Decision No. R02-318-I

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO

DOCKET NO. 97I-198T

IN THE MATTER OF THE INVESTIGATION INTO U S WEST COMMUNICATIONS, INC.'S COMPLIANCE WITH § 271(C) OF THE TELECOMMUNICATIONS ACT OF 1996.

ORDER ON STAFF VOLUME VII
REGARDING SECTION 272,
THE PUBLIC INTEREST, AND TRACK A

Mailed Date: March 15, 2002

TABLE OF CONTENTS

I. INTRODUCTION....................2

II. SECTION 272....................3

D. Section 272(a)....................4

E. Books and Records....................7

F. Separate Officers, Directors, and Employees....................14

G. Transaction Posting Completeness....................16

H. Use of a Non-Section 272 Affiliate to Develop Improvements for QC and QCC....................19

I. Examination of Qwest Marketing Practices....................20

J. Conclusion....................21

III. THE PUBLIC INTEREST....................21

G. Performance Assurance Plan....................24

H. Promoting Competition in Local and Long Distance Markets.27

I. "Unusual Circumstances" That Would Make Long Distance Entry Contrary to the Public Interest....................29

3. Competition in the Residential Market:....................30

4. UNE Prices....................32

5. Prior Qwest Conduct....................42

6. Intrastate Access Charges....................46

7. Structural Separation....................................48

c. Structural Separation Is Not a Legal Requirement of § 271...49

d. Before Structural Separation is Required as a Policy Matter, a Much More Extensive and Complete Record is Required..49

(7) Market Power and Relevant Market.............52

(8) Costs and Benefits of Separation.............56

(9) Other remedies...............................62

e. Conclusion..63

8. CLEC Failures...64

IV. TRACK A...65

C. Binding Interconnection Agreements......................66

D. Access and Interconnection to Competitors...............66

E. Competitors in the Residential and Business Markets......67

F. Competitors Offering Service Exclusively or Predominantly Over Their Own Facilities:...............................74

V. ORDER...76

I. INTRODUCTION

A. This order resolves issues brought before the hearing commissioner in Volume VII of Commission Staff's Report on the Seventh Workshop. I have determined that no further investigation, hearing, briefing, or arguments are necessary to resolve issues raised in the Volume VII report. Volume VII reflects issues that could not be agreed to by consensus in the seventh workshop of the § 271 collaborative process.

B. I have reviewed Staff's Report, Staff's recommendation, the participants' briefs, and the workshop record. Because Volume VII comprehensively recounts the participants' respective positions on the impasse issues, this order will not recapitulate those positions. Instead, this order will address § 272, Public Interest, and Track A issues separately and, where necessary, briefly summarize the positions of the parties prior to discussion and a conclusion.

II. SECTION 272

A. Section 272 of the 1996 Act defines the structural and non-structural safeguards applicable to the provision of in-region interLATA service by an affiliate of a BOC, such as Qwest, following the approval of the § 271 application by the FCC. These requirements are meant to ensure that improper cost allocation and cross-subsidization does not take place between Qwest and its § 272 affiliate, Qwest Communications Corporation (QCC or § 272 affiliate), and to assure that Qwest does not discriminate in favor of its affiliate. According to the FCC, § 272 is an independent ground for denying relief under § 271, and that judgment should be based by making "a predictive judgment regarding the future behavior of the BOC."[1]

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[1] *Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as Amended, to Provide In-Region, InterLATA Services in* Michigan, Memorandum Opinion and Order, 12 FCC Rcd. 20,543 ¶¶ 346-347 ("*Ameritech Michigan Order*").

B. AT&T challenges Qwest's compliance with § 272. The participants have submitted briefs and reply comments, testimony from the multistate workshops, and Qwest has also submitted a KPMG report and subsequent declaration in response to the Multistate Facilitator's report on § 272. AT&T has commented on the initial KPMG report. Because the impasse issues reached in Colorado are substantially the same as those reached in the multistate workshops, and because I concur with the conclusions and recommendations of the Multistate Facilitator and Staff based upon the virtually indistinguishable record presented in Colorado, I endorse those findings and accept the test results and declaration from KPMG. In reaching this conclusion, I rely both on the Colorado and the multistate records.

C. Although § 272 is obviously an important piece of the § 271 process, the impasse issues raised by AT&T fall well short of establishing Qwest's noncompliance with § 272. The structures, safeguards, separations, and procedures Qwest has in place allow this Commission to make the required predictive judgment that Qwest will comply with § 272.[2]

D. Section 272(a)

1. Section 272(a) requires Qwest to provide

[2] AT&T originally raised eighteen impasse issues in Workshop 7. Many of the impasse issues are treated in summary fashion. Where possible, I have combined several impasse issues under one subheading.

in-region, interLATA services through an affiliate that is separate from the BOC and meets the requirements of § 272(b). AT&T argues that because Qwest does not comply with § 272(b), that it therefore does not comply with subsection (a). For ease of discussion, subsection (b) will be addressed below. With regard to subsection (a), AT&T cites three previous instances where it claims Qwest provided in-region, interLATA services:

- An FCC finding on September 27, 1999, 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."[3]
- An FCC finding on September 28, 1998, 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."[4]

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[3] *AT&T's Brief on Section 272 of the Act* at 4, *citing Petition of U S WEST Communications, Inc., for a Declaratory Ruling Regarding the Provision of National Directory Assistance*, CC Docket No. 97-172, Memorandum Opinion and Order, FCC 99-133 (rel. Sept. 27, 1999), ¶¶ 2 and 63.

[4] *Id., citing AT&T Corp. et al., v. U S West Communications, Inc.*, File No. E-99-42, Memorandum Opinion and Order, FCC 98-242 (rel. Oct. 7, 1998), ¶¶ 1, 38, and 52.

- An FCC finding on February 16, 2001, that Qwest's "1-800-4US-WEST" calling card service constituted the provision of in-region, interLATA service in violation of § 271.[5]

2. Qwest counters that each of these cases resulted from a good faith difference of opinion (in some cases, that opinion being held by more than one BOC) about what the statutory term "provide" means in the context of in-region, interLATA service.[6] According to Qwest, the Commission should focus on the record of past compliance by its former § 272 affiliate (Qwest Long Distance, or QLD), and a record of compliance by its current § 272 affiliate, QCC.

3. The examples cited by AT&T, while noteworthy, are ultimately irrelevant when it comes to deciding whether Qwest meets the separate subsidiary requirements of § 272(a). Although the FCC has stated that we must "look to past and present behavior" to assess the likelihood of Qwest's compliance with § 272 in the future,[7] AT&T's examples "are not predictive of future Qwest conduct that is relevant to the issue of meeting

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[5] *Id., citing AT&T Corp. v. U S West Communications, Inc.,* File No. E-99-28, Memorandum Opinion and Order, DA01-418 (rel. Feb. 16, 2001).

[6] *See Qwest's Brief in Support of its Compliance with the Track A Entry Requirements of 47 U.S.C. § 271(c)(1)(A) and the Public Interest Test of 47 U.S.C. § 271(d)(3)(C)* at pp. 47-48 ("*Qwest Track A/Public Interest Brief*").

[7] *Ameritech Michigan Order* at ¶ 347.

the separate subsidiary requirements of § 272(a)."[8] Put differently, the failure of Qwest and its predecessor to comply with § 271 in the past under disputed circumstances is ancillary to the primary inquiry here -- whether it will provide in-region, interLATA service through a separate affiliate.

4. The evidence further demonstrates that QCC is a wholly-owned subsidiary of Qwest Communications International (QCI), separate from Qwest Corporation (QC). QC is the BOC that provides local exchange service in Colorado. Neither QCC nor QC owns any stock in the other. Therefore, I conclude that QC has demonstrated that QCC meets the separation requirements of § 272(a).

E. Books and Records

1. Section 272(b)(2) provides 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."[9]

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[8] The Liberty Consulting Group, *General Terms and Conditions, Section 272 and Track A Report* at 50 (Sept. 21, 2001)("*Multistate 272 Report*").

[9] 47 U.S.C. § 272(b)(2).

2. In its *Accounting Safeguards Order*, the FCC required the § 272 affiliate to follow generally accepted accounting principles.[10]

3. In Colorado, AT&T took issue with the following aspects of Qwest's performance under this standard:

- Use of generally accepted accounting principles (GAAP).
- Relevancy of the GAAP materiality principle.
- Adequacy of documentation or "audit trail."
- Sufficiency of internal controls.
- Separate charts of accounts.[11]

4. Upon review of Qwest's books and records, AT&T cited what it considered to be a number of failures on the part of Qwest to follow accrual accounting and to timely book billable transactions, including its failure to book any QC/QCC transactions between July 2000 and April 2001. AT&T noted that U S West Long Distance and QLD exhibited similar shortcomings.

5. Qwest says that QCC follows GAAP and has followed accrual accounting, citing an audit opinion of Arthur Andersen

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

[11] In its brief, AT&T indicates that Qwest and QCC ultimately provided their Charts of Account, and concedes that they are different. Yet, AT&T goes on to state that the difficulty in obtaining these charts "reflects a lack of diligence on Qwest's part to demonstrate compliance with section 272." *AT&T's Brief on Section 272 of the Act* at 12. AT&T is too exacting here. Qwest has demonstrated that it maintains separate charts of accounts for the entities involved. Moreover, I wonder what the remedy for this supposed lack of diligence should be? Penalty box time for Qwest before it can file its § 271 application?

which "confirms that QCI follows GAAP in all material respects." According to Qwest, there is really only one issue here: whether QCC has timely accrued and paid for its expenses attributable to QC, and vice-versa.

6. Qwest also says that consideration should be given to the difficulties it faced when deciding after the U S West/Qwest merger to change from one affiliate (*i.e.*, U S West Long Distance, thereafter QLD) to QCC as the entity that would provide in-region, long distance service. Qwest's reply brief also focused on the performance of QCC after its designation as the § 272 affiliate, adding that "AT&T has not identified any untimely QCC accruals or billing following the overlay of section 272 controls on QCC."[12]

7. Based upon the evidence presented at the Colorado workshops, Staff recommends – and I concur – that the Multistate Facilitator's conclusions with regard to Qwest's performance should control:[13]

- In the past, Qwest did not assure that transactions between QC and QCC were accrued on a timely basis, or paid promptly or subjected to interest penalties for untimely payment. However, Qwest did undertake substantial efforts to bring

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[12] *Reply Brief of Qwest Corporation in Support of its Compliance with the Requirements of 47 U.S.C. § 272* at 4.

[13] *See Multistate 272 Report* at pp. 53-54.

all of its transactions into compliance with applicable accounting principles.

- Qwest's efforts to cure past and present performance should be taken into consideration, and are likely to continue to prove sufficient to meet applicable requirements.
- The lack of attention to the kinds of transaction details that Qwest would normally afford third parties (as opposed to its own affiliate) "buttresses the need for validation of the current and future effectiveness of the recent improvements by Qwest."
- The errors revealed through AT&T's review of QLD's records also buttresses this need, although these errors, standing alone, do not "produce sufficient concern to warrant special measures at this time."

8. As a result of his findings, the Multistate Facilitator recommended that Qwest arrange for independent testing from April 2001 through August 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.[14]

9. The Multistate Facilitator determined that the independent testing should adequately address AT&T's issues regarding internal controls and documentation.[15] In addition, he directed the examination to adhere to a "materiality standard" covering the total transactions between QC and QCC over the testing period because a diminished standard would have "the effect of requiring perfection with respect to completeness, accuracy, and timeliness."[16]

10. On November 27, 2001, Qwest filed the results of the independent test performed by KPMG L.L.P. (KPMG) under the conditions defined by the Multistate Facilitator's report.[17] KPMG found that Qwest did not comply with the FCC's affiliate transaction pricing rules in twelve instances for transactions

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[14] *Id.* at 54.

[15] *Id.* at 56-57.

[16] *Id.* at 55-56.

[17] *Qwest Corporation's Notice of Filing KPMG Report* (Nov. 27, 2001).

between QC and QCC.[18] For example, KPMG concluded that fair market value (FMV) studies were not performed for real estate properties for which FMV was required.[19] Instead, QC and QCC billed these properties at fully distributed cost. On eight occasions, services provided by QC and QCC were not accounted, billed, and/or or reduced to writing.[20]

11. Qwest emphasized that the KPMG review was comprehensive, that a number of the errors cited by KPMG already had been identified by QC and QCC, and that the affiliates were engaged "in an effort to identify aspects in which their existing controls can be strengthened."[21] Qwest noted that the instances of noncompliance cited by KPMG do not rise to the level of anticompetitive conduct or cross-subsidization under § 272(c)(1) because the errors worked to the detriment to the § 272 affiliate. Qwest admitted that "some errors will and do occur," and provided an adequate explanation for the instances of noncompliance in the KPMG report. Finally, Qwest provided the affidavits of Judith L. Brunsting and Marie E. Schwartz, which stated that additional internal controls were being employed to guarantee that proper valuation procedures are

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[18] *Report of Management on Compliance with Applicable Requirements of Section 272 of the Telecommunications Act of 1996*, KPMG L.L.P. (Nov. 9, 2001).

[19] *Id.* at 2.

[20] *Id.* at 3.

[21] *Qwest's Submission of Results of Independent Testing* at 3.

followed and services provided by QC and QCC are accounted for, billed, and reduced to writing. On December 19, 2001 Qwest submitted a supplemental KPMG declaration, which found that Qwest had corrected all discrepancies identified in the KPMG Report and verified that the additional controls which address those discrepancies have been put into place.[22]

12. AT&T filed comments on the original KPMG Report. AT&T underscored the fact that KPMG had "found significant instances of noncompliance."[23] AT&T stated that the report was limited in scope, and did not address §§ 272(a), 272(b)(1), 272(b)(3), 272(b)(4), or 272(g), which are also in dispute. AT&T complained that the KPMG report was misleading because it was conditioned on a standard of "materiality," and the Biennial Audit procedures under § 272 require that all errors or discrepancies be reported. Finally, AT&T encouraged the Commission to undertake a more thorough examination of Qwest's compliance than the "limited time period of April through August 2001." AT&T did not file comments in response to KPMG's supplemental declaration.

13. AT&T's comments regarding the KPMG report are disingenuous. The Multistate Facilitator decided that

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[22] *Declaration of Philip J. Jacobsen*, Certified Public Accountant and Partner, KPMG L.L.P. (Dec. 14, 2001).

[23] AT&T's Comments on November 9, 2001 KPMG Report Filed by Qwest at 2.

materiality was the appropriate standard of review for the test because "requiring perfection with respect to completeness, accuracy, and timeliness" would be a standard that is virtually impossible to meet for any company, including AT&T. KPMG did not review Qwest's compliance with §§ 272(a), 272(b)(1), 272(b)(3), 272(b)(4), or 272(g), because the Multistate Facilitator found, as I do in this order, that Qwest already has complied with those provisions. The five-month period required for testing was a sufficient amount of time to determine whether Qwest will comply with § 272.

14. Based upon the record, I find that Qwest has shown that it has satisfied the requirements of § 272(b)(2). Qwest has been diligent in identifying errors and strengthening its internal controls, and I am satisfied that timely accrual and billing for services provided by its affiliates will take place in the future.

F. Separate Officers, Directors, and Employees

1. Qwest presented evidence that showed that there is no overlap between the officers and directors of QC and QCC.[24] Qwest also has shown that the number of transfers between QC and QCC during the transition creating the § 272 affiliate was miniscule (about 100 employees out of 2,000), that there is

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[24] *Brief of Qwest Corporation in Support of Its Compliance with the Requirements of 47 U.S.C. § 272* at 13 ("*Qwest Section 272 Brief*").

currently no payroll overlap, and appropriate safeguards are in place to establish independent operation between affiliates, including:

- 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 not disclose the affiliate's information.
- Non-disclosure agreements for employees who take positions in another Qwest entity.
- Training to ensure compliance with § 272.
- Annual employee review of Qwest's Code of Conduct.
- Providing for physical separation of the offices of QC and QCC.

2. AT&T argued that the performance of recruiting by QCC for QC and the lack of separate payroll administration between the two undermines any conclusion that the two affiliates maintain operating independence. I fail to see how shared payroll administration and recruitment encourages QC to

discriminate in favor of QCC.[25] As Staff and Qwest point out, the FCC has endorsed common services as a means of capturing economies of scale.[26]

3. In sum, AT&T has presented insufficient evidence to back its claim that "[t]here is a revolving door atmosphere" between QC and QCC.[27]

G. Transaction Posting Completeness

1. Section 272(b)(5) requires the § 272 affiliate to reduce its transactions with its affiliated BOC to writing and make them available for public inspection. AT&T argued that Qwest has failed to meet this requirement in a number of ways:

- As of January 1, 2001, by not posting specific "billed amounts" to its website. AT&T could not determine whether Qwest has complied with the FCC's accounting rules.
- By failing to post any transactions between July 2000 and April 2001.
- By failing to provide certification statements at Qwest's

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[25] Regarding Impasse Issue No. 9 (100 percent usage), I agree with the Multistate Facilitator's assessment that Qwest's proposed policy, which limits assignments of QC employees to the § 272 affiliate for no more than four months out of any 12, reasonably mitigates the possibility that the separate employment requirement will be violated. Ongoing oversight through the biennial audit will inform the Commission as to whether further modifications to this policy will be warranted.

[26] *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended,* First Report and Order, 11 FCC Rcd 21, 905 at ¶¶ 178-182 (1996)("*Non-Accounting Safeguards Order*").

[27] Impasse Issue No. 8 (The Status of Mr. Augustine Cruciotti as a QCC Employee and an Officer of QCI Simultaneously) was not briefed by AT&T. As such, I will assume that this issue is no longer at impasse.

place of business when AT&T has tried to locate them.[28]

- By failing to accrue, pay for, and post 10 months of QCC transactions back to June 2000.[29]

2. Qwest testified that its Internet postings contain the rates, terms, frequency, number, and type of personnel, and their level of expertise.[30] I find that Qwest's unrebutted testimony establishes that its Internet postings largely mirror the sort of information that the FCC found to be sufficient in the *SBC Texas Order.*[31] AT&T argues that the FCC did not address whether a BOC must post billing detail in those orders, yet AT&T has not stated how the information on Qwest's website materially differs from that contained on SBC's website. Furthermore, in meeting the FCC's test of determining whether the posted transaction description is sufficiently detailed to

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[28] Transaction information available for public inspection must be accompanied by a certification by an officer of the BOC that the statements of fact contained in the submission are true. *Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of* 1996, Report and Order, 11 FCC Rcd. 17,539 at ¶ 122 (1996)("*Accounting Safeguards Order*"). The Multistate Facilitator referred this issue to the subsequent KPMG audit "to assure that a QC officer who has the requisite knowledge provides the required certifications." *Multistate 272 Report* at pp. 68-69. I agree with Staff that, as a result of "the up-to-date positive Audit Report," the Commission need not take further action with regard to this issue. *Volume VII Report* at 69.

[29] This issue is more properly considered under the section on *Books and Records*, *supra.*

[30] Qwest § 272 Brief at 21, *citing In the Matter of Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act to Provide In-Region, InterLATA Service in the State of New York*, Memorandum Opinion and Order, FCC 99-404, ¶ 413 (rel. Dec. 22, 1999)("*Bell Atlantic New York Order*").

[31] *In the Matter of Application by SBC Communications, et al., Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in Texas,* Memorandum Opinion and Order, FCC 00-238, ¶¶ 405-406 (rel. June 30, 2000)("*SBC Texas Order*").

“facilitate the purchasing decisions of unaffiliated third parties,” the Multistate Facilitator suggested that the audit subsequently performed by KPMG would address this issue.[32] Nothing in the KPMG report suggests that Qwest’s information is lacking in sufficient detail.

3. QCC’s alleged failure to post any transactions between July 2000 and April 2001 relates to the larger issue of when QCC became subject to § 272 requirements. Qwest claimed that it established QCC as its § 272 affiliate on March 26, 2001, after a three-month transition period from Qwest LD. Qwest noted that many of the late-postings referred to by AT&T occurred during this transition period, and it has posted transactions in timely fashion ever since its initiation date. AT&T argued that QCC became a § 272 affiliate by operation of law as of the July 2000 U S West/Qwest merger effective date. Furthermore, AT&T argued that QCC was initiated on January 1, 2001, thereby violating the posting requirements prior to late March of that year.

4. I fully agree with the Multistate Facilitator’s assessment of this issue. .Under the plain language of § 272(a)(2)(B), it can be argued that there “was and is, at

[32] *Multistate 272 Report* at 65. The Multistate Facilitator also indicated that, in providing enough information to assure that audits or other formal examinations can take place, “there is no sound reason why a public posting of [transaction details] is necessary to accomplish this purpose.”

least for some purposes, no '272 affiliate' within Qwest" absent the provision of in-region, interLATA services.[33] Indeed, if none of the services under which a separate affiliate is required under § 272(a)(2) are being provided, there is no need for a separate affiliate at all. Therefore, it is incorrect to argue that QCC became a § 272 affiliate by operation of law after the culmination of the U S West/Qwest merger. Under this premise, the Multistate Facilitator continued:

> 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 . . . strain the plain language of federal law past the breaking point.[34]

I find this convincing.

H. Use of a Non-Section 272 Affiliate to Develop Improvements for QC and QCC

1. AT&T objects to the use of Qwest Services Corporation (QSC) for product design, planning or development services for QC and QCC without being posted and made available to unaffiliated parties under the non-discrimination safeguards of § 272(c)(1).

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[33] *Multistate 272 Report* at 66.

[34] *Id.* at 66-67.

2. Qwest correctly argues that § 272(c)(1) only pertains to the dealings between a BOC (or QC) and "its" § 272 affiliate, not to transactions between another BOC affiliate and the § 272 affiliate. In addition, paragraph 182 of the *Non-Accounting Safeguards Order* does not prohibit a parent company or an affiliate of a BOC from providing services to a BOC and a § 272 affiliate. Nor has the FCC stated that these services should be made available to competitors. This issue is closed.[35]

I. Examination of Qwest Marketing Practices

AT&T argues that QC does not show that it will comply with § 272(g)(1) because its "affidavit and rebuttals fail to state whether QCC intends to market information services and whether QC will also permit other information service providers to market and sell telephone exchange services."[36] Qwest cited its Direct Affidavit as stating that it will comply with § 272(g) and that it will not engage in joint marketing except as provided under § 272(b)(5).[37] This issue is closed.[38]

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[35] An analogous issue was raised under § 272(c)(1) regarding Qwest LD's alleged use of Advanced Technologies, an affiliate of the BOC, to circumvent the requirements of the section. Staff has recommended that the Commission declare this issue moot because Advanced Technologies has been dissolved, new control safeguards have been put into place, and the threat of the biennial audit exists. *Volume VII Report* at 71. I hereby incorporate Staff's findings with the discussion in this section and conclude that this issue is closed.

[36] *AT&T's Brief on Section 272 of the Act* at 29.

[37] *Reply Brief of Qwest Corporation in Support of its Compliance with the Requirements of 47 U.S.C. § 272* at 13.

[38] Impasse Issue No. 15 (Imputation and Payment of Switched Access Charges) was not briefed by AT&T. As such, I will assume that this issue is no longer at impasse.

J. Conclusion

Qwest satisfies the requirements of § 272. Necessarily, this is a predictive conclusion that the procedures, safeguards, and structures Qwest has in place will keep its § 272 affiliate separate from QCC. Because it is a predictive conclusion, it is also a modest one. Nevertheless, it is a modest conclusion that warrants a favorable recommendation from this Commission insofar as § 272 is concerned.

III. THE PUBLIC INTEREST

A. In addition to the competitive checklist items enumerated under 47 U.S.C. § 271(c)(2)(B) of the 1996 Act and § 272, Qwest bears the burden of proof in showing that its requested authorization would be consistent with the public interest, convenience, and necessity.[39] The FCC explains that the public interest analysis should focus on whether the local market is open to competition, whether there is adequate assurance that the local market will remain open after the § 271 application is granted, and whether there are "any unusual circumstances that would make entry contrary to the public

[39] 47 U.S.C. § 271(d)(3)(C). *See In the Matter of Joint Application of SBC Communications Inc., et al. Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in Arkansas and Missouri*, Memorandum Opinion and Order, FCC 01-338, n. 394 (rel. Nov. 16, 2001)("*SBC Arkansas/Missouri Order*").

interest."[40] However, in determining whether markets are open to competition, the FCC has also noted that "no one factor is dispositive" in the public interest analysis.[41]

B. This Commission previously has determined that the public interest test is not a catch-all inquiry.[42] "Public interest" is not *the* "*et cetera*" at the end of the 14-point checklist. The bad effects of an open-ended public interest inquiry are many. If the "public interest" becomes so protean to encompass anything and everything, then nothing in this record would be dispositive. Moreover, if the relative weight to be given to the various factors of public interest analysis is not known beforehand, then there is no basis for reasoned decisionmaking by the fact-finder, nor for reasoned record-making by the participants to this docket.

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[40] *In the Matter of Joint Application of SBC Communications Inc., et al. Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in Kansas and* Oklahoma, Memorandum Opinion and Order, FCC 01-29, ¶¶ 267-69 (rel. Jan. 22, 2001)("*SBC Kansas/Oklahoma Order*').

[41] *Id.* at ¶¶ 272-73.

[42] "The public interest standard gives rise to regulatory architecture that is genetically hostile to efficiency. Consumer interests are dependably eclipsed by special interests. Public interest rule makings are open-ended. The merits of entry are considered in the broadest possible context, forcing regulators to gauge the social benefits of competition *ex ante*. That requirement front-loads the regulatory process, substantially raising the cost of entry." Thomas W. Hazlett, *The Wireless Craze, the Unlimited Bandwidth Myth, the Spectrum Auction Faux Pas, and the Punchline to Ronald Coase's "Big Joke": An Essay on Airwave Allocation* Policy, 14 Harv. J.L. & Tech. 335, 403-404 (2001). For an interesting discussion about the impact of technological convergence on the public interest test and the non-delegation doctrine, *see* Randolph J. May, *The Public Interest Standard: Is It Too Indeterminate to be Constitutional?* 53 Fed. Comm. L.J. 427, 453 (2001).

C. Fortunately, the FCC and the Colorado Commission have both been careful to delimit the scope of the public interest inquiry so that there is content to the standard.

D. The *only* relevant question under the public interest test in Colorado is whether consumer and producer welfare will be maximized.[43] Welfare is enhanced when the sum of consumer surplus (*i.e.*, the amount above the price paid that a consumer would be willing to spend) and producer surplus (*i.e.*, the amount that firms receive for the goods they sell above the amount that it costs them to produce) are maximized. This is also called "total welfare." For this Commission's purposes, this welfare maximization standard shall be the touchstone for our public interest analysis.[44]

E. Why we adhere to this "welfare maximization" standard

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[43] "Properly interpreted, public interest has a . . . meaning. The meaning boils down to an economic concept: public interest means consumer and producer welfare maximization." *In the Matter of the Application of Public Service Company of Colorado for Commission Authorization for New Century Energies, Inc. to Merge With Northern States Power Company,* Order (1) Granting, In Part, and Denying, in Part, Public Service's Motion to Define Scope of Proceeding, (2) Granting Motion Requesting Approval of Procedural Schedule, and (3) Establishing Procedures. Decision No. C99-1052, Docket No. 99A-377EG (Mailed Sept. 29, 1999); "More precisely, the burden of the applicants is to show that producer and consumer welfare gains will result by merging. How can this be shown? Lower consumer rates, synergies, economies of scope or scale, cost savings, more favorable access to capital, more rapid deployment of technology, accelerated competitive entry into other markets, increased productive efficiencies, to name just a few, would indicate the welfare gains for which the Commission would be looking." *In the Matter of the Application of Qwest Communications Corporation, et al. for Approval of the Merger of Their Parent Corporations, Qwest Communications International Inc. and U S West, Inc.,* Procedural Order. Decision No. C99-1147, Docket No. 99A-407T (Mailed Oct. 15, 1999).

[44] *See also, Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.,* 429 U.S. 477, 488 (1977); *National Collegiate Athletic Association v. Board of Regents*, 468 U.S. 85, 107 (1984); Jerry A. Hausman & J. Gregory Sidak, *A Consumer-Welfare Approach to the Mandatory Unbundling of Telecommunications Networks*, 109 Yale L.J. 417, 451 (1999).

as the touchstone for our analysis is vindicated by the number of issues and the scattershot pleading and argument in this portion of the record. As is too often the case when the public interest is involved, the participants have attempted to smuggle within the standard ideas and grievances that either have nothing to do with § 271, or that -- even if true -- have no remedy in this proceeding.

F. The FCC focuses the "public interest" inquiry on the existence of a performance assurance plan (PAP) to prevent the ILEC from backsliding after gaining § 271 entry. Because Qwest has not filed a compliant PAP, I recommend the Commission refrain from recommending § 271 entry for Qwest. On all other aspects of the "public interest" inquiry, I find that Qwest's entry into the interLATA market will enhance welfare, and that these welfare gains are not overridden by alleged harms or remedies proffered by CLEC-participants. I therefore recommend to the Commission that, but for the PAP, Qwest complies with the "public interest" standard.

G. Performance Assurance Plan

1. Qwest has yet to adopt a PAP. Qwest argues that it has presented adequate assurance of future compliance that the local market will remain open to competition through its

ongoing participation in the PAP negotiation process.[45] Qwest appears to maintain that, regardless of whether the PAP process has been completed, it has satisfied the "anti-backsliding" prong of the FCC's public interest analysis because the FCC has been granted enforcement remedies under § 271(d)(6) and private remedies are available to other parties.

2. The FCC has indicated that while a PAP "is not a requirement for section 271 authority . . . the fact that a BOC will be subject to a satisfactory performance monitoring and enforcement mechanism would constitute probative evidence that the BOC will continue to meet its section 271 obligations and that its entry would be consistent with the public interest."[46] It is quite clear from this statement that the FCC considers the existence of a PAP separately from scrutiny of the characteristics of the PAP itself. Regardless of whatever latitude Qwest might find in the FCC's statement under the public interest test, no § 271 application, to date, has been submitted to and approved by the FCC without a performance assurance plan. Indeed, as I have previously stated, Qwest must adopt a PAP before I will recommend to the Commission that it certify § 271 compliance.[47]

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[45] *See Qwest Track A/Public Interest Brief* at pp. 37-39.

[46] *SBC Arkansas/Missouri Order* at ¶ 127.

[47] Decision No. R01-1142-I at 7.

3. The Office of Consumer Counsel (OCC) and Staff argue that it would be premature to find that the public interest test is met without an approved PAP, the OCC going so far as to call it "the lynchpin" of the public interest test.[48]

4. I agree with Staff and the OCC. The PAP will provide the strongest incentive for Qwest to comply with the market-opening provisions of § 271, will contain transparent performance measures and standards, and will provide oversight mechanisms that minimize transaction costs and uncertainty for Qwest and its competitors.[49]

5. Because Qwest has not adopted an adequate PAP, it is unreasonable to conclude that the market will remain open to competition after long distance entry, thus endangering the welfare gains in the local and long distance markets that would take place with interLATA entry. I, therefore, withhold making a finding that Qwest's application is in the "public interest" until Qwest has filed a compliant PAP with its SGAT.

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[48] *The Colorado Office of Consumer Counsel's Brief on the Public Interest, 47 U.S.C. § 271(d)(3)(C) of the Telecommunications Act of 1996* at 3. *Staff Volume VII Report* at pp. 129-130. *See also Brief of AT&T Regarding Public Interest* at pp. 21-26.

[49] *See, for example, WorldCom, Inc. Workshop 7 Post-Hearing Brief* at 10 ("[w]hile other remedies such as complaint filings at the FCC and antitrust actions have been mentioned . . . those remedies are expensive, often drawn out, and, in the case of the antitrust mechanism, prohibitively expensive.").

H. Promoting Competition in Local and Long Distance Markets

1. It is clear — and essentially undisputed -- that welfare will be enhanced by Qwest entry into the long distance market. Qwest is, or soon will be, in compliance with the competitive checklist.[50] According to the FCC, "compliance with the competitive checklist is, itself, a strong indicator that long distance entry is consistent with the public interest."[51] Furthermore, the FCC presumes that "BOC entry into the long distance market will benefit consumers and competition if the relevant local exchange market is open to competition consistent with the competitive checklist."[52] As Qwest argues in its brief, and as is discussed further in the section on Track A, *infra*, a number of CLECs have entered into and are competing within the local residential and business markets in Colorado.

2. Qwest entry into long distance service will permit it to offer integrated service to compete with AT&T, WorldCom, and other interexchange competitors. As a result of increased long distance competition, consumers will benefit through increased choice and lower long distance prices. Qwest

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[50] *See* Decision Nos. R02-3-I (January 2, 2002) and R02-115-I (February 1, 2002).

[51] *SBC Arkansas/Missouri Order* at ¶ 124.

[52] *Bell Atlantic New York Order* at ¶ 428; *SBC Texas Order* at ¶ 419; *SBC Kansas/Oklahoma Order* at ¶ 268; *SBC Arkansas/Missouri Order* at ¶ 125.

cites a study which concluded that, in New York, "consumers will save up to $284 million annually on long distance telephone service as a result of BOC entry into the interLATA market in that state."[53] Similar, albeit proportional, savings should occur in Colorado. Qwest also will be able to take advantage of the economies of scope inherent in local and long distance service, engaging in joint marketing of local, long-distance, data, and wireless packages. Qwest's ability to market jointly will increase competition in both local markets and in long distance and wireless markets because CLECs will be forced to respond with competitive offerings.[54] Finally, market participants will have the incentive to innovate and roll out value-added services to customers in both markets. Thus, interLATA entry will allow Qwest to take advantage of both economies of scale and scope unfettered by regulatory prescription. Section 271 entry will also increase Qwest's

[53] *Qwest Track A/Public Interest Brief* at 36, *citing* "TRAC Estimates New York Consumers Save Up to $700 Million a Year on Local and Long Distance Calling," Telecommunications Research Action Center, May 8, 2001; *see also,* Hausman, Leonard & Sidak, *The Consumer Welfare Benefits from Bell Company Entry into Long-Distance Telecommunications: Empirical Evidence from New York and Texas,* available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=289851 (posted November 6, 2001).

[54] *See also Qwest Track A/Public Interest Brief* at 37, *citing* "2000 Competitive Analysis: Analysis of Local Exchange Service Competition in New York State," New York Public Service Commission (December 31, 2000)(concluding that the number of local exchange lines served by CLECs more than doubled in the year following the grant of Verizon's § 271 application).

incentive to innovate and compete more aggressively on price.

3. I conclude that there are undeniable consumer and producer welfare benefits from Qwest entry into interLATA markets. On this basis, the "public interest" test is met. However, CLECs offer some countervailing concerns on the other side of the "public interest" ledger.

I. "Unusual Circumstances" That Would Make Long Distance Entry Contrary to the Public Interest

1. AT&T, WorldCom, Covad, the Association of Communications Enterprises ("ASCENT"), and the public[55] have raised a number of additional issues under the rubric of the "public interest." In many instances, Qwest has addressed these issues and has met its burden of proof that there are no unusual circumstances that would make interLATA entry contrary to the public interest. Otherwise, I concur the Multistate Facilitator's analysis of the burden of proof in this instance: "we would not accept a rule that upon allegations by a third-party Qwest must bear the burden of disproving them in order to

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[55] In this order, I will address the "Public Comments" filed on June 26, 2001, by Ken Swineheart. Though Mr. Swineheart does not attempt to establish his interest in the matter, in the broad spirit of collaboration, I will infer that he is an interested Colorado consumer of telecommunications services. His pleading attaches and advocates for what is known as "The LoopCo Plan" authored by Roy L. Morris. In substance, the LoopCo plan is indistinguishable from the structural separation proposals advocated by AT&T and WorldCom. *See* Direct Testimony of William Levis Re: Public Interest, pp. 64-74 (filed June 25, 2001); Affidavit of Mary Jane Rasher Regarding Public Interest, pp. 38-49 (filed June 25, 2001).

demonstrate that the public interest would be served by granting it 271 authority."[56]

2. Indeed, the multifarious grievances raised in the name of the "public interest" underscores the abuses to which the standard is prone.

3. Competition in the Residential Market:

a. AT&T argues that there is no meaningful competition for residential customers anywhere in Colorado.[57] According to AT&T, this "is a factor directly relevant to whether the local market is open."[58] The FCC recently has addressed a similar complaint by Sprint in the *Verizon Rhode Island Order*. There, Sprint argued "that low levels of residential UNE and resale service in Rhode Island indicate that meaningful competition does not exist in Rhode Island."[59] The FCC declined to "consider the market share of each entry strategy for each type of service" under its public interest analysis.[60]

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[56] The Liberty Consulting Group, *Public Interest Report* at 2 (Oct. 22, 2001)("*Multistate Public Interest Report*").

[57] *Brief of AT&T Regarding Public Interest* at 3.

[58] *Id.*

[59] *In the Matter of Application by Verizon New England Inc., et al., for Authorization to Provide In-Region, InterLATA Services in Rhode Island,* Memorandum Opinion and Order, FCC 02-63, ¶ 104 (rel. Feb. 22, 2002)("*Verizon Rhode Island Order*").

[60] *Id.*

b. The fact that many CLECs may choose to pursue higher profit margins in the business market will not have a deleterious impact on welfare maximization in local and long distance markets. AT&T's argument says nothing relevant to the public interest inquiry.[61]

c. AT&T's argument would further place Qwest in the position of being denied § 271 entry because of the historically distorted retail rate structure imposed by this, and other, state commissions.[62] The lack of CLEC entry in the residential market can be explained by only one thing: the residential retail rates make entry either unattractive relative to other markets or unprofitable altogether.

d. I fail to see the consumer welfare benefits to forestalling Qwest entry into the interLATA markets because of less-than-robust competition for residential consumers. For one, this standard would hold Qwest liable for the rate structure sins of its regulators. Second, it would give AT&T -- the main alternate facilities-based residential

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[61] Covad argues that Qwest should be required to account for the state of competition in the DSL market. *See Covad Communications Company's Brief on Public Interest* at pp. 5-8. This discussion and conclusion applies, if not more so, to Covad's position.

[62] Indeed, the only reasonable explanation for the disparity between CLEC business market entry and residential market is the opportunity cost of entering one market as opposed to the other. Depending on whose line-count numbers one believes, the business market is at least twice or manifold more likely to be served by CLECs. The residential market does not have to be unprofitable to enter, just less profitable than the business market. This is the familiar, and perfectly rational, practice known as "cream-skimming." For an explanation why this behavior, competition for

telecommunications service provider in Colorado -- a perverse incentive *not* to continue its residential service roll-out.[63] There are many plausible explanations for the slow arrival of residential competition. No explanation is explored with adequate depth in this record or is substantiated in any way beyond general opinionizing. In the end, the record does not convince me that the slow arrival of residential competition should forestall § 271 entry.

4. UNE Prices

a. AT&T objects to the use of UNE prices in excess of economic cost in Colorado, which "creates a clear barrier for CLEC entry into Qwest's local residential market in this state," particularly when a competitor tries to access an end-user through UNE-P.[64] As evidence in support of its conclusion, AT&T compared recurring and non-recurring 1FR rates against wholesale prices.[65]

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consumers who are discriminated against, is a good thing, *see* Alfred E. Kahn, *The Economics of Regulation,* II: 221-226 (MIT: 1988 reissue).

[63] Insofar as AT&T concluded that it had more to gain from keeping Qwest out of the interLATA market than by continuing to compete for residential consumers, then behavior forestalling its own residential entry would make sense for AT&T.

[64] *Brief of AT&T Regarding Public Interest* at 6.

[65] *Id.* at 7. *See also WorldCom Inc. Workshop 7 Post-Hearing Brief* at pp. 4-7 (urging the Commission to adopt UNE rates that are no higher than necessary to compensate the incumbent for the function it is providing and earn a return on its investment).

b. Qwest argues that the FCC has deemed a similar argument as "irrelevant"[66] in the *SBC Kansas/Oklahoma Order*, because "incumbent LECs are not required, pursuant to the requirements of section 271, to guarantee competitors a certain profit margin."[67]

c. The briefs in this workshop were filed before the D.C. Circuit's opinion in *Sprint Communications Co., L.P. v. F.C.C.*,[68] which remanded the FCC's foregoing public interest analysis for further consideration. The D.C. Circuit stated:

> [T]he Commission gave appellants' claim rather a brush-off. First, the Commission said that under its reading of the Act, the "profitability" considerations raised by appellants were "irrelevant" because the Act directed it to assure that the rates were cost-based, "not [to determine] whether a competitor can make a profit by entering the market." This, of course, is unresponsive. The issue is not guarantees of profitability, but whether the UNE pricing selected here *doomed* competitors to failure. (Citations omitted.)[69]

Sprint changes the public interest analysis applied to this situation.

d. Let us first be clear about the background and scope of the D.C. Circuit's opinion. Sprint, much like AT&T

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[66] *SBC Kansas/Oklahoma Order* at ¶ 92.

[67] *Id.* at ¶ 65.

[68] 274 F.3d 549 (Dec. 28, 2001).

is arguing here, pointed to the low penetration of residential service as an indicator that UNE rates did not conform to TELRIC pricing. Because rates were too high, according to Sprint, SBC was engaged in a "price squeeze" (*i.e.*, charging prices for inputs that precluded competition from firms relying on those inputs).[70] In the end, the D.C. Circuit agreed with Sprint that the FCC "should pursue their price squeeze claim, or at the very least explain why the public interest does not require it to do so."[71]

e. The failure of the FCC to explain its decision in the *Sprint* case does not compel the conclusion that a "price squeeze" exists in Colorado. Quite the contrary, without further revenue analysis AT&T's argument fails to convince that CLECs are "doomed to failure." As the Multistate Facilitator has found, "(AT&T) did not recognize that local rates consist of much more than the basic monthly charge for service. Vertical features and intrastate toll revenues must be considered."[72] When the FCC's counsel argued that residential rates have been set historically low by state commissions, the D.C. Circuit noted that *Sprint's* counsel countered with an argument analogous to that of the Multistate Facilitator,

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[69] *Id.* at 554.

[70] *Id.* at 553.

[71] *Id.* at 554.

namely, "that even with state commission regulation it would be possible to offer certain enhanced services profitably -- if only UNE rates were capped at correct TELRIC levels, or, in the alternative formulation, at lower levels within the correct TELRIC range."[73] AT&T's pricing analysis completely ignores this possibility.

f. As the Multistate Facilitator also points out, other avenues of market entry are also available to entrants, such as resale, business lines, and the "subsidies" that are available to those competitors who service qualifying residential lines through facilities-based competition.[74] These avenues of entry, along with bundled services over UNE-P, will certainly maximize consumer and producer welfare. To the extent that AT&T believes UNE prices to be above cost, that issue has been considered in the context of the pricing docket, Docket No. 99A-577T.[75]

g. All this said, I do not discount the possibility of a price squeeze occurring in the residential market given the Colorado retail rate structure. The Colorado

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[72] *Multistate Public Interest Report* at 5.

[73] 274 F.3d at 555.

[74] *Multistate Public Interest Report* at 5-6.

[75] Covad also has argued that Qwest's pricing is neither cost-based nor appropriately priced, pointing to an alleged discrepancy in the cost for the high frequency portion of the loop. As this issue is being directly addressed in the pricing docket, it lies outside the scope of the Commission's public interest inquiry.

legislature has set and capped basic local residential rates by statute. § 40-15-502(3)(b)(I), C.R.S. In isolation, UNE-P rates for basic local residential service leave scant room for profit, under any party's version of rates from 99A-577T.

h. For purposes of this hypothetical discussion, then, I shall stipulate to the possibility, in certain instances, of a price squeeze against CLECs in the basic local residential market.[76] Even if true, I still do not believe that it would countervail the public interest from Qwest entering the interLATA market.

i. First, it is necessary to explain a price squeeze, and its particular application to regulated industries. The classic price squeeze case is *United States v. Aluminum Co.*,[77] in which Judge Learned Hand affirmed Sherman Act § 2 liability against Alcoa for monopolization of the aluminum ingot and fabrication market. For a price squeeze to be possible, a firm must be active at two levels of an industry, and its competitors must be active on only one level of the same industry and be customers of the firm at the other level. The price-squeezing firm can then either sell at a price too high at

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[76] I do not find, on this record, that in fact a regulatory price squeeze will happen under the respective retail and wholesale rates in Colorado. I merely admit the possibility, and for the above-discussion, take it as a given. The record on the price squeeze issue, as in so many other places of the public interest record, *see infra*, does not display the rigor and level of detail that would permit the factual conclusion that a price squeeze will take place.

[77] 148 F.2d 416 (2d Cir. 1945).

the first level, or too low at the second level, where the competitors are. In either case, this pricing strategy drives, or squeezes, the competitors from the second market.

j. A special case of the price squeeze occurs in heavily regulated industries. Allegations of a regulatory price squeeze, as it is called, often arise between federal and state electricity rate regulation.[78] In the case of the regulatory price squeeze, it is not the firm, but the regulators who set the prices at the different levels of the industry. This scenario has been a recurring struggle in electricity regulation, where the FERC has authority to set interstate wholesale rates, while state commissions set intrastate retail electricity rates. With the regulatory price squeeze, wholesale purchasers claim that the wholesale rates are discriminatory and noncompetitive when considered in relation to the retail rates. The Supreme Court held in *Federal Power Commission v. Conway Corp.*,[79] that the Federal Power Commission (FPC), FERC's predecessor, could consider retail rates and the possibility of a price squeeze between wholesale and retail rates when setting wholesale rates, notwithstanding the fact that the FPC had no authority over the retail rates. The court reasoned that the

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[78] *See* Charles F. Phillips, Jr., *The Regulation of Public Utilities,* p. 649 (PUR 1993).

[79] 426 U.S. 271, 96 S.Ct. 1999 (1976).

FPC could look to the lower end of "reasonableness" in setting wholesale rates to avoid the possible price squeeze.[80]

k. The similar price squeeze allegation here compels inquiry whether the residential retail statutory price cap must be considered when establishing UNE-P TELRIC rates. The D.C. Circuit in *Sprint Corp.* instructed the FCC not to give such allegations "the brush-off."[81]

l. The allegation of a price squeeze counsels two things: (1) consider the residential retail rate when setting UNE-P rates; (2) consider the public interest repercussions of the rate differential between wholesale and retail. The first question is for consideration in Docket No. 99A-577T; the second question can be addressed here.

m. In *Town of Concord v. Boston Edison Company,*[82] then-Circuit Judge, now Justice, Breyer discussed the classic regulatory price squeeze scenario. The case involved three towns purchasing wholesale power from a vertically integrated utility, Boston Edison, and a challenge to the wholesale/retail rate differential as accomplishing a price squeeze in violation of the Sherman Act § 2. Judge Breyer

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[80] *Id.* at 279-280.

[81] *Id.* at 554.

[82] 915 F.2d 17 (1st Cir. 1990), *cert. denied,* 499 U.S. 931, 111 S.Ct. 1337 (1991).

concluded that no Sherman Act § 2 violation had occurred because:

> Effective price regulation at both the first and second industry levels makes it unlikely that requesting such rates will ordinarily create a serious risk of significant anticompetitive harm.[83]

His analysis continued by noting that:

> [R]egulators try to set prices that reflect costs. To the extent they succeed, the integrated utility's prices are likely to squeeze independent distributors who buy from it at wholesale only if those distributors operate less efficiently, *i.e.*, at higher cost. Consequently, a rule preventing prices that create a squeeze will more likely discourage efficient operations and deprive consumers of prices that reflect lower cost.[84]

Thus, the court cautions that too much attention to price squeeze allegations can quickly degrade into a competitor profit protection scheme, as opposed to a consumer-welfare enhancement.

n. The prudential considerations that convinced the First Circuit to limit antitrust liability when a regulatory price squeeze occurs, lead me to the same conclusion when it comes to public interest analysis under § 271.

o. When there are two levels of rate regulation –— retail and wholesale -- consumers are protected from harm. The feared behavior of a monopolist -- to raise price and lower

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[83] *Id.* at 19.

[84] *Id.* at 26.

output -- could not happen under dual level rate regulation.[85] Here, though the price squeeze scenario may impede residential entry through the UNE-P path, the squeeze does not leave consumers worse off than they are now. It may delay or make competition more difficult, but it does not harm consumer welfare.

p. Likewise, I hesitate to make a price squeeze allegation the driver for all costing and ratemaking. Taken to its logical conclusion, the price squeeze concern would mandate parallel ratemaking or rebalancing at both the retail and the wholesale level. The Telecommunications Act of 1996, nor § 271 more specifically, has never been held to require such universal rate rebalancing.

q. To be sure, not all of the First Circuit's prudential concerns about antitrust's application to regulatory price squeezes apply here.[86] Nevertheless, I find the rationale convincing enough to conclude that it translates over to the public interest inquiry.

r. I reiterate that Qwest should not be liable

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[85] That is to say, it could not in theory occur, but the ostensible purpose of regulation at both levels should restrain harm to consumer welfare, or at least make it no worse off than under traditional regulation. *See* Stigler & Friedland, *What Can Regulators Regulate? The Case of Electricity,* 5 J.L. & Econ. 1-16 (1962)(arguing from empirical studies that regulators have been ineffective at preventing monopoly pricing by utilities).

[86] *See id.* at 26-28 (fear of jury involvement in regulatory process, antitrust court interference in regulatory process).

for the errors, distortions, and imbalances of the rate structure approved by regulators, or in this case the legislature.[87] To hold up § 271 approval because of a distorted retail rate structure would be inequitable to Qwest and delay competition's benefits to Colorado consumers.

s. Thus, I do not believe that a UNE-P regulatory price squeeze, *even if it exists,* changes the public interest analysis. To the extent it does cut against the public interest analysis here, I believe that facilities-based residential market entry (almost exclusively by AT&T Broadband) obviates the need to limit the price squeeze focus to UNE-P residential competition. The fact that UNE-P competition may be

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[87] To the extent § 40-15-502(3)(b)(I) creates an entry barrier into the Colorado market by imposing a price squeeze on UNE-P entry, it may be worth petitioning to find the contours of 47 U.S.C. § 253:

> (a) In general
> No State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service.
> ***
> (d) Preemption
> If, after notice and an opportunity for public comment, the Commission determines that a State or local government has permitted or imposed any statute, regulation, or legal requirement that violates subsection (a) or (b) of this section, the Commission shall preempt the enforcement of such statute, regulation, or legal requirement to the extent necessary to correct such violation or inconsistency.

Of course, what subsections (a) and (d) give by way of barrier to entry removal, subsection (b) takes away:

> (b) State regulatory authority
> Nothing in this section shall affect the ability of a State to impose, on a competitively neutral basis and consistent with section 254 of this section, requirements necessary to preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunications services, and safeguard the rights of consumers.

But see, RT Communications v. Federal Communications Commission, 201 F.3d 1264, 1269 (10th Cir. 2000)(affirming FCC preemption under § 253 of Wyoming statute).

foreclosed in some instances by a regulatory price squeeze overlooks the other viable – indeed vibrant – entry strategies. Indeed, confining the price squeeze analysis just to UNE-P smacks of an unduly limited market definition. For indeed, by using a broader and more realistic market definition that includes facilities-based entry, resale, and wireless entry, the public interest concerns fade considerably as the UNE-P price squeeze scenario is washed out by other forms of entry and competition.

t. Because there are other modes of residential market entry, because consumer welfare is not harmed even in the event of a price squeeze, and because CLECs have not quantified with any precision the extent and harm from an alleged price squeeze, the "public interest" test post-*Sprint* is still met.

5. Prior Qwest Conduct

a. ASCENT argues that the use of statistical indicators does little to address "the myriad of problems experience [sic] by the competitive industry, nor the number of disgruntled competitors' subscribers who returned to Qwest . . . through no fault of the competitive local exchange carrier."[88] AT&T, enumerating examples drawn from FCC proceedings (many of

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[88] *ASCENT Comments on Staff's Draft Report on Volume VII Issues* at 4.

which involved the former U S West, addressed in the section on § 272, *supra*)[89] and other instances of alleged misconduct, maintains that anti-competitive and discriminatory behavior on the part of Qwest not only has hindered competition in the local market in the past, but mitigates the prospects for facilities-based and UNE-based competition in the future.[90] AT&T proffered a Supplemental Authority Regarding Public Interest on March 6, 2002, detailing a Minnesota PUC administrative law judge's findings on breaches of interconnection obligations. Covad submits that "Qwest's poor wholesale performance, and its aggressively anti-competitive conduct, has contributed greatly to the near extinction of all of Qwest's DLEC competitors."[91]

b. Qwest responded by stating that it has settled almost all of its Colorado-specific disputes with complaining CLECs, which is, at a minimum, merely an indication that the "section 271 carrot is having the effect Congress

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[89] In reading AT&T's brief, one gets the impression that Qwest entry into long distance would *never* be in the public interest due to conduct addressed by the FCC and courts in the past. This is simply contrary to § 271 decisions by the FCC, unless I misapprehend the virtue of Verizon and SBC.

[90] *Brief of AT&T Regarding Public Interest* at pp. 8-12, 16-21. Specifically, AT&T objects to the confidentiality of the settlement agreements that Qwest reached with competitors such as Sun West prior to the § 271 workshops. In addition, AT&T cites a pending matter in Minnesota regarding Qwest's "refusal to be cooperative with various testing procedures," MTE wiring issues in Washington, refusal to convert SunWest customers from resale lines to UNEs in Colorado, refusal to provide competitors with ADSL-capable and ISDN-capable loops region-wide, and delay in providing interconnection to MCI Metro in Washington. *Id.* at 19-20. Issues regarding MTE access and the settlement between Qwest and Sun West have already been addressed in this docket. The other issues have taken place in other jurisdictions and are more properly considered there.

[91] *Covad Communications Company's Brief on Public Interest* at 10.

intended."[92] Qwest emphasized that the determination of § 271 approval will be made on the record developed in this proceeding and not by reference to past cases.

c. Given the generality of the briefs on this issue, I will retort with a general discussion. This issue highlights the heightened expectations that parties have in a public interest inquiry to sling as much as they can on the wall to see what will stick. Not only have I dealt with alleged instances of anticompetitive conduct throughout this docket, several of which have unmercifully reappeared here, but I have repeatedly questioned why region-wide anecdotes and accusations are not being levied in a more appropriate forum, such as traditional state commission complaint proceedings or the courts.[93] And, if the complaints are being dealt with in those forums, that would normally be the end of the story.

d. Furthermore, I have continually stressed that future transgressions, if there are any, will be adequately addressed by the PAP or through more traditional complaint procedures. Allow me to reiterate: this is not a catch-all inquiry. The public interest test is prospective in nature, and

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[92] *Qwest Track A/Public Interest Brief* at 47, n. 194.

[93] Indeed, the number of Colorado complaint proceedings has dwindled to a very few. I draw no conclusions from this, but if parties were really interested in remediation of their contract grievances, I would expect a complaint case rather than this omnibus docket where no remediation can be had.

the record is simply devoid of any "pattern" of anticompetitive behavior in Colorado that is foreseeable to take place in the future or implicate welfare enhancement.

e. Finally, I fail to see why Qwest operating under a PAP is not to be preferred to the current situation of Qwest operating without a PAP. CLECs complain that Qwest is breaching its obligations to them, causing them commercial harm and impeding competition. Yet few, if any, complaint cases are brought to this Commission seeking recompense for these alleged interconnection agreement breaches. In part, this can be traced to remedial inadequacies under Colorado law. However, if Qwest's anticompetitive depredations are as bad as alleged in this record, then I would expect either much better business in the Commission's complaint proceedings or much less commercial activity because Qwest "anticompeted" every CLEC out of the state. Neither situation is the case.

f. Finally, there is the notional difficulty of what the public interest remedy should be for all of Qwest's anticompetitive conduct. Presumably, the demand here would be to put Qwest in the penalty box and delay its § 271 filing until it demonstrates better performance. However, as has already been noted, Qwest's wholesale performance has improved considerably over the two and one-half year course of the § 271 docket. Moreover, to put Qwest in the penalty box now for its

otherwise-penalized behavior,[94] would be both arbitrary and duplicative. The "public interest" standard of § 271 should not be used by this Commission or others in so cavalier a way.

6. Intrastate Access Charges

a. AT&T argues that Qwest's intrastate access rates are priced significantly above cost (8.22 cents per conversation minute), while the FCC has established a cost-based target of 0.55 cents per minute for interstate access rates. According to AT&T, even with imputation of these access rates to Qwest retail revenues, Qwest will be able to subsidize its other products and services to the detriment of competitors in the interexchange market.[95] Qwest said that it should be sufficient that its § 272 affiliate pay the same access rates as Qwest charges to competitors.[96]

b. AT&T's argument is hypothetical. While it may be true that the access charges paid by Qwest's § 272 affiliate ultimately benefit the corporate structure to which the affiliate belongs, the imputation requirements are in place to ensure that Qwest does not engage in predatory pricing. Does this afford Qwest higher profit margins in the current

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[94] See, e.g., *In the Matter of the Complaint of AT&T Communications of the Midwest, Inc. Against Qwest Corporation,* Findings of Fact, Conclusions of Law and Recommendation (Minn. PUC February 2, 2002) (recommending $1.1 million fine)[attached to AT&T Offer of Supplemental Authority].

[95] *Brief of AT&T Regarding Public Interest* at pp. 12-15.

[96] *Qwest Track A/Public Interest Brief* at pp. 44-46.

intercarrier access charge scheme? Perhaps, but that does not automatically lead to the conclusion that competitors will be squeezed from the market. Rather, their profit margins may be lower, but this can be negated through bundled offerings, superior quality of service, and innovative offerings, all of which result in welfare maximization.

c. Nevertheless, I concede that above-cost intrastate access rates may be a possible means to raise a rival's costs. Raising a rival's cost is a recognized anticompetitive action. However, in this instance, it is the regulators' action that is raising AT&T and other CLECs costs by establishing above-cost intrastate access rates. Qwest, therefore, should not be denied § 271 entry because Commission-set intrastate access rates end up raising its rivals costs.

d. As AT&T appreciates, the Commission has opened Docket No. 00I-494T to examine all forms of intercarrier compensation, which will resume in full after the conclusion of this proceeding. AT&T encourages the Commission to complete this docket before § 271 approval is granted. As the FCC has recognized, and as a general matter, Congress enacted § 272 and requires a separate affiliate because it "anticipated that some Bell Operating Companies ('BOCs') would obtain authorization under 47 U.S.C. § 271 to originate in-region long distance services before the completion of access charge reform . . .

[T]hose structural and non-discrimination requirements provide adequate safeguards against any effort by an incumbent to obtain an unfair competitive advantage in the long-distance market by discriminating against unaffiliated IXCs or by improperly allocating costs or assets between itself and its long-distance affiliate."[97]

e. I am not convinced by the evidence presented here that immediate intercarrier access charge reform is necessary under the public interest test, let alone § 271. I add that, once this Commission is free from the resource-consuming process of § 271, it will expeditiously take up the intercarrier compensation reform docket.[98] I note that the Commission's preliminary areas of inquiry in that docket indicate that access rates will be going down.

7. Structural Separation

a. AT&T advocates structural separation of Qwest's wholesale and retail operations because "[t]here is a clear, fundamental conflict of interest between Qwest's relationship with its retail customers, on the one hand, and its relationship with its wholesale customers on the other."[99]

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[97] Supplemental Order Clarification, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 15 FCC Rcd 9587 ¶¶ 19-20 (2000).

[98] Indeed, the current procedural schedule for the intercarrier compensation docket has its resumption tied to the completion of § 271.

[99] *Brief of AT&T Regarding Public Interest* at 25.

Through its workshop testimony, WorldCom also promotes structural separation. Public comments were also filed which supported structural separation "for the protection of the People of the State of Colorado."[100] Qwest argues that there is no statutory authority allowing forced structural separation, and that neither the FCC nor any state has required it.

b. The question to be asked is whether structural separation of Qwest's wholesale and retail operations is required for Qwest to meet the public interest test. There is an easy legal, and a more difficult policy, answer to this question.

c. Structural Separation Is Not a Legal Requirement of § 271

The easy answer is that structural separation has never been required by the FCC for a grant of § 271 authority. Because it has never been required, neither shall the Colorado Commission require it. The existence of § 272 structural requirements belie that broader structural separation of the ILECs is a legal requirement. Thus, the structural separation issue is disposed as a matter of law.

d. Before Structural Separation is Required as a Policy Matter, a Much More Extensive and Complete Record is Required

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[100] *Public Comments* at 2.

(1) The more difficult answer is also the more interesting one. I will take time to consider it as well. This involves a discussion of structural separation on the policy merits. I do not -- indeed, cannot -- dismiss arguments for structural separation out of hand.

(2) Structural separation divides the incumbent local exchange carrier into two parts, a retail and a wholesale firm. As with the price squeeze scenario described above, structural separation is aimed at a firm that is active in two levels of the same industry, supplying inputs from the first level to competitors that are active only at the second level. Here, structural separation would entail dividing Qwest into a wholesale firm that would remain regulated under traditional administrative regulatory modes; and creating a retail firm for Qwest that would compete on the retail level with other CLECs at arms-length parity from the wholesale firm.

(3) WorldCom witness Mr. Levis advocates structural separation to mitigate Qwest market power as superior to the regulatory approach used to date under the Act.[101] Mr. Levis cites the AT&T divestiture under the Modification of Final Judgment as an instance of successful structural remediation.[102]

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[101] Direct Testimony of William Levis at pp. 64-69.

[102] *Id.* at 66.

He continues that a structural division of Qwest into separate retail and wholesale units will more quickly bring competition to the local exchange market.[103]

(4) AT&T witness Ms. Rasher also advocates structural separation, in part because of the failure to date of behavioral administrative regulation.[104] She claims that the incentives for anticompetitive behavior by a vertically integrated ILEC operating at both the wholesale and retail level are just too strong for a regulator to police, and that a structural remedy would guarantee competitive parity.[105] She thus advocates the Commission to order full economic separation of Qwest into wholesale and retail arms.[106]

(5) While this is the theory and policy impetus for structural separation, AT&T and WorldCom do not even begin to provide the factual record that would justify the structural remedy they advocate. Indeed, there is a fundamental lack of seriousness in the way AT&T and WorldCom offer this remedy. In part, that could reflect that the proposal is a legal non-starter. In part, it could be part of the "let's throw everything against the wall and see what sticks" pleading that public interest inquiries can devolve into. Nevertheless,

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[103] *Id.* at 72-74.

[104] Rasher affidavit at ¶¶ 93-94.

[105] *Id.* at ¶¶ 93, 104-105.

because the issue pops up frequently in current policy debates, I do think it is important to set forth the factual record that would be required to even consider structural separation.

(6) Before a case for structural separation could be made out, a party would have to establish, at least, the following: 1) the relevant market for evaluating the market power of the firm to be divided; 2) that the benefits of the structural separation do not exceed the costs; and, 3) that other remedies or courses of policy are not preferable to separation. To conclude that structural separation is warranted, the firm would have to have market power, the benefits of separation would have to exceed the costs, and other remedies would have to be proven inferior to separation.

(7) Market Power and Relevant Market

(a) AT&T and WorldCom take it as a given that the relevant market for evaluation of Qwest's market power is its control over the historically regulated, legacy monopoly public switched telephone network (PSTN). It is by no means clear that this is indeed the relevant market. At the very least, evidence that the PSTN is the relevant market where Qwest has market power would need to be introduced into this record. There is no such evidence in the record.

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[106] *Id.* at ¶ 109.

(b) Mr. Levis points out that the Colorado Commission prescribes that the "relevant market . . . is determined by service and geographic substitutability on both the demand and supply sides of the market."[107] Once the relevant market is determined, market power can be assessed. Antitrust likewise provides help when defining the relevant market, which includes "all products 'reasonably interchangeable by consumers for the same purposes.'"[108] In evaluating and approving the merger between McCaw Cellular and AT&T, the FCC adopted the following analysis for defining the relevant market under the public interest standard:

> The relevant product market is the "line of commerce" within which there is interchangeability of use between a service or product and a reasonable substitute for it, given consideration of price, use, and quality. The relevant "geographic market" is the area in which buyers can practically turn for alternative sources of supply, or in which there are sellers who act to restrain the prices charged to those buyers.[109]

The D.C. Circuit affirmed "public interest" approval of the merger, ratifying the FCC's use of supply substitutability in arriving at its market definition.[110]

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[107] Levis testimony at p. 10, *citing,* 4 Colorado Code of Regulations 723-30-2.24(a).

[108] *United States v. Microsoft Corp.,* 253 F.3d 34, 52 (D.C. Cir. 2001), *citing, United States v. E.I. DuPont de Nemours & Co.*, 351 U.S. 377, 395 (1956)

[109] *In re Applications of Craig O. McCaw, Transferor, and AT&T American Telephone and Telegraph Co., Transferee,* Memorandum Opinion and Order, 9 FCC Rcd. 5836 at ¶. 10 (Sept. 19, 1994) (citations omitted).

[110] *See SBC Communications, Inc. v. F.C.C.,* 56 F.3d 1484 (D.C. Cir. 1995). The irony of the ILECs and AT&T reversing their views on separation should not be lost here.

(c) Another caution in assessing market power is the dynamism of the relevant market. In *SBC,* the D.C. Circuit affirmed the FCC's approval of the McCaw/AT&T merger, in part, because of impending competition from just-then-arriving PCS communications services.[111] Likewise, the *Microsoft* court noted that the dynamism of a given market might shift the relevant market for market power analysis before the regulator has time to regulate it.[112]

(d) In this record, there is no attempt to define the relevant market. There is no consideration of substitutes for the PSTN, such as cable telephony, wireless or other potential platforms that could timely enter the market in the short run. Only if Qwest has market power in the relevant market -- which would have to be established -- would structural separation be warranted.[113]

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[111] *Id.* at 1492, *citing, In re Applications of Craig O. McCaw, Transferor, and AT&T American Telephone and Telegraph Co., Transferee,* Memorandum Opinion and Order, 9 FCC Rcd. 5836 at ¶¶ 39-41 (Sept. 19, 1994).

[112] *U.S. v. Microsoft Corp.,* 253 F.3d 34, 49-50 (D.C. Cir. 2001): In technologically dynamic markets, however, such entrenchment may be temporary, because innovation may alter the field altogether. *See* Joseph A. Schumpeter*, Capitalism, Socialism and Democracy* 81-90 (Harper Perennial 1976) (1942). Rapid technological change leads to markets in which "firms compete through innovation for temporary market dominance, from which they may be displaced by the next wave of product advancements." [Howard A. Shelanski & J. Gregory Sidak, *Antitrust Divestiture in Network Industries,* 68 U.Chi.L.Rev. 1, 11-12 (2001)][full citation](discussing Schumpeterian competition, which proceeds "sequentially over time rather than simultaneously across a market"). Microsoft argues that the operating system market is just such a market.

[113] Again, I am setting aside any legal requirements for unbundling and separation required by the Act or the FCC's implementing regulations. Because the remedy is offered in such a fanciful, legally unmoored manner, I likewise indulge in

(e) If Qwest does possess market power; which is to say, the relevant market definition remains the PSTN, then the next question can be explored: the respective costs and benefits of separation.

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discussing this as a pure policy matter, separate and apart from legal authority actually to require it.

(8) Costs and Benefits of Separation

(a) On the benefits side of separation, certain anticompetitive incentives that Qwest now faces would be eliminated.[114] Structural separation should obviate a number of the current struggles of conduct regulation: issues of price squeezes, predation, cross-subsidization, discrimination, and control of quality and quantity of services supplied to competitors. If wholesale Qwest had to deal at arms-length with all retail CLECs, including retail Qwest, then the issues should revert to traditional bilateral contract

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[114] Shelanski & Sidak, in their analysis of the Microsoft structural remedy, suggest the following analysis:

> To determine whether a remedy is likely to benefit consumers and long-run economic welfare, the remedy must be shown to produce a net increase in the sum of three kinds of efficiency: allocative, productive, and dynamic. To justify a specific remedy, it does not suffice to show merely that the remedy would reduce prices in the short run or create market opportunities for a particular group of competitors. A case must instead be made that price declines will offset any production cost increases or losses in consumer-side network externalities; that the net gain from such price reductions will not entail offsetting costs in the form of inefficiently reduced innovation incentives; and that the remaining net gains cannot be achieved at a lower cost through an alternative remedial plan.

Howard A. Shelanski & J. Gregory Sidak, *Antitrust Divestiture in Network Industries,* 68 U.Chi.L.Rev. 1, 99 (2001).

problems between wholesale Qwest and a retailer.[115]

(b) The costs of separation, however, would appear to be substantial. By ordering separation, the regulator would be contradicting the very nature of the firm:

> The reasons businesses conduct a number of operations under the umbrella of a single financially affiliated entity, rather than through market transactions, is, in a fundamental sense, the belief that subjection of these several operations to unitary managerial control permits the achievement of savings of transactions costs, as well as avoiding the uncertainties of trying to achieve the requisite coordination by purchases and sales in the market.[116]

While mere unbundling also interferes with optimal integration of the firm, structural separation takes it to the next level. The economies of scale and, especially, scope that Qwest now enjoys would be destroyed by structural separation. The cost of these efficiency losses would need to be predicted before imposing structural separation.

(c) There is reason to believe that

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[115] Economist Robert Crandall doubts the efficacy of structural remedies altogether. For instance, he concludes that an equal access regime for long distance competition would have been just as effective as divestiture of AT&T, without the enormous costs. Crandall compares competitive interexchange carrier market penetration in Canada and the U.S. In both countries, the market penetration over the same time span is about the same, but Canada merely imposed an equal access requirement on its incumbent, Bell Canada; whereas the U.S. required divestiture and equal access with AT&T. Robert W. Crandall, *The Failure of Structural Remedies In Sherman Act Monopolization Cases,* 80 Oregon L. Rev. 109, 182-190 (2001).

[116] Alfred E. Kahn, *Letting Go: Deregulating the Process of Deregulation,* p. 45 (MSU 1998), *citing,* Ronald Coase, *The Nature of the Firm*, 4 Economica 386-405 (1937); Oliver Williamson, *Transaction Cost Economics: The Governance of Contractual Relations*, 22 J.L. & Econ. 233-261 (1979).

separation would impose enormous costs on Qwest and, ultimately, consumers. If Qwest were to be separated into wholesale and retail divisions new facilities, computer systems and software interfaces, management, and properly trained employees would be required, just to name a few. The economies of scale inherent in Qwest's integrated corporate structure would be torn apart, and new costs would be created that would then be internalized by the separate entities. Integrated Qwest, potentially, the most potent competitor in the market, would be eliminated from the market. Those costs would then be passed along to consumers and CLECs in the form of higher rates and inflated UNE prices.[117] CLECs would not be required to lease access from the wholesale division, of course, if they could find alternative forms of network access or build their own facilities for greater returns on investment. There is no serious consideration of these costs in the record.

(d) Qwest points out that the FCC considered such cost issues through the course of the Computer Inquiries, concluding in *Computer III* that the structural separation requirements for enhanced service providers (ESPs)

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[117] The Eastern Management Group estimated that the new costs created by these "diseconomies of scale" would add four percent to the overall cost of running the business, which would add $5 - $10 per month to each consumer's phone bill. *Structural Separation Testimony of John Malone,* Eastern Management Group, Presented to the New Jersey Board of Public Utilities at 2 (Aug. 13, 2001)(available at www.EasternManagement.com).

imposed by *Computer II* were too cumbersome. The FCC premised its elimination of structural safeguards from *Computer II* on the costs and lost innovation from structural separation compared to nonstructural safeguards:

> for the provision of enhanced services, the costs from the structural separation requirements in lost innovation and inefficiency render these requirements far less desirable than nonstructural safeguards.[118]

Computer III is by no means dispositive of the merits of structural separation here. However, it does indicate an evolution in the FCC's thinking from *Computer II* to *Computer III* about the costs of structural separation.

(e) While the productive and allocative consequences must be considered, a harder question is structural separation's effects on dynamic efficiency.[119] Wholesale Qwest would presumably still be regulated as a monopolist in traditional rate-of-return or price cap plans. These modes of regulation have traditionally been criticized as inhibiting innovation and dynamism. With other structurally

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[118] In the Matters of: Amendment of Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry); and Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Thereof Communications Protocols under Section 64.702 of the Commission's Rules and Regulations, Report and Order, 104 F.C.C.2d 958 at ¶ 98 (June 16, 1986) (subsequent history omitted).

[119] Query as to why CLECs would be willing promote full structural separation they continuously pine about Qwest's quality of service. There are two possible answers, both of which may ultimately be correct. One, the quality of service isn't as poor as CLECs would try to have me believe, or two, this proposal is nothing more than a thinly-veiled attempt to create an arbitrage opportunity by raising Qwest's cost of business to the point where further CLEC market penetration becomes possible.

separated industries, say gas and electric transmission, the technological dynamism in the regulated monopoly market is minimal. For instance, gas pipeline and electric transmission lines are not undergoing grand cost and technological changes. By contrast, technological change is occurring rapidly in telecommunications. Fiber optics, digital, optical and packet switching, broadband technologies, wireless and fixed wireless offerings, and Moore's law operating on the information systems -- all of these technological dynamics are transforming telecommunications. The innovation incentives left for "wholesale Qwest" would have to be dealt with before structural separation could be justified.

(f) Two final costs that would need to be dealt with in a record to establish structural separation are administrative and error costs. It is by no means clear that the administrative costs of structural separation will be any less than the current costs of behavioral regulation. Indeed, imagine the foregoing § 272 issues, audits, allegations, counter-allegations, and struggles magnified hundredfold. Enforcement of the MFJ in the AT&T divestiture was hardly an elegant, cost-free undertaking.[120] The *Microsoft* court also

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[120] *See* Shelanski & Sidak, 68 U.Chi.L.Rev. at 54-55: "the administrative realities of the AT&T case refute the proposition that structural remedies are necessarily more practicable than conduct remedies." *See also, id. at 90-95.*

expressed hesitation at the ability to divest a previously integrated company:

> One apparent reason why courts have not ordered the dissolution of unitary companies is logistical difficulty. As the court explained in *United States v. Alcoa*, 91 F.Supp. 333, 416 (S.D.N.Y. 1950), a "corporation, designed to operate effectively as a single entity, cannot readily be dismembered of parts of its various operations without a marked loss of efficiency." A corporation that has expanded by acquiring its competitors often has preexisting internal lines of division along which it may more easily be split than a corporation that has expanded from natural growth.[121]

(g) In addition, the error costs of mistakenly imposing structural separation on Qwest need to be considered. The analysis of the relevant market, the level of technological dynamism that could cause the market to shift, assumptions of the costs of administration, the welfare losses from denying an integrated Qwest the economies of scope and scale that caused it to integrate vertically in the first place, and the benefits of intra-platform PSTN retail competition: all of these are predictive judgments. Predictive judgments can be notoriously wrong, and the welfare effects of restructuring an industry can be enormous. To get the remedy wrong as a regulatory matter would be much more long-lasting and difficult to correct than to attempt less dramatic remedies, or to put up with the current contentious regime of conduct regulation.[122]

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[121] *Id.* at 106.

[122] *See* Frank Easterbook, *The Limits of Antitrust*, 63 Texas L. Rev. 1, 15 (1984).

(h) Assuming the record can establish that the benefits of structural separation will outweigh the costs, a final question must be answered about whether there are other, more preferable remedies.

(9) Other remedies

The implicit premise in AT&T and WorldCom's structural separation case is that the local loop is a natural monopoly; that is, the most efficient way to provide local phone service is by delivery through a single firm.[123] If this is true, at least, for, say the provision of residential service, then the question is: why not revert to regulating it as an integrated, single-firm monopoly? While there are certainly unattractive aspects to traditional monopoly regulation, it is by no means clear that the transaction, regulatory and administrative costs from separation would be outweighed by the consumer welfare gains from intra-platform competition on the PSTN. Voice telephony is a commodity service and the innovation and price competition consumers would receive for retail PSTN competition seems limited. Structural separation advocates would have to establish the superiority of multi-firm retail competition over monopoly regulation before

[123] I will make this assumption simple with the blanket statement that all segments of the local service market are a natural monopoly, even though this is clearly not the case.

the structural remedy could be justified.

e. Conclusion

(1) Structural separation is, without a drastic showing of necessity that is entirely absent here, an affront to welfare maximization and the nature of a firm.[124] I do not think that the case for structural separation is impossible. When you contrast the hesitation of antitrust courts to impose structural remedies[125] with the promiscuous advocacy for structural separation in the regulatory arena, it becomes clear that one arena has altogether lost its rigor in thinking about structural remedies. And it is not the antitrust courts.

(2) In conclusion, structural separation cannot even begin to be considered on this record. As the D.C. Circuit noted about proposed structural remedies urged by BellSouth onto the McCaw Cellular/AT&T merger:

> [t]he conditions proposed by BellSouth, like Bellsouth's arguments generally, seem to be rooted in a mistaken belief that the [FCC] should protect competitors at the expense of consumers.[126]

Likewise, here, structural separation arguments are never tied to consumer welfare enhancement, but rather usually come with

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[124] "A totally unbundled world . . . is a world in which competitors would have little, if anything, to compete about." *AT&T v. Iowa Utilities Bd.,* 119 S. Ct. 721, 754 (1999)(Breyer, J., concurring in part and dissenting in part).

[125] *See, e.g., U.S. v. Microsoft* 253 F.3d at 106.

[126] *SBC,* 56 F.3d at 1492, citing, *Hawaiian Telephone Co. v. FCC,* 498 F.2d 771, 776 (D.C.Cir.1974)("relative competitive positions of ... carriers ... is of little relevance in determining whether the public interest test is satisfied").

the vague whiff of a strategy to raise a rival's costs.

8. CLEC Failures

a. AT&T says that the prospects for UNE-based facilities-based competition in the residential market are poor because, in part, market conditions and a wave of CLEC bankruptcies threaten further CLEC market penetration in the local market.[127] AT&T notes that SBC Communications has closed many of its offices in Qwest's region, including Denver, as further proof of Qwest's market dominance. Qwest cites a multitude of reasons for CLEC troubles in the capital market beyond Qwest's control, including misdirected business plans, an overall economic slowdown (to which, I would point out, Qwest has not been immune),[128] inexperienced management, too many competitors with the same business plan vying for the same market, and unmanaged growth.[129]

b. The FCC recently has considered parallel arguments in its public interest analysis of Verizon's application in Rhode Island. Because I concur *in toto* with the FCC's analysis, I hereby incorporate and conclude this section with its pronouncement:

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[127] *Brief of AT&T Regarding Public Interest* at 9.

[128] For instance, between May 1, 2001 and November 1, 2001, Qwest's stock price and market capitalization declined 68 percent. Stratecast Partners, Assessment of Qwest Communications International, Inc.: State of the Business (available at http://www.stratecast.com/pdf/cos_3-05_toc.pdf).

[129] *Qwest Track A/Public Interest Brief* at 60.

> Sprint also argues that the fact that the BOCs have chosen generally not to compete against each other out of region (particularly against Verizon in Rhode Island) and the continuing bankruptcy of competitive LECs mean that the public interest is not served by granting Verizon section 271 approval in Rhode Island. We reject these arguments. Factors beyond the control of the applicant, such as a weak economy, individual competing LEC and out-of-region business plans, or poor business planning by potential competitors can explain the lack of entry into a competitive market. (Citations omitted).[130]

IV. TRACK A

A. Qwest must also satisfy the requirements of either § 271(c)(1)(A)(Track A) or § 271(c)(1)(B)(Track B).[131] The FCC has recently stated that, in order to qualify for Track A, "a BOC must have interconnection agreements with one or more competing providers of 'telephone exchange service . . . to residential and business subscribers.'"[132]

B. The Staff Volume VII Report and Qwest have addressed the Track A requirement along the four major inquiries enumerated by the FCC in the *Ameritech Michigan Order*:[133]

> (1) whether Qwest has one or more binding agreements with CLECs that have been approved under section 252 of the 1996 Act;
>
> (2) whether Qwest is providing access and interconnection to unaffiliated competing providers of telephone exchange service;

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[130] *Verizon Rhode Island Order* at ¶ 106.

[131] 47 U.S.C. § 271(d)(3)(A).

[132] *SBC Arkansas/Missouri Order* at ¶ 117.

[133] *Ameritech Michigan Order* at ¶¶ 62-104 (1997).

(3) whether there are unaffiliated competing providers of telephone exchange service to residential and business customers; and

(4) whether the unaffiliated competing providers offer telephone exchange service exclusively over their own telephone exchange service facilities or predominantly over their own telephone exchange service facilities in combination with the resale of the telecommunications services of another carrier.

C. Binding Interconnection Agreements

The record demonstrates that Qwest has entered into a number of binding interconnection agreements under § 252 of the 1996 Telecommunications Act. As of March 31, 2001, Qwest had entered into 64 binding and approved wireline interconnection agreements in Colorado.[134] No party has disputed the evidence submitted by Qwest with regard to the first prong of 47 U.S.C. § 271(c)(1)(A).

D. Access and Interconnection to Competitors

Satisfaction of this element of Track A does not impose geographic range, order volume number, or market share requirements.[135] Qwest presented evidence that it served an estimated 310,000 CLEC access lines as of March 2001.[136] No other party has contested the fact that Qwest is providing access and

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[134] *Qwest Track A/Public Interest Brief* at 5.

[135] *See Ameritech Michigan Order* at ¶¶ 76-77.

[136] *Qwest Track A/Public Interest Brief* at 9. "In all, as of March 2001, Qwest had leased 103,270 unbundled loops to CLECs in Colorado, and Colorado CLECs served an estimated 207,511 access lines through full facilities bypass on that date, for a total of 310,781 CLEC access lines relevant for purposes of Track A." *Id.*

interconnection to unaffiliated competing providers of telephone exchange service. Qwest satisfies this prong of § 271(c)(1)(A).

E. Competitors in the Residential and Business Markets

1. This element of the Track A test addresses whether CLECs *collectively* serve residential and business customers within the state.[137] To satisfy this prong of the test, Qwest must show that a competing carrier serves more than a *de minimis* number of end users. Although the FCC has not adopted a bright-line rule for the number of end users served by CLECs, the recent *SBC Arkansas-Missouri Order* sheds some light on the number of residential end users required to overcome the *de minimis* threshold:

> Although commenters dispute the exact number of residential customers served by carriers in Arkansas, we conclude that a sufficient number of residential customers are being served by ALLTEL through the use of their own facilities. SWBT has shown that ALLTEL serves more than a *de minimis* number of customers to qualify ALLTEL as a "competing provider" – several thousand according to the Arkansas Commission – and no commenter has challenged SWBT's claim regarding the number of customers served by ALLTEL.[138]

2. Qwest has presented survey evidence that demonstrates that major competitive exchange carriers are providing facilities-based (including UNE-based) access to end-users, in some cases using a combination of their own facilities

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[137] *Ameritech Michigan Order* at ¶ 82. The relevant question is *not* whether any single carrier is serving both groups. *Id.*

[138] *SBC Arkansas/Missouri Order* at ¶ 118.

and UNEs leased from Qwest.[139] Qwest also has presented survey evidence which shows that there are other facilities-based competitive exchange carriers operating in Colorado, such as XO Communications, Time Warner Telecom, Allegiance Telecom, and Eschelon Telecom. Allegiance Telecom, for example, is a facilities-based integrated communications provider that offers small to medium-sized business customers a suite of telecommunications services, including local, long distance, and Internet services.[140] Allegiance operates in the Denver area, where it has a switch and a fiber ring in operation.[141] Another competitive carrier cited by Qwest is Eschelon Telecom. Eschelon provides voice, Internet, and data services to small and medium business, including T-1 services over its own network.[142]

3. Qwest further submits that, as of July 9, 2001, there were 103,270 unbundled loops in Colorado served by 24 CLECs.[143] Because it cannot glean accurate residential and

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[139] *Qwest Track A/Public Interest Brief* at 9; *See also Confidential Qwest Track A/Public Interest Brief* at pp. 9-17.

[140] "Investor Relations," March 2, 2002 (available at http://www.algx.com/investor_relations/index.jsp).

[141] "Allegiance Telecom Announces Solid Fourth Quarter and Year-End Results with Annual Revenue Growth of Over 80 Percent," February 19, 2002 (available at http://www.algx.com/about_allegiance/in_the_news/4q01_results.jsp).

[142] "Products for Colorado," March 2, 2002 (available at http://www.eschelon.com/products/voicet1.asp?state=CO).

[143] *Qwest Track A/Public Interest Brief* at 20.

business line figures from incomplete data responses from CLECs or public records, Qwest has estimated the number of CLEC facilities bypass lines based on the number ported from Qwest to CLECs, which is then divided in half, minus the number of stand-alone unbundled loops Qwest provisions to CLEC switches.[144] Assuming that 90 percent of these access lines are dedicated to business customers and 10 percent to residential customers, Qwest preliminarily concludes that there are 12,857 CLEC residential facilities bypass lines in Colorado.[145]

4. Due to the supposition that this number is well below estimates of residential CLEC service in publicly available reports and incomplete data responses from the CLECs which are parties to this proceeding and subject to discovery, Qwest then "adds back" the number of residential white page listings in service as of March, 2001, and estimates that there were 78,941 residential facilities bypass lines and 128,570 business facilities bypass lines.[146] Qwest points out that this methodology results in a figure far below that which would result if the methodology that was used by SBC in Texas, Kansas,

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[144] *Id.* at pp. 22-23.

[145] *Id.* at pp. 23-24.

[146] Qwest bumps up the number of bypassed business lines the original 10% "to compensate for similar undercounting in those numbers." *Id.* at pp. 24-25, *citing* Kris Hudson, "AT&T Counts Cable Phones: 20,000 Signed Up with Broadband in 170 Days of Service," *Rocky Mountain News,* May 20, 2000, at 3B; Dan Caulk, "AT&T Corp.'s 1st-Quarter Earnings Down but Still Within Projections," *Rocky Mountain News*, Apr. 25, 2001, at 4B. *See also Confidential Qwest Track A/Public Interest Brief* at pp. 9-17.

and Oklahoma were employed. This methodology, which the FCC accepted, multiplies the number of interconnection trunks obtained by CLECs by 2.75 in order to reach a total number of bypass lines in service.[147] In Colorado, the SBC methodology would result in an estimated total of 496,994 competitive bypass lines -- Qwest's methodology results in a total estimated number of 207,511.

5. Finally, Qwest presents its estimate of CLEC market share (i.e., unbundled loops, resale, and bypass lines) as a proportion of total access lines in Colorado.[148] Under Qwest's methodology, CLEC entry is estimated at 11.5 percent of all access lines in Colorado. Under the SBC methodology, this estimate balloons to 19.2 percent. Qwest then compares these figures to states where FCC approval has been granted under the SBC methodology, such as Kansas (at an estimated 9.0 to 12.6 percent at the time of § 271 approval) and Oklahoma (at an estimated 5.5 to 9.0 percent at the time of § 271 approval).[149]

6. AT&T argues that there is no statistical basis for accepting the linkage between number porting and bypass lines and, furthermore, Qwest has adopted a methodology in Colorado that differs from that presented in the multistate

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[147] *Id.* at 25-26.

[148] *Id.* at 32-33.

[149] *Id.*

proceedings and Washington.[150] For example, Qwest has not "added back" residential white page listings in those states, but has done so here. With particular regard to residential competition, AT&T also said that the figures presented by Qwest "do not pass the straight-face test in supporting the notion that the local exchange market in Colorado is open to competition."

7. First, it should be noted that Qwest has direct information about the number of loops that are secured by CLECs through UNEs. While "fuzzy math" might best describe the methodology employed by Qwest in its estimation of bypass lines, such an approach is inevitable given the constraints on the discovery process in this docket and the scarcity of public information about the state of competition in Colorado. Qwest's approach is certainly more reasonable on its face than the SBC methodology which, it should be emphasized, results in a larger estimate of CLEC competition and has been accepted by the FCC in the past.

8. With regard to bypass lines, Qwest's decision to use ported numbers as its estimation base is acceptable. As Qwest points out, numbers are ported when a CLEC provides services to an end user over its own network, or when a CLEC

[150] *Brief of AT&T Regarding Public Interest* at pp. 3-5.

provisions service to an end user over a stand-alone UNE loop that is connected to the CLECs switch. There is a rational relation between ported numbers and access lines served by CLECs, and Qwest's decision to reduce the total amount of ported numbers by half provides comfort that it is not inflating these figures. No CLEC presented evidence that would require closer scrutiny of this presumption, other than a very general objection from AT&T.

9. AT&T's argument that Qwest has diverged from the methodology it has employed in other jurisdictions would be more compelling if Qwest had not presented evidence to show that an upward revision to its estimates were logical. Through its data requests to CLECs participating in this docket and evidence from public records, Qwest has made an independent showing that there is a rational basis to "add back" residential white page listings in its estimate of residential end users. Using either its own methodology or that which was employed by SBC, Qwest has shown that competition exists in Colorado at levels that compare to, if not exceed, those in Kansas and Oklahoma at the time of FCC approval. As the Multistate Facilitator has stated, "had the Qwest formula produced results that stray far from actual

circumstances, it would seem unusual that none of the CLECs here responded with evidence of their own."[151]

10. Finally, AT&T's complaint about the state of competition in the residential market must be addressed. As the FCC has recognized in previous § 271 orders, factors beyond the control of Qwest, such as individual CLEC entry strategies, might explain a low residential customer base.[152] There is a big difference between having a "strangle hold on the residential market"[153] and business strategies that avoid the residential market in favor of higher profit margins in the business market. That difference is attributable to rational economic behavior.[154] I would note that lower UNE prices adopted in the pricing docket may also encourage CLECs to become more active in the residential market.

11. Qwest's invitation for the Commission to serve data requests on CLECs is welcome but unwarranted. I conclude

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[151] The Liberty Consulting Group, *General Terms and Conditions, Section 272 & Track A Report* at 80 (Sept. 21, 2001).

[152] *Verizon Rhode Island Order* at ¶ 104.

[153] *AT&T Brief Regarding Public Interest* at 5.

[154] "Why is it, you ask, that CLECs will sell services to business customers and turn down an opportunity to sell to a vastly larger base of residence customers. Bear in mind that in the U.S., there are 10 residences for every business. The answer is simple economics. Business customers spend more money for communications than do residence customers. CLECs describe an ideal customer as a business with between 10 and 100 employees. CLECs refer to businesses of this size as the 'sweet spot.' When translated into dollars of communications expenditure, these businesses expend in the range of $1,000 - $10,000 each month for phone service. Meanwhile, an average residence consumer will spend less than $50 a month for phone service, with the real number closer to $20." Structural Separation Testimony of John Malone, The Eastern Management Group, Presented to the New Jersey Board of Public Utilities (Aug. 13, 2001)(available at www.EasternManagement.com).

that a sufficient number of residential and business customers are being served by CLECs either through the use of their own facilities or in combination with UNEs to demonstrate that there is an actual commercial alternative in Colorado. Qwest has shown that facilities-based carriers serve more than a *de minimis* number of residential and business customers in Colorado.

F. Competitors Offering Service Exclusively or Predominantly Over Their Own Facilities:

The fourth element of the Track A test requires that competitive providers offer telephone exchange service "either exclusively over their own telephone exchange service facilities or predominantly over their own telephone exchange service facilities in combination with the resale of the telecommunications services of another carrier."[155] As this element was addressed in the previous section, those conclusions apply with equal force here.

IV. A REMINDER

A. I take this opportunity to remind the parties of the scope of this order. This docket is not adjudicatory, but rather a special master/rulemaking hybrid. *See Procedural Order*, Decision No. R00-612-I at pp. 11-15. The ultimate authority over this application lies with the FCC, not the Commission.

[155] *Ameritech Michigan Order* at ¶ 99.

Accordingly, this Order does not have the traditional effect of compelling Qwest to undertake the ordered action. Rather, this order is hortatory.

B. Upon filing of an appropriate PAP, the hearing commissioner or the Commission as a whole, through a subsequent order, will find that Qwest has complied with the public interest test under § 271. Such a finding of compliance from the Colorado Commission would lead to a favorable recommendation to the FCC under 47 U.S.C. § 271(d)(2)(B).

C. Because this is not a final order of the hearing commissioner, nor a proceeding under the Commission's organic act or the Colorado Administrative Procedure Act, *see* C.R.S. §§ 40-2-101 *et seq.;* C.R.S. §§ 24-4-101 *et seq.*, participants in this docket do not have a right to file exceptions to this order or to ask for rehearing, reargument, or reconsideration. Likewise, this decision will not ripen into, or otherwise become, a final decision of the Commission subject to judicial review under the Commission's organic statute or Colorado law.

D. Nonetheless, should parties believe that the hearing commissioner has resolved any impasse issue based on a material misunderstanding of the law, the issue, or the factual record, they should move for modification of this Volume VII Impasse

Issue Resolution Order within seven days of its mailing date.[156] Any necessary response to a request to modify this order will be due five days after the motion to modify.

V. ORDER

A. The Commission ORDERS That:

1. Commission Staff Report Volume VII, along with this Order, establish that at this time Qwest does not meet the "public interest" requirements of 47 U.S.C. § 271(d)(3)(c). Upon the filing of a Performance Assurance Plan acceptable to this Commission, Qwest will be conditionally compliant with the public interest test. With a compliant Peformance Assurance Plan, the hearing commission recommends that the Colorado Commission certify compliance with the "public interest" test to the Federal Communications Commission.

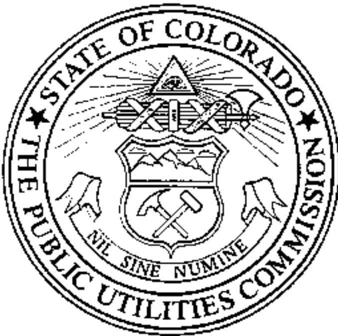
2. Commission Staff Report Volume VII, along with this Order, establish that Qwest is conditionally compliant with § 272 and "Track A," 47 U.S.C. § 271(c)(1)(A). The hearing commissioner recommends that the Colorado Commission certify compliance with the same to the Federal Communications Commission.

[156] Let this footnote reemphasize that participants should not use this procedure to seek modification of the impasse issue resolution to restate their arguments, as is often done with RRR. Rather, any motion to modify this impasse resolution order should be directed to the hopefully rare, but theoretically possible, instance where the hearing commissioner makes a material misunderstanding of fact or of the dispute itself.

3. Motions to modify this Decision shall be filed seven days from the mailing date on the Order. Responses to any motion shall be due five days after that. No extensions of time to file either motions or responses shall be granted if the motion for extension of time is filed on the day the pleadings are due, absent extraordinary circumstances.

B. This Order is effective immediately upon its Mailed Date.

(S E A L)



ATTEST: A TRUE COPY

Bruce N. Smith
Director

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

RAYMOND L. GIFFORD

Hearing Commissioner

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