Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In the Matter of	)	
	)	
Section 272(f)(1) Sunset of the BOC	)	WC Docket No. 02-112
Separate Affiliate and Related	)	
Requirements	)	

COMMENTS OF VERIZON

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COMMENTS OF VERIZON[1]

I. Introduction and Summary.

In order to reduce unnecessary costs and improve efficiency to the ultimate benefit of consumers, the Commission should do two things.

First, the Commission should not adopt any rules extending the three-year sunset of the separate affiliate requirements of section 272 of the Act. Congress clearly intended this to be a transitional measure rather than a permanent handicap for the former Bell Operating Companies ("BOCs"), and it established a statutory presumption that the section 272 separate affiliate requirements would sunset in three years. Although Congress gave the Commission the power to extend the sunset date, in order to overcome the congressionally prescribed presumption, there must be some new development that provides a compelling justification. There is none. And this is especially true given that Congress itself provided other non-discrimination requirements that will continue to apply post-sunset through sections 272(e)(1) and (3), 201, 202, and 251 of

[1] The Verizon companies ("Verizon") are the affiliated local and long distance telephone companies of Verizon Communications Inc. These companies are listed in Attachment A.

the Act. Allowing the section 272 separate affiliate requirements to sunset as Congress intended would eliminate literally hundreds of millions of dollars in regulatorily imposed costs and inefficiencies that divert capital from productive uses and ultimately are borne by consumers. Allowing the BOCs to provide local and long distance service on a combined basis, just like competitive local exchange carriers, interexchange carriers, cable companies, and wireless companies do, would promote a more competitive environment and result in better service for consumers.

Second, regardless of its decision on the issue of when the section 272 rules in general sunset, the Commission should sunset immediately the prohibition on the sharing of operating, installation, and maintenance ("OI&M") services for all BOCs. This prohibition alone, which is not mandated by the Act, results in unnecessary duplication of effort that imposes several hundred millions of dollars of extra costs and inefficiencies on the BOCs that inhibit new services and thereby discourage investment. And it is becoming increasingly burdensome and anachronistic as the BOCs deploy the next generation network and move into a broadband environment, where there is not even a logical demarcation between "local" and "long distance" calls. In short, just as the BOCs and their section 272 affiliates already share other services, they also should be permitted to share OI&M services. The result will be lower costs, broader deployment of new technologies and services, and greater competition – all to the benefit of consumers.

II. The Commission Should Allow The Section 272 Restrictions To Sunset In Three Years As Congress Intended.

The Commission should not extend the three-year statutory sunset of the section 272 separate affiliate requirements. Congress established a statutory presumption that these requirements would sunset automatically absent some new development that provided a compelling reason that they needed to be extended by the Commission. There is none. On the contrary, the record shows that in the wake of BOC entry into the long distance business, both local and long distance competition has flourished – just as it has in every market in which the BOCs have been allowed to compete unencumbered by a separate affiliate requirement. Moreover, as the Commission observed in denying a request to extend the separate affiliate requirement for interLATA information services beyond the four-year sunset provision of section 272(f)(2), there are numerous other non-structural safeguards in the Act that extend beyond sunset, including sections 201, 202, 251(c), 251(g), and 272(e). ***See*** *Request for Extension of the Sunset Date of the Structural, Nondiscrimination, and Other Behavioral Safeguards Governing Bell Operating Company Provision of In-Region, InterLATA Information Services*, 15 FCC Rcd 3267, ¶ 3 (2000). In short, Congress knew what it was doing when it decided that the Section 272 restrictions on interLATA services should expire after three years, and the Commission should reject the entreaties of the long distance incumbents who would have the Commission override the statutory scheme in order to artificially inflate the costs of their competitors.

The *NPRM* interprets section 272(f)(1) to sunset on a state-by-state basis, three years after section 271authority is granted in each state. ***See*** *Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, Notice of Proposed Rulemaking, 17 FCC Rcd 9916, ¶ 7 (2002) ("*NPRM*"). However, there is no discussion or analysis supporting this, and it contradicts the plain meaning of the statute. Section 272(f)(1) states that "[t]he provisions of this section . . . shall cease to apply with respect to the . . . interLATA telecommunications services of a *Bell operating company* 3 years after the date such *Bell operating company or any Bell operating company affiliate* is authorized to provide interLATA telecommunications services under section 271(d)." 47 U.S.C. § 272(f)(1) (emphasis added). The statute speaks not in terms of individual states, but of BOCs or BOC affiliates. The Commission itself found in the *Non-Accounting Safeguards Order* that the separate affiliate requirements sunset three years after a "BOC or any BOC affiliate is authorized to provide in-region interLATA services," and not after section 271 authority is achieved in each state. ***See*** *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, 11 FCC Rcd 21905, ¶ 14 (1996) ("*Non-Accounting Safeguards Order*"). Therefore, the separate affiliate requirement clearly sunsets three years after the first time a BOC *or* any of its BOC affiliates receives section 271 authority.

For this reason, the *NPRM* is incorrect in stating that the section 272 requirements sunset in Connecticut in July 2004, three years after Verizon obtained section 271 authority in Connecticut. *NPRM* at ¶ 7, n.19. Since the "BOC" in this case – Verizon New York – serves both New York and Connecticut, the section 272 requirements expire three years after that BOC first obtained section 271 authority in New York in December 1999. In addition, the December 2002 sunset date for Verizon New York applies as well to Verizon New York's BOC affiliates. If the Commission did not interpret the statute this way, it would treat the term "or any Bell operating company affiliate" as superfluous, which contradicts the settled legal principle that the statute must be interpreted to give meaning to all of its provisions. ***See*** *Bennett v. Spear*, 520 U.S. 154, 173 (1997); *Montclair v. Ramsdell*, 107 U.S. 147 (1883) ("It is the duty of the court to give effect, if possible, to every clause and word of a statute, avoiding, if it may be, any construction which implies that the legislature was ignorant of the meaning of the language it employed"). [2]

In fact, Congress specifically rejected a state-by-state approach. The House bill included a provision that "this section shall cease to apply to any Bell operating company *in any State* 18 months after the date such Bell operating company is authorized pursuant to section 245(c) to provide interLATA services *in such State*." ***See*** Debate on H.R. 1555, 141 Cong. Rec. H 8424, 8445, Aug. 4, 1995 (emphasis added). The Senate bill had no sunset provision. In conference, Congress included the sunset provision of the House bill but, in lieu of the state-by-state approach, allowed the section 272 separate affiliate requirement to sunset for each BOC three years after that BOC or BOC affiliate received section 271 authority. The conference report explains that "[t]he three year period commences on the date on which the BOC is authorized to offer interLATA services." Joint Explanatory Statement, S. 104-458, 152 (Jan. 31, 1996). This reference to "the BOC" notably does not contain the qualifier "in any State." The plain meaning of the statute is that the section 272 restrictions (except for section 272(e)) expire three years after a BOC or any of its BOC affiliates first receives interLATA authority in *any* state.

The Commission should not try to extend the three-year sunset established by Congress. The Telecommunications Act of 1996 was based on a "competitive, de-regulatory national policy framework" that required unnecessary regulatory restrictions to be eliminated. ***See*** Joint

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[2] The statute cannot mean that the separate affiliate requirement sunsets three years after the *last* BOC affiliate receives section 271 authority. Such an interpretation would substitute the term "or" in the phrase "Bell operating company or any Bell operating company affiliate" in section 272(f)(1) with "and."

Explanatory Statement, 113; 47 U.S.C. § 161(b). Therefore, there is a presumption that regulatory requirements such as the section 272 separate affiliate provisions should not be extended unless there is a good reason to do so. Here, there is none. The Telecommunications Act of 1996 is working – competition has grown quickly in all regions of the country and the separate affiliate requirement can be considered to have achieved its statutory goal by the three-year sunset date. Continuing the separate affiliate rules after that time harms competition and inhibits investment and innovation by saddling one set of competitors – the BOCs – with substantial unnecessary costs.

The three-year sunset of the section 272 separate affiliate requirement adopted by Congress, on its face, was intended as a transitional measure that would provide an additional safeguard of limited duration after a BOC initially entered the long distance market. And that additional measure was designed to end unless some development during that transitional period provided a compelling justification for its retention. No such development has occurred. On the contrary, competition has flourished. The number of lines served by incumbent local exchange carriers has declined for the last three years running, a trend that has never occurred before in over a century of telephone service. ***See*** *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338, Comments of Verizon, Attachment B, UNE Fact Report 2002, p. IV-8 (filed April 5, 2002) ("*UNE Fact Report*"). This is due in no small part to the migration of customers from traditional telephone company services to services offered by carriers using alternative platforms. The competitive local exchange carriers ("CLECs") operate 1,300 known circuit switches and provide service to at least 20 million local lines, and perhaps as much as 23 million, wholly or partly over their own facilities. ***See*** id., p. I-2; *Local Telephone Competition: Status as of December 31, 2001*, FCC Industry Analysis and

Technology Division, Wireline Competition Bureau (rel. July 23, 2002) ("*FCC Local Competition Report*"). At least 10 million wireline lines have migrated to wireless networks, and over a million and a half customers subscribe to telephony services offered by cable networks, which make such services available to about 10 million homes in 20 states. ***See*** *UNE Fact Report*, pp. IV-1 to IV-12. A recent USA Today/CNN/Gallup poll found that 18 percent of cell phone users "use cell phones as their primary phones." M. Kessler, *18% See Cell Phones as Their Main Phones*, USA Today (Jan. 31, 2002). The total number of lines currently served by incumbent local exchange carriers, CLECs, wireless carriers, and cable companies is approximately 317 million. ***See*** *FCC Local Competition Report*, Public Notice. Of this total, the incumbent local exchange carriers provide 173 million lines, a market share of 55 percent. This is convincing proof that, as Congress expected, competition has grown rapidly as a result of the Telecommunications Act of 1996.

Moreover, the record shows that the competition has continued to develop, and in fact is the strongest, in the states where the BOCs have been granted section 271 authority to enter the long distance market. Nationwide, the CLEC share of end user switched access lines is approximately 10 percent. ***See*** *FCC Local Competition Report*, Table 7. However, the market shares in the states where the BOCs have been granted section 271 authority are significantly higher. For example, the first state where the Commission granted section 271 authority – New York – has a 25 percent market share penetration by the CLECs, the highest in the country. ***See*** id. Similarly, states such as Texas, Pennsylvania, and Massachusetts have about 50 percent higher-than-average CLEC market shares.[3]

In this environment, continuing the section 272 separate affiliate requirements will distort competition and discourage investment and innovation. Interexchange carriers, wireless carriers, CLECs, cable companies, and other competitors are able to provide local and long distance services on an integrated basis without incurring the significant costs of section 272-type separations. These companies enjoy the efficiencies of providing long distance services together with basic "last mile" local services because they are not encumbered by separate affiliate requirements. Continuing to burden the BOCs' long distance services alone with the inefficiencies of separate affiliate rules gives customers an uneconomic incentive to use alternative providers.

For instance, many wireless customers have realized that with monthly usage allowances and "free" long distance service included in the basic wireless rate, it is far cheaper to make long distance calls on their wireless phones in many instances. Wireless communications has become a significant alternative to traditional landline telephone service, with many customers substituting wireless long distance for landline long distance and with some customers even abandoning their landline phones entirely. An IDC survey shows that 12.3 percent of customers have purchased wireless phones in lieu of a second landline phone, and that one third of wireless calls are long distance. ***See*** Dana Thorat, IDC, *Soaring Wireline Displacement and Highest*

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[3] Just as loss of local market share is not a "checklist" criterion for granting section 271 authority, it likewise can not be used as a "test" of whether to eliminate the section 272 separation requirements.

Interest in Location-Based Services: U.S. Wireless Household Survey Results, at 7 (2002) *available at* www.idc.com. The Commission itself has noted that;

> A survey by the Yankee Group, for instance, found that about three percent of mobile telephone subscribers rely on their wireless phone as their only phone and another survey conducted by the Consumer Electronics Association found that three in ten wireless phone users say that they would rather give up their home telephone than their wireless phone. In addition, a USA Today/CNN/Gallup pole found that 18 percent of wireless phone owners use their wireless phone as their primary phone. In the *Seventh Annual CMRS Competition Report*, we also found data suggesting that wireless plans are substituting for traditional wireline long distance. For example, we noted one analyst's claim that 20 percent of AT&T's customers, or 5 million people, have replaced some wireline long distance usage with wireless.[4]

The Commission has also found that "many customers are using their mobile service rather than interexchange service to make long distance calls: according to one report, 16 percent of customers surveyed now make most of their long distance calls using mobile services.[5]

The Commission has long recognized that separate affiliate requirements impose financial costs that can raise consumer prices and inhibit competition. ***See, e.g.***, *Third Computer Inquiry*, 104 FCC 2d 958, ¶ 3 (1986) ("structural separation requirements impose significant costs on the public in decreased efficiency and innovation that substantially outweigh their benefits"). The section 272 separate affiliate requirements require the BOCs to incur the costs of duplicative facilities, personnel, wholesale billing systems, and operating support systems that cannot be shared with the local operating companies. Verizon's actual experience confirms that these costs are substantial. From 1998 to 2002, Verizon Global Networks Inc, ("GNI"), the section 272 affiliate that provides underlying network services to Verizon's retail section 272

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4 *Verizon Wireless' Petition for Partial Forbearance from the Commercial Radio Services Number Portability Obligation*, WT Docket No. 01-184, Memorandum Opinion and Order, FCC 02-215, ¶ 17 (rel. July 26, 2002) (footnotes omitted).

5 *Federal-State Joint Board on Universal Service*, 17 FCC Rcd 3752, ¶ 11 (2002).

affiliates, incurred approximately $314 million of expense, including depreciation on $195 million of investment, solely to meet the section 272 separation requirements. [6] In addition, GNI expects to spend an additional $550 million through 2006 as a result of these rules. Although it may not be economic to eliminate all of the sunk investment in separate equipment, systems and facilities when the separations rules sunset, Verizon estimates that GNI potentially could save almost $247 million through 2006 if the separate affiliate restrictions were eliminated today and if Verizon could begin re-integrating its long distance operations where practicable. In addition, a large portion of the costs incurred by Verizon's retail section 272 affiliates are driven by separate affiliate rules. Verizon estimates that approximately $91 million of incremental billing expense could be avoided through 2006 if long distance charges were included as part of the BOC's bill for local and toll services.[7] Verizon also could save approximately $2 million for

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[6] ***See*** Attached Declaration of Fred Howard, ¶ 5. Verizon's domestic section 272 affiliates are successors to pre-merger companies that existed at the former NYNEX, Bell Atlantic, and GTE companies. Verizon found it was more efficient to focus these companies on specific market sectors rather than immediately combine them into a single section 272 affiliate at this time. The section 272 affiliates are; (1) GNI, which constructs and operates a domestic long distance network for the other Verizon section 272 affiliates; (2) Verizon Long Distance, which provides interLATA services to residential and small business customers; (3) Verizon Enterprise Solutions, which serves large and some small business customers; (4) Verizon Select Services, Inc., which provides long distance services to large business customers, prepaid calling cards and customer premises equipment; and (5) Verizon Global Solutions, Inc., which constructs and operates an international network for other Verizon affiliates. In addition, Verizon has established Verizon Long Distance Virginia Inc; Verizon Enterprise Solutions Virginia Inc. and Verizon Select Services of Virginia Inc. to comply with Virginia law that requires public utilities to be incorporated in Virginia. Verizon has international affiliates that are subject to section 272 requirements because they provide in-region services, primarily calling card services and international services, including Codetel International Communications, Inc.; Telus Communications Inc.; Telus Communications (Quebec) Inc.; Compania Anonima Nacional Telefonos de Venezuela (CANTV); and Telecom New Zealand USA Limited.

[7] This is based on the costs of publishing separate long distance affiliate pages in the customer's bills for local exchange service minus the mark-up in the billing and collection contract.

personnel involved in processing and tracking orders. And Verizon estimates that the process of negotiating and posting affiliate transaction agreements adds another $1 million over this period.

Without sunset of the section 272 rules, these costs ultimately are borne by consumers in the price and quality of service they receive from both Verizon and its competitors, who face less competitive pressure from Verizon. The costs of complying with separate affiliate rules diverts capital from productive investments and development of innovative services. Especially at a time of economic slowdown, the Commission should take every opportunity to eliminate unnecessary regulatory restrictions that inhibit growth.

The Commission should allow the section 272 restrictions to expire as scheduled. The record clearly shows that competition has taken hold and is irreversible. The incumbent local exchange carriers are losing both market share and absolute numbers of lines, which is the clearest evidence that the Act is working. Continuing the separate affiliate requirements beyond the statutory period will retard the development of competition by handicapping the BOCs and increasing their costs of providing long distance service. For these reasons, it is critical that the Commission not extend the section 272 separate affiliate requirements beyond the three-year sunset.

III. The Commission Should Not Adopt Any Of The Proposed Alternatives To The Statutorily Prescribed Sunset Of Section 272.

Several of the alternatives raised in the *NPRM* seem to cast doubt on whether the statutory sunset is a good idea. For instance, the *NPRM* questions whether the separate affiliate requirements should sunset in three years if the statute only requires a biennial audit every two years, causing the sunset to occur before the second biennial audit is concluded. ***See*** *NPRM*, ¶¶

19, 22. The *NPRM* also notes that section 272(e) survives after sunset, but that sections 272(e)(2) and (e)(4) would have no practical effect if the BOC decides not to maintain a separate affiliate after sunset, when it will be optional. ***See*** id., ¶ 20. The *NPRM* asks whether the Commission should re-interpret these provisions as surviving the absence of a separate affiliate. The *NPRM* also asks whether reduced separate affiliate requirements should continue after sunset, and whether elimination of such reduced safeguards should expire only after a BOC makes an evidentiary showing, such as whether its market power has eroded. ***See*** id., ¶¶ 23, 28.

One common flaw in all of these proposals is that they are not premised on any new developments to overcome the congressionally prescribed presumption that the section 272 separate affiliate requirements will sunset in three years. Rather, they seek to cure what are posited as possible shortcomings in the statutory scheme. The statute is clear, and the Commission should carry out Congress' intent unless it can show that matters arising *after* enactment of the Telecommunications Act of 1996 raise new issues that Congress would want to be addressed through administrative action. Congress knew that adopting biennial, rather than annual, audits would mean that only one full audit would apply in any three-year period for a particular state. Congress also knew that sections 272(e)(2) and (4) only applied to a BOC that maintained a separate affiliate, which would no longer be a requirement after three years. And Congress fully intended that the separate affiliate requirement was a transitional safeguard that would expire automatically after three years without any evidentiary showing or a new proceeding absent some new development that provided a compelling reason to overcome the statutory presumption. The Commission must have a better reason for overriding the three-year sunset than a disagreement with the intent of Congress. This was a deregulatory act, designed to replace regulation with competition. The Commission should adhere to the congressional intent and avoid trying to "improve" on the statute.

The *NPRM* asks how the cost-benefit analysis of continuing the separate affiliate requirements past the three-year sunset is affected if a BOC will still be required to use a separate affiliate in states where the requirement has not sunset. ***See*** *NPRM*, ¶ 17. This is irrelevant, as the BOC will be able to enjoy the efficiencies of combined operations in states where the requirements sunset regardless of whether the inefficiencies still exist in other states.[8] Moreover, as Verizon demonstrates below, the single largest source of duplicative costs is the OI&M restriction. If the Commission does not eliminate this restriction immediately, as Verizon recommends, it should eliminate the restriction for all of a BOC's states when sunset has occurred for any affiliated BOC in any individual state. This would be far more productive and consistent with the Act than extending the burdensome section 272 separate affiliate rules for all states until sunset occurs for the last state.

After sunset, the Commission should not replace the section 272 requirements with the less-stringent separation requirements that apply to independent local exchange carriers under section 64.1903 of the Commission's rules. ***See*** *NPRM*, ¶ 23. Those rules currently prevent the independent local exchange carrier from jointly owning transmission or switching facilities, which causes unnecessary duplication of facilities and higher costs. Approximately $195 million

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[8] The fact that some BOCs, such as Verizon, maintain multiple section 272 affiliates does not affect the cost-benefit analysis. Whether the BOCs pursue different lines of long distance business through separate legal entities as opposed to different divisions of the same legal entity has little effect on costs, since these affiliates may share services and network facilities with each other. The real source of inefficiency is the inability of any of these entities to share facilities or OI&M services with the local operating companies.

of the investment that Verizon incurred since 1998 to provide long distance service was spent simply to comply with the prohibition on joint ownership of facilities, a substantial investment that could have been put to better use to provide other services to the public. ***See*** Howard Declaration, ¶ 4. The Commission should not continue to impose this type of economic waste simply to pursue a misplaced desire for consistency. If the Commission is concerned that it is incongruous to require small, independent local exchange carriers to bear heavier burdens than the larger BOCs, the proper solution is to finalize the pending rulemaking in Docket 00-175 and to eliminate the prohibition on joint ownership of facilities in section 64.1903. ***See*** *2000 Biennial Regulatory Review, Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules*, Notice of Proposed Rulemaking, 16 FCC Rcd 17270 (2001). At that point, there would be little difference between the section 64.1903 rules and the rules applicable to the BOCs, including the rules implementing sections 272(e)(1) and (3).

There is no regulatory need to extend the section 272 separate affiliate requirements, or the associated biennial audits, beyond their time. The Commission has effective regulatory tools to deal with issues such as discrimination and declines in the quality of wholesale services. As the Commission notes, the nondiscrimination requirements of section 272(e)(1) and (3) survive sunset. ***See*** *NPRM*, ¶ 24. This supplements the Commission's existing authority under sections 201 and 202 of the Act to require the BOCs to provide exchange access services to their competitors on a reasonable and nondiscriminatory basis. The Commission has begun two rulemaking proceedings to consider setting performance standards for special access services and for UNEs/interconnection. ***See*** *NPRM*, ¶ 26; *Performance Measurements for Interstate Special Access Services,* Notice of Proposed Rulemaking, 16 FCC Rcd 20896 (2001); *Performance Measurements and Standards for Unbundled Network Elements and Interconnection,* Notice of

Proposed Rulemaking, 16 FCC Rcd 20641 (2001). The Commission can apply its cost accounting rules and the imputation standards of section 272(e)(3) to ensure that the BOCs properly attribute their costs to their long distance operations. And the Commission has ample authority to monitor and enforce these rules under sections 4(i), 220, 503, and 206-209 of the Act. The Commission should use these tools to deal directly with any issues that affect the ability of interexchange carriers to compete with the BOCs rather than extend the section 272 separation requirements.

IV. The Commission Should Eliminate The OI&M Restriction Immediately For All Of The BOCs.

Rather than extend selected portions of the section 272 separate affiliate requirements beyond the three-year sunset, as is discussed in the *NPRM* (at ¶ 17), a better alternative is to eliminate immediately the prohibition against the sharing of OI&M services between the local exchange company and the section 272 affiliate for all BOCs, prior to the three-year sunset. The OI&M restriction requires the long distance affiliate to hire central office, network operations center, and field personnel to perform activities that could be performed by BOC personnel or a centralized service staff at much less incremental expense. This duplication of effort serves no purpose and creates economic waste. The current rules already permit all other services to be shared between the BOC and the section 272 affiliate or to be provided by an affiliated central service organization. ***See*** *Non-Accounting Safeguards Order*, ¶¶ 178-180. The Commission should allow the sharing of OI&M services as well.

A creation of regulation and not the Act, the OI&M prohibition, in fact, is not mentioned anywhere in section 272 of the Act. On the contrary, the Commission created it when it adopted rules to implement the requirement in section 272(b)(1) that the long distance affiliate "operate independently" of the BOC. ***See*** id., ¶ 158. But that section does not itself bar the sharing of OI&M services. The Commission can and should eliminate this restriction regardless of whether the other section 272 provisions have already sunset in any state.[9]

When the Commission adopted the OI&M restriction, it did not have a record to properly conduct a cost-benefit analysis of using structural separations rather than cost accounting safeguards. The only cost that the Commission considered was the regulatory cost of monitoring cost allocations for personnel performing similar services for both the BOC and its section 272 affiliate. ***See*** *Non-Accounting Safeguards Order*, ¶ 163. The Commission did not have the information necessary to evaluate the duplication of cost and operational inefficiencies that the restriction would impose on the BOCs. Verizon has had several years of experience in establishing and running its section 272 affiliates, and its analysis shows that the OI&M restriction is the major factor in the additional costs caused by the section 272 separation rules. The restriction imposes duplicative costs on Verizon's section 272 affiliates by requiring them to hire additional personnel to do provisioning and maintenance work that could be done more efficiently by sharing personnel with the BOC, which already has employees with the skill sets that are applicable to long distance services. The restriction also requires the separate affiliate to develop and operate its own operating support systems when the BOCs' OSSs could perform the

[9] While this issue can and should be decided as part of this proceeding, Verizon also is simultaneously filing a petition for forbearance from this restriction under 10 of the Act, 47 U.S.C. § 160. ***See*** Petition of Verizon for Forbearance From The Prohibition Of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) Of The Commission's Rules, CC Docket No. 98-149 (filed Aug. 5, 2002).

same tasks with little modification, and to develop redundant network operating control systems and back office provisioning functions.

As is shown in the Howard Declaration, GNI has incurred and will incur approximately $495 million in costs through 2006 solely to comply with the OI&M restriction. This represents over half of the additional costs that GNI has incurred and will incur in order to comply with the section 272 rules. Going forward, as much as $183 million of GNI's potential savings from sunset of the section 272 rules would be achieved simply through elimination of the OI&M restriction. Clearly, these costs exceed any incremental benefit of using structural separation rather than cost accounting to prevent cross-subsidization of long distance services.

There is no regulatory need for this restriction. The Commission adopted it primarily because the Commission was concerned about its ability to monitor the allocation of costs between the BOCs and their section 272 affiliates. ***See*** *Non-Accounting Safeguards Order*, ¶ 163. However, there is no fundamental difference between the cost allocations necessary to monitor the sharing of OI&M services and the cost allocations that the Commission already applies to administrative and other services that are currently permitted to be shared between a BOC and a section 272 affiliate, such as finance, human resources, legal, and accounting. Like the sharing of administrative services, sharing of OI&M services prior to sunset would be subject to the Commission's affiliate transaction rules. ***See*** 47 C.F.R. § 32.27. These rules require that the personnel performing services for an affiliate account for all time associated with work on behalf of the affiliate. Furthermore, BOC operating personnel already use positive time reporting to record work performed for nonregulated activities such as inside wire under the Part 64 rules. Similar time reporting can and would be used for sharing of OI&M services with the long distance affiliates under the affiliate transaction rules. The Commission previously found that administrative services could be shared, because its *Accounting Safeguards* order provided sufficient mechanisms for monitoring cost allocations and deterring cross-subsidization. ***See*** *Non-Accounting Safeguards Order*, ¶ 181. The same safeguards, including the requirement for the section 272 affiliates to conduct transactions with the BOCs on an arms-length basis, to reduce them to writing and make them available for public inspection, to maintain separate books, and to be subject to audits, would be just as effective for the sharing of OI&M services.

It should also be noted that cross-subsidization is not a realistic danger for carriers such as the BOCs, who are subject to price-based regulation in the federal arena and in most states. Under price caps, misallocating costs to regulated accounts does not increase the carrier's prices or revenues. Therefore, such misallocations, even in the unlikely event that they could escape detection by the Commission's controls, would not give the carrier any ability to offer below-cost long distance services.

The OI&M restriction is becoming increasingly burdensome and anachronistic as the industry begins to deploy the next generation network and moves into a broadband environment. As is discussed in the attached declaration of Jeannie H. Diefenderfer, broadband, by its nature, gains efficiency by integrating services over a single platform. Unlike traditional circuit-switched telephony, Internet protocol networking cannot be readily categorized into "local" and "long distance" calls. A broadband network provides a platform for combining voice, data, video, etc. into a backbone that is essentially distance-insensitive. The OI&M restriction requires the use of multiple work groups to deal with arbitrarily delineated demarcations between "local" and "long distance" portions of what is technologically, as well as in the minds of customers, a single integrated end-to-end service. It saddles the BOCs and the section 272 affiliates with separate systems for network creation, ordering, provision, surveillance, maintenance, and repair. The need for separate systems and work groups imposes inefficiencies that raise the costs of introducing broadband service and discourage investment at a crucial stage in the growth of this market, which many see as a critical component in the nation's future economic growth.[10] Because of the relative newness and small size of this marketplace, the section 272 affiliates' work groups and operating support systems lack the economies of scale that would aid the BOCs in achieving the critical mass needed to spur innovative uses of the broadband network. The problems of coordinating OI&M functions among multiple affiliates and their separate systems has a particularly negative effect on new technologies such as broadband, because such new technologies must be tested separately to ensure proper interaction of all of the multiple systems.

In addition, the OI&M restriction imposes marketing handicaps on the BOCs that inhibit their ability to meet customers' needs. While this is true in all segments of the business, one particularly graphic example is in the large business segment. Competition is particularly intense in this segment, where Verizon competes with large, established carriers in attempting to attract customers with annual revenues of at least $100,000 and as much as $10 million or more. ***See*** attached Declaration of Steven McCully. Indeed, at present, the three major long distance incumbents control over two thirds of the nationwide enterprise market segment. ***See*** *UNE Fact Report*, II-24. Typical large business customers have dedicated account teams, require a custom-engineered network, and expect sophisticated installation and dedicated customer support.

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[10] ***See, e.g.,*** Robert W. Crandall & Charles L. Jackson, Criterion Economics, L.L.C., *The $500 Billion Opportunity: The Potential Economic Benefit of Widespread Diffusion of Broadband Internet Access* (July 2001).

Verizon surveys show that 90 percent of customers consider service reliability and meeting deadlines as critical factors in selecting a vendor. In order to try to break into the long distance business market segment, Verizon must convince potential customers of its ability to provide the high level of customer support that they expect, despite the fact that Verizon cannot provide the same level of efficiency in responding to customer repair requests as its competitors due to the section 272 restrictions.

The OI&M restriction puts Verizon at a significant disadvantage in competing with carriers that are able to offer an integrated service platform using their own local and long distance facilities. For large business accounts, many of Verizon's competitors provide their own transmission facilities directly to the customer's location, seamlessly integrating "local" and "long distance" networks and using a single workforce to respond to installation and repair requests. For example, CLECs use their own fiber-based last-mile facilities to serve the vast majority of their large business customers. *See UNE Fact Report*, p. IV-1. In servicing large accounts, Verizon cannot respond as a single team that can maintain end-to-end service. The section 272 rules result in a set of hand-offs of customer requests for service and repair that lead to less than optimal results. While the customer may be provided with a single phone number to call for service, the reality is that no one group at Verizon will be able to meet the customer's needs. The long distance and BOC work groups must transfer responsibility to each other as they try to verify the location of a problem and resolve it. This hinders Verizon in responding to service issues and in meeting the level of service quality that these customers expect. As a result, competition in the form of service quality suffers, detracting from the central goal of the Telecommunications Act of 1996 to promote competition in all sectors of the telecommunications industry.

For these reasons, the Commission should eliminate the prohibition on sharing OI&M services immediately for all BOCs, regardless of whether the separate affiliate rules have sunset or not in any particular state. If the Commission does not eliminate these rules for all of the BOCs in this rulemaking, it should grant Verizon's section 10 petition for forbearance from this restriction.

Conclusion

For the foregoing reasons, the Commission should not extend the section 272 separate affiliate requirements beyond the three-year sunset date.

Respectfully submitted,

By: ______________________
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Attorney for the Verizon companies

Of Counsel
Michael E. Glover
Edward Shakin

Dated: August 5, 2002

Declaration of Fred Howard

1. My name is Fred Howard. My business address is 1320 North Courthouse Road, Arlington, VA. 22201. I am the President of Verizon Global Networks Inc. ("GNI"). I have more than 37 years of service with Verizon in a host of network related positions. My responsibilities include supervision of the operating, installation and maintenance functions denoted in the FCC's section 272 separate affiliate rules, 47 C.F.R. § 53.203(a). My organization's responsibilities begin with building the long distance network after receiving work orders from engineering. Once the network is built, we are responsible for surveillance and maintenance of the network. My organization also receives orders from our sales channels and installs the services requested on our network. Should a customer experience a long distance problem, we also repair their service. My organization has other responsibilities in the administrative arena, which support our company's mission.

2. The purpose of this declaration is to provide an estimate of the costs that GNI has incurred to comply with the FCC's separate affiliate rules under section 272 of the Act. This analysis looks at the costs already incurred from 1998 through 2002 to establish and run GNI as a fully separate affiliate pursuant to the FCC's rules, as well as the projected costs to be incurred from 2003 through 2006 using GNI's current business plan. In performing this analysis, I looked at the capital investment in network switching and transmission facilities, land and buildings, operating support systems ("OSSs"), and other capitalized costs that GNI incurred to meet the separate affiliate requirements compared to the incremental investments that Verizon would have incurred if it could have developed interLATA capabilities through the BOCs. The difference between these investments represents the capital costs of complying with the section 272

separate affiliate rule. Similarly, I looked at the annual expenses that GNI incurs and determined what percentage of these expenses could be eliminated if the associated activities could be performed directly by the Verizon Bell Operating Companies ("BOCs"). Again, the difference represents the incremental costs of complying with the Commission's separate affiliate rules.

3. In the area of capital costs, I included capital costs of (1) switches and transmission facilities; (2) administration, including land and buildings, leasehold improvements, servers, computers, and capitalized software; (3) network operating center ("NOC"); (4) OSSs; and (5) laboratory test systems. In the area of expenses, I included (1) outside contractors, such as those providing field technicians, that would normally have been staffed by BOC employees; (2) staff and administrative employees; (3) leased transmission facilities; (4) OSSs; (5) network operations; (6) NOC; (7) back office functions, e.g., for calling card, repair; and (8) miscellaneous. For each category, I determined the percentage of total investment and costs that would be avoided if the investments or activities were undertaken by the BOC rather than a fully separate affiliate such as GNI.

4. The results of this study show that GNI has incurred approximately $195 million in capital costs and $314 million in expenses, including depreciation on capital, from 1998 through 2002 to meet section 272 requirements. The study also shows that GNI will incur an additional $550 million in expenses from 2003 to 2006 to continue to meet these requirements. If the Commission's section 272 rules sunsetted in 2002, it would not be economic to eliminate all of the sunk investments that were made in separate facilities and systems to meet section 272 requirements. However, a conservative estimate of the savings that could be obtained over the 2003 through 2006 time period by re-integrating operations with the BOC where it was economically advantageous to do so is about $247 million.

5. Most of the costs that Verizon incurs to meet the section 272 separate affiliate requirements are related to the prohibition on sharing of operating, installation, and maintenance services between the BOC and the section 272 affiliates. The OI&M restrictions affect expenses in the category of (1) outside contractors; (2) staff and administrative employees; (3) OSSs; (4) NOC; and (5) back office provisioning. Verizon has incurred approximately $197 million from 1998 through 2002 to comply with the OI&M restriction, and it expects to incur an additional $298 million from 2003 through 2006 to comply with this restriction, for a total of $495 million. If the OI&M restriction were eliminated, GNI would save approximately $183 million over the 2003 through 2006 time period by sharing these services with the BOCs. This is close to 75 percent of GNI's avoidable costs over this period. This shows that the OI&M restriction is the single most important source of inefficiency and duplication of costs caused by the section 272 separate affiliate rules.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on August 1, 2002

Fred R. Howard

Fred Howard

Declaration of Jeannie H. Diefenderfer

1. My name is Jeannie Diefenderfer. My business address is 1095 Avenue of the Americas, New York, NY. I am the Group President-Systems, Billing & Process Assurance for Verizon. My responsibilities include advanced services' billing operations, performance assurance and systems planning, implementation, and operations. I am also responsible for support functions such as business planning, program/project management, and regulatory compliance. I have more than 14 years of experience in the telecommunications industry in a variety of engineering and operations positions working for NYNEX, Bell Atlantic, and now Verizon. Prior to assuming my current responsibilities, I was Group President, Advanced Networks for Verizon.

2. The purpose of this declaration is to explain the inefficiencies associated with providing broadband service through a multiple affiliate structure. Elimination of this requirement would allow Verizon to compete on equal terms with other broadband providers, including the dominant providers of such services, which would result in benefits to consumers.

3. Broadband, by its nature, gains efficiency by integrating various services over a single platform. Dismembering integrated broadband services and requiring that they be offered through multiple affiliates runs counter to this concept and will only hamper the introduction of broadband capabilities into the network.

4. In addition, broadband services are relatively new and are used by only a fraction of the number of customers that use narrowband voice services. The added costs imposed by separation requirements are especially pernicious when spread across this smaller customer base.

5. Providing broadband services through structurally separate companies for the "local" and "long distance" segments of the service is inefficient and increases the cost of providing the total service. These inefficiencies are found in systems for provisioning/maintaining service, processes to manage the interaction of the multiple affiliate structure and multiple work centers to care for customers and the network.

6. Systems. A carrier uses network creation, ordering, provisioning, surveillance and service assurance (maintenance and repair) systems to provide its services. If it is required to break up what would otherwise be a single integrated end-to-end service into different pieces to be provided by separate corporate entities, each entity must have its own systems to manage its part of the service. This duplication is costly and inefficient.

7. Processes. If multiple entities must work together to provide what would otherwise be a single integrated end-to-end service, they must develop processes to work with each other. These processes serve no business or customer need and only complicate and add cost to the service.

8. Work Centers. Carrier employees deal with customers, process orders and the like. These employees typically are located in service centers or similar facilities. Separation requirements mean that separate centers have to be established to house the employees who perform these functions for each entity. And it means that multiple employees are required to perform a function that a single employee could perform if the service were offered as a single integrated end-to-end service. To make matters still worse, because of the relative newness and smallness of this marketplace, individual centers would likely not be large enough to operate efficiently.

9. Finally, the introduction of new technologies into the network can be hampered by the fact that Verizon must conduct integration testing for any new technology. Integration testing includes validation of a new technology against all of the associated systems that are affected. Under a separate affiliate structure, this means inefficiency through redundant testing of new technologies and systems.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on July 31, 2002

Jeannie H. Diefenderfer

Declaration of Steven G. McCully

1. My name is Steven G. McCully. My business address is 8300-G Guilford Road, Columbia, Maryland 21046. I am President – Enterprise Long Distance, Verizon Select Services, Inc. ("VSSI"), which is part of the Verizon Enterprise Solutions Group ("ESG"). I have a Bachelor of Science degree and a Masters of Business Administration degree from the University of Maryland. I began my career in 1980 in Consumer Marketing with Chesapeake & Potomac Telephone. I have held positions of increasing responsibility in Business Marketing and Large Business Sales prior to my 1995 appointment managing strategic regulatory initiatives for the Enterprise Business unit. I have led the long distance services unit of Verizon Enterprise Solutions Group since September 2000.

2. The purpose of this declaration is to describe the handicaps that the FCC's section 272 separate affiliate rules place on Verizon in meeting the needs of large business customers for a single-carrier solution to their telecommunications needs. VSSI provides retail long distance services to large business customers as a fully separate affiliate of the Verizon Bell Operating Companies ("BOCs"). ESG represents several Verizon entities and organizations, including VSSI and the Verizon BOCs, and focuses its sales efforts upon customers who purchase multiple services and sophisticated networks to serve several locations with potentially thousands of employees. Minimum annual revenue for an ESG customer would be approximately $100,000 and may be as great as $10,000,000 or more.

3. ESG's enterprise customers are normally located in urban, densely populated areas where numerous competitive alternatives exist. Attracting these customers requires significantly more targeted and customized marketing than the consumer market. Further, the method of providing service to these customers is significantly different than for a residential or small business customer. Typically, ESG customers require dedicated account teams, a custom-engineered network, sophisticated installation and dedicated customer support. This level of service is considered a differentiating factor by customers targeted by ESG. ESG surveys show that well over 90% of customers in this group consider service reliability and meeting deadlines as critical factors in selecting a telecommunications service provider.

4. Separate affiliate requirements result in ESG being placed at a competitive disadvantage when compared to other carriers that can provide local and long distance networks on an integrated basis. The FCC's separate affiliate rules result in handoffs of customer requests for service and repair that add cost and difficulty in meeting customer expectations. From the customer's point of view, these regulatory handicaps are irrelevant. These customers hold Verizon to the same service standards as its competitors, such as competitive local exchange carriers and interexchange carriers, who have the ability to provide service through end-to-end networks without concerns about having to structurally separate various parts of their businesses.

5. For example, financial institutions, which are a significant customer segment for ESG, are particularly demanding in seeking security, network reliability, redundancy and shortened repair intervals. A financial institution may require a

combination of local dial-up telephone services, long distance services, and special access and private line services to connect various building locations.

6. Should such a customer agree to purchase services from Verizon, Verizon must undertake a more constrained approach to responding to its needs for service. While the customer may be provided with a single phone number to call for service, the reality – due to the prohibition from sharing operating, installation, and maintenance ("OI&M") services between the Verizon local exchange companies and the Verizon long distance companies – is that no one person can fulfill the customer's needs, unlike their experience with Verizon's competitors, who can provide both local and long distance facilities through a single entity. When ESG takes the initial call reporting a service problem, a notice will be sent to the local telephone operating company to respond. The local telephone operating company may verify that its network is the root of the service problem. Should that not be the case, ESG will transfer the service request to the repair personnel of the long distance affiliate. The long distance affiliate will perform a similar network verification. Thus, the effort to meet customer response time grows significantly with every handoff.

7. Verizon's inability to use a single work force to provide OI&M services in support of its local and long distance services impairs its ability to efficiently meet the customer's demands for the quality of service that it expects in the critical large business market segment. This reduces the competitive impact of entry into the long distance market by Verizon and undermines competition in one of the areas that large business customers value the greatest – service quality.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on July 25, 2002

Steven G. McCully

Steven G. McCully

THE VERIZON TELEPHONE COMPANIES

The Verizon telephone companies participating in this filing are the following affiliates of Verizon Communications Inc.:

Bell Atlantic Communications Inc. d/b/a Verizon Long Distance
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
NYNEX Long Distance Company d/b/a Verizon Enterprise Solutions
Verizon California Inc.
Verizon Delaware Inc.
Verizon Enterprise Solutions Virginia Inc.
Verizon Florida Inc.
Verizon Global Networks Inc.
Verizon Global Solutions Inc.
Verizon Hawaii Inc.
Verizon Long Distance Virginia 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 Select Services
Verizon Select Services of Virginia Inc.
Verizon South Inc.
Verizon Virginia Inc.
Verizon Washington, DC Inc.
Verizon West Coast Inc.
Verizon West Virginia Inc.