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VIA E-MAIL

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FCC Enforcement Bureau
445 12th Street, S.W.
Washington, DC 20554

Re: In the Matter of the Merger of Qwest Communications International, Inc. and U S West Inc., CC Docket No. 99-272

Dear Maureen:

On behalf of AT&T Corp. ("AT&T"), I am submitting, in response to a request from the Commission Staff, the following comparison of the Qwest lit fiber capacity "IRU" with the *Verio/Qwest Capacity Service Agreement*,[1] AT&T's private line service agreements,[2] and the Frontier, GTE, and WorldCom IRUs.[3] As requested by the Staff,

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[1] Appended hereto as Attachment 1 is the public, redacted version of the Verio Agreement ("*Verio/Qwest Capacity Service Agreement*") discussed in the Comments of AT&T Corp. on the March 11, 2002 Audit, filed May 2, 2002, ("*AT&T's May 2, 2002 Comments*") at 10, n. 34, *citing to*, Verio Form S-1/A filed on May 8, 1998, Exhibit 10.25, http://www.sec.gov/ Archives/edgar/data/1040956/0000950134-98-003922.txt.

[2] Appended hereto as Attachment 2 is AT&T's Service Guide General Terms and Conditions which are incorporated by reference into AT&T's individual leased private line service agreements see, *AT&T's* website http://serviceguide.att.com/ABS/ext/Documents.cfm?DID=3000. Individual contracts entered into in the last 30 days can be found at AT&T's website, http://www.att.com:9001/ndcaict/ (click on "Custom Agreements"). Also appended

I have also set forth the relevant accounting standards for revenue recognition for private line service agreements and IRUs. As demonstrated below:

- The Qwest lit fiber capacity "IRUs" violate Section 271 and the *Qwest Merger Orders*;[4] they are in all material respects identical to private line service agreements and are materially different from the Frontier, GTE and WorldCom network IRUs;
- Under relevant accounting standards, Qwest had to treat its lit fiber capacity IRUs as services and accordingly recognize revenues over the life of the contract, rather than as a sale of a facility which would have permitted it to recognize revenues "up front."

Before setting forth the comparison of IRUs and service agreements, it is important to re-emphasize two key threshold points raised at our *ex parte* meeting:

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hereto as Attachments 3, 4 and 5 are three such contracts (Contract Nos. 06500, 00749 and 07853).

[3] Referred to in Qwest's October 18, 1999 Response to Comments on Application for Transfer of Control, Appendix C, filed in this proceeding ("*Qwest's October 19, 1999 Filing*") and *Touch America's Chart On Qwest IRU Agreements*, filed on June 14, 2002, ("*Touch America's June 14, 2002 Filing*") in *Touch America, Inc. v. Qwest, Communications International, Inc.,* File No. EB-02-MD-003 (Feb. 2002) ("*IRU formal complaint proceeding*") EB-02-MD-003. AT&T's discussion of the Frontier, GTE and WorldCom IRUs is constrained by the fact that while the parties to the formal complaint proceeding have access to those IRUs, AT&T does not. Commenters such as AT&T are in an untenable position. They are forced to comply with the restrictions of the formal complaint proceeding in this unrelated merger proceeding, but are not granted access to the confidential pleadings in the formal complaint proceeding.

[4] Memorandum Op. and Order, *Qwest Communications International Inc. and U S West, Inc. Applications for Transfer of Control of Domestic and International Sections 214 and 310 Authorizations and Application to Transfer Control of a Submarine Cable Landing License*, 15 FCC Rcd. 5376 (March 10, 2000) ("*March 10 Merger Order*"); Memorandum Op. and Order, *Qwest Communications International Inc. and U S West, Inc. Applications for Transfer of Control of Domestic and International Sections 214 and 310 Authorizations and Application to Transfer Control of a Submarine Cable Landing License*, 15 FCC Rcd 11909 (June 26, 2000) ("*June 26 Merger Order*") (collectively the "*Qwest Merger Orders*").

First, the ultimate issue before the Commission is whether Qwest's so-called IRUs violate the *Qwest Merger Orders* and Section 271. Therefore, the considerations relevant to both the comparison requested by the Commission and the requested accounting standards, are those related to the policies underlying the *Qwest Merger Orders* and Section 271 (considerations not applicable to the submarine cable or satellite decisions relied upon by Qwest): whether Qwest, through these "IRUs," is accumulating in-region long distance customers, effectively holding itself out as a provider of long distance service, and/or performing activities and functions that are typically performed by those who provide interLATA service to the public.[5] Thus, even if the Qwest arrangement could be classified as an IRU (which it cannot), that classification alone would not exempt an arrangement that otherwise violated the policies underlying the *Qwest Merger Orders* and Section 271.[6] In any event and as shown below, the Qwest lit fiber capacity "IRUs" constitute no more than the provision of in-region retail and wholesale interLATA private line voice and data services, in violation of the *express* terms of the *June 26 Merger Order*[7] and Section 271.

Second, Qwest's arguments regarding the extent of its disclosure of the "IRUs" in its filings[8] and the disputed *ex parte* meetings with the Commission,[9] its inconsistent

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5 *March 10 Merger Order* ¶ 13, *citing to*, Memorandum Op. and Order, *AT&T Corp. v. Ameritech Corp. et al.,* 13 FCC Rcd 21438 (1998) ("*Qwest Teaming Order*"), *aff'd sub nom., US WEST Communications, Inc. v. FCC*, 177 F.3d 1057 (D.C. Cir. 1999) ¶ 18.

6 Thus whether Qwest's lit fiber capacity "IRUs" are comparable, e.g., to AT&T's arrangements with Excite@Home is irrelevant since neither AT&T nor Excite@Home are subject to either the *June 26 Qwest Merger Order* or Section 271.

7 *June 26 Qwest Merger Order* ¶¶ 9, 13.

8 Limited to the UCAID IRU, discussed in *AT&T's May 2, 2002 Comments* at 21-22 and Exhibit II-D to the Qwest's Divestiture Compliance Report filed April 14, 2000, which, based on the publicly available disclosures made by Qwest in *IRU Chart and Analysis of Defendants Qwest Communications International Inc., Qwest Corporation, and Qwest Communications Corporation*, EB-02-MD-003 filed on

claims regarding the extent to which AT&T and other commenters addressed these disclosures,[10] and its insistence that the Commission had approved these arrangements as a result of its general approval of the divestiture -- despite Qwest's active concealment of the Touch America IRU[11] -- are ultimately irrelevant. The bottom line is that the Commission could not, through its approval of the merger, render lawful an agreement that otherwise violates Section 271.[12]

## I. Qwest's Lit Fiber Capacity "IRUs" Are In All Material Respects Similar to the Verio/Qwest Capacity Service Agreement and AT&T Private Line Agreements and Are Different from the Frontier/GTE/WorldCom Network IRUs

It is evident from a comparison of: (1) the Qwest lit fiber capacity "IRUs" at issue here, (2) the *Verio/Qwest Capacity Service Agreement*, (3) AT&T's private line service agreements, and (4) the Frontier, GTE, and WorldCom IRUs entered into in connection with the construction of Qwest's network,[13] that the Qwest lit fiber capacity "IRUs" are in

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June 28, 2002 in the *IRU formal complaint proceeding* at 6 ("*Qwest June 28, 2002 Filing*"), is materially different in that it involves the transfer of *ownership* of specific dark fiber presumably including concomitant rights to *control* the electronics and design and routing on that fiber.

[9] The discussion alleged to have occurred at a March 23, 2000 *ex parte* meeting was never documented, *See, Qwest's Answers to First and Second Set of Interrogatories,* filed on May 23, 2002 in the *IRU formal complaint proceeding*, ("*Qwest's Interrogatory Responses*") Response to Interrogatory No. 1 at 3. The second alleged discussion is the subject of conflicting affidavits, *See, AT&T's May 2, 2002 Comments* at 23, citing to, Declaration by Kenneth L. Williams ¶¶ 6-8, Exhibit B to Touch America's Reply filed in the *IRU formal complaint proceeding*.

[10] Qwest has taken conflicting positions on this. *Compare*, *Qwest's Interrogatory Responses*, Response to Interrogatory No. 1 at 5 (AT&T did not challenge Qwest's position) *with* Qwest's Brief on Legal Permissibility of Qwest's IRUs, filed in the *IRU formal complaint proceeding* on August 9, 2002, ("*Qwest's August 9, 2002 Brief*") at 8 (AT&T did challenge Qwest's position).

[11] *See, AT&T's May 2, 2002 Comments* at 24.

[12] *See, e.g., Petition of U S West Communications Inc for Relief from Barriers to Deployment of Advanced Telecommunications Services*, 13 FCC Rcd. 24,012 (1998), ¶ 73 (Commission cannot forbear from enforcing Section 271).

[13] *Qwest's October 19, 1999 Filing* at 5 and n. 3 (noting that "Qwest has no legal ability to unwind" these arrangements).

all material respects identical to private line service agreements and materially different from the Frontier, GTE and WorldCom network IRUs.

A. A Comparison of Private Line Service Agreements with the Qwest Lit Fiber Capacity "IRU" Demonstrates that those IRUs are Subject to Section 271.

As demonstrated in *AT&T's May 2, 2002 Comments*,[14] it is clear from Commission precedent under Section 271 (as well as precedent from other relevant areas of law relating to securities, bankruptcy and tax concerning the issue of whether an IRU involves a "sale" or merely a lease or a service) that the most relevant basis for comparison is whether there has been a transfer *of ownership and control* of an asset. Commission precedent also makes it clear that for purposes of avoiding Section 271, the transaction must involve the sale of an *entire network*.[15]

Qwest argued in the *IRU formal complaint proceeding* that the basis for comparison for purposes of Section 271 (or the *June 26 Qwest Merger Order*) is whether "Qwest conveys exclusive rights to use specific capacity or fiber between two specific geographic points" and whether those exclusive rights extend "for the entire economically

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[14] *AT&T's May 2, 2002 Comments* at 12-15 and 19-20.

[15] Second Order on Reconsideration, *Implementation of the Non-Accounting Safeguards of Section 271 and 272 of the Communications Act of 1934, As Amended*, 12 FCC Rcd. 8653 (1997) ("*Non-Accounting Safeguards Order*") ¶ 54 n.110 ("the one-time transfer of ownership and control of an *interLATA network* is not an interLATA service, which means it falls entirely outside the Section 271/272 framework that governs interLATA services") (emphasis added). *See generally*, *AT&T's May 2, 2002 Comments* at 12-15 and 19-20. Qwest, in its *August 9, 2002 Brief*, makes the absurd argument that any "transfer" will do, and that it need not be a sale (*id* at 10), ignoring the words "of ownership and control" which immediately follow and limit the types of transfers which will qualify. As shown by *AT&T's May 2, 2002 Comments*, Qwest's IRUs expressly retained, and did not transfer, any ownership or control. (*Id* at 9-10). Qwest makes the additional absurd argument that a capacity arrangement between two fixed points is "the epitome of a network." (*Qwest's August 9, 2002 Brief* at 11). This argument would sweep in all private line service agreements – a conclusion that would be contrary to the Commission's express prohibition of such services in its *June 26 Qwest Merger Order* ¶¶ 9, 13.

useful life."[16] Qwest's argument lacks merit. First, the Commission has held that "exclusive rights to use" *leased capacity* constitutes the provisioning of a "telecommunications service" prohibited by of Section 271.[17] Moreover, the federal district court in *Global Naps, Inc. v. New England Telephone & Telegraph* recently held that the same is true with respect to the exclusive lease of dark fiber.[18] Second, absent a *transfer of ownership and control*, the *duration* of an arrangement (and the residual rights remaining at the end of that period) is irrelevant for purposes of Section 271 (and as shown below for accounting purposes as well).[19]

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[16] *Qwest's August 9, 2002 Brief* at 2-3 and *Qwest June 28 2002 Filing* at 3.

[17] *Non-Accounting Safeguards Order* ¶ 54 n.110 (when "the BOCs seek to *maintain* ownership of their interLATA Official Services Networks and *lease* excess *capacity* on the networks to their affiliates," that "*leasing of capacity on an in-region interLATA network is plainly an in-region interLATA service*.") (emphasis added).

[18] 156 F. Supp.2d 72, 77-80 (D. Mass. 2001) ("leasing of dark fiber . . . [is] the provision of telecommunications service"). Qwest's asserts in its *August 9, 2002 Brief* (at 11-12, n. 13) that the Commission in *Non-Accounting Safeguards Order* and the federal district court in *Global Naps* "misspoke" because both relied on a pre-1996 decision, *Dark Fiber Order* [Memorandum Op. and Order, *Application of Authority Pursuant to Section 214 of the Communications Act of 1934 to Cease Providing Dark Fiber Service*, 8 FCC Rcd. 2589 (1993), *remanded on other grounds*, *Southwestern Bell Tel. Co. v. FCC,* 19 F.3d 1475 (D.C.Cir.1994)] which is irrelevant because the definition of "wire communications" from the pre-1996 version of the Act "is significantly different from" the 1996 Act's definition of "telecommunications." But as noted by the court in *Global Naps* the Commission in the *Non-Accounting Safeguards Order* expressly re-affirmed the *Dark Fiber Order* under the definition of "telecommunications" in the 1996 Act because holding that the leasing of dark fiber constituted the provisioning of a telecommunications *service* comported "with the logic of the Modified Final Judgment … which banned BOCs from providing 'interexchange telecommunications services,' comparable to interLATA services under the 1996 Act." *Id* at 80. *See, MCI Telecomms. Corp. v. BellSouth Telcomms.*, *Inc.*, 40 F.Supp.2d 416 (E.D. Ky. 1999); *MCI Telecomms. Corp. v. BellSouth Telcomms.*, *Inc.*, 7 F.Supp.2d 674, 679-80 (E.D. N.C. 1998) (dark fiber is a telecommunications service as defined in the 1996 Act).

[19] The holdings in the *Non-Accounting Safeguards Order* and the *Global Naps* decision that leases are subject to Section 271, are not qualified or limited in any way by the *duration* of the lease. Duration is similarly irrelevant for accounting purposes. *See,* Testimony Concerning Telecommunications Accounting Issues by John M. Morrissey, Deputy Chief Accountant, U.S. Securities and Exchange Commission, Before the Subcommittee on Oversight and Investigations Committee on Financial Services given

Under a proper basis of comparison, the Qwest "IRU" at issue here is virtually identical to the *Verio/Qwest Capacity Service Agreement* and AT&T private line agreements. Indeed, the *Verio/Qwest Capacity Service Agreement* provided Verio with greater control over design and routing than the Qwest IRUs.

Specifically:

- The *Qwest "IRU"* provides for the use of capacity (at OC-3, OC-12 or E-3 levels),[20] but "does *not* provide [the] Customer with any ownership or other possessory interests in any real property, conduit, fiber, or equipment in or on the Qwest Network or along the User Route of the Qwest Network;"[21] and expressly denies the Customer the right to control network service or configuration.[22] Qwest

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on March 21, 2002 at 3 ("SEC Global Crossing testimony") ("If the [capacity IRU] does not convey to the purchaser the right to use specific identifiable assets, the contract would be viewed as an arrangement for the provision of services, and revenue would be recognized over the period of the contract as the services (the access to the network capacity) are provided" regardless of duration).

The same is true under tax law, *see,* Frederick W. Quattlebaum, *Ventures on the High Seas: U.S. Federal Tax Treatment of a Sale of IRU Capacity*, 1192 PLI/Corp 583 (2000) (where an IRU conveys to the service *recipient* only a right to use an assigned amount of capacity while the service *provider* is responsible for maintenance, replacement and repair, and the service provider can utilize the underlying assets to provide services to entities unrelated to the service recipient, the IRU is likely to be a service agreement, regardless of duration), and bankruptcy law. *See, The Treatment of IRUs in Bankruptcy Proceedings*, 11 Journal of Bankruptcy Law and Practice, November/December 2001at 94-95 (noting that it would be "difficult for a bankruptcy court to see how the benefits, risks and burdens under [a prepaid lit fiber capacity IRU even for the useful life of the IRU] are similar to a sale and purchase" and that to avoid this problem "the rights and obligations of the grantee must resemble those of a purchaser of an equivalent asset," including, *inter alia*, the right of the grantee to substitute another provider for operation and maintenance services).

Contrary to Qwest's assertion in its *August 9, 2002 Brief* at 13-14, § 1-201(37) of the Uniform Commercial Code which distinguishes between a lease and a security interest, is irrelevant because it does not distinguish between a sale of a facility and a service. *Compare: In re E.Spire Communications, Inc.*, 2002 WL. 1343463 (Bank. D. Del. 2002) (distinguishing between lease and security interest) and *In re E.Spire Communications, Inc. Securities Litigation*, 127 F. Supp.2d 734, 747 (D. Md. 2001) (distinguishing between a "sale" and a "service, which turned on "whether a particular IRU between the parties contained provisions resulting in a transfer of title").

[20] IRU Agreement between Qwest and Touch America, Exhibit S to the *IRU formal complaint* ("*Lit Fiber Capacity IRU*"), Sections 2.1 and 14.1.

[21] *Id.*, Section 13.1.

[22] *Id.*, Section 6.1 (first).

controls what path is used to get from point "A" to point "B,"[23] is required to maintain certain performance standards, and must pay an outage credit when there is an outage.[24] Thus, Qwest retains the right to use or swap out the underlying fiber and if the underlying fiber used at any particular point in time deteriorates or becomes inoperative, Qwest must provide other facilities to transport the capacity, thus bearing the risk of loss.

- The *AT&T private line service agreements* similarly provide for use of capacity (at OC-3 and OC-12 levels) between two fixed points,[25] do not provide the customer with any ownership rights to any real property, conduit, fiber, or equipment in its network, and provide that AT&T controls what path is used to get from point "A" to point "B."[26]

- The *Verio/Qwest Capacity Service Agreement* similarly provides for use of capacity (at OC-3, OC-12 and OC-48 levels) between two fixed points, provides that Qwest controls network service or configuration and what path is used to get from point "A" to point "B," but further provides for a joint team to work on network design.[27] Verio makes monthly payments to cover operations and maintenance.[28]

While, as noted above, the duration is not determinative, the effective duration of all the arrangements is essentially the same. Specifically, the Qwest IRUs are for a

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[23] *Lit Fiber Capacity IRU*, Sections 2.1 (the IRU grant), read in light of the definitions in 1.2 (Capacity), 1.9 and 1.10 (defining the different amounts of capacity); Qwest's Answer to the *IRU formal complaint* ¶ 84 (conceding that the various lit fiber capacity IRU agreements involve only rights to "specific increments in capacity between two identified points").

[24] *Id.*, Section 6 and Exhibit B. The language of the Outage Credit clauses in the *Verio/Qwest Capacity Service Agreement* and the Qwest IRU is, in all material respects, identical. *Compare, Lit Fiber Capacity IRU*, Section 6.1 *with Verio/Qwest Capacity Service Agreement*, Appendix A Section 5.1.

[25] *See, e.g.,* AT&T Contract Nos. 00749 (Section 1.A.10), 06500 (Section 5.C.1) and 07853, (Section 5.A.2.(b)).

[26] AT&T General Terms and Conditions, "Provision of Service" ("AT&T will determine which of those components shall be used and make modifications to those components at its option."). The agreements do not limit the type of traffic and the direction the customer chooses to transmit private line service. *See, e.g.,* AT&T Contract Nos. 00749 (Sections 1.1 and 1.2; 3.A and D., 4, 5.B, 7.B and D).

[27] *Verio/Qwest Capacity Service Agreement*, Section 3.2; see also, Exhibit A, Section 4.

[28] *Id*, Sections 5.2 and 5.3 (Recurring charges shall be invoiced by Qwest on a monthly basis), Exhibit A, Section 3.1 (Verio's minimum annual purchase commitments total One Hundred Million Dollars for the first seven years, payable each year based on rates), Section 3.5 ("include certain Monthly Recurring and Non-Recurring charges"), and Schedule A-3 to Exhibit A (appear to include all operational -- non-recurring charges appear limited to point to point installation costs -- and maintenance charges).

maximum of twenty years or "in the Customer's determination" at the "end of [the] economically useful life" of the capacity.[29] As explained in *AT&T's May 2, 2002 Comments,*[30] "capacity" has no "economically useful life" because it is dependent upon the "economically useful" life of the underlying assets (here electronics and fiber), which vary depending upon the provider's routing, maintenance and upgrading decisions, can vary over time.

Thus, the "economically useful life" of capacity is a highly subjective determination and a customer could easily "determine," even if the same fiber and electronics are used, that the "end of [the] economically useful life" of the capacity is no more than three to five years.[31] The *Verio/Qwest Capacity Service Agreement* and AT&T private line service agreements provide for a stated period of time (for Verio, 15 years; for AT&T, closer to the three to five years time range) with a right to renewal in the Verio and some of the AT&T agreements.[32] Thus, the effective duration of all the arrangements could very well be the same.

Based on the foregoing, the Qwest lit fiber capacity IRUs are nothing more than in region private line service[33] and violate Section 271 and the *June 26 Merger Order* which

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29 *Lit Fiber Capacity IRU*, Section 5.1.

30 *AT&T's May 2, 2002 Comments* at 16.

31 *Touch America's June 14, 2002 Filing* at 13, noting that the economically useful life of capacity could be as short as the "technology life cycle of the optronics and other integral equipment necessary to the functioning and usefulness of a Capacity IRU which is estimated at between 3 and 5 years" or as long as the economically useful life of optical fiber which given proper maintenance "can last up to and well beyond the Stated Term in the typical IRU agreement;" *see also* at 31-32, 49 and 79-80.

32 *Verio/Qwest Capacity Service Agreement*, Sections 4.1 and 4.2; AT&T Contract Nos. 06500, Section 2 (five years and 8 months) and 07853, Section 2 (six years and nine months) and 00749, Section 2 (114 months or 9½ years).

33 Qwest, in its *August 9, 2002 Brief*, identifies seven purported bases for distinguishing IRUs from private line sales arrangements. Thus Qwest claims that IRUs: (1) involve an up-front capital expenditure; (2) are longer (twenty years) and use up the economically useful life of the asset; (3) convey specified identified capacity or fiber

required Qwest to divest itself of such service because it would allow Qwest to obtain an entrenched base of full-service customers prior to receiving section 271 authority and effectively hold itself out as a provider of long distance service.

B. A Comparison of the Qwest Lit Fiber Capacity "IRU" and the Frontier, GTE, and WorldCom IRUs Demonstrates that They Are Materially Different.

Based on the information available to AT&T, it is apparent that the Frontier, GTE, and WorldCom IRUs are materially different from the Qwest lit fiber capacity "IRUs" at issue here. Significantly, the Frontier, GTE and WorldCom IRUs involve a transfer of *ownership and control; the Qwest transaction does not.*

- The Frontier, GTE and WorldCom IRUs provide that: (i) "[o]wnership and control" in "specific" dark fibers were conveyed to Frontier, GTE and WorldCom

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and are facility and route specific; (4) the fixed path and wavelength of the capacity cannot be changed without the consent of the customer; (5) involve a separate operations and maintenance agreement; (6) customers bear the risk of loss related to the underlying facilities; and (7) customers are typically carriers, ISPs, other sophisticated firms with private networks. *Id* at 15-17.

Without conceding the relevance of these criteria, it must be noted not only that Qwest's lit fiber capacity "IRUs" fail to meet a number of them but also that when compared against Qwest's claimed seven criteria, AT&T private line arrangements and the Qwest/Verio service arrangements are virtually indistinguishable from Qwest's lit fiber capacity "IRUs." Specifically: (1) as Qwest now concedes, had it properly accounted for these "IRUs" it would have realized the payments over time rather than as a single "up front capital" expenditure; (2) as shown in the text, the duration of the Qwest "IRUs" are no longer than the service arrangements and are not tied to economic life of any asset; (3) the Verio and AT&T private line service agreements, like Qwest's "IRUs," convey specified identified capacity between specified fixed points; (4) AT&T has no greater ability under its private line arrangements to modify the fixed path and wavelength of a customer's capacity than Qwest does under its lit fiber capacity "IRUs;" (5) Exhibit A, Schedule 3 to the Verio arrangement demonstrates that Qwest *service* customers purchase operation and maintenance from Qwest; in all instances Outage credits are paid by the provider; (6) Qwest bears the same risk of loss under its lit fiber capacity IRUs for the underlying facilities as it does under the Verio service arrangement (and as AT&T does in its private line service arrangements) – for example, under Qwest's "IRUs," if the underlying fiber deteriorates or becomes inoperative, Qwest must provide other facilities to transport the capacity thus bearing the risk of loss; and (7) the Verio and AT&T's private line service arrangements serve precisely the same types of customers as those subscribing to Qwest's purported IRUs.

("the purchasers"); (ii) the purchasers are "treated as the owner for tax and accounting purposes;"[34] (iii) "Qwest … has no right to use purchasers' fibers during the term and … Qwest will keep the purchasers' fibers free from any lien's …;"[35] (iv) the purchasers have "full and complete control and responsibility for determining any network service configurations or designs, routing configurations, regrooming, rearrangement of consolidation of channels or circuits and all related functions with regard to the use of Dark Fiber;"[36] and (v) the purchasers otherwise control what path is used to get from point "A" to point "B."[37] Qwest does not offer or provide "Outage Credits" to Buyer and Performance is guaranteed only before conveyance of IRU, not after;[38] thus the grantee, not Qwest, bears the risk of loss if the fiber becomes inoperative.

- As noted above,[39] under the Qwest lit fiber capacity "IRUs" (and the *Verio/Qwest Capacity Service Agreement* and AT&T private line service agreements): (i) the customers have no ownership rights in any fibers or other tangible property; (ii) the customers are expressly not treated as the owner for tax purposes; (iii) Qwest retains the right to use or swap out the fiber used to provide the capacity to the customer; (iv) Qwest retains the right to control network design; and (v) Qwest controls what path is used to get from point "A" to point "B."

## II. Accounting Rules for Recognizing Revenue from Service Agreements and IRUs

As a general rule, IRUs are treated as real estate sales for accounting purposes because they involve fiber, conduit or other "physical structure or equipment attached to … real estate that cannot be removed and used separately without incurring significant cost," under FASB Interpretation 43 ("FIN 43")[40] and are therefore to be accounted for under Financial Accounting Standards Board (FASB) Statement 66 ("SFAS 66"). Under paragraph 5(d) of SFAS 66, whether or not an IRU is a *sale* of real estate so that revenue can be recognized by the full accrual method (*i.e.,* "up front") depends on whether the grantor has transferred to the customer the usual *risks and rewards of ownership* and the

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34 *Qwest's October 19, 1999 Filing* at 5-6.
35 *Touch America's June 14, 2002 Filing* at 19.
36 *Id*.
37 *Id*.
38 *Id at 18-19*.
39 *Supra* at 6-7.
40 ¶ 2. Because the Statements themselves are quite lengthy and because the paragraphs not cited are not relevant to this analysis, AT&T has provided in Exhibit 6 hereto only

grantor does not have a substantial *continuing involvement* with the property. If not, then under FASB Concept Statement 5 revenue is realized and earned when the services are rendered.[41]

Qwest has effectively conceded that its IRUs do not involve any "facilities" such as fiber, conduit, or equipment attached to real estate and therefore cannot be accounted under the rules generally used for IRUs (*i.e.,* SFAS 66 and FIN 43). Qwest made this concession when it initially took the position that its "IRUs" were "sales-leases" under FASB Statement 13 (SFAS 13) (accounting for leases).[42] Now, however, in the face of an SEC investigation, Qwest has admitted that its accounting for lit fiber capacity "IRUs" in this manner was improper and that those "IRUs" should have been booked as services.[43]

Specifically, in its *IRU Announcement*, Qwest discloses that it has "in some cases applied its accounting policies incorrectly with respect to certain optical capacity asset sale transactions in 1999, 2000 and 2001."[44] More particularly, Qwest admits that, in some instances, the "optical capacity asset sales" should have been "instead treated as operating leases or services contracts."[45] In short, because of the ongoing investigations, it appears that Qwest had no choice but to admit that its so-called lit fiber capacity "IRUs" are not

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the full text of the particular paragraphs cited. Should the Commission staff so desire, AT&T could provide the Commission staff with the text of the entire Statements.

41 FASB Concept Statement 5 ¶¶ 83-84; *see also*, SEC's Staff Accounting Bulletin (SAB) 101, http://www.sec.gov/interps/account.shtml.

42 Qwest's 2001 Annual Report 10-K, at 42; a copy of SFAS 13 is appended to *Qwest's August 9, 2002 Brief* as Exhibit 3.

43 *See* "Qwest Communications Provides Current Status of Ongoing Analysis of its Accounting Policies and Practices," July 28, 2002, www.qwest.com/about/media/pressroom ("*IRU Announcement*").

44 *See IRU Announcement* at 1. Qwest made clear that the analysis of its accounting policies and practices include those with respect to revenue recognition of sales of optical capacity assets *(i.e.*, IRUs). *Id*.

45 *IRU Announcement* at 2. Qwest has conceded in this proceeding that operating leases are subject to Section 271. *Qwest's October 19, 1999 Filing* at 6 and notes 4-5 (Qwest

facilities, but are, in fact, services, and that accordingly it has been using these "IRUs" to provide "transmission" services in violation of section 271 of the Act.

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AT&T's Comments on this matter have been pending with the Commission for more than a year, and Qwest has never responded to them in this proceeding. AT&T has demonstrated in those Comments beyond *any* doubt: (1) that the Qwest lit fiber capacity "IRUs" at issue here involve the lease of capacity on an in-region interLATA network, and that this plainly involves the provision of an in-region interLATA service in violation of Section 271 and the *June 26 Merger Order*; (2) that despite Qwest's sworn Certification to the Commission that it was providing corporate communications "to itself,"[46] it was actually providing prohibited in-region interLATA service to unaffiliated companies;[47] and (3) that Qwest continues, almost two years after the merger closed, to provide in-region interLATA services billed and branded as Qwest services, and to violate the *June 26 Merger Order*'s requirements regarding the provision of Internet access through a separate Global Service Provider.[48] Having before it now a complete record on both the law and

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noted that under Commission precedent, dark fiber *leases* could violate Section 271 and specifically committed to divest such leases).

46 Qwest Certification, appended to Arthur Anderson LLP, Report of Independent Public Accountants, submitted an April 16, 2001, ¶ 5.

47 Such as ANR Pipeline, Star Telecom, Touch America, ICG Communications, Primus Telecommunications, Cais Internet and Electric Lightwave. Complaint, *Touch America, Inc. v. Qwest, Communications International, Inc.,* File No. EB-02-MD-004 (Feb. 11, 2002) (revised and refiled March 1, 2002) ¶¶ 338-340, 350-354, 431-446, 506.

48 Letter from Andersen to Ms. Dorothy Atwood and Mr. David Solomon, filed July 31, 2002 at 2-3 (Qwest continues, years after the merger closed, to brand and bill as its own, in-region interLATA traffic. Including the revenue held in violation of the GSP obligations, Qwest has illegally collected and retained over $2.5 million of in-region interLATA revenue); March 11, 2002 Arthur Andersen Audit Report, Att. 1 at 3.

the facts, AT&T respectfully requests that the Commission take prompt action on these patent violations of Section 271 and the *June 26 Merger Order*.

Sincerely,

Aryeh Friedman

cc: Anthony Dale
John C. Keeney
Jonathan S. Marashlian
Mark Stone