



FILED

JAN 29 1996

January 26, 1996

MISSOURI
PUBLIC SERVICE COMMISSION

Lee J. Bob
Attorney
314 247-3060

Diana J. Harter
Attorney
314 247-8280

Mr. David Rauch
Executive Secretary
Missouri Public Service Commission
301 West High Street, Suite 530
Jefferson City, MO 65101

Re: Case No. [REDACTED]

Dear Mr. Rauch:

Enclosed for filing with the Commission in the above-referenced case are the original and fourteen copies of Southwestern Bell Telephone Company's Response to Staff's Proposal.

Please stamp "Filed" on the extra copy and return to me in the enclosed self-addressed, stamped envelope.

Thank you for bringing this matter to the attention of the Commission.

Sincerely,


Diana J. Harter

Enclosures

CC: Parties of Record

Legal Department

Room 630
100 North Tucker Boulevard
St. Louis, MO 63101-1876

Phone 314 247-2822
Fax 314 247-6881

FILED

JAN 29 1996

**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) Case No. TO-94-184
Company's Affiliate Transactions)

RESPONSE TO STAFF'S PROPOSAL

COMES NOW Southwestern Bell Telephone Company (SWBT) and hereby responds to the recommended proposal of the Missouri Public Service Commission (Staff). The new affiliate transaction rule proposed by Staff raises serious concerns for SWBT in terms of the:

1. Cost of implementation and the resultant impact to the ratepayer.
2. Subjectivity of the proposed measurements.
3. Harm to existing economies of scope and scale achieved and applicability to types of affiliate services.

I. COST OF IMPLEMENTATION AND THE RESULTANT IMPACT TO THE RATEPAYER.

The Staff proposes that a regulated utility be deemed to provide a financial advantage to an unregulated affiliated company if it buys goods or services from the regulated utility above the lesser of fair market price, or the cost to the regulated utility to provide the good or service itself, or if it transfers goods or services to an affiliate below the greater of fair market price or the fully allocated cost to the regulated utility.'

¹TO-94-184, Released January 5, 1996, Paragraphs (2)(A).

59.

SWBT's sale of services to affiliated companies generated only \$3.2 Million of revenues in Missouri.² SWBT estimates that the cost to perform statistically valid fair market valuations for these services would exceed the potential revenue derived for the services. The result is the ratepayer no longer benefits from these revenues for services provided to affiliates. As an example, SWBT provided 38 pages of word processing service in St. Louis to affiliates. A fair market valuation study would far exceed any revenue derived by SWBT for the service. The ratepayer currently derives benefit from this revenue because the affiliate services provided by SWBT are activities that SWBT would have to perform for itself, such as mail delivery, copy bureau service, and others. SWBT does not incur any significant additional cost to provide these services to affiliates, but does derive revenue from what normally would be non-revenue producing activities.

SWBT also purchases services from affiliated companies. The cost of fair market valuations for these services, which are services that require complex technical and subject expertise, would also be very costly. Ninety percent (90%) of these purchases are from the parent company (Board of Directors, Senior Management, Coordination of Investor Relations, Corporate Planning), the research and development subsidiary (TRI), Yellow Pages (directory publishing), and Hellicore (the Regional Holding Company owned research and development and technical services

²Based on year-end 1994 affiliate service sales reports.

subsidiary). The services provided by these companies are not commodity types of services. The vast majority of these services are either activities that no company would contract with a third party vendor (Board of Directors, Senior Management, Investor Relations, competitively sensitive Research and Development), or are services for which there are not comparable vendors in the marketplace and services for which SWBT derives significant savings because of the economies of scope and scale by sharing the cost of purchasing the service with other affiliates or Regional Bell Companies (i.e. the purchase of Bellcore services).

II. SUBJECTIVITY OF THE PROPOSED MEASUREMENTS.

Another aspect of fair market valuation that causes concern for SWBT is the very subjective nature of such a measurement, compared to the existing rules that SWBT must comply with based on Part 32 accounting. A fair market valuation will not yield an absolute result, that is, one price for the service under study. A fair market valuation will yield a range of prices. That range is caused by vendor differences, variations in the level or quality of service for one vendor versus another vendor, and other general market conditions. It is difficult, if not impossible to do an objective comparison. With the existing Part 32 rules, the revenue SWBT records for the sale of services to affiliates or for the cost of the purchase of services by SWBT from an affiliated company that do not have a tariffed rate is measured against a prevailing price for the service. Prevailing price is the price nonaffiliated third parties pay for the same

service from SWBT. If there is no prevailing price for the services, then the fully distributed cost for the provision of the service is used. These are more objective and reliable measures to assure the reasonableness of such transactions.

Staff further proposes that when a utility purchases goods or services from an affiliate that the utility could only prove that no financial advantage accrued to the affiliate if the transaction is recorded at the lesser of fair market value or the cost to the affiliate to provide the service itself. This is, again, an unreasonable test. SWBT is not in the cellular service business, and cannot compute some cost for providing the service to itself. The same is true for investor relations, board of directors, research and development functions and other services purchased from affiliates. SWBT does not currently perform these functions, and does not have the existing expertise to do so. SWBT would have to estimate some sort of valuation to itself, rather than use the existing prevailing price or fully distributed cost identification required by the Federal Communications Commission (FCC) rules. Again, Staff proposes replacing documented and reasonable reviews based on documented prevailing price (a price unaffiliated third parties pay for the same service) and fully distributed cost for the provision of the service, with an estimated valuation that will lead to increased cost and endless debate.

III. HARM TO EXISTING ECONOMIES OF SCOPE AND SCALE ACHIEVED AND APPLICABILITY TO TYPES OF AFFILIATE SERVICES.

The newly created category of non-financial advantage review prohibits any benefits of the economies of scope and scale from accruing to SWBT customers for services SWBT provides to affiliates. This is not a reasonable result for SWBT customers. According to this proposed rule, SWBT would be providing a prohibited financial advantage to an affiliate if it provides a good or service to an affiliate, and does not provide the same good or service to the affiliate's competitors.

Though the proposal apparently is intended to apply to affiliate services which are not lines of business, such an application is unreasonable in that the proposal should not apply to any affiliate services which are not tariffed lines of business. SWBT provides a number of affiliate only services that are not lines of business. These are activities that SWBT must do for itself (mail delivery, word processing, etc.) that it also makes available to affiliates, without the need for significant additional resources. These are also activities that would not normally be revenue producing, absent a sale to an affiliate. These services currently are governed by the fully distributed cost requirement of the FCC rules.

The Staff proposal would require SWBT to offer these affiliate only services to an affiliate's competitor if SWBT provides the service to an affiliate. SWBT is not in the mail delivery or word processing business. SWBT does derive revenue

from affiliates for performing these services on their behalf, to the benefit of SWBT ratepayers. With the new rule, the 38 pages of word processing done for affiliates with floor space in One Bell Center at \$5.50 per page in 1994 constitutes a financial advantage for the affiliate, so SWBT must now do word processing for third parties. That does not make sense.

The rule also places the same requirement on customer information, a very sensitive privacy issue, that has been addressed at length in federal proceedings before the FCC. As reviewed in numerous federal proceedings, Customer Proprietary Network Information is data that includes customer name and service address, technical characteristics of service, current charges, and other customer specific information. There are strict customer privacy rules that include preemption clauses, that limit the release of this information.

Staff further expresses a strong preference for competitive bidding when a regulated utility purchases goods or services from affiliates. As stated earlier, 90% of SWBT purchases from affiliates are for services for which it would not be reasonable to seek an outside vendor (Board of Directors, Senior Management, Competitively Sensitive Research or Systems Development) or for which comparable vendors are not available. The remaining services are either for products or services purchased at a prevailing price (the affiliates' price established by nonaffiliated sales in a competitive marketplace) or are for services that are centralized so that economies of scope and

scale can be achieved by sharing costs between the affiliated companies. Competitive bidding does not make a whole lot of sense in this environment, nor is competitive bidding the only viable procurement policy. These are not bulk commodity purchases. Evaluating whether to use competitive bidding takes purchasing judgment of the highest order, as the goods and services SWBT purchases are in many cases highly technical and complex in nature, or require significant levels of expertise. A competent buyer will assess all aspects of the business need and select a result that yields the lowest overall cost, which may not be the rock bottom price. Since price is the main focal point of bidding, it does not adequately address the other issues required to meet SWBT purchasing needs for affiliate transactions, and cannot be used as a reliable determinant as proposed by Staff.

Additionally, any proposed rule should ensure that tariffed services are available to affiliated and nonaffiliated customers on the same terms and conditions for the same service. The current FCC rules already address this issue and provide the necessary safeguards. However, Staff's proposed rule does not recognize tariff price as an appropriate valuation standard for services provided by SWBT to affiliates.

Staff's proposal also attempts to shift the burden of proof in all affiliate transactions to SWBT to prove the reasonableness of the transaction. Such a shifting of the burden of proof is unreasonable. The burden of proof cannot be shifted to SWBT in

all contexts concerning the issue of affiliate transactions in a vacuum. The burden of proof should rest on the appropriate party as outlined in prior Commission rules and statutes.

V. CONCLUSION

SWBT urges that Staff's proposal be severely modified to conform with the established rules of the FCC governing affiliate transactions that have been in use since 1988 and which establish a clear and identifiable method for determining the absence of cross subsidy in affiliate transactions. Staff's proposed modifications to those rules are costly and burdensome without any attendant increase in benefit to ratepayers, and in fact result in significant lost value to Missouri ratepayers. Such changes to regulated telecommunications providers create a significant competitive disadvantage because only the regulated provider, not their competitors, incur these vast compliance costs. Further, significant changes are on the horizon based on proposed federal legislation. These changes will have significant impacts on affiliate issues that make Staff's proposal very premature at best.

Respectfully submitted,

SOUTHWESTERN BELL TELEPHONE COMPANY

By *Diana J. Harter*
PAUL C. VINE
DIANA J. HARTER
LEO J. BSB

Attorneys for
Southwestern Bell Telephone Company
100 N. Tucker, Room 630
St. Louis, Missouri 63101-1976
(314) 247-8280

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing document were served to all parties on the attached Service List by first-class postage prepaid, U.S. Mail.

Dated at St. Louis, Missouri, the 26th day of January, 1996.



Attorney

**WILLIAM M. BARVICK
ATTORNEY AT LAW
240 E. HIGH STREET, SUITE 202
JEFFERSON CITY, MO 65101**

**JAMES C. STROO
WILLIAM D. KOLB
GTE MIDWEST INCORPORATED
1000 GTE DRIVE, BLDG. A
P.O. BOX 307
WENTZVILLE, MO 63385**

**MARTHA HOGERTY
OFFICE OF THE PUBLIC COUNSEL
P.O. BO 7800
JEFFERSON CITY, MO 65102**

**THOMAS SCHWARZ
MISSOURI PUBLIC SERVICE
COMMISSION
P.O. BOX 360
JEFFERSON CITY, MO 65102**

**JANE RACKERS
ASSISTANT ATTORNEY GENERAL
BROADWAY STATE OFFICE BUILDING
221 W. HIGH STREET, 7TH FLOOR
JEFFERSON CITY, MO 65101**

**CARL LUMLEY
LELAND B. CURTIS
CURTIS, OETTING, HEINZ,
GARRETT & SOULE, P.C.
130 S. BENISTON, SUITE 200
ST. LOUIS, MO 63105**

**EDWARD J. CADIEUX
NCI TELECOMMUNICATIONS CORP.
100 S. FOURTH STREET, 2ND FLOOR
ST. LOUIS, MO 63102**