

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER OF the Investigation into) UTILITY DIVISION
Qwest Corporation’s Compliance with)
Section 271 of the Telecommunications Act) DOCKET NO. D2000.5.70
of 1996)

**FINAL REPORT ON QWEST’S COMPLIANCE
WITH SECTION 272
AND RESPONSES TO COMMENTS RECEIVED ON PRELIMINARY REPORT**

In this proceeding the Commission is considering the compliance of Qwest Corporation with the requirements of Section 271 of the federal Telecommunications Act of 1996. At the end of the proceeding, the Commission will decide whether or not to recommend to the Federal Communications Commission (FCC) that Qwest be granted the authority to provide in-region interLATA long-distance service. The Commission will base its recommendation upon its findings as to whether Qwest has met the requirements of Section 271, including Section 272.

This report contains the Commission’s final findings concerning Section 272. Section 272 was addressed in the Group 5 workshops in the multistate 271 proceeding.

John Antonuk of Liberty Consulting, who was hired as a consultant by the seven states participating in the multistate proceeding, submitted his *General Terms and Conditions, Section 272 and Track A Report* (hereinafter referred to as *Report*) on September 21, 2001, which included his findings on the issues related to Section 272. Qwest submitted comments on Section 272 section of Antonuk’s *Report*.

Participants in this proceeding have been afforded sufficient opportunity to file testimony, briefs and comments regarding Section 272 and to participate in the workshops on this topic. In order to ensure that the Commission has fully considered Montana participants’ opinions related to these findings, the Commission issued a preliminary report of its findings on February 4, 2002, and invited participants to submit comments for Commission consideration. The Commission directed parties not to raise new issues concerning these issues in their

comments. In addition, in order to provide more information to the Commission on certain subjects, parties were invited to respond to certain issues as requested in the preliminary report.

In addition, in order to assist the Commission in resolving issues related to Section 272, parties were invited to provide comments on KPMG's *Report of Management on Compliance with Applicable Requirements of Section 272 of the Telecommunications Act of 1996* which was filed November 9, 2001.

The only participants to submit comments on the preliminary report were Montana Consumer Counsel (MCC), AT &T, and Qwest. MCC comments were brief and stated that Qwest has implemented all the necessary steps to be in compliance with Section 272.

Background

Section 272 of the Telecommunications Act of 1996 imposes substantial structural and nonstructural safeguards applicable to the provision of in-region InterLATA service by BOCs, such as Qwest. The FCC has said that section 271(d)(3)(B) of the Act makes compliance with section 272 an independent ground for denying relief under section 271.¹ The FCC specifically said:²

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

The FCC has recognized that this requirement obliges it to make "a predictive judgment regarding the future behavior of the BOC."

¹ *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 (released, Oct. 13, 1998) ("Bellsouth Louisiana II Order"); at ¶ 322.

Section 272 imposes a series of specific requirements, whose purposes include: (a) preventing improper cost allocation and cross-subsidization between Qwest and its §272 affiliate, and (b) assuring that Qwest does not discriminate in favor of this affiliate. The provisions of Section 272 that are in dispute here require that:

- Qwest Communications provide in-region InterLATA service through an affiliate that is separate³ from Qwest Communications (the BOC) [§272(a)]
- The §272 affiliate “maintain books, records, and accounts in the manner prescribed by the Commission, which shall be separate from the books, records and accounts maintained by” Qwest Communications [§272(b)(2)]
- The §272 affiliate have “separate officers, directors and employees” from those of Qwest Communications [§272(b)(3)]
- Transactions with Qwest Communications be conducted “on an arm’s length basis with any such transactions reduced to writing and available for public inspection” [§272(b)(5)]
- Qwest Communications not discriminate in favor of its §272 affiliate in any dealings between the two [§272(c)(1)]
- Qwest Communications account for all transactions with its §272 affiliate in accord with FCC accounting principles [271(c)(2)].

For ease of reference, the following list of Qwest entities will be discussed:

- Qwest Communications International (QCI): the parent company of the Qwest family of enterprises
- Qwest Corporation (QC): the BOC, which is the entity that provides local exchange service in the 14-state region once served by US WEST
- Qwest Services Corporation (QSC): a wholly owned subsidiary of QCI, the parent; QSC owns the long distance affiliate, which is Qwest Communications Corporation

² *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 (released Aug. 19, 1997), (“Ameritech Michigan Order”), at ¶ 346.

³ The 272 affiliate and the BOC must be structurally distinct from each other and operate independently.

- Qwest Communications Corporation (QCC): the currently designated §272 affiliate; QCC is wholly owned by QSC and it is the pre-merger entity through which Qwest had previously provided InterLATA services in many areas of the United States
- Qwest Long Distance, Inc. (QLD): the entity that Qwest and before it US WEST used for some time to provide InterLATA service outside its 14-state region, and, until fairly recently the designated §272 affiliate.

Qwest filed the Section 272 testimony of Marie Schwartz and Judith Brunsting on March 30, 2001. AT&T filed the Affidavit of Cory Skluzak on May 4, 2001 and the Supplemental Affidavit of Cory Skluzak on May 17, 2001. Qwest filed the rebuttal testimony of Marie Schwartz and of Judith Brunsting on May 23, 2001. Qwest and AT&T filed briefs on section 272 issues on July 25, 2001. AT&T and Qwest both filed Reply briefs on August 1, 2001.

Separate Affiliate Requirements

1. Separation of Ownership

Qwest's testimony was that QCC, is its designated §272 affiliate, is a wholly owned subsidiary of QSC, which in turn is wholly owned by the parent, QCI. Qwest also testified that QC and QCC own no stock in each other.⁴ AT&T presented no evidence or argument to contest this testimony, although it did perform and present the results of its extensive examination of Qwest's compliance with Section 272 requirements.⁵

Antonuk's Proposed Conclusion: The uncontroverted evidence of record in these workshops fully supports a conclusion that QCC, the QCI entity currently proposed to provide in-region InterLATA service following anticipated §271 approval, is, by virtue of the corporate structure and ownership under which it operates, separate from QC, which is the entity that provides local exchange service in the seven participating states.

Commission finding. No parties commented on the preliminary findings of this issue. The Commission accepted the facilitator's proposed resolution and considers the issue closed.

⁴ Brief of Qwest Corporation in Support of Its Compliance with the Requirements of 47 U.S.C. §272 (Qwest 272 Brief), at pages 5 and 6.

⁵ Affidavit of Cory W. Skluzak Regarding Section 272, Exhibit S7-ATT-CWS-1 (Skluzak 272 Affidavit).

2. *Prior Conduct*

AT&T cited three prior instances that it says demonstrate a history of Qwest's non-compliance with the §272(a) requirement that in-region InterLATA services be provided through a separate affiliate:

- A September 27, 1999 FCC finding that “U S WEST’s provision of non-local directory assistance service to its in-region subscribers constitutes the provision of in-region, InterLATA service,” and that “the nationwide component of U S WEST’s non-local directory assistance service was unlawfully configured.”⁶
- A September 28, 1998 FCC conclusion that U S WEST, through its marketing arrangement with pre-merger Qwest, was “providing in-region, InterLATA service without authorization, in violation of section 271 of the Act.”⁷
- A February 16, 2001 FCC ruling that Qwest’s “1-800-4US-WEST” calling card service constituted the provision of in-region, InterLATA service in violation of section 271.⁸

Qwest argued that each of these three cases resulted from a good faith difference of opinion about what the statutory term “provide” means in the context of in-region, InterLATA service. Finally, Qwest argued that reliance on past behavior as predictive of likely §272 compliance should be confined to behavior related to §272. Qwest argued that historical performance with respect to §271 requirements, which are different, has no place in a predictive examination related to §272.⁹

Antonuk’s Proposed Conclusion: The examples cited, while significant in their own right, are not predictive of future Qwest conduct that is relevant to the issue of meeting the separate subsidiary requirements of §272(a). A proper examination of the significance of AT&T’s

⁶ *Petition for U S WEST Communications, Inc. for a Declaratory Ruling Regarding the Provision of National Directory Assistance*, CC Docket No. 97-172, Memorandum Opinion and Order, FCC 99-133 (released September 27, 1999), ¶¶ 2 and 63. See Exhibit S7-ATT-CWS-1, ¶¶ 106-109.

⁷ *AT&T Corp. et al., v. U S WEST Communications, Inc.*, File No. E-99-42, Memorandum Opinion and Order, FCC 98-242 (released October 7, 1998), ¶¶ 1, 38 and 52. See Exhibit S7-ATT-CWS-1, ¶ 110.

⁸ *AT&T Corp v. U S WEST Communications, Inc.*, File No. E-99-28, Memorandum Opinion and Order, DA01-418 (released February 16, 2001). See S7-ATT-CWS-1, ¶ 113.

⁹ Qwest 272 Brief at pages 29 and 30.

references to the three prior FCC findings requires us to separate the analysis of §272(a) requirements into two related, but distinct, parts:

- Does the service in question constitute in-region intraLATA service?
- Assuming it does, then, is it being provided through a separate affiliate?

AT&T has unarguably demonstrated that Qwest has failed in a significant number of prior cases to determine correctly what does and does not constitute in-region InterLATA services. In other words, Qwest has often enough answered the first question incorrectly. However, there is no reason to believe that Qwest's subsequent decision to provide the services directly was a consequence of its refusal to accept the obligation to use a separate subsidiary for in-region, InterLATA services. Quite to the contrary, it is self-evident that Qwest only failed to use a separate subsidiary in the mistaken belief that the services did not constitute in-region, InterLATA service.

The important question here is whether Qwest accepts the separate subsidiary obligation and stands ready to meet it; the preceding proposed conclusion demonstrates that it does. Qwest's violations in the three examples cited were entirely a function of failing to meet the requirements of section 271, which is what the FCC found. Extending that to a §272 violation is at best peripheral to a predictive assessment of whether Qwest will accept the responsibility to provide in-region, InterLATA service through a separate subsidiary.

Qwest was held accountable in the past for failing to correctly interpret what constitutes in-region, InterLATA service; it should and undoubtedly will be so held in the future. There is, however, no reason to conclude here that such interpretations have had or will have anything material to do with the parallel issue of creation and maintenance of a separate subsidiary to provide in-region, InterLATA service.

Commission response and finding. AT &T provided comments to the Commission's preliminary report on this issue restating its original concern that in the past Qwest has failed to comply with section 2729(a) and section 271. The Commission agrees with facilitator that Qwest was held accountable in the past for failing to correctly interpret what constitutes in-region, InterLATA service; it should and undoubtedly will be so held in the future. Therefore

the Commission preliminary finding of accepting the facilitator's proposed resolution stands. The Commission considers the issue closed.

Books and Records

Section 272(b)(2) of the Communications Act says that the §272 affiliate:

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

AT&T took issue with several aspects of Qwest's performance under this standard:

- Use of generally accepted accounting principles (GAAP)
- Relevance of the GAAP Materiality Principle
- Adequacy of Documentation or "Audit Trail"
- Sufficiency of Internal Controls
- Separate Charts of Accounts
- Separate Accounting Software

1. Generally Accepted Accounting Principles

Qwest cited the testimony of its witness Brunsting in support of the conclusion that QCC follows GAAP.¹⁰ Qwest said that QCC and QLD have used accrual accounting¹¹, which is required by GAAP. Moreover, while contesting the requirement that QC must also follow FCC requirements in accounting for transactions with the §272 affiliate,¹² Qwest said that the rebuttal testimony of its witness Schwartz shows that QC (the BOC) does follow such accounting requirements.

¹⁰ Qwest 272 Brief at page 7.

¹¹ Accrual accounting assumes that revenue is realized at the time of the sale of goods or services irrespective of when the cash is received: and expenses are recognized at the time the service are received and utilized in the production of revenue irrespective of when payment for these services is made.

¹² Qwest said that the FCC's GAAP requirements under §272(b)(2) and (c) apply only to the §272 affiliate, not to the BOC.

AT&T's examination of books and records disclosed what it considered to be many examples of a failure by QCC and by QLD (when it was the §272 affiliate) to follow accrual accounting and to make timely transaction entries into its books and records.¹³

- Failure to record any QC/QCC transactions between July 2000 and April 2001
- Use of artificially high billing rates for service to QCC, which served to create cross subsidies and to deter use of services by third parties
- Failure to accrue and pay expenses for roughly half (as a percentage of total services billed) the services rendered to QLD until the year after the services were provided
- Billing monthly services provided to QLD (such as rent) only yearly
- Other failures to accrue expenses for services to QLD on a timely basis

Qwest's main brief did not address the merits of each of the findings made by Mr. Skluzak in his Exhibits S7-ATT-CWS-1 and 2. However, it did concede that it had not accrued expenses payable to QCC before it was designated as its §272 affiliate, but argued that this fact is not probative because the amount in issue constituted less than 1 percent of QC's total yearly affiliate transactions, and because the failure to accrue expenses was for a time period before QCC became its designated §272 affiliate.¹⁴

Qwest's reply brief did object to the AT&T contention that no QC/QCC transactions were posted between July 2000 and April 2001, but again relied not on contesting the factual accuracy of the findings of Mr. Skluzak, but upon the arguments that: (a) the transactions in question predated the time when QCC was designated as the §272 affiliate, and (b) that AT&T made no claim that Qwest is now failing to accrue and pay expenses on a timely basis.¹⁵

¹³ AT&T's Brief on Section 272 of the Act (AT&T 272 Brief), at page 5, citing specific paragraphs (see fn 17 and 18) of the examinations that Mr. Skluzak performed of Qwest books and records, which were described in Exhibits S7-ATT-CWS-1 and 2.

¹⁴ Qwest 272 brief at page 8.

¹⁵ Reply Brief of Qwest Corporation in Support of its Compliance with the Requirements of 47 U.S.C. §272 (Qwest 272 Reply Brief) at page 3.

Qwest's reply brief did address some of the AT&T findings about the failure to accrue expenses associated with services to QLD when it was the designated §272 affiliate. It provided evidence to show that:

- One expense item that AT&T found to be accrued in the year after services was in fact was accrued on a timely basis
- Two expense items that AT&T said were paid late were not paid on a current basis because they were disputed by QLD under Master Services Agreement procedures posted on the web site
- One expense item that AT&T said was not accrued properly appeared to duplicate another already criticized by AT&T.

Qwest's brief did appear to acknowledge what it would term "isolated instances" and insignificant failures to bill or accrue expenses involving QLD.¹⁶

Qwest also argued that consideration should be given to the difficulty it faced when it decided after the merger to change from one affiliate to another as the entity that would provide in-region, InterLATA service. Qwest cited the testimony of its witness Brunsting that it took from mid-January to late-March of 2001 to accomplish the transition, which included a review of all QCC asset records to address asset ownership and special billing controls issues, to realign more than 7,500 employees, and to examine all relevant contracts and post-merger transactions. QCI's outside auditor provided assistance in identifying the transactions. Qwest noted that, after completing this transition, it was able to reduce discrepancies between its postings and its billings to zero percent for April and May 2001. The April data was submitted as an exhibit at the workshop; the May data was submitted in an e-mail sent two days before the filing of reply briefs on §272 issues.¹⁷

Qwest's brief summarized a number of the detailed changes it made to assure proper controls in the area of §272 compliance:¹⁸

¹⁶ Qwest 272 Reply Brief at pages 10 and 11.

¹⁷ Qwest 272 Reply Brief at pages 7 and 8.

¹⁸ Qwest 272 Reply Brief at page 9.

- Quarterly monitoring of asset transfers
- Training of “key network leaders”
- Establishment of a Compliance Oversight Team that reviews all QCC transactions for compliance
- Annual code-of-conduct training and employee certification
- Targeted training for QC sales executives who do business with QCC
- Physical separation and color-coded badging of employees
- Establishment of a compliance hotline
- Other special training

Qwest said that the FCC has found similar measures at other BOCs sufficient to meet what Qwest quoted as the applicable test, which is to demonstrate that the BOC

*has implemented internal control mechanisms reasonably designed to prevent, as well as detect and correct, any noncompliance with Section 272.*¹⁹

Antonuk’s Proposed Conclusion: Qwest focuses on the date at which QCC and QLD were and were not designated §272 affiliates. The issue that is material here is to determine the degree of confidence that can be placed in the ability to provide proper, complete, and timely recognition on the books and records for transactions between these entities. The past customs of the Qwest family of companies is relevant whether or not the transactions occurred when QCC was designated as the §272 affiliate. QC provides local exchange service under regulation by each of the seven participating commissions. It would be difficult to imagine Qwest arguing before them that the regulated entity has not operated since time out of mind under an obligation to provide adequate assurances that the regulated entity charges and receives fair and appropriate prices. Cross-subsidization is by no means an issue that the Telecommunications Act of 1996 created. Antonuk stated that public service commissions have long concerned themselves with whether regulated services were burdened by costs that other affiliates should bear, or deprived of revenues that other affiliates should not be taking. It is doubtful, Antonuk stated, that US

¹⁹ Qwest 272 Reply Brief at pages 9 and 10, citing the *SBC Texas Order* at paragraph 398 and the *BANY Order* at paragraph 405 and note 1253.

WEST has in the past operated without recognition of this concern of state regulators; in any case if it failed to have such recognition, it should draw no sympathy at this point.

Therefore, Antonuk began the analysis of this issue under the proposition that the burden to account properly for inter-affiliate transactions has not changed sufficiently to render irrelevant the performance history for periods prior to designation as a §272 affiliate. However, by rejecting any notion that once an entity is so designated, one should look at transactions involving that entity before it was such an affiliate no differently from the transactions that predated it. He stated one should look at transactions from the perspective of what status the involved entities had when the transactions took place and then judge the significance of those transactions to forward-looking circumstances appropriately. To do otherwise, would be to anomalously apply hindsight, on the one hand, or to erroneously expunge all transaction history before the 1996 Act came along.

The material conclusions that can be drawn include the following:

- Qwest did not, outside the context of §272, find it sufficiently important to assure that transactions between QC and QCC were accrued on a timely basis, or paid promptly or subjected to interest penalties for untimely payment
- Qwest did eventually undertake substantial efforts to bring its transactions, both past and current, into compliance with applicable accounting requirements
- The very magnitude of that effort gives reason to merit validation that the efforts undertaken have had current effect and are likely to continue to prove sufficient to meet applicable requirements
- The evident lack of attention to the kinds of transaction details that QC clearly would have paid had a third party (as opposed to an affiliate) been at the other end of the bargain buttresses the need for validation of the current and future effectiveness of the recent improvement efforts by Qwest
- The fact that AT&T's testing did disclose some errors with respect to QLD also buttresses this need, although it should be emphasized that the AT&T findings that

remain valid after consideration of the documents Qwest provided on the record would not alone produce sufficient concern to warrant special measures at this time.

Therefore, 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.

This examination should be conducted under the following requirements:

- 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.

Positive answers to the three established questions, under the type of examination identified herein, should be sufficient to reduce to an acceptable level the current uncertainty about whether entry into the in-region, InterLATA market will be accompanied by compliance with the requirements of section 272(b)(2). Such answers will do so by validating whether the major efforts that Qwest has recently undertaken to produce significant change in its prior practices have achieved the changes from past practice that are necessary to comply in the future with these requirements.

Qwest's brief correctly noted that the "biennial audits" contemplated under section 272(d)(1) do not begin until after market entry under §271. Those audits serve a much broader purpose than the examination procedures contemplated here. Biennial audits, for example, will have to examine the much-expanded relationships between BOCs and their affiliates after those affiliates enter new markets. Qwest's brief also suggested that requiring it to undergo an audit here would impose an inordinate burden on it, because the FCC has required no other BOC to undergo a §272 audit before gaining §271 relief.²⁰ The examination proposed here is not, however, a "§272 audit." Rather, this examination is intended to determine whether the substantial efforts that Qwest has only recently undertaken, which it presumably undertook because it recognized the need for them, are sufficient to provide, in light of its recent history, adequate assurances that it will begin (presuming that the FCC allows it) an era of in-region InterLATA service in compliance with §272(b)(2) requirements.

AT&T Comments.

AT&T stated that the KPMG report and additional Qwest affidavits fail to demonstrate that Qwest has complied with all requirements of Section 272, much less that Qwest is in compliance with those requirements. The Report finds multiple instances of noncompliance. AT&T asserts that the most KPMG could provide was a qualified opinion that Qwest materially complied with the Section 272 requirements that KPMG reviewed. AT&T also stated that the

²⁰ Qwest 272 Reply Brief at pages 8 and 9.

KPMG report was much more limited in scope than the independent testing recommended in the Liberty Report. It did not examine Qwest's compliance with Section 272(a), 272(b)(1), 272(b)(3), 272(b)(4), or 272(g). AT&T was also concerned that the KPMG Report covered a limited time period of April through August 2001.

Qwest Comments

Qwest stated that the independent testing undertaken by KPMG was precisely the kind of validation review recommended by the Multistate Facilitator. It addressed the transactional questions that he identified for validation,²¹ and the period of time he specified.²²

Qwest stated that the KPMG Report, and the further controls implemented by Qwest in response thereto, provide additional assurance that Qwest has implemented procedures reasonably designed to assure compliance with Section 272. Qwest stated that the KPMG report showed that, except in twelve instances, both Qwest and the 272 Affiliate complied "in all material respects" with the applicable FCC accounting rules. All but one of these few discrepancies were detected by Qwest or QCC prior to the examination, and all but one preceded the completion of Qwest's effort to transition the new 272 affiliate. Qwest asserts that all of these discrepancies have since been corrected.

Qwest contends that AT&T has argued that the existence of even these few past discrepancies precludes a finding that "the requested [section 271] authorization will be carried out in accordance with the requirements of section 272," as prescribed by 47 U.S.C. § 271(d)(3)(B). As the Multistate Facilitator recognized, Qwest stated "perfection" is not and cannot be the relevant standard for judging compliance with Section 272. Such a standard could not be met in "in [AT&T's] own operations" or, for that matter, "in the operations of any wholesale supplier." Qwest stated that the FCC has agreed. It has made clear that determinations of Section 272 compliance should not place weight on "isolated instances" or on "past accounting compliance problems that have been redressed and corrected." Qwest contends that the proper inquiry is therefore not whether discrepancies have ever arisen but whether Qwest

²¹ See Facilitator's Report at 8 (recommendation of testing arose from consideration of "the Section 272(b)(2) books and records requirements").

²² The Facilitator recommended that the testing cover the period from April to August, 2001, the five-month period following the transition to QCC as Qwest's 272 affiliate. Facilitator's Report at 55; Preliminary Commission Report at 12.

has controls in place that are “reasonably designed to prevent, as well as detect and correct” such discrepancies.

Qwest asserts that the KPMG Report and the Supplemental KPMG Jacobsen Declaration demonstrate that Qwest has implemented (and strengthened) such controls. As noted above, the few discrepancies identified by KPMG did not involve recent transactions, but almost exclusively those initiated prior to the establishment of QCC as the new Section 272 affiliate; as the Facilitator recognized, AT&T’s focus on such transactions “strain[s] the plain language of federal law past the breaking point,” and ignores the need for “a reasonable transition” in imposing Section 272 requirements on QCC as the designated successor to Qwest Long Distance, Inc. Section 272 is designed to prevent BOCs from discriminating *in favor of* or cross-subsidizing their in-region, interLATA 272 affiliates. The few discrepancies detected by KPMG’s testing actually involved an estimated net *detriment* to QCC of \$2.6 million. Therefore, the results of the KPMG examination have established that Qwest did not cross-subsidize or discriminate in favor of its 272 affiliate.

Qwest asserts that it has used the findings in the KPMG Report to strengthen its existing controls. As set forth in the affidavits included with Qwest’s submission of the KPMG Report, these strengthened controls include additional safeguards at the corporate level of each company designed to ensure that all inter-company transactions are accrued, billed, and posted promptly and at correct prices: improved formal tracking mechanisms, coordination with operational personnel and comparisons to databases to verify the results of those tracking mechanisms, additional training sessions with relevant personnel, additional supporting documentation to the FCC Regulatory Accounting Department, and development of automated solutions.²³ The Supplemental KPMG Declaration confirms that each of these controls have been independently examined by KPMG and found to be in place and that “the new controls and control enhancements . . . implemented by Qwest appear to strengthen the overall control environment with respect to 272 compliance and should minimize the types of findings presented in the KPMG Report.”²⁴

Commission response and finding. The Commission has reviewed the independent auditor report provided by KPMG. The Commission also agrees with AT&T that there were

²³See Brunsting Affidavit; Schwartz Affidavit.

²⁴Supplemental Jacobsen KPMG Declaration at 23.

instances where Qwest did not comply with the FCC's affiliate transaction rules, and these transactions have been corrected to comply. Qwest has addressed each of the discrepancies by strengthening existing controls or implementing new controls in efforts to avoid them in the future. The FCC has refused to give significant weight to past accounting compliance problems that have been redressed and corrected.²⁵ After reviewing the independent auditor report the Commission finds that Qwest is in compliance with section 272(b)(2) and considers the issue closed.

2. *Materiality*

Qwest cited the opinion of its outside auditor for QCI's consolidated operations as evidence that QCI follows GAAP in all material respects. Qwest further said that the FCC has found that a showing about the parent's consolidated financial statements was sufficient to persuade the FCC in the Louisiana II 271 order that the §272 affiliate also followed GAAP.²⁶

AT&T took issue with Qwest's use of such a materiality standard. It noted that the testing and examination undertaken by the outside auditor before providing its opinion might not have tested any transactions between QC and QLD. AT&T said that, in designing its sampling, the auditor would have had to deal with a universe that included \$13.2 billion in consolidated QCI income and \$9.8 billion in consolidated expenses in 1999. By contrast, QC paid QLD \$29 million and QLD paid QC \$3.5 million in this period. Thus, AT&T said, what was material to the BOC/§272 affiliate relationship might well not be material in the consolidated QCI context. AT&T went on to reject the relevance of applying materiality even in a narrower context, however, citing the General Standard Procedures for Biennial Audits, which it said the Joint Federal/State Oversight Group has established. AT&T said that those procedures required all errors or discrepancies to be reported.

Antonuk's Proposed Conclusion: Underlying Qwest's main brief and its testimony were notions of materiality as it is defined in connection with the statements one typically sees from independent auditors in connection with the filing of required public disclosures of

²⁵ Memorandum Opinion and Order, *Application of BellSouth Corporation, BellSouth Telecommunication, Inc., and BellSouth Long Distance, Inc for Provision of In-Region, InterLATA services in Louisiana*, 13 FCC Rcd 20,599 ¶ 340 (1998)

²⁶ Qwest 272 Brief at page 7.

consolidated financial statements. Designed to give comfort to investors, such statements understandably and appropriately focus on overall results. They may well, as is likely the case here, be based on test procedures that resulted in the examination of none, let alone a representative example, of the transactions between QC and its §272 affiliate.

This feature of such statements makes them all but irrelevant in addressing the degree to which the transactions between QC and QCC or QLD comply with the requirements of §272(b)(2). What counts in addressing materiality is not QCI's entire universe, nor even QC's total universe, but the universe that consists of transactions between QC and QCC or QLD. AT&T is therefore correct to a substantial degree in its argument. It goes too far in dismissing materiality altogether, however.

That step has the effect of requiring perfection with respect to completeness, accuracy, and timeliness. It is self-evidently true that this standard could not be met in its own operations or, more importantly, in the operations of any wholesale supplier. Moreover, the standards that AT&T cited only relate to what must be reported in a biennial audit. The issue here is what should be considered material for determining pre-market entry compliance with §272(b)(2). The fact that something merely has to be included in a report of an audit for a different purpose hardly means that it would alone be grounds for a determination that market entry should be denied for non-compliance with §272(b)(2).

Thus, the concept of materiality should remain a part of evaluating compliance with §272(b)(2), but the universe to which the standard of materiality should be applied consists of the total transactions, in the time period in question, between QC and QCC or QLD.

Commission finding. No parties commented on the preliminary findings of this issue. The Commission accepted the facilitator's proposed resolution and considers the issue closed.

3. Documentation

AT&T said that, as of January 2000, QC stopped providing information that is material to meeting the disclosure requirements of §272(b)(2). Until that time, postings to its web site included the following information:

- Service agreements
- Work and task orders issued under those agreements
- Details of specific transactions under the agreements and orders.

AT&T said that Qwest dropped the transaction details from the list of posted information. AT&T further argued that the failure to post QCC transactions prior to April 2001 demonstrates lack of an audit trail.²⁷

Antonuk's Proposed Conclusion: As footnote 8 of AT&T's 272 brief indicates, this aspect of the AT&T argument depends upon the same failure to make timely accruals that AT&T cited to support its argument that Qwest does not comply with GAAP. The additional argument made here is that Qwest recently decided to remove from its Internet posting the details of particular transactions that take place under general agreements or work/task orders. That additional argument is misplaced. The point of public posting of transaction information is to permit a non-affiliated entity to decide if it wished to make use of the same services that are being provided to a Qwest affiliate.

An auditor may have reason to test actual compliance with posted terms and conditions, but that does not mean that the public posting should support audit requirements, as opposed to the need for making a decision about the value of services that a non-affiliate might be able to secure. Thus, the public posting issue, has nothing to do with the question here at issue, which is whether there exists somewhere the information necessary to allow a validation that the services actually being provided to affiliates are in accord with the posted agreements, work orders, and task orders upon which non-affiliates must rely in deciding whether to take service from Qwest.

That said, the issue raised by AT&T is not clearly severable from the accrual issue already raised and dealt with above. The examination recommended earlier in this report should test whether the posting of information is consistent not only with what the company says it provides for affiliates, but with what is actually provided. Therefore, if there is any difficulty in determining what is actually being provided and under what terms and conditions it is being

²⁷ AT&T 272 Brief at page 8.

provided, the examination required above will already address it. Therefore, no further action is necessary to address this aspect of AT&T's argument.

Commission finding. No parties commented on the preliminary findings of this issue. As stated above the Commission has reviewed the KPMG report and concluded the information is consistent with what the company says it provides. The Commission accepted the facilitator's proposed resolution and considers the issue closed.

4. Internal Controls

AT&T also argued that its findings about the lack of timely accrual and billing for services demonstrated a lack of adequate controls at Qwest.²⁸

Antonuk's Proposed Conclusion: Again, AT&T relied here upon the same factual basis as it used to argue that Qwest fails to follow GAAP. As noted under that issue, Qwest has cited many changes it has made to provide assurances that it is now complying with all applicable requirements. The examination recommended above was intended to determine whether those Qwest actions have produced sufficient assurances of such compliance. Therefore, this aspect of AT&T's concerns will be adequately addressed by that examination.

Commission finding. As stated above the Commission has reviewed the independent auditor report provided by KPMG. Qwest has addressed each of the discrepancies by strengthening existing controls or implementing new controls in efforts to avoid them in the future. After reviewing the independent auditor report the Commission finds that Qwest has sufficient internal controls and is in compliance. The Commission considers the issue closed.

5. Separate Charts of Accounts

AT&T noted that it took several efforts before it could finally secure charts of accounts for QC, QCC, and QLD. AT&T acknowledged that it eventually secured them and that they satisfied the requirement that they be separate. AT&T argued that the failure to provide evidence

²⁸ AT&T 272 Brief at page 9.

of such separateness demonstrates a lack of diligence with respect to compliance with this requirement.²⁹

Antonuk's Proposed Conclusion: The evidence of record demonstrates an acknowledgement by AT&T that the requirement about which it has expressed concern has in fact been met. The issue is not whether AT&T's examiner found them without effort, but whether they in fact existed. The record demonstrates that Qwest maintains separate charts of accounts for the entities involved.

Commission finding. No parties commented on the preliminary findings of this issue. The Commission accepted the facilitator's proposed resolution and considers the issue closed.

6. Separate Accounting Software

AT&T said that it could find no evidence that QC and QLD were using separate accounting software. AT&T also said that it had found evidence that there had been a reversal of a billing to an affiliate, which called into question the Qwest assertion that it was not possible for one Qwest entity to enter a transaction by using any Qwest entity code other than its own. AT&T acknowledged that there is evidence that QC and QCC have separate accounting codes.

Antonuk's Proposed Conclusion: Much of AT&T's argument assumes that separate accounting software between the BOC and the 272 affiliate is required. However, AT&T has provided no legal support for that contention, which, in any event, runs counter to the FCC's recognition that inter-affiliate services represent an opportunity for economies of scale that should not be denied a company such as Qwest.

The real issue is whether the accounting function is separately performed and subject to adequate controls. AT&T acknowledges that the evidence now indicates that QC and QCC have different accounting software, which is more than sufficient to demonstrate separateness. As to the issue raised about QLD, citing a single instance of a reversal is not demonstrative of a systemic weakness or failure. Moreover, the fact that a reversal was made does not necessarily relate at all to the ability of one affiliate to make entries into the records of another affiliate. Stand-alone companies (i.e., those with no affiliates at all) reverse entries when they bill the

²⁹ AT&T 272 Brief at page 11.

wrong customer. That an entity can correct its own entry should not be in question; the issue is whether one entity can enter information as if it were another entity.

The evidence presented raises no substantial argument that Qwest fails to adequately separate the accounting of the BOC and the 272 affiliate.

Commission finding. No parties commented on the preliminary findings of this issue. The Commission accepted the facilitator's proposed resolution and considers the issue closed.

Separate Officers, Directors, and Employees

AT&T asserted that Qwest's conduct to date demonstrates inadequate compliance:³⁰

- Employee transfers back and forth between QC and the 272 affiliate
- 100 percent usage by the 272 affiliate of many QC employees
- Participation of 272 affiliate employees in a QC award program
- Lack of comparison of payroll registers
- Lack of separate payroll administration³¹
- Officer Overlap

1. Routine Employee Transfers

Section 272(b)(3) says that the 272 affiliate "shall have separate officers, directors, and employees from the Bell operating company of which it is an affiliate." AT&T said that a "revolving door atmosphere" has produced movement back and forth between QC and the section 272 affiliate, which has "subverted" the purpose of this section of the Act.

Qwest argued that neither the Act nor the FCC precludes movement back and forth between QC and QCC. Specifically, Qwest said, what is prohibited is "simultaneous" employment by both.³² Qwest also cited the fact that such transfers involve fewer than 100 employees.³³ Qwest

³⁰ AT&T 272 Brief at pages 12 and 13.

³¹ These last two elements of AT&T's argument came in its 272 Reply Brief, at pages 5 and 6.

³² Qwest 272 Brief at pages 11 and 12.

³³ June 7, 2001 transcript at page 159.

also said that it has taken adequate steps to prohibit any inappropriate conduct that might result from such employment movement, including:³⁴

- Requiring the return of 272-affiliate assets by an employee leaving the 272 affiliate
- Requiring employees leaving the 272 affiliate to account for documents in their possession
- Requiring employees leaving the 272 affiliate to acknowledge that they will no longer have access to that affiliate's information and that they may not disclose the affiliate's information
- Requiring such employees who take positions with another Qwest entity to sign a non-disclosure agreement that prevents the sharing of non-public information between the companies
- Instituting procedures training to ensure compliance with section 272
- Requiring employees to review annually the Code of Conduct that governs relationships among the QC affiliates
- Providing training for new employees
- Informing employees that violations may lead to disciplinary action that includes termination of employment
- Providing for physical separation of the offices of QC and QCC
- Providing color-coded badges to identify the 272 affiliate's employees.

Antonuk's Proposed Conclusion: Congress has not prohibited movement between affiliates; it requires instead independent operation and separate employees. AT&T's argument conflates the Congressional concern about operating independence and separation of employment. A "revolving door" policy could arguably compromise independent operation. However, transfers of fewer than 100 employees out of the thousands involved in the restructuring that Qwest did among QSC, QC and QCC do not establish that Qwest is using transfers back and forth in a way intended to or actually causing a compromise of operational

³⁴ Qwest 272 Brief at pages 12 and 13.

independence. With the current level of transition in the communications business, such levels can hardly be expected even to exceed the number of displaced Qwest personnel who find employment with CLECs, let alone sufficient to raise immediate concerns about operational independence and the protection of information.

The steps that Qwest has taken to assure independent operation and protection of confidential information are adequate to establish a baseline mode of operations that gives current assurances that it will meet applicable requirements. The existence of such a baseline is all that is required for present purposes, given the monitoring and examination of employee transfers that will take place in the future, for example, as part of biennial auditing.

The record here supports a conclusion that Qwest maintains the required degree of employee separation, and that transfers to date, given the mitigation measures adopted by Qwest and not challenged as to sufficiency by any other party, do not rise to a level that suggests a compromise of operational independence.

Commission response and finding. AT &T provided comments to the Commission's preliminary report on this issue restating its original concerns of Qwest employees being transferred back and forth between the BOC and section 272 affiliates as well as wide-spread employee sharing. AT&T's concern is that the free flow of employees back and forth between the BOC and its section 272 affiliate facilitates the sharing of information between companies – including confidential information. The Commission still agrees with facilitator that Qwest does maintain the required degree of separation. The Commission finds that Qwest is in compliance and considers the matter closed.

2. 100 Percent Usage of employees

AT&T argued that employment of “many” individuals by QC who have been assigned full-time to the work of the 272 affiliate, also subverts the purpose of section 272(b)(3).³⁵

Qwest responded with the general argument that the FCC clearly does not prohibit service sharing, which presumably would require the assignment of some QC employee time to the 272 affiliate he or she serves. Qwest then went on to say that its policy is to limit such

assignments to specific time periods, functions, and projects, which relate to services posted on the Internet, and which are available to non-affiliates.³⁶ QC and QCC also agreed to implement a new policy prohibiting such assignments for periods of more than four months out of any twelve.

Antonuk's Proposed Conclusion: Antonuk stated by recognizing that the FCC allows shared services between a BOC and its 272 affiliate. It must next be understood that if the BOC is providing such services, the recipient (the 272 affiliate) must pay for them. Thus, it should not be considered surprising nor inappropriate to find a substantial percentage of a BOC employee's time being charged to the 272 affiliate over what looks to be a long period of time. In fact, if one considers the economies of scale that come from common provision of services it would also not be surprising to find that what four employees can provide the 272 affiliate through one quarter of their time, one employee can provide more efficiently through 100 percent of his or her time. Accordingly, without knowing more, there is no reason to be immediately critical upon observing that an employee has assigned substantial time to the 272 affiliate on a long-term basis.

On the other hand, for examples where 100 percent assignment of time to the 272 affiliate is more clearly troublesome. Take as an example the hypothetical case where the director of marketing for the 272 affiliate is a BOC employee who assigns all time to the 272 affiliate. Such a complete and long-lasting separation of nominal employment and actual responsibility should trigger questioning, because the use of long-term assignments of senior personnel to an affiliate can have the tendency to compromise the separate employment requirement. However, it is not possible to prescribe the exact conditions where such compromise would lead to a conclusion that there occurred a failure to meet the intent of that requirement.

Certainly, the commitment to limit full-time assignments to no more than four months of any twelve represents a good-faith effort to simplify what can become a murky, very judgmental question to address. That proposal is therefore acceptable for present purposes, recognizing that experience gained through ongoing monitoring efforts (such as those attendant to biennial

³⁵ AT&T 272 Brief at page 12.

³⁶ Qwest 272 Brief at page 14, citing the June 7, 2001 transcript at pages 300 and 301.

auditing) will be the better judge of how long-term separations of employment and assignment affect the fulfillment of Section 272 objectives.

Commission response and finding. AT&T provided comments to the Commission's preliminary report on this issue restating its original concerns. The Commission still agrees with facilitator that ongoing monitoring efforts, such as the biennial audit, will be a better judge of how long-term separations of employment and assignment affect the fulfillment of Section 272 objectives. The Commission finds that Qwest is in compliance and considers the matter closed.

3. Award Program Participation

AT&T cited an award program that allowed the participation of both QC and QCC personnel, which, AT&T said, compromised the independent operation of the two entities. AT&T said that its witness's examination of Qwest records disclosed the payment of "team awards" to former employees of QLD who were later "rehired" by QC. It appeared from AT&T's examination that, after returning to Qwest, the former QLD employees received such awards. AT&T found that a terminated work order (RMLD099) listed on QLD's website described a program that rewarded employees for customer referrals and cost saving ideas; AT&T said that QLD employees were allowed to participate in this program.³⁷

Qwest said that the FCC had already rejected a claim by AT&T that the FCC should, "prohibit the BOCs from using any compensation system that directly or indirectly bases any part of the compensation of BOC officers, directors, or employees on the performance of the affiliate, or vice versa."³⁸

Antonuk's Proposed Conclusion: As a general matter, the FCC has already decided that at least the overall performance of the BOC can be considered in compensating 272 affiliate employees and vice versa. However, tying individual compensation to overall affiliate performance is not what is at issue here. The FCC should not be read as being indifferent to a compensation mechanism that specifically induces BOC or 272 affiliate employees to act in a manner that would promote inappropriate inducements for customers to change carriers.

³⁷ Exhibit S7-ATT-CWS-1, at paragraph 30.

³⁸ Qwest 272 Reply Brief at footnote 69, citing paragraph 186 the *Non-Accounting Safeguards Order*.

Therefore, if the compensation mechanism at issue can be read to create a clear inducement to misuse information or to act anti-competitively, a further inquiry would be in order.

A close reading of the exhibit relied upon by AT&T does not present any evidence of improper inducements. There is nothing wrong with inducing a QC or a QCC/QLD employee (whether or not a former employee of the other) for referring customers or offering cost saving suggestions for the benefit of their employer. Both have customers and both have costs. The primary incentive, not to mention the primary knowledge base and the primary concern of the employee's management, can be expected to be the business of the affiliate by whom the employee is currently employed. It is farfetched to project, as AT&T does, that such a program will have the effect of causing an employee to spend material time trying to refer customers or save costs for the other company, rather than for the one by whom it is currently employed.

Except in the case of a misuse of information, there is no compromising of independent operation by virtue of the fact that there is a common customer referral and cost-saving reward system.³⁹ It is true that the record does not disclose all of the facts about the operation of this reward system. There has been no claimed shortage of discovery opportunity in these proceedings. Absent more from the proponent of this issue, therefore, it remains clear that there is no significant likelihood that running it to ground will bear significantly on Qwest's compliance with the independent operations requirements of section 272.

Commission finding. No parties commented on the preliminary findings of this issue. The Commission accepted the facilitator's proposed resolution and considers the issue closed.

4. Comparing Payroll Registers

Qwest testified that it performed a comparison of the payroll registers of QC and the 272 affiliate, and that this comparison showed no overlap.⁴⁰ AT&T argued that the evidence demonstrated that such comparisons came about only recently, thus demonstrating that Qwest had failed to verify earlier that it complied with separate payroll requirements.⁴¹ AT&T

³⁹ This conclusion stands even if (although it has not been proven that the program is intended to reward employees for actions intended to benefit QCI entities other than the one that employees them directly) the occasional impact of the program is to an employee of one affiliate for benefits to another affiliate.

⁴⁰ Qwest 272 Brief at page 10, citing its Exhibits S7-QWE-MES 1 and MES-3.

⁴¹ AT&T 272 Brief at page 13, citing Exhibit S7-ATT-CWS-1, at paragraph 31(j).

specifically said that it was clear that Qwest, before these proceedings, had never conducted a payroll register analysis for prior years.⁴²

Antonuk's Proposed Conclusion: AT&T has cited no requirement that there be routine, cyclical payroll register comparisons for some period predating a 271 application. Thus, the issue of whether Qwest has performed them repeatedly in the past is not directly relevant. The primary issue is whether the evidence before us shows what the current practice is and how well it is implemented. The evidence of record demonstrates that there is not at present an overlap, that Qwest recognizes the obligation to preclude overlap, and that Qwest considers an examination of payroll registers to be an appropriate tool in assuring that the restriction against simultaneous employment is being met.

Under these circumstances, Antonuk concluded that the requirement is being met, that there is no basis in this record for concluding that it has not been met historically, and that the biennial audits will suffice to assure that the requirement continues to be met.

Commission finding. No parties commented on the preliminary findings of this issue. The Commission accepted the facilitator's proposed resolution and considers the issue closed.

5. Separate Payroll Administration

AT&T argued that the performance of recruiting by QCC for QC and the lack of separate payroll administration between the two would undermine any conclusion that the companies maintain the operating independence required by section 272(b)(1).⁴³ Qwest noted that AT&T has conceded in testimony that separate payroll administration is not an FCC requirement, and it noted that the payroll administration function that QC provides for QCC is available as required to non-affiliates at posted rates, terms, and conditions.⁴⁴

Antonuk's Proposed Conclusion: What AT&T essentially complains of, in both the cases of recruitment and payroll administration, is the provision of common services between the BOC and the 272 affiliate (i.e., between QC and QCC). The FCC has, however, specifically rejected the notion that common services should be prohibited as a means of encouraging

⁴² AT&T 272 Reply Brief at page 5.

⁴³ AT&T 272 Reply Brief at pages 5 and 6.

“independence” as AT&T would define it. To the contrary, the FCC has endorsed common services, outside the network-related areas where they are specifically prohibited, as a means of capturing economies of scale.⁴⁵ This rule is particularly sound, as it allows Qwest to do no more than to exploit the same kinds of economies that are available to other efficient competitors in the marketplace.

Hamstringing the BOCs is not the goal; assuring that they do not unduly advantage themselves is. The conduct limits, simultaneous employment restrictions, biennial auditing, and other requirements are sufficient to mitigate the potential for such discrimination. There is no evidence here of any need to go further and remove those natural economies that, in a competitive marketplace, inure to the benefit of customers. Antonuk concluded to eliminate these two areas of common service, there would be no end to the debate, short of prohibiting any at all, about which services should be permitted and which should not.

Commission finding. No parties commented on the preliminary findings of this issue. The Commission accepted the facilitator’s proposed resolution and considers the issue closed.

6. *Officer Overlap*

AT&T expressed concern about the independence of 272 affiliate employees, officers and directors.⁴⁶

Qwest said that this individual has not been an officer of QCC since it became the 272 affiliate on March 26, 2001. From that time forward, according to Qwest, the individual has been an employee and officer of QSC and a director of QC (the BOC).⁴⁷

Antonuk’s Proposed Conclusion: The cited transcript pages contain no information from which it can be concluded that the employee whose status AT&T questioned simultaneously served the BOC and the 272 affiliate as an employee, officer, or director. In fact, there is no evidence that the employee was ever an employee or officer of QC, the BOC. The employee came from the Qwest side of the pre-merger house. The employee did become,

⁴⁴ Qwest 272 Brief at page 15.

⁴⁵ Third Order on Reconsideration, *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended*, 14 FCC Rcd 16,299, ¶ 18 (1999).

⁴⁶ AT&T 272 Reply Brief (Confidential Version) at page 6.

according to the evidence, a director of the BOC, but after leaving employment with QCC. The evidence does not show that the employee ever was a director of QCC. When asked about whether AT&T's witness had any information that the employee served both QC and QCC simultaneously, he could not recall without reference to his notes. There was subsequently no testimony from AT&T regarding those notes.

The record fully supports the conclusion that there was no simultaneous service. Moreover, this employee made a clear break from the pre-merger Qwest side of the house before taking on a position as a director of QC. It is beyond unrealistic to expect no movement between companies such as Qwest and US WEST after a merger; more importantly, such movement is not improper. AT&T's suggestion that this one cited incident somehow casts doubt on the independence of the 272 affiliate's employees, officers, and directors is without a substantial factual basis, and is lacking a clear legal foundation.

Commission finding. No parties commented on the preliminary findings of this issue. The Commission accepted the facilitator's proposed resolution and considers the issue closed.

Transaction Posting Completeness

Section 272(b)(5) requires the 272 affiliate to cause its transactions with its affiliated BOC to be "reduced to writing and available for public inspection." The FCC has set the standard for meeting this requirement in saying:

[T]he description of the asset or service and the terms and conditions of the transactions should be sufficiently detailed to allow [the FCC] to evaluate any compliance with our accounting rules.

AT&T claimed that Qwest failed to meet this standard in a number of ways:

- By deciding to stop posting the specific billed amounts necessary for AT&T to determine whether Qwest complied with FCC accounting rules
- By failing to post on a timely basis transactions with QCC from the time that it became a 272 affiliate

⁴⁷ Qwest 272 Reply Brief at page 16, citing the June 7, 2001 transcript at page 265.

- By failing to provide service completion dates for some services
- By failing to provide the required verification of the accuracy of the publicly posted information.

1. Posting Billing Detail

AT&T objected to Qwest's decision, apparently effective as of January 1, 2000, to stop posting "billed amounts" under the transactions whose terms and conditions Qwest was making public. From that point, Qwest began to limit inspection of such information to on-site examinations by those who first executed protective agreements.⁴⁸ AT&T said that posting the agreements, work orders, and task orders is not sufficient, because non-affiliates need to see the transaction details in order to make an informed decision about whether to take the same services. AT&T would include in such required detail the actual service or items purchased and the amount actually paid for it. AT&T said that such detail was also required to verify that there was no discrimination against non-affiliates in providing the services or items at issue.⁴⁹

Qwest said that its posting of Master Services Agreement, along with work orders thereunder, served to provide adequate notice of the details of the services provided, the dates of service commencement and completion, and the prices charged, with additional detail available to those willing to execute a nondisclosure agreement.⁵⁰ Qwest said that the FCC had already objected to the very same request for billing detail that AT&T made here. Specifically, according to Qwest, the FCC approved of SBC's postings, over AT&T's objections, even though they did not include "the billing details about individual occurrences of services provided pursuant to its agreements." Qwest also noted that it provided a monthly reconciliation of all transactions accrued and billed.⁵¹

Antonuk's Proposed Conclusion: The requirement for making transaction information available serves two purposes, which are distinct and which require distinct levels of information. The first purpose is to provide competitors with enough information to make a business decision, i.e., whether to avail themselves of their right to take services on the same

⁴⁸ AT&T 272 Brief at page 14.

⁴⁹ AT&T 272 Brief at page 20.

⁵⁰ Qwest 272 Reply Brief at page 12.

terms and conditions as are provided by the BOC to its 272 affiliate. Serving that purpose does not necessarily require the posting of the individual transaction detail that AT&T seeks. Depending upon what they contain, the master agreements and work orders under them may be sufficient. It is correct that the information posted needs to describe the terms and conditions under which services were actually provided, should they differ from what the master agreements or work orders provided. However, the monthly posting of what Qwest calls “reconciliation” or what AT&T calls “true up” data can serve this need. The examination recommended under the preceding *Books and Records* discussion will address the sufficiency of the master agreements, work orders, and reconciliation data to provide competitors with an adequate specification of terms and conditions to allow rational decisions about taking services.

The second purpose for making transaction data available is to assure that audits or other formal examinations of transactions can take place. There is no sound reason why a public posting of such data is necessary to accomplish this purpose. There are, to the contrary, substantial reasons for not making such information publicly available. The nature and level of services that are provided inside Qwest are competitively sensitive. A competitor may get access to any service that a BOC provides for a 272 affiliate. There should not be free access to the exact level and timing of services that a BOC is providing. Therefore, requiring non-disclosure agreements and on-site examinations of such information constitute appropriate means for assuring that audit-related work can take place without allowing competitors to make competitive use of the information observed. In fact, if there are adequate means for regulatory review of such information, it may be argued that access to such information could logically be denied to competitors altogether.

Commission response and finding. AT &T provided comments to the Commission’s preliminary report on this issue restating its original concerns. The Commission’s preliminary finding of accepting the facilitator’s proposed resolution stands. The Commission considers the issue closed.

2. *Initiation of the Posting of QCC Transactions*

⁵¹ Qwest 272 Reply Brief at page 13, citing paragraphs 405 and 407 of the *SBC Texas Order*.

There was substantial debate about when QCC became, for purposes of transaction posting, subject to section 272 requirements. AT&T argued that Qwest's assertion that the initiation date was March 26, 2001 was undercut by Qwest's own evidence, which supported a date of January 1, 2001. Thus, according to AT&T, Qwest violated the posting requirements by failing to post transactions before late March of 2001. Moreover, AT&T said that QCC became, by operation of law, a section 272 affiliate as of the July 2000 US WEST/Qwest merger effective date.⁵² AT&T continued by reciting many instances of "late" transaction postings, which generally correspond to the same cases of failure to follow GAAP or to provide sufficient internal controls (see the earlier discussion under *Books and Records*). AT&T also noted that the web site of the former 272 affiliate, QLD, was activated in September of 1998, close to two years after the effective date of the *Accounting Safeguards Order*, which established transaction posting requirements.⁵³

Qwest responded that it is now providing timely transaction posting, that it should not be obliged to post transactions before an entity becomes a section 272 affiliate, that many of the cases cited by AT&T occurred during the unsettled period of the transition to QCC as the 272 affiliate during the first 3 months of 2001,⁵⁴ and that AT&T's arguments here essentially repeat what it termed elsewhere as a failure to follow GAAP, a lack of internal controls, impermissible discrimination, and a failure to follow accounting rules.⁵⁵

Antonuk's Proposed Conclusion: In the first instance, AT&T begins from an illogical conception of what constitutes a section 272 affiliate. AT&T incorrectly argues that QCC became a 272 affiliate by operation of law when it became affiliated with a BOC through merger in July 2000. Not all BOC affiliates are necessarily section 272 affiliates; in fact, none may be, depending on the circumstances. Even an affiliate that provides out-of region InterLATA services is not automatically a 272 affiliate. That section only says that manufacturing, in-region InterLATA telecommunications, and InterLATA information services need to be provided through a separate affiliate. If no such services are being provided, then there is under the Act,

⁵² AT&T 272 Brief at page 15.

⁵³ AT&T 272 Brief at pages 15 through 18.

⁵⁴ Qwest 272 Reply Brief at page 4.

⁵⁵ Qwest 272 Reply Brief at footnote 4.

no “272 affiliate.” Moreover, the transaction posting (and other) requirements of section 272 only apply to “the separate affiliate required by” section 272.

Therefore, absent the provision of in-region, InterLATA services (the other two categories are not at issue here), it can be argued that there was and is, at least for some purposes, no “272 affiliate” within Qwest. Alternatively, if there were, then every QC affiliate would have to be so construed prior to the time that an election was made.

Thus, there is no inherent reason for concern about a decision to elect to provide what continues to be a future service offering through an affiliate different from the one earlier expected to carry out that role. Nor is it necessarily wrong to allow a reasonable transition when such a change is made. Nor does it necessarily constitute an admission against interest to post transactions for an earlier period. AT&T’s arguments to the contrary not only strain the plain language of federal law past the breaking point. They would impose a circular string of obligations that would make it impossible for a BOC to make and to revisit reasonable organizational and business decisions in the course of its preparations to meet requirements applicable to a business it has not yet even entered, but must prepare for if it is to meet the substantial public requirements associated with that business.

Antonuk stated he had already addressed whether Qwest’s traditional accounting practices and controls give sufficient confidence about its ability to meet 272 requirements after it may enter the business to which the section applies. AT&T has presented no sound argument or evidence that one should go further by addressing in this particular Qwest’s historical compliance. The recommendation under the earlier *Books and Records* discussion seeks an examination of the effectiveness of recent Qwest changes in systems, practices, and controls in giving assurances that it is committed and prepared to comply with section 272 requirements on a predictive basis. No more is required here.

Commission finding. As stated earlier the Commission has reviewed the KPMG report and Qwest has made changes to its systems to provide sufficient confidence about its ability to meet 272 requirements. The Commission accepts the facilitator’s recommendation and considers the issue closed

3. *Indefinite Service Completion Dates*

AT&T argued that the FCC requires that transaction postings provide either the length of time or estimated completion date of any project. AT&T said that it found agreements between QC and QCC that have “indefinite” completion dates.⁵⁶ There was testimony that such examples exist because the services are provided under agreements of indefinite duration, which Qwest also said was the case in its brief.⁵⁷

Antonuk’s Proposed Conclusion: Antonuk needed no evidence of record to state the self-evidently true conclusion that commercial contracts often provide for indefinite terms subject to the right of either party to terminate them by providing notice. There is no reason to believe that the FCC did or should have intended to restrict the ability of BOCs and their 272 affiliates to enter into such contracts. The requirement that completion dates or estimates be provided should not be construed as prohibiting what AT&T has objected to, which are “agreements” that have this common form of establishing duration. AT&T’s position finds no support either in commercial practice or in the requirements of the FCC, which do not prohibit agreements of indefinite duration. Whether work and task orders under such agreements are sufficiently precise and complete is a different matter; it is not those, but the “agreements” under which they are issued that AT&T has addressed here.

Commission finding. No parties commented on the preliminary findings of this issue. The Commission accepted the facilitator’s proposed resolution and considers the issue closed.

4. *Verifications*

Paragraph 122 of the *Accounting Safeguards Order* requires that transaction information available for public inspection be accompanied by a certification declaring that:

An officer of the BOC has examined the submission and that to the best of the officer’s knowledge all statements of fact contained in the submission are true and the submission is an accurate statement of the affairs of the BOC for the relevant period.

AT&T presented evidence that it found no statements during its examinations in 1998 and in 1999; Qwest admitted that it filed none, because it construed the certification requirement as

⁵⁶ AT&T 272 Brief at page 18, citing paragraph 337 of the *Bell South Louisiana II Order*.

⁵⁷ June 8, 2001 transcript at pages 40, 41, and 45 and Qwest 272 Reply Brief at footnote 53..

applying only after filing of a section 272 application.⁵⁸ AT&T later discovered certifications for QC and QCC, which were filed by the same officer. The signer was listed as an officer of QCC, but not of QC. AT&T argued that the failure of a QC officer to sign the QC certification constituted a violation of the *Accounting Safeguards Order*.

Qwest acknowledged that the signer for QC was no longer an officer of QC when she signed its certification. Qwest's testimony was that the controller position of QC was vacant at the time of the certification; therefore, the signer, who was also an officer of QC's parent, made the certification for QC. After AT&T's examination at Qwest's offices, Qwest replaced the certification with one signed by the person then serving as QC's controller.⁵⁹

Antonuk's Proposed Conclusion: Fulfilling the requirement that an officer certify the accuracy of information such as that at issue here as an important element of providing a proper environment for controlling performance. It assures accountability at a level that is presumably sufficient to assure attention to accuracy. The record here shows that, whatever requirements may have applied in past periods when, as AT&T found, QC did not file certifications, QC does recognize the obligation to make such certifications. There is no basis for a predictive conclusion that QC is not likely to comply with applicable certification requirements.

The use of a QCC officer to sign the recent certification, since amended, is more questionable. It may be, given the vacancy in the QC controller position, that no other officer of QC had the requisite knowledge to make the certification, but Qwest did not testify to that, nor does it seem probable that such was the case. Even had it been, caution should have suggested that the certification signed by the QCC officer contain a disclosure regarding the reasons why a QC officer was unavailable to make the certification.

The primary significance of the evidence on this issue is that it tends to confirm the transitional nature of Qwest's handling of inter-affiliate relationships issues in the period in question (the certification in question was signed on March 20, 2001).⁶⁰ The effectiveness of the actions taken by Qwest during that transition would already be examined under a preceding

⁵⁸ AT&T 272 Brief at page 22, citing the June 7, 2001 transcript at pages 253 and 254.

⁵⁹ June 7, 2001 transcript at pages 250 and 253.

⁶⁰ Exhibit S7-ATT-CWS-1, ¶ 61.

recommendation of this report. That examination should confirm that QC continues to have adequate controls in place to assure that a QC officer who has the requisite knowledge provides the required certifications. Beyond this confirmation, this issue raises no other predictive concerns about Qwest compliance with the requirements of section 272.

Commission findings. As stated earlier the Commission has reviewed the KPMG report and Qwest has made changes to its systems to provide sufficient confidence about its ability to meet 272 requirements. The Commission accepts the facilitator's recommendation and considers the issue closed.

Non-Discrimination

Section 272(c)(1) says that a BOC, when dealing with its section 272 affiliate:

May not discriminate between that company or affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or in the establishment of standards

Much of AT&T's argument about Qwest's non-compliance with this provision concerns the failure to make timely payments.⁶¹ In addition, AT&T presented testimony asserting that Qwest has not addressed a number of items that the FCC considers in examining compliance with this requirement.⁶² Those items were:

- Whether QCC will be informed of planned network outages before public notice is given
- Whether Qwest will continue to participate in public standard-setting bodies
- Whether Qwest has committed not to discriminate in establishing interconnection or interoperability standards
- Whether Qwest has stated that it would not discriminate in the processing of PIC orders
- Whether Qwest has stated that it would comply with the FCC's prohibition against the use of its Official Services Network to provide InterLATA services
- Whether employee transfers between the BOC and the 272 affiliate create a concern that there will be an improper flow of confidential information between the two entities

⁶¹ AT&T 272 Brief at page 25.

⁶² Exhibit S7-ATT-CWS-1, ¶ 81.

- Whether Qwest has proved that it will provide nondiscriminatory access to its OSS.

Qwest responded that its testimony contained commitments to comply with the non-discrimination requirements of sections 272(c) and (e).⁶³

Antonuk's Proposed Conclusion: AT&T's list of items ignores that the general issue of discrimination was addressed in depth at the preceding workshops, at which many of the items on the list were the subjects of testimony. In addition, Qwest's testimony for this particular workshop did address a number of additional items on the list, e.g., OSS access. Finally, as was discussed above, the evidence here shows a moderate number of employee transfers to date, the existence of measures to protect against the improper use of sensitive information, and an ability to address future transfers and information use. Thus, the evidence before us shows that the kinds of issues AT&T says the FCC considers have been addressed, and that all participants have had an ample opportunity to present any evidence that bears upon the FCC's consideration of them

Commission response and finding. AT &T provided comments to the Commission's preliminary report on this issue restating its original concerns. The Commission's preliminary finding of accepting the facilitator's proposed resolution stands. The Commission considers the issue closed.

Compliance with FCC Accounting Principles

AT&T's brief noted that the examples it testified to under issues relating to non-compliance with GAAP and the lack of internal controls also demonstrated a failure to comply with the section 272(c)(2) requirement that a BOC, in dealing with its 272 affiliate:

account for all transactions ...in accordance with accounting principles designated or approved by the Commission.

Antonuk's Proposed Conclusion: This issue has already been dealt with in the discussion of Books and Records, relating to compliance with GAAP. The application of the 272(c)(2) standard does not add materially to the considerations already made there.

⁶³ Qwest 272 Reply Brief at footnote 6, citing Exhibits S7-QWE-MEW-1 at pages 5 and 6 and 29 and 30 and S7-QWE-JLB at page 23.

Commission finding. No parties commented on the preliminary findings of this issue. The Commission accepted the facilitator's proposed resolution and considers the issue closed.

BY THE MONTANA PUBLIC SERVICE COMMISSION

GARY FELAND, Chairman

JAY STOVALL, Vice Chairman

BOB ANDERSON, Commissioner

MATT BRAINARD, Commissioner

BOB ROWE, Commissioner

ATTEST:

Rhonda J. Simmons
Commission Secretary

(SEAL)