service to any and all customer segments, or CLEC competitive service would continue to be available to all customer segments.

21. In reality, however, all customer segments do not offer identical profit margins. Typically, some classes of customers offer revenue opportunities that vary greatly relative to the cost that must be incurred to serve these segments. For example, it is common for the share of revenues available from business customers to exceed the share of costs attributable to business customers. Conversely, the share of revenues available from residential customers may fall short of their share of costs.[13] Thus, differences in retail tariffs may make the profit margins available from business customers higher than the margins available from residential customers. Similarly, it is common for geographic differences in retail rates to fail to reflect fully the differences in cost associated with serving urban customers versus rural customers.[14] Thus, urban customer profit margins may exceed those available from rural customer segments.

22. If profit margins differ across customer segments, the effect of an increase in a firm's input prices may not be dichotomous. In the face of an input price increase, a CLEC's optimal strategy may well be to curtail sales of its products to its lowest-margin customer segments, while continuing to offer service to higher-margin segments. For example, assume that there are two customer groups – business and residential customers – buying telephone services, with business customers purchasing $50 of telephone services per month, and residential customers purchasing $37 of telephone services per month. Assume further that the TELRIC of the purchased inputs required to serve a customer is $25, regardless of whether the

[13] Of course, these mismatches between revenues and costs imply only that profit margins may differ across services and do not necessarily imply that residence service is unprofitable.

[14] Indeed, even though urban customers are less costly to serve than rural customers, it is common for rates in urban retail tariffs to *exceed* those in tariffs for rural service.

customer is business or residential. Thus, the net revenue available to a CLEC from a business customer is $25 ($50 - $25) and from a residential customer is $12 ($37 - $25). Assume, as well, that the CLEC's internal direct cost of serving each type of customer is $10 per month (a CLEC's internal direct costs may, in fact, be higher). In this scenario, the profit margin would be $15 ($25 - $10) from business customers but only $2 ($12 - $10) from residential customers. Because customers in each group provide a positive margin, the CLEC would serve both customer groups, although it is likely that the CLEC would focus its marketing efforts on the business segment, where the profit margin is higher.

23. If, however, the price charged for purchased inputs in this scenario is increased by 20%, the cost of the purchased inputs required to serve business or residential customers rises to $30 (1.20 x $25). The result is a decreased, but still positive, profit margin of $10 from serving business customers, but a *negative* margin of $3 from serving residential customers. As a result, the CLEC will withdraw its service offer to residential customers. This is illustrated in Table 5, below.

Table 5: **Customer Segments Differ in Revenues**

CLEC Income Statement	*Business Customers*	*Residential Customers*
Revenues	$50	$37
Purchased input cost	$25	$25
Net revenue	$25	$12
CLEC internal direct cost	$10	$10
Profit margin available	$15	$2
Would segment be served by CLECs?	**Yes**	**Yes**
Purchased input cost @ 20% increase	$30	$30
Profit margin now available	$10	($3)
Would segment be served by CLECs?	**Yes**	**No**

24. In addition to differing in the revenues that are available from them, customer groups may differ in the costs incurred to serve them even if they pay the same retail rates. In local telephone markets, those cost differences are typically driven by differences in the loop costs of serving customers located in dense, metropolitan-type areas versus serving customers located in sparsely populated rural areas. For example, if a subset of business customers is remotely located, their higher loop costs would increase the cost of the purchased inputs required to serve them. Similarly, there may be a subset of residential customers located in urban areas (who may also live in multi-unit dwellings) whose purchased inputs are less expensive than those required to serve the average residential customer.

25. Assume, for example, that if a CLEC serves rural business customers, it faces purchased input costs of $35, or $10 higher than the business group average of $25. Similarly, assume that the purchased input costs of serving urban residential customers in multi-

unit dwellings is $20, or $5 less than the purchased input cost of $25 for the average residential customer. As Table 6 illustrates, in this scenario rural business customers would provide net revenues of $15 ($50 - $35). Because these revenues exceed the CLEC's internal direct cost of $10 and provides a profit margin of $5, rural business customers may be served along with non-rural business customers. Urban residential customers provide net revenues of $17 ($37 - $20), and will be served because this amount also exceeds the CLEC's direct internal cost of $10. However, service to non-urban residential customers would yield a *negative* profit margin of $3, because the net revenues of $7 ($37 - $30) would be below the CLEC's internal cost of $10. This is illustrated in the third column of Table 6. If the CLEC can direct its residential marketing strictly to customers that live in urban areas, it is optimal for the CLEC to serve only urban residential customers and to decline to serve non-urban residential customers.

Table 6: **Customer Segments Differ in Costs**

CLEC Income Statement	Rural Business Customers	Urban Residential Customers	Non-Urban Residential Customers
Revenues	$50	$37	$37
Purchased input cost	$35	$20	$30
Net revenue	$15	$17	$7
CLEC internal direct cost	$10	$10	$10
Profit margin available	$5	$7	($3)
Would segment be served by CLECs?	**Yes**	**Yes**	**No**
Purchased input cost @ 20% elevation	2	$24	$36
Profit margin now available	($2)	$3	($9)
Would segment be served by CLECs?	**No**	**Yes**	**No**

26. If purchased input prices are allowed to rise by 20% over TELRIC levels, even fewer customer segments would be served by CLECs, as Table 6 illustrates. Purchased input costs for rural business customers now become $42 (1.20 x $35), and the profit margin on CLEC sales to these customers drops to negative $2. In such circumstances, the CLEC would withdraw its service offering to rural business. The same 20% input price increase would increase total purchased input costs for urban residential customers to $24 (1.20 x $20). Because the profit margin received from these customers would be a positive $3, they might continue to receive service from CLECs. But for non-urban residential customers, a 20% increase in input

price would produce a further deterioration of gross margins, from negative $3 to negative $9. Thus, non-urban residential customers would continue to receive no service from CLECs.

IV. CONCLUSION

27. The foregoing analysis demonstrates that interconnection and UNE prices must be set at – rather than merely "close" to – TELRIC levels if CLECs are to have real and widespread opportunities to offer complete bundles of telecommunications services to their customers and to compete effectively in local telephone markets. Even small overstatements in these input prices almost certainly will ensure that CLECs will not enter (or will exit) the local exchange markets, and/or that very large segments of customers will be denied the benefits of competition.

28. This concludes my Declaration.

I declare under penalty of perjury that the foregoing Declaration is true and correct.

Rich N. Clarke

Richard N. Clarke

Executed on: April 23, 2001

EXHIBIT 2

Overhead Factor

Confirmation of Forward-Looking Overhead Factor

	[1]	[2]	[3]	
	1998	1998	1998	
Company	Revenue#1	Corp. Exp. #2	Rev-Corp Exp #3	
Ameritech	11,475,264	655,246	10,820,018	
Bell Atlantic South	11,967,584	1,070,562	10,897,022	
BellSouth- TOT	15,075,698	984,247	14,091,451	
Bell Atlantic North	12,402,207	1,623,137	10,779,070	
SBC West	8,855,730	1,086,295	7,769,435	
Southwestern Bell	10,021,623	810,810	9,210,813	
US West	10,154,414	1,312,440	8,841,974	
Cincinnati Bell	623,686	99,555	524,131	
SNET - CT	1,321,381	198,520	1,122,861	
Alltel	473,453	49,114	424,339	
Central Telephone	829,635	87,546	742,089	
GTE	10,847,757	1,006,329	9,841,428	
Lincoln Telephone	202,587	18,596	183,991	
Puerto Rico Tel. - PR	1,000,485	78,660	921,825	4301 data
Rochester - NY	312,536	20,219	292,317	
United Telephone	3,044,353	298,877	2,745,476	
Commonwealth - PA	153,723	20,675	133,048	4302 data - adjusted by nonreg revenue factor (6.33%)
Average	5,809,536	554,166	5,255,370	

Revenue #1 — Account 530 - ARMIS 4303 - Includes Total Regulated local, network, toll, miscellaneous, and nonregulated revenues less uncollectibles.

Corp. Exp. #2 — Account 710 - ARMIS 4303 - Includes Total Regulated Executive and Planning and General and Administrative Expense.

Rev-Corp Exp #3 — #1 - #2

Dollar figures in Billions

	[4]	[5]	[6]	[7]
	1998	1998		Predicted
	Forward-Looking	Revenue - Forward-looking	Embedded	Forward-Looking
	Corp. Exp.	Corp. Exp.	Overhead Factor	Overhead Factor
Ameritech	$0.524	$10.951	6.06%	7.92%
Bell Atlantic South	$0.856	$11.111	9.82%	7.92%
BellSouth- TOT	$0.787	$14.288	6.98%	7.92%
Bell Atlantic North	$1.299	$11.104	15.06%	7.92%
SBC West	$0.869	$7.987	13.98%	7.92%
Southwestern Bell	$0.649	$9.373	8.80%	7.92%
US West	$1.050	$9.104	14.84%	7.92%
Cincinnati Bell	$0.080	$0.544	18.99%	7.92%
SNET - CT	$0.159	$1.163	17.68%	7.92%
Alltel	$0.039	$0.434	11.57%	7.92%
Central Telephone	$0.070	$0.760	11.80%	7.92%
GTE	$0.805	$10.043	10.23%	7.92%
Lincoln Telephone	$0.015	$0.188	10.11%	7.92%
Puerto Rico Tel. - PR	$0.063	$0.938	8.53%	7.92%
Rochester - NY	$0.016	$0.296	6.92%	7.92%
United Telephone	$0.239	$2.805	10.89%	7.92%
Commonwealth - PA	$0.017	$0.137	15.54%	7.92%
Average	$0.443	$5.366	11.64%	7.92%

[4] [2] * 0.8, Corporate Expense less the 20% adjustment recommended by the FCC. See Federal-State Joint Board on Universal Service (CC Docket No. 96-45) and Forward-Looking Mechanism for High Cost Support for Non-Rural LECs (CC Docket No. 97-160). TENTH REPORT AND ORDER Adopted: October 21, 1999 and Released: November 2, 1999, Paragraph 400.

[5] [1] - [4]

[6] [2] / [3]

[7] [Workpaper "Overhead Factor: Predicted Forward-Looking Regression Analysis" Predicted Forward-Looking Corp. Exp.] / [5]

Overhead Factor

Predicted Forward-Looking Regression Analysis

Regression Statistics	
Multiple R	0.895936918
R Square	0.802702962
Adjusted R Square	0.740202962
Standard Error	0.192321825
Observations	17

ANOVA

	df	*SS*	*MS*	*F*	*Significance F*
Regression	1	2.407750183	2.407750183	65.09599691	7.75483E-07
Residual	16	0.591802949	0.036987684		
Total	17	2.999553131			

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	0	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A
X Variable 1	0.079156797	0.006349223	12.46716344	1.18082E-09	0.065697049	0.092616544	0.065697049	0.092616544

RESIDUAL OUTPUT

Observation	*Predicted Forward-Looking Corp. Exp.*	*Residuals*
1	0.8669	(0.3427)
2	0.8795	(0.0231)
3	1.1310	(0.3436)
4	0.8789	0.4196
5	0.6322	0.2368
6	0.7419	(0.0933)
7	0.7207	0.3293
8	0.0431	0.0366
9	0.0920	0.0668
10	0.0344	0.0049
11	0.0601	0.0099
12	0.7949	0.0101
13	0.0149	0.0000
14	0.0742	(0.0113)
15	0.0235	(0.0073)
16	0.2221	0.0170
17	0.0109	0.0057

Source:
Dependent Variable of 'Forward-Looking Corporate Expense' from workpaper titled "Overhead Factor: Confirmation of Forward-Looking Overhead Factor," column [4].
Independent Variable of 'Revenue less Forward-Looking Corporate Expense' from workpaper titled "Overhead Factor: Confirmation of Forward-Looking Overhead Factor," column [5].
Note:
Intercept is removed because it is not linearly significant.

EXHIBIT 3
(REDACTED FOR PUBLIC INSPECTION)

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

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

In the Matter of	)	
	)	
Joint Application by SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance for Provision of In-Region, InterLATA Services in Arkansas and Missouri	)	CC Docket No. 01-194

DECLARATION OF SARAH DeYOUNG
ON BEHALF OF AT&T CORP.

I. QUALIFICATIONS

1. My name is Sarah DeYoung. I am Division Manager -- Local Services for AT&T's Southwestern/Pacific/Ameritech Region Local Services and Access Management Organization. In my position, I am responsible for the business relationship with SBC Communications Inc. ("SBC") as it relates to supporting AT&T's plans for entering the local telephone service market. Those responsibilities include negotiating with Southwestern Bell Telephone Company ("SWBT") -- as well as other SBC-owned regional telephone carriers, such as Pacific Bell, Ameritech, and Southern New England Telephone -- to facilitate local market entry by AT&T.

2. Among the matters I have personally focused on are SWBT's performance measures, both as they relate to SWBT's unbundled network element ("UNE") Loop "Coordinated Hot Cut" processes and more generally. I have led the AT&T's performance data reconciliation efforts with SWBT in the areas of unbundled loop provisioning, coordinated conversions, and service order completions.

3. I hold a Bachelor of Arts degree from the University of Michigan in Ann Arbor, and a Master of Management degree from the Kellogg School of Business at Northwestern University.

4. I have been with AT&T since 1982. In the course of my career, I have worked in various local exchange supplier management positions and in a wide variety of engineering and finance positions. In 1995, I managed AT&T's Total Services Resale and Loop Resale operational discussions with Ameritech. In 1996, I was Program Manager - Negotiations Support in AT&T's Central States region. In that position, I was responsible for supporting the executive team that led AT&T's interconnection negotiations with Ameritech and provided subject matter expertise on a number of local issues. In addition, from late 1996 until April

1999, I also acted as AT&T's primary contact with Pacific on all operations support system and operational issues associated with AT&T's market entry in the state of California.

5. In my current position, I am actively involved with various SBC teams that are responsible for working with AT&T as a local service provider. Among the teams or organizations at SBC with which I (and members of my staff) have frequent -- sometimes daily -- contact are:

- SBC's account teams assigned to AT&T;
- SBC systems representatives;
- SBC's Local Service Centers ("LSC") and Local Operations Centers ("LOC"); and
- SBC project teams implementing various systems, operational and engineering changes within SBC in its various regions.

Through SBC's AT&T Account Team, I am also in frequent contact with policy makers at SBC regarding a multitude of issues that bear on local service.

II. PURPOSE AND SUMMARY OF DECLARATION

6. As part of this Commission's public interest analysis, the Commission has recognized that a BOC's performance monitoring and enforcement plan can "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."[1] Relying on its performance monitoring and remedy plans in Missouri and Arkansas -- plans that SWBT asserts are "key component[s]" in assessing its compliance with its statutory obligations[2] -- SWBT maintains that the

[1] *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,* 15 FCC Rcd. 3953 ¶ 429 (1999) (*"New York 271 Order"*).

[2] Affidavit of William R. Dysart for Missouri ("Dysart MO Aff.") ¶ 7; Affidavit of William R. Dysart for Arkansas ("Dysart AK Aff.") ¶ 7.

Commission's public interest analysis in this proceeding should be relatively simple and straightforward. In that connection, SWBT contends that, because its performance remedy plans accompanying the Missouri 271 Agreement ("M2A") and Arkansas 271 Agreement ("A2A") are essentially "mirror images"[3] of the Texas performance enforcement plan previously approved by the Commission, the Commission can rest assured that "SWBT will continue to provide CLECs with nondiscriminatory service following section 271 relief."[4]

7. Thus, for example, in its Joint 271 Application SWBT states that, consistent with the terms of its Texas remedy plan, the Arkansas and Missouri remedy plans include Tier I and Tier 2 performance remedy provisions. In that connection, SWBT notes that, if its performance for any Tier 1 measure violates the applicable parity or benchmark standards, "liquidated damages are payable to any adversely affected CLECs."[5] SWBT further states that, if its performance for any Tier 2 measure violates performance standards for three consecutive months, it must pay any assessments to the State Treasury.[6]

8. Noting that its Missouri and Arkansas remedy plans contain the same key components in its Texas plan, SWBT invites this Commission to "conclude, as it did in its" *Texas 271 Order* that its Missouri and Arkansas remedy plans contain "sufficient incentives for SWBT to maintain a high level of wholesale services and sufficient disincentives for SWBT to

[3] Brief in Support of the Joint Application by Southwestern Bell for Provision of In-Region InterLATA Services in Arkansas and Missouri ("SWBT AR/MO Br.") at 159.

[4] SWBT AR/MO Br. at 156. *See also* Dysart MO Aff. ¶ 14 (stating that, since the "key features of the Missouri Performance Plan are the same as" the previously-approved Texas plan that the Commission found satisfied the key elements that would assure post-271 entry checklist compliance, "the FCC should draw the same conclusion regarding the Missouri plan"); Dysart AK Aff. ¶¶ 5, 14 (stating that the Arkansas Performance Remedy Plan contains all of the key features of the Texas remedy plan previously approved by the Commission).

[5] Dysart MO Aff. ¶ 12; Dysart AK Aff. ¶ 12.

[6] Dysart MO Aff. ¶ 13; Dysart AK Aff. ¶ 13.

engage in anti-competitive behavior after section 271 relief is granted. . . ."[7] The Commission should decline SWBT's invitation.

9. Although SWBT contends that the Commission's prior approval of its Texas remedy plan means a *fortiori* that its Missouri and Arkansas plans should also be approved, real market experience has demonstrated that the Commission's high expectations regarding the efficacy of the purported self-executing mechanisms of the Texas remedy plan have not come to pass. In fact, the reality is that SWBT's Texas remedy plan has provided no meaningful protection for CLECs against backsliding. Indeed, under the Texas remedy plan, SWBT has successfully avoided making penalty payments owed to CLECs, disregarded the authority of the Texas PUC, blithely ignored or unilaterally modified provisions in that plan, and mired the CLECs in protracted proceedings that have made a mockery of the basis upon which this Commission initially approved SWBT's Section 271 application in Texas. Given that the Missouri and Arkansas performance remedy plans are, by SWBT's own admission, nothing more than carbon copies of the Texas remedy plan[8] -- a plan that has proven to be wholly ineffective in providing the necessary incentives to deter SWBT from engaging in anticompetitive conduct -- it is plainly evident that the Missouri and Arkansas plans could not possibly serve as any deterrent to anticompetitive conduct post Section 271 entry as SWBT contends.

III. <u>THE MISSOURI AND ARKANSAS PLANS ARE NOT SELF-EXECUTING.</u>

10. The principal purpose of an anti-backsliding plan is to provide sufficient incentives for a BOC to continue providing CLECs the nondiscriminatory support that is

[7] Dysart AK Aff. ¶ 19. *See also* Dysart MO Aff. ¶ 20.

[8] *See also* Dysart MO Aff. ¶ 19 (stating that "[t]he Missouri PSC correctly observed that the Missouri plan is in all material respects a mirror image of the plan approved by the FCC in Texas" (footnote omitted); Dysart AK Aff. ¶ 5

required after a Section 271 application is granted. After a BOC is authorized under Section 271 to provide long distance services, it will no longer have the powerful business incentives provided by the lure of Section 271 approval to provide nondiscriminatory support for CLECs. Quite the contrary, the BOC will have powerful incentives to take advantage of its position as the supplier of facilities and services essential to competitors to drive those competitors out of both the local and long distance markets. This problem is especially troublesome because, after Section 271 authority is granted, the BOC can provide a full array of local and long distance services through the well established "PIC change" process, while CLECs cannot provide local and long distance services to their customers without substantial reliance on the BOC's support systems and processes.

11. In these circumstances, it is necessary to counterbalance the BOC's very real, anticompetitive business incentives with the prompt application of monetary consequences based on an anti-backsliding plan that will promptly detect and deter such behavior. In order to offset the anticompetitive incentives that are inherent in the BOC's position with incentives to provide nondiscriminatory performance for CLECs, an anti-backsliding plan must have sufficient monetary consequences to preclude the BOC from rationally concluding that it stands more to gain by discriminating and paying the consequences under the plan, than by competing in a fair manner on a level playing field.

(stating that the Arkansas Performance Remedy Plan is "in all material respects, the same as the provisions of SWBT's Texas" plan).

12. As the Commission explained in its *Michigan 271 Order*,[9] to provide the most effective possible deterrent against discriminatory performance after a Section 271 application is granted, an anti-backsliding plan should include "appropriate, self-executing enforcement mechanisms that are sufficient to ensure compliance with the established performance standards."[10] In order to serve as an effective deterrent, the consequences of discriminatory performance must be direct and unambiguous, and those consequences should be essentially self-executing and as immediate as possible. In that connection, the Commission has emphasized the importance of remedial measures that are "automatically triggered" by noncompliant conduct:

> [A]s part of our public interest inquiry, we would want to inquire whether the BOC has agreed to private and *self-executing enforcement mechanisms* that are automatically triggered by noncompliance with the applicable performance standard without resorting to lengthy regulatory or judicial intervention. The absence of such enforcement mechanisms could significantly delay the development of local exchange competition by forcing new entrants to engage in protracted and contentious legal proceedings to enforce their contractual and statutory rights to obtain necessary inputs from the incumbent.[11]

13. In its Texas Section 271 application, SWBT assured the Commission that its Texas remedy plan satisfied all of the key elements of an effective performance enforcement plan identified by the Commission in its *New York 271 Order*. In this regard, SWBT represented

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[9] Memorandum Opinion and Order, *Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Michigan*, 12 FCC Rcd. 20543 (1997) ("*Michigan 271 Order*").

[10] *Michigan 271 Order* ¶ 394. *See also Memorandum Opinion and Order, Application of BellSouth Corporation, et al. for Provision of In-Region, InterLATA Services in Louisiana,* 13 FCC Rcd 20599 ¶ 364 ("*Second BellSouth Louisiana Order").*

[11] *Michigan 271 Order* ¶ 394; *see also New York 271 Order* ¶ 433 (an effective performance monitoring and enforcement plan must include, *inter alia*, "a self-executing mechanism that does not leave the door open unreasonably to litigation and appeal").

to the Commission that it had "agreed to make self-executing performance payments in the event its performance does not meet the Texas PUC's standards."[12] In fact, SWBT asserted that the payment provisions under the Texas plan were "self-executing without *any opportunities for appeal* that would conceivably affect SWBT's incentives to comply."[13] Moreover, SWBT assured the Commission that the Texas remedy plan was so carefully structured that SWBT's ability to challenge any penalty payment was confined to an extremely narrow and discrete set of circumstances:

> SWBT's performance remedy plan is self-executing. It is only in cases where SWBT payments exceed a specified procedural threshold -- $3 million to an individual CLEC or the Tier I payments in a single month for CLECs as a whole exceed the cap -- that SWBT even has the right to commence a 'show cause' proceeding regarding the payments. In such a show cause proceeding, SWBT would have the burden of proof to demonstrate why, under all the circumstances, it would be unjust to require SWBT to pay liquidated damages in excess of the applicable $3 million or the monthly cap threshold amount. Even under this scenario, moreover, SWBT must pay the damage payment into an escrow fund until a determination can be made as to whether or not the performance disparity that triggered the payments reflects a SWBT-caused problem.[14]

14. Additionally, in its Texas 271 application, SWBT touted the fact that the Texas remedy plan included provisions that would spawn ongoing revisions and improvements to performance measures that would reflect the dynamism of the telecommunications market. Thus, SWBT heralded the fact that the six-month review procedure in the Texas remedy plan required that "SWBT, the TPUC, and CLECs … re-evaluate performance measurements and

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[12] SWBT Brief in Support of Application by Southwestern Bell for Provision of In-Region InterLATA Services in Texas at 20.

[13] *Id.* at 22 (emphasis added).

[14] Affidavit of William R. Dysart, *Application by Southwestern Bell for Provision of In-Region InterLATA Services in Texas* ¶ 53.

parity or benchmark levels to determine if adjustments should be made.[15] Relatedly, in securing the support of the Texas Public Utilities Commission ("TPUC") for its Section 271 application, SWBT indicated that it planned to comply with future directives issued by the Texas PUC, and that it would willingly participate in the six-month review process.[16]

15. In opposing SWBT's Texas 271 application, the CLECs contended that the Texas remedy plan could not possibly serve to protect the CLECs and the market from the effects of future discriminatory performance by SWBT. Thus, for example, AT&T argued that, given SWBT's proclivities to inappropriately ascribe its performance failures to any number of exogenous factors, coupled with the inherent deficiencies in the structural elements of the Texas remedy plan, SWBT would undoubtedly take every opportunity to challenge penalty payments and subject the CLECs to lengthy proceedings designed to delay liquidated damages payments and discourage the CLECs from attempting to collect the same.[17] In that regard, AT&T pointed out that SWBT had succeeded in adding a provision to the Texas remedy plan (Section 7.2) that could excuse SWBT from making liquidated damages payments if its performance failure is attributable to an act or omission by a CLEC that is in "'bad faith.'"[18] At that time, AT&T predicted that SWBT would undoubtedly seize upon this provision (as well as others), refuse to

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[15] *Id.* ¶ 45.

[16] *See* AT&T Communications of Texas, L.P.'s Surreply to SWBT's Motion for Rehearing and Clarification, Project 20400, *Section 271 Compliance Monitoring of Southwestern Bell Telephone Company of Texas* (Tex. PUC) (Aug. 31, 2001) at 9 n. 4 (Ex. 1) (referencing SWBT's purported compliance with TPUC Public Interest Recommendation No. 12).

[17] Declaration of C. Michael Pfau and Sarah DeYoung on Behalf of AT&T Corp. ¶ 159, *Texas 271 Application.*

[18] Comments by AT&T Corp. in Opposition to Southwestern Bell Telephone Company's Section 271 Application in Texas at 96, *Texas 271 Application.*

make penalty payments, ascribe its performance failures to CLEC acts or omissions, and force the CLECs to collect penalty payments only after costly and lengthy proceedings.[19]

16. In its *Texas 271 Order*, relying upon, *inter alia,* the representations of the TPUC and SWBT regarding the effectiveness of the Texas remedy plan, the Commission found that SWBT's Texas remedy plan was "reasonably self-executing."[20] The Commission stated that the Texas remedy plan required SWBT "to make payments, if necessary, by the 30th day following the due date of the performance measurement report for the month in which the obligation arose."[21] Additionally, the Commission observed that the Texas remedy plan also "provide[d] for expedited dispute resolution in certain carefully designated circumstances."[22] Furthermore, the Commission was convinced that the Texas remedy plan would not be "static,"[23] but rather would reflect the changes in the marketplace. Indeed, the Commission observed that the Texas remedy plan included a six month review process during which the Texas PUC and the carriers would engage in a comprehensive analysis to determine whether modifications to performance measurements and remedies were necessary. In fact, the Commission emphasized that the six month review process was "an important feature because it allows the Plan to reflect

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[19] *Id.*, Declaration of C. Michael Pfau and Sarah DeYoung on Behalf of AT&T Corp., ¶¶ 158-159, *Texas 271 Application*.

[20] *Texas 271 Order* § 427 (footnote omitted).

[21] *Id.*

[22] *Id.*

[23] *Id.* ¶ 425.

changes in the telecommunications industry and in the Texas market."[24] Unfortunately, the Texas remedy plan has not lived up to the Commission's high expectations.

17. Although the Commission clearly anticipated that the so-called self-executing mechanisms in the Texas remedy plan would trigger spontaneous payments for non-compliant conduct, the reality is that the anticipated automatic penalty payments have not been forthcoming, and that SWBT now views the Texas remedy plan as a highly malleable document under which it can freely avoid paying liquidated damages whenever it suits its purposes.

18. Thus, for example, from April through June 2001, SWBT's own Texas performance results for AT&T revealed that SWBT failed to meet the parity standard under Performance Measure 27 ("PM 27")-- a measurement of the average installation interval for non-dispatch UNE-P orders. On June 26, members of SWBT's AT&T Account Team informed me of their view that flaws in the business rule for this measure were the sole cause for the non-parity results and requested that AT&T forgive the April penalty that was past due, as well as all future penalty payments. SWBT also asked AT&T to initiate a request to the TPUC to change the business rule governing PM 27 prior to the next six-month review process.

19. However, AT&T's examination of SWBT's performance results revealed that a sharp reduction in SWBT's retail installation interval during these same months appeared to have contributed as much, if not more, to SWBT's parity failures.[25] Furthermore, it was rather ironic that SWBT requested AT&T to initiate a request to change the business rule for this

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[24] *Id.* at ¶ 425. Similarly, the TPUC advised the Commission that the six-month review procedure would "'assure that the plan is not static in nature.'" *Id.*

[25] *See* AT&T Communications of Texas, L.P.'s Response to SWBT's Letter Regarding PM 27 (Redacted Version), Project No. 20400, *Section 271 Compliance Monitoring of Southwestern Bell Telephone Company of Texas* (Tex. PUC) (Aug. 24, 2001) ("8/24/01 AT&T Response") at 5 (Ex. 2).

measure prior to the six-month review process. In fact, in responding to AT&T's requests for changes or corrections to performance measurement business rules, SWBT and other SBC affiliates have repeatedly rebuffed these requests, stating that AT&T must wait until the next six-month review to address these matters. For example, during the course of the TPUC's audit of LMOS measures, AT&T stated that the audit should include an assessment as to whether SWBT's PM 13.1 flow-through measure captured postings to the LMOS database. Noting that the business rule governing PM13.1 did not include postings to the LMOS system, SWBT stated that "[a]ny discussion or modification to the PM 13.1 business rule to include LMOS should be handled at the next six-month review and not in the context of the audit."[26] Similarly, when AT&T discovered that the business rule governing Performance Measure 15 (Provisioning Trouble Reports) in the Pacific Bell Region inadvertently omitted UNE-P orders and requested a correction, SBC's Account Team and Pacific Bell's performance measures representative insisted that AT&T had to wait until the next six-month performance review to initiate a request to change the business rule for this measure. Further, when the CLECs filed motions requesting that the Missouri Public Service Commission reconsider its recommendation supporting SWBT's Missouri Section 271 application and reopen proceedings to examine problems with SWBT's LMOS database and flow-through rates, SWBT "argued that the performance measure issues were more appropriately addressed in the six-month review process as set out in the Performance Remedy Plan, thus allowing the collaborative process to work."[27]

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[26] TPUC Audit Plan Matrix (Ex. 3).

[27] Order Denying Motions to Reconsider Recommendation and Opening Case for Monitoring Purposes, Case No. TO-99-227 (Mo. PSC Sept. 4, 2001) at 4 (Ex. 4).

20. Notwithstanding its insistence that any changes to business rules must be addressed in the context of the six-month review process, SWBT simply withheld AT&T's liquidated damages payments instead of waiting until the next six-month review to address any concerns that it had regarding the business rule for PM 27. By letter dated August 14, 2001, SWBT advised the Texas PUC that it was withholding payment of liquidated damages to AT&T under Section 7.2 of the T2A -- the precise provision that AT&T predicted SWBT would rely upon to avoid making penalty payments under the remedy plan.[28] In that letter, SWBT alleged that it had failed the parity standard for PM 27 because AT&T submitted most of its UNE-P orders after 3:00 p.m. each day. Noting that AT&T employs telemarketers who work during evening hours to obtain customer orders, SWBT indicated that its performance results were skewed because AT&T submitted the far majority of its UNE-P orders after 3:00 p.m. and requested the standard one day installation interval. Moreover, SWBT maintained that it was justified in withholding payment under Section 7.2 of the T2A which states in pertinent part:

> SWBT shall not be obligated to pay liquidated damages or assessments for noncompliance with a performance measure if the Commission finds such noncompliance was the result of an act or omission by a CLEC that is in bad faith, for example, unreasonably holding orders and/or applications and 'dumping' such orders or applications in unreasonably large batches, at or near the close of a business day. . . .[29]

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[28] Letter from Cynthia Malone (SWBT) to Texas PUC dated August 14, 2001 ("8/14/01 Malone Letter") at 1 (Ex. 5) (noting "that SWBT has invoked the provision contained in Attachment 17, paragraph 7.2 of the T2A interconnection agreement for AT&T").

[29] Attachment 17: Performance Remedy Plan - TX (T2A) § 7.2.

SWBT also urged the Texas PUC to reclassify PM 27 as a "diagnostic" measure so that it could subject this measure to continuing scrutiny and address the impact of AT&T's ordering practices.[30]

21. There was and is no sound factual or legal basis upon which SWBT can properly withhold the liquidated damages to which AT&T is entitled. Under the business rules governing PM 27, SWBT is permitted to exclude from its performance data any CLEC order that requests an installation interval beyond the standard interval. Accordingly, under PM 27, if a CLEC submits an order after 3:00 p.m. and requests a due date beyond the next business day, SWBT can exclude that order when calculating its performance results for PM 27. Notably, SWBT *excluded* from its PM 27 performance results approximately *90%* of AT&T's UNE-P orders because AT&T had requested due dates *beyond* the standard interval.[31] Thus, only 10% of AT&T's actual UNE-P orders were captured in SWBT's performance results for PM 27. Because SWBT excluded 90% of AT&T's orders from its data calculations for PM 27, SWBT could not seriously ascribe its out of parity condition to AT&T's ordering practices.[32]

22. Because SWBT improperly withheld liquidated damages payments, AT&T was forced to file a complaint that is currently pending before the Texas PUC.[33] Although SWBT never explicitly accused AT&T of acting in bad faith -- nor could it -- AT&T pointed out in its complaint, that even if SWBT did, it could not make the required showing that

[30] 8/14/01 Malone Letter (Ex. 5) at 2.

[31] *See* 8/24/01 AT&T Response (Ex. 2) at 4.

[32] Even SWBT stated that "[n]otwithstanding, the above adverse affect (sic) on PM27, it does not matter to SWBT when AT&T submits its orders." 8/14/01 Malone Letter (Ex. 5) at 2.

[33] *See* AT&T Communications of Texas, L.P.'s Informal Complaint Relating to SWBT's Failure to Pay Damages Under the Interconnection Agreement, Project Nos. 21000 and 20410 (Tex. PUC) (Aug. 27, 2001) (Ex. 6).