BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Investigation Into U S WEST Communications, Inc.'s Compliance With Section 271 of the Telecommunications Act of 1996	)	Docket No. UT-003022
In the Matter of U S WEST Communications, Inc.'s Statement of Generally Available Terms Pursuant to Section 252(f) of the Telecommunications Act of 1996	)	Docket No. UT-003040

AT&T'S BRIEF ON SECTION 272 OF THE ACT

September 10, 2001

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AT&T'S BRIEF ON SECTION 272 OF THE ACT

AT&T Communications of Pacific Northwest, Inc., TCG Seattle and TCG Oregon, (collectively, "AT&T") hereby file their brief on section 272 of the Telecommunications Act of 1996.

I. INTRODUCTION

Section 272(a) of the Telecommunications Act of 1996 ("Act") states that a Bell operating company ("BOC") may not provide originating, in-region interLATA services unless it does so though a separate affiliate. Sections 272(b) and (c), respectively, impose structural and transactional safeguards, and nondiscrimination safeguards. Section 272(d) and (e), respectively, impose a biennial audit requirement and an obligation on the BOC and section 272 affiliates to fulfill requests from unaffiliated entities or third parties. Section 272(g) imposes certain marketing restrictions on the BOC. Finally, section 272(h) allows a transition period of one year to comply with section 272 with respect to any activities that fall under section 272(a)(2) that a BOC is engaged in at the time the Act was enacted.

The Federal Communications Commission ("FCC") has promulgated a number of rules to implement the requirements of section 272.[1] The *Accounting Safeguards Order*, in relevant part, generally addresses sections 272(b)(2)(5), 272(c)(2) and 272(d).[2]

[1] *Accounting Safeguards Under the Telecommunications Act of 1996, CC Docket No. 96-150, Report and Order*, FCC 96-490 (rel. Dec. 24, 1996) ("*Accounting Safeguards Order*"); *Implementation of the Non-Accounting Safeguards of Section 271 and 272 of the Communications Act of 1934*, as amended, CC Docket No. 96-149, First Report and Order, FCC 96-489 (rel. Dec. 24, 1996) ("*Non-Accounting* Safeguards *Order*").

[2] *Accounting Safeguards Order*, ¶¶ 110-205.

The *Non-Accounting Safeguards Order*, in relevant part, generally addresses the remainder of the requirements of section 272(a), (b), (c), (e) and (g). The FCC has determined that the BOC must comply with the Act since the date of its enactment and must comply with the *Accounting Safeguards Order* since the effective date of the order.[3]

The FCC has made it clear that, based on section 217(d)(3)(B), a finding that the BOC fails to comply with section 272 constitutes an independent ground for denying relief under section 271.[4]

> …Congress required us to find that a section 271 applicant has demonstrated that it will carry out the requested authorization in accordance with the requirements of section 272. We view this requirement to be of crucial importance, because the structural and nondiscrimination safeguards of section 272 seek to ensure that competitors of the BOCs will have nondiscriminatory access to essential inputs on terms that do not favor the BOC's affiliate. These safeguards further discourage, and facilitate detection of, improper cost allocation and cross-subsidization between the BOC and its section 272 affiliate. These safeguards, therefore, are designed to promote competition in all telecommunications markets, thereby fulfilling Congress' fundamental objective in the 1996 Act.[5]

The FCC has stated that to determine whether a BOC will comply with section 272, it must make a "predictive judgment regarding the future behavior of the BOC."[6] In making such a determination, the FCC will "look to past and present behavior of the BOC applicant as the best indicator of whether it will carry out the requested

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[3] *Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Michigan*, CC Docket No. 97-137, Memorandum Opinion and Order, FCC 97-298 (rel. Aug. 19, 1997), ¶ 371 ("*Ameritech Michigan Order*").

[4] *Application of BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in Louisiana*, CC Docket No. 98-121, Memorandum Opinion and Order, FCC 98-271 (rel. Oct. 13, 1998), ¶ 322 ("*BellSouth Louisiana II Order*"); *Ameritech Michigan Order*, ¶ 342. *See* section 271(d)(3)(B): The FCC shall not approve a section 271 application unless it finds that "the requested authorization will be carried out in accordance with the requirements of section 272."

[5] *Ameritech Michigan Order*, ¶ 346. *See BellSouth Louisiana II Order*, ¶ 320.

[6] *Ameritech Michigan Order*, ¶ 347.

authorization in compliance with the requirements of section 272."[7] Furthermore, "mere paper promises to comply are insufficient."[8]

The state commission must also evaluate Qwest's past behavior to determine if it is satisfied that Qwest will comply with section 272 in the future. Qwest maintains to this day that its section 272 affiliates have had processes in place to be in compliance, and have been in compliance, with section 272 since 1996.[9] Therefore, the past is even more relevant, because if Qwest maintains it always has been section 272 compliant, its refusal to recognize, understand and correct past noncompliance and past violations of section 271 which directly implicate section 272 raises into question its willingness and ability to comply with section 272 in the future. AT&T believes that Qwest's past history reflects a failure to comply with section 272, and the only conclusion that can be drawn is that Qwest and its section 272 affiliate will not comply with section 272 in the future.

II. ARGUMENTS

A. Section 272(a)

Section 272(a) states that a BOC may not provide in-region, interLATA services unless it provides that service through an affiliate that is separate from the BOC and meets the requirements of section 272(b).[10] Qwest acknowledges this requirement.[11] However, a brief review of Qwest's (and the former U S WEST's) history belies Qwest's statements.

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[7] *Id*.
[8] *BellSouth Louisiana II Order*, ¶ 339. *Ameritech Michigan Order*, ¶ 55.
[9] TR 144-145 and 156 (June 7, 2001). Transcript cites are to the multistate transcripts unless otherwise noted.
[10] 47 U.S.C. § 272(a).
[11] Ex. 1095T (Brunsting Supp. Direct) at 6; Ex. 1125T (Schwartz Supp. Direct) at 5.

On September 27, 1999, the FCC found that "U S WEST's provision of non-local directory assistance service to its in-region subscribers constitutes the provision of in-region, interLATA service," and "the nationwide component of U S WEST's non-local directory assistance service was unlawfully configured."[12]

On September 28, 1998, the FCC concluded that U S WEST Communications, Inc., the BOC, through its marketing arrangement with pre-merger Qwest, was "providing in-region, interLATA service without authorization, in violation of section 271 of the Act."[13]

On February 16, 2001, the FCC concluded that Qwest, through its 1-800-4US-WEST calling card service, was providing in-region, interLATA service in violation of section 271.[14]

In each of the cases, the party providing the in-region, interLATA service was the BOC. Therefore, U S WEST, the BOC, was providing in-region, interLATA services in violation of section 272(a) also. Thus, Qwest was in violation of section 272(a) and cannot continue to support their oft-repeated claim of an unbroken chain of section 272 compliance since the Act's inception.[15]

Furthermore, section 272(a) requires the affiliate to meet the requirement of section 272(b). Qwest simply ignores this requirement. Since AT&T maintains that Qwest does not meet all the requirements of paragraph (b), the Commissions cannot

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[12] *Petition for U S WEST Communications, Inc. for a Declaratory Ruling Regarding the Provision of National Directory Assistance*, CC Docket No. 97-172, Memorandum Opinion and Order, FCC 99-133 (rel. Sept. 27, 1999), ¶¶ 2 and 63. *See* Ex. 1155T (Skluzak Affidavit), ¶¶ 157-160.
[13] *AT&T Corp. et al., v. U S WEST Communications, Inc.*, File No. E-99-42, Memorandum Opinion and Order, FCC 98-242 (rel. Oct. 7, 1998), ¶¶ 1, 38 and 52. *See* Ex. 1155T, ¶ 161.
[14] *AT&T Corp v. U S WEST Communications, Inc.*, File No. E-99-28, Memorandum Opinion and Order, DA01-418 (rel. Feb. 16, 2001). *See* Ex. 1155T, ¶ 164.
[15] Ex. 1140 at 5. WA TR 5120 and 5123-5124 (July 17, 2001).

conclude that Qwest is in compliance with paragraph (a).

B. Section 272(b)(2)

Section 272(b)(2) states that the section 272 affiliate:

> …shall maintain books, records, and accounts in the manner prescribed by the Commission which shall be separate from the books, records and accounts maintained by the Bell operating company of which is an affiliate.

To determine compliance with this section, the FCC has looked to such evidence as different charts of accounts, use of separate accounting software maintained at a separate location and regular audit program for the affiliate that ensures compliance with Generally Accepted Accounting Principles ("GAAP").[16]

1. Generally Accepted Accounting Principles

The FCC has stated that section 272(b)(2) requires the BOC's section 272 affiliate to maintain its books, records and accounts pursuant to GAAP, principles that include timeliness and accruals, and maintain the records separate from the BOC.[17]

AT&T's review of Qwest's records found numerous instances of the failure to follow accrual accounting and to timely book billable transactions.[18] Most ominously, Qwest and QCC failed to book *any* transactions between July 2000 and April 2001 because it failed to bill any of these transactions.[19]

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[16] *BellSouth Louisiana II Order*, ¶ 328.
[17] *BellSouth Louisiana II Order*, ¶ 328; *Accounting Safeguards Order*, ¶ 170.
[18] Ex. 1155T, ¶ 37(a). *See* B4, *infra*.
[19] Ex. 1155T, ¶ 39 and Ex. 1156C (Skluzak Affidavit, confidential), ¶ 125. Also, specific transactions were noted at Ex. 1156C, ¶¶ 104(a), 104(f), 109(a), 109(b) and 109(f). Qwest has argued that QCC did not become a section 272 affiliate until March 26, 2001. AT&T maintains that Qwest's own records demonstrate that QCC was representing that QCC was a section 272 affiliate as of January 1, 2001; however, regardless of the date QCC became the section 272 affiliate, it was required to follow GAAP.

QCC's representative admitted that the GAAP principle of timeliness was not always followed.[20] Qwest's representative admitted that they had not captured all of the transactions between the 272 affiliate and the BOC.[21]

The FCC looks for a regular audit program for the affiliate that ensures GAAP compliance.[22] Qwest does not, and cannot, offer such evidence. Failure to follow GAAP is not limited to QCC. Numerous instances were cited by AT&T regarding U S WEST Long Distance and Qwest LD.[23] Qwest has demonstrated that it consistently has not taken the requirement to follow GAAP seriously.

2. Materiality

AT&T has documented that Qwest, Qwest LD and QCC have failed to accrue and timely pay for services. This is a violation of GAAP. Qwest has noted that Arthur Andersen LLP audited Qwest Corporation and QCI, and the accounting firm found that QCI and subsidiaries were complying with GAAP.[24] Qwest has also argued that the problems identified by AT&T are not material.[25]

First, the audit only takes a sample of items to reach its conclusion.[26] Second, the audit was performed "to obtain reasonable assurance about whether the financial statements are free of *material* misstatement."[27] Third, the audit was for QC and QCI, but there was no audit of the 272 affiliates. The FCC looks to a regular audit program for

[20] "The transactions between July 1, 2000 and April 2001 were not concluded, posted or billed in a timely manner." Ex. 1105T (Brunsting Rebuttal) at 6.
[21] Ex. 1139T (Schwartz Rebuttal) at 5.
[22] *BellSouth Louisiana II Order*, ¶ 328; Ex 1155T, ¶ 35, n. 27.
[23] Ex. 1155T, ¶¶ 65(c), 65(d) and Ex. 1156C, ¶ 79.
[24] TR 177 (June 7, 2001).
[25] TR 178 (June 7, 2001).
[26] TR 179 (June 7, 2001).
[27] Ex. 1141 at 1 (emphasis added).

the *272 affiliate* for evidence of compliance with section 272(b)(2), not the BOC.

Qwest Communications International, Inc. had $13.2 billion in combined revenues and $9.8 billion in combined expenses in 1999.[28] According to Mr. Cory W. Skluzak, in 1999, Qwest paid Qwest LD approximately $29 million, and this amount was over 8 times (approximately $3.5 million)[29] the money paid from Qwest LD to Qwest. The total represents less than 1% of the combined revenues ($32.5 M ÷ $13.2 B).

It is possible Arthur Andersen did not test *any* transactions between Qwest LD and Qwest, or, if it did, it selected different items than AT&T.[30] Notably, Qwest states that it will accrue for a section 272 transaction over $25,000 not billed in the current month and that this current policy is a strengthening over past practice.[31] If this is a "strengthened" policy, then the assumption is that the past practice for the accrual of section 272 transactions was weaker and had a higher dollar threshold. Even if materiality were the applicable standard in a section 272 analysis (which it is not), the transactions identified by Mr. Skluzak should be judged against the size of the section 272 affiliates' revenues and expenses, not the combined revenues and expenses of the parent or all affiliates.[32]

Materiality is not the sole determination in an audit.

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[28] *Id*. at 3.
[29] Ex. 1155T, ¶ 55, n. 71.
[30] TR 179-181 (June 7, 2001).
[31] Ex. 1139T at 16.
[32] TR 182-183 (June 7, 2001). For the period April 1, 1999, to December 31, 1999, Mr. Skluzak tested U S WEST LD's expenses to U S WEST (services provided by U S WEST). Seventeen billed amounts were selected, representing $1,974,736, or 56% of the total expense. Mr. Skluzak found various problems with all 17 selections. Ex. 1155T, ¶¶ 62, 64 and 65. For the period July 1, 2000, to December 31, 2000, Qwest failed to bill and account for *all affiliated transactions with QCC*. These findings are not immaterial.

> Magnitude by itself, without regard to the nature of the item and the circumstances in which the judgment has to be made, will not generally be sufficient basis for a materiality judgment.[33]
>
> Almost always, the relative rather than the absolute size of a judgment item determines whether it should be considered in a given situation.[34]

As the issue is whether the section 272 affiliate complies with GAAP, it is this company's financial statement that should be reviewed, as well as the section 272 affiliate's accounting records. The size of the section 272 affiliate alone determines the materiality of the amounts at issue. However, one cannot forget the relevance of the audit. One needs to evaluate materiality "as it relates to the other qualitative characteristics, especially relevance and reliability."[35]

However, regardless of the proper application of materiality, the Joint Federal/State Oversight Group has established General Standard Procedures for Biennial Audits Required Under Section 272 of the Communications Act of 1934, as amended. The Procedures, at page 6, state: "It should be noted that [Agreed-Upon Procedures] engagements are not based on the concept of materiality; therefore, the practitioner must report all errors or discrepancies discovered while performing the AUP engagement." Since the practitioner must report all errors of discrepancies in the Biennial audit, all issues raised by Mr. Skluzak are relevant. Accordingly, Qwest's materiality claims are meritless.

[33] FASB (Financial Accounting Standards Board) Statement of Concepts 2, Glossary.
[34] *Id.*, ¶ 129.
[35] *Id.*, ¶ 124.

3. Audit Trail

In addition to looking at the sufficiency of the Internet postings, the FCC looks to see if the BOC maintains an audit trail of past Internet postings.[36] The FCC looks at publicly available accounting and financial data, as well as confidential data.[37]

Qwest maintains that it has complied with the Internet posting requirement. As noted by Mr. Skluzak, up until January 1, 2000, Qwest published agreements, work orders and task orders, and the details of individual transactions pursuant to the agreements and orders. Beginning January 1, 2000, Qwest only posts agreements, work orders and task orders. Postings are no longer made for the individual transactions pursuant to the work orders and task orders. Regardless of the merit of Qwest's position, Mr. Skluzak's reviews of accounting records and the Internet postings demonstrate a failure to maintain an audit trail for numerous transactions.[38]

Qwest claims it has cleaned up its act.[39] However, regardless if this is true or not, Qwest was required to comply with section 272 of the Act since 1996. This means that there are many years of documented, poor record keeping and a lack of an audit trail.

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[36] *Application of SBC Communications, Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance Pursuant to Section 272 of the Telecommunications Act of 1996 To Provide In-Region InterLATA Services in Texas*, CC Docket No. 00-65, Memorandum Opinion and Order, FCC 00-238 (rel. June 30, 2000), ¶ 405 ("*SBC Texas Order*").

[37] *Id*., ¶ 404, n. 1172.

[38] Ex. 1155T, ¶¶ 64, 65(b), 65(m)-(p) and Ex. 1156C, ¶¶ 80, 81, 99 and 104. As Mr. Skluzak noted, none of the transactions between QCC and Qwest for the period July, 2000 to March, 2001 were billed until April, 2001. Ex. 1155T, ¶ 100. Qwest concurs. Ex. 1105T at 6; Ex. 1139T at 10-11. This results in a total lack of an audit trail. Furthermore, until the *SBC Texas Order* came out, even *Qwest* believed it had to post individual transactions pursuant to the work orders and task orders. The extensive problems documented by Mr. Skluzak reinforce the conclusion that Qwest had poor internal controls and inadequate training. *See* B.4., *infra*.

[39] Ex. 1140 at 20; WA TR 5136.

Qwest is asking the Commissions to accept its paper promises. There is no significant history of compliance with section 272, the posting requirements and GAAP on which the Commission can rely to warrant a finding of compliance with section 272.

4. Lack of Internal Controls

Numerous instances of failure to timely accrue, timely bill for services and meet the terms of the intercompany agreements demonstrate a lack of internal controls. Mr. Skluzak cited numerous instances where the companies failed to timely accrue and account for transactions.[40] In some cases, contract payment terms were not adhered to.[41] In essence, this provided interest free loans to the other company.[42] Not only does this demonstrate a lack of internal controls and noncompliance with GAAP, interest free loans provide a form of subsidy and, potentially, are discriminatory.

In response to Mr. Skluzak's allegations of improper float, Qwest, for the first time at the June 8, 2001, multistate workshops, stated that they had "discovered" that the master service agreement excluded an interest component in the payment terms "by mistake."[43] Qwest calculated interest back to the merger date and stated that the master service agreement would be amended "to contain reasonable and customary payment terms one would expect to find."[44] The amount that will be accrued and paid by QCC to Qwest for the period June 30, 2000 to April 30, 2001, is substantial.[45] This error was not

[40] Ex. 1155T, ¶¶ 37(a), 65(c), and 65(h); Ex. 1156C, ¶¶ 79, 80, 99, 104, 109 and 125. These are all examples of the failure to comply with GAAP.
[41] Ex. 1155T, ¶¶ 65(c), 88(b); Ex. 1156, ¶¶ 79(c), 104(f) and 109(d).
[42] Ex. 1155T, ¶¶ 65(d); Ex. 1156C, ¶¶ 78 and 104(c); TR 65 (June 8, 2001).
[43] TR 66 (June 8, 2001). *See also* Ex. 1139T at 11.
[44] TR 66-67 (June 8, 2001).
[45] TR 70 (June 8, 2001) (confidential).

discovered by Qwest's internal accounting controls and counters Qwest assertions that it has controls in place.

Qwest asserts, as additional evidence of compliance with section 272(b)(2), that it files annual reports via the FCC's Automatic Reporting and Management Information Systems ("ARMIS") which are accompanied by the report of independent accountants, Arthur Andersen.[46] AT&T reviewed the ARMIS report for Qwest for the year 2000, the most recent report posted by the FCC.[47] For services purchased by Qwest from QCC, AT&T did not locate an amount or a line entry. For services sold by Qwest to QCC, a total of $1,545,000 has been entered.[48] These amounts do not reconcile to the amounts that AT&T discovered during supplemental on-site testing.[49]

Since QCC and Qwest had not billed any of their affiliated transactions for the period July 2000 to April 2001, there is serious doubt that the ARMIS report accurately reflects the transactions between Qwest and section 272 affiliates. Once again, this demonstrates a lack of internal controls.

Qwest and its section 272 affiliates' controls are inadequate. They have demonstrated a cavalier attitude to the requirements of section 272.

5. Chart of Accounts

Initially, there was no evidence that Qwest and Qwest LD had separate charts of accounts. During an on-site review, Qwest LD provided its Chart of Accounts, but

[46] Ex. 1125 at 37.
[47] FCC's ARMIS website, Report 43-02, Table 12 "Analysis of Services Purchased from or Sold to Affiliates."
[48] Mr. Skluzak's findings are consistent with Ms. Marie Schwartz's rebuttal testimony. Ms. Schwartz stated: "The BOC did accrue for approximately $1.5 million of revenue as a receivable from QCC in the year 2000 for affiliate services which had been identified. As a result of the merger, no expenses were accrued as a payable to QCC because services being provided by QCC had not yet been identified." Ex. 1139T at 15-16.

Qwest did not. Qwest and QCC did subsequently provide their Charts of Account, and they are different.[50] The failure to initially provide evidence of separate charts of accounts reflects a lack of diligence on Qwest's part to demonstrate compliance with section 272. Many of the issues raised in AT&T's testimony may appear insignificant alone, but the Commissions must decide based on the totality of the evidence if Qwest will comply with section 272 in the future.

C. Section 272(b)(3)

The section 272 affiliate "shall have separate officers, directors and employees."[51] Qwest's attitude and approach to this requirement also is disturbing. There is a revolving door atmosphere with employees going back and forth between the BOC and section 272 affiliates.[52] There is wide-spread employee sharing, and many Qwest employees spend 100% of their time working for the section 272 affiliate.[53] This wide-spread employee sharing subverts the purpose of section 272(b)(3).

The *Biennial Audit Procedures* require the auditor to extensively review employee transfers from the BOC to the section 272 affiliate and determine whether BOC proprietary information was used or made available by employees after the transfer to the section 272 affiliate.[54] Thus, the free flow of employees back and forth between Qwest and its section 272 affiliate should not be taken lightly. It can be argued that an employee cannot and does not turn off knowledge gained at another company. As the number of

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[49] Ex. 1155T, ¶ 32. It appears that the FCC reviews ARMIS data to compare total amount of affiliated transactions. *Bell Atlantic New York Order*, ¶ 411.
[50] Ex. 1156C, ¶ 37(c).
[51] 47 U.S.C. § 272(b)(3).
[52] Ex. 1156C, ¶ 47(c)-(e); Ex. 1155T, ¶ 47(f)-(h).
[53] Ex. 1156C, ¶¶ 50-52.
[54] Ex. 1155T, ¶ 46.

employee rehires, transfers and sharing increases, the chance of abuse increases and independence is suspect.

Qwest had an employee reward program that it allowed employees of the section 272 affiliate to participate in.[55] This raises serious concerns regarding independence. If an employee of the section 272 affiliate can participate in a BOC awards program, can the employee be truly independent? AT&T thinks not, because the reward incents the employee to dedicate time to the BOC, time which may not be accounted and paid for by the BOC.

It is AT&T's position that the rehiring, transfer and sharing of employees has demonstrated that the employees of the BOC and section 272 affiliate are not truly independent.

It is AT&T's position that there has been an overlap, and therefore a non-separation, of officers and/or directors.[56] Initially, there was no comparison of payroll registers.[57] Qwest stated that it "does not do a comparison, per se, of actual payroll registers for employee matches on a regular basis." Evidently, this control was put in place recently but this is evidence of a failure initially to verify compliance with this subsection.

D. Section 272(b)(5)

1. Posting Transactions to the Web Page

Section 272(b)(5) states that the section 272 affiliate:

[55] *Id*., ¶ 47(f).
[56] Ex. 1156C, ¶¶ 47(a)-(b) and 52(e) and (h).
[57] Ex. 1155T, ¶ 47(j).

> …shall conduct all transactions with the Bell operating company of which it is an affiliate on an arm's length basis with any such transactions reduced to writing and available for public inspection.

The FCC, in its *Accounting Safeguards Order*[58] and *Non-Accounting Safeguards Order*,[59] has promulgated rules and requirements that must be followed to demonstrate compliance with section 272(b)(5).

As noted earlier, the requirement to publicly disclose transactions was effective the date the Act was enacted. The requirement to post on the Internet became effective with the implementation of the *Accounting Safeguards Order* on August 12, 1997.[60] The *Accounting Safeguards Order* requires that all transactions be posted to the Internet within 10 days of the transaction on the company's home page. "[T]he description of the asset or service and the terms and conditions of the transactions should be sufficiently detailed to allow [the FCC] to evaluate any compliance with our accounting rules."[61] The FCC, in numerous subsequent orders evaluating BOC applications, has embellished on this requirement.[62] AT&T itemized a significant number of instances of Qwest's failure to follow the requirement to post transactions within 10 days of the transaction.[63]

After January 1, 2000, specific "billed amounts" were no longer posted to the website.[64] Therefore, AT&T was unable to determine if Qwest was in compliance with

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[58] *Accounting Safeguards Order*, ¶¶ 112-166. The relevant paragraph regarding posting of transactions is paragraph 122. AT&T generally did not contest the prices paid for services, except to note that they appear excessive to the point that no non-affiliated third party would avail themselves of the agreements between the BOC and section 272 affiliate. It appears to AT&T, then, instead of allowing subsidization by below-cost pricing, one company is being subsidized by above market cost pricing. *See* Ex. 1156C, ¶ 109(a) and (b); section 254(k); TR 31-32 (June 8, 2001).
[59] *Non-Accounting Safeguards Order*, ¶¶ 191-194.
[60] Ex. 1155T, ¶ 55. *See BellSouth Louisiana II Order* at paragraphs 333-337; the FCC reviewed BellSouth's postings preceding the filing of the application for compliance with the *Accounting Safeguards Order* posting requirement. *See also Ameritech Michigan Order*, ¶ 371.
[61] *Accounting Safeguards Order*, ¶ 122.
[62] *Ameritech Michigan Order*, ¶¶ 367-369; *BellSouth Louisiana II Order*, ¶¶ 335-337.
[63] Ex. 1155T, ¶¶ 64-65; Ex. 1156C ¶¶ 80-81 and 106-109.
[64] Ex. 1155T, ¶ 72.

the FCC's accounting rules without viewing information Qwest now considered confidential and available for inspection only on-site and after executing a protective agreement.

Qwest claims that its posting methodology is consistent with the way Southwestern Bell Telephone Company ("SBC") posts its transactions, and that the FCC approved SBC's methodology in the SBC Texas 271 proceeding. Qwest claims it no longer has to post billing detail or volumes and the FCC allowed SBC to keep this information confidential.

Putting aside the issue of the posting of billing detail,[65] Qwest and its section 272 affiliate do not meet even the SBC standard. As indicated by AT&T, QCC did not post *any* transactions for the period July 2000-April 2001. Not one work order for services provided by QC to QCC was posted to the Internet prior to March 27, 2001.[66] In another instance, the work order was signed and posted after the work was complete.[67]

Qwest has responded that it declared QCC a section 272 affiliate on March 26, 2001; therefore, its postings were timely. This pronouncement was made for the first time on June 7, 2001, in the multistate workshops.[68] The problem is, Qwest's own documentation supports a January 1, 2001, date. Furthermore, QCC became a section 272 affiliate by operation of law as of the date of the merger in July 2000.

The evidence provided by Qwest does not support a March 26, 2001, date.

1. "Qwest Long Distance (QLD), formerly U S WEST Long Distance, Inc. (USWLD) was the section 272 affiliate through December 31, 2000."

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[65] *See* D.2, *infra*.
[66] Ex. 1156C, ¶ 105.
[67] TR 41-42 (June 8, 2001).
[68] TR 208-209 (June 7, 2001).

To view transactions between Qwest Corporation and Qwest Communications Corporation beginning in January 2001, please click here:"[69] Quotes are from the "Qwest Long Distance Section 272 Affiliate Transaction" web page.

2. "Qwest Communications Corporation is its Section 272 affiliate as of January 2001…Prior to January 2001, Qwest Long Distance operated as the section 272 affiliate." Quote is from Qwest web page, with the heading "Qwest Communications Corporation Section 272 Affiliate Transactions."[70]

This information was on the web page as late as June 2, 2001, and possibly later. According to the web page dated June 2, 2001, many of the work orders were dated January 1, 2001, and the Master Service Agreement and Service Agreement were dated January 19, 2001.[71] Therefore, 4 days before the first workshop on section 272 held in the multistate proceedings, Qwest's web page reflected an effective date of January 1, 2001, for QCC as the section 272 affiliate.

None of the agreements, work orders, or task orders contained in Ex. 1117, S7-QWE-MES-10(b), copies of the web pages dated June 2, 2001, were posted to the website before March 26, 2001.[72] Therefore, based on Qwest's own documentation, there is a violation of the requirement to post transactions to the web page within 10 days of the transaction. At the multistate workshop on June 7, 2001, Qwest distributed S7-QWE-MES-9,[73] which lists the Internet postings, and provides the "signed date" for the Master Service Agreement and Service Agreement as March 22, 2001. This contradicts the information on the web page dated June 2, 2001.[74]

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[69] Ex. 1117, S7-QWE-MES-10(a). *See* Ex. 1144 for recent web pages that were changed to reflect a March 26, 2001 transition date to QCC.
[70] Ex. 1117, S7-QWE-MES-10(b). *See* Ex. 1123 for recent web pages that were changed to reflect a March 26, 2001 transition date to QCC.
[71] *Id*.
[72] *See* Ex. 1143.
[73] Ex. 1143 in Washington.
[74] S7-QWE-MES-9 and Ex. 1143 also contradict the updated web posting (Ex. 1123).

Only one task order and none of the work orders have a "signed date" earlier than March 22, 2001.[75] S7-QWE-MES-9 (Ex. 1143), the list of Internet postings, once again contradicts the web page dated June 2, 2001. If Qwest claims that the documents posted on the website were not signed until March 2001, than the transactions were not reduced to writing in a timely manner, and Qwest was in violation of section 272(b)(5) during the period Qwest and QCC were transacting business without signed agreements.

It is also interesting to note that S7-QWE-MES-10(a)[76] contains task orders and work orders that date back as far as June 30, 2000 and July 1, 2001, respectively. This supports AT&T's position that QCC was truly a section 272 affiliate the day the merger was completed, or June 30, 2000.

QCC was providing long distance services at the date of the merger. Qwest entered into transactions with QCC as early as June 30, 2001. The FCC orders require public disclosure and posting to the website effective the date of the *Accounting Safeguards Order*. As pointed out earlier, in the *Ameritech Order* and *BellSouth Louisiana II Order*, the FCC reviewed all transactions that preceded the date of the application. If a company could have a long distance affiliate and not "declare" it a section 272 affiliate, the BOC affiliate could evade the obligations of section 272. Or a BOC could have two long distance companies -- Qwest LD and QCC, for example -- and conduct business with both, with only one company being subject to the requirements of the Act. This is illogical and cannot be supported by law.

[75] Ex. 1143.
[76] Ex. 1123 in Washington.

AT&T also pointed out that when it asked for the accounting detail for Qwest LD, AT&T received the accounting detail up to December 31, 2000.[77] Furthermore, the Qwest LD transactions were moved from the current transaction section to the expired transactions section effective December 31, 2000. Qwest claims this was a "mistake" and has corrected it, after AT&T discovered it.[78] Once again, this series of events undermines Qwest's position.

Qwest LD did not activate its web site until September 28, 1998, although the *Accounting Safeguards Order* was released on December 24, 1996, and became effective August 12, 1997. Therefore, Qwest waited over a year to post any transactions to website, although Qwest knew about its obligation since the release date of the order.[79] This is yet another clear violation of section 272, but Qwest ignores such evidence in its rush to proclaim an unblemished history of compliance with section 272 since the enactment of the Act.

AT&T maintains that QCC was subject to the obligations of section 272 since the date of the merger, or July 1, 2000. Even assuming for the sake of argument that a company could declare when a long distance affiliate becomes a section 272 affiliate, Qwest's own publicly-available information indicates that the date of declaration was January 1, 2001.[80] Based on the January 1, 2001, date, Qwest did not timely post its transactions to the website.

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[77] TR 211 (June 7, 2001). Ex. 1155T, ¶ 68.

[78] TR 215-216 (June 7, 2001). "However, when the QCC website was being created, some confusion caused errors to be made on the Qwest LD website, which have now been corrected. For example, in 2001, all transactions with Qwest LD were inadvertently moved to the terminated section, but there are still some current transactions." Ex. 1139T at 8-9.

[79] TR 46 (June 8, 2001). Agreements existing prior to September 28, 1998, were not posted until September 28, 1998. Ex. 1142.

[80] Qwest's "transition" argument and its argument that it did not declare QCC a section 272 affiliate until March 26, 2001, is very convenient, to say the least, because it would arguably solve many of its Internet

The FCC also requires that the postings describe the length of the time required to complete the project or the approximate date of completion.[81] Qwest and its section 272 affiliate have agreements that have an "indefinite" completion date.[82] Qwest stated the word "means that the service is being provided indefinitely."[83] This hardly qualifies as an approximate date of completion date.

Qwest has repeatedly and continuously failed to comply with the 10-day posting requirement.

2. What is a Transaction?

The BOC must post its transactions with the section 272 affiliate on the Internet website. The issue is, what is transaction for posting purposes. Qwest and QCC, beginning January 1, 2000, post the agreements, task orders and work orders, but not the detail of actual transactions pursuant to the agreements, work orders or task orders. Prior to January 1, 2000, Qwest and its section 272 affiliate posted monthly the detail of services or items purchased under the work orders or task orders.[84]

After the *SBC Texas Order* came out, Qwest reevaluated and changed its policy. Also, prior to January 1, 2000, Qwest and its section 272 affiliate did not claim the detail it posted monthly was confidential. After it changed its policy on posting, it began claiming the monthly detail was confidential.

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posting violations. However, the records and documentation are conflicting and the conflict must be construed against the party in control of such documentation and subject to section 272. Also, the so-called "transition" argument is convenient in that it avoids the consequences of the "one-time hiccups," as Qwest refers to the egregious 10 month lapse in accounting for affiliated transactions. WA TR 5125-5126.

[81] *BellSouth Louisiana II Order*, ¶ 337.

[82] Exs. 1142 and 1143.

[83] TR 40-41 (June 8, 2000). *See* TR 45 (June 8, 2001).

[84] Ex. 1155T, ¶¶ 63 and 72, AT&T should say Qwest and Qwest LD attempted to comply with the filing requirement. AT&T pointed out numerous instances where transactions were not posted timely.

The issue is not access. Qwest claims it will provide access to the detail if a person signs a nondisclosure agreement. The issue is whether the detail should be posted so the public can see services and items actually received pursuant to the agreements, task orders and work orders, without having to go to Qwest's principal place of business to see confidential information.

The FCC has stated that the postings serve a number of functions. The FCC has stated that the posting should be "sufficiently detailed" to allow the FCC to evaluate compliance with its accounting rules and safeguards.[85] Furthermore, failure to totally disclose the details of the transactions between a BOC and its section 272 affiliate "deprives unaffiliated parties of the information necessary to take advantage of the same rates, terms and conditions enjoyed by the BOC's section 272 affiliate."[86]

Further, the FCC has stated that summaries are insufficient.[87] The final contract price alone is not sufficient for evaluating compliance. Instead, such disclosures should include a description of the rates, terms and conditions of all transactions, as well as the frequency of recurring transactions and the approximate date of completion.

Posting of the master agreements, work orders and task orders are insufficient. These documents are no more than an offer to provide services or items at specific rates, terms and conditions. Without posting the detail of the actual transaction, the detail of the actual service or items purchased and the amount actually paid for the service or item

[85] *Accounting Safeguards Order*, ¶ 122. *BellSouth Louisiana II Order*, ¶ 335.
[86] *BellSouth Louisiana II Order*, ¶ 335.
[87] *Id*, ¶ 337.

actually received, no company can evaluate properly whether it would want the same service performed for it or purchase the same item. Thus, the purpose of the postings is undermined.

In addition, no company can determine if it is receiving the same rates, terms and conditions without the detail, because the detail reflects what was actually received and paid for, not what was offered. The detail, therefore, also permits detection of the failure to follow accounting rules and provides a means to detect discrimination. Posting serves no useful purpose if a non-affiliated carrier does not know what was actually paid until true ups are posted. This would allow the BOC and section 272 affiliate to provide services at different rates and without detection until months later when a true up is done.

Qwest has asserted that it need not produce detail or volumes, citing the *Bell Atlantic New York Order*[88] and the *SBC Texas Order*.[89] First, paragraph 413 of the *Bell Atlantic New York Order* does not state the BOC need not provide detail or volumes. The FCC stated in the *Bell Atlantic New York Order* that

> Bell Atlantic discloses "the number and type of personnel assigned to the project, the level of expertise of such personnel, any special equipment used to provide the service, and the length of time required to complete the project."[90]

The FCC in this paragraph was talking about the descriptions on the website. This quote cannot be considered words of limitation because it does not speak of the obligation to post rates,[91] which even Qwest does not contest is an obligation.

The *SBC Texas Order* at paragraphs 405-407 also does not state that the BOC

[88] Qwest usually cites ¶ 413 of this Order.
[89] Qwest usually cites ¶¶ 405-407.
[90] *Bell Atlantic New York Order*, ¶ 413, quoting the *Bell South Louisiana II Order*, ¶ 337.
[91] *See Ameritech Michigan Order*, ¶¶ 368-369.

need not post the detail or volume of transactions. The FCC merely stated that it found that the postings, on the whole, were sufficiently detailed."[92] This language alone cannot be used to justify not posting the detail of transactions under the work orders or task orders.

Finally, the issue of confidentiality is a non-issue. Although the FCC stated that it would protect the BOC's confidential data,[93] Qwest claimed the detail was confidential *after* it changed its posting policy. The fundamental issue is whether detail must be posted.

AT&T believes it is necessary for Qwest and QCC to post the detail of transactions to the web site, as it did before January 1, 2000, to comply with the *Accounting Safeguards Order*, the FCC's subsequent section 271 orders, and the requirement under the Act to make agreements between the BOC and section 272 affiliate public.

3. Certification Statement

Not only must the date of the transaction be posted to the web page, the agreement must be made available for public inspection at the principal place of business of the BOC. "The information made available at the principal place of business of the BOC must include a certification statement…Such certification statement declares that an officer of the BOC has examined the submission and that to the best of the officer's knowledge all statements of fact contained in the submission are true and the submission is an accurate statement of the affairs of the BOC for the relevant period."[94]

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[92] *SBC Texas Order*, ¶ 405.
[93] *Accounting Safeguards Order*, ¶ 122
[94] *Id.*

AT&T numerous times tried to locate the certification statements -- once in 1998 and twice in 1999. Although AT&T attempted to review the certification statements at Qwest's principal place of business, they were never provided.[95] The only conclusion that can be drawn is that the statements were not publicly available as required by the *Accounting Safeguards Order*. Qwest subsequently admitted there were no certification statements to provide, because it believes its obligation does not begin until it files its section 271 application and believed it "an unnecessary step for the states."[96]

During AT&T's follow-up testing during the week of April 22, 2001, Mr. Skluzak examined certification statements of QCC and Qwest on file at Qwest. Both certification statements were signed by Robin Szeliga, as Senior Vice-President.[97] According to QCC's listing of officers filed May 16, 2001, Ms. Szeliga is an officer of QCC.[98] There is no evidence Ms. Szeliga is an officer of Qwest, and Qwest subsequently acknowledged she never was an officer of Qwest.[99] Therefore, the certification statement by Qwest was not signed by an officer, as required by the *Accounting Safeguards Order*.[100] Had Ms. Szeliga been an officer of Qwest, Qwest would have violated section 272(b)(3), which requires separate officers for the BOC and section 272 affiliate.

Qwest and QCC did not have certification statements signed by their officers until May 11, 2001, although the *Accounting Safeguards Order* required that Internet postings,

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[95] Ex.1155T, ¶ 65(k); TR 253 (June 7, 2001).
[96] TR 253-254 (June 7, 2001).
[97] Ex. 1155T, ¶ 63.
[98] Ex. 1095T, JLB-20.
[99] TR 251 (June 7, 2001). It appears that in a rush to get the certification statement signed, Qwest knowingly disregarded the rule that an officer sign the certificate statement. Ex. 1139T at 25. The rush to provide the certification statement is inconsistent with Qwest's position it need not provide the statements before it filed its section 271 application.
[100] Qwest acknowledged that an officer must sign the certification statement and subsequently corrected the problem. TR 253 (June 7, 2001); Ex. 1139T at 25.

as well as public inspections of transactions and their certification commence the date the *Accounting Safeguards Order* became effective. And, when Qwest finally did provide certification statements, the requirement that the statement be signed by an officer was not followed.

E. Transition – Section 272(h)

Qwest has made the argument that it transitioned to the new section 272 affiliate within 3 months of its decision to make QCC the new section 272 affiliate.[101] This transition period, Qwest argues, is less than the one year period permitted by section 272(h). The FCC has not provided precedence for a BOC's self-proclamation or "turning up" a section 272 affiliate.

First, section 272(h) is inapplicable. Section 272(h) allowed BOCs one year from the date of the Act to comply with section 272(h) *with respect to any activity in which a BOC is engaged on the date of enactment of the Act.* Section 272(a)(2) states that a BOC must provide certain manufacturing activities, in-region interLATA services, interLATA information services and alarm monitoring services through separate affiliates that comply with section 272(b). If the BOC at the date the Act was enacted was providing these services, it had one year to transfer those activities to an affiliate. Nowhere in the Act does it state a BOC has one year to comply with section 272 generally. Section 272(h) cannot be read to apply to the situation envisioned by Qwest because the one year period from the date of enactment of the Act had passed, and any covered services should have already been transitioned.[102]

[101] WA TR 5125-5126. The 3 month period covers January, February and March 2001. Qwest argues it declared QCC to be the new section 272 affiliate on March 26, 2001.

[102] It is curious that Qwest has maintained its section 272 affiliate was compliant since the enactment of the Act, not one year after the Act was enacted.

Qwest and QCC had the ability to make sure QCC was in compliance with section 272 the date QCC began entering into transactions with Qwest. It could have established its web site, entered into its agreements and posted them to the Internet within 10 days, if it had put its plans into effect timely. The same can be said for the timely payment of transactions. If proper internal controls had been put in place first, payments could have been made timely. It is only because internal controls, processes and training had not been accomplished before Qwest began dealing with QCC that it became necessary to have a transition and declare QCC the section 272 affiliate on March 26, 2001, essentially to clean up the mess and reflect some semblance of compliance with section 272.[103]

The Act does not provide for a transition period for QCC to become a section 272 affiliate, and the proper controls, processes and training should have taken place before QCC became the section 272 affiliate and Qwest LD was dropped as the section 272 affiliate. Qwest was contemplating making QCC the section 272 affiliate as early as September 2000. In fact, it began ramping down Qwest LD as the section 272 affiliate in September 2000.[104] Nothing precluded Qwest from beginning to ramp up QCC to be the section 272 affiliate in September 2000. Qwest surely knew it was not going to obtain section 272 relief in early 2001 and had plenty of time to do so. It would be ironic if a

[103] It was also necessary to bring in Arthur Andersen personnel as loaned staff to assist in determining how big a mess there really was. TR 206 (June 7, 2001); TR 140-141 and 146 (June 8, 2000); Ex. 1139T at 5-6.
[104] TR 147 (June 8, 2001).

company could fail to comply with section 272, discover its noncompliance, subsequently enter into the written agreements required by section 272 (b)(5), post them to the Internet within 10 days, and argue it is in compliance since all the postings were made within 10 days of the date it *finally* got around to complying with the requirements of the Act and the *Accounting Safeguards Order*. It wasn't until after Mr. Skluzak's review that any of the agreements were posted or transactions billed. The Act does not provide for a transition period 5 years after the Act was passed, and one cannot be condoned to allow Qwest to justify its noncompliance.

F. Section 272(c)(1)

Section 272(c)(1) provides that a BOC when dealing with its section 272 affiliate, may not discriminate between the affiliate and any other entity. Mr. Skluzak itemized a number of items that the FCC reviews which were not addressed by Qwest.[105] Mr. Skluzak also noted that there was a failure to timely pay pursuant to the agreements, task orders and work orders and a failure to make timely payments generally.[106] Also, QC is circumventing the non-discrimination safeguards by using a non-272 affiliate to develop improvements to QC's services provided to the 272 affiliate.[107] Once again, QC utilized circumvention to avoid the strictures of section 272.

By shifting such services to another affiliate, QC and QCC can now participate in joint planning, design and development free of the strictures of the section 272 nondiscrimination safeguards. This is emblematic of QC's approach to section 272 -- to circumvent where possible and accomplish the bare minimum to pass the form test. The

[105] Ex. 1156C, ¶ 129.
[106] *See* B.4, *supra*, generally, and n. 39-41.
[107] Ex. 1156C, ¶ 130.

Commissioners should carefully weigh Qwest's machinations when tendering its recommendation to the FCC.

Qwest has failed to demonstrate compliance with section 272(c)(1).

G. Section 272(c)(2)

Section 272(c)(2) states that a BOC shall account for all transactions with a section 272 affiliate in accordance with the FCC's accounting principles. Qwest has failed to do so. Mr. Skluzak cited numerous examples of the failure to follow the FCC's accounting rules and refutes Qwest's assertions.[108]

In section 272(c)(2), the Act requires the BOC to account for all transactions with the section 272 affiliate in accordance with accounting principles "designated or approved" by the FCC. The FCC has held that the BOC must comply with the Part 32 affiliate transaction rules to satisfy section 272(c)[109] "GAAP is incorporated into the Commission's Uniform System of Accounts [Part 32] to the extent that regulatory considerations allow."[110] Furthermore, Part 32 states that the BOC's financial records shall be kept in accordance with GAAP to the extent permitted by Part 32.[111]

Qwest has failed to demonstrate compliance with section 272(c)(2).

H. Section 272(g)

Section 272(g) states the restrictions on joint marketing between the BOC and its section 272 affiliate. QC's affidavit and rebuttal fail to state whether QCC intends to market information services and whether QC will also permit other information service

[108] *See* B.1 and 4, *supra*.
[109] *Bell Atlantic New York Order* ¶ 415. 47 C.F.R. § 32.27.
[110] *BellSouth Louisiana II Order*, ¶ 328, n. 1026, citing 47 C.F.R. § 32.1. 47 C.F.R. § 32.12.
[111] 47 C.F.R. § 32.12

providers to market and sell telephone exchange services.[112] Such a failure means that QC does not meet its burden of persuasion that it will comply with section 272(g)(1).

III. CONCLUSION

Qwest claims it and its section 272 affiliates have been section 272 compliant since the date the Act was enacted. They claim processes are in place to ensure compliance. The evidence does not bear this out. With all the mistakes, corrections, transitions, it is hard to arrive at any conclusions other than Qwest and its section 272 affiliates have not taken their section 272 obligations seriously and there was and is a lack of internal controls and processes to make sure Qwest and QCC comply with section 272 in the future. If the past is any indication of the future, Qwest and QCC will not comply with section 272 in the future.

The Commissions should find that Qwest and QCC do not and will not comply with section 272 of the Act and the FCC's order.

Dated this 6th day of September 2001.

Respectfully Submitted,

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[112] *BellSouth Louisiana II Order*, ¶ 356.