULD THE COMMISSION BE CONCERNED THAT WHOLESALE GEOGRAPHIC DEEVERAGING WILL IMPERIL UNIVERSAL SERVICE OR NECESSITATE PARALLEL RETAIL RATE DEEVERAGING?**

A. No. U S WEST's primary policy argument in opposition to legitimate geographic deeveraging in other states has been that deeveraging unbundled loop rates allegedly will have a negative impact on universal service and will require that U S WEST's retail rates be geographically deeveraged to mirror the wholesale deeveraging. U S WEST has yet to produce any evidence that wholesale geographic deeveraging will have any such effect. In Utah, for example, the Commission deeveraged unbundled loops almost one year ago, but U S WEST never sought to deeverage retail rates when it had the opportunity to do so or to allege, much less prove, any shortfall in revenues used to provide universal service. To the contrary, U S WEST is exceeding anticipated revenues under its current price cap regulation in Utah and is seeking pricing flexibility, which would enable U S WEST selectively to *lower* its retail rates in response to competition, without the ability to raise retail rates in other areas where customers lack choice.

In Arizona, U S WEST's recent retail rate proposals do not contemplate geographic deeveraging, even though U S WEST has long been on notice of the need to deeverage wholesale rates. The Commission should not be concerned about universal service shortfalls or retail rate deeveraging when U S WEST's past actions demonstrate that wholesale rate deeveraging simply does not raise these issues.

1  
2 The only legitimate policy issue presented by geographic deaveraging in this proceeding  
3 is whether the Commission wants to foster the development of local exchange  
4 competition – other than wholly facilities-based competition – *anywhere* in Arizona.  
5 Unless the Commission adopts cost-based geographically deaveraged loop prices, at least  
6 some of which are significantly less than the statewide averaged recurring price, CLECs  
7 will simply have no economic incentive or ability to use U S WEST unbundled loops to  
8 serve the vast majority of Arizona consumers, and there will be no effective competition  
9 beyond the reach of CLECs' own networks.  
10

11 **Q. WHY DOES NEXTLINK SUPPORT ADOPTION OF FIVE GEOGRAPHIC**  
12 **ZONES GROUPED BY WIRE CENTER COSTS?**  
13

14 A. The five zone proposal in Mr. Denney's testimony represents a good compromise  
15 between cost-based rates and ease of implementation. The wire center costs contained in  
16 the exhibit to Mr. Denney's testimony demonstrate that costs vary significantly between  
17 wire centers. Accordingly, the more zones created using these wire center costs, the more  
18 accurately the resulting rates will reflect the underlying costs. It is my understanding  
19 based on testimony U S WEST presented in Washington state that U S WEST's  
20 operations support systems currently account for unbundled loops on a wire center basis.  
21 Establishing five zones based on wire center groupings, therefore, should minimize any  
22 implementation concerns while bringing prices closer to cost in two more zones than the  
23 minimum number the FCC has required. Given that U S WEST maintains well over 100

1 wire centers in Arizona ranging in per loop cost from \$11.46 to \$336.34, grouping those  
2 wire centers by loop cost into five zones is the least the Commission should consider  
3 doing to fulfill the FCC's mandate.

4  
5 Taking the principle of deaveraging even farther, NEXTLINK and other CLECs  
6 sponsored testimony in Washington that proposed geographic deaveraging based on loop  
7 length from the central office within defined zones. I explained in those proceedings that  
8 distance-sensitive pricing not only more accurately reflects underlying cost, but it  
9 encourages CLECs to collocate in more central offices, because loops closest to the  
10 central office are affordable in most central offices. As CLECs are able to recover their  
11 investment using the shorter and least expensive loops, the CLEC could afford to serve  
12 customers located farther away from the central office, maximizing the use of collocated  
13 equipment and CLEC network facilities while offering service alternatives to a greater  
14 number of potential customers. The result is a broader customer choice and the attendant  
15 consumer benefits that the Commission has sought to encourage.

16  
17 NEXTLINK continues to believe that distance sensitive pricing should be explored, but  
18 as was the case in Washington, insufficient time is available in this phase of the  
19 proceeding to develop a record sufficient to address cost, implementation, and other  
20 issues. NEXTLINK, therefore, supports the use of five zones based on wire center  
21 groupings by cost as described in Mr. Denney's testimony to develop interim deaveraged

1 rates, just as all participating CLECs in Washington ultimately agreed to support a similar  
2 proposal. If the Commission decides to develop prices for only the FCC-minimum of  
3 three zones, NEXTLINK also supports the alternative three-zone proposal AT&T is  
4 sponsoring. NEXTLINK further recommends that the Commission consider distance  
5 sensitive pricing as part of the second phase of this proceeding.

6  
7 **Q. DOES THAT CONCLUDE YOUR TESTIMONY?**

8 **A.** Yes, it does.