

**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

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| In the Matter of                         | ) |                      |
|  | ) |                      |
| Section 272(d) Biennial Audit of Verizon | ) | EB Docket No. 03-200 |
| Communications, Inc                      | ) |                      |
|  | ) |                      |

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

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**RESPONSE OF VERIZON<sup>1</sup> TO COMMENTS  
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SECOND SECTION 272 BIENNIAL AUDIT REPORT**

**I. Introduction and Summary**

The Second Biennial Section 272 Audit Report (“Second Report”) provides substantially more data than the previous audit to show that Verizon is complying with the Section 272 safeguards. Nonetheless, in its continuing efforts to handicap its competitors in the long distance business, AT&T continues to criticize both Verizon’s performance and the audit procedures adopted by the Federal-State Joint Oversight Team.

Because the audit was conducted under agreed-upon procedures (“AUP”), the auditor was required to report all results regardless of materiality. Accordingly, the Second Report contains a handful of minor observations and inconclusive data that AT&T has seized upon to argue that the Commission should take action against Verizon. AT&T does not show that any of the facts in the Second Report demonstrate material noncompliance with the Commission’s rules. Nor could it.

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

AT&T's criticisms of the audit procedures are without merit. The auditor followed standard accounting principles and procedures in performing the AUP and its work was monitored and supervised by the Joint Oversight Team, which included representatives from the FCC and the regulatory commissions of 13 states and the District of Columbia. These procedures were more extensive than in the previous audit, concentrating on the most important issues to confirm Verizon's compliance with the Section 272 rules. In fact, these procedures resulted in an audit report that is at least twice as voluminous as the First Biennial Section 272 Audit Report dated February 6, 2002. The data provide overwhelming evidence that Verizon is complying with the Section 272 rules.

## **II. The Second Report Confirms Verizon's Compliance with the Section 272 Rules.**

AT&T's focus on immaterial facts should not be allowed to distract the Commission from the overwhelming evidence in the Second Report that Verizon has complied with the Commission's Section 272 rules in all material respects. The Second Report contains over 200 pages of observations and results that describe in detail how the auditors tested Verizon's compliance with the Commission's Section 272 rules. This is only a small portion of the data in the work papers that the auditor collected and made available to the Joint Oversight Team under Section 272(d)(3) of the Act to document Verizon's compliance. The Second Report summarizes voluminous data in the work papers drawn from the BOCs' and Section 272 affiliates' financial records, transaction records, methods and procedures, and provisioning data.

As described in the Second Report, the data show that Verizon's Section 272 affiliates have been operated independently from the BOCs as separate corporations with their own switching and transmission facilities. The auditor examined the affiliates' books and accounts to confirm that they maintained separate books and accounts and conducted transactions with the

BOCs in accordance with the Commission’s affiliate transaction rules. The auditor reviewed the list of officers, directors, employees of the Section 272 affiliates to confirm that these personnel are not shared with the BOCs. The auditor looked at the debt instruments and credit arrangements to confirm that the Section 272 affiliates have not obtained credit with recourse to the assets of the BOCs. The auditor also examined contracts between the Section 272 affiliates and the BOCs to confirm that the transactions were on an arm’s-length basis and were posted on web sites. The auditor gathered performance data by the BOCs for affiliates and non-affiliates and documented the services rendered to the Section 272 affiliates by the BOCs to confirm that they have not received discriminatory treatment. The Second Report provides overwhelming evidence that Verizon complies with the Section 272 safeguards.

The fact that the Second Report discusses a small number of immaterial issues cannot be used to conclude Verizon failed to comply with the Section 272 safeguards. Unlike an attestation audit, where the audit report must contain a discussion of any issues where the auditor, in its independent judgment, finds material violations of the rules, this audit was conducted as an “agreed-upon procedures” audit.<sup>2</sup> In an agreed-upon procedures audit, the auditor does not render an opinion on the company’s compliance.<sup>3</sup> Rather, the auditor carries out the procedures specified by the “users” and “must report all results in the form of the findings from application of the agreed-upon procedures,” regardless of materiality.<sup>4</sup> For these reasons,

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<sup>2</sup> See *General Standard Procedures for Biennial Audits Required under Section 272 of the Communications Act of 1934, As Amended*, Joint Federal/State Oversight Team for Verizon Communications, Final Procedures as of June 1, 2003, at 6 (“*2002 Biennial Audit Procedures*”).

<sup>3</sup> See *Statements on Standards of Audit Engagements* 10, Section 2.25 (“The practitioner should report all findings from application of the agreed-upon procedures. The concept of materiality does not apply to findings to be reported in an agreed-upon procedures engagement unless the definition of materiality is agreed to by the specified parties”).

<sup>4</sup> *2002 Biennial Audit Procedures* at 7.

none of the facts disclosed in the Second Report constitute a finding that Verizon failed to comply with the Section 272 rules. In fact, the Second Report provides extensive data to show just the opposite – Verizon has faithfully complied with those safeguards in establishing and operating its Section 272 affiliates.

### **III. The Second Report Does Not Demonstrate Material Violations of the Section 272 Rules.**

The Second Report provides substantial data to show that Verizon is complying with the Section 272 safeguards. AT&T has nonetheless seized upon a handful of minor observations and inconclusive data to argue that the Commission should take action against Verizon. AT&T does not, and, indeed, could not, show that any of the facts in the Second Report demonstrate material noncompliance with the Commission’s rules.

#### **A. Verizon Has Not Discriminated in Favor of its Section 272 Affiliates in the Provision of Goods and Services.**

In Objective VIII of the AUP, the auditor conducted procedures to determine whether the BOCs discriminated in favor of their Section 272 affiliates in the fulfillment of requests for services. Among other things, the auditor examined all federal and state complaints involving allegations of discrimination and found that the complaints had either been denied by the relevant state commissions or have been addressed by the BOCs without any findings that the BOCs had violated federal or state law. *See* Second Report, Appendix A at 13-15.

The auditor collected information regarding the BOCs’ practices and processes to fulfill requests for telephone exchange service and exchange access service for their Section 272 affiliates, other affiliates, and non-affiliates in each state where the BOC has been authorized to provide in region interLATA services. Verizon demonstrated that “at each step in the fulfillment

of requests the same treatment is given to non-affiliated customers and affiliate customers.” *See id.* at 63. Verizon applies the same installation and repair interfaces with the Verizon ILEC operations as are made available to non-affiliates. Verizon’s systems that process installation orders apply the same standard minimum provisioning intervals (where facilities exist) and the same first-come-first-served priority to special access orders regardless of the identity of the customer. *Id.*

The auditor also collected the BOCs’ reports of time intervals for processing orders, provisioning service, and performing repair and maintenance services for affiliates and non-affiliates as required by Procedure 4 of Objective VIII of the AUP. *See id.* at 66-75. The BOCs provide reports for average installation intervals, percent commitments met, average repair intervals, total trouble reports, firm order confirmation response times, and presubscribed interexchange carrier (“PIC”) change intervals. These data demonstrated that the BOCs’ affiliates had longer special access service intervals in some months, and shorter intervals in other months, than the general population of non-affiliates.

AT&T argues that the “Section 272 affiliates received preferential treatment over unaffiliated carriers.” AT&T Comments at 7. AT&T’s argument is based simply on the results of certain performance measures. The Commission, however, has consistently treated such results in its Section 271 proceedings as “a reasonable basis for us to begin our analysis.”<sup>5</sup> To the extent there is no statistically significant difference between Verizon’s provision of service to competitors and its own retail customers or the performance benchmark, “we need not look any

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<sup>5</sup> *Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act To Provide In-Region, InterLATA Service in the State of New York*, 15 FCC Rcd 3953, ¶ 57 (2001) (“NY 271 Order”).

further.”<sup>6</sup> On the other hand, where there is a statistically significant difference, “we will examine the evidence further to make a determination whether the statutory nondiscrimination requirements are met.”<sup>7</sup>

[W]e will examine the explanation that [Verizon] and other commenters provide about whether these differences provide an accurate depiction of the quality of [Verizon’s] performance. For instance, we may examine the data on a more disaggregated level, in order to evaluate arguments made by [Verizon] that competitive LEC error, or differences in the composition of competitive LEC orders, or sudden changes in the quantity or timing of orders made by competitive LECs, are responsible for the apparent poor performance. We also may examine how many months a variation in performance has existed and what the trend has been in recent months. A steady improvement in performance over time may provide us with an indication that problems are being resolved. It may also provide us with evidence as to whether [Verizon’s] systems are scaleable and can handle large volumes of orders for services. Finally, in some instances, we may find that statistically significant differences in measured performance may exist, but that such differences have little or no competitive significance in the marketplace. As such, we may deem such differences non-cognizable under the statutory standard.<sup>8</sup>

As a preliminary matter, no valid comparisons can be drawn from the data AT&T cites comparing the performance for the BOCs’ affiliates and non-affiliates because of the extremely small number of orders for the BOCs’ affiliates. In Massachusetts and New York, the states with some of the largest volumes of affiliate orders, the BOCs’ affiliates had twelve or fewer orders for each service in nearly all of the reported months, while non-affiliate orders were often in the hundreds or even thousands. *See* Second Report, Attachment A at A-15 to A-19; A-35 to A-36. No statistically significant conclusion can be drawn from data for such small population sizes. The Commission has stated numerous times that a difference in performance between affiliates

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<sup>6</sup> *Id.* ¶ 58.

<sup>7</sup> *Id.* ¶ 59.

<sup>8</sup> *Id.*

and non-affiliates must be statistically significant to be relevant to the issue of discrimination.<sup>9</sup>

In particular, the Commission has found that,

volumes may be so low as to render the performance data inconsistent and inconclusive. Performance data based on low volumes of orders or other transactions is not as reliable an indicator of checklist compliance as performance data based on larger numbers of observations. Indeed, where performance data is based on a low number of observations, small variations in performance may produce wide swings in the reported performance data.<sup>10</sup>

This is certainly true here. For instance, in August 2001, the BOC's Section 272 affiliates submitted only one DS-1 order in New York and that order was completed on time, so the Second Report shows that the BOC completed 100 percent of the BOC's Section 272 affiliates orders on time that month. But in November 2001, the BOC's Section 272 affiliates submitted three DS-1 orders in New York and only one of those orders was completed on time, so the Second Report shows that the BOC completed only 33.3 percent of orders on time for the BOC's affiliates that month, compared to a total of over 2,300 orders for non-affiliate companies, where the BOC completed 73.5 percent on time. But this does not mean that the BOC gave its Section 272 affiliates in November poorer service, any more than it means the BOC gave its Section 272 affiliates better service in August. To suggest that such isolated results have statistical validity is not credible.

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<sup>9</sup> See, e.g., *Application of Verizon Pennsylvania Inc., Verizon Long Distance, Verizon Enterprise Solutions, Verizon Global Networks Inc., and Verizon Select Services Inc. For Authorization to Provide In-Region, InterLATA Services in Pennsylvania*, 16 FCC Rcd 17419, Appendix C, ¶ 11 (2001) ("PA 271 Order").

<sup>10</sup> *Id.*; see also *Joint Application by SBC Communications Inc., Southwestern Bell Telephone Co., and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in Arkansas and Missouri*, 16 FCC Rcd 20719, Appendix C, ¶ 11 (2001); *Application of Verizon New York Inc., Verizon Long Distance, Verizon Enterprise Solutions, Verizon Global Networks Inc., and Verizon Select Services Inc., for Authorization to Provide In-Region, interLATA Services in Connecticut*, 16 FCC Rcd 16831, Appendix C, ¶ 11 (2001).

Even Robert M. Bell's declaration on behalf of AT&T concedes that "it can be difficult to extrapolate from single month comparisons due to small sample sizes of affiliate orders . . . ." AT&T Comments, Bell Decl. ¶ 6. Nonetheless, he states, without any statistical analysis for support, that the differences between affiliate and non-affiliate data are significant by just looking at the standard errors for the year-long averages. *See* AT&T Comments, Bell Decl. ¶ 11. However, standard error values vary based on the sample size and they say nothing about whether the differences are statistically meaningful. Indeed, in the very same paragraph, Mr. Bell admits that it is not possible to perform a valid statistical analysis due to the skewness (long tail) of the installation times and the small sample sizes. *Id.* Mr. Bell bases his conclusion regarding Verizon's performance on a "stare and compare" assessment of "annual averages of monthly averages" that has no statistical validity, because any data will show random variations between samples even when the samples are drawn from the same population.

Moreover, even if the quantities of Section 272 affiliates' orders were large enough to allow tests for statistical significance, which they are not, the performance data cannot support AT&T's claims of discrimination. In many months, the FOC intervals and average installation intervals show better performance for non-affiliates. For example, AT&T ignores the reported FOC intervals in New York and Massachusetts for DS-0 services, DS-3 services, and OCn services, which often show better performance for unaffiliated carriers during the audit.<sup>11</sup>

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<sup>11</sup> In New York, unaffiliated carriers had shorter FOC intervals for DS-0 services in 11 out of the 21 months where the BOC's Section 272 affiliates ordered service; for DS-3 services in 11 out of 18 months; and for OCn services in 6 out of 12 months. *See* Second Report, Attachment A at A-35 to A-36. In Massachusetts, unaffiliated carriers had shorter FOC intervals for DS-0 services in 6 out of the 9 months where the BOC's Section 272 affiliates ordered service; for DS-3 services in 4 out of 6 months; and for OCn services in 1 out of 2 months. *See* Second Report, Attachment A at A-15 to A-16.

In addition, the results of the performance data cannot be attributed to the BOC alone. For installation, the differences in intervals were likely affected by the facts that (1) non-affiliates tended to request installation dates that were longer than the standard interval; (2) non-affiliate orders required building of facilities more often than affiliate orders; and (3) non-affiliate orders involve copper facilities rather than fiber more often than affiliate orders. *See* Second Report, Appendix A at 71-75. In addition, the time necessary to install a special access order can be affected by (1) whether the BOC has transport facilities and equipment in place to provision the specific route and service configuration requests by the customer; and (2) the specific location and complexity of the circuits requested.

Verizon performed an analysis of all special access orders for July 2002 in both New York and Pennsylvania to determine whether non-affiliates more frequently request longer installation intervals. For this sample, 60 percent of the non-affiliate orders requested installation intervals longer than the standard minimum provisioning interval, whereas only 11 percent of the 272 affiliates' orders requested longer intervals. *See* Second Report, Appendix A at 72. By more frequently requesting longer intervals, the non-affiliates skewed the performance results for average installation interval. In fact, the Commission has generally found in Section 271 proceedings that Verizon's performance was nondiscriminatory where competing carriers were more frequently requesting longer intervals. *See NY 271 Order* ¶ 204 ("we find that [Verizon] demonstrates that its average completed interval data for competing carriers reflects a disproportionate share of orders with installation dates beyond the first available date offered by [Verizon]").

In addition, Verizon performed an analysis of DS-1 orders in New York for July 2002 to determine whether non-affiliates' orders more frequently require the construction of new

facilities. For this sample, 34% of the non-affiliate orders required Verizon to build facilities, while none of the orders from Section 272 affiliates required a facilities build. When examining only the orders where a “facilities build” was not required, the average installation interval for the 77 non-affiliate orders was 16 days, equal to the 16 days for the Section 272 affiliates. *See* Second Report, Appendix A at 72. By more frequently submitting orders that require facilities builds, the non-affiliates skewed the performance results for average installation. In fact, the Commission has generally found in Section 271 proceedings that Verizon’s performance was nondiscriminatory where competing carriers were more frequently requesting wholesale services that had longer provisioning intervals. *See NY 271 Order* ¶ 205 (“we also find persuasive [Verizon’s] argument that its average completed interval data for competing carriers’ non-dispatch orders reflects a disproportionate share of order types with longer-than-average standard intervals.”)

AT&T also criticizes performance results for DS-1 repair service in New York and FG-D repairs service in Massachusetts. AT&T Comments at 7. Again, no valid comparison can be made between the performance for the BOCs’ affiliates and non-affiliates because of the extremely small number of trouble tickets. *See PA 271 Order*, App. C ¶ 11. In New York, the BOC’s affiliates had fewer than 12 DS-1 trouble tickets in all but two months. *See* Second Report, Attachment A at A-41. In Massachusetts, the BOC’s affiliates had six or fewer FG-D trouble tickets per month. *See* Second Report, Attachment A at A-22.

In addition, the performance results for DS-1 service cannot be credited to the BOC alone. Because non-affiliates more often have DS-1 service on copper facilities rather than fiber facilities, they more often submit repair requests for copper facilities than Section 272 affiliate repair requests. It is typically easier and quicker for Verizon to repair a trouble on a fiber facility

than on a copper facility. Copper facilities ride cables with basic exchange services and therefore run through multiple splices and cross connections within the field. Troubles on copper facilities often require dispatches to several outside work groups and interdepartmental team conference calls may be required to resolve the trouble. Since fiber circuits do not have as many possible failure points, multiple dispatches and interdepartmental coordination is less likely to be required. *See* Second Report, Appendix A at 74.

The overall results for FG-D repair intervals are consistent with expectations for random variation. For the FG-D repair interval results, the non-affiliate category had longer intervals in 49 percent of the instances. *See* Second Report, Appendix A at 75.

**B. Verizon Conducted Transactions with Its Long-Distance Affiliates on an Arm's-Length Basis And It Did Not Discriminate in Favor of Its Long-Distance Affiliates in the Provision of Goods and Services.**

Objectives V and VI of the AUP included extensive procedures to determine if Verizon's Section 272 affiliates conducted their transactions with the BOCs on an arm's-length basis and accounted for all these transactions in accordance with the Commission's rules. *See* Second Report, Appendix A at 8-54. The auditor examined the BOCs' processes for tracking and responding to competitors' complaints concerning procurement issues and noted that no complaints have been received. The auditor noted that the BOCs' written procedures for transactions with affiliates are consistent with the Commission's rules. The auditor also documented the BOCs' training and compliance program and noted that all employees interviewed were aware of the rules and received training. The auditor compared written agreements to services provided to the Section 272 affiliates. The auditor reviewed the postings of these contracts on Verizon's web site and described the timeliness and accuracy of the postings. The auditor documented and tested Verizon's accounting for affiliate transactions

based on tariff rates, fair market value, fully distributed cost, or prevailing market price, as appropriate, and, with the exception of one erroneous bill, noted no differences between the amounts recorded in the books of the Section 272 affiliates and the BOCs. The auditor examined the Section 272 affiliates' balance sheets and listings of fixed assets and determined that no fixed assets have been transferred from the BOCs to the Section 272 affiliates. The comprehensive procedures required by Objectives V and VI showed that Verizon has complied with the Commission's affiliate transaction rules and has conducted its transactions on an arm's-length basis as required by Section 272.

AT&T points to several instances where services were provisioned prior to the execution of a written agreement or amendment. AT&T Comments at 21-22. During the engagement period, Verizon self-disclosed several instances where services between the domestic Section 272 affiliates and the ILECs were provided prior to the execution of a written agreement or amendment. All of these instances have been remediated and written agreements/amendments have been executed.

These minor errors do not demonstrate material noncompliance with the Commission's Section 272 rules. Perfection is not and cannot be the standard. If companies were required to prove that there were no errors or omissions in their financial books, no company would ever pass a financial audit. Indeed, even the audit of the Commission's own financial statements employs a materiality standard in certifying that the Commission has complied with the applicable accounting standards. *See FCC Office of the Inspector General, Semiannual Report to Congress, Oct. 1-2002-March 31, 2003*, at 13-15 (rel. June 3, 2003) available at [http://hraunfoss.fcc.gov/edocs\\_public/attachmatch/DOC-235086A2.pdf](http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-235086A2.pdf). Furthermore, the Commission has recognized that "[i]t is not the Commission's practice to impose forfeitures for

insubstantial noncompliance.” *SBC Communications, Inc., Apparent Liability for Forfeiture*, 16 FCC Rcd 5535, ¶ 17 (2001).

Of the nine instances referenced by AT&T, three reflect GTE relationships that were in place prior to the merger with Bell Atlantic and that continued without a contract for a period after the merger. For two of the instances, there was a contract, but a single element was omitted from the contract due to human error. One of the instances was associated with Verizon’s post September 11 reconstruction activities. The remaining three instances involved very limited activities. *See* Second Report, Attachment E at 2.

AT&T points out that the Second Report identified potential Internet posting discrepancies. AT&T Comments at 23. The discrepancies noted by the auditor were largely technical in nature. As Verizon explained to the auditor, the Commission’s contract posting requirements are complex, requiring a multitude of data entries to be posted for each contract. Some contracts require the mapping of hundreds (in some cases, thousands) of data elements for a single contract. The failure to perfectly map only one of 1,000 rate elements from a contract to the Internet would be reflected as a discrepancy for that contract for the rate category without any allowance for typographical or administrative human error or oversight. Using a conservative estimate, Verizon’s overall web error rate is less than one percent. *See* Second Report, Attachment E at 4-5. Again, such a low error rate does not demonstrate material noncompliance.

AT&T also states that the Second Report identified discrepancies between the posted transactions and those available for public inspection. AT&T Comments at 24. Only one of the 87 sampled contracts was not available for inspection and that was due to human error. Five of the contracts that the auditor included in its sample were for Verizon Advanced Data Inc.

(“VADI”), but the auditor erroneously sought to review those contracts at the headquarters of VADI’s sister ILECs. As prescribed by Section 272(b)(5), VADI contracts are made available for inspection at VADI’s headquarters, which is located in New York. Two of the contracts were available and would have been provided if the auditor requested assistance. *See* Second Report, Attachment E at 6. In addition, where contracts had missing pages or dates, most of them could have been reviewed in their entirety on CD-ROMs available at the inspection sites. *Id.*

AT&T notes that the Second Report identified late Internet postings. AT&T Comments at 24. As Verizon explained, two instances were associated with contracts that were executed and posted in 1998 and are outside the audit period; and one was associated with a contract executed in 2000 and remediated in 2001. In most instances, the postings were made within a month of contract execution. None of the late postings were associated with contracts that were executed in 2002. *See* Second Report, Attachment E at 8.

In addition, AT&T notes that the Second Report identified Internet postings with missing disclosures. AT&T Comments at 25. As Verizon explained to the auditor, almost 80 percent of the noted discrepancies were associated with one posting oversight: failure to add a one-sentence description of the components of Verizon’s fully distributed cost calculations. Missing the definition of fully distributed costs did not affect the terms, conditions or pricing of services being offered. *See* Second Report, Attachment E at 9.

AT&T claims that Section 272 affiliates (VES and GNI) provided voicemail and Internet website maintenance services to the BOCs on a sole source basis without soliciting bids. AT&T Comments at 10. At the time these contracts were entered, no BOC was a party to them. These arrangements were between VADI, VES and GNI and were in place prior to the time that the Commission classified VADI as a successor or assignee of the BOCs. Until that time, VADI

was classified as a non-regulated affiliate and, as such, its transactions with Section 272 affiliates were not subject to Section 272(b)(5) requirements. Upon the sunset of the separate data affiliate requirement, Verizon documented the existing relationships as required by Section 272(b)(5), then later terminated them. *See* Second Report, Attachment E at 11. There was therefore no violation of Section 272 rules.

AT&T also claims that Section 272 affiliates obtained preferential rates for billing and collection services. AT&T Comments at 10. The differences were due to the fact that the non-affiliated company was operating under a 1992 billing and collection contract that had expired and was extended on a month-to-month basis while negotiations on a new contract were pending. The negotiations were not successful, and the non-affiliate company's contract was terminated effective November 1, 2001. *See* Second Report, Appendix A at 58. The rates for the affiliate were based on an updated contract and applied to both affiliates and non-affiliates after November 1, 2001. *See id.* In addition, some of the billing and collection rates that applied to the non-affiliate company under the old contract were lower than the new rates. For example, the price per billed message in excess of an average of 10 messages per bill was \$0.01 in the old contract and between \$0.015 and \$0.02 for less than 50 messages per bill in the new contract. *See* Second Report, Appendix A, Table 20.

AT&T made similar claims with respect to local exchange service rates offered to Section 272 affiliates. AT&T Comments at 10. But in each case, the difference noted by the auditor was due to reasons other than discrimination. For example, some of the differences were attributable to timing; when rates change, they are not updated in the specific customer service records, which the auditors examined, until that customer's next billing cycle. *See* Second Report, Appendix A at 59-60. In addition, some of the differences were customers falling into

separate rate groups, based on the customer's geographic area, or into separate rate classifications, based on whether the customer had one or multiple lines. *Id.*

AT&T also argues that on a sample of 100 inbound calls, the BOCs' sales representatives failed to inform new customers of their long distance options on 9 calls. AT&T Comments at 10. But Verizon explained that on three of these calls, after Verizon's sales representative advised the customers that they had a choice of carriers, the customers interrupted with their choice of carrier. Since the customer had made a selection, there was no obligation to read the list of carriers. Moreover, Verizon uses a Voice Response Unit that includes a neutral script so that most customers, who are calling to order new local service, prior to reaching a call center representative, hear the following: "You have a choice of local (or regional toll) and long distance providers. A list of providers is available." *See* Second Report, Attachment E at 12. Although the audit procedure did not require the auditor to listen to the call prior to the time that the live operator picked up the call, it is highly likely that all of these customers had heard the recorded announcement.

On just one call, the customer service representative erred when mentioning the \$5.00 PIC Change Fee since it is not applicable to customers who are selecting an interLATA carrier when establishing new local telephone service with Verizon. This mistake by Verizon's representative was not an attempt to steer the customer to Verizon's Section 272 affiliate. *See* Second Report, Attachment E at 12.

AT&T also claims that Verizon failed to maintain certain data to ascertain compliance under the AUP. AT&T Comments at 12. For example, AT&T notes that the auditors were not able to compare certain invoice amounts to the amount recorded by the Verizon BOC/ILEC's in their general ledger. *Id.* As Verizon explained to the auditor, the comparison could not be made

because of limitations in Verizon's financial systems. Verizon East records revenue and receivable amounts in its billings systems at a detail customer level. These amounts are summarized at a financial account code level as they pass to the BOCs' general ledger systems. *See Second Report, Appendix A at 87.*

Despite these limitations in the financial systems, Verizon has internal control functions in place between the billing systems and financial systems to ensure all billed amounts are recorded. As Verizon explained to the auditor, receivable collection systems maintain currently due and past due balances from customers regardless of whether the customer is an affiliate or not. There is also a process in place whereby the expenses recorded by the affiliate correspond to the revenue booked by the BOC. This process is used to eliminate intercompany revenue and expenses. *See Second Report, Appendix A at 87.*

AT&T also argues that "compliance with the imputation obligation of § 272(e)(3) could not be verified for one of the services tested." AT&T Comments at 12. As Verizon explained to the auditor, entries which would have normally been booked in November 2002 were instead booked in February 2003 and provided to the auditor due to work constraints. These entries were relatively small in nature. *See Second Report, Appendix A at 86.*

Finally, AT&T notes that in a sample of 87 invoices involving services provided to the Verizon BOC/ILEC by a Section 272 affiliate, Verizon was unable to locate the corresponding amount in the Verizon BOC/ILECs' books for 10 of the sample transactions. AT&T Comments at 27. For none of these ten invoices, did the auditor conclude that the Verizon BOC/ILEC did not pay. Four of the invoices were for voice long distance service totaling \$5,540.63. For these invoices, VSSI sends a billing file containing hundreds of line items to Verizon Service Group, which in turn, sends it on to a third party for allocation to the various BOCs/ILECs. The

BOCs/ILECs each pay VSSI separately and those payments are recorded to a single customer number on VSSI's accounts receivables. For this reason, it is not possible to associate each BOC's payment with the original VSSI invoice. Five of the invoices were for CPE services totaling \$12,176.01 and contain credit memos with a total of \$190. The VSSI invoice numbers were converted to ILEC purchase numbers. ILEC personnel were not able to locate the purchase numbers associated with these invoices and therefore could not extract the required data. *See* Second Report, Attachment E at 11. However, the Commission cannot conclude from this minor discrepancy that the BOC did not pay the VSSI invoice.

**C. The Verizon Long Distance Affiliates Operated Independently From the Bell Operating Companies.**

In Objective I of the AUP, the auditor conducted procedures to determine if Verizon's Section 272 affiliates operated independently from the BOCs as required by the Commission's rules. *See* Second Report, Appendix A at 1-4. Among other things, the auditor determined that Verizon Section 272 affiliates are separate corporations, are not owned by the BOCs, have separate employees, do not receive operations, installation, or maintenance services from the BOCs, and did not own any switching or transmission facilities jointly with the BOCs. These data demonstrate that Verizon has complied with the "operated independently" requirements.

AT&T notes that the auditor found two leases between VSSI and Verizon Credit Inc. "were not properly recorded as capital leases." AT&T Comments at 17. The impact of this recording error was not significant to the balance sheet or income statement of the VSSI legal entity. Moreover, Verizon has instituted new procedures to have a central accounting staff perform capital lease tests of all new leases by obtaining all pertinent information directly from Verizon Credit Inc., the lessor, when a new lease or an amendment of an existing lease is

executed. In any event, the auditor found that “the Company’s lease accounting policies were consistent with GAAP.” *See* Second Report, Appendix A at 5.

AT&T also challenges the second biennial audit report for failing to “disclose the identity of the ‘third party vendors’ providing OI&M services.” AT&T Comments at 14. There was no reason for the audit to disclose the identity of these third party vendors because, by definition, they are not affiliated with Verizon. In Objective I, Procedure 2, the auditor inspected Verizon’s corporate entities’ organizational charts, which disclosed all of the Verizon affiliates. *See* Second Report, Appendix A at 1. Accordingly, the AUP does not require disclosure of the identity of any third party vendor.

Another claim raised by AT&T is that “[t]he auditor found that 7% of sampled assets were not properly billed to the Section 272 affiliates.” AT&T Comments at 15. Like AT&T’s other claims, this one is without merit. For three of the 100 sampled items, the auditor “inspected the invoices and noted that the assets were billed to the appropriate Section 272 affiliates.” *See* Second Report, Appendix A at 4. For another three of the 100 sampled items, Verizon explained to the auditor that the items were either capitalized interest or capitalized labor relating to transmission and switching facilities and provided reconciliations of the journal entry to the amount stated on the detailed fixed asset listing. *Id.* For the remaining sampled item, Verizon explained that the item was related to capitalized labor relating to an asset reclassified from transmission and switching to another category. *Id.*

AT&T also argues that for three Section 272 affiliates, the list of fixed assets was incomplete because it excluded “construction in progress.” AT&T Comments at 15. As Verizon explained to the auditor, “construction in progress” assets are excluded from the lists of fixed assets because they reflect assets not yet placed in service. *See* Second Report, Appendix A at 3.

AT&T suggests that the auditors found an understatement in the list of fixed assets of over \$3 million in capitalized software for GNI and \$1.5 million for VSSI. AT&T Comments at 16. But the auditor found no such understatement. As Verizon explained to the auditor, the \$3 million difference for GNI represents accumulated amortization related to capitalized software. *See* Second Report, Appendix A at 3. In addition, the \$1.5 million for VSSI was due to certain credit amounts and write-offs held in a clearing account in the balance sheet, which had not yet been classified to the appropriate fixed asset category. *Id.*

Finally, AT&T faults Verizon for providing “invoices” to the auditors, rather than title documents it claims are required by the AUP. AT&T Comments at 16. AT&T misrepresents the AUP requirements for documenting ownership. The AUP requires the auditor to “[i]nspect title and/or other documents, which reveal ownership.” AUP at 28, Objective 1, Procedure 5. Verizon complied with this requirement by providing “invoices” that document ownership.

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

Objective III of the AUP includes procedures to determine whether the Section 272 affiliates complied with the requirement to have separate officers, directors, employees. The auditor determined that Verizon has procedures in place to prevent a person from being an officer, director, or employee of both a BOC and a Section 272 affiliate at the same time, and that the Company’s procedures do not allow the loaning or sharing of employees between these entities. *See* Second Report, Appendix A at 6. The auditor obtained the lists of officers and directors for the BOCs and Section 272 affiliates and found no overlap. The auditor obtained lists of employees and determined there was no instance where an individual was employed by both a Section 272 affiliate and a BOC at same time. *See* Second Report, Appendix A at 6. For

this reason, the Joint Oversight Team agreed that there was no need to examine bonuses in this audit.

AT&T complains that the audit did not inquire whether the calculation of annual bonuses for overlapping employees was tied to the performance of the BOC, or the performance of the BOC and the Section 272 affiliate. AT&T Comments at 18. There was no reason for the auditor to examine annual bonuses, as this is not an explicit requirement of the Section 272 rules. The real issue is whether there were any overlapping employees, and the auditor “noted no instance where an individual was simultaneously employed by a Verizon BOC/ILEC and Section 272 affiliate.” *See* Second Report, Appendix A at 6.

AT&T also complains that there were instances of common officers and directors between Compañía Anónima Nacional Telefónica de Venezuela (“CANTV”) and Puerto Rico Telephone Company. AT&T Comments at 18. CANTV has not been engaged in activities that would require it to comply with Section 272 separate affiliate rules. CANTV was included as an affiliate in the AUP based on Verizon’s expectation that CANTV would offer originating interLATA services through the marketing of prepaid calling cards in the former Bell Atlantic region. Those services were never provided and Verizon does not expect them to be provided in the future. Instead, CANTV’s activities in the calling card business were limited to marketing prepaid calling cards in Venezuela. To the extent customers who purchase these cards in Venezuela travel to the United States or other countries, the cards also can be used while traveling in these other countries. Specifically, the calling cards allow the customer to use a home country direct service by dialing an 866 number provided by a United States carrier that reaches the CANTV operator platform in Venezuela. *See, e.g., AT&T Corporation Country Direct Service Agreement with Telecomunicaciones Internacionales de Argentina Telintar,*

*S.A.*, 11 FCC Rcd 13893, ¶ 2 (Intl. Bur. 1996). These calls are handled in the same manner as other international settlements traffic between the United States and Venezuela. This means that the United States corresponding carrier originates the call and is responsible for carrying it to the international mid-point of the call, where it is handed off to CANTV consistent with the terms of the international settlements process, and CANTV provides only the foreign half-circuit for the call between the United States and Venezuela. Therefore, as with other types of international settlements traffic between the United States and Venezuela, CANTV is not originating calls in the United States.

In addition, the 866 call, like other international toll-free calls, is treated for billing purposes as originating in Venezuela, with CANTV compensating the United States carrier for the portion of the call carried on the United States carrier's network under standard international settlements procedures. Under Section 271(j) of the Act, therefore, this toll-free call would not be treated as originating in the Verizon region, but, instead, would be treated as originating in Venezuela.

CANTV's limited involvement in prepaid calling cards does not constitute the provision of originating interLATA telecommunications services in the Verizon region. While the card may be used on an occasional basis by Venezuelan customers traveling in the United States, the card is not available in the United States and CANTV does not hold itself out as providing interLATA service in the United States. Since CANTV has not and does not plan to sell any prepaid calling cards in the United States, it is not a Section 272 affiliate.

**E. The Verizon Long Distance Affiliates Did Not Obtain Credit with Recourse to the Assets of the BOC.**

Object IV of the AUP includes procedures to determine whether the Section 272 affiliates complied with the requirement to obtain credit without recourse to the assets of the BOCs. The auditor examined each Section 272 affiliates' debt agreements/instruments and credit arrangements with lenders and major suppliers of goods and services and did not note any language indicating guarantees of recourse to the Verizon BOCs/ILECs' assets, either directly or indirectly through another affiliate. The auditors also examined lease agreements and determined that they did not contain any language indicating recourse to the Verizon BOCs' assets, either directly or indirectly through another affiliate. *See* Second Report, Appendix A at 7.

AT&T notes that the Section 272 affiliates' debt agreements/instruments were with Verizon Global Funding and it speculates that Verizon Global Funding provided its creditors with recourse to the Verizon BOCs' assets in order to obtain lower rates in the financial markets and pass them along to the Section 272 affiliates. AT&T Comments at 19. There is nothing in the Second Report to support AT&T's speculation. Moreover, Verizon Global Funding's creditors do not have recourse to the Verizon BOCs/ILECs' assets.

AT&T also notes that the auditor sought written confirmations from loan institutions and lessors that they lacked recourse to the Verizon BOC/ILEC assets, but received responses from only 17 out of 35 institutions and lessors contacted. AT&T Comments at 20. This is a good response rate, considering the fact that these third parties were under no legal obligation to respond. Verizon cannot be held responsible for the failure of third parties to respond to the

auditor. Moreover, there is no basis to infer anything from the failure of these institutions and lessors to respond to the auditor.

#### **IV. AT&T's Criticisms of the Audit Procedures Are Unwarranted.**

AT&T criticizes the process used by the Commission to develop the AUP for the second biennial audit. AT&T Comments at 2-3. These criticisms are completely unwarranted. The Commission followed its own rules for the planning and execution of the second biennial audit.

As required by the Commission's rules, Verizon submitted preliminary audit requirements to the Federal/State Joint Oversight Team, which was comprised of representatives of the FCC and the commissions from 13 states and the District of Columbia. *See* 47 C.F.R. § 53.211. The preliminary audit requirements included the proposed scope of the audit and the extent of compliance and substantive testing.

The Joint Oversight Team reviewed the preliminary audit requirements to determine their adequacy to meet the audit requirements of the Commission's rules. In conducting its review, the Joint Oversight Team was fully aware of AT&T's comments on the prior biennial audit. The Joint Oversight Team then modified the preliminary audit requirements to collect more detailed information for certain issues and to streamline audit activities that were no longer necessary. The final AUP adopted by the Joint Oversight Team were implemented by an independent auditing firm that produced an audit report that was at least twice as lengthy as the first biennial audit report. There is simply no basis for AT&T's criticisms of the audit process.

AT&T also claims that the process was subject to "inexcusable delay." AT&T's Comments at 3. According to AT&T, Verizon submitted a redacted audit report "deleting all of the critical performance measurement data." *Id.* at 4. AT&T is wrong. The second biennial audit report Verizon submitted in June 2003 included Verizon's performance results. Verizon

simply deleted the volume data associated with those results in order to protect proprietary and confidential information. AT&T was the only party that sought access to such information. Although the Bureau directed Verizon to make this information public, Verizon's efforts to preserve the confidentiality of this information were fully consistent with the Commission's rules.

**V. AT&T's Claims that Enforcement Action Is Warranted Are Baseless.**

AT&T ignored the bulk of the positive audit results and distorted a few anomalies in a blatantly self-serving effort to handicap Verizon's ability to compete in the long distance business. AT&T makes a half-hearted request for enforcement action for issues that clearly do not rise to the level of violations, much less material violations. *See* AT&T Comments at 28. The Second Report provides no evidence that Verizon has discriminated in favor of its affiliates.

The minor clerical errors noted in the Second Report do not support enforcement action. As noted above, the standard of compliance is not and cannot be perfection. Verizon has implemented procedures and controls designed to ensure its compliance with the Commission's Section 272 rules. The few immaterial items noted by AT&T do not demonstrate any violations of the Commission's Section 272 rules, much less knowing or willful violations.

**VI. Conclusion**

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

Respectfully submitted,



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THE VERIZON TELEPHONE COMPANIES

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

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