Exhibit H

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of Petition 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. 96-149**

Ex Parte Declaration

of

LEE L. SELWYN

on behalf of

AT&T Corp.

July 9, 2003

EX PARTE DECLARATION OF LEE L. SELWYN

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Verizon's assumption that its ILECs have sufficient existing capacity to "absorb" GNI's OI&M demands would ascribe to GNI no more than the short-run incremental cost of these newly integrated functions, which would be less than TELRIC-based prices that Verizon charges to its CLEC competitors for unbundled access to its network. 10

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EX PARTE DECLARATION OF LEE L. SELWYN

1 **Introduction**
2

3 1. My name is Lee L. Selwyn; I am President of Economics and Technology, Inc. ("ETI"),
4 Two Center Plaza, Suite 400, Boston, Massachusetts 02108. I have previously submitted an *ex*
5 *parte* Declaration in this matter on behalf of AT&T Corp. on March 15, 2003; my Statement of
6 Qualifications was attached thereto. I have been asked by AT&T to review certain recent *ex parte*
7 filings made by Verizon, and to offer an opinion as to the content thereof.
8

1 **Background**
2

3 2. The Commission has interpreted the 47 U.S.C. §272(b)(1) "operate independently"
4 requirement as prohibiting a BOC's ILEC entities and Section 272 affiliates from (a) sharing
5 operations, installation and maintenance ("OI&M") functions, and (b) jointly owning switching
6 and transmission facilities and the associated land and buildings.[1] In its *Petition* filed August 5,
7 2002, Verizon asked the Commission only to forbear from enforcing the OI&M prohibition.[2]
8 Verizon asserts that if the various OI&M functions that are currently being performed by the
9 affiliates on a stand-alone basis were instead to be performed by its ILEC personnel utilizing
10 facilities that are fully integrated with ILEC network operations, the Verizon Section 272 affiliates
11 would realize ongoing savings of $247-million over the coming three years.[3] Although Verizon

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1. *Implementation of the Non-Accounting Safeguards of Section 271 and 272 of the Communications Act of 1934, as Amended,* 11 FCC Rcd 21905, 21981-21982 (1996).

2. *Petition for 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. 96-149, Petition for Forbearance, filed by Verizon, August 5, 2002. Significantly, the Table used by Verizon to establish "Incremental Operating Expenses Driven by Structural Separation" in its *ex parte* filings is not limited to the OI&M restriction. *See*, Verizon's June 4, 2003 *ex parte*, Attachment 3, p. 2, Table 1; *see also*, June 24, 2003 *ex parte,* at 8, Table 1. There Verizon identifies, for example, "Leased facilities" as one of those expenses, asserting that "[w]ithout section 272 restrictions, VZ would have built rings instead of leasing facilities (both for use by GNI and by the local exchange company)." Of course, that expense is driven by the joint ownership prohibition of Section 272(b)(1), not by the OI&M restriction.

3. *Petition for 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. 96-149, Declaration of Fred Howard, filed by Verizon, August 5, 2002. In fact, Verizon would never realize the full extent of the savings it purports to have projected. Verizon's analysis is based upon historical data. However, Verizon is already permitted to operate its local
(continued...)

had advanced specific dollar figures for the claimed savings in its August 5, 2002 *Petition*, the Company provided no data or analysis in support of such claims. Apparently at the request of the Wireline Competition Bureau, Verizon has now submitted documents, in the form of several *ex parte* filings made on May 19, June 4, and June 24, 2003, as well as documents transmitted via letter to AT&T dated June 2, 2003, that purport to provide "support" for its "savings" forecast.

Verizon's latest *ex parte* submissions advance no new facts or other evidentiary support for the cost "savings" that Verizon claims would result from elimination of the "operate independently" requirement.

3. At the request of AT&T, I have reviewed the three Verizon *ex parte* submissions, and conclude that they offer no additional substantive facts or analyses than had been present in the original *Petition*. In these submissions, Verizon purports to calculate the "costs" that (it contends) the OI&M rules impose upon Verizon's Section 272 affiliate, Verizon Global Network Inc. ("GNI"). The essence of Verizon's "analysis" is a series of irreproducible and largely

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3. (...continued)
and long distance OI&M services on an integrated basis in New York, where the FCC has allowed the requirements of Section 272(b)(1) to sunset. FCC Public Notice, "Section 272 Sunsets for Verizon in New York State By Operation of Law On December 23, 2002 Pursuant to Section 272(f)(1)," rel. December 23, 2002. As I discuss in more detail, *infra*, at paras. 3-4, because Verizon has provided no workpapers or other data or documentation underlying its cost savings calculation, the estimate can neither be reproduced nor verified. That said, nothing in Verizon's *Petition* or in its various *ex parte* filings would indicate that there had been any allocation of the purported cost savings to (or other than to) New York, or any discussion of excluding New York expenses from GNI accounts for the purposes of determining cost savings. Therefore, it would appear that the GNI accounts include OI&M costs for which no forbearance is required, or expense savings that could (presumably) be obtained without the regulatory relief being sought here. In either case, these putatively structural separations-driven expenses should not have been included in Verizon's analysis.

1 undocumented "percentages of each GNI expense category that Verizon claims had been driven
2 by the requirements of the Commission's section 272 structural separations rules" pertaining to
3 OI&M.[4] Each of these "percentages" are then applied to the dollar value of the GNI expenses in
4 each category, respectively, from which Verizon then calculates what purports to represent, in
5 each case, the "incremental operating expenses driven by structural separation." No workpapers
6 or other documentation underlying the calculation of the proffered percentages or the specific
7 expense amounts to which they had been applied were included in any of the Verizon *ex parte*
8 submissions.
9
10 4. By its own admission, however, each of these percentages was developed from
11 "assumptions" ostensibly made by "[s]ubject matter experts representing GNI Operations,
12 Information Technology, Engineering, and Business Services."[5] No documentation explaining
13 how the specific numerical values of the various percentages had been arrived at by the subject
14 matter experts, what facts they had relied upon, what analyses they had conducted, what efforts
15 had been made by the subject matter experts or other Verizon personnel to examine or verify the
16 reasonableness of the "assumptions" that had been utilized, or any other aspects of the underlying
17 work, were provided by Verizon. Nor is the "study" verified by an affidavit. Other than the

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4. June 24, 2003 *ex parte*, at 6. GNI provides the wholesale network operations functions to Verizon's three separate *retail* Section 272 long distance affiliates, Bell Atlantic Communications, Inc. (BACI) d/b/a Verizon Long Distance (VLD), NYNEX Long Distance Company (NLD) d/b/a Verizon Enterprise Solutions (VES), and Verizon Select Services Inc. (VSSI) f/k/a GTE Communications Corporation. June 4, 2003 *ex parte*, at Attachment 1.

5. *Id.*, at 6-7.

slightly-lengthened verbal descriptions of the "assumptions" that were made with respect to each expense category, however, this latest round of Verizon *ex parte* submissions presents no new facts or quantitative analyses beyond what had been included with the original August 5, 2002 *Petition*. Without such documentation, workpapers, supporting facts and analyses, there is no possibility for any independent reproduction or validation of the proffered "savings" projections, which must, for that reason, be afforded no weight by the Commission.

Beyond its numerous methodological infirmities, Verizon's latest "analysis" focuses solely and exclusively upon "savings" that would be realized by its Section 272 affiliates, ignoring entirely the additional costs that would necessarily be absorbed by its ILEC entities as they assume responsibility for GNI's OI&M functions.

5. What does emerge from the June 24 submission is a clarification of the limitations of even this highly superficial analysis and, in particular, the fact that it fails even to provide a complete exposition of what it purports to present. Specifically, Verizon's "analysis" focuses solely and exclusively upon expenses that are incurred by its Global Networks, Inc. ("GNI") affiliate ostensibly as a result of the OI&M structural separation requirement; *nowhere does Verizon even attempt to examine the level of costs that the Verizon ILECs do not incur by virtue of the fact that GNI is responsible for its own OI&M*. By Verizon's own admission, its "subject matter experts" were in all cases *employees of GNI* and for each expense category were asked to estimate costs that had been "reported monthly by GNI's finance group."[6] Nowhere in Verizon's work-up of

6. *Id.*, at 7.

these "structural separation driven costs" is there any indication that ILEC OI&M subject matter experts, financial experts, or financial reports were either consulted or considered.

6. To the contrary, what Verizon has actually done is to *assume* that if integrated into ILEC OI&M activities, the various functions performed by the Verizon ILECs for the benefit of GNI "could be *absorbed* by the existing [ILEC] staff of local exchange carrier technicians" and that the ILEC resources are "sufficiently large to *absorb* the incremental work."[7] The theory here seems to be that because the separate Section 272 affiliate is so small relative to the ILEC, the additional demands that would be placed upon the ILEC's personnel, systems and other resources would be so inconsequential to the total ILEC operation as to constitute little more than the proverbial "drop in the ocean."

7. Moreover, from the verbal discussion in the June 24 filing, one is compelled also to conclude that GNI does not expect to actually "pay" the Verizon ILECs, or impute into its own operations, the costs for the ILEC resources used for performing any of these "drop in the ocean" functions on GNI's behalf.[8] Presumably, if such payments were anticipated, they would have

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7. *Id.*, emphasis supplied.

8. GNI notes, in its June 4 *ex parte* filing, at 2, that the Section 272(c)(1) non-discrimination obligations would apply: "If a Verizon BOC offers OI&M services to Verizon's Section 272 affiliates, it will be required to offer the same service to other carriers on a nondiscriminatory basis." In order for GNI to realize these savings, the ILEC would have to charge its Section 272 affiliate the ILEC's incremental cost for these services. However, Verizon also notes in the same June 4th *ex parte* that under the circular "prevailing price" definition, "any price charged by the ILEC will be considered to be the prevailing price." Based upon this statement, and the fact that

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been captured in any *pro forma* financial reports that the GNI subject matter experts would have developed as part of their undertaking. Even with "perfect" price cap regulation, Verizon has a strong incentive to shift costs to the regulated ILEC entity so as to evade the requirements of imputation. That is, by "lowering" the affiliate's "costs," Verizon is in a better position to effect a price-cost squeeze. Price cap regulation without sharing of excess earnings or an earnings cap (so-called "pure" price caps) makes the BOC's parent corporation financially indifferent as to whether a particular cost is booked to the ILEC entity or to a nonregulated affiliate. This provides a BOC with three additional reasons to shift costs to the ILEC, wherever possible:

(1) The higher ILEC costs resulting from large quantities of spare or excess capacity can be advanced by the ILEC to justify higher prices for essential (bottleneck) services furnished to downstream competitors (access and UNEs);

(2) The lower affiliate costs will enable the affiliate to be competitive with respect to those aspects of its operations that compete directly with downstream rivals; and

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8. (...continued)
GNI estimates appear not to have included *any* ILEC costs attributable to the ILECs' assumption of these functions, it would seem that the ILECs would be providing OI&M services to the Section 272 affiliates at a "prevailing price" equal to the ILECs' short-run incremental cost, which would itself be based upon the "absorption" concept. In theory, of course, Verizon will be required to offer to provide the equivalent OI&M functions to nonaffiliated entities at the same "prevailing company prices." However, as I discuss in more detail, *infra,* at paras. 20-21, Verizon has offered no explanation as to how it would confer the same efficiencies of OI&M integration to a nonaffiliated carrier as it claims it can only achieve with respect to its own affiliates only by transferring the affiliates' OI&M functions to the ILECs.

(3) By raising ILEC costs overall, the BOC paves the way for maintaining or increasing access charges once the *CALLS* rate freeze has expired, or for the reinitialization of a state price cap plan.

8. According to Verizon's June 24 filing, the subject matter expert group apparently based this "absorption" theory upon headcounts of ILEC vs. Section 272 affiliate personnel: "GNI employs 34 technicians compared to thousands employed by the local exchange carrier"[9] Likewise, Verizon explains that "[t]here are enough local exchange carrier technicians in geographical areas where GNI has built its Hubs and POPs that the work could be absorbed by the existing staff of local exchange carrier technicians."[10]

9. A simple example shows the flaw in this logic. With regard to Professional Services, Verizon states that "almost all (95 percent) of the professional services expenses were driven by section 272 requirements." The ability for the ILEC to "absorb" the incremental Professional Services work related to GNI operations while incurring only 5% of the costs of the Section 272 affiliate, however, has little to do with the number of employees engaged in this work at the two entities, but rather the utilization and productivity of the respective employees. If it is actually the case that the ILEC can, for only 5% of the cost of the affiliates' self-provisioned service, do the incremental work currently being handled by 34 technicians with no increase in ILEC work forces, then the ILEC is *not* working efficiently. The presence of such inefficiencies in the

9. June 24 *ex parte*, at 7.

10. *Id.*

1 Verizon ILEC operations is hardly a basis for the Commission to forbear from enforcing a
2 statutory requirement whose sole purpose is to limit the BOCs' ability to leverage their local
3 service monopolies to gain market power in the adjacent long distance market through
4 discrimination in favor of their affiliate and through misallocation of the costs of joint operations.
5 Indeed, if the Commission were to afford any weight whatsoever to Verizon's "absorption"
6 theory, it would encourage BOCs to deliberately instill inefficiencies by deliberately building up
7 excess capacity into their ILEC operations, impose the costs thereof upon captive customers of
8 monopoly services (including carrier access services and UNEs), and then seek integration
9 authority so as to utilize the inefficient excess capacity for the benefit of nonregulated affiliates
10 while retaining the costs thereof largely or entirely within the regulated ILEC entities.
11
12 10. Verizon's theory that its ILECs have sufficient capacity to "absorb" GNI's OI&M
13 demands also cannot be squared with the statement, at page 9 of its June 24 *ex parte* filing, that
14 "GNI's traffic volumes continue to grow substantially." According to Verizon, GNI traffic
15 volumes are projected to grow by a substantial amount between 2001 and 2003, and Verizon
16 further states that "[t]his is a conservative projection, as GNI has already exceeded its quarterly
17 projection for the first quarter of 2003." Verizon claims to be the third largest US long distance
18 carrier based upon the number of presubscribed customers, and has most recently reported that
19 some 13.2-million customers have signed up for Verizon long distance service.[11]
20

11. Verizon Corp. First Quarter 2003 Quarterly Bulletin, April 22, 2003, at 4.

Verizon's assumption that its ILECs have sufficient existing capacity to "absorb" GNI's OI&M demands would ascribe to GNI no more than the short-run incremental cost of these newly integrated functions, which would be less than TELRIC-based prices that Verizon charges to its CLEC competitors for unbundled access to its network.

11. That Verizon would here advance this "absorption" principle as the basis for its expense savings claim is particularly remarkable in light of Verizon's persistent contention that the Commission's Total Element Long Run Incremental Cost ("TELRIC") requirements fail to adequately compensate the Verizon ILECs for services furnished to CLECs on an unbundled basis. Verizon has repeatedly argued that prices set at TELRIC fail to recover the "actual costs," as reflected on its books, that it incurs in providing unbundled network elements ("UNEs").[12] Incredibly, Verizon's newly-minted "absorption" theory would not produce transfer prices (if any) that were well below those that would emerge from application of TELRIC. Here, the GNI subject matter experts have premised their "costs driven by structural separation" analysis by looking solely to the Verizon ILECs' *short-run incremental costs* which, if not expressly identified as being incremental to the affiliates' operations, they then apparently assume to be zero!

12. In fact, Verizon's operating expense "analysis" is totally at odds with the basic costing principles inherent to the Commission's TELRIC methodology. As expressed in the Commission's seminal order adopting TELRIC:

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12. *See, e.g., Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, *Deployment of Wireline Service Offering Advanced Telecommunications Capability*, CC Docket No. 98-147, *Comments and Contingent Petition for Forbearance of the Verizon Telephone Companies*, April 5, 2002.

> Costs must be attributed on a cost-causative basis. Costs are causally-related to the network element being provided if the costs are incurred as a direct result of providing the network elements, and can be avoided, in the long run, when the company ceases to provide them.[13]

By limiting its analysis to the short run only, Verizon ignores the fact that, in the long run, the ILEC excess capacity that it assumes is available for use by GNI (i.e., the technical staff, back office systems, etc.) ultimately must be replenished, and thus must be considered as a cost *caused by* and thus attributable to GNI. In the long run, all costs and capacities are variable, and there is no "free" "excess capacity" that is available to be "absorbed."

13. Moreover, the Commission must seriously question whether the Verizon ILECs presently have excess capacity in their work forces, systems, and other resources that are already sufficient to fully "absorb" the additional GNI demands. There is certainly no evidence in either the Verizon *Petition* or in any of its *ex parte* filings to support this claim. There are, however, several possibilities, any of which work to fundamentally undermine Verizon's OI&M integration claims:

(1) *The Verizon ILECs do not, in fact, have any excess capacity.* In that case, any shift of OI&M demand from GNI to the ILECs would engender additional costs to the ILECs, rendering invalid the asserted expense savings resulting from OI&M integration.

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13. *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket Nos. 96-98 and 95-185, *First Report and Order* (released August 8, 1996), ("Interconnection Order") at para. 691, 11 FCC Rcd 15499, 15851.

1 (2) *The Verizon ILECs have sufficient excess capacity to satisfy GNI's needs.* This
2 possibility is, of course, inconsistent with the assumption that price cap ILECs are
3 operating efficiently. Verizon and its predecessor companies in the past have offered
4 analyses to both the FCC and state PUCs purporting to show that its realized earnings
5 levels for price capped services had deteriorated, as evidence that the X-factors in those
6 plans had been set too high and should be reduced or eliminated altogether.[14] If Verizon
7 has pursued a policy of consistently maintaining excess capacity, that would have
8 explained the apparently low productivity growth that Verizon claims to have
9 experienced, and would have resulted in higher rates for monopoly services, all else being
10 equal, than would have prevailed had such excess capacity not been present and the
11 resulting productivity growth had been greater. Verizon's latest effort to shift this excess
12 ILEC capacity to the uncompensated benefit of its Section 272 affiliates would thus
13 constitute an unlawful cross-subsidy of the competitive services being provided by the
14 affiliates funded by excessive prices for Verizon's regulated monopoly ILEC services.
15

14. See, e.g., CC Docket No. 94-1, Reply Comments of Bell Atlantic, March 1, 1996; CC Docket Nos. 96-262 and 94-1, Bell Atlantic Comments on Further Notice, January 7, 2000; Massachusetts D.T.E. Docket No. 01-31 (Phase I), Initial Brief of Verizon Massachusetts (Public Version), February 12, 2002; Pennsylvania Public Utility Commission Docket No. P-00001854, Prepared Rebuttal Testimony of Robert J. Mcgonagle on behalf of Verizon North Inc., February 20, 2001.

Verizon's "absorption" theory runs counter to the cost allocation requirements at Part 64 of the Commission's Rules.

14. Verizon's "absorption" theory also runs directly counter to the Commission's cost allocation requirements at 47 CFR § 64, which require apportionment of costs between regulated and nonregulated ILEC services on the basis of fully distributed cost. If excess capacity is present in the Verizon ILECs as the GNI subject matter experts have assumed, the Commission's cost allocation rules would require that the costs of that excess capacity be spread ratably across all utilized capacity, rather than being made available, without charge, to the nonregulated affiliate.

15. Subpart I of Part 64 requires carriers to separate the costs of regulated activities from those of nonregulated activities, and sets forth broad rules for allocating such costs. The cost allocation rules also provide that a telecommunications carrier may not use services that are not competitive to subsidize services subject to competition.[15] However, even if one could assume Verizon's complete technical compliance with the principles set forth at Part 64, these rules leave substantial room for improper and anticompetitive allocation of costs whenever regulated and nonregulated activities take place on a fully integrated basis.

16. Carriers are required to assign costs directly to regulated or nonregulated activities "whenever possible."[16] The Commission's rules recognize, however, that not all of a carrier's

15. 47 CFR § 64.901(c)

16. 47 CFR § 64.901(b)(2)

costs are directly assignable. Under Part 64, all costs not directly assignable are considered "common" costs. The rules require the carrier to group common costs into "homogeneous cost categories" and then assign each cost category based upon a "hierarchy" of cost allocation principles:

(i) Where possible, the carrier must allocate a category of common costs "based upon direct analysis of the origin" of those particular costs.

(ii) If this is not possible, the allocation shall be based upon an "indirect, cost-causative linkage to another cost category (or group of cost categories) for which a direct assignment or allocation is available.

(iii) If neither of the first two methods are feasible, then the carrier must use "a general allocator computed by using the ratio of all expenses directly assigned or attributed to regulated and nonregulated activities."

If these rules are not vigorously enforced, they leave Verizon with significant discretion that can be used to shift costs from GNI to its regulated activities. Moreover, although Part 64 requires the ILECs to provide a more detailed explanation of their actual cost allocations in their cost allocation manuals ("CAMs"), there has been little scrutiny of the CAMs. Cost accounting abuses ultimately uncovered in a biennial audit can often be "too little, too late" to redress the harm to competition that occurs from cost misallocation in the intervening period.

17. In the case of central office equipment and outside plant investment, Part 64 requires that costs be assigned based upon relative use by regulated and nonregulated activities.[17] However, since an allocation based solely upon relative usage is "blind" to other cost causative factors, it can provide opportunities for cost shifting between regulated and nonregulated activities. Take, for instance, the following example. A Verizon ILEC provides service to a community using copper loops that are provisioned exclusively for POTS; this original outside plant is valued at $100,000. As currently provisioned, this outside plant cannot be used to provide high-speed Internet access service. The ILEC decides to deploy fiber in order to support advanced services, such as high-speed Internet access, which are nonregulated services being provided by an affiliate. Once deployed, however, the replacement outside plant, which has a cost of $300,000, will also be used to provide POTS, which will in fact account for 90% of the usage on these loops. Prior to the "upgrade," the ILEC's regulated POTS service is required to support 100% of $100,000. As a consequence of the upgrade, POTS will get a cost allocation of 90% of $300,000, i.e., $270,000, while the nonregulated services that drove the investment decision will pick up only $30,000. The regulated activity is $170,000 worse off, bearing costs that are not necessary for the functionality of the regulated service, whereas the nonregulated activity receives the benefit of a $300,000 outside plant upgrade for a mere 10% of that cost.

18. If the existing OI&M restriction is eliminated, one can readily imagine a comparable scenario. Suppose that in order to capture GNI's OI&M functions, the Verizon ILECs must

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17. For purposes of this allocation, the carrier must look at usage in each of three calendar years ("beginning with the calendar year during which the investment usage forecast is filed") and use the ratio from the year in which the relative usage by nonregulated activities was the greatest.

1 undertake broad upgrades to their existing operations support systems ("OSS"), at a cost of $100-
2 million. However, once completed, the upgraded OSS will be utilized on an integrated basis to
3 support traditional POTS and affiliate long distance and other services. As a result, Verizon could
4 attempt to treat the $100-million upgrade and subsequent ongoing maintenance expenses as a
5 "common" cost, and so "allocate" it on some sort of relative use basis as between its POTS and
6 long distance operations. *Any non-zero allocation of these incremental system development and*
7 *maintenance costs to POTS would have the effect of shifting costs away from the competitive long*
8 *distance operations and onto regulated monopoly local exchange services.*
9
10 19. If excess ILEC capacity is not present, it is entirely possible that a shift of OI&M
11 functions from the affiliates to the ILECs could also result in a net *increase* in costs being allocated
12 to monopoly ILEC ratepayers than under the existing separated OI&M arrangement. This would
13 occur if, for example, the ILEC were required to construct or acquire a block of additional
14 capacity to serve the affiliate (or even to accept a transfer of capacity from the affiliate) that would
15 not be fully utilized within the three-year usage allocation time frame contemplated at 47 CFR
16 § 64.901(b)(4). In such a case, the excess spare capacity might be disproportionately allocated to
17 monopoly services until such time (in the more distant future) when it is placed in active use in
18 support of nonregulated services. Due to the utter absence of any data or other facts pertaining to
19 the impact of OI&M integration *upon the Verizon ILECs*, there is nothing in Verizon's
20 submissions would permit the Commission to affirmatively establish that such an outcome would
21 not arise.
22

Verizon has not demonstrated that it will be able to achieve the specific efficiencies that Verizon projects to result from OI&M integration without directly violating the nondiscrimination requirements of Sections 272(c) and 272(e)(1).

20. The existing OI&M structural separation requirement has the effect of creating comparability in the interactions between the Verizon ILECs and Verizon's Section 272 affiliates and those confronting nonaffiliated IXCs and CLECs in their dealings with the Verizon ILECs. Under the existing separated arrangementment, orders initiated by customers of the affiliate must first flow through the affiliate's OSS before being transmitted to the ILEC. The formal process for such transmission, in the case of IXC private line services, is the Access Service Request ("ASR"). The affiliate (or a nonaffiliated IXC) prepares an ASR and transmits it to the ILEC, which receives it, validates it, and based thereon proceeds to process the service order. Although less than specific in its details, Verizon's vision of OI&M integration contemplates that customer service orders initiated by its affiliate would instead be communicated directly (through an unspecified, apparently informal channel) to the ILEC for processing, which would include, among other things, preparation of the ASR by the ILEC itself.[18]

21. Much of the "savings" that Verizon seeks to ascribe to OI&M integration appears to arise from the potential for the Verizon Section 272 affiliate to bypass many of the formalities that have

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18. Verizon's June 24 *ex parte* includes "Example 3" outlining the ordering and provisioning process flow Verizon would implement should it receive forbearance. In this process flow, six functions usually performed by GNI (or competing IXCs) could be contracted to ILEC personnel. These services include creation of the private line order, creation of the ASR for the access circuit, design of the interLATA component, provision of the interLATA network, notification of firm order confirmation and design layout record, and test and turn-up of the circuit.

been established for interactions between the Verizon ILECs and IXCs (or CLECs). Yet to comply with the nondiscrimination requirements at Sections 272(c)(1) and 272(e)(1) and (2), Verizon would have to offer the same "bypass" opportunities to competing IXCs and other nonaffiliated telecommunications carriers. This requirement suggests two possible scenarios, neither of which has been specifically addressed in any of the Verizon *ex parte* submissions:

(1) In order to comply with Sections 272(c) and (e) following OI&M integration, Verizon would also need to allow nonaffiliated companies to similarly bypass the formal service ordering/provisioning processes and instead provide the nonaffiliated carriers with the same direct access to ILEC personnel and systems that would exist for its own affiliate under OI&M integration. Verizon has not, of course, stated that it either would or could do that; indeed, if such informal, direct access could be provided to nonaffiliated carriers who are clearly not otherwise "integrated" with the Verizon ILEC with respect to OI&M, then this could be accomplished without the requested forbearance by the Commission. Indeed, if in fact Verizon would provide nonaffiliated ILECs with such informal access as a condition for approval of its OI&M *Petition*, that would simply confirm the long-held view that the formal ASR/LSR transmittals were never really necessary in the first place, but were introduced by Verizon as a means both for increasing its rivals' costs and for slowing down their service ordering/provisioning processes.[19] In that event, the putative

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19. This would be analogous to the requirement, adopted in the wake of the Commission's 1968 *Carterphone* decision, that customer-provided terminal equipment be interconnected with the public telephone network via so-called "Protective Connecting Arrangements" ("PCAs"). *Use of*
(continued...)

1 gain in efficiency ostensibly arising from OI&M integration is not so much the result of
2 actual integration efficiencies, but rather from the elimination of contrived *inefficiencies*
3 that had been artificially introduced into the system.
4
5 (2) Alternatively, if Verizon is unable to provide a means for nonaffiliated carriers to bypass
6 the formal ASR/LSR transmittal processes, Verizon would then be unable to satisfy the
7 Sections 272(c) and (e)(1) nondiscrimination requirements, since it would then be
8 affording its affiliates superior (informal) access to its systems and personnel that would
9 be unavailable to its nonaffiliated rivals.
10
11 It is, in fact, difficult to see how Verizon's contentions regarding its own efficiency gains under
12 OI&M integration can be squared with the overarching Section 272(c)(1) requirement that it "not
13 discriminate between that company or affiliate and any other entity in the provision or procurement
14 of goods, services, facilities, and information, or in the establishment of standards" and the Section
15 272(e) requirements that it "(1) shall fulfill any requests from an unaffiliated entity for telephone

---

19. (...continued)
the Caterfone Device in Message Toll Telephone Service, FCC Docket No. 16942, *Thomas F. Carter and Carter Electronics Corp. (Complainants), v. AT&T et al (Defendants)*, Docket No. 17073, *Decision*, 13 FCC 2d 420 (1968). As subsequently determined by the federal courts, PCAs had no function or purpose other than to impose additional costs upon competitors in the nascent CPE market. *See e.g., Litton Systems, Inc. v. Am. Tel. & Tel. Co.*, 700 F.2d. 785 (2nd Cir., 1983). I and others have previously argued that ILECs could provide nonaffiliated carriers with direct access to their OSSs without cumbersome and error-prone manual or off-line electronic interfaces. Although it has not in fact conceded that it would actually do this as a condition for OI&M integration, that possibility certainly raises serious concerns as to the veracity of Verizon's purported compliance with Sections 251, 252 and 271(c)(2)(B).

1 exchange service and exchange access within a period no longer than the period in which it
2 provides such telephone exchange service and exchange access to itself or to its affiliates" and "(2)
3 shall not provide any facilities, services, or information concerning its provision of exchange
4 access to the affiliate described in subsection (a) unless such facilities, services, or information are
5 made available to other providers of interLATA services in that market on the same terms and
6 conditions." *By definition*, the specific efficiency gains being envisioned by Verizon would in
7 each case be limited solely to its own affiliate and not be offered or available to nonaffiliated rivals.
8 The fact that Verizon might (arguably) be forced to incur costs that might otherwise be avoided
9 through integration does not justify a wholesale abandonment of the multiple statutory
10 nondiscrimination requirements.
11
12 **Verizon has not shown that *any* integration efficiencies would result from elimination of the**
13 **"operate independently" requirement.**
14
15 22. Verizon's focus solely and exclusively upon the impact of the structural separation
16 requirement upon GNI cannot and does not support Verizon's claim that structural separation is
17 burdensome to the corporation as a whole or that it is wasteful of societal resources. Verizon has
18 not shown that *any* integration efficiencies would result from elimination of the OI&M portion of
19 the "operate independently" requirement; it is only (perhaps) demonstrated that the costs that
20 would be *assigned* to GNI would be reduced. Indeed, Verizon's own *voluntary* actions with
21 respect to its separate Section 272 affiliates belies any claim of actual integration efficiencies.
22 Verizon has decided to *voluntarily* create five different Section 272 Affiliates, each with its own
23 OI&M resources, despite being under no statutory obligation to have more than one. Two of these

five separate affiliates are facilities-based wholesale service providers, Verizon Global Solutions and Global Network Inc., that apparently each operate switching facilities in the same cities — New York and Los Angeles.[20] There is nothing in Verizon's submissions that would indicate that GSI and GNI have themselves taken any initiative to integrate their respective OI&M functions. The obvious difference between the GSI/GNI situation and the GNI/ILEC case lies in the fact that because of their roughly equal size, there is no "absorption" benefit that would result from GSI/GNI integration, which may perhaps explain why it has not occurred. Clearly, Verizon's OI&M integration strategy is aimed not so much at achieving substantive integration efficiencies, but rather upon shifting costs out of its Section 272 affiliates and over to its ILECs.

Conclusion

23. Nothing in Verizon's recent *ex parte* submissions provides new substantive facts or evidence to support Verizon's claimed cost savings from OI&M integration. What the new material does confirm is that Verizon's entire claim is premised upon the entirely unsupported "assumption" that substantial portions of GNI's OI&M requirements could be "absorbed" within *existing* ILEC OI&M systems and personnel resources, and where such "absorption" has been assumed, Verizon ascribes no "cost" to GNI for the OI&M functions that would be performed on its behalf by the ILEC entities. Moreover, most of the actual integration efficiencies that are described by Verizon result from the elimination of formal transmittals between GNI and the ILECs, to be replaced by largely unspecified, informal communications mechanisms. The use of

20. June 24 *ex parte,* at Attachment 1.

1 such informal arrangements as between the Verizon ILECs and their Section 272 affiliates will
2 surely result in discriminatory treatment of nonaffiliated IXCs and CLECs unless these other
3 entities are similarly permitted to participate in the same informal processes. Verizon has not
4 provided any indication that this will be permitted; indeed, if it *could* be permitted, then Verizon
5 would need to explain, which it has not done, why formal integration of its affiliates' and its
6 ILECs' OI&M functions is required if nonaffiliated (and by definition non-integrated) entities
7 could be afforded similar treatment. Allowing Verizon to integrate its affiliate and ILEC OI&M
8 functions will afford its affiliates with unique competitive advantages that will violate the
9 nondiscrimination requirements of Section 272(c) and (e).
10

VERIFICATION

The foregoing statements are true and correct to the best of my knowledge, information and belief.

Lee L. Selwyn

Exhibit I

Frank S. Simone
Government Affairs Director

Suite 1000
1120 20th Street, NW
Washington DC 20036
202-457-2321
202-263-2660 FAX
fsimone@att.com

September 16, 2003

VIA ELECTRONIC FILING

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, S. W. – Room TWB-204
Washington, D. C. 20554

Re: *Ex parte,* CC Docket No. 96-149, Verizon Petition for Forbearance from the Prohibition of sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) of the Commission's Rules

Dear Ms. Dortch:

On Monday, September 15, 2003, Aryeh Friedman and the undersigned of AT&T and Dr. Lee Selwyn and Hilary Thompson, of Economics and Technology, Inc., met by telephone with Pamela Megna and Christi Shewman of the Wireline Competition Bureau's Competition Policy Division. The purpose of the meeting was to discuss Dr. Selwyn's written submissions in the above-captioned proceeding and Verizon's August 11, 2003 response to those arguments. The attached document provides a summary of the topics discussed and was distributed via electronic mail to the Commission staff on the call.

Consistent with Section 1.1206 of the Commission's rules, I am filing one electronic copy of this notice and request that you place it in the record of the above-captioned proceeding.

Sincerely,

ATTACHMENT

cc: W. Dever
P. Megna
C. Shewman
R. Tanner

Verizon has not demonstrated that OI&M integration will result in any net savings in resources used.

- In fact, Verizon's characterization of the FCC's affiliate transaction rules as being "based on fully distributed cost principles" underscores the concern about how GNI intends to "pay" the Verizon BOCs for OI&M services that the BOC would provide if Verizon's forbearance petition is granted.

- Section 272 Affiliate transactions are supposed to be based upon "arm's length" principles requiring that the BOC ILEC realize the full market value of the service provided, not merely that it be reimbursed for its costs. Verizon and the other BOCs have flaunted this requirement by exploiting the "prevailing company price" loophole for virtually all affiliate transactions, ensuring that the BOC never receives full and fair market value for the services it provides.

- Verizon's use of the "prevailing company price" loophole is premised upon its representation that all services being furnished to a Sec. 272 affiliate will be offered and available on a nondiscriminatory basis to nonaffiliated firms.

- Verizon's claims that it will provide OI&M services to unaffiliated entities on a nondiscriminatory basis are disingenuous considering that Verizon regularly structures its affiliate transactions such that, as a practical matter, only the Verizon affiliate is capable of using the service or qualifying for the lowest price. For example, its Section 272(b) posting regarding billing and collection offers large discounts to "any" purchaser of these services that provides 85% of its *total* Verizon end user billing to Verizon for processing.[1] The only entity that would typically qualify for this discount is, of course, Verizon Long Distance.

- Verizon asserts that it "would file Cost Allocation Manual ('CAM') changes" using time reporting codes "to be created and defined" (*see*, Verizon June 24, 2003 *ex parte* at 4) and "new non-regulated cost pools as *necessary*" that should allay any fear that it "would violate the Commission's Part 64 cost allocation rules by failing to allocate BOC OI&M expenses to the section 272 affiliates at fully distributed cost. Verizon August 11, 2003 *ex parte* at 3. But the possibility of undefined costs and possible new cost pools would not help to detect or deter any cost misallocation by Verizon. ARMIS reports simply report a regulated/non-regulated split, and do not lend themselves to tracing back specific expenses. Moreover later, after-the-fact audits are insufficient to deter current misallocation.

[1] *See*, http://www.verizonld.com/PDFs/am06bsarates08-04-03.pdf.

Verizon is unclear as to whether the GNI OSS functions will be provided by BOC personnel using GNI OSS, or through modifications to the BOC's OSS.

- Verizon appears to have told the FCC staff that BOC personnel will continue to utilize GNI's OSS.

- However, in the June 4 *ex parte* Attachment 3 at 5, note 4, Verizon states that if the Petition is granted GNI will then avoid the cost of purchasing software and hardware updates for its OSS. But if GNI ceases purchasing software and hardware updates for GNI's OSS, that implies that GNI intends to *abandon* its OSS and rely instead solely upon the BOC's systems.

- After years of claiming that it was impractical for Verizon to grant others access to the BOC's OSS, Verizon apparently now intends to give GNI access to its BOC OSS if it is no longer subject to OI&M separation. This would then require that the Verizon BOCs afford direct access to their OSS to nonaffiliated CLECs and IXCs, something that they have long insisted cannot be done — and which they have not explained how it will be done if the forbearance petition is granted.

Verizon has always been free to contract with any number of unaffiliated entities for many of the OI&M services that it now seeks to "purchase" from the BOC.

- For example, Verizon could have contracted with any number of other "call center" service providers for back office operator services, and thereby avoided the cost of building the Altoona and Worcester operator service facilities that it claims was made necessary specifically because of the OI&M separation requirement.

- However, such a contract would have been a true arm's length transaction, and would therefore almost certainly represent an out of pocket cost to Verizon higher than the fully distributed cost Verizon intends to charge itself.

- Hence, the "savings" that Verizon now claims will result from OI&M integration is, in reality, primarily if not solely attributable to the fact that its "prevailing company price" transfer price will be well below the fair market value of the services that the BOC will be providing to the Sec. 272 affiliates.

Verizon's intentions regarding the expansion or overextension of the BOC workforce are not clear.

- Verizon's newest claim is that it does not assume an "absorption without incurring additional cost" of GNI work by BOC employees. However, this assertion is belied by

statements such as, "[t]his over-dependence on vendor-supplied labor would not have been necessary if Verizon could have used BOC personnel, which had both the necessary skill sets as well as the ubiquitous presence to perform OI&M services for GNI on an as-needed basis" (Howard Supplemental Declaration, at 3).

- Importantly, it was *Verizon*, not AT&T, that had first raised the notion of "absorption" of the GNI requirements within BOC workforces:

  June 24 ex parte at 7:

  "Professional Services – ... Furthermore, there are enough local exchange carrier technician in geographic areas where GNI built its Hubs and POPs *that the work could be absorbed by the existing staff of local exchange carrier technicians* (GNI employees 34 technicians compared to thousands employed by the local exchange carrier)." Emphasis supplied.

  "Back Office – ... the existing local exchange carrier 611 centers (Customer Repair Service Answering Bureau, or CRSAB) can do the same thing *and they are sufficiently large to absorb the incremental work.* The existing local exchange carrier Recent Change Administration Center, or RCMAC, is likewise able *and sufficiently large to absorb* the incremental manual provisioning of long distance orders." Emphasis supplied.

Verizon's claim that the existence of price cap regulation removes its incentives to cross-subsidize its Sec. 272 affiliates is patently false.

- *CALLS* is not "pure price caps" as Verizon claims. However, even if it were, Verizon would still have a powerful incentive to shift costs *out* of its long distance affiliates so as to enhance their ability to compete with nonintegrated rivals.

- *CALLS* is set to expire — and to be reviewed and perhaps replaced — in 2005. Indeed, when the *CALLS* plan was adopted by the FCC, the Commission specifically expressed the *expectation* that by 2005:

  "..increased competition will serve to constrain access rates in the later years of the CALLS Proposal as X-factor reductions are phased out. We believe that market forces, instead of regulatory prescription, should be used to constrain prices whenever possible. As competitors utilizing a range of technologies, including cable, cellular, MMDS and LMDS, continue to enter the local exchange market, we expect that rates will continue to decrease... Therefore, the significant up-front reductions coupled with increased competition ultimately should result in access charges that are comparable to those that

would be achieved under out current price cap system over the five-year term of the CALLS Proposal. Furthermore, after the five year term we can re-examine the issue to determine whether competition has emerged to constrain rates effectively."[2]

That, of course, has not happened, and is unlikely to happen by 2005.

- Although Verizon would like to relegate to mere "speculation" the issue of Commission review of price caps and of *CALLS*, with the expiration of *CALLS* and an access market that is still far from being competitive, the Commission will necessarily have to consider the future of access charges and of price cap regulation generally. If Verizon is able to load costs onto its ILECs, those costs (if not detected and eliminated) could then be used to support a higher overall ILEC access charge rate level and a less onerous (from Verizon's perspective) price adjustment mechanism under a reexamination of CALLS and possible reinitialization of access charges at the 11.25% ILEC authorized rate of return.

[2] *Access Charge Reform*, CC Docket No. 96-262, *Sixth Report and Order*, CC Docket Nos. 96-262 and 94-1, *Report and Order*, CC Docket No. 99-249, *Eleventh Report and Order*, CC Docket No. 96-45, 15 FCC Rcd 12962, 13031 (2000).

Exhibit J

Frank S. Simone
Government Affairs Director

Suite 1000
1120 20th Street, NW
Washington DC 20036
202-457-2321
202-263-2660 FAX
fsimone@att.com

October 1, 2003

VIA ELECTRONIC FILING

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, S. W. – Room TWB-204
Washington, D. C. 20554

Re: *Ex parte,* CC Docket No. 96-149, Verizon Petition for Forbearance from the Prohibition of sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) of the Commission's Rules

Dear Ms. Dortch:

Attached please find AT&T's response to Verizon's August 11, 2003 written ex parte submission in the above-captioned proceeding.

Consistent with Section 1.1206 of the Commission's rules, I am filing one electronic copy of this notice and request that you place it in the record of the above-captioned proceeding.

Sincerely,

ATTACHMENT

cc: W. Maher
J. Carlisle
M. Carey
W. Dever
P. Megna
C. Shewman
R. Tanner

Aryeh S. Friedman
Senior Attorney

Room 3A231
900 Route 202/206 North
Bedminster, NJ 07921
Phone: 908 532-1831
Fax: 908 532-1281
EMail: friedman@att.com

October 1, 2003

VIA E-MAIL

Marlene Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W., TW-A-325
Washington, DC 20554

Re: *Verizon Petition 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. 96-149

Dear Ms. Dortch:

AT&T Corp. ("AT&T"), hereby responds to Verizon's August 11, 2003 *ex parte*. That *ex parte* still does not cure the failure of Verizon to produce any credible evidence that the OI&M safeguard, found by the Commission to be "necessary" to prevent "unjust[] and unreasonably discriminatory" practices by Verizon,[1] has imposed any costs on Verizon.[2] That the OI&M safeguard in no way hinders Verizon is reflected by the realities

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1 *See Non-Accounting Safeguards Order* ¶ 163 ("[a]llowing a BOC to contract with the section 272 affiliate for operating, installation and maintenance services would inevitably afford the affiliate access to the BOC's facilities that is superior to that granted to the affiliate's competitors"); *Non-Accounting Safeguards Second Order On Reconsideration* ¶ 12; *Non-Accounting Safeguards Third Order On Reconsideration* ¶ 20.

2 For the reasons set forth in AT&T's July 9, 2003 *ex parte* responding to Verizon's June 4, June 17, and June 24, 2003, *ex parte* filings ("AT&T's July 9, 2003 substantive *ex parte*") at 3, no matter how costly compliance with the OI&M safeguards is claimed to be, so long as there is a "strong connection" between those safeguards and the protection of long distance competition, they are "necessary" within the meaning of Section 10 and forbearance may not be granted. As further demonstrated by AT&T in a separate *ex parte* filed the same day, the Commission

of the marketplace. Despite the alleged "costs" of the Section 272 safeguards, Verizon, in the *two years* following its entry to New York, has had no problem achieving a 34 percent market share in that state. Verizon has captured more market share in 24 months than all AT&T's interexchange competitors combined were able to realize ten years after implementation of equal access in 1985.[3] There is simply no basis in the record for forbearing from the OI&M safeguard that will, in any event, expire as soon as Section 272 sunsets in each of the BOC's states.[4]

AT&T would further note that the Commission, in finding the BOCs non-dominant in the *LEC Classification Order*,[5] did so because the BOCs' affiliates were required by section 272 to be "structurally separate" from the BOCs and to "operate independently" from the BOCs.[6] At the time the *LEC Classification Order* was issued, the "operate independently" requirement had been construed by the Commission to include the OI&M restriction. Should the Commission now forbear the OI&M requirement, the non-dominance determination would no longer be valid.

1. <u>*GNI's Cost Savings Claims Remain Unsubstantiated*</u>

As demonstrated by AT&T's prior *ex parte* filings, Verizon has utterly failed to substantiate its *ipse dixit* cost savings claim.[7] The Supplemental Declaration of Fred Howard ("Howard Supplemental Declaration") appended to Verizon's August 11, 2003 *ex parte* does not cure this failure to substantiate Verizon's claims.

---

cannot in any event forbear under Section 10(d) from applying section 272(b)(1)'s "operate independently" requirement including the operation, installation, and maintenance ("OI&M") safeguard.

3 Further Notice of Proposed Rulemaking proceeding in FCC WC Docket No. 02-112 and CC Docket No. 00-175, FCC 03-111 FCC 03-111 (rel. May 19, 2003) ("*Non-Dominance FNPRM*"), Reply Declaration of Lee L. Selwyn appended to AT&T's Comments (July 28, 2003) ¶¶ 8, 53 and 67.

4 Indeed, Verizon's submission of a cost analysis that goes through 2006, even though the bulk of Verizon territory will be free of the OI&M safeguard in 2004 and 2005, materially and artificially inflates Verizon's costs by not taking into account the impact of these Section 272 sunsets. More specifically, assuming that the Commission will, as occurred in New York and Texas, *see,* Public Notice, *Section 272 Sunsets for Verizon in New York State by Operation of Law on December 23, 2002 Pursuant to Section 271(f)(1)*, WC Docket No. 02-112, 17 FCC Rcd. 26864 (2002); *Public Notice*, 18 FCC Rcd. 13566 (2003) ("*Texas Sunset Notice*"), allow section 272 to sunset without extension in the remaining Verizon states, section 272 will sunset in Massachusetts in April, 2004; in Pennsylvania in September, 2004; in New Jersey in March 2005; and in Virginia in October 2005.

5 Second Report and Order, *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area,* 12 FCC Rcd. 15756, ¶¶ 83, 158-61 (1997) ("*LEC Classification Order*"), unrelated provisions modified, Order on Reconsideration, *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area,* 12 FCC Rcd. 8730 (1997).

6 *Id.* ¶ 91, 112-18.

7 *See*, AT&T's July 9, 2003 substantive *ex parte* at 3-4.

In his Supplemental Declaration, Mr. Howard seeks to cure Verizon's defective evidentiary showing by now asserting that he has "first-hand knowledge" of the percentages and dollar amounts and the generalized description of assumptions contained in Verizon's May 12, 2003, June 4, 2003 and June 24, 2003 *ex partes*.[8] Even if Mr. Howard had "first hand knowledge" of the numbers and assumptions included in those *ex partes*, a general averment to that effect is no substitute for the underlying data, including financial reports, and related workpapers that *Verizon could and should have submitted* under the Protective Order. Thus, neither the Commission nor commenters could test and verify Verizon's numbers, calculations or assumptions, such as, for example, labor rates, capital costs, depreciation lives, and whether the costs in question are actually "driven" by section 272 and the prohibition on OI&M sharing, in particular.

Moreover, it is eminently clear from Mr. Howard's Supplemental Declaration that Mr. Howard in fact does not have "personal knowledge" of the underlying cost data. As Mr. Howard himself avers, in preparing all three *ex partes*, "Verizon asked the subject matter experts in each job function to estimate the costs that would have been incurred if they had been able to ask the BOCs to perform the OI&M services rather than to develop a separate workforce or hire outside contractors."[9] Thus, it is the "GNI subject matter experts representing Operations, Information Technology, Engineering, Business Services and Finance"[10] who are the persons with "personal knowledge" and affidavits should have been submitted by each of the subject matter experts consulted setting forth: (i) their background and area of expertise; (ii) what they looked at and relied upon; (iii) how the specific numerical values of the various percentages had been arrived at; (iv) what facts they relied upon, (v) what analyses they conducted, and (vi) what efforts they made to examine and verify the reasonableness of the "assumptions" that had been utilized.

In response to AT&T's concerns that Verizon's cost analysis was incomplete because it reflected only the costs avoided by GNI but not the additional costs incurred by the BOC, Mr. Howard's avers that "the Verizon petition was reviewed by BOC representatives"[11] but that GNI did not "include the BOC operational personnel in the development of the cost study."[12] But the expertise of the unidentified representatives (who were apparently other than operational personnel) is not provided. Nor does Mr. Howard's declaration disclose to what extent those representatives concurred that GNI's "avoided [GNI] cost" analysis correlated with the arms-length price that, as shown below,[13] the BOC must charge GNI under the affiliate transaction rules.

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8 Howard Supplemental Declaration, ¶ 2.

9 *Id.*, ¶ 3.

10 *Id.*, ¶ 4.

11 It appears they were given access to GNI's internal proprietary data in apparent disregard of the required structural separation between the two entities.

12 Howard Supplemental Declaration, ¶ 4.

13 Item 3 at page 5 below.

2. *GNI's Restatement of its "Absorption" Argument Into an "Economies of Scale and Scope" Argument is Similarly Unsubstantiated and Not Credible*

In its June 24, 2003 *ex parte*, Verizon stated that the incumbent LEC's "existing staff" and "existing" facilities would "absorb" all of GNI's OI&M work.[14] Verizon now contends that this "absorption" claim (resulting in almost 60% cost savings to GNI)[15] was not based on the assumption "that the BOC is working inefficiently and that it would provide OI&M services using workers that are currently idle" but rather that "[b]y purchasing services from the BOC, GNI could take advantage of the BOC's economies of scale and scope."[16]

Efficiency claims such as "economies of scale and scope" should be substantiated "so that the Agency can *verify by reasonable means* the *likelihood* and *magnitude* of each asserted efficiency."[17] Verizon's economies of scale savings claim [18] is supported only by its *ipse dixit* assertions of savings and general averments about the BOC's substantially larger workforce.[19] That is clearly insufficient where, as here, it could have been substantiated with the underlying historical data and related workpapers, and by affidavits from the specific subject matter experts.

The presence of multiple facilities-based long distance carriers confirms that the "minimum efficient scale" of operations – the point at which the long run average unit cost levels off – occurs at output levels that are a small fraction of total industry capacity. Thus, Verizon's general "size of operation" averment rings hollow in light of Verizon's claim that Verizon Long Distance ("Verizon LD") is the third largest provider of interexchange service in the United States, exceeding in size other long distance carriers that have themselves achieved "minimum efficient scale."[20] At that level of operations,

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14 *See*, Verizon's June 24, 2003 *ex parte* at 7, discussing both "Professional Services ("[GNI's] *work could be absorbed by the existing staff of local exchange carrier technicians*") and Back Office ("the *existing* local exchange carrier 611 centers ... *are sufficiently large to absorb the incremental work* [and t]he *existing* local exchange carrier Recent Change Administration Center, or RCMAC, is likewise able *and sufficiently large to absorb* the incremental manual provisioning of long distance orders") (emphasis supplied).

15 That is, Verizon claims that forbearance will allow it to save $183 million out of the $298 million (approximately 60%) it would have otherwise spent between 2003 and 2006. Verizon August 11, 2003 *ex parte* at 6.

16 Howard Supplemental Declaration ¶ 5; *see also*, Verizon August 11, 2003 *ex parte* at 2.

17 *See, e.g.*, Department of Justice and Federal Trade Commission, *Revision to the Horizontal Merger Guidelines* (April 8, 1997) ("*Efficiency Guidelines*") at 1 (emphasis added).

18 Verizon's bald assertion of "economies of scope" is never explained anywhere in Verizon's many filings in this proceeding.

19 Howard Supplemental Declaration ¶ 5 ("These economies are shown in the net reduction in GNI's projected budget with OI&M relief").

20 Verizon Press Release, "Verizon Now Third Largest Long-Distance Company, Passes Sprint with More than 10 Million Customers, Variety of Long Distance Plans Power

Verizon LD, and its network provider GNI, should be operating at or near minimum average cost, *i.e.,* should have been able to achieve most or all of the potential economies of scale or scope (*i.e.*, should have achieved "minimum efficient scale"), such that the magnitude of any *bona fide* additional economies of scale arising from integration of its operations with the Verizon BOCs would be minimal, perhaps even zero.

Moreover, the economies of scale claimed by GNI could be achieved without eliminating the OI&M safeguards. For example, Verizon could have contracted with any number of other "call center" service providers for back office operator services, and thereby avoided the cost of building the Altoona and Worcester operator service facilities that it claims was made necessary specifically because of the OI&M separation requirement. However, such a contract would have been a true arm's length transaction, and would therefore almost certainly represent an out of pocket cost to Verizon higher than the fully distributed cost Verizon intends to charge itself.[21]

3. *GNI's Cost Savings Calculations are Based on an Artificial "Prevailing Company Price" Calculation that Will Not Practically Be Available to Unaffiliated IXCs*

Verizon further asserts that the $115 million GNI would have to pay the BOC over the four year period[22] "reflected the incremental cost that the BOCs incur to provide OI&M services to a section 272 affiliate [that] will be charged to that affiliate on a fully distributed cost basis" consistent with the affiliate cost allocation rules.[23] Verizon's characterization of the FCC's affiliate transaction rules as being "based on fully distributed cost principles" underscores the concern about whether GNI will be paying an artificially low price to the Verizon BOC for OI&M services if Verizon's forbearance petition is granted. Section 272 affiliate transactions are supposed to be based upon "arm's length" principles requiring that the BOC ILEC realize the full market value of the service provided, not merely that it be reimbursed for its costs.

Verizon has evaded this requirement in the past by exploiting a "prevailing company price" loophole for affiliate transactions, ensuring that the BOC never receives full and fair market value for the services it provides. Verizon's use of the "prevailing company price" loophole is premised upon its representation that all services being furnished to a section 272 affiliate will be offered and available on a nondiscriminatory basis to nonaffiliated firms.

But Verizon's claims that it will provide OI&M services to unaffiliated entities on a nondiscriminatory basis are disingenuous, considering that Verizon regularly structures its affiliate transactions such that, as a practical matter, only the Verizon affiliate is capable of using the service or qualifying for the lowest price. For example, its Section 272(b)

Customized Service Packages," January 7, 2003. http://newscenter.verizon.com/proactive/newsroom/release.vtml?id=78494&PROACTIVE_ID=cecec7c8c8cecccbcbc5cecfcfcfc5cececdc8c9cfcbcacacac5cf

21 Discussed more fully in the next section.

22 See n. 15 *supra.*

23 Verizon August 11, 2003 *ex parte* at 3; Howard Supplemental Declaration ¶ 5.

posting regarding billing and collection offers large discounts to "any" purchaser of these services that provides 85% of its *total* Verizon end user billing to Verizon for processing.[24] The only entity that would typically qualify for this discount is, of course, Verizon Long Distance.

4. *GNI's "Undertaking" to File Cost Allocation Manual Changes Will Neither Help Detect Nor Will It Deter the Misallocation of OI&M Costs*

Verizon asserts that there could be no misallocation of OI&M expenses because it "would file Cost Allocation Manual ('CAM') changes to capture these costs," using time reporting codes "*to be* created and *defined*" (Verizon June 24, 2003 *ex parte* at 4) and "new non-regulated cost pools as *necessary*."[25] Without knowing what cost pools Verizon will unilaterally deem "necessary" or what "definitions" GNI will use for the time reporting codes, Verizon's assurances are meaningless.[26] Nor would meaningful definitions and the inclusion of necessary cost pools cure the problem. The CAM data, even with the changes proposed by Verizon would not, for example, allow regulators to determine whether or how the BOC allocated joint OI&M costs. That is, for a joint local and long distance installation or repair service call, would GNI be charged only for the "incremental" long distance portion of the work so that it would not be charged for its allocable portion of the joint cost of sending the field force and vehicles to the job site?

ARMIS simply reports a regulated/non-regulated split, which does not lend itself to tracing back specific expenses. Later, after-the-fact audits are insufficient to detect or deter current misallocation. As the recent *Verizon NAL*[27] demonstrates, such after-the-fact audits are an ineffective means for policing -- let alone preventing -- violations of Section 272.[28] The *Verizon NAL* validates the Commission's concern, expressed herein, that the sharing of OI&M services would force it to engage in "excessive, costly and

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24 *See*, http://www.verizonld.com/PDFs/am06bsarates08-04-03.pdf.

25 Verizon August 11, 2003 *ex parte* at 3.

26 In its Original Petition, Verizon stated that it would use existing time reporting codes and did not think there would be any necessary changes for monitoring cost allocations. Verizon's *Petition for Forbearance* (August 5, 2002) at 4.

27 *In the Matter of Verizon Telephone Companies, Inc. Apparent Liability for Forfeiture*, File No. EB-03-IH-0245 (rel. Sept. 8, 2003).

28 There the Commission found that the Section 272 biennial audit showed that "Verizon failed to record a total of 43 transactions [out of 70 sampled] according to the methods specified in section 32.27" so that "Verizon has apparently failed to justify its accounting entries for approximately $16 million in services provided to its section 272 affiliate;" *id*, ¶ 13 and imposed a fine of $283,000. *Id*, ¶ 17. For the Internet posting violations, "because we are barred by the one year statute of limitations" all the Commission could do was "admonish the company." *Id*, ¶ 13. Finally, although the audit guidelines required disaggregation of service for purposes of measuring performance, because Verizon unilaterally induced the auditor to adopt measurements that did not disaggregate the data (*see* AT&T Comments on the Biennial Audit at 16-22) "to a level sufficient to permit a service-by-service discrimination analysis" the Commission declined to find any violation. *Id*, ¶ 16, n.18.

burdensome" auditing and monitoring of "day-to-day activities" in order to ensure that the BOCs were not using OI&M as a tool for anticompetitive practices.[29]

5. *Verizon's Reliance on Price Cap Regulation As An Effective Deterrent to Cross-Subsidization Ignores the Realities of that Regulation*

Dr. Selwyn has fully described in this[30] and related proceedings,[31] how even if *CALLS* were "pure price caps," Verizon would still have a powerful incentive to shift costs *out* of its long distance affiliates so as to enhance their ability to compete with nonintegrated rivals. In any event, *CALLS* is not "pure price caps" as Verizon claims, because it is scheduled to expire in July 2005, and the Commission has expressly committed to reexamine ILEC price caps if, at the time that *CALLS* expires, the level of competition is still not sufficient to constrain rates effectively. Indeed, when the *CALLS* plan was adopted by the FCC, the Commission specifically expressed the *expectation* that by 2005:

> "increased competition will serve to constrain access rates in the later years of the CALLS Proposal as X-factor reductions are phased out. We believe that market forces, instead of regulatory prescription, should be used to constrain prices whenever possible. As competitors utilizing a range of technologies, including cable, cellular, MMDS and LMDS, continue to enter the local exchange market, we expect that rates will continue to decrease.... Therefore, the significant up-front reductions coupled with increased competition ultimately should result in access charges that are comparable to those that would be achieved under our current price cap system over the five-year term of the CALLS Proposal. Furthermore, after the five year term we can re-examine the issue to determine whether competition has emerged to constrain rates effectively."[32]

That, of course, has not happened, and is unlikely to happen by 2005.

Although Verizon would like to relegate to mere "speculation" the issue of Commission review of price caps and of *CALLS*,[33] with the expiration of *CALLS* and an access market that is still far from being competitive, the Commission will necessarily have to consider the future of access charges and of price cap regulation generally. This affects Verizon's current incentives and conduct. If Verizon is able to load costs onto its ILECs, those costs (if not detected and eliminated) could then be used to support a higher

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29 *BOC Separation Order* ¶ 70.

30 *See*, Ex Parte Declaration of Lee L. Selwyn, appended to AT&T's Comments CC Docket No. 96-149 (November 15, 2002) ¶¶ 44-45.

31 *See*, Declaration of Lee L. Selwyn appended to AT&T's Comments in the *Non-Dominance FNPRM* (June 30, 2003) ¶¶ 97-103 ("Price Cap plans often allow upward; Reply Declaration of Lee L. Selwyn appended to AT&T's Comments in the *Non-Dominance FNPRM* (July 28, 2003) ¶¶ 57-58.

32 *Access Charge Reform*, CC Docket No. 96-262, *Sixth Report and Order*, CC Docket Nos. 96-262 and 94-1, *Report and Order*, CC Docket No. 99-249, *Eleventh Report and Order*, CC Docket No. 96-45, 15 FCC Rcd 12962, 13031 (2000).

33 Verizon August 11, 2003 *ex parte* at 3.

overall ILEC access charge rate level and a less onerous (from Verizon's perspective) price adjustment mechanism under a reexamination of CALLS and possible reinitialization of access charges at the 11.25% ILEC authorized rate of return.

6. *The Savings GNI Claims Will Be Realized on OSS Systems is Based on GNI's Discriminatory Access to the BOCs OSS Systems*

In the June 4 *ex parte*, Attachment 3 at 5, note 4, Verizon states that "[b]ecause OSS suites are already in place with considerable software and hardware capital investment, the incremental savings for OSS due to elimination of the section 272 restrictions in the future are relatively small, relating primarily to reductions in the need to purchase software and hardware updates in the future." In light of the purported need for forbearance to serve the most demanding large business customer,[34] one would assume that if GNI will not update its systems, GNI will use "the BOCs OSS [that] could perform the same tasks with little modification."[35]

After years of claiming that it was impractical for Verizon to grant others access to the BOC's OSS, Verizon apparently now intends to give GNI access to its BOC OSS if it is no longer subject to OI&M separation. This would then require that the Verizon BOCs afford direct access to their OSS to nonaffiliated CLECs and IXCs, something that they have long insisted cannot be done[36] – and they have not explained how it will be done if the forbearance petition is granted.

Verizon does not presently provide nonaffiliated CLECs and IXCs with direct access to its OSS. Instead, carriers are required to communicate with Verizon's OSS using a variety of manual and electronic order forms and other message formats, transmitted via specially designed interfaces between their systems and Verizon's. For example, rather than obtaining direct access to Verizon data bases to order services and to check the status of pending orders, nonaffiliated carriers are required to submit "requests" that are then responded to by Verizon's systems or by Verizon personnel. Before a carrier's "request" can be processed by Verizon, it must be checked for completeness by Verizon systems and/or personnel, and will frequently be returned unfulfilled to the requesting carrier if the

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[34] Declaration of Steven G. McCully appended to Verizon's *Petition for Forbearance*, *passim.*

[35] Verizon's *Petition for Forbearance* at 3.

[36] *See, e.g.,* Commonwealth Of Massachusetts Department Of Telecommunications And Energy, *Investigation by the Department on its own Motion Into the appropriate Pricing, based upon Total Element Long-Run Incremental Costs, for Unbundled Network Elements and Combinations of Unbundled Network Elements, and the Appropriate Avoided Cost Discount For Verizon New England, Inc. d/b/a Verizon Massachusetts' Resale Services in the Commonwealth of Massachusetts,* D.T.E. 01-20 ("Massachusetts UNE rates case"), Direct Testimony of Louis D. Minion on behalf of Verizon Massachusetts on Costs And Rates For Access To OSS (May 4, 2001) at 4-5 and 14-15 (CLECs are not permitted to access Verizon's OSS directly, but instead must do so through "interfaces" or "gateway" systems specially developed by Verizon for this purpose; made clear that this differs from the manner in which Verizon's own personnel access its OSS).

required information is incomplete or incorrect. Under the existing OI&M separation requirements, GNI (and other section 272 affiliates) presumably communicate with Verizon's OSS in exactly this manner, like any nonaffiliated carrier.

However, if the OI&M restriction is lifted, GNI would then be afforded direct access to Verizon's OSS, bypassing these various interfaces and messaging requirements, and avoiding the various delays and opportunities for error created thereby. Of course, affording GNI such direct access to the Verizon BOCs' OSS would require that Verizon offer similar direct access to other carriers *via* section 272(b)(5) postings. Verizon has offered no details as to how such direct access to its BOCs' OSS would be practically and economically provided to nonaffiliated carriers, nor has it explained why it could not have made such direct access available all along, rather than subjecting its competitors to what now appears to have been deliberately degraded interface arrangements. Indeed if, as Verizon now apparently claims, it would be able to afford nonaffiliated carriers the same direct access to its BOC OSS that GNI would enjoy if the OI&M restriction is lifted, then it needs to explain why it could not do exactly the same thing without being relieved of the OI&M separation requirement, since the nonaffiliated carriers to whom direct access would be provided would obviously not be integrating their own OI&M activities with Verizon's.

7. *Verizon's Reliance on Computer III is Misplaced*

Verizon criticizes as "revisionist history" AT&T's discussion of the *BOC Separations Order*,[37] although this decision was expressly cited by the Commission in the *Non-Accounting Safeguards Order*,[38] and cites as the relevant precedent the Commission's *Computer III* decision.[39] It is Verizon that is engaged in "revisionist history" "neglect[ing] to mention" that the Ninth Circuit rejected the cost-benefit analysis applied by the Commission in the *Computer III* proceedings to eliminate, *inter alia*, the OI&M restriction.[40] Despite over eight years since the court of appeals' last remand, the

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[37] *Policy and Rules Concerning the Furnishing of Customer Premises Equipment, Enhanced Services and Cellular Communications Equipment by the Bell Operating Companies*, CC Docket 83-115, Report and Order, 95 FCC 2d 1117, 1144 (1984), *aff'd sub nom. Illinois Bell Telephone Company v. FCC*, 740 F.2d 465 (7th Cir. 1984), *aff'd on reconsideration*, FCC 84-252, 49 Fed Reg. 26056 (1984), *aff'd sub nom. North American Telecommunications Association v. FCC*, 772 F. 2d 1282 (7th Cir. 1985).

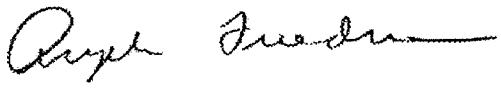
[38] *Non-Accounting Safeguards Order*, at 21984 ¶ 163 and fn. 389 ("We conclude, as we did in the BOC Separations Order, that allowing the sharing of [OI&M] services would require 'excessive, costly and burdensome regulatory involvement in the operation, plans and day- to-day activities of the carrier ... to audit and monitor the accounting plans necessary for such sharing to take place'").

[39] Verizon August 11, 2003 *ex parte* at 5.

[40] *See, e.g.*, *California* v. *FCC*, 39 F.3d 919, 930 (9th Cir. 1994); *see also California* v. *FCC*, 905 F.2d 1217 (9th Cir. 1990); *California* v. *FCC*, 4 F.3d 1505 (9th Cir. 1993).

Commission has yet to issue an order that justifies the view that the BOCs rely on here.

Sincerely,



Aryeh Friedman

cc: W. Maher
J. Carlisle
M. Carey
W. Dever
P. Megna
C. Shewman
R. Tanner

Exhibit K

Frank S. Simone
Government Affairs Director

Suite 1000
1120 20th Street, NW
Washington DC 20036
202-457-2321
202-263-2660 FAX
fsimone@att.com

October 31, 2003

VIA ELECTRONIC FILING

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, S. W. – Room TWB-204
Washington, D. C. 20554

Re: *Ex parte,* CC Docket No. 96-149, Verizon Petition for Forbearance from the Prohibition of sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) of the Commission's Rules

Dear Ms. Dortch:

Attached please find AT&T's response to Verizon's October 27, 2003 submission in the above-captioned proceeding.

Consistent with Section 1.1206 of the Commission's rules, I am filing one electronic copy of this notice and request that you place it in the record of the above-captioned proceeding.

Sincerely,

ATTACHMENT

cc: B. Tramont
C. Libertelli
M. Brill
J. Rosenworcel
D. Gonzalez
L. Zaina
W. Maher

Aryeh S. Friedman
Senior Attorney

Room 3A231
900 Route 202/206 North
Bedminster, NJ 07921
Phone: 908 532-1831
Fax: 908 532-1281
EMail: friedman@att.com

October 31, 2003

VIA E-MAIL

Marlene Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W., TW-A-325
Washington, DC 20554

Re: *Verizon Petition 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. 96-149

Dear Ms. Dortch:

AT&T Corp. ("AT&T") hereby responds to Verizon's October 27, 2003 *ex parte*.

First, AT&T has made it clear that it seeks a "level playing field," not protectionism. AT&T has repeatedly invoked the "reality of the market" – that Verizon has been able to capture substantial interLATA market shares shortly after receiving section 271 authority even with the OI&M safeguard in place – to demonstrate that the OI&M has imposed no meaningful costs on Verizon. AT&T has not, as claimed by Verizon, made "a plea for protectionism."[1] To the contrary, as AT&T has demonstrated throughout this proceeding, the OI&M safeguard is necessary to ensure that the BOCs compete on a *level playing field*, placing BOCs and their affiliates in the same position as their competitors in the local and interLATA markets.[2] Moreover, the need for a level playing field is as necessary in the business market as in the residential market because Verizon and the other BOCs maintain a firm grip on critical inputs in the business market, such as special access.

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1 Verizon's October 27, 2003 *ex parte* at 1.

2 Letter from David L. Lawson on behalf of AT&T to Marlene Dortch, Secretary, Federal Communications Commission, November 15, 2002, at 1.

Second, Verizon's ex parte does not refute that it uses the "prevailing price" loophole to structure its affiliate transactions in a manner that is economically irrational except for the fact that it will benefit its section 272 affiliate (and perhaps tangentially other smaller unaffiliated entities). Nor does Verizon's ex parte refute AT&T's showing that post-conduct audits are no substitute for structural safeguards. As noted in AT&T's October 1, 2003 *ex parte*, Verizon has structured its affiliate transactions, such as its billing and collection service, so as not to offer discounts based on volume of business (which might be economically rational to the extent that the discount reflects volume-related savings that would be passed on to purchasers), but rather to offer discounts based upon a specified percentage of business (e.g. 85% of *total* Verizon end user billing).

Because a percentage of billing discount does not correlate with savings that might be realized by Verizon, Verizon's offer effectively limits the discount to Verizon's Section 272 affiliate and perhaps other smaller competitors. Such pricing arrangements have, in other contexts, been seen by the Commission precisely for what they are – attempts to discriminate in favor of the BOC's section 272 affiliate.[3]

Moreover, Verizon's claim that there is a biennial audit of the CAM,[4] in no way refutes AT&T's demonstration of the limited utility of post-misconduct audits, particularly in light of Verizon's demonstrated efforts to delay issuance of the audit data. Indeed, Verizon continues to delay the release of critical audit data. It has just recently petitioned for review of the Commission's order denying its request for confidentiality for the most recent Section 272 Biennial audit,[5] even though Verizon lost the very same motion with respect to its first Section 272 Biennial audit. As a result of Verizon's actions in the first Section 272 audit proceeding, Verizon was able to delay the release of the audit data for almost a year and a half after it was collected.[6] By doing it again with respect to the

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[3] *See Access Charge Reform*, Fifth Report And Order And Further Notice Of Proposed Rulemaking, 14 FCC Rcd. 14221 (1999) ¶ 134 (The Commission specifically noted that "growth discounts," which offer reduced prices based on growth in local traffic, "create an artificial advantage for BOC long distance affiliates with no subscribers, relative to existing IXCs and other new entrants"). *See also,* Comments of AT&T Corp., WC Docket No. 02-150, at 47-51 (filed July 11, 2002) ("AT&T Alabama 271 Comments") (BellSouth similarly proposed a tariff that would establish a discriminatory growth discount that would favor BellSouth's long distance affiliate over large, established IXCs such as AT&T).

[4] Verizon's October 27, 2003 *ex parte* at 2-3.

[5] *See* Verizon's Application for Review in EB-03-IH-0341 filed on August 14, 2003.

[6] *In the Matter of Accounting Safeguards Under the Telecommunications Act of 1996: Section 272(d) Biennial Audit Procedures*, Memorandum Opinion and Order, CC Docket No. 96-150 (rel. Jan. 10, 2002). Verizon filed a Petition for Reconsideration and Request for Stay on January 15, 2002, and pursuant to an Order issued by the Commission on January 23, 2002, the unredacted version was made available on February 6, 2002. Thus, contrary to Verizon's assertion at Verizon's October 27, 2003 *ex parte* at 3 n. 1, Verizon, by redacting the data and then repeatedly opposing disclosure, successfully delayed the release of the audit data for almost eight months; by that time the data, the latest of which was collected in September 2000, was almost

second Section 272 audit, Verizon will be able to delay the release of that audit data for an equivalent period of time. Moreover, as shown in AT&T's October 1, 2003 *ex parte*, there was no effective remedy for the Section 272 violations identified in the first Section 272 audit. Specifically: (1) the statute of limitations had run for a key violation, so that all the Commission could do was "admonish" Verizon; and (2) Verizon deviated from the auditing guidelines, providing data in a format that precluded the Commission from determining whether other violations occurred.[7]

Third, GNI's now conceded joint use of the LEC's OSS will "inevitably" lead to discrimination and cost misallocation. Verizon's October 27, 2003 *ex parte* makes it clear that if the OI&M forbearance petition is granted, Verizon will be using "the local exchange carrier's OSSs to provide OI&M services to the section 272 affiliate."[8] As the Commission found in the *Non-Accounting Safeguards Order*, allowing a BOC to provide network related services on behalf of an affiliate, "would *inevitably* afford the affiliate access to the BOC's facilities that is superior to that granted to the affiliate's competitors," and "would create substantial opportunities for improper cost allocation."[9]

This is made evident by Verizon's failure to address the inevitable risk that the LEC will provide its affiliate with *superior* access to its OSS.[10] Verizon also fails to explain its past claims that its LEC *cannot* provide unaffiliated IXCs with comparable direct access to their OSSs.[11] Nor has Verizon addressed the issue of likely cost misallocation with respect to the common OSS upgrades, as more fully explained in Dr. Selwyn's prior declaration in this proceeding -- that to the extent the OSS upgrade will be utilized on an integrated basis, the BOC could treat both the upgrade and subsequent ongoing maintenance expenses as a "common cost," and "*any non-zero allocation of these incremental system development and maintenance costs to POTS would have the effect of shifting costs away from the competitive long distance company and onto regulated monopoly local exchange service*" (emphasis in the original).[12]

Fourth, Verizon utterly mischaracterizes its prior "absorption" claim in an attempt to minimize it. Verizon seeks to minimize the OI&M costs the LEC will "absorb," noting that in its June 24, 2003 *ex parte* it had stated that forbearance would only relieve it of *30%* of its "Workforce & Employee related expenses."[13] However, in that same *ex parte,* Verizon also stated that GNI would save *95%* of its costs for "Professional

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18 months old. Verizon appears to be doing precisely the same thing with the second Section 272 audit data.

7 AT&T's October 1, 2003 *ex parte* at 6, n. 28.

8 *Id* at 4.

9 *Non-Accounting Safeguards Order* ¶ 12 (citing *BOC Separations Order*, 95 F.C.C.2d 1117 (1983)) (emphasis added).

10 Verizon states only that "the 272 affiliates and other carriers would only have access to data about their own networks in those OSSs" Verizon's October 27, 2003 *ex parte* at 3.

11 *See* AT&T's October 1, 2003 *ex parte* at 8 and note 36.

12 Ex Parte Declaration of Lee L. Selwyn, in CC Docket No. 96-149, July 9, 2003 ¶ 18.

13 Verizon's October 27, 2003 *ex parte* at 4.

Services," and *80%* of its "Back Office" expenses.[14] As previously shown by AT&T, not only are Verizon's savings claims utterly unsubstantiated,[15] but the magnitude of savings Verizon attributes to "absorption" by the LEC's workforce (whether 20%,[16] 30% or 80-95%) cannot be attributed to "efficiencies," as claimed by Verizon. At Verizon LD's level of operations, its network provider, GNI, should be operating at or near minimum average cost, *i.e.,* should have been able to achieve most or all of the potential economies of scale or scope (*i.e.*, should have achieved "minimum efficient scale"), such that the magnitude of any *bona fide* additional economies of scale would be minimal, perhaps even zero.[17] Thus, any savings above this level will result only because the LEC has excess capacity paid for by its ratepayers – excess capacity that it is now willing to provide to GNI for free.[18]

Finally, Verizon doesn't contest AT&T's showing that even if CALLS were pure price caps Verizon would still have a powerful incentive to shift costs out of its long distance affiliates to enhance their ability to compete with nonintegrated rivals. In any event, Verizon has utterly failed to refute AT&T's showing that CALLS are not pure price caps. In its prior filings, AT&T demonstrated that even if CALLS were pure price caps, Verizon has strong incentives to discriminate against nonintegrated rivals and to misallocate costs.[19] Verizon's October 27, 2003 *ex parte* does not address that issue at all. Instead, Verizon cites to data on the number of retail lines Verizon lost in the last three years and the percentage of minutes of use on retail services lost in the last quarter,[20] challenging only AT&T's assertion about the likelihood that the Commission will reexamine ILEC price caps in July 2005 when *CALLS* expires. However, the data, even if correct, neither demonstrate that the level of competition is (or in 2005 will be) sufficient

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14 *See* Verizon's June 24, 2003 *ex parte* at 7 (emphasis added) and Table 1 at 8-9.

15 Verizon failed to provide both affidavits by the persons Verizon identified as having "personal knowledge" explaining how these *ipse dixit* numbers were derived and the underlying data even though a Protective Order was in place. AT&T's October 1, 2003 *ex parte* at 3.

16 Verizon's October 30 letter to Commissioner Adelstein now suggests that the savings realized by having these services absorbed by the LEC will exceed 20% of its total savings. Letter from Kathryn C. Brown, Senior Vice President, Verizon, to Commissioner Jonathan S. Adelstein, October 31, 2003 at 2 ($39 million out of $183 million). AT&T would further note that the disclosure of the dollar figure in the Adelstein letter demonstrates the sham nature of Verizon's request for confidential treatment since this information was previously redacted.

17 AT&T's October 1, 2003 ex parte at 4-5.

18 AT&T further demonstrated that Verizon could achieve the same savings by having third party call center operators provide these services, thereby retaining the benefits of structural savings and allowing Verizon to avoid the construction and operation costs it claims it has incurred by providing OI&M services. *Id.* at 5.

19 *See e.g.*, Ex Parte Declaration of Lee L. Selwyn, appended to AT&T's Comments CC Docket No. 96-149 (November 15, 2002) ¶¶ 44-45; Declaration of Lee L. Selwyn appended to AT&T's Comments in the *Non-Dominance FNPRM* (June 30, 2003) ¶¶ 97-103; Reply Declaration of Lee L. Selwyn appended to AT&T's Comments in the *Non-Dominance FNPRM* (July 28, 2003) ¶¶ 57-58.

20 Verizon's October 27, 2003 *ex parte* at 4.

to constrain rates effectively[21] nor change Verizon's current incentives to misallocate costs regardless of whether or not the Commission ultimately reexamines ILEC price caps in July 2005.

Sincerely,

Aryeh Friedman

cc: B. Tramont
C. Libertelli
M. Brill
J. Rosenworcel
D. Gonzalez
L. Zaina
W. Maher

[21] *See, e.g.*, AT&T's Comments, WC Docket No. 02-112 and CC Docket No. 00-175, June 30, 2003 at 17, and because