

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

In the Matter of	)	
	)	
Accounting Safeguards Under The	)	CC Docket No. 96-150
Telecommunications Act of 1996	)	
	)	

**RESPONSE OF VERIZON TO COMMENTS ON  
BIENNIAL SECTION 272 AUDIT REPORT**

Of Counsel  
Michael E. Glover  
Edward Shakin

Joseph DiBella  
  
1515 North Courthouse Road  
Suite 500  
Arlington, VA 22201  
(703) 351-3037  
joseph.dibella@verizon.com

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**I. Introduction and Summary**

The biennial section 272 audit reports provide an overwhelming amount of data demonstrating Verizon's compliance with the section 272 safeguards. Among other things, the audit reports show that Verizon operated its section 272 affiliates independently from the former Bell Operating Companies ("BOCs"), maintained separate books for the section 272 affiliates according to the Commission's accounting rules, maintained separate officers, directors, and employees, conducted transactions between the section 272 affiliates and the BOCs on an arms' length basis, and did not discriminate in favor of the section 272 affiliates in the provision of goods or services. Since these were agreed-upon procedures audits, the auditors were required to report all results, regardless of materiality. Consequently, the audit reports contain a handful of minor observations and inconclusive data that the commenters have seized upon to argue that the

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<sup>1</sup> The Verizon telephone companies ("Verizon") are the affiliated local telephone companies of Verizon Communications Inc. These companies are listed in Attachment A.

Commission should take action against Verizon to enforce the section 272 rules. However, the audit reports provide no basis for enforcement action.

Indeed, with little to complain about regarding Verizon's conduct, the commenters' criticisms are directed primarily at the way that the auditor carried out its duties and at the adequacy of the General Standard Procedures that the Commission adopted for section 272 audits. These criticisms are unwarranted. The auditor followed standard accounting principles under agreed-upon procedures that were developed through public comment and the collaborative efforts of the FCC and the state regulatory commissions of 44 states and the District of Columbia, representatives from the accounting profession and a coalition of the Bell Operating Companies.<sup>2</sup> These procedures were exhaustive and more than sufficient to confirm Verizon's compliance with section 272.

## **II. The Audit Reports Confirm Verizon's Compliance With The Section 272 Rules.**

The commenters' focus on immaterial issues should not be allowed to distract the Commission from the overwhelming evidence in the audit reports that Verizon has complied with the section 272 rules in all material respects. The audit reports contain over 100 pages of observations and results that describe in detail how the auditors tested Verizon's compliance with the section 272 rules. This is only a small portion of the data in the workpapers that the auditors collected and made available to the Joint Oversight Team under section 272(d)(3) of the Act to document Verizon's compliance. The audit reports summarize voluminous data in the

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<sup>2</sup> *See* letter dated Feb. 15, 2000 to Gerald Asch, Director Federal Regulatory from Hugh L. Boyle, Chief of the FCC Audits Branch.

workpapers drawn from the BOCs' and the section 272 affiliates' financial records, transactional records, methods and procedures, and provisioning data. As described in the audit reports, the data show that Verizon's separate long distance affiliates have been operated independently from the BOCs as separate corporations with their own switching and transmission facilities. The auditors examined the affiliates' books and accounts to confirm that they maintained separate books and accounts and conducted transactions with the BOCs in accordance with the Commission's affiliate transaction rules. The auditors reviewed the lists of officers, directors, and employees of the section 272 affiliates to confirm that these personnel are not shared with the BOCs. They looked at the debt instruments and credit arrangements to confirm that the section 272 affiliates have not obtained credit with recourse to the assets of the BOCs. They examined contracts between the section 272 affiliates and the BOCs to confirm that the transactions were on an arm's length basis and were posted on the web sites. The auditors gathered performance data by the BOCs for affiliates and non-affiliates and documented the services rendered to the section 272 affiliates by the BOCs to confirm that they have not received discriminatory treatment. The audit provides overwhelming evidence that Verizon has complied with the section 272 safeguards.

The fact that the audit reports discuss a small number of immaterial issues cannot be used to conclude that Verizon failed to comply with the section 272 safeguards. Unlike an attestation audit, where the audit report must contain a discussion of any issues where the auditor, in its independent judgement, finds material violations of the rules, these audits were conducted as "agreed-upon procedures audits."<sup>3</sup> In an agreed-upon procedures audit, the auditor does not

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<sup>3</sup> After having considered all types of audits and engagements and past experience with cost allocation manual audits, the Federal/State Joint Oversight Team decided to conduct the biennial

render an opinion on the company's compliance. Rather, the auditor carries out the procedures specified by the "users" and reports all results of the procedures, regardless of materiality. *See* Statements on Standards of Audit Engagements 10, American Institute of Certified Public Accountants. For these reasons, none of the facts disclosed in the audit reports constitute findings that Verizon failed to comply with the section 272 rules. In fact, the reports provide extensive data to show just the opposite – Verizon has faithfully complied with those safeguards in establishing and operating its section 272 long distance affiliates.

### **III. The Audit Reports Do Not Demonstrate Material Violations Of The Section 272 Rules.**

#### **A. Verizon Has Not Discriminated In Favor Of Its Section 272 Affiliates In The Provision Of Access Services.**

In Objective VIII, the auditor conducted procedures to determine whether the BOCs discriminated in favor of their section 272 affiliates in the fulfillment of requests for services. Among other things, the auditor examined all federal and state complaints involving allegations of discrimination and found that the complaints had either been denied by the relevant state commissions or had been addressed by the BOCs without any findings that the BOCs had violated federal or state law. *See* Section 272 Audit Report, Appendix A, 31. The auditor also collected the BOCs' reports of the time intervals for processing orders, provisioning service, and performing repair and maintenance services for affiliates and non-affiliates as required by Procedure 3. *See id.*, 32-37. The BOCs provided reports for average installation intervals,

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audit under section 272(d)(1) as an agreed-upon procedures engagement. *See* General Standard Procedures for Biennial Audits Required Under Section 272 of the Communications Act of 1934, as Amended, ¶ 2 (rel. Dec. 18, 1998) ("General Procedures").

percent commitments met, average repair intervals, total trouble reports, firm order confirmation response times, and presubscribed interexchange carrier (“PIC”) change intervals. These data demonstrated that the BOCs’ affiliates had longer special access service intervals in some months, and shorter intervals in other months, than the general population of non-affiliates. However, due to the very low volume of orders by the BOC affiliates for special access facilities during the evaluation period, the differences with the data for non-affiliates were not statistically significant. For PIC change orders, the data show that the BOCs completed orders for both affiliates and non-affiliates, on average, in only a few hours. The auditors tested the validity of these data and found only insignificant differences with Verizon’s calculations in a few of the 18 tests they conducted. In almost every case, the auditor noted “no differences.” Finally, the auditor examined and reported on how the BOCs make information regarding service intervals available to non-affiliates. The auditor reported that the BOCs provide this information in their tariffs and in reports to individual carriers upon request in a timely manner and as required by the Commission’s rules under section 272(e)(1) of the Act.

WorldCom objects (at 2) that Verizon did not provide performance data under Procedure 3 in the format that Verizon described in its section 271 application for New York. Objective VIII, Procedure 3 states that the auditor will “obtain BOC’s reports . . . indicating time intervals for processing orders, provisioning of service, and performing repair and maintenance services for the affiliate and for nonaffiliates, as customers.” Procedures 5 and 6 further provide that if no such reports are available, the auditor will obtain a statistically valid sample of orders and prepare a comparison of service performance for the end user customers of the BOC, affiliates and non-affiliates. During the preparations for the 2000 biennial audit, Verizon proposed to the Joint Oversight Team and to the auditor that it would provide comparative performance data in

the format described in Verizon's section 271 application for Massachusetts, filed in September 2000. This format addressed the same measurement categories as described in the New York section 271 application, at the same level of detail, while being more closely aligned with the performance data reported in the Commission's automated regulatory management information system ("ARMIS") reports.<sup>4</sup> Under section 53.211 of the Commission's rules, the Joint Oversight Team reviews the audit plan. In addition, the Joint Oversight Team and the BOCs are the "users" who specify the procedures to be followed by the auditor in an AUP engagement. *See* General Standard Procedures, ¶ 2. Since no user disagreed with the usefulness of the format proposed by Verizon, the auditor used it in carrying out Procedure 3 of Objective VIII.

AT&T and WorldCom also complain that the reports did not cover the first few months of 2000 for all categories and that Verizon did not retain the underlying data necessary to test the validity of these performance measurements. *See* AT&T, 18-19 & n.12; WorldCom, 2-3. However, the audit procedures are written flexibly to permit the auditor to use the carrier's reports if they are available, or, if they are not, to create its own reports using a sample of orders for one month and for one state. *See* General Standard Procedures, Objective VIII, Procedures 3, 5. In this case, the auditor did not need to create its own reports, since Verizon produced the reports in the format that it had proposed to the Joint Oversight Team. While the reports were not available for all months for the repair and PIC change intervals, the data were sufficiently representative to permit the auditor to detail the comparative performance for the BOCs'

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<sup>4</sup> *See Application of Verizon New England Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a Verizon Enterprise Solutions) And Verizon Global Networks Inc., For Authorization to Provide In-Region, InterLATA Services in Massachusetts*, CC Docket No. 00-176, Declaration of Susan Browning, Attachment Q (filed Sep. 22, 2000).

affiliates vs. non-affiliates.<sup>5</sup> Moreover, while underlying transaction data for these reports were not routinely retained or archived in the operating support systems for the full period, the auditor was able to confirm the validity of Verizon's calculations by executing queries to capture the underlying data elements. *See* Section 272 Audit Report, Appendix A, 37-40. Consequently, the data provided by Verizon were sufficient to allow the auditor to rely on Verizon's reports for Procedures 3 and 4 rather than to create its own reports under Procedures 5 and 6. *See id.*, 40.

AT&T and WorldCom argue that the performance data show systematic discrimination in favor of the BOCs' long distance affiliates. *See* AT&T, 19-22; WorldCom, 3-4. However, they selectively cite to only three measures – average installation intervals, percent commitments met, and presubscription change intervals.<sup>6</sup> As to the first two, no valid comparison can be made between the performance for the affiliates vs. non-affiliates due to the extremely small number of orders for the BOCs' affiliates. In practically all months, there were a dozen or fewer installation orders for BOC affiliates, compared to thousands for non-affiliates.<sup>7</sup> No statistically significant conclusion can be drawn from data for such small population sizes. The Commission has stated numerous times that a difference in performance between affiliates and non-affiliates must be

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<sup>5</sup> Verizon explained that supporting data for repairs are not routinely retained for extended periods, and that the company only began using the mechanized PIC change interval process in March 2000, making comparisons with unaffiliated companies prior to that time meaningless.

<sup>6</sup> AT&T also complains (at 21) that Verizon had few trouble tickets for its affiliates, and that the average repair interval for affiliates was shorter than for non-affiliates. Of course, with a relatively small number of circuits in service, it is to be expected that the Verizon affiliates will have few or no trouble reports. Moreover, with only nine trouble reports in the months audited, no conclusion can be drawn about the differences in average repair intervals compared to thousands of total company repairs.

<sup>7</sup> *See* Section 272 Audit Report, Appendix A, Table 14a.

statistically significant to be relevant to the issue of discrimination.<sup>8</sup> In particular, the

Commission has found that;

“volumes may be so low as to render the performance data inconsistent and inconclusive. Performance data based on low volumes of orders or other transactions is not as reliable an indicator of checklist compliance as performance based on larger numbers of observations. Indeed, where performance data is based on a low number of observations, small variations in performance may produce wide swings in the reported performance data.”<sup>9</sup>

This is certainly true here. For instance, in April 2000, only 33 percent of commitments were met for 3 orders by the BOCs’ affiliates for high speed special access, compared to 86.9 percent for non-affiliates. In other words, commitments were not met for two of the three BOC affiliate orders. This does not mean that the BOC gave its affiliates poorer service, any more than the two BOC affiliate orders that were fulfilled on time in July of that year means that the BOC gave its affiliates better service in that month than it gave non-affiliates. To suggest that such isolated results have statistical validity is ludicrous.

Moreover, even if the data were statistically significant, which they are not, they do not support the claims of discrimination. In many months, the installation intervals and percent commitments met show better performance for non-affiliates. *See* Section 272 Audit Report,

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<sup>8</sup> *See, e.g., Application of Verizon Pennsylvania Inc., Verizon Long Distance, Verizon Enterprise Solutions, Verizon Global Networks Inc., and Verizon Select Services Inc. for Authorization To Provide In-Region, InterLATA Services in Pennsylvania*, 16 FCC Rcd 17419, Appendix C, ¶ 11 (2001).

<sup>9</sup> *Id.*; *see also Joint Application by SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance Pursuant to Section 271 of the Telecommunications Act of 1996 To Provide In-Region, InterLATA Services in Arkansas and Missouri*, 16 FCC Rcd 20719, Appendix C, ¶ 11 (2001); *Application of Verizon New York Inc., Verizon Long Distance, Verizon Enterprise Solutions, Verizon Global Networks Inc., and Verizon Select Services Inc., for Authorization to Provide In-Region, InterLATA Services in Connecticut*, 16 FCC Rcd 16831, Appendix C, ¶ 11 (2001).

Appendix A, Table No. 14a. For firm order confirmations, non-affiliates almost always received a greater percentage of their confirmations in a day or less than the BOCs' affiliates. *See id.*, Table No. 14b.

In addition, the results of the performance data cannot be attributed to the BOC alone. When a customer requests special access service, it is responsible for performing certain "make ready" activities at its premises, including providing space, power, and access for certain special access arrangements. Also, the customer may request longer due dates, may submit orders that are part of projects that span long periods of time, and may extend originally requested installation dates on specific circuits based on changes in their plans and capabilities. The raw data do not indicate whether the differences, even if statistically significant, are attributable solely to Verizon's performance or reflect other customer-specific factors.

Only the third measure – presubscribed interexchange carrier ("PIC") change intervals – had a significant number of observations for the BOCs' affiliates. AT&T and WorldCom argue that these results show discrimination in favor of the BOCs' affiliates, whose PIC orders were processed in less time than non-affiliates. *See* Section 272 Audit Report, Appendix A, Table 14c. However, as Verizon pointed out in its comments on the audit report, the differences in processing time between affiliates and non-affiliates is insignificant in light of customer expectations. The BOCs processed PIC change orders for all carriers in far less than the 24 hours that the interexchange carriers use in their customer satisfaction surveys as the measure of Verizon's performance in providing timely PIC changes. More importantly, these data do not show that the BOCs discriminated in favor of their affiliates. These orders were processed through the BOCs' mechanical systems in the same manner, without manual intervention, for

both affiliates and non-affiliates. Both affiliated and non-affiliated interexchange carriers submitted PIC change orders electronically in batches to the Express Electronic Access (“XEA”), which validates the PIC data by jurisdiction and submits valid requests to the switch for processing. XEA picks up these files for processing eleven times a day, six days a week, on the odd hour (except for 11 PM) and twice on Sunday. Each file is mechanically stamped by XEA upon receipt and sits in a queue until the next scheduled processing time. The orders are processed in the order in which they are received regardless of which carrier, affiliate or non-affiliate, submits them. The system does not discriminate based on the identity of the carrier.

The processing times for PIC change orders may, however, be affected by the time of day that a carrier submits them. The BOCs schedule “down time” for XEA each night between the hours of 9:00 PM and 1:00 AM for necessary maintenance on the system. In addition, the BOCs schedule down time for switch maintenance in the late evening and early morning hours. During the down time periods, XEA pulls the files and holds them in queue according to the time they were received. At the end of the down time period, XEA processes the PIC change orders in the queue. A carrier that submits PIC change orders to XEA shortly before or during the down time periods would experience longer processing intervals than a carrier that submits them earlier in the day. Verizon has informed the interexchange carriers about the down time periods in each area and the possible impact on PIC change processing intervals. *See* Attachment B. Carriers can avoid the down time simply by submitting their PIC change orders to avoid this period. However, to our knowledge this issue has never come up, presumably because the PIC processing intervals easily surpass the 24 hour standard even if the carrier submits them during the down time.

To assess the reasons for the differences in the section 272 audit report for PIC change processing intervals between affiliates and non-affiliates, Verizon performed a special study in the last week of August, 2001 for the same carriers that were represented in the data for the section 272 audit report. This included one affiliate (Verizon Long Distance) and five non-affiliated carriers. The carriers submitted their PIC change orders in the following pattern:

Carrier BLX (affiliate) – one file submitted each day between the hours of 8:00am and 9:05am.
Carrier A (non-affiliate) – one or two files submitted each day between the hours of 9:00pm and midnight.
Carrier B (non-affiliate) – six or seven files submitted each day between the hours of 4:00am and 10:00pm.
Carrier C (non-affiliate) – two or three files submitted each day between the hours of 5:00am and midnight.
Carrier D (non-affiliate) – three or four files submitted each day between the hours of 11:00am and midnight.
Carrier E (non-affiliate) – one file submitted each day between the hours of 9:00am and 9:10am.

Verizon measured the PIC change processing intervals for these orders in two jurisdictions and observed the following results:

**New York**

<b>CARRIER</b>	<b># RECORDS</b>	<b>INTERVAL (HR/MIN)</b>
BLX	30	0:50
A	4970	3:54
B	3619	1:09
C	1471	1:04
D	1477	0:34
E	1146	0:56

Average PIC Interval for Non-Affiliated Carriers: 2 hours, 8 minutes

## Massachusetts

CARRIER	# RECORDS	INTERVAL (HR/MIN)
BLX	17	0:27
A	4832	3:31
B	5318	1:49
C	916	1:28
D	607	0:37
E	399	0:46

Average PIC Interval for Non-Affiliated Carriers: 2 hours, 23 minutes

This study shows that the two carriers that consistently submitted their PIC change orders early in the day – Verizon Long Distance and Carrier E – had similar average PIC change intervals that were significantly shorter than those for carriers that submitted orders in the late evening hours, when the orders would be impacted by the XEA and switch down time periods.<sup>10</sup> The minor differences noted above between Verizon Long Distance and Carrier E are likely the result of the position of each order in the queue and the size of the files, since XEA holds each batch of orders until the next processing time and then processes them in the order received. Carrier A, which submitted all of its orders between 9:00 PM and midnight, when they are most likely to be affected by the down time, had the longest intervals.

This study shows that the differences observed in the section 272 audit between affiliate and non-affiliate PIC processing intervals are the result of the carriers' voluntary decisions about when and how to submit orders, and that the differences are not due to any discrimination in how Verizon treats different carriers. Since even orders submitted in the late evening are processed within a few hours, most carriers have not seen any need to avoid the down time periods. Since

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<sup>10</sup> Carrier D also had similarly short processing times, which may have occurred because it submitted many orders during the daytime hours.

this is a voluntary decision on their part, the Commission cannot conclude that the BOCs' PIC change processing performance indicates any discrimination in favor of their affiliates.

**B. Verizon Has Conducted Transactions With Its Long Distance Affiliates On An Arm's Length Basis And It Has Not Discriminated In Favor Of Its Long Distance Affiliates In The Provision Of Goods And Services.**

Objectives V & VI included extensive procedures to determine if Verizon's section 272 affiliates conducted their transactions with the BOCs on an arm's length basis and accounted for all of these transactions in accordance with the Commission's rules. *See* Section 272 Audit Report, Appendix A, 13-26. The auditors examined the BOCs' processes for tracking and responding to competitors' complaints concerning procurement issues and noted that no complaints had been received. The auditors noted that the BOCs' written procedures for transactions with affiliates were consistent with the Commission's rules. They documented the BOCs' training and compliance program and noted that all employees interviewed were aware of the rules and had received training. They documented the fact that the BOCs' long distance affiliates must order services from the BOCs in the same manner as unaffiliated companies. They compared written agreements for services to the section 272 affiliates and noted no differences with the services rendered. They reviewed the postings of these contracts on Verizon's web site and described the timeliness and accuracy of the postings. The auditors documented and tested Verizon's accounting for affiliate transactions based on fair market value, fully distributed cost, or prevailing market price, as appropriate, and noted no differences between the amounts recorded in the books of the section 272 affiliates and the BOCs. They examined the section 272 affiliates' balance sheets and listings of fixed assets and determined that no fixed assets had been transferred from the BOCs, and were able to confirm in the vast

majority of the cases that fixed assets had not been originally transferred from the BOCs to another non-regulated affiliate prior to the transfer to the section 272 affiliate. The comprehensive procedures required by Objectives V & VI showed that Verizon has complied with the Commission's affiliate transaction rules and has conducted its transactions on an arm's length basis as required by section 272.<sup>11</sup>

AT&T and WorldCom claim that Verizon had an error rate of almost 40 percent in its web postings of contracts and agreements between the section 272 affiliates and the BOCs. *See* AT&T, 32; WorldCom, 7. In fact, the discrepancies represented less than 1 percent out of approximately 20,000 data entries. As Verizon pointed out in its comments on the audit report, the Commission's contract posting requirements are complex, requiring a minimum of 13 data entries, and sometimes as many as 100, for each contract posting. *See* Verizon Response to Section 272 Audit Report, 2. Even if the 129 discrepancies noted by the auditors are combined with the 68 postings that the auditors stated were incomplete, this is an error rate of less than 1 percent. Moreover, there is a tension between the filing deadline and the requirement for posting all of the required data. For instance, of the 68 web postings where the auditors found that some of the required data were missing, 34 had "TBD" or "to be determined" in the pricing

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<sup>11</sup> Objective VII, Procedure 7 also tested the treatment of inbound calls to the BOCs' customer service representatives. AT&T complains (at 23) that one caller was not informed that there were providers of interLATA services other than Verizon's section 272 affiliates, and that the caller was not informed of its right to make a selection. However, the audit report explains (at Appendix A, 29) that this was a call to make a telephone number change, for which the representative was allowed to proactively inform the customer of Verizon's long distance services after making the requested change. The requirement to inform the caller of alternative interLATA carriers only applies to customers calling to establish new local telephone service or a move to another location. *See Non-Accounting Safeguards Order*, 11 FCC Rcd 21905, ¶ 292 (1996); *AT&T Corp., Complainant, v. New York Telephone Company, d/b/a Bell Atlantic - New York, Defendant*, 15 FCC Rcd 19997, ¶ 15 (2000).

information, because Verizon had not yet received long distance authority for those states and therefore the contracts were not yet operative. There were no applicable rates to be posted, nor any requirement to post rates for a yet to be provided service. However, to meet the requirement to post the contract terms on the web site within 10 days of execution, Verizon filed the contracts despite the fact that the terms and conditions had not yet been finalized. Consequently, this is not a web posting error.

It is important to note that in all cases Verizon disclosed transactions between the BOCs and 272 affiliates, including the terms and conditions for each offering and the prices for the offering in those states where the services were being offered.<sup>12</sup> These fundamental components of each posting are key for competitors to assess possible interest in the services offered to others on a nondiscriminatory basis and for competitors to have information on services permitted to be provided on an exclusive basis (i.e. joint marketing). The audit did identify some minor issues associated with the underlying details of the postings, but competitors with potential interest in an offering have sufficient information to pursue that interest.

Most of the web posting errors noted in the audit were minor clerical errors in only one of the data entries on a contract, with no material impact on the overall accuracy of the contract and associated web posting. For instance, 86 of the 129 discrepancies noted above were minor errors in the contract effective date or start date. *See* Section 272 Audit Report, Attachment I. The “errors” noted by AT&T and WorldCom include 96 written agreements that were in the form of Access Service Requests, which did not contain sufficient detail concerning rates, terms and

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<sup>12</sup> In one case a contract between the BOCs and two of the section 272 affiliates was posted, but the same agreement was not posted for a third section 272 affiliate until the following year. *See* Section 272 Audit Report, Attachment I, at 63.

conditions. *See* Section 272 Audit Report, Appendix A, 16-17 & Attachment I, Table 3. However, since Access Service Requests refer to the purchase of access services under the publicly available state and federal tariffs, these “agreements” do not and should not contain the rates, terms and conditions in the tariffs. While Verizon posted these agreements to meet the section 272(b)(5) posting requirement, Verizon subsequently executed and posted a Memorandum of Understanding to cover all access services ordered by the section 272 affiliates to avoid this problem in the future. Even including these as “errors,” the number of web postings errors listed in the audit report does not rise to the level of materiality.

AT&T and WorldCom also complain that Verizon failed to post the contracts on the web site within the required 10 days. *See* AT&T, 32; WorldCom, 7. However, as Verizon pointed out in its comments on the audit report, 94 percent of the web postings were filed on time, and 99 percent were filed within 10 days after the deadline. *See* Verizon Response to Section 272 Audit Report, 4. The 51 late postings represent only 7 contract amendments multiplied by the number of entities and states where the transactions were posted. Overall, Verizon complied with the web posting requirements in all material respects.

WorldCom argues (at 5) that Verizon discriminated in favor of its section 272 affiliates in the procurement of certain support services (operator services and security escort services) during the August 5, 2000 to August 24, 2000 work stoppage by not using the written procurement procedures. However, Verizon met with the Common Carrier Bureau during the work stoppage to discuss the use of employees of the section 272 affiliates to provide services to the Verizon local exchange carriers. The Bureau advised Verizon that it could use the section 272 employees to provide strike-related services, provided that it accounted for the transaction according to the

Commission's rules. *See* Section 272 Audit Report, Appendix A, 24. The rules do not require that these services be procured through open bidding processes, and Verizon determined that such procedures were not appropriate in light of the short-term emergency nature of the work stoppage. Verizon posted contracts for these services on its web site and billed for the services according to the terms of the contracts. *See id.*, Appendix A, 18, Table 7.

AT&T and WorldCom also complain that Verizon did not provide a comparison of fair market value ("FMV") to fully distributed cost ("FDC") for 70 percent of the sampled transactions between the section 272 affiliates and the BOCs. *See* AT&T, 34; WorldCom, 5-6. Contrary to their claims, the auditors explained why these comparisons were not carried out – because FMV assessments could not be made for services that were unique to the company. *See* Section 272 Audit Report, Appendix A, 21. As Verizon pointed out in its comments, Verizon attempted in good faith to obtain FMV assessments for these transactions by hiring an outside accounting firm to do so. *See* Verizon Response to Section 272 Audit Report, 5. The accountants reported that it was not possible to make such assessments for unique services. AT&T claims that they could have done so by making comparisons to "industry benchmarks," but this assumes that the service being benchmarked are "like" services, and by definition this does not apply to services that are unique. Since section 32.27 of the Commission's accounting rules require that provision of services by the BOC to a section 272 affiliate be accounted for at the higher of FDC or FMV, if no good faith determination of FMV was possible, there is no alternative but to account for these services at FDC.<sup>13</sup>

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<sup>13</sup> WorldCom suggests that Verizon could have sought a waiver of section 32.27, but a waiver is only requested when the company seeks to avoid applying a rule. Verizon did not apply for a waiver because it does not claim that section 32.27 should not apply to the transactions between

Finally, AT&T complains (at 34-35) that Verizon failed to produce third-party invoices for 14 of 86 assets transferred from non-regulated affiliates to the section 272 affiliates, making it impossible to determine whether these assets were originally transferred from the BOC to the non-regulated affiliate. As noted in the audit report, the auditors confirmed that none of the 72 assets for which third-party invoices were obtained originated from the BOCs. *See* Section 272 Audit Report, Appendix A, 25. As Verizon noted in its comments, none of the remaining items originated from the BOCs. *See* Verizon Response to Section 272 Audit Report, 6. All of these items were transferred from a Verizon non-regulated entity – formerly Bell Atlantic Network Integration, Inc. (“BANI”). Eleven of the items could not be traced back to a vendor invoice because BANI found a new vendor after the first vendor could not fulfill the order on time, but BANI billed the section 272 affiliate based on the original vendor quote. Verizon subsequently found almost all of the invoices for the remaining 3 items. These minor discrepancies do not demonstrate non-compliance with the Commission’s affiliate transaction rules.

**C. The Verizon InterLATA Affiliates Operated Independently From The Local Operating Companies.**

In Objective I, the auditor conducted procedures to determine if Verizon’s section 272 affiliates operated independently from the BOCs as required by the Commission’s rules. *See* Section 272 Audit Report, Appendix A, 3-6. Among other things, the auditor determined that Verizon’s section 272 affiliates are separate corporations, are not owned by the BOCs, have separate employees, do not receive operations, installation, or maintenance services from the

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its section 272 affiliates and the BOCs. Rather, the issue is how the rule should apply when no good faith estimate of FMV is possible. Verizon’s reasonable application of the rule was to use FDC in these circumstances.

BOCs, and did not own any switching or transmission facilities jointly with the BOCs. These data demonstrate that Verizon has complied with the “operate independently” requirements.

AT&T argues (at 25) that these procedures were deficient because Verizon provided an incomplete list of fixed assets owned by the section 272 affiliates. This is incorrect. As required by Objective I, Procedure 7, the auditor compared the total amount of fixed assets on the section 272 affiliate’s general ledger with the total amount of fixed assets on its detailed fixed asset listing and noted the reason for the difference – the fact that the general ledger includes amounts recorded for construction in progress but the fixed asset list does not. The amounts expended for construction in progress are included as a separate capital account in the general ledger and they are not assigned to a particular plant account until a project is completed. *See* 47 C.F.R. § 32.2003(d). Such projects should not be included in the detailed fixed asset list because there would be incomplete data concerning the “description and location of each item, date of purchase or transfer, price paid and recorded, and from whom the asset was purchased or transferred.” Consequently, the construction in progress items do not, and should not, appear on the detailed fixed asset list.

AT&T also complains (at 26) that the auditor did not audit any title documents for transmission and switching facilities, because Verizon asserted that title documents did not exist for these assets. These items, all of which were less than \$21,000 each, do not have “title” documents – they are purchased from outside suppliers through invoices, which establish Verizon’s ownership when they are paid, and from affiliates through accounting entries. Verizon cannot manufacture title documents that do not exist. The General Standard Procedures require the auditors to “[i]nspect title and *other documents, which reveal ownership*” of a statistically

valid sample of these assets. *See* Objective I, Procedure 7 (emphasis added). Accordingly, the auditor examined the Display Asset Accounting Documents for assets transferred from an affiliate and invoices for assets purchased from non-affiliates to confirm that the Section 272 affiliates owned the assets on their books.

**D. The Verizon InterLATA Affiliates Maintained Separate Officers, Directors, and Employees.**

Objective III includes procedures to determine whether the section 272 affiliates comply with the requirement to have separate officers, directors, and employees. The auditor determined that Verizon has procedures in place to prevent a person from being an officer, director, or employee of both a BOC and a section 272 affiliate at the same time, and that the company's procedures do not allow the loaning or sharing of employees between these entities. *See* Section 272 Audit Report, Appendix A, 9. The auditor obtained lists of officers and directors for the BOCs and the section 272 affiliates and found no overlap. The auditor determined that no departments of the section 272 affiliates report directly or indirectly to an officer of the BOCs. The auditor obtained lists of employees and determined that there was no instance where an individual was employed by both a section 272 affiliate and a BOC at the same time. The auditors confirmed that no employees who had been transferred from a BOC to a section 272 affiliate had used any proprietary information obtained while an employee of the BOC. The auditors noted no instances where employees had transferred from a BOC to a section 272 affiliate and back again. Finally, the auditors analyzed the annual bonuses for officers and management employees of each section 272 affiliate and determined that these bonuses were not tied to the exclusive performance of the BOC or to the combined performance of the BOC and

the section 272 affiliates. These audit results demonstrate that Verizon complies with the rules on separate officers, directors and employees.

AT&T complains (at 29) that the auditor did not follow up on a “concession” by Verizon that an officer of one section 272 affiliate appeared on both the Consents in Lieu of Meeting of the Section 272 Affiliates and on the Minutes of the Bell Atlantic Board of Directors meeting. This is incorrect. The auditor did follow up on this item and found that the individual who appeared on both documents was an officer of the section 272 affiliate but was *not* an officer or director of the BOC and was *not* on the BOC’s list of employees and directors. *See* Section 272 Audit Report, Appendix A, 9. Therefore, the auditor confirmed that the section 272 affiliate and the BOC maintained separate officers, directors, and employees as required by the Act.

AT&T also complains (at 29-30) that the auditor’s observation that Bell Atlantic’s (*i.e.*, the Verizon holding company’s) earnings per share is a component of the financial portion of the annual bonus calculation for the officers and management employees of the section 272 affiliates demonstrates a violation of the “operate independently” requirement. It does not. In the *Non-Accounting Safeguards Order*, the Commission specifically rejected an AT&T request that the Commission interpret section 272(b)(3) of the Act to prohibit compensation schemes that base the level of remuneration of section 272 affiliate officers, directors, and employees on the performance of the corporate parent, or vice versa. The Commission found that “tying the compensation of an employee of a section 272 affiliate to the performance of a Regional Holding Company and all of its enterprises as a whole, including the performance of the BOC, does not make that individual an employee of the BOC.” *Non-Accounting Safeguards Order*, 11 FCC Rcd 21905, ¶ 186 (1996). Verizon’s compensation practices are consistent with this holding.

AT&T is trying to re-argue an interpretation of the Act that was rejected by the Commission years ago.

#### **IV. The Scope Of The Audit Included All Of Verizon's Section 272 Affiliates.**

AT&T argues (at 12, 24) that the audit is incomplete because no audit was performed of a “fourth” section 272 affiliate, Telecommunications Services Inc. (“TSI”), which Verizon disclosed on June 14, 2001 as having provided a limited amount of interLATA services, and because one contract for interLATA services was provided by another non-section 272 affiliate (GTE Data Services, Inc.) until the contract was transferred to a section 272 affiliate shortly after the merger. Verizon disclosed these matters to the Commission and to the auditors, and it transferred these contracts to the section 272 affiliates, out of an abundance of caution. *See* Section 272 Audit Report, Attachment II; Supplemental Section 272 Audit Report, Observation of the Federal/State Joint Audit Team for the Verizon Section 272 Biennial Audit. The small number of interLATA services that TSI and GTE Data Services provided did not constitute “interLATA telecommunications services” for which a separate affiliate is required under section 272(a)(2)(B).

Section 272(a)(2)(B) requires a separate affiliate for, *inter alia*, “[o]rigin of interLATA telecommunications services.” The Act defines “telecommunications services” as “the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public.” 47 U.S.C. § 153(46). This is intended to incorporate the common law principle of “common carriage.” *See* Joint Explanatory Statement, S. 104-230, 115 (Jan. 31, 1996); *Non-Accounting Safeguards Order*, 11 FCC Rcd 21905, ¶ 265

(1996). The Commission has found that the Act’s definition of telecommunications services, and the scope of the section 272 separate affiliate requirements, excludes private carriage. *See Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended, Second Order on Reconsideration*, 12 FCC Rcd 8653, ¶ 33 (1997); *see also Implementation of the Non-Accounting Safeguards of Section 271 and 272 of the Communications Act of 1934, as Amended*, 16 FCC Rcd 9751, ¶ 22 (2001) (Congress viewed “interLATA telecommunications services” in Section 272 as a subset of “interLATA services” under Section 271).

Neither TSI nor GTE Data Services engaged in an indiscriminate offering of service to the public, or to classes of users, such that its services would fall within the concept of common carriage that is embodied in the definition of “telecommunications service.” TSI only provided 10 circuits to three customers by reselling the private line services of unaffiliated interexchange carriers. GTE Data Services provided services under one contract to one customer in New York. All of these services were provided under individual contracts, not general tariff offerings. Neither company generally advertised its services as being available to all potential customers in a given area. Consequently, both carriers’ interLATA services in New York constituted private carriage for which a separate affiliate is not required under section 272. However, to remove any issue in the audit, Verizon transferred these contracts to its section 272 affiliates. These minor transactions do not affect the validity of the audit or the materiality of Verizon’s compliance.

## **V. The Commenters' Criticisms Of The Audit Procedures Are Unwarranted.**

Many of the commenters' criticisms are aimed at the audit plan and the auditor rather than at Verizon's performance. AT&T complains that the agreed-upon procedures are "incomplete" and "inadequate," that the auditor improperly used statistical sampling techniques rather than examining the entire population, and that the samples were too small and violated accepted sampling techniques. *See, e.g.*, AT&T, 3, 14-15. WorldCom also argues (at 7-9) that the audit procedures did not address key issues or gather sufficient information. These criticisms have no merit.

As AT&T concedes (at 5, 11), the Joint Oversight Team placed its proposed procedures on public notice for parties such as AT&T to comment upon. *See Proposed Model for Preliminary Biennial Audit Requirements*, 12 FCC Rcd 13132 (1997). The procedures were expanded significantly as a result of that notice. There was no need to seek additional comments, as AT&T suggests – section 53.211(d) states that review of the audit program is limited to the Joint Oversight Team. The audit procedures reflect the input of the entire industry, as well as the state regulatory commissions of 44 states and the District of Columbia and representatives from the accounting profession. There is no basis for AT&T to complain that it did not have an opportunity to provide its input at the appropriate time into the audit procedures.

In addition, the original procedures specifically contemplated that some areas would be reviewed by using samples rather than examining the entire universe of data. *See, e.g., id.*, Requirement V, Procedure 2 ("Sample affiliate transactions"). This is in line with standard auditing practices, which rarely test 100 percent of a population. Moreover, the General Standard Procedures established guidelines for sampling sizes and methodologies to achieve a

desired confidence level and provided for approval of the sampling plan by the Joint Oversight Team. The procedures state that the sample sizes and methodologies will be determined by the auditor and the users after the initial survey and during the audit.<sup>14</sup> The auditor is required to use statistically valid samples to provide a desired confidence level of 95 percent and a desired upper precision limit equal to 5 percent with an expected error rate of 1 percent. These standards are consistent with accepted statistical tests. There is no merit to the commenters' criticisms either of the use of samples or of the statistical standards that the auditor applied in determining the size of the samples.

## **VI. The Commenters' Claims That Enforcement Action Is Warranted Are Baseless.**

The commenters have ignored the bulk of the positive audit results and have distorted a few anomalies in a blatantly self-serving effort to thwart the growth in long distance competition that has resulted in every market where Verizon has received section 271 authority. They seek enforcement action for issues that clearly do not rise to the level of violations, much less material violations. *See* AT&T, 4; WorldCom, 3. In fact, the issue that they argue is most deserving of enforcement action – the allegedly preferential treatment that Verizon gave its section 272 affiliates in the provision of access services and PIC change orders – is completely baseless. The audit provides no evidence that Verizon has discriminated in favor of its affiliates.

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<sup>14</sup> *See* General Standard Procedures, ¶ 8. AT&T objects (at 14) to the fact that the audit report does not provide details of the sampling methodology. However, Section 272 of the Act does not contemplate that the audit report will include the underlying data and additional detail that is contained in the workpapers, which may be examined only by the Commission and by the State members of the Joint Oversight Team. *See* 47 U.S.C. § 272(d)(3)(B).

The minor clerical errors noted in the audit do not support enforcement action. The standard of compliance is not and cannot be perfection. Verizon has implemented procedures and controls designed to produce substantial compliance with the Commission's rules. The few items noted by the commenters do not demonstrate any violations of the Commission's rules, much less knowing or willful violations.

### **Conclusion**

The audit confirms that fact that Verizon has complied with the Commission's section 272 safeguards. The Commission should reject the criticisms of Verizon's conduct and of the scope and conduct of the section 272 audit.

Of Counsel  
Michael E. Glover  
Edward Shakin

Respectfully submitted,

By: 

Joseph DiBella  
1515 North Court House Road  
Suite 500  
Arlington, VA 22201-2909  
(703) 351-3037  
joseph.dibella@verizon.com

Attorney for the Verizon  
telephone companies

Dated: June 10, 2002

THE VERIZON TELEPHONE COMPANIES

The Verizon telephone companies are the local exchange carriers affiliated with Verizon Communications Inc. These are:

Contel of the South, Inc. d/b/a Verizon Mid-States  
GTE Midwest Incorporated d/b/a Verizon Midwest  
GTE Southwest Incorporated d/b/a Verizon Southwest  
The Micronesian Telecommunications Corporation  
Verizon California Inc.  
Verizon Delaware Inc.  
Verizon Florida Inc.  
Verizon Hawaii Inc.  
Verizon Maryland Inc.  
Verizon New England Inc.  
Verizon New Jersey Inc.  
Verizon New York Inc.  
Verizon North Inc.  
Verizon Northwest Inc.  
Verizon Pennsylvania Inc.  
Verizon South Inc.  
Verizon Virginia Inc.  
Verizon Washington, DC Inc.  
Verizon West Coast Inc.  
Verizon West Virginia Inc.

October 4, 2000

To: All Interexchange Carriers

SUBJECT: NOTIFICATION OF DAILY "BLACKOUT ACTIVITY" FOR SWITCH ACTIVITY

Dear Customer,

We at Verizon have learned of some scheduling information related to our switches and the jobs that interface with our switches that could have an impact on your PIC processing intervals. Each night, there is what is termed a "blackout period" for switch activity. This is a down time that is scheduled in each of the switches and the XEA jobs that interface with them to have an opportunity for daily maintenance and monitoring.

In response to this information, you may decide to alter your file submission schedules or you may determine that this information serves only as an FYI and that there is no need to alter your current schedules. The periods of time included in the blackout period varies slightly in the North and the South and on weekends. They are as follows:

In reference to Switch Manager's interface to MARCH only our times are:

**North:**

MARCH NY from 04:00 to 23:30 Sun - Sat.

MARCH NE from 04:00 to 22:30 Mon - Fri  
from 04:00 to 21:30 Sat  
from 04:00 to 19:30 Sun

**South:**

All MARCH systems from 04:00 to 22:50 Sun - Sat

**MARCH's Down times are:**

CP0 & CP1: Down 01:00 - 02:30 Sunday  
Down 23:00 - 00:30 Mon - Sat

NJ0: Down 01:00 - 02:30 Sun - Sat

PA0: Down 01:00 - 02:30 Sunday  
Down 00:00 - 01:30 Mon - Sat

NE: Down 23:00 - 00:00 Mon - Fri  
Down 22:00 - 00:00 Sat  
Down 20:00 - 00:00 Sun

NY: Down 00:00 - 02:00 Mon - Sun

This notification serves as an informational tool that you may or may not determine requires any action on your part. The schedules for the blackout period have been in place for years and is currently factored into your current intervals. XEA currently pulls the files in and during the blackout period, the files are held in que according to the time that they were sent in and released as the switches are opened up for processing each day.

Altering your schedules for file submission to avoid sending them during the blackout periods could shorten the processing time for your CARE files, if you are currently submitting files during those timeframes. If not, there is no need to consider any changes.

Any question that you may have concerning this notification may be directed to your Verizon PIC Interface Manager.

Sincerely,

Brenda A. Spriggs  
PIC Process Owner  
Verizon