

STATE OF IOWA
DEPARTMENT OF COMMERCE
UTILITIES BOARD

IN RE: U S WEST COMMUNICATIONS, INC., n/k/a QWEST CORPORATION	DOCKET NOS. INU-00-2 SPU-00-11
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**CONDITIONAL STATEMENT REGARDING
47 U.S.C. § 272 COMPLIANCE**

(Issued April 4, 2002)

On February 10, 2000, the Utilities Board (Board) issued an order initiating an investigation relating to the possible future entry of U S WEST Communications, Inc., n/k/a Qwest Corporation (Qwest), into the interLATA market. The investigation was identified as Docket No. INU-00-2.

In a filing dated May 4, 2000, Qwest encouraged the Board to consider a multi-state process for purposes of its review of Track A (competition issues),¹ various aspects of each item on the 14-point competitive checklist, section 272 (separate subsidiary) issues and public interest considerations. The Board considered the concept of a multi-state process for purposes of its review of a Qwest application to provide in-region, interLATA services, sought comment, and subsequently issued an order dated August 10, 2000, indicating that its initial review of Qwest's compliance with the requirements of 47 U.S.C. § 271 would be through participation in a multi-state workshop process with the Idaho Public Utilities

¹ See, 47 U.S.C. § 271(c)(1)(A).

Commission, North Dakota Public Service Commission, Montana Public Service Commission, Wyoming Public Service Commission, and the Utah Public Service Commission. Since the time of that order, the New Mexico Public Regulation Commission has also joined in the workshop process.

A report was filed with the Board on September 24, 2001, addressing issues related to Track A, section 272, and general terms and conditions. Only the section 272 compliance issues of the September 24, 2001, report are considered in this conditional statement. Issues relating to Track A were considered by the Board in a conditional statement issued January 25, 2002. In a conditional statement issued March 12, 2002, the Board considered issues relating to general terms and conditions.

BACKGROUND

Pursuant to 47 U.S.C. § 272, Qwest is subject to structural and nonstructural safeguards applicable to the provision of in-region interLATA service. The FCC set standards for compliance with section 272 in the *Accounting Safeguards Order* and the *Non-Accounting Safeguards Order*.² The standards set by the FCC in those orders, in combination with the requirements of section 272 discourage, and facilitate

² See, *Implementation of the Accounting Safeguards Under the Telecommunications Act of 1996*, CC Docket No. 96-150, Report and Order, 11 FCC Rcd 17539 (1996) (*Accounting Safeguards Order*), Second Order on Reconsideration, FCC 00-9 (rel. Jan. 18, 2000); *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, CC Docket No. 96-149, First Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd 21905 (1996) (*Non-Accounting Safeguards Order*); First Order on Reconsideration, 12 FCC Rcd 2297 (*First Order on Reconsideration*), Second Order on Reconsideration, 12 FCC Rcd 8653 (1997) (*Second Order on Reconsideration*), *aff'd sub nom. Bell Atlantic Telephone Companies v. FCC*, 133 F.3d 1044 (D.C. Cir. 1997), Third Order on Reconsideration, FCC 99-242 (rel. Oct. 4, 1999) (*Third Order on Reconsideration*).

the detection of, improper cost allocation and cross-subsidization between the Bell Operating Company (BOC) and its section 272 affiliate. These safeguards also ensure that BOCs do not discriminate in favor of their section 272 affiliates.

The FCC has indicated that non-compliance with section 272 is grounds for denying relief under section 271.³ The FCC also stated:

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.⁴

The specific provisions of section 272 include:

- Section 272(a) – separate affiliate requirement
- Section 272(b) – structural and transactional requirements
- Section 272(c) – nondiscrimination safeguards
- Section 272(d) – biennial audit requirement
- Section 272(e) – fulfillment of requests for telephone exchange service
- Section 272(f) – sunset provisions

³ *In the Matter of Application of BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, Inter-LATA Service in Louisiana*, Memorandum Opinion and Order, CC Docket No. 98-131, 13 FCC Rcd 20599, at ¶ 322. (*Bellsouth Louisiana II Order*).

⁴ *In the Matter of Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Michigan*, Memorandum Opinion and Order, CC Docket No. 97-137, 12 FCC Rcd 20,543 at ¶ 346. (*Ameritech Michigan Order*)

- Section 272(g) – joint marketing
- Section 272(h) – transition provisions

Generally, the most challenged requirements of section 272 are found in subsections (a)-(c) and are summarized below.

- § 272(a) – separate affiliate – require the affiliate to be structurally separate from the BOC.
- § 272(b)(2) – separate books, records, and accounts - requires that the separate affiliate maintain books, records, and accounts in the manner prescribed by the FCC, which shall be separate from those of the BOC.
- § 272(b)(3) – separate officers, directors, and employees – requires that the separate affiliate have separate officers, directors, and employees from the BOC.
- § 272(b)(5) – affiliate transactions – specifies that the separate affiliate may not obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the BOC. Additionally, the separate affiliate shall conduct all transactions with the BOC on an arm's length basis with any such transactions reduced to writing and available for public inspection.
- § 272(c)(1) – nondiscrimination safeguards - prohibits the BOC from discrimination in favor of its 272 affiliate in the provision or procurement of goods, services, facilities, and information, or in the establishment of standards.
- § 272(c)(2) – accounting principles – requires the BOC to account for all transactions with its 272 affiliate in accordance with accounting principles designated or approved by the FCC. Additionally, § 272(d) requires a biennial audit of the BOC's compliance with section 272 by an independent auditor following receipt of interLATA authorization.

Qwest's compliance with 272 sections (d)-(g) was not briefed prior to Liberty's report, an indication that no participant had issues about Qwest's compliance with those requirements. Thus Liberty did not address these sections in its report. The

report addressed 20 sub-issues under 272 sections (a)-(c). Liberty concluded that the record demonstrates Qwest has met each of the separate affiliate requirements of section 272.⁵ However, in addressing the evidence provided by AT&T under the books and records requirement of section 272(b), Liberty noted problems Qwest has had in bringing its transactions into compliance with applicable accounting requirements.

In recognition of the problems Qwest has had with its books and records, Liberty recommended additional third-party testing of Qwest's practices for the period April 2001 to August 2001. Liberty suggested that the testing evaluate whether: (a) Qwest is accurate, complete, and timely as it records transactions between Qwest and its 272 affiliate; (b) the relationship between Qwest and its 272 affiliate is carried out at arms length; and (c) reasonable assurances exist that the practices addressing points (a) and (b) will continue. In all, Liberty tied its recommendation for additional third party testing to six of the 20 sub-issues addressed in its report.

In its post-report comments, Qwest denied the necessity of the third-party testing, but agreed to compliance in order to expedite the section 272 process. Qwest engaged KPMG, LLP (KPMG) to conduct the testing based on the recommendations in the September 24, 2001, report. Qwest filed KPMG's report of the examination on November 15, 2001. On December 3, 2001, the Board issued an order allowing comments and responses to the KPMG report. AT&T filed its

⁵ Report, p. 7.

comments on December 11, 2001. Qwest filed responsive comments on December 18, 2001.

AT&T filed a letter on March 28, 2002, which purported to be "supplemental authority" in support of its positions on section 272 issues. Attached to the letter was a copy of an Administrative Law Judge's (ALJ) recommendations on section 272 issues in Minnesota. The Board notes that Minnesota was not one of the states to participate in the multi-state process with Iowa, and therefore the evidentiary record would most likely be different from the one before the Board. Additionally, simply filing a recommended resolution by an ALJ, without directing the Board's attention to specifics within that document that further the arguments made by a participant do not assist the Board in making its determinations on the various issues in Iowa.

Although Liberty concluded that Qwest meets each of the separate affiliate requirements of section 272 and no participant filed comments objecting to any of the report recommendations, the status of the six sub-issues tied to the KPMG testing remain at impasse because AT&T has contested the results of the KPMG testing. The results of the KPMG audit will be discussed later in this statement.

For those remaining issues concerning section 272 where the September 24, 2001, report indicates that agreement has been reached, the Board is prepared to indicate at this time its conclusion that Qwest has conditionally satisfied the checklist requirements related to general terms and conditions. To the extent that some of these issues are to be further evaluated in the Regional Oversight Committee (ROC) OSS test or some other proceeding, the Board will incorporate that evidence into its

final recommendation to the Federal Communications Commission (FCC) as to whether Qwest has fully complied with a checklist requirement. To the extent that an issue requires performance of some duty or activity on Qwest's part, Qwest will need to demonstrate that it adequately performs as expected in order for the Board to make a positive recommendation to the FCC following an application filed by Qwest.

After reviewing the portions of the September 24, 2001, report addressing section 272 issues, the testimony, pre-report briefs, and post-report comments filed by those interested participants on these issues, the Board finds that no further proceedings are necessary to reach a conditional determination on those issues that remain subject to disagreement.

Throughout this conditional statement, the following abbreviations are used to denote the various Qwest entities:

- **QCI:** Qwest Communications International - the parent company of the Qwest family of enterprises.
- **QC:** Qwest Corporation (normally "Qwest" herein) - the company that provides local exchange service in the 14-state region once served by US WEST.
- **QSC:** Qwest Services Corporation - a wholly-owned subsidiary of QCI, the parent company. QSC owns Qwest Communications Corporation - the long distance affiliate.
- **QCC:** Qwest Communications Corporation - the currently designated section 272 affiliate. QCC is wholly owned by QSC. It is the pre-merger entity through which Qwest had previously provided interLATA services in many areas of the United States.
- **QLD:** Qwest Long Distance, Inc. - the entity that Qwest, and before it US WEST, used to provide interLATA service outside its 14-state region. Until recently QLD was the designated section 272 affiliate.

Liberty grouped the overall 272 requirements into loose categories in its report. For ease in considering the separate impasse issues, the Board will follow the categories and sub-issues that were set out in the September 24, 2001, report filed by Liberty.

Separate Affiliate Requirements

1. Separation of Ownership (Report p. 49; Qwest pre-report brief pp. 5-6)

The undisputed testimony was that Qwest's designated section 272 affiliate, QCC, is a wholly owned subsidiary of QSC, which in turn is wholly owned by the parent, QCI. Liberty concluded that QCC is separate from QC, which is the entity that provides local exchange service in the seven states participating in the multi-state process. No comments were filed contesting this conclusion.

The Board agrees with Liberty's conclusion.

2. Prior Conduct (Report pp. 49-50; Qwest pre-report brief pp. 29-30)

AT&T argued that three prior instances, in which the FCC found Qwest to be providing services that constituted in-region, interLATA services, demonstrated a substantial and predictive history of Qwest's non-compliance with section 272 requirements. Liberty concluded that Qwest's prior violations of section 271 should not be considered violations of section 272 separate affiliate requirements. No comments were filed contesting this conclusion.

The Board agrees with Liberty's conclusion.

Books and Records

Liberty defined six separate sub-issues that relate to the requirement that the affiliate maintain separate books, records, and accounts, and that they be maintained in accordance with accounting principles designated or approved by the FCC.

1. Generally Accepted Accounting Principles (Report pp. 51-55; Qwest pre-report brief pp. 6-8; Qwest pre-report reply brief pp. 7-11; AT&T pre-report brief pp. 5-6; AT&T pre-report reply brief pp. 2-4; KPMG Report pp. 1-5; Qwest KPMG Report comments pp. 1-4; AT&T KPMG Report comments, pp. 2)

No comments were filed in response to the Liberty recommendation that this issue be further evaluated in testing by a third party, noting that Qwest made a showing that it had recently undertaken substantial efforts to assure that it meets these requirements. This issue is more fully discussed under the heading "KPMG Audit Report Issues."

2. Materiality (Report pp. 55-56; Qwest pre-report brief p. 7; AT&T pre-report brief pp. 6-8; KPMG Report pp. 1-5; Qwest KPMG Report comments p. 2; AT&T KPMG Report comments p. 3)

No comments were filed in response to the Liberty recommendation that this issue be further evaluated in testing by a third party. Liberty recommended that the examination should apply the materiality standard, but limit it to the universe of transactions between the BOC and the section 272 affiliate from April through August of 2001. This issue is more fully discussed under the heading "KPMG Audit Report Issues."

3. Documentation (Report pp. 56-57; AT&T pre-report brief pp. 8-9; KPMG Report pp. 1-5; Qwest KPMG Report comments pp. 1-4; AT&T KPMG Report comments p. 3)

No comments were filed in response to the Liberty recommendation that this issue be further evaluated in testing by a third party. Liberty recommended that the examination address whether the postings Qwest made during the period covered by the examination were sufficient, and accurately reflective of the terms and conditions actually made available. This issue is more fully discussed under the heading "KPMG Audit Report Issues."

4. Internal Controls (Report pp. 57-58; Qwest pre-report reply brief, p. 9; AT&T pre-report brief pp. 9-11; AT&T pre-report reply brief p. 4; KPMG Report pp. 1-5; AT&T KPMG Report comments p. 2)

No comments were filed in response to the Liberty recommendation that this issue be further evaluated in testing by a third party. Liberty recommended the third party examination test the adequacy of internal controls in the wake of the changes recently made by Qwest. This issue is more fully discussed under the heading "KPMG Audit Report Issues."

5. Separate Charts of Accounts (Report p. 58; AT&T pre-report brief p. 11; Qwest post-report comments p. 6)

Liberty concluded the record demonstrates that Qwest maintains separate charts of accounts for QC, QCC, and QLD. No comments were filed contesting Liberty's conclusion.

The Board agrees with Liberty's conclusion.

6. Separate Accounting Software (Report p. 58; AT&T pre-report brief pp. 11-12; Qwest post-report comments p. 6)

AT&T argued that Qwest presented no evidence that the BOC and the 272 affiliate were using separate accounting software. Liberty noted that there is no

requirement for a BOC and a 272 affiliate to have separate accounting software. The primary issue is whether the accounting function is separately performed and subject to adequate controls. Liberty concluded there was no evidence to support a conclusion that QC and the 272 affiliate failed to adequately separate their accounting. No comments were filed contesting Liberty's conclusion.

The Board agrees with Liberty's conclusion.

Separate Officers, Directors, and Employees

1. Routine Employee Transfers (Report pp. 59-60; Qwest pre-report brief pp. 11-13; Qwest pre-report reply brief pp. 13-15; AT&T pre-report brief pp. 12-13; AT&T pre-report reply brief pp. 5-6; Qwest post-report comments pp. 9-10)

Liberty stated that Congress did not prohibit the movement of employees between affiliates. However, such movement could compromise independent operation unless steps are taken to assure independence and to protect confidential information. Liberty concluded that Qwest maintains the required degree of employee separation, and the transfers to date have not been of such significance to compromise operational independence. No comments were filed contesting Liberty's conclusion.

The Board agrees with Liberty's conclusion.

2. 100 Percent Usage (Report pp. 60-61; Qwest pre-report brief pp. 13-14; Qwest pre-report reply brief pp. 14-15; AT&T pre-report brief p. 12; Qwest post-report comments pp. 10-11)

AT&T argued that many individuals employed by QC account for 100 percent of their time as time spent working for the section 272 affiliate, which subverts the purpose of section 272(b). Qwest responded that although the FCC does not prohibit

service sharing, nevertheless, it had recently implemented a new policy to limit such assignments of individuals to four months out of any twelve.

Liberty agreed that the FCC allows service sharing between a BOC and its section 272 affiliate, but it noted that the costs of the shared services must be charged to the section 272 affiliate. Liberty concluded that Qwest's proposal to limit service sharing was "acceptable for present purposes." Liberty noted, however, that experience gained through ongoing monitoring efforts will better show how long-term separations of employment will affect the fulfillment of section 272 objectives. No comments were filed contesting Liberty's conclusion.

The Board agrees with Liberty's conclusion.

3. Award Program Participation (Report pp. 61-62; Qwest pre-report brief p. 15; AT&T pre-report brief pp. 12-13; Qwest post-report comments pp. 11-12)

AT&T cited award programs open to employees of QC and other affiliates, maintaining such programs compromise the independent operation of the entities. In its response, Qwest pointed out that the FCC has determined that section 272(b) (3) does not prohibit providing compensation to an employee of a section 272 affiliate, based on the performance of the BOC.⁶

Liberty noted that the FCC is not indifferent to compensation mechanisms that would create inducements to act anti-competitively, but concluded a close reading of AT&T's evidence did not indicate improper inducements. Liberty also concluded there is nothing wrong with providing an inducement to a QC, QCC, or QLD

⁶ *Non-Accounting Safeguards Order* at ¶ 186.

employee for referring customers or offering cost-saving suggestions for the benefit of their employer.

Liberty noted the record lacked specific details about the operation of the reward programs that might suggest the inducements offered were improper, although AT&T had ample opportunity to provide those details. Based on the record, Liberty concluded the programs do not compromise the independent operation requirements of section 272. No comments were filed contesting Liberty's conclusion.

The Board agrees with Liberty's conclusion.

4. Comparing Payroll Registers (Report pp. 62-63; Qwest pre-report brief pp. 15-16; AT&T pre-report reply brief p. 5)

Liberty stated there is no requirement for routine or cyclical comparisons of payroll registers between QC and its section 272 affiliate, for a specified time period, prior to an application for in-region interLATA authority. Liberty concluded there is not currently an overlap between the payroll registers. The future biennial audits will assure the requirement continues to be met. No comments were filed contesting Liberty's conclusion.

The Board agrees with Liberty's conclusion.

5. Separate Payroll Administration (Report p. 63; Qwest pre-report brief pp. 15-16; AT&T pre-report brief p. 6)

Liberty concluded that the FCC specifically rejected arguments that common services should be prohibited as a means of encouraging independence between a BOC and its section 272 affiliate. Liberty noted that the FCC endorses common

services, outside the network-related areas where they are specifically prohibited, as a means of capturing economies of scale. No comments were filed contesting Liberty's conclusion.

The Board agrees with Liberty's conclusion.

6. Officer Overlap (Report pp. 63-64; Qwest pre-report brief p. 16; AT&T pre-report brief p. 6; AT&T pre-report reply brief pp. 5-6; Qwest post report comments pp. 9-10, 12)

Liberty concluded there was no evidence of simultaneous service for an individual who worked for QCC before taking a position as a director of QC. Liberty also concluded that such movement is not improper. No comments were filed contesting Liberty's conclusion.

The Board agrees with Liberty's conclusion.

Transaction Posting Completeness

1. Posting Billing Detail (Report pp. 64-66; Qwest pre-report brief pp. 20-23; Qwest pre-report reply brief pp. 12-13; AT&T pre-report brief pp. 13-18; Qwest post-report comments pp. 12-14; KPMG Report pp. 1-5; AT&T KPMG report comments pp. 1-4)

Section 272(b)(5) requires transactions between the BOC and the section 272 affiliate be "reduced to writing and available for public inspection." The FCC's *Accounting Safeguards Order* requires all transactions to be posted, within ten days, to the company's website.

Qwest posts its master services agreement and amendments, along with associated work orders, on its website specifically at the following URL:

http://www.qwest.com/about/policy/docs/sa_3.html. However, Qwest makes

additional billing detail available only to those who execute nondisclosure agreements. AT&T argued that Qwest's policy violated FCC requirements.

Liberty noted that the requirement for making transaction information available serves two purposes. The first is to give CLECs enough information to make business decisions concerning the use of Qwest's services. Complete detail is not necessarily needed for this purpose. Nevertheless, Liberty recommended the independent testing discussed under "Books and Records" to address the sufficiency of Qwest's website postings.

The second purpose for making transaction information available is to allow audits or other formal examinations to be conducted. Liberty concluded that public posting is not necessary for this purpose, and Qwest's requirement for non-disclosure agreements is justified.

The Board notes that KPMG's report does not contain a statement directly addressing the sufficiency of Qwest website postings. The report only makes note of the specific instances of Qwest's "noncompliance with certain aspects of Section 272 of the Act and associated FCC rules and regulations."⁷ Because KPMG did not identify the website postings as an area of noncompliance, it is reasonable to conclude that KPMG found Qwest's website postings to be compliant.

AT&T argued that KPMG's Report did not approach the level of examination and testing that Liberty had recommended, and noted that KPMG states that its

⁷ KPMG report, p. 1.

"examination does not provide a legal determination on the Company's compliance with specified requirements."⁸

The Board notes that Liberty could have proposed a conclusion for this issue without relying on independent testing. The FCC previously addressed this issue when granting 271 approval in the *SBC Texas Order*. In that case, Southwestern Bell Telephone Company (SWBT) required third parties to sign a nondisclosure agreement before reviewing SWBT's detailed billing information. However, the SWBT nondisclosure agreement prohibited any party that identified discrimination from disclosing the evidence of that discrimination to a regulatory agency until SWBT had been allowed 30 days to explain or make changes.⁹

The FCC did not express concern over SWBT's nondisclosure agreement requirement per se, but it did recognize the nondisclosure agreement "might deter unaffiliated third parties from notifying the Commission about potential violations of our rules."¹⁰ Ultimately, the FCC allowed SWBT to require unaffiliated third parties to sign nondisclosure agreements before viewing detailed billing information, because the transactions themselves "were properly posted on the Internet."¹¹

In Qwest's case, there is no record that its nondisclosure agreement includes the additional terms that caused concern to the FCC about SWBT's nondisclosure

⁸ AT&T KPMG report comments, p. 3.

⁹ *Application by SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc., d/b/a Southwestern Bell Long Distance; Pursuant to Section 271 of the Telecommunications Act of 1996 To Provide In-Region, InterLATA Services in Texas*, Memorandum Opinion and Order, CC Docket No. 00-65, 15 FCC Rcd 18,354 at footnote 1182. (*SBC Texas Order*)

¹⁰ *SBC Texas Order* at ¶ 407.

¹¹ *Ibid.*

agreement. Therefore, it would appear that sufficient precedent exists for the Board to approve Qwest's use of a nondisclosure agreement before it allows unaffiliated third parties to view detailed billing information.

The Board finds that Qwest's nondisclosure agreement requirement is not a violation of section 272(b)(5) or associated FCC rulings.

2. Initiation of the Posting of QCC Transactions (Report pp. 66-67; Qwest pre-report brief pp. 18-19; Qwest pre-report reply brief pp. 3-4; AT&T pre-report brief pp. 15-18; AT&T pre-report reply brief pp. 7-8)

Qwest maintained that QCC became subject to section 272 posting requirements on March 26, 2001, the date it became the long-distance affiliate. AT&T asserted section 272 posting should have begun as early as September 1998 when QLD, the former long distance affiliate, activated its website.

Liberty noted that not all BOC affiliates should be considered section 272 affiliates. QLD was not a section 272 affiliate because it did not provide in-region interLATA services. Liberty concluded Qwest has met its obligations, because it is now posting for its designated 272 affiliate. No comments were filed contesting Liberty's conclusion.

The Board agrees with Liberty's conclusion.

3. Indefinite Service Completion Dates (Report pp. 66-67; Qwest pre-report brief pp. 18-19; Qwest pre-report reply brief pp. 3-4; AT&T pre-report brief pp. 15-18; pre-report reply brief pp. 7-8)

AT&T argued that the FCC requires transaction postings to provide either the length of time or the estimated completion date of any project. Qwest responded that some of its services are offered for an indefinite period.

Liberty noted that it is common for commercial agreements to have indefinite terms. Liberty concluded there is no basis for finding that the FCC or the 1996 Act intended a BOC to be precluded from offering such terms. No comments were filed contesting Liberty's conclusion.

The Board agrees with Liberty's conclusion.

4. Verifications (Report pp. 68-69; AT&T pre-report brief pp. 22-23; KPMG Report pp. 1-5; AT&T KPMG report comments pp. 1-4)

No comments were filed in response to the Liberty recommendation that this issue be further evaluated in testing by a third party, noting that Qwest made a showing that it had recently undertaken substantial efforts to assure that it meets these requirements. This issue is more fully discussed under the heading "KPMG Audit Report Issues."

Non-Discrimination

1. Non-Discrimination (Report pp. 69-70; Qwest pre-report brief pp. 23-24; Qwest pre-report reply brief pp. 29-30; AT&T pre-report brief p. 25)

Liberty concluded that the issues raised by AT&T concerning non-discrimination were addressed in previous workshops. No comments were filed contesting this conclusion.

The Board agrees with Liberty's conclusion that these issues have already been addressed.

Compliance with FCC Accounting Principles

1. Compliance with FCC Accounting Principles (Report p. 70; Qwest pre-report brief pp. 24-25; AT&T pre-report brief pp. 34-35; AT&T pre-report reply brief p. 8; Qwest post-report comments p. 6)

Liberty noted this issue was addressed under section 272(b) – Generally Accepted Accounting Principles. Liberty concluded that applying a section 272(c) standard does not add materially to its conclusions made under section 272(b). No comments were filed contesting this conclusion.

The Board agrees with Liberty's conclusion.

KPMG AUDIT REPORT ISSUES

Liberty recommended that Qwest engage an independent third party to conduct testing of Qwest's compliance with section 272. Qwest agreed to this independent testing. AT&T did not file any comments to Liberty's report recommendation. Liberty recommended as follows:

Qwest should be required to arrange for independent (i.e., third-party) testing, covering the period from April through August of 2001 to determine: (a) whether there have been adequate actions to assure the accurate, complete, and timely recording in its books and records of all appropriate accounting and billing information associated with QC/QCC transactions, (b) whether the relationship between QC as a vendor or supplier of goods and services and QCC has been managed in an arm's length manner, including, but not necessarily limited to a consideration of what would be expected under normal business standards for similar contracts with an unaffiliated third party, and (c) whether there are reasonable assurances that a continuation of the practices and procedures examined will continue to provide the level of accuracy, completeness, timeliness and arm's length conduct found in examining the preceding two questions.¹²

¹² Report p. 54.

Additionally, Liberty recommended that the following requirements be incorporated for any examination by a third party:¹³

- Apply the testing and evaluation criteria deemed necessary by an independent party (qualified to perform such an examination) to provide a high degree of confidence that the answers it provides to these two questions can be relied upon by regulators
- Consider in the development of test procedures the need for the completion of the examination and the filing with the seven participating commissions of the report described below no later than November 15, 2001
- Produce a report and supporting work papers that present a factual basis upon which regulators can form their own, independent answers
- The current independent auditor, whose personnel have substantially contributed to the creation of transaction detail whose adequacy will be examined, should not be considered for the performance of this examination
- Apply a materiality standard that does not consider consolidated financial results, or even the overall financial results of QC. In determining what would constitute a material failing or exception in connection with the two questions to be answered, the examination will consider as the applicable universe not more than the total transactions between QC and QCC over the period to be covered. The reasons for this application of this materiality standard are described in the discussion of the immediately following issue.

KPMG was engaged by Qwest to conduct the third-party testing of its section 272 compliance, as recommended by Liberty. Qwest filed KPMG's "Report of Independent Public Accountants" on November 9, 2001.

In its KPMG report comments, AT&T raises several issues it argues should require a finding by the Board that Qwest has failed to meet the section 272 requirements. Qwest filed reply comments to AT&T's comments on KPMG's report.

¹³ Report pp. 54-55.

The Board has broken down the comments into seven different issues that were raised in response to the report by KPMG and will address each of those issues separately herein.

1. Scope of KPMG Examination (AT&T KPMG comments p. 2; Qwest KPMG Comments p. 1)

AT&T argues that the KPMG report was much more limited in scope than the independent testing recommended by Liberty. The KPMG report, for example, did not include an examination of Qwest's compliance with sections 272(a), 272(b)(1), 272(b)(3), 272(b)(4), or 272(g). AT&T further argues the requirements in those sections are at issue in this proceeding.

Qwest argues that the reason that the KPMG report "did not include an examination of Qwest's compliance with sections 272(a), 272(b)(1), 272(b)(3), 272(b)(4), or 272(g)" is because no such further examination was deemed necessary or appropriate by Liberty. Qwest noted that Liberty concluded in its September 24, 2001, report that each of the separate affiliate requirements established by section 272 had been met. The sole area in which the facilitator directed Qwest to provide further validation of its controls was concerning affiliate transactions. KPMG therefore appropriately limited its review to those specific requirements of section 272 related to affiliate transactions.

Liberty's report specifically explains the details and requirements of audit to be completed by the third party examiner. Liberty's report further recognized that the audit should not be a section 272 audit, such as that required under section 272(d)(2), due to the burden it would be to Qwest. Instead, Liberty specified that its

recommended examination was intended to determine whether the substantial efforts that Qwest recently undertook, presumably because it recognized the need for them, were sufficient to provide adequate assurances that it will begin (presuming that the FCC grants an application for 271 relief) an era of in-region interLATA service in compliance with section 272(b)(2) requirements.

It appears that KPMG's examination was completed in the manner recommended by Liberty. The Board agrees with Liberty's conclusions about the scope of the audit and rejects AT&T's arguments that the scope of the third party examination was inadequate.

2. Detail of KPMG Examination (AT&T KPMG comments pp. 2-3; Qwest KPMG comments p. 3)

AT&T argues that KPMG failed to explain the depth of examination to which KPMG subjected each individual transaction. AT&T states that KPMG repeatedly noted that it was examining "management's assertion" that Qwest was in compliance with certain aspects of section 272 and suggested the report failed to explain the extent to which KPMG independently examined individual transactions, rather than simply reviewed the information that Qwest management compiled to support its assertions of compliance. AT&T also states the KPMG report does not address whether "there are reasonable assurances that a continuation of the practices and procedures examined will continue to provide the level of accuracy, completeness, timeliness and arm's length conduct found in examining" Qwest's past actions. AT&T asserts that the report does not approach the level of examination and testing that Liberty recommended.

Qwest argues that the report itself conforms to established examination practices, as set forth in standards developed by the American Institute of Certified Public Accountants (AICPA). Use of the concept of materiality and language such as "complied in all material respects," which AT&T characterizes as a "qualified" finding, is completely customary for the nature of this examination. Qwest notes that AT&T complains the report fails to explain the extent to which KPMG independently examined individual transactions. Consistent with AICPA standards, however, this information is documented in the KPMG work papers, not in the independent accountant's report. KPMG did not simply review the information that Qwest provided. On the contrary, KPMG, in accordance with AICPA standards, requested and obtained supporting evidence to the extent deemed sufficient by KPMG and independently evaluated the evidence to reach its own conclusion as to Qwest's compliance with the applicable regulations.

Liberty's report specifically delineated the requirements for the examination it recommended to be completed by a third party. It appears that KPMG completed the audit utilizing the requirements for examination as recommended by Liberty in the September 24, 2001, report. The Board agrees with Liberty's recommended examination parameters and finds that the examination completed by KPMG was performed following those conditions.

3. Materiality (Liberty Report p. 55; KPMG Report p. 1-5; AT&T KPMG comments p. 3; Qwest KPMG comments p. 2)

AT&T argues that KPMG reduced the utility of its report by conditioning its opinion on "materiality," opining that Qwest "complied, in all material respects," with

the specified section 272 requirements. According to AT&T's comments, biennial audit procedures would require reporting of all errors or discrepancies discovered while performing the type of examination KPMG undertook. AT&T states that KPMG expressly provided that its examination does not provide a legal determination on the company's compliance with specified requirements. KPMG, however, would have had to make such a determination in order to determine whether a specific instance of noncompliance was material. AT&T suggested that the Board should place little confidence in such an internally contradictory report.

In response, Qwest states KPMG was following Liberty's express recommendation from its September 24, 2001, report, which the Board notes was not challenged by AT&T. As Liberty recognized, "perfection" is not the relevant standard for purposes of determining whether Qwest has the ability and intention of providing interLATA service in compliance with section 272 once it receives FCC approval to do so. Qwest further stated Liberty made clear that the independent third-party testing proposed was not comparable to a biennial audit.

As Liberty noted, this examination was not an audit as contemplated by section 272(d)(1) to be performed after interLATA market entry. Rather, Liberty recommended the examination as a way to determine if Qwest's efforts are sufficient to provide adequate assurances that it will begin an era of in-region interLATA service in compliance with 272 requirements.

The Board finds that KPMG completed the third-party examination, as recommended by Liberty, following the parameters set forth in the September 24, 2001, report.

4. Time Period Covered by KPMG Examination (AT&T KPMG comments p. 3; Qwest KPMG comments p. 2)

AT&T argues that the KPMG examination covered only the very limited time period of April through August 2001, which was the time period recommended by Liberty in the September 24, 2001, report. AT&T indicates that it conducted a subsequent review of Qwest's affiliated transactions for the time period of May through October 2001 and, as outlined in an affidavit filed recently in Minnesota, cites examples of noncompliance that were not included in the KPMG Report. AT&T urges the Board to require Qwest to undertake a much more thorough examination, testing a more recent time period before considering whether Qwest is in compliance with, and will continue to comply, with its section 272 obligations.

Qwest's response points out that the KPMG examination covered the time period that was recommended by Liberty, for the purpose of determining the adequacy of "the substantial efforts that Qwest has only recently undertaken." Liberty's report made clear that the purpose of the recommended testing was to validate Qwest's compliance in the recent past in order to make predictive judgments about the future. Qwest engaged KPMG to complete the audit as recommended by Liberty using the time period recommended in the September 24, 2001, report.

The Board notes that Qwest, in its post-report comments indicated that it intended to comply with Liberty's recommendation and file the results with the state

commissions by November 15, 2001. If AT&T was concerned with the time period to be included in the examination as recommended by Liberty, it should have raised those concerns in post-report comments or, alternatively, once it was disclosed by Qwest that it intended to engage in the third party testing recommended by Liberty.

AT&T's arguments that it conducted its own evaluation of a different time period, finding examples of noncompliance is not given a great deal of weight. First, the examination done by AT&T was not a third-party independent test. Second, there will always be differences in results depending on the time period. Arguably, further testing done on yet another period of time could result in more, or less, findings of noncompliance. Third, the testing AT&T refers to was presented in a Minnesota proceeding, not the multi-state proceeding or record being considered by this Board.

The Board disagrees with AT&T's suggestion that an inappropriate time period was used for the KPMG examination.

5. Instances of Noncompliance (AT&T KPMG comments pp. 1-2)

AT&T makes a general statement describing KPMG's qualified opinion that Qwest complied with section 272 requirements. AT&T states the KPMG report finds multiple instances of noncompliance, resulting in a total dollar amount, on an annualized basis, of approximately \$6,350,000. AT&T also notes that KPMG could provide only a "qualified" opinion that Qwest materially complied with the section 272 requirements that KPMG reviewed "except for the instances of noncompliance."

AT&T suggests that these qualifications by KPMG really mean Qwest did not comply with section 272 during the time period examined.

As noted previously, Liberty did not recommend that the third-party examination be a full scale audit as required by section 272(d)(1), but rather for the purpose of determining whether the efforts taken by Qwest were sufficient to provide adequate assurances that it could provide in-region interLATA service in compliance with section 272(b)(2) requirements. The KPMG audit was completed as recommended by Liberty.

The Board finds that no further testing is necessary.

6. Inappropriate Use of Testimony to Refute KPMG Findings (AT&T KPMG comments p. 2)

AT&T argues that Qwest's attempt to minimize the findings of specific instances of noncompliance noted in KPMG's report, by filing the affidavits of Judith L. Brunsting and Marie E. Schwartz, is inappropriate. The affidavits identify actions Qwest allegedly has undertaken to correct the areas of noncompliance indicated in the KPMG report. AT&T suggests that this information does not change the fact that the independent examiner found that Qwest was not in full compliance during the test period. AT&T notes that these are the same witnesses who previously testified that Qwest was in full compliance with its section 272 obligations during the time period covered by the examination. AT&T suggests that it is inappropriate for the Board place reliance on such testimony.

Liberty was not looking for perfection in the audit conducted by KPMG, but to provide adequate assurances that Qwest could provide in-region interLATA service in

compliance with section 272(b)(2) requirements, once an application for 271 authority has been granted by the FCC. The Board considers information provided to show measures taken to improve compliance as clearly appropriate and useful to the Board in making its recommendation to the FCC.

The Board disagrees with AT&T's suggestion that the information supplied by Qwest should not be considered.

SUMMARY

Assuming Qwest implements each of the conclusions as set forth in the body of this order, the Board is prepared to indicate at this time that Qwest has conditionally satisfied 47 U.S.C. § 272. This conditional statement indicating these requirements are satisfied is subject to the same limitations noted earlier in this statement related to other proceedings and processes.

UTILITIES BOARD

/s/ Diane Munns

/s/ Mark O. Lambert

ATTEST:

/s/ Judi K. Cooper
Executive Secretary

/s/ Elliott Smith

Dated at Des Moines, Iowa, this 4th day of April, 2002.