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CARL J. KUNASEK
Chairman
JIM IRVIN
Commissioner
WILLIAM A. MUNDELL
Commissioner

IN THE MATTER OF THE APPLICATION OF US) DOCKET NO. T-01051B-99-0105
WEST COMMUNICATIONS, INC., A)
COLORADO CORPORATION, FOR A HEARING) **ARIZONA PAYPHONE**
TO DETERMINE THE EARNINGS OF THE) **ASSOCIATION'S NOTICE OF**
COMPANY, THE FAIR VALUE OF THE) **SURREBUTTAL TESTIMONY**
COMPANY FOR RATEMAKING PURPOSES, TO)
FIX A JUST AND REASONABLE RATE OF)
RETURN THEREON AND TO APPROVE RATE)
SCHEDULES)

The Arizona Payphone Association ("APA"), through undersigned counsel, hereby provides notice that on this day it has filed Surrebuttal Testimony of Michael J. Ileo, Ph.D. in the docket captioned above.

RESPECTFULLY SUBMITTED this 8th day of September, 2000.

ROSHKA HEYMAN & DEWULF, PLC

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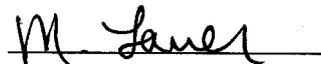
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BEFORE THE ARIZONA CORPORATION COMMISSION

CARL J. KUNASEK
Chairman
JIM IRVIN
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WILLIAM A. MUNDELL
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IN THE MATTER OF THE APPLICATION OF US) DOCKET NO. T-01051B-99-0105
WEST COMMUNICATIONS, INC., A)
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FIX A JUST AND REASONABLE RATE OF)
RETURN THEREON AND TO APPROVE RATE)
SCHEDULES)

**PREPARED SURREBUTTAL TESTIMONY OF
MICHAEL J. ILEO, PH.D.
PRESIDENT/CHIEF ECONOMIST
TECHNICAL ASSOCIATES, INC.**

1 Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.

2 A. My name is Michael J. Ileo. I am President and Chief Economist of Technical
3 Associates, Inc., which maintains its offices at James Center III, Suite 6011, 1051 East Main
4 Street, Richmond, Virginia 23219.

5 Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING?

6 A. Yes. I submitted direct testimony and exhibits dated August 9, 2000 in this case on
7 behalf of the Arizona Payphone Association ("APA"). My direct testimony presents specific
8 costing and pricing recommendations applicable to the Public Access Line ("PAL") services in
9 Arizona of what is now Qwest Corporation ("Qwest"). These recommendations are directed at
10 fulfilling the mandates of Section 276 of the Act and the attendant "new services test" of the FCC.
11 In the prior PAL case of Qwest (i.e., Docket No. T-01015A-99-0024 et al.), Commission Decision
12 No. 61304 appropriately found that the PAL services rates of Qwest are subject to the pricing
13 requirements of the FCC's "new services test."

14 Q. HAS ANYTHING TRANSPIRED, DR. ILEO, THAT WOULD WARRANT
15 MODIFICATIONS TO THE PAL COSTING AND PRICING RECOMMENDATIONS
CONTAINED IN YOUR DIRECT TESTIMONY?

16 A. No. If anything, the need to proceed with the recommendations in my direct
17 testimony has become more apparent, as the settlement and other aspects of Commission Decision
18 No. 61304 have been upheld in the appellate process. Thus, since Qwest has failed in its attempt
19 to overturn the findings in Commission Decision No. 61304, the Commission should now move
20 forward expeditiously to implement PAL rates fully consistent with the Act and "new services
21 test."

22
23
24

1 Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

2 A. In response to my direct testimony, Jerold H. Thompson, Scott A. McIntyre, and
3 William E. Taylor have filed rebuttal testimony dated August 22, 2000 on behalf of Qwest. The
4 purpose of my surrebuttal testimony is to comment on and reply to this Qwest rebuttal testimony
5 as it pertains to PAL issues. I also address the August 9, 2000 direct testimony of Thomas M.
6 Regan on behalf of the Commission Staff, which is referenced in the rebuttal testimony of Qwest
7 with respect to PAL costing and pricing matters.

8 Q. PLEASE SUMMARIZE YOUR COMMENTS ON AND REPLIES TO THE
9 REBUTTAL TESTIMONY OF QWEST.

10 A. The rebuttal testimony of Messrs. Thompson and McIntyre, as well as that of Dr.
11 Taylor, is far more in the nature (at best) of direct rather than rebuttal testimony. To illustrate,
12 while my direct testimony presents detailed PAL costing and pricing counter-proposals to those in
13 Qwest's initial filing, none of these specific recommendations are addressed to any degree in the
14 rebuttal of Qwest. In a combined total of 15 pages, for example, not once does either Mr.
15 Thompson or Mr. McIntyre refer to a particular section, page, paragraph, line, exhibit, figure, or
16 calculation in my direct testimony. Nor do these witnesses or Dr. Taylor ever mention
17 Commission Decision No. 61304, even though it plays a prominent role in my direct testimony.

18 Paralleling this evasion of specific relevant issues, Qwest's rebuttal engages in sweeping
19 rhetoric and hyperbole that frequently is inaccurate and serves to misrepresent my direct
20 testimony. Through innuendo interwoven therein, moreover, inferential attacks on my
21 professionalism are exhibited in the rebuttal testimony of Qwest. The strategic tactics of Qwest to
22 delay and obfuscate the resolution of significant issues is further exemplified by its raising of
23 entirely new matters--referenced neither in my direct testimony nor in its initial filing--that are also
24 of questionable relevance. Mr. Thompson even goes so far in this regard to "reserve the

1 opportunity to comment” on my adjustments to Qwest’s cost studies of PAL “in later rounds of
2 testimony” because he allegedly has not had time to do so (p.21).

3 As my rebuttal testimony demonstrates, the Commission should proceed with the steps
4 necessary to fully implement the findings in its Decision No. 61304 regarding PAL rates
5 undistracted by the superficial and meritless claims in what is largely improper rebuttal by Qwest.
6 To the extent that any relevance might be ascribed to the rebuttal testimony of Qwest pertaining to
7 PAL issues, such matters should have been part of its initial filing.

8 Q. SHOULD QWEST’S REQUEST FOR ANOTHER OPPORTUNITY TO
9 ADDRESS YOUR DIRECT TESTIMONY BE GRANTED?

10 A. No. Qwest has been aware for several years as to the specific PAL matters that
11 must be addressed pursuant to federal law; e.g., since the passage of the Act in 1996. Additionally,
12 while my present testimony is more precise and complete, it is essentially the same as that
13 submitted on behalf of the APA in the prior PAL case, which gave rise to Commission Decision
14 No. 61304 and in which this proceeding is designated as the forum for final resolution of PAL
15 costing and pricing issues. Qwest surely cannot claim ignorance or surprise in this regard,
16 especially since it appealed Commission Decision No. 61304.

17 The question is further posed as to why Qwest conceivably should need or be allowed more
18 time in “later rounds of testimony” when my PAL costing and pricing recommendations involve
19 nothing more than a reapplication of the data and computations in Qwest’s cost studies. For Mr.
20 Thompson to now attempt to “reserve the opportunity” to comment later on my adjustments to
21 Qwest’s cost studies, suggests that he was unaware of the cost determinations upon which the PAL
22 rate proposals in Qwest’s initial filing were based even though he sponsored these PAL pricing
23 recommendations of Qwest.
24

1 To allow Qwest “another bite of the apple” would be tantamount to sanctioning the tactics
2 of delay and obfuscation exhibited in its rebuttal. Such an unreasonable granting would serve,
3 moreover, to shift the burden of proof and impose added litigation costs on the APA in what
4 presently is an unusually long and expensive proceeding. To some degree, this has already
5 occurred with the necessity of the APA having to respond to rebuttal testimony that is rife with
6 inaccuracies and misrepresentations.

7 Q. IS THE SAME TRUE OF DR. TAYLOR’S REBUTTAL TESTIMONY?

8 A. Yes. In the first instance, the rebuttal testimony of Dr. Taylor is clearly of a direct
9 nature. Had the positions of Dr. Taylor on PAL issues been incorporated in Qwest’s initial filing,
10 the need for which should have been obvious in view of Commission Decision No. 61304, I
11 would have addressed them in my direct testimony and would not now be required to revisit much
12 of my direct testimony in order to correct and otherwise place Dr. Taylor’s remarks in proper
13 context. This is true, in part, because Dr. Taylor also engages in “broad-brush” tactics, never
14 mentioning any particular calculation or exhibit pertinent to my counter-proposals to those of
15 Qwest for PAL costing and pricing. His sweeping generalities further cause Dr. Taylor to
16 advance concepts that have been rejected by the FCC; to reach findings that contradict Qwest’s
17 proposals in this proceeding; to misrepresent applications of the “new services test” made by the
18 FCC; and, to mischaracterize my direct testimony. He further conveniently ignores any reference
19 to Commission Decision No. 61304.

20 Q. WHAT HAS HAPPENED WITH RESPECT TO QWEST’S APPEAL OF
21 COMMISSION DECISION NO. 61304?

22 A. The Arizona Court of Appeals affirmed Commission Decision No. 61304 in its
23 entirety on August 17, 2000. Among other things, the Court recognized that the “Commission
24 made it clear that the Basic PAL [BPAL] rates” resulting from the settlement “are subject to

1 revision in [Qwest's and Citizen's] next respective rates cases" (p.13). The Court further found
2 that the Commission, as reflected by its Decision No. 61304, is obligated under federal law "to
3 insure that [Qwest's] PAL rates [are] cost-based, reasonable, non-discriminatory and fixed at a
4 level that [do] not subsidize other services" (p.25). The recommendations set forth in my direct
5 testimony are designed to fulfill these mandates contrary to the improper rebuttal of Qwest.

6 **Mr. Thompson's Rebuttal Testimony**

7 Q. WHAT ASPECTS OF MR. THOMPSON'S REBUTTAL TESTIMONY
8 DEMONSTRATE ITS IMPROPER NATURE?

9 A. Consider first the following statement made by Mr. Thompson: "Because Dr. Ileo
10 did not provide specifics on how he thinks Qwest's [PAL] rate proposals are unlawful, it is
11 impossible for me to address his accusations" (p.19, lines 21-23). Yet, a detailed explanation and
12 itemization of what I mean by unlawful subsidy with respect to Qwest's BPAL rates begins just
13 seven pages into my direct testimony. Perhaps a novice to regulation or telecommunications might
14 have difficulty in understanding this comparison, but surely not the Executive Director-Service
15 Cost Information of Qwest. If it is truly the case that Mr. Thompson is unable to comprehend the
16 simple figures that appear on Page 7 of my direct testimony, many of which are those of Qwest
17 and on which Mr. Thompson testified in his direct testimony, serious questions are raised as to his
18 technical expertise.

19 Q. DO YOU BELIEVE IT IS LIKELY, DR. ILEO, THAT MR. THOMPSON
20 LACKS THE TECHNICAL EXPERTISE TO UNDERSTAND THE FIGURES PRESENTED IN
21 YOUR DIRECT TESTIMONY?

22 A. No. Indeed, based on subsequent statements of Mr. Thompson, his claim about it
23 being "impossible" for him to understand my unlawful subsidy calculations is clearly designed to
24 avoid addressing the specifics of the computations. Qwest's strategic tactics; e.g., the creation of

1 "strawmen' to avoid discussing what is both obvious and pertinent, is replete throughout its
2 rebuttal testimony.

3 Q. TO WHAT SUBSEQUENT STATEMENTS OF MR. THOMPSON DO YOU
4 REFER?

5 A. Immediately following his "impossible" assertion, Mr. Thompson is somehow able
6 to relate on the very next page of his rebuttal testimony my position as to what federal law requires
7 for PAL pricing:

8 ...from the context that Dr. Ileo's testimony is framed, it appears
9 that he believes that any price above a TSLRIC plus common cost
10 level is a "subsidy." I base this conclusion on the level of rates
11 that he proposes, which is his version of TSLRIC plus common
12 costs (p. 20).

13 Mr. Thompson nearly has it totally correct, despite his "impossible" claim. The only
14 needed modification is the substitution of "TELRIC" for "TSLRIC" and the insert of "reasonable"
15 before "common costs." As detailed at Page 7 of my direct testimony. Mr. Thompson fails to
16 address, however, these specific issues as would be normally found in proper rebuttal. He
17 proceeds instead at Page 20 to raise an entirely new matter; i.e., his unfounded claim as to my so-
18 called "disagreement" with the implications of the stand-alone cost ("SAC") test as set forth in the
19 direct testimony of Thomas M. Regan on behalf of Staff. The inappropriateness of Mr.
20 Thompson's attempt to bring into play SAC with respect to PAL costing and pricing is indicated
21 by the following:

22 (1) while the relevance of SAC has been recognized by regulators such as the FCC, it has
23 not been adopted as the costing and pricing standard in this evolving era of telecommunications
24 either generally or with respect to the "new services test" applicable to the PAL services of ILECs;

(2) to the extent that Qwest truly believes SAC to be the appropriate costing and pricing
standard for its PAL services, then SAC studies should have been part of its initial filing -- either

1 as a substitute for or in addition to its improper mixing of TELRIC and TSLRIC study results --
2 but in no event should Qwest now be allowed to use the unknown implications of non-existing
3 SAC studies to prolong and further burden this proceeding; and,

4 (3) as no party to this case has presented SAC study results (not the Staff, RUCO, AT&T,
5 COX, etc. and, most significantly, not Qwest), it is disingenuous for Mr. Thompson to infer at
6 Page 21 that I should have conducted SAC studies, especially when he acknowledges on the very
7 same page that the "new services test" of the FCC does not require SAC studies to be performed.

8 Q. HAVE YOU CONDUCTED SAC STUDIES DURING YOUR PROFESSIONAL
9 CAREER?

10 A. Yes. During the 1970s and 1980s, for example, the Interstate Commerce
11 Commission ("ICC") employed the SAC test in establishing the maximum reasonable rates that
12 railroads could charge captive shippers for relatively long movements of heavy/dense commodities
13 such as grain, fertilizer, minerals, chemicals, paper, and coal. The term "captive shippers" meant
14 that no economically viable alternative means of transportation readily existed at that time; i.e.,
15 neither truck nor pipeline. The duties of the ICC were subsequently transferred to the Department
16 of Transportation (e.g., the National Transportation Board) and to the Department of Energy (e.g.,
17 the FERC).

18 Throughout the indicated timeframe, I presented the results of numerous SAC studies on
19 behalf of captive shippers before the ICC, such as with respect to long-haul coal movements to
20 electric generating facilities. Under the methodology approved by the ICC, my SAC studies were
21 directed at determining the current cost of reproducing these transportation serves using the then
22 most contemporary and cost-effective techniques of constructing, operating, and managing railroad
23 facilities dedicated to the movement of heavy/dense commodities given prevailing economic and
24 financial conditions. Thus, the SAC test procedures that the ICC utilized some 20 years ago were

1 essentially identical to the “forward-looking economic cost” standards that underlie the TELRIC
2 (wholesale) and TSLRIC (retail) methodologies currently employed by the FCC and state
3 regulators for telecommunications.

4 Q. IS THE SIMILARITY AMONG SAC, TELRIC, AND TSLRIC WELL
RECOGNIZED?

5 A. Yes. Contrary to the inferences in that Mr. Thompson’s rebuttal testimony, neither
6 do I disagree with the definition of a subsidy inherent in the theory of SAC, nor are significant
7 differences in pricing pose by the results of properly conducted SAC, TSLRIC, and TELRIC
8 studies. However, the theory and application of SAC must be carefully understood.

9 To illustrate, the question that appears on Page 7 of Mr. Regan’s direct testimony is taken
10 from a Notice of Proposed Rulemaking (NPR) by the FCC in CC Docket No. 96-112. While the
11 broad pricing implications drawn by Mr. Regan from the cited FCC remarks regarding SAC are
12 generally true, the FCC was addressing cost allocation principles for regulated and deregulated
13 services rather than the making of rates. This is evident by the following: “These are the upper
14 and lower bounds within which costs allocated to regulated and non-regulated services must fall.”

15 The FCC more pertinently dealt with the subject of SAC for pricing in Paragraph 698 of its
16 First Report and Order on Implementation of the Local Competition Provisions of the
17 Telecommunications Act of 1996 (CC Docket Nos. 96-98 and 95-185, released August 9, 1996):

18 We further conclude that, for the aggregate of all unbundled network elements, incumbent
19 LECs must be given a reasonable opportunity to recover their forward-looking common costs
20 attributable to operating the wholesale network. In no instance should prices exceed the stand-
21 alone cost for a specific element, and in most cases they should be below stand-alone costs. Stand-
22 alone costs are defined as the forward-looking cost that an efficient entrant would incur in
23 providing a given element or an combination of elements. No price higher than stand-alone cost
24

1 could be sustained in a market from which entry barriers were completely absent. Where there are
2 few common costs, there is likely to be only a minimal difference between the forward-looking
3 costs that are directly attributable to the particular element, which excludes these costs, and stand-
4 alone costs, which includes all of them. Network elements should not, however, be priced at levels
5 that would enable the incumbent LEC to recover the same common costs multiple times from
6 different elements. A multiple recovery would be unreasonable and thus in violation of the
7 statutory standard. Further, we note that the sum of the direct costs and the forward-looking
8 common costs of all elements will likely differ from the incumbent LEC's historical, fully
9 distributed costs.

10 Ultimately, the FCC did not adopt SAC either for the pricing of local network elements
11 and services or for applying the "new services test" (see Pages 18-19 and 21-22 of my direct
12 testimony). The above language of the FCC is nevertheless instructive. For the reasons noted by
13 the FCC, one should not expect significant variances between the results of properly conducted
14 SAC and TSLRIC (or TELRIC), studies. Indeed, the major cost component of SAC should be
15 identical to the direct costs determined under TSLRIC or TELRIC depending on whether retail or
16 wholesale services, respectively, are at issue. The difference between SAC and TSLRIC (or
17 TELRIC), accordingly, rests solely with respect to common costs. In a SAC study, common costs
18 are considered as direct costs because all facilities are implicitly of a dedicated nature; i.e., there
19 are no joint, shared, or common costs to be assigned or allocated to other services.

20 Thus, the difference between the minimum reasonable price (as established by direct costs
21 in a TSLRIC or TELRIC study) and the maximum reasonable price (as established by a SAC
22 study) will be invariably of a small magnitude relative to direct TSLRIC or TELRIC unless: (i) one
23 or more of these studies has been improperly conducted; or, (ii) an exceptionally rare circumstance
24

1 prevails; i.e., the prevalence of significant economies of scope, as distinguished from economies of
2 scale, such that the level of common costs deemed appropriate and treated as direct costs in a SAC
3 context differs radically from the level of common costs deemed appropriate and added to direct
4 TSLRIC or TELRIC. Presumably with its recognition that the latter situation is not applicable to
5 the telecommunications services of ILECs, the FCC adopted the pricing standard of forward-
6 looking direct costs plus a reasonable level of forward-looking common costs. This same logic
7 appears to underlie the 15% common cost prescription adopted in Commission Decision No.
8 60635, to which Mr. Thompson refers as the "Generic Cost Docket" (p.22).

9 Q. HAS MR. THOMPSON ACCURATELY REPORTED APPLICATIONS OF THE
10 "NEW SERVICES TEST" BY THE FCC?

11 A. No. Once again, Mr. Thompson conveniently omits salient aspects of relevant
12 issues. In particular, with respect to the claims at Page 21 of his rebuttal testimony about the FCC
13 permitting price to direct cost ratios as high as 4.8 times, Mr. Thompson fails to report that this
14 has occurred only in instances when the implications are immaterial (e.g., when no customers have
15 existed for the service in questions) and when the FCC has made it clear that ratios of 2, 3.4, and
16 4.8 times are of no precedential consequence. I further discuss this matter in some detail later with
17 respect to the remarks of Mr. McIntyre.

18 Q. DR. ILEO, HOW DO YOU RESPOND TO MR. THOMPSON'S CLAIMS
19 REGARDING THE RATIOS OF PRICE TO DIRECT COST FOR PAL AS COMPARED TO
20 THOSE FOR CALLER ID-NUMBER AND LAST CALL RETURN?

21 A. While the claims of Mr. Thompson that appear on Page 22 of his rebuttal testimony
22 as to price/direct cost ratios are presented with no factual support and, even if true, are of no
23 relevance for a basic service, it is instructive to first consider how these unfounded remarks come
24 about. Mr. Thompson's claims are made in response to a multi-phrased question stated on Page
21, in which a host of erroneous predicates are posed. This question comes on the heels,

1 moreover, of Mr. Thompson's assertion that he did not have enough time to "examine" my
2 adjustments to Qwest's cost studies, although he sponsored these cost studies in his direct
3 testimony. The merits of this allegation are further suspect because it is made by Mr. Thompson
4 in relation to the effort he claims to have undertaken to determine whether I performed a SAC
5 study. One can only speculate as to why Mr. Thompson would even attempt such an inquiry,
6 when the introduction (Pages 3 and 4) of my direct testimony makes clear at the outset that, as with
7 the initial filing of Qwest, I did not conduct a SAC study.

8 Had Mr. Thompson reviewed the content of just these two pages of my direct testimony,
9 time would not have been spent searching for something therein that obviously did not exist. By
10 the same token, time would have been available for Mr. Thompson to examine my adjustments to
11 Qwest's cost studies. But since Mr. Thompson chose another path and, therefore, has not
12 examined my calculations, the suppositions incorporated in the question starting on Page 21 (Line
13 25) extending through Page 22 (Line 5) of his rebuttal testimony are totally unfounded.

14 Mr. Thompson additionally creates the inference that I was "left" with nothing "to argue"
15 and, therefore, have misled my clients "to believe that their rates are too high." In an ill-fated
16 effort to support this attack on my professionalism, Mr. Thompson states the following at Page 22
17 of his so-called rebuttal testimony:

18 All that is left is that his clients appear to believe that their rates
19 are too high and that their rates should not be set to recover levels
20 of direct, common, shared and embedded costs that are
21 comparable to that provided by other retail services. Even though
22 the ratio of proposed PAL rates to TSLRIC plus common costs is
23 far less than half of some other services such as Call ID-Number
24 or Last Call Return, Dr. Ileo proposes rates equal to direct costs
or below. The argument presented by Dr. Ileo is that PAL rates
should be given preferential treatment over other retail services by
dramatically reducing (if not eliminating) contributions over
direct cost for PAL services. This is not good public policy and

1 could potentially result in accusations of discrimination by
2 consumers of other services. (emphasis added)

3 Q. WHAT IS THE PURPOSE OF THE EMPHASIS ADDED TO MR.
4 THOMPSON'S STATEMENTS?

5 A. The phrases presented in bold serve to underscore the fatal flaws of Mr.
6 Thompson's assertions, as well as the extent to which his remarks mischaracterize my direct
7 testimony. Perhaps the most telltale sign of the defects of Mr. Thompson's position is his claim
8 that PAL rates should be set to "recover direct, common, shared, and embedded costs that are
9 comparable to that provided by other retail services." The incorporation of embedded costs in
10 PAL pricing violates Section 276 of the Act and the corresponding "new services test" of the FCC.
11 I also take exception to Mr. Thompson's characterization of PAL as a retail service, especially
12 when Qwest itself has recognized PAL as a wholesale service.

13 Mr. Thompson's assertion that I propose PAL rates "equal to direct costs or below" is
14 flatly wrong, indicating once again that he could not have possibly taken the hour or so necessary
15 to read my direct testimony. To illustrate, once again, just seven pages into my direct testimony, I
16 show that Qwest will receive more per month for its BPAL service under the APA's proposed
17 initial rates, than the overstated total recurring costs calculated by Qwest for BPAL. For Mr.
18 Thompson to allege that I propose PAL rates "equal to direct costs or below" is a blatant example
19 of the improper nature of his rebuttal and why Qwest should be denied any further opportunity to
20 mischaracterize my positions and attack my professionalism.

21 Of final note are Mr. Thompson's references to "preferential treatment" and "accusations
22 of discrimination." As with other aspects of his so-called rebuttal testimony, Mr. Thompson
23 provides no factual support for these claims, including the assertion that the "ratio of proposed
24 PAL rates to TSLRIC plus common costs is far less than half of some other services such as Caller

1 ID-Number or Last Call Return.” In the first instance, it is a misnomer to refer to Qwest’s PAL
2 cost studies as TSLRIC, for they constitute an improper and overstated mixture of TSLRIC and
3 TELRIC. Moreover, even if the undocumented “far less than half” price/direct cost ratios are
4 correct, comparisons of such ratios for essential basic services (PAL access and usage) with ratios
5 for discretionary vertical services (Caller ID-Number and Last Call Return) are woefully
6 inappropriate. This is particularly disturbing with respect to his assertion of “preferential
7 treatment,” as the PAL rates that I propose in this proceeding cover far more than direct costs
8 contrary to the erroneous observation of Mr. Thompson.

9 Q. WHAT IS YOUR VIEW OF MR. THOMPSON’S CLAIM THAT THERE IS NO
10 NEED TO CLARIFY THE GENERIC COST DOCKET?

11 A. In his remarks regarding the UNE rate determinations in Commission Decision No.
12 60635, Mr. Thompson never mentions the recent findings of the United States Court of Appeals
13 (Eighth Circuit). Moreover, the nature of his statements suggests Mr. Thompson has not
14 familiarized himself with the Court’s conclusions that UNE rate determinations based on models
15 of hypothetical local networks fail to comply with the requirements of the Act. As I stated in my
16 direct testimony, clarification is needed in this regard because Commission Decision No. 60635
17 couches engineering/investment parameters in terms of the Hatfield Model -- a model of a
18 hypothetical local network -- rather than the local network model of Qwest.

19 Mr. Thompson refers to this clarification as a “burdensome task” and an “obtrusive
20 investigation” that would “unjustly delay this proceeding...to provide Dr. Ileo with information
21 that is irrelevant” (p.22). Claims about unjustly delaying this proceeding appear contradictory
22 from someone who requests the opportunity to address my direct testimony again” in later round of
23 testimony” (p.21). Mr. Thompson also alleges that clarification of Commission Decision No.
24 60635 is unnecessary because: “There is already evidence that Qwest has passed the test” (pgs.

1 22-23). However, as with other aspects of his rebuttal testimony, neither is this “test” defined nor
2 is this “evidence” provided by Mr. Thompson.

3 His assertion that classification of Commission Decision No. 60635 will produce nothing
4 but “information that is irrelevant” again serves to avoid pertinent issues. Mr. Thompson fails to
5 explain, for instance, why Qwest’s current cost models contain engineering/investment parameters
6 that are rejected in Commission Decision No. 60635 as noted at Pages 15-17 of my direct
7 testimony. This surely is not an irrelevant fact.

8 Q. UNDER WHAT CIRCUMSTANCES WOULD CLARIFICATION OF
COMMISSION DECISION NO. 60635 BE UNNECESSARY?

9 A. There would be no need for clarification of Commission Decision No. 60635 under
10 two conditions. First, Qwest must stipulate that the engineering/investment parameters set forth in
11 Commission Decision No. 60635 are applicable to Qwest’s local network cost models. Second,
12 Qwest must rerun these models with respect to its PAL services using the stipulated
13 engineering/investment parameters rather than the input values currently utilized. Without the
14 stipulation and cost model reruns noted, Qwest could appeal any decision made with respect to
15 PAL rates that relied on findings in Commission Decision No. 60635 as it has previously.

16 **Mr. McIntyre’s Rebuttal Testimony**

17 Q. IS THE REBUTTAL TESTIMONY OF MR. MCINTYRE SIMILAR IN
18 NATURE TO THAT OF MR. THOMPSON?

19 A. Yes. The so-called rebuttal testimony of Mr. McIntyre is, in fact, entirely direct
20 testimony. To illustrate, within the 10 pages of his discussion on PAL issues extending from Page
21 18 (Line 22) to Page 27 (Line 12), Mr. McIntyre never cites any part of my direct testimony either
22 directly or indirectly. He briefly refers to my direct testimony only once within the statement that
23 “Other Qwest witnesses will also address issues raised by Dr. Ileo” (p.19, ln.3), but never does so
24

1 again despite his use of the term "also." Rather, he proceeds immediately and totally to
2 "specifically address [Qwest's] proposed [PAL] rates and why these rates are reasonable" (p.19,
3 ln. 4). Thus, void of any point of reference to my direct testimony, the remaining some nine pages
4 of discussion by Mr. McIntyre constitutes improper rebuttal. The support claimed therein by Mr.
5 McIntyre for the alleged reasonableness of Qwest's PAL rates should have been incorporated in its
6 direct case.

7 Q. ARE THERE OTHER ASPECTS OF MR. MCINTYRE'S REBUTTAL
8 TESTIMONY WITH WHICH YOU TAKE EXCEPTION?

9 A. Yes. Two aspects of Mr. McIntyre's so-called rebuttal testimony are of particular
10 concern. First, as with witnesses for Qwest in the prior PAL case, Mr. McIntyre continues to
11 misrepresent applications by the FCC of its "new services test." Second, Mr. McIntyre's assertion
12 that PAL rates should be equal to business rates contradicts requirements of the Act, as well as
13 rests on premises that are either faulty or have not been established by Qwest as accurate.

14 Q. HOW DOES MR. MCINTYRE MISREPRESENT APPLICATIONS OF THE
15 "NEW SERVICES TEST" BY THE FCC?

16 A. Mr. McIntyre attempts to justify the high levels of Qwest's PAL rates relative to
17 direct costs by citing price to direct cost ratios as great as 4.8 times. He states the following in this
18 regard at Page 22 of his rebuttal testimony:

19 In its review and approval of another Bell Operating Company's
20 pricing, the FCC stated, "Bell Atlantic's ratio of rates to direct
21 costs for pay phone features range from a low of zero times greater
22 than the direct cost to a high of 3.4 times greater than the direct
23 costs, while the ratio of rates to direct costs for the payphone
24 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.

As with Qwest's rebuttal testimony generally, the superficial and erroneous claims of Mr.
McIntyre are exposed upon specific reference to the FCC decision that he cites; i.e., Memorandum

1 Opinion and Order in CC Docket No. 97-140, released October 29, 1997. This is a multi-
2 paragraphed opinion in which, while the ratios of 3.4 and 4.8 times are mentioned, the FCC's
3 discussion makes clear that they are not to be used on a generic basis in applying the "new services
4 test" for either federal or state regulatory purposes, particularly the latter.

5 Q. WHAT IS THE BASIS OF YOUR PREVIOUS ANSWER?

6 A. ACC Docket No. 97-140 pertained to federal rate filings by Bell Atlantic and GTE
7 "applicable to the offering of various unbundled payphone features and functions," as
8 distinguished from the basic payphone access line services that are to be tariffed at the state level
9 (.1). The FCC noted regarding Bell Atlantic that rates for five of six unbundled payphone features
10 and functions has been revised downward from the levels contained in its initial filing. The
11 resulting maximum ratio of rate to direct cost for these features and functions became 3.4 times, on
12 which the American Public Communications Council (APCC) took the position that the "revised
13 overhead allocations are acceptable in the context of the de minimis rates" in question, but "would
14 be unreasonable in the context of other services, such as line and local usage rates" (.10). The
15 position of the APCC was essentially adopted by the FCC, although in an expanded and clarified
16 form as indicated by the following:

17 (1) because Bell Atlantic "did not have customers for the relevant services, we find that it
18 is unnecessary to consider the lawfulness of those rates or to consider the need for refunds" (.11);

19 (2) reaffirmation of the principles set forth in the FCC's Payphone Order on
20 Reconsideration, including requirements for "LEC's to file tariffs for basic payphone lines at the
21 state level only," where such tariffs must be "cost-based, nondiscriminatory, and consistent with
22 both Section 276 and the Commission's Computer III tariffing guidelines, including the new
23 services test" (.12); and,
24

1 (3) while a rate to direct cost ratio of 3.4 times is acceptable in the instant cost, the FCC
2 “did not find that our determination here concerning overhead loadings for Bell Atlantic’s
3 provision of payphone features and functions will necessarily be determinative in evaluating
4 overhead loadings for other services” (.13).

5 Thus, the message of the FCC in CC Docket No. 97-140 could not have been clearer. A
6 price/direct cost ratio of 3.4 was acceptable to the FCC only because it applied to services for
7 which there were no customers. Additionally, the FCC permitted the ratio of 3.4 to go into effect
8 with the caveat that it had no precedential value. Yet, Mr. McIntyre infers (if not alleges) that this
9 ratio of 3.4 times has been adopted by the FCC as a pricing standard in applying its “new services
10 test.”

11 Q. IS THE SAME CLEAR MESSAGE EVIDENT FROM THE FCC’S DECISION
12 WITH RESPECT TO GTE?

13 A. Yes. The price/direct cost ratio ultimately approved in CC Docket No. 97-140 for
14 GTE was 2.0 times, which pertained to an unbundled payphone feature designated as Selective
15 Class of Call Screening (SSOCS) that enables the customer to block outgoing calls charged to the
16 originating number. The discussion of the FCC makes clear that the ratio of 2.0 times was
17 acceptable because the direct cost of SCOCS averaged only 15¢ per access line per month. The
18 resulting rates, therefore, ranged form only 23¢ to 24¢ per month for SCOCS. A \$5.00
19 nonrecurring charge proposed by GTE for SCOSC was rejected by the FCC, noting that “GTE
20 may seek to justify a nonrecurring charge for SCOCS by means of adequate cost support and a
21 demonstration of compliance with the new services test” (.24).
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1 Q. WHAT HAS THE ARIZONA COURT OF APPEALS STATED ABOUT THE
2 PRICE/DIRECT COST RATIOS CITED BY MR. MCINTYRE?

3 A. In confirming Commission Decision No. 61304, the Arizona Court of Appeals
4 notes the following regarding Qwest's claim as to price/direct cost ratios of 0.0 to 4.8 times:

5 ...reliance on the ratio range is misplaced. Although the FCC has
6 determined that rates in the 0 to 4.8 range met the new services test
7 for certain payphone features and functions, the FCC never stated
8 that any rates for payphone service, let alone PAL services, met the
9 test simply because they fall within that range. To the contrary, the
10 FCC noted that its rulings were not meant to be a definitive
11 statement of permissible rates for other services...Rather, the FCC
12 expressly delegated to the Commission the determination whether
13 PAL rates met the new services test...PAL rates must meet not only
14 the new services test, but also other FCC criteria namely they must
15 be non-discriminatory and priced at a level that does not subsidize
16 other services (pgs. 16-17).

17 The Commission in its Decision No. 61304, the FCC in its Payphone Order on
18 Reconsideration and in its CC Docket No. 97-140 opinion, and the Arizona Court of Appeals all
19 see it as I do; i.e., PAL rates must be no less than or greater than the sum of properly determined
20 direct cost and a reasonable portion of properly determined common costs. Obviously, Mr.
21 McIntyre and his cohorts at Qwest share a different view.

22 Q. WHY DO YOU TAKE EXCEPTION, DR. ILEO, WITH MR. MCINTYRE'S
23 CLAIM THAT QWEST'S PAL AND BUSINESS RATES SHOULD BE THE SAME?

24 A. In his assertions regarding the equivalence of PAL and business rates, Mr.
McIntyre conveniently neglects to acknowledge that, unlike retail services rendered to businesses
by ILECs, PAL services are specifically addressed within the requirements of the Act. These
provisions in Section 276 of the Act do not state that PAL rates should be set equal to business
rates, but rather that PAL rates must be subsidy free; i.e., contain neither subsidies from or to other
telecommunications services of ILECs. Section 276 further requires the FCC to promulgate rules
that achieve this pricing mandate, which the FCC has fulfilled by extending its "new services test"

1 to PAL ratemaking, such that PAL rates must be cost-based, non-discriminatory and determined in
2 accordance with properly applied forward-looking economic cost methodology.

3 An additional reason why PAL rates need not be equal to business rates is that PAL
4 services are clearly of a wholesale rather than retail nature. Marketing, advertising, customer
5 information, and related costs necessary for retail business services are not, therefore, applicable to
6 PAL services. No mention is made in this regard by Mr. McIntyre of Qwest's internal recognition
7 of PAL as a wholesale service, although it is noted at several places in my direct testimony (e.g.,
8 see Page 5). The individualized treatment of PAL services in the Act, as distinguished from the
9 absence of such treatment of business services, is further indicative of the wholesale nature of PAL
10 services.

11 Of final note regarding the equivalence of PAL and business rates is the following
12 statements of Mr. McIntyre:

13 I consider a rate equal to the flat business rate to be as low as this
14 service could reasonably be priced. The flat business rate is the
15 basic rate that any business pays for its basic connection to the
16 network. It is not reasonable that payphone service providers
17 contribute to Qwest's operating costs any less than other
18 businesses do. This is a cost of operation for many types of
19 business customers and it should be the absolute price floor for
20 PAL services as well.

21 Consistent with the strategic tactics underlying Qwest's rebuttal, Mr. McIntyre's use of
22 "reasonably" and "reasonable" presumes something that Qwest has not established with respect to
23 PAL rates. In particular, in order for it to be true that Qwest's "cost of operation" for a business
24 services "should be the absolute price floor for PAL services as well," a demonstration that this
"cost of operation" is applicable to PAL is required. Nowhere in either the direct or so-called
rebuttal testimony of Qwest is such a demonstration presented.

Dr. Taylor's Rebuttal Testimony

1
2 Q. WHAT ARE YOUR DISAGREEMENTS WITH THE REBUTTAL TESTIMONY
3 OF DR. TAYLOR?

4 A. Approximately 26 of the last 80 pages of Dr. Taylor's rebuttal testimony are
5 devoted to PAL. I take no strong exception to the contents of roughly the first 12 pages of Dr.
6 Taylor's discussions, although much of the material therein should have been part of Qwest's
7 initial filing. At this stage of the proceeding, the plethora of new facts, figures, theories,
8 documents, and other matters about the payphone industry and services cited by Dr. Taylor
9 constitutes improper rebuttal.

10 My first significant disagreement with Dr. Taylor relates to the claims made at Page 66 of
11 his rebuttal testimony. Therein, Dr. Taylor mistakenly alleges that "nowhere in" Section 276 of
12 the Act "does it require that PAL services not contain subsidies (or contribution) to other
13 telecommunication services." He goes on to assert that, to the extent implicit subsidies to other
14 services are embodied in PAL rates, this matter can be resolved only within the context of Section
15 254 (Universal Service) of the Act. He further claims that Section 254 "requires the elimination of
16 all implicit subsidies, to be replaced with explicit support."

17 Q. HOW IS DR. TAYLOR MISTAKEN IN HIS VIEWS ABOUT 276 OF THE
18 ACT?

19 A. A significant flaw in Dr. Taylor's reasoning is his failure to recognize that Section
20 276 of the Act prohibits both implicit and explicit subsidies in PAL rates as reflected by the
21 following at §276 (a):

22 any Bell operating company that provides payphone service - (1)
23 shall not subsidize its payphone service directly or indirectly from
24 its telephone exchange service operations or its exchange access
operations. (emphasis added)

1 The terms “explicitly” and “directly” are commonly used as synonyms, as are the terms
2 “implicitly” and “indirectly.” Section 276 prohibits, accordingly, both types of subsidization
3 without regard to Section 254. This is further indicated in §276 (b)(1)(c) of the Act, wherein the
4 FCC is required to: prescribe a set of non-structural safeguards for Bell operating company
5 payphone service to implement the provisions of paragraphs (1) and (2) of subsection (a), which
6 safeguards shall, at a minimum, include the non-structural safeguards equal to those adopted in the
7 Computer Inquiry - III (CC Docket No. 90-623) proceeding.

8 As described in the FCC’s Payphone Order on Reconsideration, one of the non-structural
9 safeguards adopted in the Computer Inquiry III proceeding was the “new services test.” (See also
10 Pages 21 and 22 of my direct testimony.) Dr. Taylor is, therefore, incorrect when he states that
11 “neither the Act nor any FCC rules require the elimination of subsidies (in the form of reduced
12 contribution) from...payphone access services...” (p.66). By its very nature, the “new services test”
13 is designed to eliminate subsidies.

14 Q. IN CONTRAST TO DR. TAYLOR’S POSITION, WHAT IS THE PROPER
RELATIONSHIP BETWEEN SECTIONS 276 AND 254 OF THE ACT?

15 A. As noted in my previous answer, Section 276 mandates that PAL rates must be free
16 of both direct and indirect subsidies in the first instance, irrespective of what may ultimately
17 transpire with regard to Section 254. But this is not to say that PAL subscribers are or should be
18 exempt from making a contribution to universal service, such as through a separate surcharge in
19 addition to tariffed rates. This surcharge or any other means, however, must be imposed in an
20 equitable and nondiscriminatory manner as envisioned in §254 (b)(4).

21 Moreover, the responsibility for making a showing as to universal service requirements
22 rests solely with Qwest. It has not done so in this proceeding. Until Qwest fulfills this obligation,
23 the revenues that flow to Qwest from PAL customers should be no greater than the revenues
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1 necessary to cover Qwest's direct costs of its PAL services plus a reasonable share of Qwest's
2 common costs, excluding universal service costs, as required by the "new services test."

3 Q. HOW DO YOU RESPOND TO DR. TAYLOR'S REMARKS CONCERNING
4 PAL SUBSIDIES, PRICING FLEXIBILITY, AND PRICE DISCRIMINATION?

5 A. As reflected by the comments at Pages 67-69 of his rebuttal, Dr. Taylor has missed
6 the major point of my recommendation that the Commission defer the granting of pricing
7 flexibility to Qwest until PAL pricing matters are properly and fully resolved. In particular, and
8 aside from the erroneous assertions of Dr. Taylor noted in previous answer, substantial danger to
9 local competition is posed as long as Qwest is permitted to use a faulty costing methodology, such
10 as that underlying the total recurring costs that Qwest has presented with respect to PAL in this
11 proceeding. This follows because, absent specification of appropriate costing procedures for PAL
12 consistent with the "new services test," Qwest will retain the ability to manipulate cost study
13 results to fit its interests given particular circumstances.

14 Qwest's behavior in the current proceeding exemplifies this danger. Its cost study results
15 for PAL services reflect an inappropriate mixture of TELRIC and TSLRIC, neither of which,
16 moreover, reflect the specific characteristic of PAL. Input values used by Qwest in its cost models
17 are largely unsupported, as well as bear little relation to those found reasonable in Commission
18 Decision No. 60635. Qwest further currently possesses the ability to significantly change cost
19 study results at will, literally through a few keystrokes, because no specific guidelines are in place.
20 Under present circumstances, accordingly, rivals will have little chance of ever establishing that
21 Qwest has priced its services in an anticompetitive manner -- even though Qwest may have
22 actually done so.

23 If local competition were well-beyond its incipient stage, the ability to manipulate cost
24 study results would be of little concern. However, as this condition has yet to materialize, the

1 granting of pricing flexibility to Qwest is premature absent specification as to an appropriate
2 application of the "new services test."

3 Q. DO YOU AGREE, DR. ILEO, WITH THE COMMENTS OF DR. TAYLOR
4 ABOUT THE APPLICATION OF THE "NEW SERVICES TEST" BY THE FCC?

5 A. Yes, at least in a general context. In the remarks in questions, which appear at
6 Pages 69-71 of his rebuttal, Dr. Taylor does not attempt (as Messrs. Thompson and McIntyre) to
7 suggest that the FCC has sanctioned price/direct cost ratios for PAL of 3.4 or 4.8 times. The only
8 shortcoming of Dr. Taylor's discussion therein is the failure to acknowledge that the FCC has not
9 acted pro-actively in applying the "new services test" to PAL because this responsibility largely
10 rests with state regulators as noted at Page 21 of my direct testimony.

11 Q. HOW DO YOU INTERPRET DR. TAYLOR'S COMMENTS AS TO EQUATING
12 THE COMMISSION'S TASKS IN THIS CASE WITH THOSE UNDERLYING COMMISSION
13 DECISION NO. 60635?

14 A. The remarks of Dr. Taylor cited begin at Page 72 of his rebuttal testimony.
15 Between the question at Page 72 (Lines 1-5) and the remarks at Page 73 (Lines 19-24) of his
16 rebuttal, Dr. Taylor never specifically refers to my direct testimony. Thus, aside from the
17 predicate and certain end-result conclusions that Dr. Taylor asserts pertain to my positions, his
18 intervening discussions are void of any reference to my direct testimony.

19 Moreover, since I draw no analogy between the past and current tasks of the Commission --
20 especially not at Page 5 of my direct testimony as cited by Dr. Taylor -- his comments appear to
21 serve no purpose other than as an introduction for the discussions that follow in Dr. Taylor's
22 rebuttal, which largely constitute direct testimony. To illustrate, I refer to Commission Decision
23 No. 60635 on Page 5 of my direct testimony only in relation to the needed clarification of
24 engineering/investment parameters. Nowhere therein do I equate the "Commission's task in this
proceeding with that in Commission Decision No. 60635" as alleged by Dr. Taylor.

1 Within this same context of mischaracterizing my testimony, Dr. Taylor nevertheless
2 proceeds to acknowledge “some surface similarities between the tasks in that proceeding and the
3 present one,” but warns that “it is dangerous to read too much into those similarities.” Nowhere in
4 my direct testimony do I discuss these “surface similarities,” nor does my direct testimony address
5 the danger alluded to by Dr. Taylor.

6 Q. IF YOUR DIRECT TESTIMONY DOES NOT DRAW THE ANALOGY
7 BETWEEN TASKS OF THE COMMISSION AS ALLEGED BY DR. TAYLOR, WHAT IS THE
8 POINT OF HIS REBUTTAL?

9 A. For some unknown reason, Dr. Taylor seems to believe that I support the pricing of
10 PAL services on an unbundled network element or UNE basis. However, nowhere in my direct
11 testimony do I either state or infer that the PAL services of Qwest should be priced in such a
12 manner. Indeed, my direct testimony clearly and repeatedly takes issue with Qwest for its use of
13 the statewide \$21.98 2-wire UNE rate that resulted from Commission Decision No. 60635 as the
14 loop and drop monthly recurring cost component of its PAL service. Further, as my direct
15 testimony continually advocates the proper application of the “new services test” to PAL, as well
16 as that the BPAL cost calculations contained in my direct testimony are all performed on a bundled
17 basis, it remains to be seen how Dr. Taylor could have possibly arrived at the conclusion that I
18 support the use of an unbundled TELRIC methodology for the pricing of PAL.

19 I do take the position, both presently and in my direct testimony, that PAL should be
20 recognized as a wholesale rather than retail service in applying the forward-looking economic cost
21 methodology embodied in the “new services test.” Qwest, itself, has designated PAL as a
22 wholesale service. The wholesale nature of PAL (and the resulting lower marketing, advertising,
23 customer information, and related costs) is the only aspect of a TELRIC methodology that I
24 recommend be applied to PAL as clearly noted in my direct testimony.

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Q. ARE THERE OTHER ASPECTS OF DR. TAYLOR'S INTERVENING DISCUSSIONS WITH WHICH YOU TAKE ISSUE?

A. Yes. Dr. Taylor's use of the term "surface similarities" (p.72, ln.5) connotes a wide difference between TELRIC and TSLRIC methodologies, when that is not true for such reasons as discussed at Pages 9-10 of my direct testimony. The statement of Dr. Taylor that "Therefore, the cost standard for UNE's, namely, TELRIC, is very different from the cost standard for services, namely, TSLRIC" (p.73, lns. 7-9) similarly envisions a wide disparity between these two long-run incremental cost procedures that does not exist.

A more substantive disagreement with Dr. Taylor's intervening discussions resides with his claim that "any reasonable costing methodology that is appropriate for services (e.g., Qwest's choice of TSLRIC or some other) would be consistent with the new services test" (p.73, lns. 13-15). I take issue with this remark because, if Qwest were inappropriately granted the "choice" of determining the "reasonable costing methodology...consistent with the new services test," a condition would prevail that violated the pronouncements of the FCC as to how state regulators must apply the "new services test" to PAL and that further posed the prospect of undermining the development of local exchange competition. This latter fact underscores why Qwest should be denied pricing flexibility until matters regarding the proper application of the "new services test" to PAL are resolved by the Commission.

Of further note is that Dr. Taylor's assertions in his intervening discussions about the inapplicability of a TELRIC methodology to Qwest's services contradicts a major position taken by Qwest in this proceeding. I refer here to Qwest's proposal to utilize the 2-wire loop and drop UNE rate found in Commission Decision No. 60635 of \$21.98 as the access cost component for the monthly recurring cost of PAL.

1 Q. PLEASE DESCRIBE THE NATURE OF THE CONFLICT BETWEEN DR.
TAYLOR AND QWEST.

2 A. Put simply, if a TELRIC methodology is inappropriate for PAL, as Dr. Taylor
3 asserts, then the \$21.98 is also inappropriate for PAL, as it also rests on a TELRIC methodology.
4 The only plausible explanation for the contradiction between Dr. Taylor's statements and Qwest's
5 proposed costing of PAL is that Dr. Taylor was unaware of Qwest's reliance on the UNE rates in
6 Commission Decision No. 60635 for the costing of PAL in this case when he prepared his rebuttal
7 testimony, even though my direct testimony repeatedly takes issue with this approach of Qwest to
8 PAL costing.

9 It is further difficult to conceive how Dr. Taylor could possibly conclude that Qwest has
10 "employed the proper cost standard in this proceeding" (p. 73, ln. 25- p.74, ln.3). I say this, first,
11 because Dr. Taylor's rebuttal testimony is void of any description of the costing methodology
12 employed by Qwest in this proceeding. Additionally, since Dr. Taylor objects to a costing
13 methodology based on TELRIC, when TELRIC-derived results are a significant part of the costing
14 methodology proposed by Qwest in this case, the basis of his conclusion as to a "proper cost
15 standard" is questionable.

16 Q. DO YOUR OBSERVATIONS AS TO DR. TAYLOR'S UNDERSTANDING OF
17 QWEST'S COSTING METHODOLOGY EXTEND TO HIS COMMENTS ABOUT MARK-UPS
18 ABOVE DIRECT COSTS?

19 A. Yes. As with what appears as a totally unfounded assertion that Qwest has used a
20 "proper cost standard" in this case for PAL, Dr. Taylor's remarks on Pages 74-80 of his rebuttal as
21 to the mark-ups incorporated in Qwest's proposed PAL rates raise many questions. This is true
22 most particularly beginning at Page 76, with Dr. Taylor's comment that the "FCC approved
23 loadings as high as 4.8 times" direct costs. I discussed earlier in my surrebuttal with respect to Mr.
24

1 McIntyre's claims that the FCC has permitted such price/direct cost ratios in circumstances that
2 have no relevance or precedence; e.g., when no customers have existed for the services.

3 Dr. Taylor's discussion regarding Ramsey Pricing (also known as the Inverse Elasticity
4 Rule) for spreading Qwest's common cost to services requires comment, as several issues in
5 connection with the use of Ramsey Pricing need to be recognized. In the first instance, Qwest has
6 neither established that the markups incorporated in its PAL rates are consistent with the Inverse
7 Elasticity Rule, nor has Qwest performed the various elasticity of demand studies necessary to do
8 so. In addition to fulfilling these requirements, application of Ramsey Pricing will necessitate a
9 meshing of statutory standards with the economic standard of "allocative efficiency."

10 The FCC wrestled with this question in its First Report and Order on Implementation of the
11 Local Competition Provisions of the Telecommunications Act of 1996 (CC Docket Nos. 96-98 and
12 95-185, released August 9, 1996), noting the following at Paragraph 696 with respect to forward-
13 looking common costs:

14 ...we conclude that an allocation methodology that relies
15 exclusively on allocating common costs in inverse proportion to
16 the sensitivity of demand for various network elements and
17 services may not be used. We conclude that such an allocation
18 could unreasonably limit the extent of entry into local exchange
19 markets by allocating more costs to and thus raising prices of, the
20 most critical bottleneck inputs, the demand for which tends to be
21 relatively inelastic. Such an allocation of these costs would
22 undermine the pro-competitive objective of the 1996 Act.

19 Coupled with a consideration of these competitive impacts, the appropriateness and
20 reasonableness of Ramsey Pricing must be judged in relation to other concerns. Suppose it is true,
21 hypothetically, that residential and small business basic services are the most inelastic of
22 telecommunications demands. Application of the Inverse Elasticity Rules requires these services
23 to bear proportionally greater shares of common costs. With such an allocation, heighten concerns
24

1 with universal service ensue, as well as with respect to scale and scope economies lost as a result
2 of the repression of residential and small business demand. The resulting diminished value of the
3 network may also pose concern.

4 The Commission should further understand that, while Ramsey Pricing is the appropriate
5 economic method for assigning common costs, it is difficult to implement in practice. This is true
6 not only from a technical perspective in performing Ramsey Pricing studies, but further because
7 considerable controversy will invariably surround price and cross-price elasticity estimates. For
8 example, with respect to the SAC studies that I conducted noted earlier in my surrebuttal, the ICC
9 employed the Inverse Elasticity Rule to allocate a railroad's common costs to the different
10 commodities for which separate SAC studies were performed. In so doing, the ICC first has to
11 determine which elasticity estimates were the most appropriate.

12 The various obstacles and concerns noted above probably best explain why regulator have
13 typically determined that the most reasonable solution to the multi-faceted issue of common cost
14 allocation is the application of a single flat percentage levied across all services, much like the
15 15% adopted by the Commission in Qwest's UNE docket.

16 Q. HOW DO YOU RESPOND TO DR. TAYLOR'S CLAIM THAT QWEST'S PAL
17 RATES ARE REASONABLE?

18 A. I find nothing in Dr. Taylor's rebuttal testimony that conceivably could lead him to
19 conclude that the PAL rates of Qwest are reasonable. He has conducted no cost study of PAL. He
20 has performed no Ramsey Pricing study. He has contradicted Qwest's inclusion of a TELRIC-
21 based UNE rate in the costs of PAL, which further suggests he is unaware of the PAL costing
22 methodology of Qwest. He has mischaracterized by direct testimony, which implies he is also
23 unaware of the PAL costing procedures that I have employed. While Dr. Taylor may believe that
24 Qwest's PAL rates are reasonable, nothing in his rebuttal testimony supports such a finding.

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Q. HAVE YOU COMPLETED YOUR SURREBUTTAL TESTIMONY.

A. Yes.

apa/pl/99-0105/surrebuttal testimony01