

TABLE OF CONTENTS

I. INTRODUCTION AND QUALIFICATIONS 1

II. SCOPE OF AFFIDAVIT AND SUMMARY 2

III. THE FEDERAL ACT AND RULES 6

IV. SWBT HAS THE BURDEN OF ESTABLISHING SECTION 272 COMPLIANCE
THROUGH TANGIBLE EVIDENCE, NOT MERE PROMISES OF FUTURE
COMPLIANCE 8

V. BASED ON AVAILABLE INSPECTION, TRANSACTIONS
BETWEEN SWBT AND SBLD DO NOT APPEAR TO BE
ARMS-LENGTH AND NONDISCRIMINATORY 12

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)
)
Application of SBC Communications, Inc.,)
for Authorization Under Section 271)
of the Communications Act to Provide) CC Docket No. 97-121
In Region InterLATA Services in the)
State of Oklahoma)
)

**AFFIDAVIT OF DENISE CROMBIE
ON BEHALF OF
AT&T CORPORATION**

I. INTRODUCTION AND QUALIFICATIONS

1. My name is Denise Crombie. I am employed by AT&T as Area Regulatory Chief Financial Officer (CFO) - Southwest Region. As Area Regulatory CFO, I have responsibility for AT&T's financial matters and for certain local exchange carrier ("LEC") cost analysis functions for the Southwest Region, consisting of Arkansas, Missouri, Kansas, Oklahoma and Texas. My duties also include the analysis of state and federal statutes, rules, and orders.

2. I majored in accounting at the University of Massachusetts in Amherst, Massachusetts and graduated in 1979 with a Bachelor's Degree. In 1996, I received a Master of Science in Management Degree from Purdue University in West Lafayette, Indiana.

3. I began my career with Western Electric in 1979 as an Internal Auditor where I was responsible for conducting financial and operational audits. From 1982 through 1988, I held various line and staff positions in the AT&T Financial Operations Center where I was responsible for accounting operations in Plant, Inventory, Lessee Accounting, and Intra-

FCC DOCKET NO. CC 97-121
AFFIDAVIT OF DENISE CROMBIE

company Billing. In March of 1988, I transferred to Internal Auditing where I was responsible for conducting financial, operational, and compliance audits in AT&T Federal Systems. Effective June 1991, I accepted a position in the Financial Regulatory Matters organization with responsibility for AT&T financial regulatory matters in the Southwest Region. From 1991 through 1996, I was primarily involved with the review of LEC cost information filed before the Texas Public Utility Commission ("PUC") or in other regulatory proceedings involving potential changes to access charges in the Southwest Region.

4. I have testified in numerous state regulatory arbitration proceedings concerning the AT&T/SWBT interconnection negotiations. I have testified before the Oklahoma Corporation Commission ("OCC") in Cause Nos. PUD 960000218 and 960000242, the Arkansas Public Service Commission in Docket Nos. 96-395-U and 94-301-U, the Missouri Public Service Commission in Case Nos. TO-97-40 and TO-97-63, and the Kansas Corporation Commission ("KCC") in Docket Nos. 97-AT&T-290-ARB and 97-FCC-149-GIT. I also have filed testimony before the Texas PUC in Docket No. 11025.

II. SCOPE OF AFFIDAVIT AND SUMMARY

5. Section 272 of the Communications Act of 1934, as amended by the federal Telecommunications Act of 1996 ("Act"), bars a Bell Operating Company ("BOC") from providing in-region interLATA service unless it provides such service through an affiliate that operates independently from the BOC. By imposing a variety of accounting and nonaccounting safeguards, Section 272 attempts both to prevent a BOC from recovering costs of the affiliate that provides long distance and other services under the Act from the BOC's

FCC DOCKET NO. CC 97-121
AFFIDAVIT OF DENISE CROMBIE

local and exchange access service customers, and to prevent a BOC from discriminating against its competitors in those markets.

6. The purpose of my Affidavit is to discuss the failure of SWBT and its Section 272 affiliate, Southwestern Bell Long Distance ("SBLD"),¹ to meet their burden of establishing that they will operate in compliance with Section 272 if and when SWBT is granted authorization to provide in-region interLATA service. Moreover, my Affidavit shows how SWBT and SBLD have allowed only restricted access to records reflecting their many past and ongoing transactions, and thus have not provided the type of full disclosure concerning these transactions anticipated by Section 272.

7. Section 271(d)(3)(B) precludes the Commission from granting authority for in-region interLATA service unless it finds that "the requested authorization will be carried out in accordance with the requirements of section 272." The Commission has made clear that such a review should be meaningful and vigorous.² In its Section 271 application, however, SWBT has taken the position that even though it has a Section 272 affiliate already in

¹ According to SWBT's Section 271 application, Southwestern Bell Communications Services, Inc., d/b/a SBLD, is a wholly owned subsidiary of SBC Communications Inc. (SBC). SWBT also is a wholly owned subsidiary of SBC, as is Pacific Telesis Group (owner of BOCs Pacific Bell and Nevada Bell). See Brief In Support Of Application By SBC Communications, Inc., Southwestern Bell Telephone Company, And Southwestern Bell Long Distance For Provision Of In-Region, InterLATA Services In Oklahoma at 42 (hereinafter SWBT Brief In Support).

² For example, in its Non-Accounting Safeguards Order, the Commission pointed to the "disclosure requirements" under Section 271(d)(3)(B) as a justification for declining to impose certain additional Section 272 reporting requirements for BOCs. See Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended, CC Docket No.96-149, First Report and Order and Further Notice of Proposed Rulemaking (rel. Dec. 24, 1996) at ¶ 323 ("Non-Accounting Safeguards Order").

FCC DOCKET NO. CC 97-121
AFFIDAVIT OF DENISE CROMBIE

existence, and even though that affiliate, SBLD, has been involved in a series of ongoing transactions with SWBT in anticipation of providing in-region interLATA service, the restrictions of Section 272 and its implementing rules do not govern the current conduct of either SWBT or SBLD, and are largely irrelevant to this application. Indeed, SWBT's apparent position is that it has no obligation to present any specific evidence of these transactions to the Commission, nor does it have an obligation to explain how it plans to end and correct any cross-subsidization and discrimination that may already have occurred. This position of SWBT and SBLD cannot withstand scrutiny.

8. SWBT appears to acknowledge that its transactions with SBLD in preparation for entry into the in-region interLATA market have not been in compliance with the affiliate-transaction rules under Section 272.³ **[This portion of the affidavit addresses information designated as confidential by SWBT. In accordance with the Commission's April 11, 1997 protective order in this docket, the information in question has been removed from the publicly-available version of this affidavit, and the unredacted version**

³ See, e.g., SWBT Brief In Support at 48 ("When the rule changes adopted in the Accounting Safeguards Order become applicable, all transactions between SBLD and SWBT will comply with its accounting requirements."); Affidavit Of Karol Sweitzer On Behalf Of Southwestern Bell Long Distance ¶ D.2.f. ("To date, all of the SWBT-Provided Services have been recorded on a basis consistent with Parts 32 and 64 as determined by the FCC prior to the adoption of the Accounting Safeguards Report and Order."); Affidavit of Elizabeth A. Ham On Behalf Of Southwestern Bell Telephone Company ¶ E.1.a.vi. ("Since the entry of the Non-Accounting Safeguards First Report and Order, SWBT has undertaken to identify and discontinue, subject to any reconsideration by the FCC or by appellate courts, any product development services provided to SBLD that could not be provided on a nondiscriminatory basis to other, similarly-situated, telecommunications carriers.").

FCC DOCKET NO. CC 97-121
AFFIDAVIT OF DENISE CROMBIE

of the affidavit has been filed under seal and served only on SWBT.]⁴ If SWBT and SBLD are allowed to provide only promises of future compliance and to withhold their transactions from review in this Section 271 application, they could evade the requirements of the Act and the Commission's rules by engaging in improper cross-subsidization and discrimination in establishing SBLD and preparing it to provide interLATA services.⁵ Thus, SWBT's reading of the Act essentially ignores the requirement under Section 271(d)(3)(B) that the BOC make a

⁴ See *infra* ¶¶ 18-19.

⁵ For example, there is a substantial danger that service transfers between SWBT and SBLD provided SBLD with unlawful subsidies that would be impermissible under the accounting rules for Section 272 affiliate transactions. In its Accounting Safeguards Order, the Commission changed the existing affiliate-transaction rules regarding the appropriate valuation methods to be used for the transfer of services. Under the previous rules for transfer of services, "carriers [could] record services sold to their affiliates at cost even if the fair market value of such services [was] actually much higher, allowing the carrier's affiliates to take advantage of services at below market costs to the detriment of the carrier's ratepayers." Implementation of the Telecommunications Act of 1996, Accounting Safeguards Under the Telecommunications Act of 1996, CC Docket No. 96-150, Report and Order (rel. Dec. 24, 1996) at ¶ 146 ("Accounting Safeguards Order"). The Commission changed this rule for Section 272 affiliates, "requiring carriers to record all affiliate transactions that are neither tariffed nor subject to prevailing company prices at the higher of cost and estimated fair market value when the carrier is the seller . . . and at the lower of cost and estimated fair market value when the carrier is the buyer." Accounting Safeguards Order ¶ 147. The Commission stressed that the rule change was necessary "to ensure that the transactions and their nonregulated affiliates take place on an 'arm's length' basis, guarding against cross-subsidization of competitive services by subscribers to regulated telecommunications services." *Id.* SWBT appears to acknowledge that its transactions with SBLD follow the previous rule, not the rules under the Accounting Safeguards Order. See, e.g., SWBT Brief In Support at 48 ("When the rule changes adopted in the Accounting Safeguards Order become applicable, all transactions between SBLD and SWBT will comply with its accounting requirements."); Affidavit Of Karol Sweitzer On Behalf Of Southwestern Bell Long Distance ¶ D.2.f. ("To date, all of the SWBT-Provided Services have been recorded on a basis consistent with Parts 32 and 64 as determined by the FCC prior to the adoption of the Accounting Safeguards Report and Order.").

FCC DOCKET NO. CC 97-121
AFFIDAVIT OF DENISE CROMBIE

showing that it will comply with 272, and defeats the purpose of the separate-affiliate safeguards.

9. Section 271(d)(3)(B) clearly anticipates, and requires, more than simple promises of future compliance. For the Commission to be able meaningfully to evaluate whether SWBT and SBLD will comply with Section 272 once granted in-region interLATA authority, SWBT and SBLD must, at a minimum, present concrete evidence that (i) discloses in detail the specific terms, conditions, and arrangements of each of the transactions between SWBT and SBLD to date; (ii) provides a plan as to how the past and ongoing transactions, if not in compliance with Section 272 and its implementing rules, will be brought into compliance before SBLD begins providing interLATA service; and (iii) shows how SWBT and SBLD will "true-up" these past transactions so that SBLD does not enter the interLATA market with unlawful pre-authorization subsidies and other improper advantages from SWBT. SWBT has not presented such evidence.

III. THE FEDERAL ACT AND RULES

10. The Act sets forth a series of accounting and non-accounting safeguards intended to protect customers of the BOCs' local telephone service against the risk of being forced to pay costs incurred by the BOCs to provide services in competitive markets, such as in-region interLATA services. The Act also seeks to protect competition in those markets by preventing the BOCs from using the market power in the local exchange market otherwise to obtain an anticompetitive advantage. These safeguards are contained in Section 272 of the Act. Central to these safeguards is the requirement, in Section 272(a), prohibiting a BOC

FCC DOCKET NO. CC 97-121
AFFIDAVIT OF DENISE CROMBIE

from providing in-region interLATA service except through a separate affiliate operating independently from the BOC. The Section 272 affiliate, among other things, is required to maintain separate books and records, to have separate officers, directors, and employees, and to conduct all transactions with the BOC on an arm's length basis, reducing such transactions to writing, available for public inspection. In addition, the BOC is prohibited from discriminating in favor of its Section 272 affiliate in the provision of goods, services, facilities, and information.

11. On December 24, 1996, the Commission issued its Accounting Safeguards Order addressing the Act's accounting-safeguards requirement.⁶ The Accounting Safeguards Order prescribed the way BOCs, such as SWBT, must account for transactions with Section 272 affiliates and allocate costs incurred in providing regulated and non-regulated telecommunications services.

12. Moreover, the Accounting Safeguards Order modified in a number of significant respects the existing affiliate transaction rules and cost allocation rules, Parts 32 and 64. The modifications included requirements that the BOC may only use prevailing prices for transactions with its affiliates if it meets an annual 50% threshold of external sales per product or service,⁷ value certain service transfers to the BOC's Section 272 affiliate at fair market

⁶ Implementation of the Telecommunications Act of 1996, Accounting Safeguards Under the Telecommunications Act of 1996, CC Docket No. 96-150, Report and Order (rel. Dec. 24, 1996) ("Accounting Safeguards Order").

⁷ See 47 C.F.R. 32.27(d); Accounting Safeguards Order ¶¶ 133-137.

FCC DOCKET NO. CC 97-121
AFFIDAVIT OF DENISE CROMBIE

value rather than at cost,⁸ and provide public access to detailed records of its transactions with the Section 272 affiliate.⁹ The Accounting Safeguards Order also directed that an audit of the affiliate is required to begin at the end of the first full year of operations, with the next audit to begin two years thereafter covering the operations of the previous two years.¹⁰

IV. SWBT HAS THE BURDEN OF ESTABLISHING SECTION 272 COMPLIANCE THROUGH TANGIBLE EVIDENCE, NOT MERE PROMISES OF FUTURE COMPLIANCE

13. Section 271(d)(3)(B) places the burden on SWBT and SBLD to establish they will comply with the separate-affiliate requirements of Section 272. This showing must be made as a condition of obtaining authority to provide in-region interLATA service. As discussed above, SWBT and SBLD cannot meet their burden of establishing compliance with Section 272 simply by promising that they will comply at some future date. Rather, SWBT and SBLD must come forward with specific, tangible evidence that shows:

- that transactions between SWBT and SBLD to date have, in fact, been on an arms-length basis and have been nondiscriminatory;
- that none of the transactions between SWBT and SBLD provide impermissible cross-subsidization of SBLD;

⁸ See Accounting Safeguards Order ¶¶ 144-148.

⁹ See Accounting Safeguards Order ¶¶ 122-124.

¹⁰ See Accounting Safeguards Order ¶ 203.

FCC DOCKET NO. CC 97-121
AFFIDAVIT OF DENISE CROMBIE

- that detailed accounting procedures are in place and operational so as to comply with the Accounting and Non-Accounting Safeguards Orders and with Section 272;
- that appropriate mapping is in place between the Part 32 accounting used by SWBT and the Generally Accepted Accounting Principles (GAAP) used by SBLD;
- that asset allocations required by the Accounting Safeguards Order have been fairly established;
- that methods of evaluating transactions between SWBT and SBLD meet Commission guidelines (such as the derivation of the price to be charged by SWBT for marketing services it will provide to SBLD) and have been fairly and accurately established; and
- that all transactions between SWBT and SBLD have been reduced to writing and made available for public inspection.

Moreover, if discriminatory conduct or cross-subsidization has occurred, SWBT and SBLD must come forward with a plan establishing how they will "true-up" these past transactions so that SBLD does not enter the interLATA market with unlawful pre-authorization subsidies or other unlawful advantages from SWBT.

14. To meet their substantial burden under Section 271(d)(3)(B), the type of evidence that SWBT and SBLD must present should include, but not be limited to:

- financial reports of SWBT and SBLD;

FCC DOCKET NO. CC 97-121
AFFIDAVIT OF DENISE CROMBIE

- specific terms and conditions of asset transfers and other transactions between SWBT and SBLD, including transfers, sales and/or leases of property, equipment, and information;
- the specific terms and conditions of service transactions conducted between SWBT and SBLD;
- the extent to which the affiliate has "borrowed" the services of SWBT employees in the planning or construction of SBLD's network; and
- the specific nature and extent of funding of SBLD.

15. The need for such specific, tangible evidence, rather than simple promises of future compliance, is made apparent by SWBT's Section 271 application itself. That application notes that SBLD currently owns four interexchange switches that are located on premises leased from SWBT.¹¹ Moreover, the application identifies no fewer than fifteen services that SWBT currently provides to SBLD, including "the administration of local, intraLATA, and interLATA communications service, and . . . consulting and engineering;" "licensing or other sale of SWBT programming efforts to create, maintain, or customize software;" "duplication of documents, overflow electronic typing services, and various other administrative support activities;" and "lease administration; architectural planning, design, and construction; floor space planning."¹² No specific, detailed information concerning these

¹¹ See Affidavit Of Karol Sweitzer On Behalf Of Southwestern Bell Telephone Company ¶ D(2)(i).

¹² See Affidavit Of Karol Sweitzer On Behalf Of Southwestern Bell Telephone Company ¶ D(2)(e).

FCC DOCKET NO. CC 97-121
AFFIDAVIT OF DENISE CROMBIE

many transactions is included in the application, however, and, as discussed below, see infra ¶¶ 21-26, SWBT has not provided full access to records reflecting these transactions, as anticipated by Section 272(b)(5).

16. SBLD's ownership of four interexchange switches and its many ongoing transactions with SWBT raise a number of questions, including the following:

- from what source did SBLD obtain financing for the interexchange switches and for any other purchases and/or leases of facilities?
- what are the specific terms and conditions of the collocation arrangements between SBLD and SWBT, and are those terms and conditions consistent with those currently offered to other carriers, specifically Brooks Fiber?
- are the terms and conditions offered in connection with these transactions consistent with the terms and conditions offered to other carriers for similar services or elements?
- has SBLD "borrowed" the services of SWBT employees in the planning or construction of its network, and have SWBT and SBLD properly accounted for these services?
- has SWBT engaged in OSS development work on behalf of its affiliate, is such work available to unaffiliated carriers on the same terms and conditions, and has SWBT provided the same information and level of

FCC DOCKET NO. CC 97-121
AFFIDAVIT OF DENISE CROMBIE

cooperation to unaffiliated carriers as it has to itself in connection with any such work?

- has SWBT's conduct in connection with its many transactions with SBLD displayed favorable treatment of SBLD as compared to SWBT's conduct in connection with proposed or completed transactions with other carriers?

None of these questions is answered in the Section 271 application, except through vague promises of arms-length dealings and nondiscriminatory conduct.¹³

V. BASED ON AVAILABLE INSPECTION, TRANSACTIONS BETWEEN SWBT AND SBLD DO NOT APPEAR TO BE ARMS-LENGTH AND NONDISCRIMINATORY

17. [This portion of the affidavit addresses information designated as confidential by SWBT. In accordance with the Commission's April 11, 1997 protective order in this docket, the information in question has been removed from the publicly-available version of this affidavit, and the unredacted version of the affidavit has been filed under seal and served only on SWBT.] SWBT and SBLD appear to acknowledge that these transactions were not conducted in compliance with the requirements of Section 272 and the Accounting Safeguards Order and the Non-Accounting Safeguards Order.¹⁴ SWBT and SBLD have stated:

¹³ See, e.g., SWBT Brief In Support at 47, 49; Affidavit of Elizabeth Ham On Behalf Of Southwestern Bell Telephone Company ¶¶ E.1.a., F, Affidavit of Kathleen Larkin On Behalf Of Southwestern Bell Telephone Company ¶ E.4, E.5.

¹⁴ See supra n. 3.

FCC DOCKET NO. CC 97-121
AFFIDAVIT OF DENISE CROMBIE

In accordance with the Commission's regulations relating to operational independence and nondiscrimination, SWBT has undertaken to identify and discontinue the provision to SBLD of any services the Commission has determined to be impermissible or subject to a nondiscrimination requirement under the Act.¹⁵

SWBT and SBLD do not identify, however, what services they have identified as being "impermissible," or provide a timetable as to when their "undertak[ing]" to discontinue such services will be completed.

18. **[This portion of the affidavit addresses information designated as confidential by SWBT. In accordance with the Commission's April 11, 1997 protective order in this docket, the information in question has been removed from the publicly-available version of this affidavit, and the unredacted version of the affidavit has been filed under seal and served only on SWBT.]**

20. Indeed, the results of a joint federal/state audit in 1994 of SWBT's dealings with affiliates give little reason to be confident about SWBT's current claims that it

¹⁵ SWBT Brief In Support at 47.

FCC DOCKET NO. CC 97-121
AFFIDAVIT OF DENISE CROMBIE

will act in compliance with Section 272. The 1994 audit, undertaken on behalf of the National Association of Regulatory Commissioners, concluded that the "affiliates' dealings with SWBT are not in full compliance with the affiliate transactions standards."²⁰ The audit concluded that "telephone ratepayers may have been burdened by a potential \$93.7 million in excess costs resulting from transactions with two of [SWBT's] affiliates: Southwestern Bell Corporation (SBC), the parent company, and Southwestern Bell Asset Management, Inc. (AMI), the real estate affiliate."²¹ The audit identified the following specific problems with SWBT's dealings with its affiliates:

- Inadequate documentation was kept to support costs charged to SWBT for services provided by employees of SBC.
- The allocation of marketing costs to SWBT by SBC was not in conformance with regulatory standards and procedures.
- The use of an improper general allocator wrongly allocated costs to SWBT.
- Office space leased to SWBT by its unregulated affiliate, AMI, was at more than prevailing market prices.

²⁰ Five States Regulatory Commissions And Federal Communications Commission Joint Audit Team, Review Of Affiliate Transactions At Southwestern Bell Telephone Company (May 1994) (hereinafter 1994 SWBT Audit). A copy of the Executive Summary of this 1994 audit report is attached to my affidavit as Attachment 1.

²¹ 1994 SWBT Audit, Executive Summary at C-2.

FCC DOCKET NO. CC 97-121
AFFIDAVIT OF DENISE CROMBIE

- Costs associated with various hotel expenses were improperly allocated to SWBT.²²

In light of SWBT's noncompliance with affiliate-transaction requirements in 1994, there is reason to doubt its current promises of future compliance, unsupported by specific tangible evidence.

21. Another fact that raises doubts as to the arms-length, nondiscriminatory character of the SWBT/SBLD transactions is that SWBT and SBLD have not provided sufficient access to records of transactions in which they have been involved. Under Section 272(b)(5), a Section 272 affiliate must "conduct all transactions with the [BOC] of which it is an affiliate on an arm's length basis and available for public inspection." To implement the disclosure requirement of Section 252(b)(5), the Commission has held:

[W]e require the separate affiliate, at a minimum, to provide a detailed written description of the asset or service transferred and the terms and conditions of the transaction on the Internet within 10 days of the transaction through the company's home page. The broad access on the Internet will increase the availability and accessibility of this information to interested parties, while imposing a minimal burden on the BOCs. We require that the description of the asset or service and the terms and conditions of the transaction should be sufficiently detailed to allow us to evaluate compliance with our accounting rules. This information must also be made available for public inspection at the principal place of business of the BOC.²³

²² 1994 SWBT Audit, Executive Summary at C-3 - C-4.

²³ Accounting Safeguards Order ¶ 122.

FCC DOCKET NO. CC 97-121
AFFIDAVIT OF DENISE CROMBIE

The Commission also made clear that "agreements between a BOC and its affiliate for the provision of unbundled elements and facilities . . . constitutes a 'transaction.'"²⁴

22. These public disclosure requirements are critical for competing local exchange carriers ("CLECs"), interexchange carriers ("IXCs"), and the Commission to be able to assess, among other things, whether (i) the BOC is impermissibly subsidizing the Section 272 affiliate, and (ii) the BOC is impermissibly engaging in transactions with its Section 272 affiliate with terms, conditions, or arrangements that are more favorable than those offered to CLECs and IXCs.

23. SWBT and SBLD have affirmatively refused to provide the type of disclosure contemplated by Section 272. On February 12, 1997, AT&T requested, by letter, that SWBT in Oklahoma provide "access to . . . any transactions between the affiliate and SWBT in order to make the public inspection contemplated in Section 272(b)(5)."²⁵ Such requests for public inspection also were made to SWBT in Texas, Kansas, Missouri, and Arkansas. A little over two-weeks later, on February 28, 1997, SWBT responded by letter to this request for public inspection in Oklahoma. In that letter, SWBT denied AT&T access to any records of transactions between SWBT and its affiliate SBLD. SWBT claimed that it was not yet required to afford any such public inspection, because its affiliate SBLD had not yet been authorized to provide in-region interLATA service. Specifically, SWBT stated that

²⁴ Accounting Safeguards Order ¶ 124.

²⁵ Letter to Robert Stafford, Division Manager, SWBT from Max L. Lehew, State Director, Government Director, AT&T, dated February 12, 1997. A copy of this letter is attached to my affidavit as Attachment 2.

FCC DOCKET NO. CC 97-121
AFFIDAVIT OF DENISE CROMBIE

AT&T's request was "premature" because it sought "information relating to an affiliate that is not yet required by the 1996 Act or Commission Orders. . . . [SBLD] has not yet been authorized in any state to provide, and is not yet providing, such services." The letter concluded with the obscure statement, "As of this date, there are no documents that meet the terms of your Request."²⁶

24. On March 26, 1997, AT&T submitted a "Request for Information" (RFI) to SWBT in connection with the Oklahoma Section 271 proceedings.²⁷ This RFI again requested that SWBT

describe and provide documentation of all transactions, agreements, and arrangements between SWBT and SBLD, including a description of the subject of each (e.g. what consideration was exchanged, provided, or agreed to), the financial terms of each (e.g. what consideration was exchanged, what expenses were shared), and a chronology for each identifying dates of agreement, implementation, and performance.²⁸

SWBT initially objected to providing any response to this RFI. At a hearing in Oklahoma on April 3, 1997, however, SWBT agreed to allow AT&T limited access to records of the transactions between SWBT and SBLD, under the following significant restrictions: (i) AT&T could make no copies of the materials; (ii) review of the materials had to be on site at

²⁶ Letter to Max L. Lehew, State Director, Government Director, AT&T, from David F. Brown, Attorney, SBC Communications, Inc., dated February 28, 1997. A copy of this letter is attached to my affidavit as Attachment 3.

²⁷ RFI No. 1.8, dated 3/26/97, OCC Cause No. 97-94. A copy of this RFI is attached as Attachment 4 to my affidavit.

²⁸ Id.

FCC DOCKET NO. CC 97-121
AFFIDAVIT OF DENISE CROMBIE

SWBT's offices, subject to oversight by SWBT employees; (iii) only limited note-taking was allowed when reviewing the materials, meaning that SWBT could restrict note taking on specific details in the documents, such as price or cost information; and (iv) any dissemination of information from these materials was subject to the terms of a strict protective order.

25. On April 25, 1997, I visited the offices of SWBT in Oklahoma City, Oklahoma and was permitted to review various agreements between SWBT and SBLD. **[This portion of the affidavit addresses information designated as confidential by SWBT. In accordance with the Commission's April 11, 1997 protective order in this docket, the information in question has been removed from the publicly-available version of this affidavit, and the unredacted version of the affidavit has been filed under seal and served only on SWBT.]**

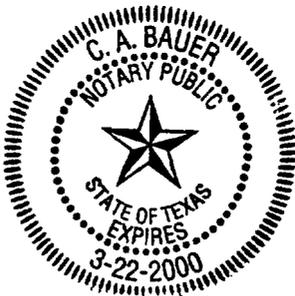
26. This recitation of events establishes that SWBT and SBLD have not provided the type of detailed and complete disclosure of their transactions that is necessary to satisfy their burden under Section 271(d)(3)(B). This disclosure is not in compliance with the disclosure requirements of the Act, the Accounting Safeguards Order, or the Non-Accounting Safeguards Order.

27. SWBT cannot meet its burden to show that it is fully prepared to meet the requirements of Section 272 without disclosing the details of their many transactions. They have not done so.

FCC DOCKET CC NO. 97-121
AFFIDAVIT OF DENISE CROMBIE

I declare under penalty of perjury that the foregoing is true and accurate to the best of my knowledge and belief.

Executed on April 29, 1997.



Denise Crombie
Denise Crombie

SUBSCRIBED AND SWORN TO BEFORE ME this 29th day of April 1997.

C. A. Bauer
Notary Public

My Commission Expires:

3/22/2000

ATTACHMENT 1

**FIVE STATES REGULATORY COMMISSIONS
AND
FEDERAL COMMUNICATIONS COMMISSION
JOINT AUDIT TEAM**

**REVIEW OF AFFILIATE TRANSACTIONS
AT
SOUTHWESTERN BELL TELEPHONE COMPANY**

MAY 1994

C

Executive Summary

EXECUTIVE SUMMARY

JOINT AUDIT REPORT

1. This report is the product of a joint audit team comprised of auditors from the regulatory commissions of the states of Arkansas, Kansas, Missouri, Oklahoma, and Texas and auditors from the Federal Communications Commission (FCC). It covers the results of the examination of affiliate transactions at Southwestern Bell Telephone Company (SWBT). SWBT is the telephone subsidiary of Southwestern Bell Corporation (SBC), one of the seven regional telephone holding companies created at the divestiture of AT&T on January 1, 1984. SBC is headquartered in San Antonio, Texas and as of December 31, 1992 employed approximately 60,000 people, had more than \$10 billion in operating revenues, and approximately \$24 billion in assets. SBC provides telephone service, sales of customer premises equipment, yellow page advertising, printing and distribution of telephone directories, wireless communications services, and has investments in several international operations, through many subsidiary companies. Affiliate transactions cover the provision of services and sales of assets between and among sister companies of an affiliated group such as SBC.

2. The objective of this examination of affiliate transactions was, (i) to determine compliance with the affiliate transactions standards and, (ii) to ensure that the telephone ratepayers had not been adversely affected by potential cross-subsidies flowing to nonregulated affiliates as a result of noncompliance with these standards. Cross-subsidies could flow to the nonregulated affiliates in the form of overcharges to the telephone company. Conversely, cross-subsidies could flow to the nonregulated affiliates in the form of undercharges by the telephone company. The FCC recognized that transactions with affiliates may not be conducted at arm's length, therefore, it instituted accounting safeguards (costing standards) to protect the telephone ratepayers. These accounting safeguards were established in CC Docket 86-111, Report and Order, released February 6, 1987, and are contained in the Uniform System of Accounts (USOA) Section 32.27 Transactions with Affiliates and Section 64.901 Allocation of Costs. The audit team employed these accounting safeguards to determine compliance and to gauge the effect of any transgression on the telephone ratepayers. The examination covered the period 1989 - 1992 and included reviews of policies and procedures and tests of selected transactions with particular emphasis on 1992 activities.

3. For the purpose of this audit, the FCC's affiliate transactions standards have been utilized by the auditors of the regulatory agencies of the five states having jurisdiction over SWBT. However, other regulations, statutes, and/or ratemaking standards in each of the jurisdictions may impact the determination of the extent to which affiliate transactions will be considered just and reasonable for state ratemaking purposes. The audit team did

not review the affiliate transactions for compliance with other applicable standards, if any, and expresses no opinion on compliance with such standards.

4. From the audit work performed, the audit team concludes that the affiliates' dealings with SWBT are not in full compliance with the affiliate transactions standards and, depending on SWBT's earnings and the regulatory process in each regulatory jurisdiction, the telephone ratepayers may have been burdened by a potential \$93.7 million in excess costs resulting from transactions with two of its affiliates: Southwestern Bell Corporation (SBC), the parent company, and Southwestern Bell Asset Management, Inc. (AMI), the real estate affiliate. In addition, the dollar impact resulting from the lack of support for time reporting by SBC cannot be determined. Because of differences in the regulatory process in each jurisdiction, the audit team has chosen not to make any recommendations in this report. Each jurisdiction may take steps as deemed appropriate.

5. The opinions and conclusions stated in this report are those of the audit team and not necessarily those of the individual regulatory commissions participating in this audit. This report has not been presented to the individual regulatory commissions for approval as to the accuracy of the statements contained herein. Authorization to publish this report does not constitute an express or implied decision by the individual regulatory commissions on any of the issues raised by this report.

6. The audit team's conclusions related to SBC, totaling \$92.4 million, include:

(a). No supporting documentation for time charging by SBC's employees. For the most part, the cost allocation system used by SBC to either directly assign or allocate its costs to its subsidiaries is driven by survey time studies. The audit team was not provided and could not review the adequacy of the results of the survey time studies for the audit period 1989 - 1992. Consequently, the audit team could not determine the reasonableness of SBC's expenses charged to SWBT. The audit team was told by a representative of SBC that at one time four-week survey time studies were made, but that none are currently available. Section 32.12(b) of the Uniform System of Accounts for Telecommunications Companies requires, in part, that "...[t]he detail records shall be filed in such manner as to be readily accessible for examination by representatives of this Commission".

(b). Improper marketing allocator. SBC allocates its indirect marketing costs (those costs that cannot be directly assigned to a subsidiary) by the use of a marketing allocator derived from the sum of SBC's directly-assigned marketing costs to its subsidiaries as well as the direct marketing costs incurred by those subsidiaries. This practice is not in conformance with the regulatory standards and procedures for the apportionment of joint and common costs which require, "...all costs that can be apportioned on the basis of direct assignment or cost causational attribution measures to be so apportioned. Residual marketing expenses will be divided between regulated and