APPENDIX A

SETTLEMENT AGREEMENT

This SETTLEMENT AGREEMENT is the final and complete expression of the agreement entered into the 16th day of May 2003 by and between the Consumer Protection and Safety Division ("CPSD") (formerly known as Consumer Services Division or "CSD") of the California Public Utilities Commission ("Commission"), on the one hand, and Verizon California Inc. ("Verizon California"), successor in interest to GTE California Incorporated ("GTEC"), and Verizon West Coast Inc. ("Verizon West Coast"), successor in interest to GTE West Coast Incorporated, (hereinafter collectively, "Verizon"), which collectively are the Parties to this Agreement.

WHEREAS, General Order No. 96-A ("GO 96-A") establishes that local exchange carriers: (1) must obtain the Commission's authorization for any contract for the furnishing of any public utility service at rates or conditions other than the rates and conditions contained in their tariff schedules; and (2) provides that contracts shall not become effective until Commission approval has been obtained;

WHEREAS, D.91-07-010 establishes safeguards for local exchange telephone companies (LECs) and interexchange carriers (IXCs) entering into contracts with governmental agencies. D.91-07-010 modified GO 96-A by revising Section X.B. and adding a new penalty mechanism designated as Section X.D. These sections include alternative safeguards against telephone companies providing below-cost services under the New Regulatory Framework (NRF). In addition, D.91-07-010 provided for late-filing penalties that would apply to any telephone utility that failed to file its governmental agency contracts within 15 days after the date of execution. Finally, D.91-07-010 added Section X.E. to GO 96-A, which exempts governmental agency contracts from the pre-approval requirement of the Commission;

WHEREAS, Commission Rule 1 establishes that any person who signs a pleading or brief, enters an appearance at a hearing, or transacts business with the Commission, by such

act agrees to comply with the laws of the State of California; to maintain the respect due to the Commission; and never to mislead the Commission or its staff by an artifice or false statement of fact or law;

WHEREAS, the Commission has stated in the Appendix to Decision (D.) 98-12-075 in *Rulemaking to Establish Rules for Enforcement of the Standards of Conduct Governing Relationships Between Energy Utilities and Their Affiliates Adopted by the Commission in Decision 97-12-088,* that it expects utilities to diligently monitor their own compliance with Commission requirements, and to promptly report infractions to the Commission;

WHEREAS, in or about July 1998, in compliance with D.98-12-075, Verizon California voluntarily disclosed to the Commission that its Individual Case Basis (ICB) contract with UCLA was filed late and contained certain below-cost elements and subsequently made other voluntary disclosures of additional contracts which were not in compliance with Commission rules;

WHEREAS, the Commission issued Resolution No. 16218 on December 3, 1998 ("the Resolution"), fining Verizon California EIGHT HUNDRED NINE THOUSAND TWO HUNDRED AND EIGHTY-NINE DOLLARS AND FORTY-SIX CENTS ($809,289.46), placing Verizon California on three years probation starting March 1, 1999 (later extended to May 1, 1999), and providing that there would be no revocation of Verizon California's government contracting authority for those historical non-compliant government contracts that Verizon California disclosed to the Commission by the start of its probationary period through an outside audit of its ICB contracts;

WHEREAS, at the time of the Commission's Resolution, Verizon had already begun an outside review of ICBs through Arthur Andersen LLP ("AALLP") and retained AALLP with notice to the staff, to complete the review in accordance with the Resolution;

WHEREAS, on or about March 11, 1999, in compliance with D.98-12-075, Verizon voluntarily reported to the Commission, CPSD, and the Director of the Telecommunications Division: i) the preliminary results of the AALLP review; ii) that it had

discovered instances of potential contract date alteration that, as altered, would give the inaccurate appearance of compliance with Commission filing requirements as well as other potential violations of Commission Rule 1; iii) that Verizon had undertaken an intensive review of all ICB practices; and iv) that Verizon had engaged the services of O'Melveny & Myers LLP ("O'Melveny") to conduct an investigation of non-compliant activity and root causes, and to voluntarily report on same to the Commission;

WHEREAS, Verizon submitted the AALLP and O'Melveny reports as well as supplemental reports, in a timely manner to CPSD;

WHEREAS, on April 22, 2002, the Commission issued an Order Initiating Investigation ("OII") (I.02-04-027) in which, among other things, it ordered the CPSD staff to investigate, through outside consultants, the matters set forth in AALLP and O'Melveny's reports and also to independently review Verizon's ICB contracting programs;

WHEREAS, by a ruling dated February 27, 2003, the Administrative Law Judge assigned to the OII ordered that the Parties enter into settlement discussions;

WHEREAS the CPSD has reviewed the reports submitted by AALLP, O'Melveny and supplemental reports submitted by Verizon;

WHEREAS the CPSD has met with Verizon representatives regarding corrective actions taken by Verizon and its current ICB contracting processes;

WHEREAS, CPSD believes that the conduct described in the AALLP and O'Melveny reports constitutes numerous and serious instances of non-compliance with Commission rules and regulations, including Rule 1;

WHEREAS, Verizon has incurred costs both in conducting the reviews resulting in the reports as described herein and in taking corrective actions;

WHEREAS, Verizon has cooperated in CPSD's review;

WHEREAS, CPSD believes that discovery of the allegedly non-compliant conduct by the Commission would have required expenditure of significant public resources;

WHEREAS, the Commission has held in Decision No. 98-12-075 (April 9, 1998), 1998 Cal. PUC LEXIS 1016 (December 17, 1998) that prompt reporting and correction may be considered in assessing any penalty for violation of PUC rules;

WHEREAS, CPSD and Verizon have agreed to settle all allegations of violation of CPUC contracting and other rules, as set forth in the reports of AALLP, O'Melveny and Verizon submitted to the CPUC on or before the effective date of the decision in which the Commission adopts this Settlement Agreement ("Effective Date"), for an amount totaling $4,836,000; and

WHEREAS, CPSD and Verizon will seek Commission adoption of the Settlement Agreement through a joint filing with the assigned Administrative Law Judge (ALJ) and the assigned Commissioner in this proceeding;

NOW, THEREFORE, in consideration of the foregoing, and the mutual promises hereinafter made, and intending to be bound, the Parties, by their respective authorized representatives, hereby agree and contract as follows:

1. Verizon agrees to obey all Commission rules and regulations and all laws of the State of California including, but not limited to, Commission Rule 1 as well as all statutes and rules governing Individual Case Basis (ICB) and express contracts, and to continue monitoring its compliance in compliance with D.98-12-075.

2. Within 30 days of Effective Date, Verizon agrees to forward a check to CPSD, made payable to the General Fund, in the amount of FOUR MILLION EIGHT HUNDRED THIRTY SIX THOUSAND DOLLARS ($4,836,000) in full satisfaction of any and all fines and other remedies that could be sought or imposed for violation of California Public Utilities Code and Commission rules and regulations relating to ICB and express contracts.

3. The Parties agree that this Settlement Agreement concludes, settles and finally resolves all enforcement efforts by the Commission and all divisions thereof concerning Verizon's compliance with Commission orders and rules in connection with Verizon's ICB and express contracts up to and including the Effective Date, including, without limitation, any and all

instances of Verizon's below-cost pricing, late filing, or performance at variance with terms of contracts or service arrangements entered into before the Effective Date. If subsequent disclosure reveals contracting or reporting behavior which in its nature or scope cannot reasonably be considered to have been an aspect of the behavior addressed in this Settlement Agreement, CPSD may take enforcement action as it deems appropriate. Nothing in this Settlement Agreement or provision is intended to excuse Verizon from complying with all Commission Rules in the future or from its ongoing obligation to bring any existing non-compliant contracts or service arrangements into compliance with Commission Rules for any remaining term of the contract or service arrangement.

4. The Parties intend that this Settlement Agreement will not determine the outcome of any other proceeding before the Commission or in any other jurisdiction pending or instituted in the future. The positions taken herein, and the actions taken in furtherance of this Settlement Agreement, are in settlement of disputed claims and do not constitute admissions. The Parties agree that the actions required to be taken by them pursuant to this Settlement Agreement are taken without prejudice to positions each party has taken, or may take hereafter, in any proceeding.

5. CPSD agrees that it will make no effort to initiate actions by law enforcement agencies against Verizon or its current or former employees related to the allegedly non-compliant conduct, which is reported to the Commission on or before the Effective Date.

6. In the event of any violation of this Settlement Agreement, CPSD reserves the right to initiate a formal proceeding and to seek whatever remedies that it deems necessary. Prior to bringing any alleged evidence of such violations to the attention of the Commission, CPSD will notify Verizon of CPSD's belief that such violation has occurred so that Verizon can respond informally.

7. The Parties agree to recommend that the Commission approve and adopt this Settlement Agreement in its entirety without change as a complete and full resolution of all issues of which they are aware. If the Commission fails to adopt the Settlement Agreement in its entirety,

without change or modification as proposed herein, the Parties shall meet within 15 days after Commission action on this Settlement Agreement to discuss whether they can resolve issues raised by the Commission's actions. If the Parties cannot mutually agree to resolve the issues posed by the Commission order, the Settlement Agreement shall be terminated and the Parties shall be released from their obligation to support this Settlement Agreement.

8. The Parties agree that the Commission shall have exclusive jurisdiction over any issues related to the interpretation of this Settlement Agreement and that no other court, regulatory agency, or other governing body shall have jurisdiction over any issue related to the interpretation or the enforcement of the Settlement Agreement, or the rights of the Parties thereunder, except for judicial review of any Commission decision in this proceeding. All rights and remedies are limited to those available before the Commission or in such judicial review.

9. The Parties further agree that no signatory to this Settlement Agreement, nor any member of the Staff of the Commission, assumes any personal liability as a result of this Settlement Agreement.

10. This Settlement Agreement shall be governed by the laws of the State of California as to all matters, including, but not limited to, matters of validity, construction, effect, performance and remedies.

11. This Settlement Agreement sets forth the entire understanding and agreement between the parties with reference to the subject matter hereof and this Settlement may not be modified or terminated except in accordance with its terms or by an instrument in writing signed by all Parties hereto. This Settlement Agreement supersedes all prior agreements, negotiations, and understandings among the parities, both oral and written related to this matter.

12. This Settlement Agreement may be executed in counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

13. In witness whereof, intending to be legally bound, the Parties listed here duly execute this Settlement Agreement on behalf of the parties they represent.

Dated as of this _____ day of _____. 2003

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Richard W. Clark Consumer Protection & Safety Division
Public Utilities Commission Of the State of California
Dated: 5/9/03, 2003

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Elaine M. Duncan General Counsel Verizon California Inc.
Dated: April 30, 2003

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Elaine M. Duncan General Counsel Verizon West Coast Inc.
Dated: April 30, 2003