[Service Date: January 4, 2005]

BEFORE THE
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. ADVANCED TELECOM GROUP, INC.; ALLEGIANCE TELECOM, INC.; *et al.*, Respondents.	Docket No. UT-033011 **TIME WARNER TELECOM OF WASHINGTON LLC'S OFFER OF PROOF IN RESPONSE TO ORDER NO. 19**

1. In Order No. 19, the Commission denied Time Warner Telecom of Washington LLP ("TWTC"), an intervenor in this proceeding, the right to a hearing on the merits on the key issues in the case and limited TWTC's future participation in the case to filing a "written offer of proof in support of its preferred result with respect to the proposed settlement." In response, TWTC submits this offer of proof.

2. The complaint against Qwest in this case alleges willful and repeated violations of its statutory obligations in sections 252 (e) and (i) of the Communications Act of 1934, as amended (the "Act")[1], and violations of RCW 80.36.170; RCW 80.36.180; and RCW 80.36.186.

[1] 47 U.S.C. § 252(e) and (i).

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3. As TWTC stated in its Opposition to the Proposed Settlement filed on October 7, 2004, it is TWTC's position that the proposed settlement should be rejected because (1) it does not resolve all disputed material issues of fact and law; (2) does not contain all of the important findings of fact; (3) does not accurately describe certain unfiled agreements between Qwest and McLeodUSA Telecommunications Services, Inc. ("McLeodUSA") and between Qwest and Eschelon Telecom of Washington, Inc. ("Eschelon"); (4) contains a penalty that is too small; and (5) is not in the public interest.

4. TWTC submits that among the agreements Qwest should have filed were a series of agreements with Eschelon and McLeodUSA and that prefiled evidence from Richard A. Smith on behalf of Eschelon and Stephen C. Gray on behalf of McLeodUSA would show the following.

5. The agreements with Eschelon and McLeodUSA were drafted specifically in an attempt to avoid the filing requirements of Section 252 in order to avoid having other CLECs opt into favorable provisions. In 2000, Eschelon and McLeodUSA were two of Qwest's largest resellers. Both wanted to move away from reselling Centrex products and wanted to provide service over an unbundled network element platform ("UNE-P"). Under UNE-P, they believed they would earn higher margins and be able to collect their own access fees.

6. In the summer of 2000, McLeodUSA and Qwest began negotiations that resulted in a Confidential Billing Settlement Agreement entered into on September 29, 2000, in which McLeodUSA agreed to pay Qwest an amount for the conversion from resale to UNE-P. Qwest and McLeodUSA finalized their agreement on October 26, 2000, when they executed a series of six agreements. The key component of these agreements was the creation of a product called UNE-Star (or UNE-M when purchased by McLeodUSA). The UNE-M product is a flat-rated UNE platform that converted McLeodUSA resold lines directly to UNE-P. With UNE-M, McLeodUSA would avoid the provisioning issues associated with UNE-P, such as submitting individual Local Service Requests ("LSRs") for each line. One of the agreements entered into on October 26, 2000 sets out the publicly disclosed terms and conditions of the UNE-M product. In

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this agreement, McLeodUSA agreed to pay Qwest $43.5 million to convert to the UNE-M platform. McLeodUSA agreed to maintain a minimum number of local exchange lines, to remain on "bill and keep" for the exchange of Internet-related traffic, and to provide rolling 12-month forecasted line volumes. Qwest agreed to provide daily usage information to McLeodUSA so that McLeodUSA could bill interexchange companies and others for switched access.

7. In addition, Qwest and McLeodUSA also entered into several agreements that were not filed or otherwise made public. One was the Purchase Agreement in which McLeodUSA agreed to purchase from Qwest Communications Corporation ("QCC", Qwest's affiliate), its subsidiaries or affiliates, a certain amount of services and products over a multi-year period. At the same time, they entered into a Purchase Agreement in which QCC and its subsidiaries agreed to purchase products from McLeodUSA over the same multi-year period. McLeodUSA and Qwest also entered into an Amendment to Confidential Billing Settlement Agreement which revised the earlier agreement to conform with the ultimately agreed upon payment amount from McLeodUSA for the conversion and agreed with the amount set forth in the agreement that was filed.

8. In addition to these written agreements, McLeodUSA and Qwest entered into two oral agreements, one of which provided a 10% discount on McLeodUSA's purchases from Qwest and the other precluded McLeodUSA from participating in Qwest's Section 271 proceedings. In developing the UNE-Star product, McLeodUSA was not satisfied that the pricing was sufficiently low to justify McLeodUSA keeping its traffic on Qwest's network. Thus, Qwest and McLeodUSA agreed to enter into the Purchase Agreements whereby McLeodUSA would purchase goods and services from Qwest and Qwest agreed to provide McLeodUSA with discounts ranging from 6.5% to 10% if McLeodUSA's purchases exceeded its take-or-pay commitments. Qwest did not want to put the discount agreement into writing because Qwest was concerned that other CLECs might feel entitled to the same discount. In response to McLeodUSA's concerns that the discount provision was not in writing, Qwest agreed to a take-or-

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pay agreement to purchase products from McLeod. The amount of the Qwest take-or-pay commitment was calculated by applying the discount factor to a projected amount of purchases by McLeodUSA from Qwest.

9. Qwest made payments to McLeodUSA pursuant to the Purchase Agreements from October 2000 through September 2001. Qwest prepared spreadsheets that calculated the amount of the payment by applying the 10% discount factor to all purchases made by McLeodUSA during the relevant time period. After McLeodUSA would confirm the accuracy of the spreadsheets, McLeodUSA would send Qwest an invoice. Qwest paid invoices for the period October 23 2000 through March 2001, April 2001 through June 2001, and July 2001 through September 2001. Qwest did not make payments on the amount that would have been due for the fourth quarter of 2001 because this is when the Department of Commerce in Minnesota began investigating the discount agreement. Although no written agreement refers to a 10% discount in McLeodUSA's purchases, Qwest acted consistently with the existence of such discount.

10. On November 15, 2000, Qwest and Eschelon entered into an Escalation Procedures and Business Solutions Letter, in which the parties agreed: (1) to develop an implementation plan that Eschelon agreed to not oppose Qwest efforts to obtain Section 271 approval or file any complaints with any regulatory body concerning interconnection agreements provided the plan was in place by April 30, 2001; (2) that Qwest would send a vice president level or above executive to attend quarterly meetings with Eschelon to address, discuss and attempt to resolve business issues and disputes and issues related to the parties' interconnection agreements; (3) that Qwest would adopt a six-level set of escalation procedures that gave Eschelon access to Qwest's senior management; and (4) that Qwest would waive limitations on damages.

11. Also, on November 15, 2000, Qwest and Escehlon entered into the Confidential Amendment to Confidential/Trade Secret Stipulation in which Eschelon agreed to purchase at least $15 million of telecommunication services between October 1, 2000 and September 30, 2001 and Qwest agreed to pay Eschelon $10 million to resolve issues related to the UNE platform

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and switched access. In addition, Eschelon agreed to provide consulting and network-related services and Qwest agreed to pay Eschelon 10% of the aggregate billed charges for all of Eschelon's purchases from Qwest from November 15, 2000 through December 31, 2005. Qwest also agreed to credit Eschelon $13.00 per UNE-platform line per month for each month during which Qwest failed to provide Eschelon with accurate daily usage information.

12. The evidence would demonstrate that the volume commitment and consulting service terms that Qwest now asserts non-favored CLECs would have to accept to be able to opt-into the favorable pricing discounts of the secret McLeodUSA and Eschelon agreements bore no legitimate relationship to those favorable pricing terms. Instead, those terms were merely part of Qwest's subterfuge, intended to conceal or wall-off the preferable pricing terms of its secret agreements from other carriers. As the Minnesota Public Utilities Commission ("PUC") ALJ and Commission found in that state's unfiled agreements case, the "consulting services" term in the Eschelon agreement "was a sham designed to conceal the discount." The volume commitments were also a sham. That is apparent from the fact that Qwest accepted a $150 million volume commitment from Eschelon in return for a flat 10% discount, while ostensibly requiring the substantially greater volume commitment of $480 million from McLeodUSA for a lower variable discount of 8% to 10%. TWTC submits that it is obvious that the volume of purchases had no analytical relationship to the discount, but was merely recited in the secret agreements to discourage other carriers from obtaining the favorable pricing discounts that Qwest wanted to limit to the two CLECs from whom Qwest needed help to secure regulatory approval to enter the lucrative interLATA long distance market.

13. Qwest's deliberate decision to conceal the Eschelon/Qwest and McLeodUSA/Qwest agreements and avoid the pick and choose requirements of Section 252(i), demonstrates that Qwest itself had little confidence in its ability to legitimately tie its volume commitments and other peripheral terms to the price discounts and credits. From the beginning, Qwest was focused on keeping the favorable pricing terms from others, not on developing a

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cohesive set of rationally related provisions. For example, when McLeodUSA's negotiator insisted on reducing the 10% discount agreement to writing, Qwest refused out of concern that "other CLECs might feel entitled to the same discount if the agreement were written and made public." Qwest then concocted a take-or-pay commitment to purchase "products" from McLeodUSA, which was calculated by applying an 8% discount factor to McLeod's projected purchases from Qwest. This was merely a mechanism for disguising the minimum 8% that Qwest ended up giving McLeodUSA.

14. TWTC submits that the evidence would show that these volume commitments and other terms were mere contrivances, not serious terms legitimately related to the substantive price provisions of the secret agreements. The secret agreements allowed Eschelon and McLeodUSA to receive a 10% discount on all the products and services they purchased from Qwest for a period of at least 18 months. This is the deal that other CLECs should have been able to opt-into but were prevented from doing so by Qwest's intentional refusal to comply with its filing and non-discrimination obligations.

15. Accordingly, the Commission should find that the Eschelon and McLeodUSA secret agreements are interconnection agreements that should have been filed pursuant to Section 252(e) and their terms made available to other CLECs to opt-into pursuant to Section 252(i). The Commission should also find deliberate violations by Qwest for failure to file the McLeodUSA and Eschelon agreements and of the state statutory prohibitions against undue discrimination and undue preferences.

16. Moreover, as pointed out in TWTC's Opposition to the Proposed Settlement, the proposed settlement does not address the issue of the harm caused by Qwest's failure to file the Eschelon and McLeodUSA secret agreements. As stated by Mr. Wilson in his prefiled testimony:

> To the extent that one CLEC paid more for wholesale serivces that were provided more quickly or on an expedited basis for other CLECs who enjoyed the benefits of secret interconnection agreements that were not made avaialble for adoption, the CLEC

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> was harmed. To the extent a CLEC loses customers or reputation because of unavailability of a specific pricing or provisioning term or condition granted in secret to a competitor, it might have sustained harm.

Direct Testimony of Thomas L. Wilson, at 77. Further, as explained by TWTC's witness, Timothy J. Gates:

> Clearly Qwest forced a higher cost structure on TWTC by virtue of the higher rates paid by TWTC *vis a vis* the favored CLECs. Mr. Wilson recognizes this harm in his testimony wherein he states, "[p]ricing and provisioning are critical to entry into the local market and any improvement would have made entry easier for a CLEC." If we assume, for discussion purposes, that the discount was 10 percent, then the favored CLECs paid 10 percent less than TWTC for the same services. A 10 percent difference in the cost of a monopoly input is a tremendous difference and can make the difference between winning and losing a customer. Viewed from another perspective, the 10 percent difference in the cost structure can affect a decision to enter a market or to say ina market, or a decision whether to expand into new areas of the state. Indeed, at the margin, competitors win or lose customers on tenths of a percent.

Response Testimony of Timothy L. Gates, at 12. He also discusses the harm to consumers citing the following statement of the Minnesota PUC Commission in its unfiled agreements case:

> Furthermore, CLECs have been harmed monetarily and customers have been harmed by Qwest impeding fair competition in this manner. The direct and inevitable result of such anti-competitive behavior is that customers have been deprived of the benefit of a market place fairly and freely open to competition. While this harm may not be quantified in terms of dollars and centss, the first fruits of competition (lower prices and wider choices) were undoubtedly impacted by Qwest's anticompetitive and discriminatory behavior.

(Footnotes omitted). *Id.*, at 13.

17. Accordingly, the Commission should make findings of harm caused to other CLECs, the competitive market, and consumers by Qwest's violations. The findings of discrimination and damage should not be restricted to Section 251 items. The FCC has already

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rejected the claim that a non-Section 251 item in an interconnection agreement is not subject to the pick and choose rule in Section 252(i). *See In the Matter of Global NAPs South, Inc. Petition for Preemption of Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Dispute with Bell Atlantic-Virginia*, CC Dicket No. 99-198, Memorandum Opinion and Order ("*Global NAPs*"), 15 F.C.C.R. 23318 (rel. Aug. 5, 1999). In *Global NAPs*, the FCC found that an interconnection agreement may include terms outside the ambit of Section 251, and if it does those non-Section 251 services are subject to pick and choose under Section 252(i). Thus, once an ILEC includes such terms in an agreement, it must file the agreement and make the non-Section 251 terms available with all other terms to requesting CLECs under Section 252(i). In this case, Qwest's secret agreement with Eschelon included a discount in "an amount that is ten percent (10%) of the aggregate billed charges for *all* purchases made by Eschelon from Qwest from November 15, 2000 through December 31, 2005." Similarly, Qwest's agreement with McLeodUSA provided reduced rates "for UNEs, wholesale telecommunications services, interconnection services, tariffed services, retail services, access charges and every other product and service purchased by McLeodUSA from Qwest."

18. As discussed above, the Commission should also find that the essence of the Eschelon and McLeodUSA agreements was that Qwest would provide a discount to Eschelon and McLeodUSA on whatever purchases they made; other provisions of the agreements, such as volume commitments and consulting services, were simply a sham and not legitimately related to the pricing discounts.

19. TWTC also submits that the size of the penalty in the proposed settlement is too small. It does not begin to offset the economic benefit Qwest obtained by violating the law's requirement that it file all interconnection agreements and make them available to other CLECs. From TWTC's perspective, the failure to file the discounts that were offered to Eschelon and McLeodUSA was the most egregious violation. If the penalty imposed upon Qwest is to have any deterrent effect, it must be at least sufficiently large to offset the benefit Qwest gained by

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violating the law. Particularly given the fact that the remedies here will do nothing to correct the harm caused by Qwest's violations, it is important that Qwest not be rewarded by its failure to comply with the law's requirements.

20. As TWTC has pointed out previously, in *Qwest Corp. v. Minn. Pub. Utils. Comm'n*, Civil No. 03-3476 ADM/JSM, 2004 WL 1920970 (D. Minn., Aug. 25, 2004), the U.S. District Court discussed the standards for an appropriate regulatory penalty in Minnesota's unfiled agreements case. In that case, the Minnesota PUC had ordered Qwest to pay a fine of $25.95 million and also to pay restitutional remedies to CLECs. The court upheld the penalty, noting that, in determining the amount of a penalty, the Minnesota PUC must consider the following nine factors: (1) the willfulness or intent of the violation; (2) the gravity of the violation, including the harm to customers or competitors; (3) the history of past violations; (4) the number of violations; (5) the economic benefit gained by the person committing the violation; (6) any corrective action taken or planned by the person committing the violation; (7) the annual revenue and assets of the company committing the violation; (8) the financial ability of the company to pay the penalty; and (9) any other factors that justice may require. The court then concluded that the Minnesota PUC properly penalized Qwest under these factors and its findings were not arbitrary and capricious.

21. These same factors relied upon by the Minnesota PUC and the application of which was upheld by the U.S. District Court in Minnesota should be considered by this Commission in setting any penalty in this case. Evaluation of those factors in this case inevitably leads to the conclusion that the penalty included in the proposed settlement is too low and does not counteract the benefit Qwest received from just avoiding having to make the discounts offered to Eschelon and McLeodUSA available to other CLECs. The penalty should be increased.

CONCLUSION

22. For the reasons state above, TWTC requests that the Commission reject the proposed settlement as not being in the public interest and not resolving all disputed issues of

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material fact and law, or, in the alternative, make findings that Qwest intentionally and deliberately failed to file the Eschelon and McLeodUSA secret agreements and unlawfully discriminated against other CLECs in violation of federal and state legal requirements. The Commission should also find that the Eschelon and McLeodUSA agreements provided discounts on all purchases made by the favored CLECs from Qwest, both interstate and intrastate, and the other terms such as volume commitments and consulting services, relied on by Qwest as a shield against liability were a mere sham and not legitimately related to the pricing discounts. The Commission should also find that the failure to file the Eschelon and McLeodUSA agreements and failure to make their favorable pricing terms available to other CLECs harmed those other CLECs, the competitive market in Washington, and consumers. The Commission should also increase the size of the penalty for Qwest's violations.

RESPECTFULLY SUBMITTED this 4th day of January, 2005.

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