ATTACHMENT A

DECLARATION OF JERROLD L. THOMPSON

1. My name is Jerrold L. Thompson. I am employed by Qwest Corporation ("Qwest")[1] as Executive Director-Public Policy. My business address is 1801 California St., Room 4740, Denver, CO, 80202. I have been employed by Qwest and its predecessor companies, U S WEST and Mountain Bell, for over 29 years. My current responsibilities include the supervision of regulatory filings before state commissions in Qwest's fourteen state territory. In prior positions I have supervised the preparation of forward-looking cost studies and sponsored the presentation of those studies before state commissions in state rate cases and cost dockets.

I received a Bachelor of Arts degree from the University of New Mexico in 1973, a Master of Business Administration degree from the Anderson School of Management at the University of New Mexico in 1976, and a Master of Taxation degree from the University of Denver Schools of Law and Business in 1996. After working for a large international public accounting firm for two years I have been continuously employed by Qwest and its predecessor companies since that time. I have held a number of management positions in various departments, including Regulatory Finance, Pricing and Public Policy.

[1] "Qwest" will be used to refer to U S WEST Communications for periods prior to the merger of the two entities in 2000.

2. The purpose of this declaration is to demonstrate that: 1) both Qwest and its state regulators used forward-looking long run incremental cost ("TSLRIC") studies to establish rates for many years prior to 1997; 2) both Qwest's PAL rates in existence in 1997 and its new Smart PAL rates were cost-based, nondiscrimatory and had reasonable overhead loadings; 3) Qwest closely examined its PAL rates in existence as of April 14, 1997 for compliance with the FCC's new services test; and 4) the FCC's *Wisconsin Order* significantly modified the application of the new service test to payphone services.

STATE COMMISSIONS' USE OF FORWARD-LOOKING COSTS IN PRICING PRIOR TO THE FCC'S PAYPHONE ORDERS

3. The majority of states in the Qwest region have either statutes or commission rules that were in effect prior to 1997 that required Qwest to have Total Service Long-Run Incremental Cost ("TSLRIC")[2] studies available for examination by commissions and other parties with regard to its retail prices. Arizona Corporation Commission's TSLRIC rules date back to at least 1995. The Colorado Public Utilities Commission's Rules on costing were adopted in 1993 (Docket No. 92R-596T). Oregon and Montana's commission rules on TSLRIC date to the early 1990's. Iowa, Utah, Wyoming and Minnesota's TSLRIC statutes were adopted in the mid-1990's. Washington and New Mexico's TSLRIC commission rules date to the mid-1980's.

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[2] Or the similar Long Run Incremental Cost ("LRIC").

4. TSLRIC studies are used by state commissions to make determinations for reasonable prices and price floors.[3] Incremental forward-looking cost-of-service studies were, and continue to be, used by regulators along with the price of the service to quantify the margins between the direct cost (TSLRIC) and the price of the service. State commission staffs typically analyze Qwest's cost studies and make judgments as to assumptions, statistical data, engineering details, time-in-motion studies, etc. Price to direct cost ratios for a service are compared by commissions to other services to judge whether a specific price is reasonable. For example, if a price of a service is $10.00 a month, and the TSLRIC is $6.00, the price to cost ratio is 1.67, or $10.00 divided by $6.00.[4]

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[3] This is not unlike the process used by the FCC in evaluating the price of a new service. *See In the Matter of Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture, Policy and Rules Concerning Rates for Dominant Carriers,* Report and Order & Order on Further Reconsideration & Supplemental Notice of Proposed Rulemaking, 6 FCC Rcd 4525, rel. July 11, 1991, "...a LEC introducing new services will be required to submit its engineering studies, time and wage studies, or other cost accounting studies to identify the direct costs of providing the new service, absent overheads, and must also satisfy the net revenue test." *Id.* at 4531 ¶ 42.

[4] This price to cost ratio analysis for determination of reasonable prices is consistent with the FCC ONA pricing requirements, for example, *id.* at 4531 ¶ 44, "Once the direct costs have been identified, LECs will add an appropriate level of overhead costs to derive the overall price of the new service. To provide flexibility needed to achieve efficient pricing, we are not mandating uniform loading, but BOCs will be expected to justify the loading methodology they select as well as any deviations from it. We will evaluate the reasonableness of the manner in which overhead costs are loaded onto the cost of the service, including review of the ratios of direct unit cost to unit investment and direct unit cost to unit price. Therefore, we require the BOCs to include these ratios in their tariff filings."

5. A Total Service Long Run Increment Direct Cost study is a forward-looking cost study that calculates the cost added (or avoided) by offering (or discontinuing) the entire service under study while holding constant the costs of production of all other services produced by the firm. This cost is often referred to in economic terms as the *direct cost*. These costs include capital costs for depreciation, return on investment, and income taxes. Other direct costs include maintenance expenses, assignable administrative expenses, product management expenses, right to use fees, property taxes, and business fees. In addition, common overhead costs can be added to the direct costs or may be represented by the margin between price and direct cost.

6. Total Service Long Run Incremental Cost is a costing methodology that estimates product and service costs over a period of time long enough to fully adjust to changes of output (including changes in the size of facilities, levels of investment, etc.) in order to optimally accommodate the change. This methodology is forward looking in nature in that it only uses costs of the latest technology available, not historical or the embedded costs of the actual network. The forward-looking costs are based on an assumption of fully replacing the network required to provision the service, beginning from the existing grid of network nodes in place when the study was done. Switching and transport equipment assumes digital technology. Modern technology is assumed in the inter-office network. Local distribution loop facilities include a least-cost mix of twisted pair copper,

fiber optic feeder facilities, along with digital and analog pair gain equipment. The loop and drop investments are based on weighting together samples of loop costs from all classes of service, but with factors applied to develop a service specific loop and drop cost. The latest commission-authorized cost of money and depreciation rates are used in the study.[5]

7. TSLRIC studies develop a cost per unit of service for a particular service. Public Access Line ("PAL") service is a service that provides a telephone line to providers of pay telephone service. Purchasers of PAL service purchase the line, switching and transport services, and central office intelligent features such as protection from false customer provided information.[6] Qwest's PAL TSLRIC studies identify the cost of outside plant (typically copper cables) for a line to reach a payphone set; the cost of the two strands of copper wire that join the cable to the payphone set (called "drop wire"); the central office terminal equipment that connects the cable to the switch (called central office non-traffic sensitive or "NTS-COE"); costs of the central office switch that provides a connection from the payphone set to the called party; costs required to bill the PAL purchaser; and the costs for a listing in the white page directory.

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[5] Qwest has routinely used its TSLRIC studies for its filings with the FCC when cost studies are required to support its proposed prices.

[6] Qwest's PAL customers include payphone service providers ("PSPs") whose primary revenue is derived from payphone sets, but also long distance telephone companies, community centers, hospitals, restaurants, gas stations, convenience stores, bars, etc.

8. Prior to 1997, state commissions frequently required or requested Qwest's TSLRIC studies for PAL services in order to determine the reasonableness of Qwest's PAL rates. During the late 1980's and throughout the 1990's, payphone service providers were active in state cases where PAL rates and costs were examined. These cases included Qwest general rate cases and also payphone specific investigations.

9. In state general rate cases, after completion of the determination of the overall need for additional revenue, Qwest offered TSLRIC studies as support for its proposed prices for individual services. This phase of the general rate case, often called the rate-setting phase, commonly included discussions of the reasonableness of prices relative to the TSLRIC of the service. In addition, non-rate case investigations of prices for specific services often utilized cost studies to evaluate the reasonableness of prices. In order to provide an example of the level of detail in Qwest's TSLRIC studies for PAL and Smart PAL, I have attached copies of studies for Colorado that were prepared in late 1996 and used by Qwest in PAL pricing investigations in 1997.

10. The following examples show how state regulators in Qwest's fourteen state territory examined the reasonableness of Qwest's PAL rates using the TSLRIC studies as a basis for that examination. In 1994, (Docket No. RPU-94-1), the Iowa Utilities Board described its use of Qwest's incremental cost studies:

> The LRIC studies were not designed to allocate revenue requirements to major classes of service and the Board will not use them for this purpose, LRIC studies were designed to set price floors for existing and new services. The Board currently uses LRIC studies as cost support for new tariff filings by U S West. LRIC studies also can be useful as a guide in setting rates within a class of service.[7]

The Iowa Utilities Board made the following findings in this case:

> It is reasonable to consider the cost studies, the market analysis, and the public policy goals presented in this docket in setting an appropriate rate design. ...It is reasonable to eliminate all business LMS (local measured service) calling packages and to charge a single rate of $24.00 per line for all measured business lines.[8]

The $24.00 rate was used as the PAL flat rate in Iowa.[9]

11. In Docket No. P-421/M-89-254, issued March 29, 1991, the Minnesota Public Utilities Commission approved rate reductions for Qwest's PAL services noting its reliance upon Qwest's TSLRIC studies:

> "The Company's substantive filings in this matter consist of 1) its initial proposal and supporting documents filed April 19, 1989; 2) its revised rate proposal and over 1,000 pages of cost data showing the access and usage costs of providing service to customer-owned pay telephones filed June 15, 1990. Finally, the Company provided the Department with an additional 375 pages of the cost

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[7] At page 13.
[8] At page 37.
[9] Iowa Administrative Code 199-22.3(5), "*Pay telephone services and facilities.* All telephone utilities shall make available to customers provisions for the interconnection of pay telephone equipment on the same basis as business service. A separate access line shall not be required for pay telephone equipment. Nonrate-regulated telephone utilities shall provide service consistent with this subrule, but the subrule shall not apply to the pricing by nonrate-regulated telephone utilities of access lines to pay telephones."

information in response to an information request." (at page 4, footnote 2)

In sum, the Commission finds that the cost studies provided by the Company when viewed in conjunction with the expert opinion filed explaining the reasons for the rate changes are adequate. The Company's filings together with the additional factors considered here support a finding that the proposed rate changes are fair and reasonable and the Commission so finds." (at page 8, clerical error correction July 17, 1991, p. 6)

12. Qwest's long standing use of TSLRIC studies to support its PAL prices was also common knowledge to the payphone providers. An example of this is found in an exchange of letters from the Colorado Payphone Association ("CPA") attorney and a Qwest attorney in Colorado. The CPA attorney filed a letter with the Colorado Public Utilities Commission on May 1, 1997 that was in response to Qwest's filing of its Smart PAL service in January 1997.[10] Among various complaints the CPA attorney alleged was that Qwest's PAL rates did not comply with the FCC's requirements under the FCC Payphone Orders because there was no certification by the Colorado PUC that Qwest's PAL prices "be provided at 'cost-based' rates, defined by the FCC to equal direct costs plus an appropriate level of overhead costs." The CPA letter demonstrates a detailed understanding of Qwest's TSLRIC studies that had been filed with the Colorado PUC in the past:

[10] Letter from Craig D. Joyce, dated May 1, 1997 to Bruce N. Smith, Director Colorado Public Utilities Commission.

"In order to determine whether current rates charged to IPPs for PAL service are "cost-based," the Commission should start its inquiry with review of U S WEST's PAL cost studies, including MSEA Mass Markets Team's "Colorado Public Access Line Service Costs -- 1995 Level" and MSEA "Public Access Line 1996 Recurring and Non-recurring Cost Study; State of Colorado; November, 1996." CPA believes the 1995 cost study provides the more reliable information since it was prepared before U S WEST had the incentive to inflate its loop costs as a result of the requirement in the Telecom Act to offer unbundled loops to competitors."

13. Qwest responded to CPA's allegation with the following:[11]

"USWC certifies through this letter that its tariffed PAL rates are cost-based and non-discriminatory in accordance with Commission Rules, FCC requirements, and state and federal law. In each of the tariff filings for PAL rates, USWC has provided pursuant to Commission Rules, its cost studies for Commission review so that the Commission could make the determination that the rates are just and reasonable."

14. By 1997, Qwest had a long history of state commissions using TSLRIC studies in establishing Qwest's rates, including PAL rates. Qwest used updated TSLRIC studies for the rates it proposed for its Smart PAL service in 1997. Because Qwest's 1997 PAL rates were set by state commissions in earlier rate cases where Qwest provided TSLRIC studies for the commissions' review, Qwest's PAL rates were cost-based. Because state commissions evaluated the reasonableness of Qwest's PAL prices relative to the direct

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[11] Letter from Richard Corbetta to Mr. Bruce Smith, Executive Director, The Public Utilities Commission of the State of Colorado, dated May 19, 1997.

costs of those services, in approving Qwest's PAL prices, state regulators also *approved* the reasonableness of common overhead costs included in those prices.

QWEST USED THE TSLRIC OF PAL WITH THE APPROVED STATE COMMISSION COMMON OVERHEAD ALLOCATION TO SET THE PRICE OF SMART PAL

15. In late 1996, Qwest personnel prepared TSLRIC studies for its Basic PAL service and for the new Smart PAL service for each of its fourteen states. The new Smart PAL TSLRIC study was identical to the Basic PAL TSLRIC study except that it was designed to include costs for central office coin control functions for payphone equipment that do not have these features built in. This equipment is known as "dumb" payphone sets which required a "smart line". The cost of necessary intelligence to signal a payphone to determine if a coin is present and to accept or return the coins at the end of a call is included in the Smart PAL TSLRIC study. The additional costs identified were related to functions for operator services, central office equipment for coin recognition, mechanized customer record information, and computer coding. These additional functions for Smart PAL added about $3.00 to $6.00 of cost to the Basic PAL cost per line per month depending upon the state.

16. With an objective to set the price of Smart PAL service at a non-discriminatory level, Qwest personnel examined the TSLRIC of Basic PAL in relationship to the approved prices by state commissions. By comparing the existing price of PAL with the

TSLRIC by state by service[12], the amount of common overhead could be determined on a percentage basis. Qwest examined these overhead loadings to determine whether they were still reasonable (i.e., compared to overhead loadings on similar services in a given state). These same percentages were then multiplied by the Smart PAL TSLRIC for the different states to establish the proposed price. Therefore, the proposed price of the Smart PAL service was set to recover the cost of the service plus the reasonable mark-up over cost that was included in PAL by the state commission for each state for each service.

17. An example of this process is as follows. In Arizona:

Basic PAL Price	$42.31
Basic PAL TSLRIC	$29.01
Common overhead	$13.30 ($42.31 - $29.01)
Percent common	45.85% ($13.30/$29.01)
Smart PAL TSLRIC	$31.94
Basic PAL common percent	45.85%
Smart PAL common overhead	$14.64 ($31.94 x .4585)
Smart PAL Price	$46.58 ($31.94 + $14.64)
Smart PAL Percent common	45.85%

18. Qwest's Smart PAL filings in January 1997 reference this method. For example, in a letter dated January 13, 1997 from Rick Hays, Qwest Vice-President Montana to the

[12] There were several variations of Basic PAL service in each state. There was a measured service that was priced on a per-minute-of-use basis; a message service that was priced on a partial flat rate with a per call charge; and a flat unlimited usage service. All three services were not available in every state- some states had all three, some only one or two of the varieties.

Montana Public Service Commission requesting approval of the Smart PAL tariff, he stated the following:

> The factors used in setting the proposed "Smart PAL' recurring prices are based on the Basic PAL price/cost relationships. The price/cost analysis is considered proprietary and is provided under separate cover under the general non-docket protective order. The non-recurring rate for Smart PAL mirrors the tariffed non-recurring rate Basic PAL.

In a letter dated January 15, 1997 to the Oregon Public Utility Commission requesting approval of the Smart PAL tariff, Chuck Lenard, Qwest Vice-President Oregon, said the following:

> The recurring rates for the Smart PAL line were developed using the existing price/cost relationship of the basic PAL. Attachment C includes a cost/price comparison and the December 1996 recurring Smart PAL Total Service Long Run Incremental Cost Study.

19. In testimony, in the New Mexico State Corporation Commission's Docket No. 97-69-TC, *In the Matter of Compliance with Federal Regulations of Payphones*, dated February 28, 1997, Warren R. Couture, Jr., Qwest Regulatory Support Manager, described the Smart PAL pricing process as follows:

> First, updated cost studies for the existing PAL service, as well as new cost studies for the Smart PAL were developed on a state-by-state basis. Our objective in setting the proposed Smart PAL price, was to base it on cost, and determine a price level that was fair and reasonable on a

stand alone basis, as well as when compared to the price of the currently tariffed PAL.

It is important to recognize that the essential difference between a Basic and Smart PAL is that the Smart PAL requires Central Office Coin Control functionality and the Basic PAL does not. In setting the price of the Smart PAL, we looked at the cost/price relationship of the already tariffed PAL, and then applied that same percentage relationship to the cost of the Smart PAL to determine its price. Confidential Attachment No. 1, is a spreadsheet which demonstrates this calculation.[13]

QWEST FILED TSLRIC STUDIES FOR ITS PAL SERVICE IN 1997

20. Qwest filed PAL and Smart PAL cost information with its tariff filings in multiple states in 1997. In several cases these filings were opposed by payphone associations that led to investigations into all of Qwest's PAL rates. It is important to emphasize that Qwest's Smart PAL TSLRIC studies were identical to its PAL TSLRIC studies with a few additional costs included that add about $3.00 to $6.00 per line per month, depending upon the state. Thus, when Qwest filed TSLRIC studies for Smart PAL service in a given state, it was also filing direct costs for PAL service in that state.

Arizona

21. Qwest filed Smart PAL rates in Arizona on January 17, 1997 to be effective April 15, 1997. On February 6, 1997, the Arizona Corporation Commission ("ACC") suspended the filing for sixty days to allow its staff to review Qwest's filing. On

[13] Direct Testimony of Warren R. Couture Jr., February 28, 1997, Docket No. 97-69-TC, pp. 10-11.

February 11, 1997, the Arizona Payphone Association was granted intervention. On April 16, 1997 the ACC approved Qwest's tariff to be effective on April 15, 1997, subject to a true-up pending an investigation into those rates over the following 180 days.[14] The ACC ordered its staff to continue its review of Qwest's compliance with the FCC Payphone Orders. The ACC invited intervenors to participate in the review. During 1997, Qwest filed PAL and Smart PAL TSLRIC studies in data requests and supported its cost studies with testimony in that investigation.[15] The Arizona Corporation Commission acknowledged the requirements in the FCC's Payphone Orders and the New Services Test as an objective in this investigation.

22. On October 24, 1997 the ACC Staff filed its response to the issues in the investigation. The Staff responded as follows:

> ...Nothing precludes reliance in this case upon the Commission's previous PAL rate determinations in USWC's last rate case and upon the Commission's prior determinations with regard to what is a "reasonable" allocation of common overhead costs.
>
> ...Staff also points out that USWC submitted cost studies to Staff on the various payphone service elements found in USWC's tariff. Staff, upon subsequent review, found that the rates for USWC's payphone services comply with the "new services" test contained in the FCC's rules, corroborating the Commission's previous findings in USWC's last rate case.

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[14] Docket No. T-1051A-97-0024 Decision No. 60135.

[15] Qwest has copies of the PAL and Smart PAL TSLRIC studies.

> …Staff reiterates its earlier position that based upon its review of the cost studies submitted, all of USWC's payphone service rates comply with the requirements of the 1996 Act and the FCC's Payphone Compensation Orders.
>
> …There is no single or "correct" methodology for determining what constitutes a "reasonable portion of the carrier's overhead costs". As Staff pointed out in its recent response to an APA data request, it is a widely accepted economic tenet that there is no established method to allocate joint or common cost to a particular service. The notion that a "reasonable" allocation of joint and common costs should be the same for all services or that one allocation is more or less reasonable than another cannot be supported on economic efficiency grounds."…

23. In January 1998, the Staff of the Arizona Corporation Commission issued a report after analyzing Qwest's PAL and Smart PAL TSLRIC studies. The Staff reported the following:

> The FCC indicates that if a rate complies with the "new services test" (described at 47 C.F.R. Section 61.49(g)(2)) then it is consistent with <u>Computer III tariffing guidelines.</u> The "new services test" simply requires that a rate can not recover more than a reasonable portion of the carriers overhead costs. The FCC provides no guidance as to what a "reasonable portion" of overhead costs is. Also, there is no generally accepted method to determine what a "reasonable portion" of overhead costs is. In CC Docket 97-140 the FCC found rates between and including zero times direct cost and 4.8 times direct cost are "reasonable." Note that the FCC did not state that rates above 4.8 times direct cost are "unreasonable." Thus, CC Docket 97-140 does not preclude the ACC from concluding that rates above 4.8 times direct cost are "reasonable." In fact, in U S West's filing with the FCC concerning unbundled payphone service elements, rates as high as 74.95 times direct cost were approved. However, Staff can demonstrate that U S West's basic PAL rates are between zero times direct cost and 4.8 times direct cost. Therefore, these rates are clearly consistent with recent FCC orders' interpretations of the "new services test."

> Staff concludes that U S West's current basic Public Access Line (PAL) rates comply fully with the requirements of the Telecommunications Act of 1996 (the Act) and with the FCC's orders which implement the payphone reclassification and compensation provisions of the Act (CC Docket 96-128). [Footnotes omitted.]

24. The ACC held hearings and released its Decision No. 61304, dated December 31, 1998, (copy attached). The Decision adopted rate reductions for Qwest's PAL services retroactive to April 15, 1997. The Settlement Agreement adopted by the ACC stated the folowing:

> "The US West Matter and the Citizens Matter concern, among other things, those companies' tariff rates for Public Access Lines ("PAL") service and whether US West's and Citizens' PAL rates comply with the Telecommunications Act of 1996 and Federal Communications Commission ("FCC") requirements that PAL rates be "cost-based" and meet the "new services test."[16]

The ACC, stated in its Decision, "The rates and charges contained in the Agreement are just and reasonable and in compliance with all applicable state and federal law."[17]

25. The Arizona Payphone Association ("APA") was an active participant in this investigation. The ACC notes in its Decision that on July 16, 1997 the APA "filed a Motion for Procedural Order in the US West Matter requesting that the Commission require US West to establish that its PAL rates comply with the Telecommunications Act of 1996 and all FCC requirements, and further that APA be allowed to submit data

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[16] Settlement Agreement, Recitals 3.
[17] Decision No. 61304, Conclusions of Law 6.

demonstrating that US West's PAL rates do not comply with Federal requirements, and to propose alternate PAL rates." Qwest filed PAL cost studies and testimony in the proceeding in response to this motion. The APA reached agreement with the ACC staff and that agreement was approved by the ACC. The agreement called for Qwest to reduce its PAL rates to the same rate as Qwest's common business line rate of $33.03 and that Qwest refund the difference between the prior PAL rate of $42.31 and the $33.03 retroactively to April 15, 1997.[18]

Idaho

26. In 1996, the Idaho Public Utilities Commission undertook an investigation into Qwest's rates.[19] In that investigation Qwest filed PAL TSLRIC studies and imputations for coin services using those PAL cost studies. Shortly after the release of the FCC's Payphone Orders in September and October of 1996, the Northwestern Payphone Association ("NWPA") intervened in this proceeding and served Qwest with interrogatories that requested these TSLRIC studies and imputations.[20] Qwest requested information from the NWPA in a data request dated November 12, 1996. During

[18] The Settlement Agreement references an agreed upon rate of $17.68 which was the usage part of the two part Business Flat Rate Service. The second part of the service was the Dial Tone Rate of $15.35 which was required in addition to the Business rate, for a combined total of $33.03. The refund included interest at 10% per annum.

[19] *In the Matter of the Application of U S WEST Communications, Inc. for Authority to Increase its Rates and Charges for Regulated Title 61 Services, Case No. USW-S-96-5.*

[20] First Set of Interrogatories and Requests for Production from the Northwest Payphone Association, Request for Production No. 25P. "Please provide a 3.5 inch floppy disk containing copies of any of the following spreadsheets that U S WEST has prepared in Lotus 1-2-3 compatible files, of: A. Any Payphone cost studies; B. Any Payphone imputation analyses."

November Qwest provided the requested cost studies and imputation analyses to the NWPA. On December 2, 1996, Qwest received a letter dated November 27, 1996 from Mr. Brooks Harlow, representing the NWPA that read as follows:

> After I reviewed the imputation analysis you provided and discussed the case (without disclosing confidential information) with the Northwest Payphone Association, the Association has decided not to participate further in the above-referenced case. Under the circumstances, I assume U S West will withdraw its first request for production to the Northwest Payphone Association. We appreciate your providing the information we needed to analyze whether the Association should further participate in the case.

27. Qwest withdrew its production request of the NWPA on December 3, 1996. In 1997, the Idaho Public Utilities Commission reviewed cost studies for many of Qwest's services in this case, including PAL, and reached a conclusion that the prices approved by the Commission "significantly altered the Company's rate design structure to more closely reflect relative cost levels. We find that the rates and charges for Title 61 services set out in the Order and Appendix are fair, just, and reasonable and nondiscriminatory."[21]

28. Qwest filed Advice Letter No. 97-06-N with the Idaho Public Utilities Commission on May 16, 1997. Attached to this letter was an analysis that provided the TSLRIC for PAL and Smart PAL[22] compared to the basic price of PAL and Smart PAL and the federal Multi-line business CALC. This analysis is what Qwest considered to be

[21] Order No. 27204, dated November 4, 1997.
[22] Qwest has a copy of the Smart PAL TSLRIC study.

evidence of compliance with the FCC's New Services Test. When the weighted average price of basic PAL ($24.07) was added to the CALC ($6.00) the resulting revenue was $30.07. The TSLRIC was $29.55. This resulted in a price to cost ratio of 1.02. This meant that the price including CALC included 2% common overhead loadings. The analysis for Smart PAL included its prices and TSLRIC in a similar manner and indicated an identical common overhead loading of 2%.

Minnesota

29. On January 15, 1997 Pete Budner, Qwest Manager-Public Policy and David Seykora, Qwest Senior Attorney, filed a letter with the Minnesota Public Utilities Commission requesting that the Smart PAL rate be approved. The letter was provided with the following statement:

> Attached and included as part of this filing is the expert opinion regarding the introduction of the Smart PAL. The expert opinion was prepared under the supervision of Pete Budner and he is responsible for the expert opinion contained in this filing. The expert opinion is included in the following attachments: Attachment A- Factual Support; Attachment B- Tariff/Price List; **Attachment C- Cost Information**; and Attachment D- Revenue Impact. (Bold added)

30. On April 15. 1997, the Minnesota Independent Payphone Association ("MIPA") filed a petition to intervene in Docket No. P-421/EM-97-93, *In the Matter of USWC's Introduction of Coin Line or Smart PAL Service*. On June 4 and June 9, 1997, AT&T and MCI filed comments in this proceeding. On July 11, 1997, The Department of

Commerce, in its role of consumer protection, filed comments indicating that Qwest's proposed rates "meet the new service tests." In its Order dated November 4, 1997, the Minnesota Public Utilities Commission ("MPUC") stated, "In short, the Department recommended approval without conditions." The MPUC made note that it understood the FCC's requirements under its Payphone Orders that Qwest's proposed rates "must meet the guidelines for a new services test established in the FCC's Computer III proceeding." The MPUC noted that Qwest "provided cost studies that show the proposed rates to be above its TSLRIC." [23] The MPUC Order indicated that "MIPA initially expressed concerns that the proposed rates more than cover its share of reasonable costs but later withdrew its objection. The Department stated that the proposed rates meet the new services test since the contribution level for Smart PAL is lower than or in line with the contribution levels for other services subject to the new services test."[24] The MPUC noted that "MIPA initially asked the Commission to suspend USWC's filing but later withdrew its request and no longer challenges USWC's proposed rates." The MPUC concluded "In sum, the Commission finds that USWC's proposal tariff introducing "coin Line" or "Smart PAL" meets the requirements of ¶¶ 146-147 of FCC 96-388 as modified in ¶ 163 of FCC 96-439 and will approve it."

[23] Qwest has a copy of the Smart PAL TSLRIC study.
[24] "Contribution" is sometimes used meaning contribution toward common overhead costs, or margin.

Montana

31. On March 21, 1997, the Montana Public Service Commission ("MPSC") opened a Notice Of Inquiry, In the Matter of the Commission's Inquiry Into Payphone Issues Arising Out of the Telecommunications Act of 1996 and Subsequent Federal Communications Commission Orders To Implement the Payphone Provisions of the Act.[25] The MPSC also granted interim approval of Qwest's Smart PAL tariff effective April 15, 1997 pending the outcome of the Inquiry.

32. In its Notice of Inquiry, the MPSC raised several questions to which it expected the parties to respond. Among those directions was the following:

> Provide comments regarding the FCC's directive that states must ensure the payphone services tariffs required to be filed by the LECs are cost-based, consistent with Section 276, and nondiscriminatory. Do the payphone tariff revisions filed in January by US West, PTI Communications and Citizens Telecom meet these requirements? Do the existing PAL tariffs meet these requirements? Should the Commission consider opening a proceeding to review existing PAL tariffs?

33. Intervention was granted to the Northwest Payphone Association ("NWPA") on March 4, 1997. Qwest filed testimony and TSLRIC cost studies in the proceeding for its Basic and Smart PAL services.[26] The MPSC combined this docket with another, Docket

[25] Docket No. 97.2.33.
[26] Qwest has a copy of the Smart PAL TSLRIC study.

No. 97.4.65. In its Final Order dated September 2, 1998, No. 5965c, the MPSC summarized the NWPA's position as follows:

> NWPA asserts that U S WEST's proposed measured and flat business rates cover all PAL costs even when compared to U S WEST's cost study. If the Commission finds that U S WEST's business rates cover its costs, NWPA urges the Commission to adopt PAL rates that mirror U S WEST's business rates. According to NWPA, requiring full parity between PAL and business line rates will cover direct and shared costs, will eliminate rate discrimination against PSP's, and will serve the public interest by promoting lower payphone rates and widespread deployment of payphones....

34. The MPSC found in its Final Order:

> The Commission concludes that U S WEST's PAL rates do satisfy the requirement of the new services test that prices cover costs, even if NWPA's arguments are accepted as true. The Commission further concludes that the margin is not unacceptably high and, therefore, the second prong of the new services test is satisfied....
>
> The Commission has discretion to determine a reasonable margin for U S WEST's PAL service. U S WEST's witnesses Owen and Wilcox established that the cost/price relationship in the proposed PAL rates is not much different from that established for business local exchange service.
>
> The Commission concludes that U S WEST's proposed PAL rates satisfy the FCC's new services test.

35. The NWPA challenged the lawfulness of the PAL rates approved by the MPSC in District Court entitled, *Northwest Payphone Association v. Montana Department of Public Service Regulation and U S WEST Communications, Inc.,* Lewis and Clark County Cause No. BDV 9800559. This litigation concluded with a settlement between NWPA and Qwest. Under the terms of the Agreement, Qwest agreed to file a new tariff

for its payphone rates, terms and conditions with changes in its rates and terms. Qwest made a filing pursuant to the Agreement in January 1999. The MPSC adopted Qwest's proposed rates with an Interim Order No. 5965d on January 22, 1999 and a Final Order No. 5965e closing the docket on March 2, 1999.

36. The MPSC concluded Docket No. 97.2.33 on September 2, 1999 with its Order No. 6050a and 6051a.

New Mexico

37. In February, 1997, the New Mexico Corporation Commission ("NMCC") consolidated four existing dockets and created Docket No. 97-69-TC. This docket was captioned "In the Matter of Compliance with Federal Regulation of Payphones." The NMCC directed LECs that filed new payphone tariffs and "all other LECs who are required to comply with the Federal Regulations to file a formal application and pre-filed testimony by February 28, 1997", intervention was to be completed by March 17, 1997, and reply testimony was required to be filed by March 21, 1997. Qwest filed testimony on February 28, 1997 with TSLRIC cost studies for Basic PAL and Smart PAL.[27] AT&T filed testimony on March 17, 1997. Hearings were held on March 24, 25, and 26, 1997.

[27] Qwest has copies of the PAL and Smart PAL TSLRIC studies.

38. In its Order dated August 21, 1997,[28] the NMCC expressed a thorough understanding of the FCC's requirements of the Payphone Orders:

> The FCC made it clear in the New Services Test Order that the states have the responsibility of determining whether the intrastate tariffs have been filed in accordance with the "new services" test.

The Order reported that US WEST "acknowledged the New Services Test Order required all LECs to meet the "new services" test with respect to its payphone services. US WEST stated that its payphone related services in New Mexico include Basic and Smart Public Access Lines, Answer Supervision-Line Side and Split Blocking. US WEST stated that these payphone related services were reviewed for compliance with the "new services" test, and each was found to meet that test."

39. The NMCC's Order found as follows:

> US WEST's tariff is just and reasonable and in compliance with all legal requirements. The Commission hereby approves as just and reasonable and in compliance with all applicable legal requirements US WEST's offering of Smart PAL service under the rates, terms and conditions proposed to its Exchange and Network Service Tariff retroactive to April 15, 1997.
>
> Navajo, GTE and US WEST have fully complied with the parts of the Act and orders in FCC docket number 96-128 requiring the appropriate state regulatory body to make certain factual and legal determinations more fully described in the findings of fact.

[28] Copy attached.

Utah

40. On April 8, 1997 Qwest filed for Commission approval for rate changes in Utah. The Public Service Commission of Utah ("PSCU") granted intervention to a number of parties from April 21 through April 23, 1997, including the Utah Payphone Association. Hearings were held between September 8-11, 15-18 and September 29- October 3 and October 8, 1997. The PSCU issued its Report and Order in Docket No. 97-049-08 on December 4, 1997.

41. On April 8, 1997, Qwest filed testimony supporting TSLRIC studies for the majority of its services.[29] Included in that filing was testimony and TSLRIC for Qwest's PAL service. In discovery, Qwest provided an analysis of price and cost for Basic PAL service and Smart PAL service.[30]

42. In its Report and Order, the PSCU did not decide issues specifically related to the FCC's Payphone Orders, but did comment on its use of Qwest's TSLRIC studies:

> As in recent past dockets, again in this one parties introduce testimony and evidence on the subject of incremental costs and how such costs are to be used in pricing. The Company enters incremental cost studies for each of the services for which it recommends new prices. Though parties continue to differ about the manner of estimation of incremental costs, they seem agreed on the use of them as a floor, and in that a cross-subsidy test, for

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[29] Direct Testimony of Geraldine G. Santos-Rach.

[30] Qwest has a copy of the Smart PAL TSLRIC study.

> service prices. In past cases, this is how we used incremental costs. We do so in this Docket as well.[31]

43. The result of the PSCU's Report and Order on PAL rates in Utah was a reduction in the rate from $36.02 to $27.46. This reduction lowered the common overhead allocation to 38%, using Qwest's prescribed TSLRIC study and 2.6% using Qwest's economic TSLRIC study.[32]

South Dakota

44. On January 15, 1997, Qwest filed its request for approval of its Smart PAL tariff. The Public Utilities Commission of South Dakota ("PUCSD") set a docket TC97-006 and noticed the filing and established an intervention deadline of January 31, 1997. On April 15, 1997, Gemini Companies, Inc. late-filed a Petition to Intervene. On April 28, 1997, the PUCSD granted Gemini's intervention. A confidentiality agreement was executed between Gemini and Qwest on July 24, 1997 that allowed Gemini to receive Qwest's TSLRIC PAL studies and other confidential data. On July 24, 1997 Gemini filed a complaint regarding the rates Qwest charged for Basic PAL services. The PUCSD held a hearing on July 28, 1997. In that hearing the PUCSD requested additional information

[31] Report and Order, Docket No. 97-049-08, *In the Matter of the Request of U S WEST COMMUNICATIONS, INC. For Approval of an Increase in its Rates and Charges*, issued December 4, 1997, at p. 69.
[32] Two versions of TSLRIC studies were filed with testimony in this Utah proceeding. The prescribed study utilized previous PSCU decisions on cost-of-money and depreciation. The economic study utilized Qwest proposed cost-of-money and depreciation data.

from Qwest regarding its PAL costs. On August 7, 1997, Qwest provided six exhibits to the PUCSD which were responsive to its questions. On September 25, 1997 the PUCSD considered the evidence in the case and in a public meeting approved Qwest's proposed tariff.

45. The PUCSD's Order Approving Revisions to Tariff found the following:

> U S WEST priced Smart PAL to provide the same contribution margin as its basic PAL service. Tr. At 14. The only difference in price between the Smart PAL and basic PAL is the difference in the costs between the two services. Tr. At 15. The monthly rate for the message Smart PAL service does not cover costs so it provides no contribution. Tr. At 39. The usage charges provide the contribution for the service as a whole. Tr. At 39-40.
>
> The Commission finds that the prices and terms and conditions contained in the Smart PAL tariff are fair and reasonable. The Commission further finds that measured rates are appropriate since there are incremental costs associated with each call. Tr. At 20.[33]

46. In South Dakota in Docket No. TC97-006, Qwest submitted TSLRIC studies for its Basic PAL service and its Smart PAL service as indicated by the PUCSD's acknowledgment of the "only difference" in costs between Basic PAL and Smart PAL.[34] The PUCSD also acknowledged that it compared the difference between the Basic PAL cost and its price and the Smart PAL cost and its price when the PUCSD stated that the

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[33] Order Approving Revisions to Tariff, TC97-006, *In the Matter of the Filing By U S WEST Communications, Inc. for Revisions to Its Exchange and Network Services Tariff*, October 17, 1997.
[34] Qwest has a copy of the Smart PAL TSLRIC study.

"contribution margin" was the same.[35] Payphone company interests were represented by Gemini who filed a complaint against Qwest's Basic PAL rates and actively participated in the investigation, including access to Qwest's confidential material such as its TSLRIC studies.

Washington

47. On January 15, 1997 Qwest filed its tariff for Smart PAL service in Washington. Along with its application Qwest filed its TSLRIC study as was required by the Washington Utilities and Transportation Commission ("WUTC") rules.[36] The Smart PAL rates were approved by the WUTC on March 12, 1997[37] and went into effect on April 15, 1997. Qwest received questions from the WUTC staff on June 3, 1997, to which it provided updated TSLRIC studies and its analysis of the FCC's New Services Test.

48. In total in 1997, Qwest submitted PAL TSLRIC studies in eight states (Arizona, Idaho, Minnesota, Montana, New Mexico, Utah, South Dakota, and Washington). In five of these eight states there were specific investigations on the compliance of Qwest's PAL rates (Arizona, Minnesota, Montana, New Mexico, and South Dakota) with the FCC Payphone Orders. The other two states, (Idaho and Utah), had payphone associations as

[35] "Contribution margin" is the difference between TSLRIC and price and is another expression for common overhead recovery in pricing.
[36] Qwest has a copy of the Smart PAL TSLRIC study.
[37] Washington Utilities and Transportation Commission, Open Meeting Minutes of March 12, 1997, R. 2-150, Docket Number UT-970073, US WEST Communications (T045) Tariff Revision (advice 2825T).

active intervenors in the general rate proceedings that included PAL rates. With Idaho, the Northwest Payphone Association requested access to Qwest's TSLRIC studies and was given the studies to examine after which, the Association withdrew from the case. In these cases, state commissions found Qwest's PAL prices either to be compliant with the FCC's New Service Test and therefore, the rates to be lawful under the law as interpreted by the commissions, or in Washington's case, allowed the rates to go into effect after investigation.

IN APRIL 1997 QWEST CAREFULLY REVIEWED ITS PUBLIC ACCESS LINE PRICES PURSUANT TO THE FCC NEW SERVICES TEST

49. Subsequent to the FCC's Payphone Order of April 4, 1997 the team of Qwest rate analysts, product managers, federal tariff managers and attorneys that were responsible for the implementation of and compliance with the FCC's payphone orders, reviewed the FCC requirements relative to the New Services Test. The declaration of Ms. Glenda R. Weibel describes in detail the series of meetings and conference calls that this team undertook in the April to May 1997 time period.

50. Attached as an exhibit to the declaration of Ms. Weibel is a copy of a memo dated April 7, 1997,[38] that was addressed to twenty-six different Qwest employees with the Subject Line reading "Telecom Act - Payphone Requirements". The message reads

[38] April 7, a Monday, was the first business day following the April 4, FCC Payphone Order.

"Attached is information that will be reviewed on the next call to discuss the FCC's April 4, 1997 Payphone Order. The next scheduled meeting has been scheduled for: Tuesday April 8 ...." The first page of this fax provided the following information for the team:

> FCC Rules 61.49(g)(2): Each tariff filing submitted by a local exchange carrier ...that introduces a new service or a restructure unbundled basic service element (BSE) ...must be accompanied by cost data sufficient to establish that the new service or unbundled BSE will not recover more than a reasonable portion of the carrier's overhead costs.

51. The fax went on to say "ONA Rules - CC Docket 89-79, paras. 38-44 (See attached)." The fax included copies of this FCC Order and an explanation of the ONA New Services Test rules. Page 2 continued with questions that the working group would review in its April 8, 1997 meeting/conference call. The list of questions reads:

> 1. Does the FCC require the new services test to be applied to the Smart PAL, Basic PAL, and unbundled features (ASLS, CUSTOMNET, BNS)?
> 2. Is the cost support filed with the states equivalent to the federal new services test?
> 3. Do all the states require "cost based" filings?
> 4. When were the PAL lines and features tariffed in each state?
> 5. The APCC has been contacting state regulators and informing them that the FCC's 4/4 Order requires the retariffing of the Basic and Smart PAL. How would the new services test impact those services? Would rates have to be revised?
> 6. Would the states oppose the FCC's new services test requirement?
> 7. Would the states sign a letter that says that USW's rates meet the FCC's new service test, if we can provide that information? Could this be done before 4/15?
> 8. How long would it take to retariff the PAL lines and the features in the states?
> 9. If retariffing is required, would there be a revenue impact? If so, what is it?

52. In Exhibit D of this declaration is a spreadsheet analysis entitled "SmartPAL (Coin Line) Price Development Matrix, Monthly Recurring Cost and Price for Message

and Flat Service."[39] The spreadsheet has fifteen columns that list the fourteen states in the Qwest region with Idaho split into two for the southern and northern study areas. The spreadsheet lists the Basic PAL long run incremental costs and existing rates and the Smart PAL long run incremental costs and proposed rates. This spreadsheet was prepared using the current TSLRIC studies[40] at that time for Public Access Line services used by Qwest in support of its prices before investigations by state commissions for previously existing Basic PAL services and to support prices for the new Smart PAL service. The spreadsheet was developed as a guide for consideration of the price of the Smart PAL service.

53. The spreadsheet lists costs and tariff prices for Qwest's Basic PAL service and its new Smart PAL service. Qwest offered Basic PAL and Smart PAL on a Measured, Message and a Flat rate basis. The Measured and Message rate bases have a variable charge dependent upon usage, that is, the number of messages or completed calls in a billing cycle. The Flat rate basis has a non-variable charge that is assessed regardless of the usage. The Flat, Measured and Message rates were not each available in all states or in all areas served by Qwest. In some cases the existing PAL rates were set by state commissions at the same price as basic business service, (e.g., Iowa and Minnesota) and

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[39] This spreadsheet was provided to the group that met on April 8, 1997 on the conference call discussed by Ms. Glenda Weibel. The Time and Date on this spreadsheet is "4/7/97 6:05 PM".

[40] Qwest has copies of all fourteen state Smart PAL TSLRIC studies and five of PAL TSLRIC studies used for this analysis. Since Smart PAL TSLRIC studies are identical to PAL TSLRIC studies with some additional elements, all TSLRIC values for both PAL and Smart PAL are contained in these studies.

in some states the commissions set the price of PAL at higher levels to reflect higher costs to provide PAL services.[41]

54. For simplicity, my explanation centers on the Basic PAL Flat calculation for the New Services Test that was explained in this spreadsheet. As I have explained earlier in this Declaration, the tariff monthly rate in Arizona was $42.31 in April 1997. Qwest's Long Run Incremental Direct Cost for that service was a monthly cost of $29.01. The difference between the rate and the cost to cover common overhead is $13.30. This $13.30 difference as a percent of cost is 45.85%. The difference between the Smart PAL cost and proposed price was $14.64 with the same percent common overhead as the Basic PAL service.

55. The New Service Test analysis that Qwest undertook was to compare 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. Viewing that amount as a percentage of cost allowed for a test of reasonableness of the price. Subsequent analyses

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[41] The practice of setting PAL rates comparable to basic business service seemed to be common place in the country in 1997. It was often the level espoused by the payphone providers as a reasonable rate, but also it was often the rate approved by the state commissions. For example, in the Colorado payphone proceeding evidence was provided that historically, the Florida commission had set the flat PAL rate at the level of basic business for Bell South at a range of $19.80 to $29.10; Georgia at $45.00 for Bell South; and SBC Texas with a range of $20 to $28.

in April of the New Services Test added the federal subscriber line charge ("SLC") to the revenues derived from the service.[42] Because TSLRIC PAL studies are conducted without consideration of the jurisdictional assignment of accounting costs (what is termed "un-separated"), forward-looking costs are recovered from rates charged primarily from intrastate tariffs, both also from Qwest's interstate common-line access tariff (i.e., the SLC). The SLC was included as additional revenues with the PAL rate in Qwest's NST review which increased the percent of common overhead recovered from payphone providers.

56. In its Reply to Petitions to Suspend and Investigate (Qwest's payphone services tariff filing at the FCC),[43] Qwest provided a response to payphone providers' criticisms of Qwest's prices for its new payphone feature service *Answer Supervision Line side* (AS-LS) services.[44] Qwest stated that:

> "In the states, costs for AS-LS were calculated on an Average Direct and Shared Residual Costs ("ADSRC") basis. The most recent recurring cost studies in the states had a range of costs from \$1.2253 in Montana to \$2.0390 in Colorado. Using the ratio of price to lowest cost (\$3.95/\$1.23 = 3.21) or the ratio of price to highest cost (\$3.95 / \$2.04 = 1.94), the rates approved in the states are clearly not outrageous, as suggested by APCC...."[45]

[42] The federal line charge for multi-line businesses was charged for each Public Access Line.
[43] *In the Matter of U S WEST Communications, Inc., Tariff F.C.C. No. 5,* Transmittal No. 823, dated February 24, 1997.
[44] The price for Answer Supervision Line side service was allowed to become permanent by the FCC and is the price for this service in Qwest's current tariff.
[45] "ADSRC" is another term for TSLRIC that was used by Qwest at this time.

Thus, the FCC found a range of price to cost ratios of 1.94 to 3.21 to satisfy the NST – or, in other words, a common overhead allocation between 94% to 221% was compliant with the NST.[46]

57. This description of the cost to price analysis is the same as the analysis Qwest undertook for the Basic and Smart PAL services. Like the New Service Test ratios for AS-LS, the ratios for Basic flat rated PAL service varied by state and ranged as follows:[47]

State	NST Ratio	Price/Cost	Margin (Common Overhead %)
Arizona	1.96	($48.31 / $24.63)	$23.68 (96.14%)
Colorado	2.28	($52.63 / $23.02)	$29.61 (128.63%)
Iowa	1.65	($32.84 / $19.82)	$13.02 (65.69%)
Idaho	1.02	($30.07 / $29.55)	$00.52 (01.76%)
Minnesota	2.03	($64.74 / $31.86)	$32.88 (103.20%)
Montana	1.24	($43.40 / $35.07)	$08.33 (23.75%)
Nebraska	2.34	($47.50 / $20.32)	$27.18 (133.76%)
New Mexico	2.00	($63.14 / $31.62)	$31.52 (100.00%)
N. Dakota	1.61	($35.81 / $22.23)	$13.58 (61.08%)
Oregon	2.46	($48.22 / $19.57)	$28.65 (146.40%)
S. Dakota	1.59	($39.94 / $25.05)	$14.89 (59.44%)
Utah	2.55	($42.02 / $16.49)	$25.53 (154.82%)
Washington	1.74	($30.66 / $17.63)	$13.03 (73.91%)
Wyoming	2.25	($36.56 / $16.20)	$20.36 (125.68%)

[46] Report No. CCB/CPD-30, Release Number DA 97-806, FCC, April 15, 1997, The "Competitive Pricing Division of the Common Carrier Bureau has reviewed the petitions to reject and the petitions to suspend and investigate the tariff transmittals listed in this Report. We conclude that none of the parties filing petitions against the tariff transmittals listed in this Report have presented compelling arguments that these transmittals are so patently unlawful as to require rejection. Similarly, we conclude that none of these parties have presented issues regarding these transmittals that raise significant questions of lawfulness which require investigation of the tariff transmittals list in this Report."

[47] From the Couture worksheets, 5/14/97, price is PAL rate plus the CALC (SLC). Montana, New Mexico, and Oregon are Measured PAL, the remaining states are Flat rate PAL.

58. These New Service Test ratios indicate that the prices that covered from 2% (Idaho) to 155% (Utah) of the direct cost recovered in the price of the Basic PAL service. This is an NST ratio range of 1.02 to 2.55. Using the Answer Supervision Line side service New Service Test range that was ultimately accepted by the FCC (1.94 to 3.21), the range of price to cost for Basic PAL appeared satisfactory to the Qwest team that conducted the New Services Test. The weighted average of these price/cost ratios is 98.01% common cost as a percent of direct cost.

59. On June 13, 1997, the FCC provided additional guidance as to what a "reasonable" allocation of common overhead would be in its Second Report and Order, in CC Docket No. 93-162, *In the Matter of Local Exchange Carriers' Rates, Terms, and Conditions for Expanded Interconnection Through Physical Collocation for Special Access and Switched Transport*. In Appendix D of this Order, the FCC allowed NST ratios from 1.00 to 4.18, or common overhead allocations of zero to 318%.[48] The NST ratios that Qwest calculated in May 1997 that ranged from 1.02 to 2.55 fell into this range allowed by the FCC.

60. In October, 1997, the FCC provided additional information on the application of the NST to payphone rates. In its Memorandum Opinion and Order, adopted October 27,

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[48] This is the same Order that the FCC references in its Wisconsin Order as a guide for reasonable common overhead allocations for the NST.

1997, *In the Matter of Local Exchange Carriers' Payphone Functions and Features; Bell Atlantic Telephone companies Revisions to Tariff F.C.C. No. 1; GTE System Telephone companies Revisions to Tariff F.C.C. No. 1; GTE Operating Companies Revisions to Tariff F.C.C. No. 1,* the FCC noted that the overhead allocation of 38% of direct costs was not "unreasonable" and that the payphone association did not "object to this rate".[49] The FCC also noted that:

> Bell Atlantic's ratio of rates to direct costs for payphone features range from a low of zero times greater than the direct costs to a high of 3.4 times greater than the direct costs while the ratio of rates to direct costs for the payphone features offered by other LECs ranges from a low of zero times greater than the direct costs to a high of 4.8 times greater than the direct costs.

61. In this same docket, the payphone association was quoted by the FCC: "APCC sees no reason why overhead loading allocations should exceed 30 or 40 percent of the direct costs."[50] However, a ratio for GTE's rates for a payphone feature, "a rate to direct cost ratio of 2 (rates are two times greater than its direct costs for this service)" were found by the FCC to not be unreasonable.[51]

62. Between July 1997 and July 1998, Qwest filed eleven tariff transmittals to the FCC seeking changes to its federal tariff to add new services. In all of these transmittals,

[49] Footnote 39, for prices for interLATA dialing service.
[50] Id. at 20.
[51] Id. at 22.

Qwest provided a price/cost ratio for these new services. The lowest price/cost ratio was 1.12 (Transmittal 858, Originating Line Number Screening service, Aug. 1, 1997) and the highest price/cost ratio was 29.41 (Transmittal 872, Frame Relay Priority PVC service, Oct. 10, 1997), with many of the new services with a price/cost ratio that exceeded the ratios for Qwest's PAL service. None of these filings were rejected by the FCC.

63. In summary, in the April to May 1997 period, Qwest was diligent in its attempts to determine whether its rates complied with the New Services Test. It used the best information available to determine the reasonable level of common overhead that would be allowed under the NST plus its direct costs. FCC guidance in June 1997, October 1997, and later did little to change Qwest's view that its rates complied with the NST.

AFTER 1997, STATE COMMISSIONS RECEIVED PAL TSLRIC INFORMATION FROM QWEST IN FILINGS AND RATE INVESTIGATIONS

Colorado

64. On January 24. 1996, the Colorado Payphone Association ("CPA") filed a complaint against Qwest which challenged its PAL rates. The Colorado Public Utilities Commission ("CPUC") opened Docket No. 96F-035T to investigate the complaint. This

docket was settled with a stipulation between Qwest and the CPA. The CPUC, based on a request from the CPA on March 14, 1997, closed that docket on April 4, 1997.[52]

65. On March 31, 1998, the Colorado Payphone Association ("CPA") filed a formal complaint with the Colorado Public Utilities Commission ("CPUC") against Qwest. On April 29, 1998 Qwest filed an answer. On May 6, 1998, the Staff of the Colorado Public Utilities Commission ("Staff") petitioned to intervene. Hearings were held by the CPUC on June 11, 1998 and July 22, 1998.[53]

66. The Staff filed a Statement of Position September 4, 1998, stating the following:

> Staff's position is that the rates charged by U S WEST are approved by the Commission and in compliance with the law....
>
> The gravamen of the complaint is that the rates charged by U S WEST to the CPA business members are in violation of the FCC pricing standards, promulgated pursuant to the authority granted the FCC in § 276 of the Act. Therefore, the primary issue before the Commission in this proceeding is whether the rates charged by U S WEST are in violation of the FCC pricing rules. It is the position of Staff that the rates approved by the Commission and charged by U S WEST to the CPA members are just and reasonable and are in compliance with applicable law....
>
> The FCC pricing standard referred to in the Order on Reconsideration (FCC 96-439) is called the new services test. The new services test

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[52] The Colorado Payphone Association filed intervention into Docket No. 96S-331T where it requested and Qwest, on January 10, 1997, provided copies of its 1995 and 1996 TSLRIC studies for PAL services. The Colorado Commission staff was presented with copies of these studies at this same time.

[53] Before the Public Utilities Commission of the State of Colorado, Docket No. 98F-146T, *Colorado Payphone Association, a Colorado Non-profit Corporation, Complainant, v. U S WEST Communications, Inc., Respondent.*

> requires that rates be based on direct costs plus an appropriate, just and reasonable level of overhead costs....
>
> It is a position of Staff that the rates currently charged by U S WEST to CPA have been approved by the Commission in a number of dockets, and have been found to be appropriate, just and reasonable....
>
> The Commission found that the rates approved in 544T were just, reasonable and supported by the cost based evidence....
>
> The Commission has again recently examined and approved the PAL rates charged by U S WEST to independent payphone providers. The hearing in Docket No. 96A-331T involved extensive testimony regarding U S WEST's costs.

67. In the Recommended Decision of Administrative Law Judge William J. Fritzel Denying Requested Relief and Dismissing Complaint mailed November 20, 1998, the Judge concluded:

> ...The FCC in its payphone orders developed a four-part test to ensure that the goals and stated purpose of § 276 would be implemented. The allegations of CPA that U S WEST has not complied with the four-part test is not supported by the record of evidence. The record establishes that U S WEST has complied with the four-part test: (1) U S WEST's basic PAL rates are cost based, and approved by the Commission in Decision No. C91-1128; (2) the PAL rates are non-discriminatory in that they are tariffed rates applicable to all payphone providers including U S WEST's payphones Division; (3) the rates are consistent with the requirements of § 276; and (4) the rates comply with the new services test since the record demonstrates that the rates are based on direct costs plus a reasonable level of overhead costs.

68. Upon review by the CPUC, the CPUC reached the following conclusion:

We are not required to apply 96S-331T[54] determinations here, and we find it would be inappropriate to do so. We do, however agree with CPA that the record demonstrates that payphone service rates should be reduced to implement the pro-competitive provisions of § 276….

USWC asserts—and we agree—that the FCC's mandates concerning the pricing of payphone service provide for substantial flexibility and discretion on the part of the Commission. The FCC requires that payphone prices exceed direct costs and include a reasonable level of overhead costs. Consistent with that flexibility, the FCC has approved a wide range of price to cost ratios under the methodology applicable to payphone service (i.e., the new services test).

USWC presented a fully allocated cost study[55] for payphone service (Exhibit 11) in this docket. That study provides sufficient information for us to conclude that USWC's payphone charges should be reduced. The study indicates that existing payphone service rates include a substantial mark-up over fully allocated costs. USWC and Staff argue that these significant mark-ups are justifiable as a contribution necessary to maintaining the affordability of basic service rates, particularly residential rates. State and Federal enactments encourage the removal of implicit subsidies (to basic service) like these from telephone utility rates.
We conclude that the price to cost ratios for PAL service, as indicated in USWC's fully allocated cost study, are excessive. We further observe that PAL service provides a virtually identical functionality as business basic exchange service. Given these considerations, we will direct USWC to reduce PAL charges to those applicable to two-way trunks. This reduction reflects a fair and reasonable modification of PAL rates for purposes of this docket….

Additionally, if the FCC issues future specific directives regarding the pricing of payphone service, USWC will be directed to submit appropriate and timely filings with this Commission to comply with such directives.[56]

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[54] 96S-331T refers to the docket where the CPUC established UNE price levels pursuant to Section 251 and 252 of the Telecommunications Act of 1996.
[55] The CPUC's reference to "fully allocated cost" is a term used by Qwest in its TSLRIC studies to calculate an amount of common overhead to be used in circumstances where the regulator requires at least a minimum amount of common overhead in a retail price floor.
[56] Decision Granting Exceptions, Public Utilities Commission of the State of Colorado, Docket No. 98F-146T, Decision No. C99-497, Adopted May 4, 1999.

69. In its Decision Denying Applications for Rehearing, Reargument, or Reconsideration, and Granting Requests for clarification and Extension of Time,[57] the CPUC made the following statements:

> CPA contends that the Decision should be modified to require refunds of excessive charges paid by PAL customers retroactive to April 15, 1997 the date by which USWC was required to implement new PAL rates under directives issued by the Federal Communications Commission ("FCC"). CPA argues that USWC's rates became unlawful on the date it failed to comply with FCC rules. Therefore, refunds and reparations for unlawful charges are required retroactive to the date the rates became unlawful, April 15, 1997. We disagree.
>
> As noted in the Decision, paragraph 14 (page 9), the challenged rates were previously approved by the Commission. We further observe, as CPA concedes, that USWC refile its PAL rates with the Commission in accordance with the FCC's rules. The refiled rates were the same as the then existing ones. Because USWC has been charging rates specifically approved by us, we will not require refunds in this case either pursuant to our own authority under state law or even when acting under the FCC assigned review function because of the questions raised in this docket regarding the appropriate cost-to-price ratios under the FCC guidelines.
>
> The critical, but mistaken, premise of CPA's argument for refunds is that the Decision held that USWC's PAL rates violated 47 U.S.C. § 276 and attendant regulations. However, we did not make such a finding in Decision No. C99-497. Nothing in the Decision indicates a determination that USWC violated any federal mandate. We simply concluded that it is appropriate to decrease PAL rates in light of the pro-competitive purposes of § 276 and our determination that the present cost-to-price ratios for basic PAL service were excessive. In doing so, we noted in Decision No. C99-497 the wide latitude in the cost-to-price ratios previously employed by the FCC. As such, we do not find our decision imposes requirements

[57] Decision No. C99-765, Adopted July 14, 1999, copy attached.

> on payphone service pricing that are inconsistent with the FCC guidelines. For these reasons, we deny the application for RRR on this point.
>
> CPA next contends that we should set PAL rates according to the business basic exchange rate (e.g., 1FB); not the two-way business trunks. We reject this suggestion....
>
> Finally, CPA apparently argues that PAL rates should not include the $9 end-user common line ("EUCL") charge. We disagree. The EUCL is a federally mandated charge that, as stated by CPA in its applications for RRR, provides a contribution to USWC non-traffic sensitive costs. Until the FCC provides further specific guidance on this issue, it is fair and equitable that PAL subscribers, like other telephone customers, contribute to the recovery of the cost of the telephone network through such charges. In essence, the CPA argument on this issue is another version of the argument that the cost-to-price ratio is inappropriately set under the FCC guidelines. In this instance, we have determined that the cost-to-price ratios yielded by the modified PAL rates are just and reasonable, even with inclusion of the EUCL. Therefore, this argument is rejected.

70. It is clear that the CPUC found that Qwest had submitted TSLRIC cost studies for its PAL services.[58] It is also clear that the CPUC found that the modified rates met the FCC New Services Test. It is also clear that the CPUC believed that Qwest's PAL rates prior to the modification were not in violation of the New Services Test. The CPUC believed that the FCC had approved a wide range of price-to-cost ratios and that it was given the ability to use its discretion in determining what a reasonable common overhead would be.

[58] Qwest has copies of the PAL and Smart PAL TSLRIC studies.

71. With regard to the proper disposition of the federal end-user line charge (EUCL)[59], the CPUC rejected the CPA argument that the EUCL be subtracted from the approved level of cost, and selected the method that considers the EUCL as a price that is combined with the PAL price in the price-to-cost ratio. For example, if the cost of PAL was $20.00 and the intrastate price of PAL is $30.00, the price-to-cost ratio would be 1.5:

$30.00 divided by $20.00 = cost-to-price ratio of 1.5

If the PAL purchaser also pays a federal price, in addition to the state price, of $9.00, the PAL purchaser pays $39.00 in total. If this combined price level is compared to the cost, the cost-to-price ratio is 1.95:

$30.00 + $9.00 =$39.00 and $39.00 divided by $20.00 = 1.95 cost-to-price ratio

The CPUC agreed with this methodology instead of the CPA proposed methodology that treated the federal price, $9.00 in this illustration, as a recovery of cost. With this alternative methodology, the $9 federal charge is considered a recovery of cost, or $20 less $9, rather than additional revenue. With this method the cost-to-price ratio becomes:

$30.00 divided by $11.00 ($20.00 minus $9.00) = 2.73 cost-to-price ratio

The CPUC did, however, indicate that "until the FCC provides further specific guidance on this issue", this approach was "fair and equitable."

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[59] The federal end-user line charge (EUCL), also known as Customer Access Line Charge (CALC) or Subscriber Line Charge (SLC), is a rate assessed to each access line provided by Qwest. The tariffed rate varies by: residential and business customers; by state; by single or multiple lines at a location; and is updated and reset up or down to new levels each year. Colorado, for example, had rates for multi-line business lines as follows- 1997 $6.00, 1998 $9.00, 1999 $9.20, 2000 $9.01, 2001 $9.20, 2002 $8.80.

Iowa

72. On March 22 and 25, 1999, Pay Phones Concepts, Inc., filed complaints with the Iowa Utilities Board ("IUB"). The complaint alleged that incumbent telephone companies, including Qwest, had PAL rates that did not comply with the FCC's New Service Test. On April 23, 1999 the IUB initiated an investigation into the allegation. The IUB asked for comment and information from Qwest and other LECs in Iowa. Qwest offered statements that it complied with the FCC's New Service Test. GTE stated that its PAL rates, which were set by the IUB at basic business rates like all LECs in Iowa, were actually below cost. The IUB issued an Order on June 10, 1999 concluding that there was "no reasonable basis for further investigation of the general complaints", but that the complainant could file specific complaints against specific LECs within 14 days. The IUB terminated the generic investigation and invited Pay Phone Concepts to file individual complaints against specific LECs. The IUB concluded:

> Each of the rate-regulated LECs has made at least a *prima facie* showing that its existing rates for a pay telephone line are consistent with the applicable FCC requirements and with Board rules that require rate-regulated LECs to price pay phone lines at their existing business line rates. The Complainant has not advanced any real challenge to those rates, beyond a non-specific and unsupported request that the Board force the carriers to conduct proceedings that would essentially be single-service rate cases. There does not appear to be any reasonable basis for further investigation.[60]

Nebraska

[60] Order Terminating Investigation, *In Re: Payphone Services*, Docket No. INU-99-1, Issued July 30, 1999.

73. The Nebraska Public Service Commission ("NPSC") initiated Docket C-1519 in response to the joint petition of AT&T and MCI asking the NPSC to determine compliance of Nebraska companies with the FCC payphone orders. In this proceeding the NPSC served a data request on each company asking for responses by May 19, 1997. A series of the requests were "(a) Has your company filed General Exchange tariffs for basic payphone line services, for "dumb" and "smart" payphones? (b) Provide the monthly rates for coin line service and coin supervision which have been established as a result of the deregulation of pay telephone service. (c) Provide a description of how the rates filed under part (b) were determined, i.e., what type of cost study was performed?" Qwest responded to the request on May 19, 1997 with information that described the pricing process that it developed for Smart PAL service using the cost and prices of the Basic PAL service. In a subsequent investigation, Docket No. C-2112/PI-30, the NPSC requested the following information from Qwest:

> A description and explanation of the processes, rules, or precedent that US West employs or follows as it allocates fixed or common costs related to the provisioning of payphone service, in general, and specifically to Nebraska, and Iowa. Provide the most recent cost study prepared to establish rates in Nebraska and Iowa. The cost study should be detailed and include a description of the cost studies used to price payphones in each state, basic costs allocated to the provisioning of payphones and any differences in the cost-based assumptions that would explain to this Commission why US West charges substantially higher rates for those lines in this state than it does in the state of Iowa.[61]

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[61] *In the Matter of the Commission, on its own motion, to conduct an investigation into specific areas of concern in the provisioning of payphones in the state of Nebraska*, Application No. C-2112/PI-30, April 18, 2000.

Qwest responded to the request with its TSLRIC studies. On May 4, 2004, the NPSC concluded its investigation and noted that it requested input from the local companies on the FCC's New Services Test, costs, pricing of PAL services, and comparisons to UNE costs and prices. With regard to Qwest's payphone rates, the NPSC stated that it "devoted particular review and focus on [Qwest's] filed payphone rates." The NPSC concluded that Qwest's payphone rates (i.e., in effect as of May 4, 2004) were "indeed competitive and appropriate."

Oregon

74. In 1990, the Oregon Public Utility Commission ("OPUC") initiated a proceeding to investigate the costs of providing telephone service. In its Order No. 90-920, the OPUC mandated that a series of workshops be conducted to develop methods for incremental cost studies to be used by Local Exchange carriers such as Qwest. A series of workshops were held between 1990 and 1993 that resulted in the OPUC adopting seven cost principles and adopting cost studies submitted by Qwest.[62] On July 5, 1994 the OPUC adopted revisions to Qwest's cost studies. At that time the OPUC directed that efforts related to further development of cost studies be continued. On December 9, 1994

[62] Order No. 93-1118, Issued August 10, 1993.

the OPUC issued Order No. 94-1851 that adopted new procedures for cost studies for unbundled network elements that would be based on the cost work that had been accomplished since 1990. On September 29, 1995 Qwest filed cost studies in compliance with Order No. 94-1056 which established Docket No. UM 773. After several workshops reviewing Qwest's TSLRIC/Building Block studies, a stipulation was reached with the Oregon commission staff that "the cost models filed by U S WEST in this matter conform to the cost principles in UM 351 and that the building block cost studies will be used in the rate design portion of docket UT 125." On November 1, 1996, the OPUC concluded:

> The Commission has examined the Stipulation and the specific and general arguments for and against it. We have also considered the recommendations by the opposing parties as to how we should treat the Stipulation. As we have discussed throughout this order, we conclude that the provisions of the Stipulation will lead to the development of sound cost estimates. We conclude that the Stipulation is in the public interest and should be adopted in its entirety.
>
> We note that the 1996 Telecommunications Act may have implications for the policies we have adopted in this order. We direct that cost and rate issues relating the Act and the FCC rules adopted pursuant to the Act be addressed in UT 125.[63]

Qwest participated in Docket No. UT 125 for the next several years.

[63] Docket No. UM 773, Order No. 96-284, *In the Matter of U S WEST Communications, Inc.'s UM 351 Cost Study Summaries, November 1, 1996.*

75. In Docket UT 125/UT 80, the OPUC approved Qwest's rates on September 14, 2001.[64] In this proceeding the Northwest Payphone Association ("NWPA") argued that Qwest's PAL prices and other payphone prices were not developed using the FCC's New Service Test. The OPUC concluded:

> Payphone Rates and New Services Test. For payphone service rates, we first address NWPA's arguments that Qwest must set rates consistent with the new services test and the FCC's four part test. We note that the FCC's test requires that payphone rates be cost based, consistent with Section 276 (that is, must encourage deployment of payphones), nondiscriminatory, and consistent with Computer III guidelines (that is, must pass the new services test). The new services test requires that rates be cost based with reasonable overhead. Therefore, the test really states that rates be cost based, nondiscriminatory, and consistent with increasing competition for payphones.
>
> NWPA asserts that in order to comply with the new services test, Qwest must submit studies and cost data. We disagree. We find NWPA's reading of FCC requirements to be overly formal. The FCC requires only that rates be cost based and in compliance with the new services test. The new services test requires a showing that rates for a service include direct costs and reasonable overhead. Beyond that, the FCC has not specified what kind of evidence is necessary to determine whether PAL rates satisfy the new services test.
>
> We conclude that UM 773 costs are a reasonable approximation of direct costs. Qwest has used UM 773 costs to figure its direct costs. Qwest's rates for payphone services range from 26 percent to 91 percent above direct costs. Like the FCC, we find that the cost to price ratio is sufficient to allow us to infer the overhead on payphone rates. Payphone Features Order at ¶ 6. Further, we find that this overhead is reasonable. As Qwest has pointed out, the FCC and state commissions have determined that a range of overhead loading up to 4.8 times direct costs is reasonable.

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[64] *In the Matter of the Application of U S WEST Communications, Inc (QWEST CORPORATION)., for an Increase in Revenues*, UT 125/Phase II Rate Design, Order No. 01-810, Entered September 14, 2001.

> We agree with Qwest's arguments about the meaning of cost based rates. This phrase does not mean that rates must be set at cost. This conclusion renders moot NWPA's arguments about the inclusion of contribution and market driven return. We conclude that Qwest's PAL rates satisfy the new services test.

76. By 1996, after six years of investigation, the OPUC had accomplished the most exhaustive examination of TSLRIC principles and studies that had been undertaken in the United States. The concepts and details of the Oregon building blocks of telecommunications costs were the proto-type for cost proceedings that spread across the country following the FCC's First Report and Order in CC Docket No. 96-98 and CC Docket No. 95-185, Released August 8, 1996. When Qwest utilized the TSLRIC costs and the common overhead allocations that had been approved by the OPUC to set its PAL prices it was complying with the directions of the OPUC.[65] Like other state commissions, the OPUC was knowledgeable about the FCC's Payphone Orders and the New Services Test and without additional guidance from the FCC, the OPUC used its best judgment to conclude that Qwest's PAL rates were in compliance with the FCC's New Services Test in 2001.

77. The NWPA filed an application for reconsideration, which was denied by the OPUC on January 8, 2002. The NWPA then filed an appeal of OPUC's denial. The Oregon Court of Appeals reversed and remanded OPUC's 2001 Order that found Qwest's

[65] Qwest has a copy of the Smart PAL TSLRIC study.

PAL rates complied with the new services test.[66] On remand in 2007, the OPUC approved new PAL rates that were agreed upon in a joint stipulation by Qwest, the NWPA and the OPUC staff and found that these rates complied with the new services test.[67]

Washington

78. On April 16, 1997 MCI and AT&T filed a formal complaint that Qwest had not complied with the FCC's Payphone Orders. The basis of AT&T and MCI's complaint was that Qwest's intrastate access rates were set to provide an implicit subsidy to Qwest's payphone operations. The Washington Utilities and Transportation Commission ("WUTC") opened Docket No. UT-970658 to address this allegation. The WUTC ordered the parties to provide testimony and witnesses in the investigation. Qwest filed direct testimony in this proceeding with TSLRIC cost studies on January 20, 1998.

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[66] 776 100 P.3d 776, 196 Or.App. 94, Decided November 10, 2004. The appellate court acknowledged that it was required to base its decision on the facts as they exist at the time of the appellate decision, not at the time the OPUC made its decision. Therefore, the appellate court had the ability to know the details of the FCC's Wisconsin Order, when the OPUC did not have that Order when it reached its decision on the NST.

[67] Docket No. UT 125, Order No. 07-497, Entered November 15, 2007.

79. The WUTC ultimately rejected Qwest's analysis of subsidy in the AT&T/MCI complaint using its TSLRIC PAL studies and approved an accounting based analysis proposed by the WUTC staff.[68]

Wyoming

80. In 1995, Wyoming passed legislation known as the Wyoming Telecommunications Act of 1995 ("1995 Act"). The new law eliminated traditional rate-of-return regulation for telecommunications companies and replaced that regulation with cost based regulation using Total Service Long Run Incremental Costs. Wyoming Statutes, Section 37-15-402 Cost based pricing reads as follows:

> (a) Services provided by a telecommunications company that provides noncompetitive services shall be priced to ensure that the service's revenues from sale of the service recover the total service long-run incremental cost of providing that service, except as provided in this section. Total service long-run incremental cost studies used by a telecommunications company shall be filed with the commission every three (3) years unless required by the commission more frequently. All total service long-run incremental cost studies required pursuant to this section shall be filed in the form required by commission rule and under protective order as a trade secret and shall be subject to commission review and approval....
>
> (b) For those existing prices for essential and noncompetitive telecommunications service below the service's total service long-run incremental cost as of the effective date of this act; notwithstanding the provisions of W.S. 37-15-403(a), and to avoid significant one-time price increases to customers, essential and noncompetitive telecommunications

[68] Docket No. UT970658, Fourth Supplemental Order. This proceeding did not deal specifically with Qwest's PAL rates, but the WUTC thoroughly reviewed Qwest's PAL TSLRIC studies in its analysis.

> service prices which are below total service long-run incremental costs may move over a thirty-six (36) month period to a level, so that at the end of that period the price of each noncompetitive telecommunications service covers its required cost.

81. Qwest filed its application for implementation of the 1995 Act with the Public Service Commission of Wyoming ("PSCW") on June 23, 1995. In that application Qwest filed testimony and its TSLRIC studies as required by the 1995 Act. The PSCW opened Docket No. 70000-TR-95-238 to investigate Qwest's filing. Public hearings were held on October 9, 1995 when Qwest and the Consumer Advocate Staff ("CAS") submitted a Stipulation and Agreement to the PSCW for consideration. All parties except AT&T, TCI (the local cable TV company's parent), and WTCI (a Wyoming carrier of long distance telephony), supported the settlement. Qwest and CAS submitted that:

> Use of U S WEST's TSLRIC studies in Phase I is appropriate and that an appropriate TSLRIC methodology can be established after the promulgation of Commission rules on this issue, at which time the price floors proposed to be implemented in Phase I can be modified to comply with the rules, if necessary.
>
> Common overhead cost must be recovered in addition to TSLRIC costs in the pricing of services for a company to remain financially viable. Pricing all services at their respective TSLRIC costs will put the Company out of business. Common overhead costs are not reflected in the TSLRIC studies but are recovered through the pricing process (Tr. p. 322).

82. The PSCW approved the rates proposed in the settlement and utilized Qwest's TSLRIC studies. The PSCW concluded:

> The Commission finds that the results of the U S WEST TSLRIC studies are acceptable as an initial guide, particularly within the context of this filing which constitutes the first step of the transition to cost-based pricing.

> As estimates, the TSLRIC studies need not be viewed as precisely accurate, but rather reasonable in magnitude. The Commission does not believe it necessary to argue about minor aspects of a particular cost study and ignore the fact that the cost studies can be used as guides in determining the direction and the magnitude of the rate rebalancing process and price flexibility.

83. The prices for PAL that were set in Docket No. 70000-TR-95-238 were in place in 1997 when Qwest applied the FCC's New Services Test to its PAL rates.[69] Since these rates were based on TSLRIC studies pursuant to Wyoming law, Qwest believed the PAL rates to be cost based.

84. On April 26, 1999, Qwest filed a Price Plan in Docket No. 70000-TR-99-480. The Price Plan proposed new prices for the majority of Qwest's services. These prices were supported by TSLRIC studies performed in accordance with the PSCW's TSLRIC rules that were established in Docket No. 70000-TT-97-378 in 1998.[70] The PSCW approved Qwest's rates in the Price Plan and concluded:

> Regarding the prices for services themselves, as stated in Section V of the Consumer Advocate Staff Stipulation and in Attachment 1 thereto, all of the evidence presented to us by U S WEST and the Consumer Advocate Staff, discussed, *supra*, goes to demonstrate the reasonableness of the prices found in the Consumer Advocate Staff Stipulation. They build on Commission-approved depreciation rates and on the Commission-approved TSLRIC study which provides an excellent and comprehensive view of the U S WEST cost situation. They deaverage U S WEST's local

[69] Qwest has copies of the PAL and Smart PAL TSLRIC studies.
[70] With these new rules, the TSLRIC (plus shared direct costs) for Qwest's PAL service was determined to be $27.36 on a statewide average basis and a price of $30.56, resulting in a price cost ratio of 1.12.

> exchange service and other prices and bring U S WEST into full compliance with the TSLRIC pricing requirements of the Wyoming Telecommunications Act of 1995. The prices are not set exactly at the determined TSLRIC levels, but the only requirement of the Act is that they each be above those levels. If a company were forced to price at TSLRIC, it would, in our opinion, go quickly out of business, and that is not an outcome envisioned by the Act.[71]

85. The PSCW noted that the contribution levels, or the difference between the TSLRIC and the price of business service was around 40% of the TSLRIC level. With the Federal CALC and the Federal USF price credit the ratio changed to closer to 50%. The PSCW concluded that the price of Qwest's PAL services constitutes "well reasoned and proper applications of the Act and the evidence to reach an acceptable pricing result."[72]

86. During the period 1997 through 1998, many state commissions were investigating payphone rates of the Bell Operating Companies.[73] State commissions in Qwest's fourteen states were no different. In summary, Qwest's 1997 PAL rates were set by 11 of its state commissions with their use of TSLRIC studies (Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, New Mexico, Oregon, Utah, Washington, and Wyoming) and were therefore, cost based. Qwest filed TSLRIC studies for PAL or Smart PAL in 1996 or 1997 with 10 of its state commissions (Arizona, Colorado, Idaho, Minnesota, Montana,

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[71] Docket No. 70000-TR-99-480, Record No. 4868, dated September 16, 1999, at 135.
[72] *Ibid.*, at 141.
[73] During the Colorado payphone investigation, evidence was provided that Maryland, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia, Delaware, North Carolina, Florida, Alabama, and Arizona all had current investigations in progress.

New Mexico, South Dakota, Oregon, Utah, and Washington). Qwest responded to state commission investigations into its PAL rates in three states where the commissions dismissed the complaints (Iowa, South Dakota, and Utah). In 4 states, public utility commissions investigated Qwest's PAL rates and concluded that those rates met the FCC's New Services Test without adjustment (Minnesota, Montana, New Mexico, and Oregon). In Arizona, the state commission adjusted Qwest's PAL rates retroactively to April 15, 1997 and then stated that the rates complied with "all applicable" federal law.[74] In Colorado, the state commission adjusted Qwest's rates slightly on a prospective basis, not because the rate did not meet the NST, but because it felt the common overhead was somewhat excessive.[75] In Nebraska, after a protracted proceeding which reviewed Qwest's TSLRIC studies, the state commission found Qwest's rates that were in effect in 2004 to be appropriate.

[74] The Arizona Corporation Commission lowered the PAL rate to $33.03 with a SLC of $6.00 is $39.03 and a 1996 TSLRIC of $24.63. The price cost ratio was 1.58, or a 58% common overhead allocation. Qwest lowered the Arizona PAL rate in October 1999 to $32.78 and to $31.80 in April of 2002 in general rate proceedings.

[75] The Colorado Public Utilities Commission lowered the PAL rate to $40.79 with a SLC of $6.00 is $46.79 and a 1996 TSLRIC of $23.02. The price cost ratio was 2.03, or 103% common overhead allocation. Qwest further lowered the Colorado PAL rate to $39.75 in November 1999 in a general rate proceeding.

ACTIONS QWEST TOOK AFTER THE FCC WISCONSIN ORDER

87. The FCC issued its *Memorandum Opinion and Order*, In the Matter of Wisconsin Public Service Commission Order Directing Filings, [76]on January 31, 2002. Qwest immediately reviewed the *Wisconsin Order* and decided to join several other companies in an appeal of the Order.

88. Qwest immediately started preparing new TSLRIC studies for PAL services while it awaited the outcome of an appeal of the Order. On March 18, 2002, Qwest received a letter from the Colorado Public Utilities staff referencing the *Wisconsin Order* and inquiring about Qwest's intentions pursuant to the CPUC's Order from 1999 that required Qwest to "submit appropriate and timely filings" should the FCC ever issue "future specific directives regarding the pricing of payphone service." Qwest responded on April 3, 2002 that it was "reviewing its tariffed Colorado PAL rates along with the underlying cost studies in light of the FCC Order." It noted that "part and parcel of this analysis is Qwest's receipt and review of the Commission's final order in the nearly completed Colorado Cost Docket, Docket No. 99A-577T." The CPUC responded on April 24, 2002 with a letter giving Qwest notice of a Show Cause proceeding to investigate the requirements of the *Wisconsin Order*, or alternatively Qwest could file changes to its

[76] *See In the Matter of Wisconsin Public Service Commission, Order Directing Filings*, Memorandum Opinion and Order, 17 FCC Rcd 2051, rel. January 31, 2002 ("*Wisconsin Order*").

rates in compliance with the *Wisconsin Order*. Qwest responded to the CPUC on May 24, 2002 notifying the CPUC it would file its Advice letter on June 14, 2002 complying with the CPUC directives.

89. The *Wisconsin Order* noted that state commissions often used TSLRIC studies "in setting rates for intrastate services. It is consistent with the *Local competition Order* for a state to use its accustomed TSLRIC methodology (or another forward-looking methodology) to develop the direct costs of payphone line service costs."[77] Just as it had in 1996, Qwest prepared TSLRIC studies to determine the current TSLRIC of PAL services.

90. In addition to directions regarding direct costs, the *Wisconsin Order* provided state commissions with three alternatives to determine the amount of common overheads that would be acceptable for compliance with the New Services Test. The three methods were: (1) the same or equivalent common overhead allocation as that allowed in the state Cost Dockets where unbundled network element ("UNE") rates were established; (2) the same or equivalent common overhead allocation as that allowed in the FCC's *Physical Collocation Tariff Order*, and; (3) the same or equivalent common overhead allocation as that allowed in the FCC's *ONA Tariff Order*.

[77] *Id.* at 2066 ¶ 49.

91. Qwest undertook an analysis of each of these three methodologies. The ONA method resulted in common overhead percentages that varied by state from 30% to 42%. The Physical Collocation method, as discussed earlier in this declaration, ranged from zero to 318 %, but was specific to individual carriers. While Qwest's range was from 1% to 33%, Sprint Illinois was 111% to 318%, NYNEX New York was from 32% to 113%, NYNEX Massachusetts was from zero to 217%. The UNE method was mostly impossible to determine due to the manner that state commissions established the UNE prices in Qwest's fourteen state region. State commissions often used multiple cost models from different carriers for different elements and weighted final prices in ways that could not be duplicated by Qwest. Other commissions averaged results from multiple cost models that used significantly different methods of common overhead loadings that made it impossible to tell what common overhead loadings, if any, were included in the UNE prices.

92. Qwest determined that it would use its existing TSLRIC study methodology that included an allocation of common overhead as optional information required under some state commission rules. Qwest referred to this TSLRIC amount as a Fully Allocated Cost ("FAC").[78] The FAC category was frequently displayed in Qwest's TSLRIC studies,

[78] The fully allocated cost was calculated by Qwest and included in its TSLRIC studies to provide a minimum amount of common overhead to be included in the determination of a retail price floor as required by some state commissions.

although not utilized by many state commissions. The percentage common overhead determined with the FAC averaged about 5%. Although the 5% allocation was much less than allowed by the FCC under its three alternatives, Qwest chose to use this method in an attempt to avoid lengthy proceedings before the FCC and/or state commissions over the options for common overhead.

93. In its *Wisconsin Order*, the FCC's directions changed the method used by Qwest, and accepted by its state commissions, on the proper treatment of the federal subscriber line charge, or SLC. This issue had been debated in investigations regarding the price/cost ratio in several proceedings. Prior to the *Wisconsin Order*, state commissions generally agreed that the SLC should be considered a *price* and included with the *price* of PAL on a combined basis. For example, in 1997 the price of the SLC paid by payphone companies was $6.00 in most of Qwest's states. If the PAL rate was $30.00, for example, and the SLC was $6.00, then the payphone company would pay a total of $36.00. If, for example, the TSLRIC was $15.00, then the price/cost ratio was $36.00 / $15.00, or 2.40. The FCC did not adopt this approach, instead, the FCC considered the SLC to be a negative cost, or a reduction in cost. The FCC adopted a method that subtracted the SLC from the TSLRIC and then calculated the price/cost ratio.[79] In the

[79] *Wisconsin Order,* 17 FCC Rcd at 2070 ¶ 61, "At whatever point in time a state reviews a BOC's payphone line rates for compliance with the new services test, it must apply an offset for the SLC that is then in effect."

above example, the TSLRIC of $15.00 would be reduced by the $6.00 SLC to become $9.00. Therefore, the price/cost ratio would increase to 3.33, or $30.00/$9.00, using the same data.

94. Between 1997 and 2002 the multi-line business SLC increased in most of Qwest's states due to FCC decisions to lower carrier-to-carrier charges for access to the local network. The rates changed usually twice a year in this period. The following is a history of the rates by state for the 1997 to 2002 period using the rate in effect in April of each year:

	1997	1998	1999	2000	2001	2002
AZ	$6.00	$9.00	$8.60	$8.25	$8.83	$6.71
CO	$6.00	$9.00	$9.20	$9.01	$9.20	$8.80
IA	$4.69	$7.40	$7.65	$6.63	$7.21	$4.82
ID-s	$6.00	$9.00	$8.67	$7.70	$8.28	$7.09
ID-n	$6.00	$9.00	$9.20	$8.90	$9.20	$8.88
MN	$5.27	$7.45	$6.82	$6.37	$6.95	$4.89
MT	$6.00	$9.00	$9.20	$9.20	$9.20	$9.20
ND	$6.00	$8.69	$8.61	$8.53	$9.11	$8.51
NE	$6.00	$8.90	$7.95	$7.14	$7.72	$6.64
NM	$6.00	$9.00	$9.20	$9.20	$9.20	$9.20
OR	$6.00	$8.98	$9.20	$8.34	$8.92	$7.45
SD	$5.19	$9.00	$8.01	$7.83	$8.41	$7.03
UT	$6.00	$8.69	$8.50	$7.95	$8.53	$6.86
WA	$5.61	$7.96	$8.00	$7.36	$7.94	$5.92
WY	$6.00	$9.00	$9.20	$9.20	$9.20	$9.20

95. The effect of these increases in the SLC, given the FCC's different view of the treatment of SLC, was to decrease the allowable PAL rate under the New Services Test.

In conjunction with the Wisconsin Order's requirement that the SLC be treated as a *negative cost*, rather than a *price,* these SLC increases resulted in significantly lower PAL rates in 2002 than would have existed in 1997, even if all other cost factors remained unchanged.

96. Between 1997 and 2002, a number of state commissions conducted cost investigations pursuant to their delegated authority from the FCC in compliance with Sections 251 and 252 of the Telecommunications Act of 1996. In these proceedings the state commissions undertook significant investigations of the forward-looking costs of telecommunications. In many decisions, in an effort to encourage competition through the use of leased network elements with prices based on these costs, the state commissions approved costs that were lower than the costs in Qwest's earlier TSLRIC studies. In addition, Qwest voluntarily reduced the cost estimates determined by several of the state commissions for UNE rates as an accommodation to receive permission to offer long distance service. As a result of both of these actions, Qwest's TSLRIC studies in 2002 were lower in most states than they were in 1997.

97. The effect of the wholesale cost dockets in each state and the voluntary cost study reductions made by Qwest to gain entry to long distance telephone service, caused Qwest's TSLRIC studies to be lower in most states in 2002 compared to 1997. The

average TSLRIC PAL study in 2002 was about 20% lower than the comparable study in 1997.

98. Overall, the FCC's revisions on how to interpret the New Services Test had a dramatic impact on the calculations that were used by the state commissions to evaluate Qwest's PAL rates. For example, in Arizona, the Arizona Corporation Commission agreed with the joint Agreement filed by the commission staff and the Arizona Payphone Association and found that Qwest's PAL rates met the New Services Test. The rate that was agreed upon by the Arizona Commission staff and the Arizona Payphone Association was $33.03 per month for the flat rated basic PAL service, which was also the general business rate. The NST ratio (i.e., price/TSLRIC) for that rate was 1.34 ($33.03/$24.63) without the SLC, and 1.58 ($39.03/$24.63) with the SLC treated as a price. Calculating the PAL rate using current data in 2003,[80] the TSLRIC with common overhead at that time was $17.73, the SLC was $6.60, and the net of these two was $11.13. The common overhead included in the $17.73 was 5%. The TSLRIC without common was $16.87. After a year of investigation, the Arizona Corporation Commission approved Qwest's $11.13 as "just and reasonable" and not subject to true-up.[81] By 2002 Qwest's forward-looking direct costs for PAL in Arizona had decreased from $24.63 to

[80] Because the PAL rate was ordered by the ACC to be the same rate as the business line rate, Qwest's PAL rate reduced from $33.03 to $32.78 in October 1999 and from $32.78 to $31.80 in October 2002 in general rate proceedings. In every rate proceeding, Qwest filed its TSLRIC studies to support all of its rates, including PAL.
[81] Docket No. T-01051B-03-0087, Decision No. 66890, dated April 6, 2004.

$16.87, a 32% decrease. The SLC had increased 10%, from $6.00 to $6.60 between 1997 and 2003. Whereas the SLC was treated as a price until 2002, with the *Wisconsin Order* the SLC was treated as a reduction in the TSLRIC. The price of Qwest's PAL rate decreased twice between 1997 and 2003. The price/cost ratio changed as well during this period. Overall, the price/cost ratio changed from 1.58 to 3.10 before the Arizona Corporation Commission approved the 2003 rate reductions proposed by Qwest. The following is an analysis of the change in the price cost/ratio due to the numerous changes that occurred between 1997 and 2003 for Arizona.

	NST % Change
1997 PAL and SLC price/1997 TSLRIC	$39.03/$24.63= 1.58
1997 PAL price/1997 TSLRIC-SLC	$33.03/$18.63= 1.77 (12% increase)
2003 PAL price/2003 TSLRIC	$31.80/$16.87= 1.89 (7% increase)
2003 PAL price/2003 TSLRIC-'96 SLC	$31.80/$10.87= 2.93 (55% increase)
2003 PAL price/2003 TSLRIC-'03 SLC	$31.80/$10.27= 3.10 (6 % increase)

With the change Qwest made to the PAL rate:

2003 PAL price/2003 TSLRIC-'03 SLC	$11.13/$10.27= 1.08

Whereas Qwest's PAL rates were compliant with the FCC's NST in 1997, as determined by the ACC and supported by the Arizona Payphone Association, Qwest needed to lower its PAL rates even further due to the FCC's *Wisconsin Order* which required updates in the TSLRIC and the use of the SLC as a TSLRIC offset "for the SLC that was then in effect."

99. Qwest examined all fourteen of its states for compliance with the FCC's *Wisconsin Order* especially due to the change in methodology of treating the SLC as a cost offset rather than a price. Qwest determined that all fourteen of its state payphone rates needed to be adjusted to comply with this new method. It also needed to use its most current TSLRIC studies, as those would be required to be used by the state commissions. The change in the PAL rates between 1997 and 2002 was primarily the result of the change in the method of treating the SLC, but also due to the decreases in the TSLRIC values, and the choice by Qwest to limit its common overhead allocations to about 5% of its direct costs.

100. The overall reduction in Qwest's PAL rates starting in 2002 was about 60% due to the cumulative effect of the change in the method of applying the federal SLC, the reduced TSLRIC study values, and the reduction in the common overhead allocation. Qwest's flat PAL prices were set at the following levels:

Arizona	$11.13
Colorado	$14.93
Idaho-n	$15.10
Idaho-s	$16.30
Iowa	$14.09
Minnesota	$15.02
Montana	$16.80
Nebraska	$19.21
New Mexico	$12.69
N. Dakota	$11.74
Oregon	$ 8.87
S. Dakota	$18.88

Utah	$10.30
Washington	$13.99
Wyoming	$18.47

Qwest has some of the lowest flat PAL prices in the nation, yet has some of the highest forward-looking costs in the nation due to its low population and rural service territory. According to a national survey of forward-looking costs conducted by the Consumer Advocate Division of the Public Service Commission of West Virginia,[82] Qwest has some of the highest forward-looking costs in the nation, as measured by the price of an unbundled network element loop:

	2002 Price Range	2003 Price Range[83]
Arizona	$18.96- $56.53	$ 9.05- $36.44
Colorado	$ 5.91- $32.74	$ 5.91- $32.74
Idaho	$15.81- $40.92	$15.65- $40.50
Iowa	$13.11- $27.27	$12.69- $26.39
Minnesota	$ 8.81- $21.91	$ 5.83- $15.66
Montana	$23.10- $29.29	$23.10- $29.29
Nebraska	$15.14-$77.92	$12.14- $62.50
New Mexico	$17.75- $26.23	$16.04- $23.70
N. Dakota	$14.78- $56.44	$13.53- $51.65
Oregon	$13.95- $56.21	$13.95- $56.21
S. Dakota	$17.01- $24.37	$15.20- $21.77
Utah	$14.77- $20.29	$11.41- $19.11
Washington	$ 6.41- $19.06	$11.26- $67.77
Wyoming	$19.91- $40.98	$19.91- $40.98

[82] *A Survey of Unbundled Network Element Prices in the United States, Updated July 1, 2002,* Billy Jack Gregg, Director, Consumer Advocate Division, Public Service Commission of West Virginia. The national average during this survey for an unbundled loop was $13.43, according to Mr. Gregg.
[83] 2003 UNE Loop rates from Qwest's UNE Price list (Exhibit A), Statement of General Available Terms. The PAL rates are heavily weighted toward the urban lower loop costs.

101. Qwest noted that its PAL rates were significantly lower than PAL rates in some other states where another former Bell Operating Company was the largest telephone company. For example, even current PAL rates are higher (loop rates provided for comparison):

	PAL rate	Loop rate[84]
Connecticut	$30.40[85]	$ 8.95- $19.69
Oklahoma	$22.00 to $27.00[86]	$12.14- $26.25
Nevada	$21.00[87]	$11.75- $66.31
Louisiana	$25.00[88]	$14.05- $49.30
Missouri	$30.70[89]	$12.71- $16.41
Indiana	$16.37-$26.09[90]	$ 8.03- $ 8.99
Arkansas	$28.64 to $41.75[91]	$11.86- $23.34

102. It should be no surprise that Qwest had significant decreases in its PAL rates between 1997 and 2002, especially compared to some other locations in the country, but that fact alone should not be considered evidence that Qwest's pre-2002 PAL rates were not compliant with the NST for the reasons that I have described.

[84] From the Gregg report.
[85] Gen Ex. Tariff, Part II, Section 29, Sheets 7 and 7A, effective 4/15/97.
[86] Gen Ex. Tariff, Schedule A022, Sheet 9, effective 6/29/06.
[87] Nevada Guidebook, Part 13, Section 2, Sheet 6, effective 10/1/07.
[88] Gen. Subscriber Services Tariff, Section A7, Page 8, effective 8/3/2001.
[89] P.S.C. Mo. No. 35, Gen Ex. Tariff, Section 34, Sheet 5, effective 2/1/1999.
[90] IURC No. 20, part 13, Section 2, Sheet 10, effective 9/1/2000.
[91] Gen. Ex. Tariff, Section 47, Sheet 6, ref. Local Ex. Service, Section 1, Sheet 4, effective 3/1/2008.

SUMMARY

103. My declaration provides clear evidence that, Qwest carefully evaluated and understood the FCC directions to assure compliance with the New Services Test for its payphone services in the April to May 1997 time period. Qwest employees utilized existing direct cost studies (TSLRIC) that were used by state commissions in the approval of the PAL rates in their states. These were the same type of studies routinely prepared by Qwest and filed with the FCC where it had cost study requirements. Qwest conducted the New Services Test in a manner consistent with its understanding from Part 61.49(g)(2) and CC Docket 89-79, paragraphs 38 to 44. Further, Qwest had reason to believe that this was a reasonable understanding of the application of the New Services Test in that it had utilized the same methodology in defending its payphone feature rates just a few months before. The ratios of cost to price were in a range that was consistent with this earlier filing. Not only did Qwest reach this conclusion, but four state commissions reached the same conclusion where there were lengthy investigations undertaken (Arizona, Colorado, Montana, and New Mexico). Qwest filed its payphone TSLRIC cost studies in Arizona (1997), Colorado (1996,1997 and 1998), Idaho (late 1996 and 1997), Minnesota (early 1997), Nebraska (2000), New Mexico (early 1997), Montana (1997), Oregon (1996), South Dakota (1997), Utah (1997), Washington (1997), and Wyoming (1996 and 1999), (twelve states). Payphone associations were actively

protesting Qwest's Smart PAL tariff filings and its existing tariff filings in nearly every state, sometimes on multiple occasions during the period 1997 to 2002, in a similar fashion to investigations in other states. State commissions opened investigations where Qwest's TSLRIC studies were submitted as evidence to support its PAL rates. In some cases, Qwest was ordered to lower its PAL rates and commissions found that the rates were in compliance with all federal law, including the FCC's Payphone Orders. Qwest's PAL rates were decreased multiple times in multiple states during the period between 1997 and 2002 in general rate proceedings. Subsequent to the FCC's *Wisconsin Order*, Qwest lowered its PAL rates even further to level that are some of the lowest in the nation, especially in comparison to Qwest's above average forward-looking costs.

I certify that the forgoing is true and correct to the best of my information and belief.

Executed on June 3, 2008.

Jerrold L. Thompson

Jerrold L. Thompson
Executive Director
Public Policy
Qwest Communications