

The Energy And Technology Committee

March 4, 2010

**R.B. 351: An Act Concerning
Telecommunications Companies' Audits And Filings**

Testimony of

The Office of Consumer Counsel

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The Office of Consumer Counsel (OCC) has carefully reviewed and **Does Not Support** section two of R.B. 351 *An Act Concerning Telecommunications Companies' Audits And Filings*, proposing to revise existing state law (C.G.S. § 16-32) to provide any telecommunications company held by a holding company with an exemption from being required to file an annual comprehensive audit and report by independent public accountants satisfactory to the Department of Public Utility Control made of its state accounts and operations.

As it unsuccessfully attempted in the 2009 legislative session with a virtually identical bill, AT&T is once again promoting this bill. The Energy & Technology Committee did not even pass the audit section of this bill out last year and the OCC strongly suggests that the same result prevail again this year.

The section of the bill calling for the elimination of paper filings at the DPUC did not become law in 2009 and should that section of the bill progress, the OCC requests, on the same terms proposed for the DPUC, that it also be delivered one copy of all filings via first class mail, at a minimum.

It is hardly ironic that the Hartford Courant published an article (copy attached hereto) in June 2009 reporting that independent auditors hired by the DPUC had discovered that the AT&T subsidiary operating in Connecticut had been paying millions of dollars to an AT&T affiliate in Nevada for use of the company's trademarks on buildings and customer bills. Of concern to the auditors and the DPUC was the fact that none of the payments was subject to the Connecticut income tax because the holding company receiving the royalties, SBC Knowledge Ventures L.P., is in Nevada, a state with no income taxes.

The DPUC forwarded the AT&T audit to the state Department of Revenue Services, requesting that the state tax agency "should be apprised of the royalty payment arrangement" so that it "might investigate to ensure that equity prevails

among Connecticut taxpayers." Hartford Courant, *AT&T Investigated For Avoiding Connecticut Taxes; Trademark Royalties*, June 17, 2009.

The DPUC-ordered independent audit of the largest of regulated telecommunications companies operating in this state featured a rancorous docket of discovery and hearings and it should serve as an example of why continued, if not indeed strengthened, oversight by audits is necessary for such public utilities. The claim that holding company consolidated audits should suffice is disingenuous since a state audit is the only method for breaking out the operations of the regulated local operating companies. For instance, the state audit of AT&T-CT was the only way to determine the profitability of an operating company like AT&T-CT, which the OCC estimates based on the last audit to be earning a 30% return, while paying the holding company huge affiliate transactions fees and dividends that are many times larger than the local company's net income.

If this bill passes, it would be impossible to calculate this pattern of a holding company bleeding local income from Connecticut telecommunications ratepayers to the Texas corporate headquarters and its shareholders. In this period of repeated investigations of poor utility quality of service by the DPUC and in the media, and when the economic condition of the country and the state's corporations are on the front page everyday, this is hardly the time to reduce audit reports to the state's public utility regulator and the OCC.

The DPUC and the OCC are a part of an entire system of gatekeepers -- auditors, corporate boards, analysts, ratings agencies, investment bankers, lawyers and accounting standard-setters -- which operate and regulate the regulated markets, be they the financial markets so much in the news of late, or the public utilities in question in this bill. In this case, the confidence of public utility ratepayers depends on fully informed gatekeepers such as the DPUC and the OCC.

The basic financial audit lies at the heart of rate regulation and the proper maintenance of regulatory pressure on public utility conduct. That instrument must not be lost simply so a telecommunications holding company in another state can shield financial maneuvers that benefit it at the expense of Connecticut ratepayers and taxpayers.

AT&T INVESTIGATED FOR AVOIDING CONNECTICUT TAXES; TRADEMARK ROYALTIES

Hartford Courant (Connecticut) June 17, 2009 Wednesday

Attorney General Richard Blumenthal is investigating AT&T for creating a Nevada corporation that he said "appears to be a device for diverting and siphoning revenue away from Connecticut" for the purpose of avoiding state taxes.

State regulators learned last month that the Connecticut subsidiary of AT&T, which owns about 1.67 million telephone lines, has been paying millions of dollars to an AT&T affiliate in Nevada to use the company's trademarks on buildings and customer bills.

These "intercompany royalties" totaled \$144.5 million between June 2002 and December 2004, according to state regulators, and another \$46.7 million last year, according to company financial statements.

None of the payments was subject to the Connecticut income tax because the holding company receiving the royalties, SBC Knowledge Ventures L.P., is in Nevada, according to independent auditors hired by the state.

The practice is not uncommon. Companies, especially ones with valuable intellectual property such as popular logos, have created "intellectual property holding companies" and based them in states where taxes on royalties are low.

States have fought the practice in court with mixed results. In 2002, Massachusetts lost a case against Sherwin-Williams Co., which created two subsidiaries in Delaware to hold its trademarks. The state called the subsidiaries a sham to avoid paying state taxes, but the courts upheld the company's right.

AT&T maintained Tuesday that its royalty practice is legal, noting that the independent auditors hired by Connecticut's Department of Public Utility Control did not find that the payments violated state regulations. The DPUC did, however, forward the audit to the state Department of Revenue Services last month, saying the agency "should be apprised of the royalty payment arrangement" so that it "might investigate to ensure that equity prevails among Connecticut taxpayers."

AT&T Connecticut said Tuesday that it would cooperate with the Department of Revenue Services.

"AT&T believes its treatment of these payments was appropriate and consistent with trademark law and tax requirements," company spokesman Chuck Coursey said in a

statement.

Blumenthal said he is also investigating whether AT&T Connecticut used customer money to pay for the royalties, which he said "adds insult to injury."

"Consumers would surely rather go without the AT&T logo affixed to Connecticut buildings or bills than pay these unconscionable costs," he said. "AT&T's logo does nothing for consumers who simply want good service and jobs maintained."

According to AT&T Connecticut's financial statements, the payments are not a part of its operating budget, so they may not be reflected in customer rates.