

**BEFORE THE WASHINGTON UTILITIES
AND TRANSPORTATION COMMISSION**

In the Matter of the Investigation Into)
U S WEST Communications, Inc.'s) Docket No. UT-003022
Compliance With Section 271 of the)
Telecommunications Act of 1996)
_____)

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

AT&T'S SECTION 272 REPLY BRIEF

September 14, 2001

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AT&T'S SECTION 272 REPLY BRIEF

AT&T Communications of the Pacific Northwest, Inc. and AT&T Local Services on behalf of TCG Seattle and TCG Oregon, (collectively, "AT&T") hereby file their reply brief on Qwest's compliance with section 272 of the Telecommunications Act of 1996.

I. INTRODUCTION

The most apparent difference between the brief of AT&T and the brief of Qwest Corporation ("Qwest") is the different perspective of the parties regarding the factual history of Qwest's section 272 compliance and the ultimate conclusions that are drawn from the facts. AT&T sees a historical pattern of noncompliance. Qwest sees "hiccups,"¹ "one-time disruptions"² and "catch-up billing,"³ and relies on a "transition" to a new section 272 affiliate to justify noncompliance with section 272. Nor does Qwest see its "mistakes" as failures to comply with section 272. Based on the totality of the evidence, AT&T believes only one conclusion can be drawn: Qwest has failed to comply with section 272, and its attitude regarding instances of past noncompliance leaves no doubt that it will fail to comply with section 272 in the future.

Qwest has mentioned in its brief that Qwest Communications International, Inc. ("QCI"), which is the parent of Qwest Communications Corporation ("QCC"), is already

¹ WA TR at 5126.

² *Id.* at 5124.

³ Ex. 1139T (Schwartz Rebuttal) at 10.

the nation's fourth-largest interexchange carrier.⁴ This makes it all the more imperative that the provisions of section 272 be implemented correctly. The Federal Communications Commission ("FCC") made it clear that it viewed the structural and nondiscrimination safeguards of section 272 to be of "crucial importance" because they "ensure that competitors will have nondiscriminatory access to essential inputs on terms that do not favor the BOC's affiliate [and] further discourage, and facilitate detection of, improper cost allocation and cross subsidization between the BOC and its 272 affiliate."⁵

Qwest's section 272 affiliate is not starting from scratch; it is already one of the largest interLATA, or interexchange, carriers in the country, which makes it even more important that the section 272 safeguards are properly in place and implemented.

Qwest repeats time and again that it has had a fully compliant section 272 affiliate since the passage of the 1996 Telecommunications Act.⁶ That is not true. As was discussed in AT&T's Brief, the requirement to post on the Internet became effective on August 12, 1997, but Qwest did not activate its section 272 web site until September 28, 1998.⁷ Based on just this one example of noncompliance, Qwest's oft-repeated claim of an unblemished history of compliance since the enactment of the Act is simply not

⁴ Qwest Brief at 9. In its brief filed in the multistate docket, Qwest referred to QCC as the fourth largest interLATA provider. No explanation is given as to the change in distinction and entity in its Washington Brief. Perhaps Qwest wishes to downplay QCC's present involvement in the intraLATA and interLATA toll markets. However, given that Qwest's own testimony boasts that QCC is "already the fourth largest interLATA provider nationwide," it is clear that QCC is well positioned in the toll market. Ex. 1125T (Schwartz Supp. Direct) at 11.

⁵ *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), ¶ 346 ("Ameritech Michigan Order").

⁶ WA TR at 5120, 5123 and 5124, for example.

⁷ AT&T Brief at 18.

credible. However, AT&T agrees with Qwest that an unbroken chain of section 272 compliance is “very, very important to remember ...”⁸

Finally, Qwest states that its section 272 compliance was modeled after the FCC’s previous section 271 approval orders.⁹ However, it is apparent that Qwest’s focus was much narrower. Qwest has stated in past workshops that it has benchmarked itself to the SBC-Texas Order. Implicit in Qwest’s strategy is the belief that SBC-Texas is dispositive of any section 272 issues and the FCC’s case-by-case approach is to be ignored. AT&T strongly disagrees with this view.

II. ARGUMENTS

A. Section 272(h) and the so-called “Transition Phase”

AT&T will follow the convention used by Qwest in its brief in discussing QCC’s need for a so-called “transition phase” in the initial part of this reply brief, although this discussion in AT&T’s initial brief was contained in several sections.

Initially, in its testimony, Qwest relied heavily on section 272(h) to support its “transition phase” arguments.¹⁰ At the Washington workshop, Qwest even engaged in a bit of legerdemain by using an exhibit that stated “Congress gave BOCs one year to comply with Section 272 [and] QCC became Section 272 compliant-ready in three months ...”¹¹ The Qwest witness also stated at the Washington workshop that “Congress gave the BOCs one year to comply with Section 272. QCC became a compliant 272

⁸ WA TR at 5123.

⁹ Qwest Brief at 5.

¹⁰ Ex. 1125T at 6: (“Section 272(h) of the Act allowed the BOC one year to become 272 compliant.”) Also, *see id.* at 9 – 10.

¹¹ Ex. 1140 at 7.

affiliate in three months ...”¹² The use of “one year” is an obvious reference to the language of section 272(h), and Qwest attempted to utilize that language as justification for its “transition”.

In its brief, Qwest signaled its retreat from reliance on section 272(h).¹³ To circumvent the fact that the language in section 272 does not support its so-called “transition phase,” Qwest now relies on an argument by analogy to convince the Commission that Congress did carve out such a transition loophole and that it was for “considerable time.”¹⁴ This argument is quite convenient in that it is ambiguous enough and flexible enough to allow Qwest to subjectively decide what is a “considerable time” for its transition.¹⁵ At the Washington workshop, in response to a question from the Washington Staff, Qwest admitted that it had never requested a waiver from the FCC and stated that “this is new ground that we’re in here ...”¹⁶

As a corollary matter, AT&T would clarify Qwest’s apparent method of quoting its own attorney under the guise of an FCC pronouncement: “Moreover, Congress itself recognized ... what the FCC later did in SBC-Ameritech – that the requirements for Section 272 separation are extensive and therefore, ‘you don’t turn a 272 up on [a] dime.’”¹⁷ This is a quote of Qwest’s attorney, and not of the FCC. To wit: “I was just going to say, for purposes of filling out the record on this point, we talked a good bit about transition, that you don’t turn a 272 up on the dime.”¹⁸

¹² WA TR 5125 (July 17, 2001).

¹³ Qwest Brief at 8, n. 19.

¹⁴ *Id.*

¹⁵ *Also see*, AT&T Brief at 24 – 26, for further discussion of Qwest’s so-called “transition” argument.

¹⁶ WA TR at 5166.

¹⁷ Qwest Brief at 8.

¹⁸ TR 143 (June 8, 2001). Transcript cites are to the multistate transcripts unless otherwise noted. This is a quote from Qwest attorney Charles Steese.

AT&T finds itself in agreement with Qwest that the focus on the “transition phase” issue obscures Qwest Long Distance’s (“Qwest LD’s”) prior record of compliance.¹⁹ However, in Qwest LD’s case, it is more appropriate to characterize this as the *lack* of compliance. By way of example, AT&T discussed a blatant instance of Qwest LD’s noncompliance in its brief,²⁰ and it provided numerous examples in its testimony.²¹

Qwest cites to section 272(a) for the proposition that it cannot provide “in-region, interLATA services except through [a Section 272 affiliate].”²² This is precisely the point that AT&T made in its initial brief. As discussed in its opening brief, because Qwest and the former U S WEST were found to have been providing in-region, interLATA services on at least three occasions in violation of section 271, it also was in violation of section 272(a). Accordingly, Qwest could not possibly have had a compliant section 272 affiliate since the passage of the 1996 Telecommunications Act (the “Act”).²³ In light of the foregoing discussion, AT&T also disagrees with Qwest’s characterization that section 272(a) issues duplicate section 272(b) issues.²⁴

Qwest relies on self-righteous indignation regarding AT&T’s audacity to question its compliance based upon the total accounting failure during the so-called “transition” period. Qwest’s testimony stated that “It would be completely unreasonable to look only at this [so-called] transitional period and conclude that the BOC will not meet the Section

¹⁹ Qwest Brief at 6.

²⁰ AT&T Brief at 18.

²¹ See 1155T and 1156C. ¶¶ 37 (a) – (f); 47 (a), (c), (f) – (j); 49; 64 (a) – (e), 65 (a) – (p); 77; 78; 79 (a) – (c); 80; 88(d) – (e); 118; 128; 129; 130; 147 – 153.

²² Qwest Brief at 11.

²³ AT&T Brief at 3 - 5.

²⁴ Qwest Brief at 11, n. 36.

272 rules going forward under more typical circumstances.”²⁵ Qwest puts a different spin on the “transition” theme in its section 272 Brief. “AT&T would prefer that the Commission examine instead whether QCC happened to meet the extensive requirements for a Section 272 *affiliate before it was even identified as such*, or during this brief transition period.”²⁶

Given these two quotes, it is confusing what “transition” period Qwest is referring to. Qwest divides the so-called transition period into two distinct periods. The second period commences on or about January 1, 2001, and is the date that QCC was “identified” as the 272 affiliate. The first period is prior to the identification date. It is indisputable that from January to the end of March 2001, there was absolutely no accounting between QC and QCC because there was no billing. Evidently, this is the transition period that Ms. Schwartz refers to in the quoted testimony above. Qwest’s Brief must be referring to the “transition” period prior to January 2001. Qwest seemingly wants the Washington Utilities & Transportation Commission (the “WUTC”) to either ignore or forget about this glaring omission in compliance. The WUTC should not be led astray by the confusion. There is an indisputable gap from January to the end of March 2001 with respect to accounting between QC and QCC. As QCC admitted in its testimony, “The transactions between July 1, 2000, and April 2001 were not concluded, posted, or billed in a timely manner.”²⁷

Qwest’s argument that its so-called “transition phase” was prompted by “an unprecedented merger” begs the question: Why didn’t Qwest LD need a like transition

²⁵ Ex. 1139T (Schwartz Rebuttal) at 10.

²⁶ Qwest Brief at 6 (emphasis in original).

²⁷ Ex. 1105T (Brunsting Rebuttal) at 6.

phase? Both Qwest LD and QCC were subsidiaries in this unprecedented merger and Qwest admits that the merger “significantly transformed U S WEST and had significant impacts on *all* operational areas of its business.”²⁸ Yet, it was only necessary for QCC to have a two-tiered transition phase. It was only QCC that suffered from a severe case of the “one-time hiccups” in its accounting.²⁹ It was Qwest’s decision to abruptly drop Qwest LD in 2000 as its section 272 affiliate and replace it with QCC. This, in turn, necessitated a transition of QCC into compliance with section 272. The merger had nothing to do with QCC’s need for the shelter of a “considerable” transition period to come into compliance with section 272. Nothing prevented Qwest from maintaining Qwest LD as its section 272 affiliate until QCC was fully compliant with section 272.

Qwest’s statement that a decision was not made until January 2001 to abandon Qwest LD as the section 272 affiliate is simply wrong and misleading.³⁰ Qwest was winding down Qwest LD as the section 272 affiliate in September 2000.³¹ Its own web sites provide evidence to the contrary,³² and its attorney, Andrew Crain, notified the multistate proceeding participants of the following:

This week, Qwest made a decision that the traditional U S WEST subsidiary, U SWEST Long Distance, Inc. (renamed Qwest Long Distance, Inc.), will not be serving as Qwest's Section 272 subsidiary. Qwest *is in the process of developing a transition plan* for another subsidiary to become Section 272compliant. As a result, Qwest recommends that the Section 272 topic be addressed in the second workshop, rather than the first. Qwest will be prepared to supplement its direct testimony in a timely

²⁸ Qwest Brief at 9.

²⁹ WA TR 5126.

³⁰ Qwest Brief at 9.

³¹ AT&T Brief at 25.

³² *Id.* at 16. Qwest wishes to characterize this as “confusion” resulting in “errors”. Ex. 1139T at 8. However, AT&T maintains that the literal language on the initial websites are evidence of Qwest’s intent.

fashion, so that this issue can be fully addressed in the second workshop.³³

This e-mail was sent on September 15, 2000. Further, direct testimony for the second workshop in the multistate proceeding, mentioned by Mr. Crain above, was due on November 20, 2000. Thus, on September 15, 2000, evidence supports the fact that Qwest had made a decision to abandon Qwest LD as its section 272 affiliate and was ready to submit testimony as to section 272 compliance for its new section 272 affiliate. The statements in Qwest's brief that it was not until January 2001 that the decision was made needs to be judged against the weight of evidence to the contrary.

B. Section 272(b)(2) and compliance with GAAP - Issue 272-2

AT&T has alleged that Qwest and QCC fail to follow a requirement of the *Accounting Safeguards Order* that mandates adherence to Generally Accepted Accounting Principles ("GAAP").³⁴ AT&T has provided numerous examples of noncompliance by both QCC and QC.

Section 272(b)(2) states that the section 272 affiliate shall maintain its books, records and accounts in a manner prescribed by the FCC.³⁵ In its *Accounting Safeguards Order*, the FCC made it clear that the section 272 affiliate must follow GAAP.³⁶

Qwest alleges that QCC's compliance with GAAP is not relevant prior to

³³ This quote was alluded to in Mr. Skluzak's workshop testimony. WA TR 5151 – 5152. This item was included in AT&T's testimony filed in Colorado and subsequent filings. Also, it was included in AT&T's Brief in the Colorado Docket. *In the Matter of the Investigation into U S WEST Communications, Inc.'s Compliance with section 271(c) of the Telecommunications Act of 1996*, Colorado Docket No. 97I-198T, AT&T's Brief on Section 272 of the Act at 17 (emphasis added).

³⁴ See AT&T Brief at 5 - 8 and 27, regarding discussion of noncompliance with GAAP as to sections 272 (b) and 272 (c)(2).

³⁵ 47 U.S.C. § 272(b)(2).

³⁶ *Accounting Safeguards Under the Telecommunications Act of 1996*, CC Docket No. 96-150, Report and Order, FCC 96-490 (rel. Dec. 24, 1996), ¶ 167 ("*Accounting Safeguards Order*").

March 26, 2001, because QCC did not become a section 272 affiliate until that date. This is nonsense, because as a subsidiary of a publicly-traded company, QCC has always been required to follow GAAP, regardless of the section 272 requirement to do so. Indeed Qwest admits to QCC's noncompliance or "delays in billing,"³⁷ which is evidently some kind of code for the complete failure to account for section 272 affiliated transactions for a 10-month period. Further, QCC admitted "timeliness did not deter activities from being completed."³⁸ This is tantamount to saying, "Why bother with accounting for transactions?"

Qwest implies throughout its brief that the departures from GAAP are not material. AT&T addressed the issue of materiality at length in its brief.³⁹ However, it should be noted that Part 32 requires compliance with Part 32 "irrespective of an individual item's materiality under GAAP."⁴⁰ Qwest must comply with 47 C.F.R. §32.27 in accordance with GAAP, irrespective of the materiality of the individual transaction.

In its eagerness to divert attention from its noncompliance with GAAP, Qwest appears to misdirect the Commission in its brief. Qwest seizes upon comments made by Mr. John Antonuk, the multistate workshop facilitator, to downplay or dismiss the section 272 GAAP requirements.⁴¹ In fact, the facilitator readily acknowledged that "obviously you need to be following GAAP," and his comments were in the greater context of blunting the probative value of Qwest's proffer of an Arthur Andersen audit.⁴² In light of Qwest's use of the multistate facilitator's quote, it is also instructive to emphasize that

³⁷ Qwest Brief at 23.

³⁸ Ex. 1105T at 6.

³⁹ AT&T Brief at 6 - 8.

⁴⁰ 47 C.F.R. § 32.26.

⁴¹ Qwest Brief at 13.

⁴² TR 184 (June 7, 2001).

timeliness is a central principle of GAAP⁴³ and encompasses timely accounting, such as billing and transaction posting to accounts. The timely transaction posting that Mr. Antonuk refers to applies to the section 272(b)(5) 10-day website posting requirement which is a requirement separate from GAAP financial accounting.⁴⁴ This posting should not be confused with timely posting of accounting transactions to appropriate accounts and billing as required by GAAP.

Finally, Qwest places heavy reliance on the Arthur Andersen audit opinion for its case that QCC was and is compliant with section 272(b)(5).⁴⁵ As mentioned in AT&T's brief, that audit was of QCI, and not QCC.⁴⁶ At the Washington workshop, under questioning from Washington Staff, the Qwest witness admitted that its much touted Arthur Andersen audit⁴⁷ did not address, *in any way*, Qwest's compliance with section 272 transactions.⁴⁸ In fact, the Qwest witness admitted that the audit did not include a "specific regulatory purpose."⁴⁹ The Qwest witness further admitted that the Arthur Andersen audit opinion was only entered "to show evidence of compliance with GAAP," and not as evidence of the reasonableness of the affiliate transactions.⁵⁰ As is discussed directly below, the Multistate Facilitator put very little, if any, probative value on this type of proffer:

I don't think this opinion [the Arthur Andersen opinion of QCI] tells you a lot about – I don't think this is giving me a lot of evidence on whether or not 272 is being met or not. And I also don't think that a general conclusion about

⁴³ AT&T Brief at 5.

⁴⁴ TR 184 (June 7, 2001). *See also*, Qwest Brief at 13 ("... the real issue here is whether the transactions are "being posted timely" ...").

⁴⁵ Qwest Brief at 12. *See also*, WA TR at 5130.

⁴⁶ AT&T Brief at 6.

⁴⁷ Ex. 1141. Arthur Andersen Audit Opinions.

⁴⁸ WA TR 5157 – 5159 (emphasis added).

⁴⁹ *Id.* at 5159.

⁵⁰ *Id.* at 5158 - 5159.

compliance with GAAP or noncompliance with GAAP is going to help me address 272 either.⁵¹

Mr. Antonuk further elaborated on the dubious probative value of the Andersen audit opinion:

And I will tell you, I will be honest with you. The only reason I got into this issue at all, having done an affiliate audit or two in the telecommunications industry, and having looked at the annual reports of auditors, I am surprised at how few -- well, not surprised. *I always find that their work is not very helpful in addressing affiliate audits, because their test procedures don't -- generally don't include many of those kinds of transactions.* So, all I was really getting at is that *I am hoping that this debate is not going to end up focusing on the Andersen audit* as part of the annual audit, because that's happening at 50,000 feet, let's say, and I think we're, you know, a lot closer to the ground than that, as I read the Section 272 requirements.⁵²

Qwest's representative agreed with Mr. Antonuk regarding the lack of probative value of the Andersen audit.⁵³ Further, the Washington Staff appeared to recognize the dubious value of this audit and recognized that section 272 transactions between Qwest and QCC are "washed out" after consolidation.⁵⁴ Thus, it is surprising that Qwest continues to place heavy reliance upon the Arthur Andersen audit as evidence of compliance.⁵⁵

Qwest states that "AT&T conceded in the Arizona workshop that it has identified no untimely accruals following the overlay of Section 272 controls on QCC."⁵⁶ First, the

⁵¹ 7 Qwest 11, TR 184 (June 7, 2001).

⁵² *Id.* at 187 (emphasis added).

⁵³ *Id.* ("Mr. Steese: We would agree with that.")

⁵⁴ WA TR at 5158.

⁵⁵ Qwest Brief at 13.

⁵⁶ *Id.* at 24. Quoting from the June 11, 2001, AZ transcript at 64.

reference to the Arizona transcript does not support the proposition of a “concession” in any way. Second, to state that AT&T did not identify any untimely accruals following the overlay of controls on QCC suggests that the controls were not in place until some time subsequent to AT&T’s last review of Qwest’s and QCC’s data, which was in May, 2001.⁵⁷ If controls were not in place until sometime after the last review in May, then this contradicts Qwest’s statements that controls were in place as of March 26, 2001.⁵⁸ Thirdly, AT&T did identify untimely accruals (as well as failure to post and to bill) from a 10-month period which ended in April, 2001. Qwest argues that there were no untimely accruals after controls were in place, but AT&T could not have found untimely accruals during its testing if controls had been put in place. Finally, to the extent that Qwest suggests that AT&T found no untimely accruals after its final round of testing, such suggestion is meaningless. AT&T did not conduct further testing after May 2001, and this testing extended to the latter half of the April 2001 timeframe.⁵⁹ In summary, the Commission should be wary of Qwest statements trumpeting any “AT&T’s concessions” or statements that AT&T did not identify untimely accruals after March or April 2001.

C. **Audit Prior to Section 272 Relief (Issue 272-4)**

Qwest states that “[a]ny imposition of an opening audit requirement would constitute disparate regulatory treatment for QC.”⁶⁰ AT&T did not argue that an audit is required under section 272 prior to a finding that Qwest complies with section 272. Neither did AT&T argue that Qwest be the entity audited. AT&T suggested that the

⁵⁷ Ex. 1155T at 3.

⁵⁸ Qwest Brief at 10, 22, *inter alia*.

⁵⁹ Ex. 1155T at 45.

⁶⁰ Qwest Brief at 30.

Commission may, and should, based on the section 272 affiliates' past section 272 violations, perform an audit of accounting safeguards of the section 272 affiliate prior to finding that Qwest is in compliance with section 272.⁶¹

An audit would not "constitute disparate treatment" for Qwest. Section 272 compliance must be reviewed on a case-by-case basis. As was discussed in AT&T's initial brief, the FCC has looked to a section 272 affiliate's regular audit program to ensure compliance with GAAP and to its internal controls as evidence of compliance with section 272.⁶² Qwest argues that controls are in place.⁶³ This is, in fact, one of the issues that ultimately must be decided, and Qwest and AT&T disagree on whether appropriate controls are in place and if those controls are working. An audit regarding these controls would assist the Commission in resolving the conflict.

Qwest states that an opening audit is not warranted "in light of the lack of any demonstration by AT&T that Qwest LD has failed adequately to account for and post its affiliate transactions."⁶⁴ Although the past practices of Qwest LD, with respect to section 272 compliance (or noncompliance) are still pertinent, it is QCC that should be subjected to an audit of its controls. Second, it is unbelievable that Qwest would make a statement that AT&T had not demonstrated a failure of the 272 affiliate to account for and post its transactions with Qwest. Even Qwest's own witnesses admit to this failure. QCC's witness stated that "[t]he transactions between July 1, 2000 and April, 2001 were not concluded, posted or billed in a timely manner. However, timeliness did not deter

⁶¹ Ex. 1155T, ¶ 37(f).

⁶² AT&T Brief at 6. *See also, BellSouth Louisiana II Order*, ¶ 328.

⁶³ Qwest Brief at 30.

⁶⁴ *Id.*

activities from being completed.”⁶⁵ At the Washington workshop, the Qwest witness mentioned the failure of QCC to account for and post its transactions through numerous statements: “one time challenges and disruptions in our accounting controls,”⁶⁶ “it created some one time disruptions in our accounting controls,”⁶⁷ “a merger of this size would trigger some one time mistakes,”⁶⁸ and “[the transitions] contributed to some one time hiccups in our processes.”⁶⁹ Thus, AT&T strongly disagrees that it failed to demonstrate a failure to account for and post section 272 transactions.

At the Washington workshop, the Qwest witness stated that the section 272(d) biennial audit would begin “within our first year of 271 authority.”⁷⁰ That is incorrect. The section 272 biennial audit of the BOC would begin “at the close of the first full year of operations.”⁷¹ As an example, if Qwest were granted section 271 status on January 15, 2002, its “first full year of operations” would not be until December 31, 2003, and the biennial audit would commence sometime in 2004, with an audit opinion delivered (most likely) during the 2nd quarter of 2004.⁷² Or, perhaps even later, given the latest strategy of at least one of the BOCs to extend out the filing of audit reports.⁷³ Given QCC’s and Qwest’s past departures from noncompliance, it is strongly suggested that the

⁶⁵ Ex. 1105T at 6.

⁶⁶ WA TR at 5123.

⁶⁷ *Id.* at 5124.

⁶⁸ *Id.*

⁶⁹ *Id.* at 5126.

⁷⁰ WA TR at 5140.

⁷¹ *Accounting Safeguards Order*, ¶ 203.

⁷² The auditor’s biennial report for Verizon Communications, Inc.’s first full year of operations (for the year 2000) in New York was not filed with the FCC until June 11, 2001 (initial report), and June 18, 2001 (supplemental report). Also, information relating to apparent violations of section 272 requirements by Verizon were redacted and are the subject of a pending FCC comment cycle. CC Docket No. 96-150 (Verizon Section 272 Compliance Biennial Audit Report). *Also see*, FCC hyperlink at: http://gullfoss2.fcc.gov/cgi-bin/websql/prod/ecfs/comsrch_v2.hts

⁷³ On August 15, 2001, the FCC granted an extension to SBC Communications of the deadline for filing the independent auditor’s report required by the SBC/Ameritech Merger Order from September 4, 2001, to November 1, 2001.

Commission seriously consider if it wants Qwest to operate under a shroud of secrecy for that length of time.

As previously discussed, AT&T initially proposed that an audit be conducted to verify that all accounting safeguards are in place and operational prior to Qwest LD's provision of long-distance service. This proposal would now apply to the new section 272 affiliate, QCC. Such an audit is well within the Commission's supervisory powers, and is certainly a condition it could impose prior to a finding of section 272 compliance if the Commission believes that Qwest has not implemented the requirements of section 272, in whole or in part.

Finally, Qwest states that it has appropriate controls in place to ensure compliance.⁷⁴ That is not true. AT&T, in the course of its testing and the filing of its testimony, reported on numerous failures in internal accounting processes or compliance with section 272 that were only corrected by Qwest after reported by AT&T. Some of these include:

1. Failure to accrue interest on billings to QCC for a period from June, 2000 to April 30, 2001.⁷⁵
2. The Master Services Agreement did not include an interest component.⁷⁶
3. Failure to post to ARMIS report.⁷⁷ It does not appear that this has been corrected.

⁷⁴ Qwest Brief at 3 and 30.

⁷⁵ Qwest Brief at 24. ("QC has calculated interest to be paid on all late-delivered invoices from the date on which they should have been billed, and the revised Master Services Agreement now reflects QCC's legal obligation to pay interest for that entire period.") AT&T Brief at 10.

⁷⁶ Qwest Brief at 23. ("QC failed to include an interest component in QCC's Master Services Agreement"). AT&T Brief at 10.

⁷⁷ AT&T Brief at 11.

4. Qwest LD transactions were moved from the current transaction section to the expired transactions section effective December 31, 2000. Qwest claims that this was a “mistake” and subsequently corrected it.⁷⁸
5. Certification Statements. Qwest’s history of not being compliant with this requirement is well documented and was not corrected until AT&T so noted it.⁷⁹
6. Shared Employees. In response to AT&T’s discovery that many employees were 100% dedicated from Qwest to QCC, Qwest instituted a new policy to mitigate this practice.⁸⁰
7. Failure to initially compare payroll registers.⁸¹ As is discussed elsewhere in this Reply Brief, Qwest only conducted such an analysis after AT&T cited a lack of such analysis in its initial Multistate testimony.

AT&T in its initial testimony in the multistate proceedings filed in September 2000, noted a lack of evidentiary material, such as a comparison of a chart of accounts or failure to compare payroll registers. It is interesting to note that in recent filings in other states’ section 272 proceedings, Qwest “fixed” these gaps in their evidence of compliance and now proclaims that “AT&T concedes” or “AT&T acknowledges” that the BOC and section 272 affiliate have separate charts or compare payroll registers. The Commission should not forget that the filing of Qwest has been remedied in many respects because of the matters raised in the first instance by AT&T.

⁷⁸ Ex.1139T at 8. AT&T Brief at 18.

⁷⁹ Qwest Brief at 13, n. 50. AT&T Brief at 22.

⁸⁰ Ex. 1139T at 23. Ex. 1156C at ¶ 52 (b), (d) and (f).

⁸¹ Qwest Brief at 13.

AT&T concedes nothing by acknowledging past deficiencies or gaps have been addressed.

D. Section 272(b)(3) – Issue 272-7

Qwest notes that it conducted an analysis of payroll registers of both entities and found no overlap.⁸² What is conveniently not noted is that Qwest conducted this analysis in response to AT&T’s assertions that the section 272 affiliate and Qwest had not compared payroll registers.⁸³ Qwest’s witness also testified that she did not personally conduct the analysis; she merely “oversaw” it, and that it was done for the “section 272 affiliate,” which may or may not include QCC.⁸⁴ It is clear, though, that there is no evidence from Qwest that, for the years prior to the analysis, a payroll register analysis was done to ensure that there was no overlap of employees between the BOC and the section 272 affiliate.

Qwest cites to the multistate transcript for its statement that “AT&T has made no claim to the contrary” regarding the existence of overlap of employees on the payroll registers.⁸⁵ This is a disingenuous and misleading assertion. Regarding the records that Mr. Skluzak had access to, the employees’ names were blocked out and Mr. Skluzak stated that this decision “raises an appearance of impropriety.”⁸⁶ Rather than provide an explanation for why these names were blacked out, Qwest instead focuses on AT&T’s absence of a claim.

⁸² Qwest Brief at 13.

⁸³ Ex. 1155T, ¶ 47(j).

⁸⁴ Ex. 1125T at 20.

⁸⁵ Qwest Brief at 14.

⁸⁶ Ex. 1125T, ¶ 47(f).

Qwest fails to mention that QCC recruits employees for Qwest and the impact such activity has as on the separateness requirement of this subsection.⁸⁷

Finally Qwest and QCC do not have separate payroll administration. Qwest provides payroll administration for both entities.⁸⁸ As previously discussed, the FCC looks to separate payroll administration as evidence of compliance.⁸⁹ Qwest will not acknowledge this and, instead, prefers to focus on the fact that, although separate payroll administration is evidence of compliance, it is not a requirement.⁹⁰ Although it may not be a requirement, failure to comply with this item further undermines the position that Qwest and QCC are separate.

E. Section 272(b)(5) - Issue 272-13

Qwest pats itself on the back for taking almost 10 months to bill, accrue, pay for and post 10 months of QCC transactions back to July 2000.⁹¹ QCC cannot claim that the items were accrued properly and timely paid because it admits it did not even know what transactions took place.⁹² Furthermore, QCC admits that the bill for transactions during the period was not submitted until May 2, 2001, and would not be paid until perhaps May 24, 2001.⁹³

Qwest argues that, contrary to assertions by AT&T, Qwest LD did not benefit

⁸⁷ *Id.*, ¶ 52(g).

⁸⁸ Ex. 1155T, ¶ 47 (j). Qwest Brief at 14.

⁸⁹ Ex. 1155T, ¶ 44, n. 47.

⁹⁰ Qwest Brief at 14.

⁹¹ *Id.*, at 9 - 10.

⁹² AT&T Brief at 11, n. 48.

⁹³ Ex. 1105T at 23. Curiously, in the Colorado proceedings, the QCC witness stated that the bill was submitted May 31, 2001. No explanation has been given for the change in the billing date.

from a “float”⁹⁴ and states that “QCC does not receive extended payment terms.”⁹⁵ QCC did benefit from a float and extended payment terms because none of the services rendered by Qwest to QCC from July 2000 to April 2001 were billed until May 2 (or 31), 2001. This sum did not include interest either. Interest was not included until AT&T pointed out this omission. Qwest admits that the Master Service Agreement did not include an interest component.⁹⁶ Accounting controls, properly implemented and maintained, should have captured these deficiencies. As it was, Qwest did not correct the internal control malfunction until after AT&T discovered it.

Qwest argues that these were “one-time hiccups in our processes” because of the merger and redesignation of the section 272 affiliate,⁹⁷ or nonchalantly characterizes them as “some delays in billing.”⁹⁸ First, these were actual transactions that Qwest should have billed to QCC in a timely manner for services Qwest provided QCC. Part 32 accounting rules were never temporarily suspended during the merger or after it. Qwest should have had no problem determining and billing for the services provided to QCC. Once again, either the internal accounting processes were not in place or there was a total collapse of them. Second, the redesignation of the section 272 affiliate, according to Qwest, did not take place until January 2001. This is well after the merger was completed and billings should have commenced, at a minimum, during the time period

⁹⁴ Qwest Brief at 22.

⁹⁵ *Id.*, at 22. Of course, the Qwest Brief fails to mention that this is the policy only since May, 2001. *See*, 1095T at 24.

⁹⁶ Qwest Brief at 24, n. 125. The Master Services Agreement was not amended until July 18 – 19, 2001 to reflect the payment of interest. *See also*, Ex. 1139T at 11. Qwest states that its omission was “inadvertent”.

⁹⁷ WA TR at 5126.

⁹⁸ Qwest Brief at 23.

from January through the end of May. “Catch-up billing”⁹⁹ is not a principle found under GAAP.

Qwest states that Qwest LD satisfied the 10-day posting requirement, “averaging less than six days.”¹⁰⁰ This assertion is not credible. As was discussed in the introduction to this reply brief, Qwest LD failed to post to its Internet website for over one year from 1997 to 1998.

F. Section 272(c)(2) - Issue 272-16

In its brief, AT&T referred to specific instances where Qwest failed to comply with section 272(c)(2).¹⁰¹ In addition, AT&T maintains that if the section 272 affiliate fails to properly account for a transaction in accordance with section 272(b)(2), and the BOC also fails to properly account for the transaction, then the BOC has failed to comply with section 272(c)(2).

It is apparent that the principles of GAAP apply (*e.g.*, timeliness) to the BOC’s section 272 transactions when the transaction rules of Part 32 apply. 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).¹⁰² “GAAP is incorporated into the Commission’s Uniform System of

⁹⁹ Ex. 1139T at 10.

¹⁰⁰ Qwest Brief at 19.

¹⁰¹ AT&T Brief at 27.

¹⁰² *Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act to Provide In-Region, InterLATA Service in the State of New York*, CC Docket No. 99-295, Memorandum Opinion and Order, FCC 99-404 (rel. Dec. 22, 1999), ¶ 415 (“*Bell Atlantic New York Order*”). 47 C.F.R. § 32.27.

Accounts [Part 32] to the extent that regulatory considerations allow.”¹⁰³ Furthermore, Part 32 states that the BOC’s financial records shall be kept in accordance with GAAP to the extent permitted by Part 32.¹⁰⁴

Thus, the BOC must comply with Part 32, and Part 32 incorporates the concept of GAAP. In other words, both Qwest and QCC, whatever side of the transaction they are on, must comply with GAAP, and depending on how a transaction is treated by the companies, there may be a violation of section 272(b)(2), section 272(c)(2), or both.

As far as AT&T can discern, Qwest’s proffer of compliance with section 272(c)(2) consists of a statement that “QC also follows GAAP,”¹⁰⁵ and an assertion of compliance with the FCC’s affiliate rules as confirmed by the Joint Cost Audit and the FCC’s review of Qwest’s ARMIS data. As was admitted by Qwest in its testimony, the Joint Cost Audit does not focus specifically on the relationship between the BOC and the 272 affiliate;¹⁰⁶ and the “statement of compliance rendered by Arthur Andersen as part of that audit is general in nature.”¹⁰⁷

As to the reliance on the FCC’s review of ARMIS data, Qwest never provides a rational explanation in its testimony or brief for the failure to properly reflect affiliated amounts with QCC in its ARMIS report beyond the \$1.5 million in revenue received from QCC that was reported.¹⁰⁸ There can be no dispute that Qwest failed to identify

¹⁰³ *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), ¶ 328, n. 1026, citing 47 C.F.R. § 32.1 (“*BellSouth Louisiana II Order*”). 47 C.F.R. § 32.12.

¹⁰⁴ 47 C.F.R. § 32.12

¹⁰⁵ Qwest Brief at 12.

¹⁰⁶ Ex. 1125T at 37. *See also*, Ex. 1155T at ¶¶ 37(f), 42, 43, 119(c), 122.

¹⁰⁷ *Id.*

¹⁰⁸ *See generally*, AT&T Brief at 11.

most of QCC's affiliated transactions and failed to implement a system of controls designed to account for such in a timely manner.¹⁰⁹

Qwest's assertion that it "has consistently complied with the FCC's affiliate transaction rules . . .," and "[t]he FCC's reviews of QC's ARMIS reports have not identified any discrepancies with respect to QC's affiliate transactions in the past three years" is simply empty rhetoric.¹¹⁰ Further, Qwest has admitted that its most recent ARMIS filing (for the year 2000) is not accompanied by a report from its independent auditors, Arthur Andersen.¹¹¹ Thus, even less probative value can be placed on the ARMIS annual report given the lack of any independent verification. Qwest may argue that this is not relevant, but it is indisputable that the FCC compares posted transactions with the BOC's ARMIS report for evidence of compliance with section 272.¹¹²

G. Section 272(c)(1) - Issue 272-15

Qwest wishes to distill this section down to one issue:¹¹³ whether Advanced Technologies ("AT") was used to circumvent the requirements of this section. However, as discussed in AT&T's brief, there is more to this issue.¹¹⁴ AT&T has summarized its position in the filed testimony.¹¹⁵ The Commission should especially focus on those paragraphs that illustrate how U S WEST was using a "straw" non-272 affiliate to

¹⁰⁹ Ex. 1139T at 15 –16. ("[N]o expenses were accrued as a payable to QCC because services being provided by QCC had not yet been identified.")

¹¹⁰ Qwest Brief at 13.

¹¹¹ Ex. 1125T at 19, n. 8. ("[T]hus the audit engagement for the year 2000 will be combined with 2001 and the report will be issued in 2002.") As will be discussed below, this lag in timing is analogous to the crucial lag in any forthcoming biennial audit report.

¹¹² *BellSouth Louisiana II Order*, ¶ 335.

¹¹³ Qwest Brief at 27.

¹¹⁴ AT&T Brief at 26.

¹¹⁵ Ex. 1155T, ¶¶ 126 *et seq.*

cleverly circumvent the section 272 nondiscrimination rules.¹¹⁶ It is unassailable that U S WEST LD was receiving favorable services from the then U S WEST via AT. This arrangement resulted in *de facto* discrimination in favor of the 272 affiliate. Qwest's testimony that the services provided by AT "did not involve the BOC in any way," is wrong.¹¹⁷

At the Colorado workshop, under questioning from AT&T, Qwest revealed for the first time that product design, planning or development services for Qwest and QCC would be provided by Qwest Services Corporation ("QSC"), the parent of both entities. Further, such services would not be required to be posted and made available to unaffiliated parties.¹¹⁸ The significance of this is that Qwest's participation in the planning, design and development of QCC's offerings is subject to the nondiscrimination requirements of section 272(c) and, therefore, are required to be posted to the website and made available. By shifting such services to another affiliate, Qwest and QCC are now able to participate in joint planning, design and development free of the strictures of section 272. The Commission should carefully weigh Qwest's strategy when tendering its recommendation to the FCC.

H. Qwest's Past History - Issue 272-20

Qwest earnestly argues that the Commission should not examine its (and U S WEST's and the section 272 affiliates') past history¹¹⁹ and, once again, touts the

¹¹⁶ Ex. 1156C at ¶ 129 (a), (d), (f) and (g).

¹¹⁷ Ex. 1139T at 28.

¹¹⁸ CO TR 84, 89 –90 and 92. In its written testimony, Qwest and QCC gave the impression that joint design, planning and development services would be posted and made available and certainly never mentioned that QSC would provide such services. It should be further noted that the Colorado workshop was held on July 24, 2001, and well after the Washington workshop.

¹¹⁹ Qwest Brief at 33.

biennial audit as a panacea for future protection against transgressions.¹²⁰ As has been previously discussed, the FCC realistically might not receive a biennial audit report until mid-2004, and possibly later if Qwest receives extensions. By then, any remedial action by the FCC for noncompliance with section 272 might be of no consequence. Thus, the Commission is again cautioned not to place heavy reliance upon Qwest's arguments that the biennial audit process will provide protection.¹²¹

Qwest starts with the premise that it meets all requirements of section 272, and concludes that AT&T's arguments regarding the past are irrelevant. Therefore, it argues, AT&T is engaging in "character assassination."¹²² Qwest's arguments are nonsensical and its *ad hominem* conclusion is unwarranted. The FCC has stated that it must make a predictive judgment about the section 272 affiliate's compliance with section 272.¹²³ QCC's own witness acknowledged that the Commission must review past history as a predictive indicator of Section 272 compliance.¹²⁴ Qwest wishes to keep past violations in the dark and away from the Commission's scrutiny, arguing these violations are irrelevant. However, as explained in AT&T's brief, the violations of section 271 by the BOC are contrary to the requirements of section 272.¹²⁵ But more importantly, the violations reflect a decision by Qwest to test the boundaries of legally acceptable behavior and sheds light on Qwest's willingness to circumvent the requirements of

¹²⁰ *Id.*, at 35.

¹²¹ A theme of Qwest's is to use the biennial audit as a "fallback", or to fill gaps. See WA TR at 5140 ("It's important to note that this proceeding is not the only place where 272 will be tested."); 5142 ("we will reaffirm our Section 272 compliance through the first biennial audit . . ."); 5159 ("We have other audits to do that. For instance, the biennial audit will specifically test for 272 compliance."); 5166 ("And then once you have the 272 authority, there would be a biennial audit to ensure that that's, in fact, taking place.")

¹²² Qwest Brief at 33.

¹²³ *BellSouth Louisiana II Order*, ¶ 321.

¹²⁴ Ex. 1105T at 5, n. 2.

¹²⁵ AT&T Brief at 3 - 4.

section 271, and consequently, section 272(a).¹²⁶ This is an issue of character and is highly relevant, considering the important goals of section 272 as expressed by the FCC.¹²⁷

Qwest attempts to diminish the significance of its section 271 violations by arguing that its history of past violations hinged on the definition of “provide.”¹²⁸ In a strictly legal sense, this may be true. The FCC had to determine if Qwest was providing interLATA long distance service. The FCC noted:

During its own internal strategy sessions, U S WEST similarly determined that offering a package of services that includes in-region, interLATA service would afford it a means to “[target] high value customers for retention, winback and competitive response reasons...,” “[i]mprove U S WEST value proposition in its toll markets by ‘packaging’ competitive intraLATA calling plans with a compelling long distance offer,” and “[p]re-position customers for U S WEST Long Distance by providing the convenience of one-stop shopping.” U S WEST stated further in its marketing plans that “[U S WEST’s] endeavor with Qwest will initially allow [U S WEST] to become an interLATA carrier for customers...”¹²⁹

It is apparent that the internal strategy sessions involved more than a semantical discussion of the word “provide.” The United States Court of Appeals affirmed the FCC’s conclusion “that the disputed arrangements would give the two BOCs [U S WEST and Ameritech] positions in the market for local and long distance service that would greatly advantage them once they became explicitly entitled to provide any long distance service.”¹³⁰ The Court concluded that the FCC’s approach -- to determine whether the

¹²⁶ Qwest did not shut down the 1-800-4USWEST calling card program after the merger. Its new management must accept some accountability for the subsequent finding that the program violated section 271.

¹²⁷ See AT&T Brief at 2, quoting *Ameritech Michigan Order*, ¶ 346.

¹²⁸ Qwest Brief at 34.

¹²⁹ *AT&T Corp. et al. v U S WEST Communications, Inc.*, File No. E-98-42, Memorandum Opinion and Order, FCC 98-242 (rel. Oct. 7, 1998), ¶ 14 (footnotes omitted) (emphasis added) (“*FCC Order*”).

¹³⁰ *U S WEST v FCC*, 177 F.3d 1057, 1058 (D.C. Cir. 1999).

BOC obtained a competitive advantage, thereby reducing its incentive to open the local market -- was reasonable.¹³¹

Essentially, the Commission is making a similar decision regarding section 272. The FCC noted that the section 272 safeguards “are designed to promote competition.”¹³² If the safeguards are not in place before Qwest obtains section 271 relief, competitors may not “have nondiscriminatory access to essential inputs on terms that do not favor the BOC affiliate.”¹³³

Regarding Qwest’s history of provisioning of section 271 services, it should not be allowed to lay claim to its “good” history and disown the “bad.”

III. CONCLUSION

Qwest continues to claim an unbroken chain of compliance with section 272 since the Act was passed. This claim is not supported by the evidence. In fact, the evidence contradicts Qwest’s claim.

It should be noted that many of the “mistakes” and problems brought to light by AT&T were corrected *after* AT&T raised the issues, not before. This alone suggests a lack of internal controls, processes, and training. Solving the problems after the fact does not erase the history of these underlying deficiencies.

Finally, a future section 272 Biennial Audit does not justify noncompliance. Between audits, carriers may be discriminated against. The “float” issue provides a

¹³¹ *Id.*, at 1060. (“In order to determine whether a BOC is providing interLATA service within the meaning of section 271, we must assess whether a BOCs involvement in the long distance market enables it to obtain competitive advantages, thereby reducing its incentive to cooperate in opening its local market to competition.” *FCC Order*, ¶ 37).

¹³² *Ameritech Michigan Order*, ¶ 346.

¹³³ *Id.*

glaring example. It is illogical to assume that Qwest would allow a non-affiliated interexchange carrier to go 10 months without a bill and not provide for interest in the initial contract terms. Simply having QCC subsequently amend its contract and pay interest does not “cure” the problem because for 10 months QCC had a distinct advantage over other interexchange carriers. This sort of behavior exemplifies why it is imperative that processes and internal controls are in place before section 271 relief is granted. Qwest has not made an adequate showing of compliance with section 272.

The Commission should find that Qwest is not in compliance and in the future will not comply with section 272.

Respectfully submitted this 14th day of September 2001.

Respectfully Submitted,

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