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**STATE OF MISSOURI  
PUBLIC SERVICE COMMISSION**

At a session of the Public Service  
Commission held at its office  
in Jefferson City on the 11th  
day of April, 1995.

In the matter of the investigation into Southwestern )  
Bell Telephone Company's affiliate transactions. ) Case No. TO-24-184  
)

**ORDER APPROVING STIPULATION AND AGREEMENT**

On November 4, 1994, the Commission issued an order requiring the parties in this case to file a stipulation on all agreed-upon procedures and safeguards concerning the review of Southwestern Bell Telephone Company's (SWB's) affiliate transactions and to file a hearing memorandum on those procedures or safeguards where there was disagreement. On February 16, 1995, the parties filed a Stipulation And Agreement. In addition, SWB filed a motion to hold this case in abeyance and on March 3, 1995, Commission Staff, the Office of Public Counsel (OPC) and SWB filed separate Hearing Memoranda. OPC states in its Hearing Memorandum that it supports Staff's position.

The Stipulation And Agreement filed by the parties contains twelve pre-audit procedures which will allow parties access to information concerning SWB's affiliate transactions. The parties have agreed to a pre-audit conference in June 1997 to begin utilization of the procedures, but they state that no audit of affiliate transactions will occur in 1997.

The parties indicate in the Stipulation And Agreement that while they agree on the procedures for reviewing affiliate transactions, they disagree on the standards which should be used to determine whether the transactions are reasonable. Basically, SWB proposes utilization of Federal Communications Commission (FCC) standards, which are being revised in a Notice of Proposed Rulemaking (NPRM). FCC Docket No. 93-181. Staff and OPC's position is that

FCC rules, even the revisions being considered, are not sufficient to protect ratepayer interests and that additional safeguards should be adopted.

These safeguards would address three specific deficiencies listed by Staff in SWB's current practices. These are (1) lack of adequate time documentation for Southwestern Bell Corporation personnel; (2) failure to include all relevant costs in converting incremental costs to fully distributed costs; and (3) a lower than reasonable sales standard for determining market price to affiliates. Staff recommends 75 percent as a reasonable standard. Staff also proposes additional standards for affiliate transactions. These include solicitation of bids from outside vendors, and sales of goods to affiliates at tariffed rates or at the higher of fair market value or net book value, and sales of services at the higher of fair market value or fully distributed costs. Staff also proposes additional monitoring procedures. SWB contends that any safeguards or procedures beyond those agreed to in the Stipulation And Agreement or those developed by the FCC should be applied to all telecommunications companies and established in a Commission rule.

The Commission has reviewed both the Stipulation And Agreement and the positions of the parties as set out in the Hearing Memoranda. (The Stipulation And Agreement will be Attachment A to this order and incorporated herein by reference.) The Commission believes that the parties have developed procedures for review of affiliate transactions which should enable parties in future cases to determine compliance with standards for transactions between SWB and its affiliates.

The issues left unresolved are what standards should be established to use as a measure of the reasonableness of the prices paid by SWB to affiliates and the prices paid by affiliates to SWB for goods and services. These standards will become even more important as the telecommunications market is opened to further competition. As stated in its November 4 order, the Commission believes

that FCC rules should provide the basic safeguards. Consistency between state and federal requirements will minimize cost and allow for consistent enforcement of the standards. Also, as stated in the November 4 order, the Commission is not convinced that FCC procedures should not be supplemented by additional safeguards. The Commission, though, finds that additional standards may be of general applicability and may have to be applied to all local exchange companies.

To allow for a full development of the additional safeguards which parties may determine are appropriate and to allow time for the FCC to issue any revisions to its rules, the Commission will grant SWB's motion to hold this docket in abeyance until January 5, 1996. At that time the parties should present either a proposed rule for adopting safeguards for affiliate transactions for regulated telecommunications companies or a procedural schedule including prefiled testimony and a hearing for addressing safeguards for SWB's affiliate transactions.

**IT IS THEREFORE ORDERED:**

1. That the Stipulation And Agreement, Attachment A to this order, is hereby approved.
2. That this docket shall be held in abeyance until January 5, 1996.
3. That parties shall file either a proposed rule or a proposed procedural schedule as described in this order on or before January 5, 1996.
4. That this order shall become effective on the date hereof.

**BY THE COMMISSION**

( S E A L )



**David L. Beach**  
Executive Secretary

Shallor, Chm., McClure, Perkins,  
Kinkelade and Cragston, CC., counsel.

FILED

FEB 16 1995

BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI

MISSOURI  
PUBLIC SERVICE COMMISSION

In the Matter of the Investigation )  
into Southwestern Bell Telephone )  
Company's Affiliate Transactions )

Case No. TO-94-184

STIPULATION AND AGREEMENT

I. Background

This docket arose as a result of the Commission's finding that in the two most recent Southwestern Bell Telephone Company (SWBT) rate cases the records were insufficient for the Commission to determine if adjustments to SWBT's revenue requirement for certain affiliate transactions were necessary or the amounts of such adjustments. The parties<sup>1</sup> disputed the appropriate standards (FCC or otherwise) for affiliate transactions; the existence of data to gauge compliance with, or violation of, such standards; and the documentation necessary to support that data.<sup>2</sup>

Procedurally, the Commission opened this docket in its Report and Order of December 17, 1993, in Docket TC-93-224. Pursuant to subsequent orders in this docket the Staff of the Commission (the Staff) filed a copy of a Joint FCC/Five State Report of SWBT affiliate transactions; each party filed a statement of the

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<sup>1</sup>"Parties" refers to SWBT, Office of the Public Counsel (OPC), and the Staff. Although other parties intervened only MICPA has taken an active role.

<sup>2</sup>In Staff's Comments filed on May 31, 1994, in which SWBT agrees, it was stated that because of the prevalence of parent company cost allocations in Missouri utilities, focusing the docket only on SWBT would unduly limit the scope of the issues under examination. The examination of procedures used by other utility groups to allocate parent company costs could provide a more systematic review which could lead to a generic policy for issues posed by the affiliate transactions of all regulated utilities.

proposed scope of this docket; the Staff and SWBT filed a joint report of the parties on August 24, 1994; the parties filed position statements on October 21, 1994; and the Commission subsequently ordered this filing, with a Hearing Memorandum and suggested procedural schedule to be filed on March 3, 1995.

A number of developments since the inception of this docket may affect the further proceedings of this docket. The Commission, SWBT and OPC settled the issues appealed in Docket TC-93-224 in August, 1994. By the terms of the settlement the signatories foreswore initiation of general review of SWBT rates until 1998, with no rate or complaint case to be filed until January 1, 1999. Also currently pending is FCC action on proposed amendments to its affiliate transaction rules for common carriers. There is also a complete review of all nonstructural safeguards underway, including the affiliate transaction rules, in response to the Ninth Circuit Court's remand to the FCC of the Computer Inquiry III proceeding. In addition to complying with the Missouri Rules, SWBT must comply with any changes to the current rules which the FCC eventually adopts. Finally, the Commission on Informational Technology has recommended adoption of legislation to change the structure and regulation of the telecommunications industry in Missouri. Each of these intervening events can and will have an impact on the position of the parties, and implementation of Commission policies, on affiliate transactions.

The parties have agreed on a number of SWBT-specific pre-audit procedures for affiliate transactions, but substantially disagree

over the standards by which affiliate transactions will be judged. In this filing the parties will set out the pre-audit procedures on which they agree, and note disputed items. Each party will more fully explain its position on the disputed issues in the Hearing Memorandum to be filed on March 3, 1995.

## **II. Items of Agreement**

The parties have agreed that a structure for a pre-audit conference should contain the following items:

1. Copies of all affiliate purchases and sales contracts for the test period will be provided. These purchase and sales contracts will be indexed by year and by affiliate company.
2. Reports containing the revenue and/or expense of purchases from and sales to affiliates, by affiliate, for the test period will be provided.
3. Review of existing FCC affiliate transaction rules with emphasis on any significant changes since the last audit with the opportunity for direct interview by Staff of SNBT subject matter experts. This review will include an overview of what constitutes audit compliance of sales of services to affiliates. Purchases of services from affiliates will be outlined by type of affiliate: i.e., cost allocation, prevailing price, etc.
4. Review with staff auditors the following sections of the Cost Allocation Manual:
  - a. Sections IV - Chart of affiliates
  - b. Sections V - Transactions with affiliates
5. Review any significant operational changes to the purchases or sale of services to affiliates since the last audit.
6. Provide copies of any SNBT compliance reviews of purchases from affiliates conducted during the test period. SNBT agrees to perform and provide compliance reviews for its transactions with Southwestern Bell Communications (SBC).

7. Provide copies of any SWBT internal audits of affiliate transactions conducted during the test period. SWBT affiliate services group will coordinate with the SBC internal audit group to schedule timely audits of SBC and Yellow Pages prior to the next complaint case.
8. Provide the cost/price worksheets for sales of services to affiliates only for the test period. These worksheets will include incremental unit cost, fully distributed cost and price for each billing element.
9. Respond to specific questions concerning tariff sales or prevailing price sales to affiliates, with the understanding that affiliated companies receive tariffed and prevailing price services under the same terms and conditions as similar non-affiliated companies.
10. Present to staff auditors an overview of the audit trail for the purchases from the major affiliates (SBC, Yellow Pages, Telecom, Mobile Systems). The audit trail for the major affiliates will include time reporting, as appropriate, cost allocation, prevailing price review, etc.
11. Present to staff auditors an overview of sales to the major affiliates. The audit trail will include a cost studies overview, pricing, billing, etc.
12. Answer any remaining instant audit trail process questions that Staff Auditors may have.

The Staff, SWBT, and OPC have agreed to convene a pre-audit conference on affiliated transactions in June, 1997, to permit analysis of how the process works. The pre-audit conference will also permit the Staff and OPC to address concerns with the data, and documentation of data, that SWBT provides so that problems might be resolved to provide appropriate test year records for any future SWBT rate case. There will be no actual affiliate transaction audit in 1997. The parties agree that the Commission should use this docket to resolve SWBT-specific questions regarding affiliate transactions.

### III. Items of Difference

The parties disagree on the appropriate standard by which affiliate transactions will be measured. SWBT avers that the current FCC standards are adequate to insure that its affiliate transactions are proper and that no subsidy flows from SWBT to its affiliates. The Staff and OPC contend that the proposed amendments to the FCC affiliate transaction rules must be adopted and enforced to secure adequate protection for regulated ratepayers.<sup>3</sup>

SWBT avers that Commission enunciation of appropriate affiliate transactions standards is a general statement of policy affecting the rights of, and procedures applicable to, all utilities or at least all local exchange telephone companies, and should be made in compliance with the provisions of Chapter 536, RSMo, through a rulemaking or a generic docket. SWBT believes that the Commission cannot lawfully develop and apply unique affiliate transaction standards to SWBT alone. Such standards should not be applicable to SWBT, particularly if such standards differ from the Commission's current rules in regard to such transactions.

The Staff avers that review of affiliate transactions must begin with an inquiry into the reasonableness of entering the particular transaction in the first place, preferably by reference to a bid process. SWBT believes that the items of agreement address the SWBT issues involved in this docket and that any

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<sup>3</sup>Staff has suggested audit of regulated/deregulated services is also necessary to protect ratepayers.




remaining questions Staff has must be addressed in a generic docket or rulemaking.

The Staff avers that SWBT's audit trail of FDC studies in support of sales by SWBT to affiliate transactions is not sufficient to permit the conclusion that all SWBT costs for the relevant time period have been considered in the studies, and all property costs included. Without adequate data on this issue, computation of adjustments, if needed, is not possible in a rate case. SWBT avers that the cost studies are adequate and that Staff will have ample opportunity to assess the adequacy of the studies in the 1997 pre-audit meeting.


#### IV. Conclusion

If the Commission does not close this docket then the Staff, OPC, and SWBT will address their differences in more detail in the Hearing Memorandum to be filed in this docket on March 3, 1995.


Respectfully submitted,

  
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Commissioner  
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**STATE OF MISSOURI**

**OFFICE OF THE PUBLIC SERVICE COMMISSION**

I have compared the preceding copy with the original on file in this office and I do hereby certify the same to be a true copy therefrom and the whole thereof.

WITNESS my hand and seal of the Public Service Commission, at Jefferson City, Missouri, this 11th day of April, 1998.

David L. Rauch  
David L. Rauch  
Executive Secretary