

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of)
)
Implementation of the Pay Telephone)
Reclassification and Compensation) CC Docket No. 96-128
Provisions of the Telecommunications)
Act of 1996)
)
Petition of TON Services, Inc. for)
Declaratory Ruling on a Primary)
Jurisdiction Referral)

**FURTHER OPPOSITION OF QWEST CORPORATION TO
PETITION OF TON SERVICES, INC. FOR DECLARATORY RULING
ON A PRIMARY JURISDICTION REFERRAL**

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June 4, 2008

TABLE OF CONTENTS

	Page
I. INTRODUCTION AND SUMMARY.....	2
II. QWEST’S PAL RATES WERE PROPERLY EVALUATED AND COMPLIED WITH THE NST.....	5
III. DETAILED ANALYSIS CONFIRMS THE REASONABLENESS OF QWEST’S PAL RATES.	12
IV. THE <i>WISCONSIN ORDER</i> IS NOT, AND CANNOT LEGALLY BE MADE, RETROACTIVE.....	13
V. CONCLUSION.....	14

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Qwest Corporation (“Qwest”)¹ hereby files this “Further Opposition” to a Petition for Primary Jurisdiction Referral filed by TON Services, Inc. (“TON”). TON’s Petition was filed on May 2, 2008, Qwest filed a timely opposition on May 12, 2008 and TON filed its Reply to Qwest’s Opposition on May 19, 2008.² By *Public Notice* of May 15, 2008,³ the Federal Communications Commission (“Commission”) formally requested comments on the Petition. This Further Opposition adds several important elements into the discussion, and does not repeat the analysis already submitted in the Initial Opposition.

¹ During 1996-97, Qwest Corporation was named U S WEST Communications, Inc. We utilize the Qwest name throughout this document to refer to U S WEST Communications in 1996-97.

² Reply to Opposition of Qwest Corporation to Petition of TON Services, Inc. for Declaratory Ruling on a Primary Jurisdiction Referral (“TON Reply”).

³ *Public Notice*, CC Docket No. 96-128, DA 08-1148, rel. May 15, 2008.

I. INTRODUCTION AND SUMMARY.

TON claims that Qwest did not file cost studies with its state regulators in 1997 specifically to demonstrate that its Basic PAL rates complied with the Commission's new services test ("NST"),⁴ that this "failure" constituted a violation of the Communications Act, and that the Commission should establish "damages" based on the difference between Qwest's actual rates and NST compliant rates (to be based on a particular application of the NST established in 2002). The real basis of the TON complaint, both before the court in Utah and in its filings here, is the unsupported allegation that Qwest simply ignored the Commission's dictate to configure its payphone access line ("PAL") rates to comply with the NST -- that is, that PAL rates be set based on forward-looking costs and a reasonable allocation of overhead. In fact, TON goes so far as to assert that Qwest deliberately "withheld the cost information [from state regulators] that could have raised a suspicion about Qwest's rates."⁵ TON's allegations are fundamentally false and misleading.

In the federal court action, Qwest was prevented by procedural rules from challenging the factual predicates of TON's claims. The federal litigation in TON's lawsuit to date has proceeded solely on the permissive "Rule 12" standard in which TON's allegations -- although false -- had to be presumed to be true. However, that limitation no longer applies to this proceeding. Now with the opportunity to present accurate facts, Qwest submits in rebuttal the attached Declarations of Jerrold L. Thompson (Attachment A) and Glenda R. Weibel (Attachment B). As described in detail in Mr. Thompson's Declaration, in late 1996, Qwest prepared forward-looking total service long run incremental cost ("TSLRIC") studies for its

⁴ 47 C.F.R. § 61.49(f) and (g).

⁵ TON Reply at 5.

Basic PAL service and for the new Smart PAL service for each of its fourteen states.⁶ In 1997, Qwest filed Basic PAL and Smart PAL cost information with its tariff filings in multiple states.⁷ Studies filed for Smart PAL service included direct costs for Basic PAL services, plus (separately shown) the added costs of central office processing necessary for the Smart PAL service to function. In several states, Qwest Smart PAL filings were opposed by payphone associations, which led to investigations into Qwest's PAL rates and, ultimately, rulings on compliance of Qwest's Smart PAL rates with the NST and other federal and state requirements.⁸

Qwest also conducted a careful review of its Basic PAL rates in April and May of 1997 to ensure compliance with the NST.⁹ The NST analysis that Qwest undertook compared the cost of Basic PAL service to the state commission approved tariff price for that service. The mathematical difference between the two numbers was viewed as the amount of common overhead costs that were recovered from the tariff price. Based on the Commission's previous interpretations of the NST, Qwest concluded that the overhead allocations in its Basic PAL rates were reasonable. Indeed, those allocations fell squarely within ranges viewed by the Commission as reasonable in multiple decisions relating to payphone rates in 1997 and 1998.¹⁰ Subsequently, various states requested cost information from Qwest regarding its PAL services and undertook investigations into the rates for those services.¹¹

⁶ Thompson Declaration ¶¶ 15-19. The cost study is comprised of a single document that breaks down the various cost elements for both services.

⁷ *Id.* ¶¶ 20-48. The cost studies themselves were generally filed, and were in all cases available to state regulators for study.

⁸ *Id.* ¶¶ 20-48.

⁹ Thompson Declaration ¶¶ 49-63; Weibel Declaration ¶ 7.

¹⁰ Thompson Declaration ¶¶ 49-58.

¹¹ *Id.* ¶¶ 64-86.

In point of fact, contrary to the unsupported allegations of TON and others, Qwest took its obligation to comply with the NST in maintaining its PAL rates very seriously, actually litigating NST compliance in five states. Qwest's Basic PAL rates were examined by state commissions after 1997 in an additional six states, and Qwest had lawfully filed and the states approved Basic PAL¹² rates in all of its 14 states (when state approvals prior to 1997 are considered). And of equal significance, its PAL rates were NST compliant from the beginning. Qwest conducted current forward-looking cost studies for Basic and Smart PAL services in 1996, used these studies to support Smart PAL filings in January 1997, and further used them in evaluating NST compliance for their Basic PAL services in April of 1997. These studies have been located and will be made available to the Commission on request.¹³

In this further opposition, Qwest outlines the process and studies that it undertook in complying with the Commission's rules regarding PAL pricing. The detailed affidavits of Mr. Thompson and Ms. Weibel provide extensive back-up for the conclusions set forth herein. But this case should not reach the stage where this Commission puts itself in the place of reviewing Qwest's intrastate PAL rates. The Commission delegated the task of evaluating PAL rates to state regulators in 1996 (and the violation that Qwest allegedly committed occurred in early 1997), and state processes were open to payphone providers from 1997 on to challenge New Services Test compliance. While Qwest had a federal obligation to ensure that its rates complied with the Commission's rules, this federal obligation was to be enforced (and was enforced) by

¹² In this document we distinguish between "Basic" or "dumb" PAL services, those used by TON and other payphone providers, and "Smart" PAL services, those used by Regional Bell Operating Companies' ("RBOC") payphones. The sole difference between the costs of Basic and Smart PAL services is that Smart PAL services use additional central office coin functionality.

¹³ In this regard it is very relevant that TON waited until five years after expiration of the statute of limitations to bring its claim, causing significant difficulties in reconstructing Qwest's PAL actions in 1996-97.

state regulators and courts. Moreover, payphone providers in numerous instances utilized the state processes to challenge Qwest's PAL rates for violation of federal standards, thus following the regulatory structure established by the Commission. The Commission should not be called upon at this late hour to second guess its own regulatory scheme. What is more, TON's extremely untimely federal court filing was its first ever foray into the payphone rate arena, guarantying that a full and accurate record would be extremely difficult, if not impossible, to reconstruct.¹⁴

Nevertheless, despite these obstacles, Qwest has been able to recreate with confidence its rate development and analysis process for both Basic and Smart PAL services in 1996-97, and this documentation demonstrates full NST compliance from the beginning. This further opposition will focus on Qwest's PAL rate development.

II. QWEST'S PAL RATES WERE PROPERLY EVALUATED AND COMPLIED WITH THE NST.

Significantly, as this and other payphone proceedings have dragged on, Qwest has been able to piece together more of its ancient payphone rate history. Qwest has previously shown that it carefully analyzed its intrastate PAL rates in April/May of 1997 to determine whether they complied with the NST.¹⁵ Having at that time determined that its rates were compliant, Qwest made no formal intrastate cost support filings in April/May of 1997 other than filings to increase

¹⁴ Qwest remains at a loss as to just what can be said or done. The two-year statute of limitations ought to protect Qwest and similarly-situated parties against plaintiffs that wait until long after documents have been destroyed, memories clouded, and the statutes of limitations have run, to bring claims, even if the claim might otherwise have merit if timely brought. Our problem is very simply expressed. Qwest is being asked to justify its 1997 Basic PAL rates, rates that were first challenged before the Commission in 2003 (and first challenged by TON in 2004). This is a situation that Section 415 of the Act was meant to prevent.

¹⁵ The assertion by TON and others that the NST was a rigid rate structure that formulaically would, if properly applied, always reach the "correct" result, is simply untrue, both in 1997 and today.

rates (realizing, of course, that TSLRIC studies supporting both Basic and Smart PAL rates were already on file). Qwest's analysis of the relevant orders indicated that this was a reasonable decision -- and the record shows that the Commission was aware that new tariff filings were not required, having already ruled that neither federal cost showings nor state tariff filings were necessary (unless a particular tariff was not NST compliant).

But Qwest's interpretation of the Commission's rules as allowing it to evaluate its rates internally for NST compliance does not mean that Qwest did not file cost support for its PAL rates with state regulators, or that its rates were not reviewed by the states for NST compliance. Moreover, it does not mean that Qwest cannot defend those rates today as being in compliance with the NST. The contrary is true. As will become obvious as we proceed, Qwest has now located much of the cost support confirming the conclusion that its 1997 Basic PAL rates were NST compliant. These papers are voluminous. Two samples of these cost studies are attached to Mr. Thompson's Declaration. At the Commission's request, Qwest is willing to deliver copies of the other papers in its possession to the Commission for review, but does not desire to burden the Commission with this paperwork unless the Commission requests it. Because this is a declaratory ruling proceeding and not a proceeding to actually evaluate Qwest's 1997 PAL rates, it seems to Qwest that filing these papers at this time may be unduly burdensome and unnecessary, and only samples are submitted herein. Should the Commission actually desire to conduct a formal proceeding on Qwest's 1997-2002 PAL rates, Qwest will of course submit the papers at that time. In any event, Qwest hereby makes a formal offer of production -- should the Commission desire to examine the cost studies and other paperwork that Qwest has managed to retrieve dealing with Qwest's 1997 Basic and Smart PAL rates and NST compliance, Qwest will produce them within five business days of receiving a request therefor.

A key to understanding Qwest's position is to comprehend that there were multiple sets of tariff filings and evaluations concerning PAL rates required in 1996-1997:

- New intrastate tariffs were required for so-called “Smart” PAL services, those services utilized by Qwest's own payphones. These filings were required to avoid unlawful discrimination and to eliminate subsidies. Qwest made “Smart” PAL filings in each of its 14 jurisdictions.¹⁶ As is discussed below, TSLRIC cost studies were prepared for each of these tariff filings. Because of the nature of these particular studies, they separated the TSLRIC costs of Basic and Smart PAL services in a single study.
- Basic PAL rates were to be filed with state commissions, and were required to be governed by the NST, which was a flexible test based on forward-looking costs and a reasonable allocation of overhead. It was not immediately clear whether existing Basic PAL rates would need to be modified to conform to the NST, but the Commission ultimately clarified that intrastate Basic PAL rates would need to conform to the NST in order for local exchange carriers (“LECs”) to collect per-call payphone compensation.¹⁷ If a LEC's Basic PAL rates were already on file with the state commission and were NST compliant, a new tariff filing was not required (whether additional cost support was required to be filed at that time if a tariff was already NST compliant is a matter of dispute—Qwest claims that such filings were not required).

¹⁶ Weibel Declaration ¶ 5.

¹⁷ See *In the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Order, 12 FCC Rcd 20997, 21013 ¶ 33 (1997).

- Some payphone features were required to be filed at the Commission. Qwest made these filings and the payphone industry challenged the rates based on the claim that the overhead allocations were excessive (in the range of 94% to 221%). These challenges were not given credence by the Commission.¹⁸

This is the regulatory environment in which Qwest and others found themselves in 1996-97 when PAL rates were being evaluated. In a nutshell, Qwest's evaluation process and filing processes were as follows;

- Qwest had had Basic PAL rates on file in its states for some time. These rates were developed and implemented based on state mandated rate-making standards. However, Qwest also conducted TSLRIC studies for these rates every year for evaluation purposes. These studies were conducted for a variety of Qwest rates,¹⁹ not only Basic PAL rates. These studies were generally filed with state regulators on a routine basis, as they established the "floors" that were the basis for minimum service prices in many states. The TSLRIC studies confirmed that the rates were consistent with reasonable (state approved or mandated) forward-looking cost standards.²⁰
- The Commission's rules required that new tariff filings be made for "Smart" PAL services (the services used by Qwest's own payphone services). The primary rules applicable to Smart PAL rates were that they not be "discriminatory," that is, that they not give an unfair advantage to Qwest's

¹⁸ Thompson Declaration ¶ 56. This is an important concept, as Qwest relied on the Commission's decisions regarding these overhead percentages in its analysis of its own Basic PAL rates.

¹⁹ *Id.* ¶ 9.

²⁰ *Id.* ¶¶ 4, 10-14.

own payphone services, and that they not be subsidized by other services -- that is, that the prices be cost based. The regulatory vehicle chosen to meet these objectives was the pricing of Smart PAL services based on the NST.

- In order to prepare for the filing of intrastate Smart PAL rates, Qwest conducted additional TSLRIC studies for Smart PALs. These studies evaluated the TSLRIC costs for the payphone features common to both Smart and Basic PAL services, plus the TSLRIC for the additional components necessary for the Smart PAL service to be functional. The cost studies broke these elements out so that appropriate comparisons between Basic and Smart PAL rates could be analyzed.²¹
 - The overhead percentage for the existing rate for Basic PAL service was determined by dividing the existing rate by the TSLRIC.²²
 - The TSLRIC for the Smart PAL service was then determined by adding the TSLRIC for the additional Smart PAL CO functions to the TSLRIC for the Basic PAL service.²³
 - The overhead percentage for the Basic PAL service rate was then applied to the new TSLRIC for the Smart PAL service to derive the proposed Smart PAL rate.²⁴
- Thus, for example, if the Basic PAL TSLRIC was \$10 and the price was \$20, the overhead percentage would be 100%. If the Smart PAL TSLRIC was \$15, then

²¹ *See below*. One such cost study is attached to the Declaration of Mr. Thompson. Additional cost studies will be submitted to the Commission on request.

²² Thompson Declaration ¶¶ 16-17.

²³ *Id.* ¶¶ 15-16.

²⁴ *Id.* ¶¶ 15-19.

the 100% overhead percentage would be applied to the new TSLRIC to reach a total price of \$30.

- These new Smart PAL rates were duly filed with state regulators by January 15, 1997. The cost support described above was either filed with the state regulators or made available to them, depending on the processes used by each state in evaluating new rates.²⁵
- When the Commission made it clear that the state Basic PAL rates already on file would need to comply with the NST even in the absence of other rate filings, Qwest already had cost studies that detailed the TSLRIC for Basic PAL services. These cost studies were both on file and available to state regulators as part of the support for the Qwest Smart PAL filings. Hence, evaluation of Basic PAL rates for NST compliance was a matter of examining the TSLRIC on file, determining whether the overhead was reasonable and taking action if necessary.²⁶ In this regard, Qwest did make state filings based on this evaluation in three states because it determined that the PAL rates were too low to comply with the NST.²⁷
- In evaluating whether overhead loadings were reasonable (the second part of the NST), Qwest relied on, among other things, Commission decisions allowing comparable overhead percentages in the case of federal PAL feature tariff filings, as well as overheads in other filings involving the NST.

²⁵ *Id.* ¶¶ 15-48.

²⁶ *Id.* ¶¶ 49-63; Weibel Declaration ¶ 7.

²⁷ Weibel Declaration ¶ 3.

- Based on this analysis, Qwest made the required certifications of compliance. It was Qwest’s opinion that its Basic PAL rates were well within the limits of the flexible NST. It had firm documentation that its rates were consistent with state-approved TSLRIC studies and its overheads were consistent with overhead percentages approved by the Commission in evaluating other PAL rates.²⁸

However, this analysis and action by Qwest were not the final words on the subject. Over the course of the next five years, Qwest was called upon to formally defend its PAL rates in no fewer than eleven of its fourteen state jurisdictions.²⁹ In five of these proceedings the actual issue of NST compliance was litigated,³⁰ and the other six involved cost analyses that by necessary implication invoked the NST (and, of course, provided TON and other payphone providers the full opportunity to review Qwest’s Basic PAL rates and to argue that they did not meet the NST). These state proceedings ultimately resulted in precisely the type of review and analysis that TON and others claim was not conducted in the case of Qwest’s PAL rates.³¹ And the state regulators had the NST documentation prepared by Qwest available while conducting these analyses. While state regulators took varying actions concerning Qwest’s PAL rates (based generally on state public interest considerations which went beyond mere consideration of the NST), no state regulator found that Qwest’s PAL rates had violated the NST.³²

²⁸ Thompson Declaration ¶¶ 49-63; Weibel Declaration ¶ 7.

²⁹ Thompson Declaration ¶¶ 64-86.

³⁰ *Id.* ¶¶ 64-79.

³¹ *Id.* ¶ 86.

³² The Oregon Court of Appeals reversed the Oregon Commission’s finding that Qwest’s PAL rates satisfied the NST because the Oregon Commission had failed to consider the impact of the *Wisconsin Order*. *Northwest Public Communications Council v. Public Utility Commission of*

In other words, the premise of the TON complaint is factually completely false.

III. DETAILED ANALYSIS CONFIRMS THE REASONABLENESS OF QWEST'S PAL RATES.

The foregoing summary does not do complete justice to the extent of Qwest's actions to comply with the Commission's PAL pronouncements, including the NST. Additional details of this process are set out below in the attached Declarations of Ms. Weibel and Mr. Thompson previously referenced. Mr. Thompson's Declaration outlines the TSLRIC and rate processes for both Basic and Smart PAL tariffs, and how the rates were designed to comply with the Commission's rules. He examines how the Basic and Smart PAL filings intersected and supported each other, and the relationship between the TSLRIC of Basic and Smart PAL services. This includes examination of the Commission decisions on reasonable overhead percentages for PAL services. He also describes in detail the state proceedings that resulted in state examination of the compliance of Qwest's Basic PAL rates with the NST in eleven of its states, and is further supportive of the reasonableness of the Qwest PAL rates in the remaining three states. Mr. Thompson's Declaration includes numerous exhibits that are illustrative of the process applied by Qwest.

Ms. Weibel's Declaration, focuses on the process of evaluating the Qwest PAL rates in 1997, and the determination that the rates were NST compliant. As a Qwest Regulatory Docket Manager and Staff Advocate directly involved in the process in 1996-97, she identifies the people involved and the reports that were generated in the PAL analysis that Qwest conducted in 1996-97. The key documents from that analysis are attached to her declaration.

Oregon, 196 Ore. App. 94, 100 P.3d 776 (2004). In Oregon, the issue of whether Qwest's PAL rates prior to 2003 satisfied the NST is still pending before the Oregon Commission.

IV. THE *WISCONSIN ORDER* IS NOT, AND CANNOT LEGALLY BE MADE, RETROACTIVE.

One final matter merits brief attention. TON claims that its “damages” should be based on the difference between the rates that Qwest filed after the issuance of the *Wisconsin Order* and the rates that Qwest had on file at various times between 1997 and 2003.³³ As has been repeatedly pointed out in this docket, interpreting the *Wisconsin Order* as having retroactive effect -- presumably even to the extent that state ratemaking proceedings would be overruled -- is simply legally, historically and factually impossible. The NST was applied to intrastate payphone service rates in 1997 as a flexible test based on state costing standards. Indeed, the *Wisconsin Order* itself continues to rely on state costing methodologies, leaving ample room for varying prices consistent with the *Wisconsin Order* today. Not only did the *Wisconsin Order* itself not apply retroactively, but the cost standards applied in 1997 were quite different than those applied in 2002-03, differences having nothing to do with the NST or the Commission’s PAL rules. To claim that 2002-03 rates set the level for maximum 1997 rates because of some sort of “retroactive” application of the *Wisconsin Order* would be ridiculous, a fact highlighted by the fact that the Commission itself represented to the D.C. Circuit Court of Appeals that the *Order* was not even ripe for appeal.

However, Mr. Thompson’s analysis has been able to provide additional insight into Qwest’s NST analysis after the *Wisconsin Order* and prior thereto. Specifically, when Qwest undertook to review its PAL rates after the *Wisconsin Order*, state regulators had modified their views of forward-looking costs. Rather than using the TSLRIC approach that states (and Qwest) had relied on for years, states were now more and more relying on the Commission’s total element long run incremental cost (“TELRIC”) costing approach. When Qwest reevaluated its

³³ TON Reply at 19.

PAL rates after the *Wisconsin Order*, it utilized the TELRIC costing methodologies used by the states at that time -- consistent with the directive to use the forward-looking costing standards applied generally by the states. Qwest also applied different overhead loadings than were used in evaluating its 1997 rates, and made other adjustments, including using the state subscriber line charges (“SLCs”) in effect in 2002-03 that were often significantly higher than the 1997 SLCs.³⁴ Mr. Thompson’s Declaration details the reasons for the differences between the 1997 and post-2002 rates.³⁵

The bottom line of this analysis is that, even if some aspects of the *Wisconsin Order* were interpretive rather than prospective, this would still not warrant the assumption or the conclusion that Qwest’s post-*Wisconsin Order* rates set a standard for pre-*Wisconsin Order* rate evaluation.

V. CONCLUSION.

Qwest submits that there is no legal basis for granting TON’s petition, or the other petitions pending in this docket. Once the Commission delegated the responsibility for regulating RBOC compliance with the NST to state regulators, it similarly delegated to them the responsibility and authority to implement appropriate procedures and remedies. But more important than the legal errors in the positions of the various petitioning parties in this docket, Qwest is very concerned that the false impression that TON and others have sought to create -- that Qwest did nothing to comply with the Commission’s requirement that intrastate Basic PAL rates be conformed to meet the NST -- be corrected. As is detailed herein, that accusation is completely false. Whether or not Qwest committed “procedural non-compliance” with the Commission’s rules regarding intrastate Basic PAL rates when it relied on existing rates and previously filed cost studies to meet the Commission’s requirement that its Basic PAL rates be

³⁴ Under the *Wisconsin Order*, a higher SLC would result in a lower PAL rate.

³⁵ Thompson Declaration ¶¶ 87-101.

NST compliant, rather than making entirely new filings in April/May of 1997, it cannot be seriously argued that Qwest did not take its NST obligations seriously. And, as is documented herein, Qwest's rates were and have been substantively compliant with the Commission's rules throughout.

The TON petition should be denied.

Respectfully submitted,

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June 4, 2008

CERTIFICATE OF SERVICE

I, Richard Grozier, do hereby certify that I have caused the foregoing **FURTHER OPPOSITION OF QWEST CORPORATION TO PETITION OF TON SERVICES, INC. FOR DECLARATORY RULING ON A PRIMARY JURISDICTION REFERRAL** to be:

- 1) filed via ECFS with the Office of the Secretary of the FCC in CC Docket No. 96-128;
- 2) served via e-mail on Ms. Lynne Hewitt Engledow at lynne.engledow@fcc.gov, Ms. Pamela Arluk at pamela.arluk@fcc.gov and Albert Lewis at albert.lewis@fcc.gov all of the Wireline Competition Bureau, Pricing Policy Division; and 3) served via e-mail on the FCC's duplicating contractor, Best Copy & Printing, Inc. at fcc@bcpiweb.com.

/s/ Richard Grozier

June 4, 2008