BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

BARRY ROAD ASSOCIATES, INC., d/b/a MINSKY'S PIZZA, and	)	
THE MAIN STREET ASSOCIATES, INC. d/b/a MINSKY'S PIZZA, and	)	
HARRY MARK WOOLDRIDGE,	)	
COMPLAINANTS,	)	Case No. TC-2011-0396
v.	)	
SOUTHWESTERN BELL TELEPHONE COMPANY, d/b/a AT&T MISSOURI	)	
RESPONDENT.	)	

RESPONDENT AT&T MISSOURI'S BRIEF IN REPLY TO COMPLAINANTS' RESPONSE TO AT&T MISSOURI'S MOTION FOR SUMMARY DISPOSITION

Respondent AT&T Missouri,[1] pursuant to 4 CSR 240-2.080 (15), respectfully submits this Reply to Complainants' Response to AT&T Missouri's Motion for Summary Disposition.

Background

For decades, AT&T Missouri has paid hundreds of millions of dollars to Missouri municipalities in business license taxes. In 2004, lawsuits[2] were filed on behalf of more than two

[1] Southwestern Bell Telephone Company, d/b/a AT&T Missouri, will be referred to in this pleading as "AT&T Missouri."

[2] Complainants' underlying claims regarding the pass through of back taxes are rooted in three prior lawsuits filed against AT&T Missouri and related entities. *See* Memorandum of Law in Support of AT&T Missouri's Motion for Summary Disposition at 4 (*City of Wellston, Mo., v. SBC Communications Inc.*; *City of Springfield v. AT&T Missouri*; and *St. Louis County, Missouri v. AT&T Corp*.).

hundred and seventy-one of those municipalities in an effort to expand the tax base to include additional sources of revenue. Contrary to Complainants' repeated mischaracterization of the case as one in which AT&T "failed" to pay its taxes and avoided its "tax liabilities," no taxes on the additional streams of revenue were in fact "assessed" **except** through the filing of the lawsuits. *See, e.g.*, Complainants' Response 2, 11. After years of contentious litigation, AT&T Missouri reached a compromise with these cities with respect to the amount of the back taxes sought through the lawsuits and passed this payment through to its customers pursuant to its tariff authority. In their Response before this Commission, Complainants readily concede that AT&T Missouri's tariff permits it to pass-through business license taxes to its customers. Complainants' Response 1 ("In fact, Complainants believe the rate at issue, which is clearly designed to allocate the unavoidable costs of providing telephone services to residents of municipalities by recovering such costs from the residents of those municipalities, is both practical and logical."). But now, twisting logic and ignoring the underlying April 4, 2011, Order of the Circuit Court of Jackson County ("Circuit Court"), Missouri (and attached as Exhibit A to Complainants' complaint), Complainants argue that the resolution of this tax dispute by a compromise settlement payment is not a tax. Their position is contrary to established case law and regulatory rulings. That AT&T Missouri compromised a tax liability that was first assessed in litigation does not change the essential fact that a tax was imposed, which AT&T Missouri paid.

Moreover, Complainants' position that the tariff would permit AT&T Missouri to pass-through a tax judgment, but not a tax settlement, is contrary to legislative intent and would lead to an absurd result. Complainants' challenge to the pass-through of this back tax is without any basis in either law or logic, and summary disposition should be granted in favor of AT&T Missouri.

Argument

Complainants concede that AT&T Missouri's tariff permits it to pass-through to its customers business license taxes paid to municipalities. Complainants' Response 8. The question presented to the Commission is straightforward: whether the settlement payments made by AT&T [Missouri] are to be passed through to AT&T [Missouri] customers pursuant to 17.11 General Exchange Tariff 35 or similar and related tariffs." Ex. A to the Complaint at 8.[3] In their response, Complainants argue that AT&T Missouri was not paying taxes when it settled the tax litigation cases. However, that is simply not true. Two Courts have already held that the settlement payments made by AT&T Missouri were taxes, and this Commission does not have the authority to hold otherwise. AT&T Missouri undoubtedly paid a tax. As such, the tariff applies, and AT&T Missouri was required by its General Exchange tariff to pass-through that tax payment to its customers.

A. AT&T Missouri paid a back tax when it settled the tax collection actions.

That AT&T Missouri paid a tax when it settled the tax collections action could not be more clear. Indeed, both the Circuit Court that referred this case to the Commission and the court that approved the settlement of the *Wellston* tax collection action in November 2009 (the "*Wellston* Court") recognized that the settlement payments made by AT&T Missouri to the municipalities were "for back and future taxes." Ex. A to the Complaint at 7. The Circuit Court further found that it had no authority to ignore or to "'reverse' [the] critical findings" of the *Wellston* Court that the settlement payments were actually for taxes, both past and future. Ex. A to the Complaint at 6.

[3] Complainants devote significant attention to the meaning of the word "impose" in their Response. The definition of "impose" Complainants rely upon is the levying of a tax. Complainants' Response 13. And the definition of a tax is something that is imposed. *See City of Bridgeton v. Nw. Chrysler-Plymouth, Inc.*, 37 S.W.3d 867, 871-72 (Mo. App. 2001) (holding that a municipal business license fee is a tax, which it defines as a "proportional contribution[] **imposed** by the state upon individuals for the support of government and for all public needs") (emphasis added). It is obvious that the payment AT&T Missouri made in settling the tax collection actions was a tax and is therefore by definition an *imposed* payment.

And Staff of the Commission likewise agrees that the Circuit Court treated the settlement payments as back taxes "which are the type of payments contemplated by AT&T's [General Exchange] tariff." *See* Staff's Response to Southwestern Bell Telephone Company d/b/a AT&T Missouri's Motion for Summary Disposition, at ¶ 8. And even if there could be any doubt as to whether the payments were a tax, the settlement agreements at issue as well as analogous case law and regulatory rulings demonstrate that AT&T Missouri paid a tax when it settled the tax collection actions. Accordingly, AT&T Missouri's tariff mandates that it pass-through this tax payment, and summary disposition in its favor is warranted.

1. *The tax collection settlement agreements make clear that AT&T Missouri settled by making a tax payment.*

AT&T Missouri did not donate nearly $60 million dollars to Missouri cities. Rather, when faced with the tax collection actions seeking hundreds of millions of dollars in back taxes, it reached a compromise with respect to the **amount** of taxes it would pay. *See* Ex. 10 at 3 (*Wellston* Settlement)[4] (whereas clause indicating that plaintiffs and defendants intend to "compromise[e] Defendants' alleged past **tax** liability") (emphasis added); *see also* Ex. 12 at Ex. 12A at 3 (*County* Settlement) (same); Ex. 12 at Ex. 12B at 3 (*Springfield* Settlement) (noting that Springfield's receipt of the back tax payment was sufficient consideration for a release of AT&T Missouri's back tax liability). That AT&T Missouri paid less than the back taxes originally claimed due does not convert the nature of this payment into a donation.

Even a cursory analysis of the tax collection action settlements makes clear that in making payments pursuant to the settlement, AT&T Missouri paid a tax. For example, to determine each participating city's share of the back tax payment, the *Wellston* and *County* settlement agreements

[4] Exhibit references refer to the exhibits AT&T Missouri filed with its Memorandum of Law in Support of its Motion for Summary Disposition.

applied a formula that took into account the amount of taxable revenues earned in the city multiplied by the city's applicable license tax rate. Ex. 10 at Ex. G; Ex. 9 at 8-9. And each city participating in the *Wellston* settlement was required to enact an ordinance accepting the amount of back tax payment set by this formula as a condition of receiving the payment. Ex. 10 at 31-32; *see also* Ex. 12 at Ex. 12B at 4 (referencing that calculations were used to determine the amount of the compromised back tax payment). Indeed, the word "tax" appears at least fifty times in the *Wellston* settlement agreement alone. *See generally* Ex. 10.

Moreover, in exchange for the settlement payments, the cities moved to dismiss their tax collection actions, which would have been contrary to their municipal authority unless a tax payment had been made. In fact, the judge in the *Wellston* case approved the settlement, certified a class, and ordered dismissal. Ex. 11 (*Wellston* Final Judgment & Order Approving Settlement). The Circuit Court agreed with the *Wellston* Court's findings—and, indeed, found that it had no authority to reverse these critical findings and that the earlier *Wellston* Court found that the *Wellston* settlement "specifically involves past and future gross receipts and sales taxes." Ex. A at 6. This Commission has no jurisdiction or authority to ignore the critical findings of both the Circuit Court and the *Wellston* Court that the payments made to settle the *Wellston* case were tax payments. Taken as a whole, the settlement agreements, and the facts surrounding their creation and implementation, plainly establish that AT&T Missouri made a tax payment to the Missouri cities. Because these tax payments form the very basis of the pass-through charge Complainants challenge, and because Complainants concede that AT&T Missouri's tariff permits it to pass-through tax payments, summary disposition in favor of AT&T Missouri is appropriate.

AT&T Missouri's denial of liability in the settlement agreements does not change the fact that a tax was paid. The Circuit Court agreed and found that "[t]his court knows of no law that

denies a party the right to deny liability as a part of a settlement, and especially as to an area about which the law is unsettled." Ex. A to Complaint at 5. *See also id.* ("AT&T did nothing more than vigorously defend its right to challenge interpretations of law as it relates to past and future taxes…."). Denial of liability clauses are routinely included in settlement agreements as a precautionary measure should the settlement not be finalized. *Cf. State ex rel. St. Joseph Sch. Dist. v. Mo. Dep't of Elementary & Secondary Educ.*, 307 S.W.3d 209, 215 n.6 (Mo. App. 2010) (noting that an admission of liability in a settlement agreement would be "unusual"). Such clauses are especially important in class action settlement agreements such as the *Wellston* agreement because class settlements require court approval, the probability of which is unknown at the time the settlement agreement is signed. MO. R. CIV. P. 52.08(e). Indeed, a denial of liability would be necessary for a compromise to be valid. *See Lynn v. Bus. Men's Assurance Co. of Am.*, 111 S.W.2d 231, 235 (Mo. App. 1937) (holding that an insurance company could not settle a claim against a policy for less than the policy's full amount absent "an honest difference between the parties, a dispute in good faith"). AT&T Missouri's denial of liability, therefore, is not dispositive of whether or not it made a tax payment. *See Anderson v. Curators of the Univ. of Mo.*, 103 S.W.3d 394, 397-401 (Mo. App. 2003) (university's denial in settlement agreement that wages paid in settlement of dispute could be included in retirement calculations not dispositive of whether such wages were properly included in retirement calculations). *Cf. Joice v. Mo.-Kan.-Tex. R.R. Co.*, 189 S.W.2d 568, 575 (Mo. 1945) ("[P]roof of a compromise or settlement with a third person is not admissible for the purpose of establishing either the validity or the invalidity of a claim.").

2. *The origin of the claim test supports that AT&T Missouri made a tax payment in settling the tax collection actions.*

The "origin of the claim test," applied by courts to determine the tax consequences of a settlement, supports the conclusion that AT&T Missouri made a tax payment when it settled the tax

collection actions. The origin of the claim test looks to "the origin and character of the claim against the taxpayer" rather than any statements made in the defense or settlement of a claim. *Woodward v. Comm'r*, 397 U.S. 572, 578 (1970). In other words, the taxpayer's statements in reaching settlement are irrelevant to determining the nature of the payment made in settlement, which is instead established by the origin of the claim asserted in the lawsuit. *Dower v. U.S.*, 668 F.2d 264, 266 (7th Cir. 1981). Numerous state courts adopt this analysis as well. *See, e.g.*, *Perconti v. Commonwealth*, No. 2006-CA-002512-MR, 2007 WL 4292118 (Ky. Ct. App. Dec. 7, 2007); *Appeal of Jaensch*, 97R-1331, 2000 WL 1178431 (Cal. St. Bd. Equal. July 26, 2000); *Janes v. Dep't of Rev.*, IT-2001-2, 2004 WL 180524 (Mont. B.T.A. Jan. 29, 2004).[5]

Applying the test here makes clear that the settlement payments AT&T Missouri made to the cities originated in a claim for tax payments. The *Wellston* Complaint brought a class action on behalf of all political subdivisions which have "**impose[d]** a business or occupational license **tax**" on telecommunication providers.[6] Ex. 7 at ¶ 8 (*Wellston* Complaint) (emphasis added); *see also* Ex. 9 at ¶¶ 10-11 (reciting St. Louis County's license tax ordinance) (*County* Complaint); Ex. 8 at ¶ 21 (reciting Springfield's license tax ordinance) (*Springfield* Complaint). Each Complaint alleged that AT&T Missouri failed to pay the taxes that were imposed. The Complaints, in particular, sought a declaration that AT&T Missouri owed license taxes for the preceding five years. Ex. 7 at ¶¶ 17 & 30 and Wherefore Clause ¶ C (seeking the declaration on behalf of several hundred Missouri cities); *see also* Ex. 9 at ¶ 14 and Wherefore Clause ¶¶ C & E (alleging AT&T Missouri owed license taxes and seeking to collect the same); Ex. 8 at ¶¶ 57-58 (alleging AT&T Missouri owed license taxes, which it refused to pay). Count II of the *Wellston* Complaint, titled "Back Taxes, Interest and

[5] Missouri courts have not yet had the occasion to determine whether the origin of the claim rule applies in Missouri. Because the majority of state courts to have considered this issue have been convinced by the Supreme Court's rationale in *Woodward*, AT&T Missouri believes Missouri courts would adopt this doctrine.

[6] Incidentally, this is the settlement class certified by the court in the *Wellston* action. Ex. 11.

Penalties (License Taxes)," alleged that AT&T Missouri owed certain Missouri cities "back taxes," and sought a judgment for the back taxes allegedly due from AT&T Missouri. Ex. 7 at Count II Wherefore Clause ¶ A; *see also* Ex. 9 at Count II Wherefore Clause ¶¶ B & C (same); Ex. 8 at ¶ 64 (seeking a declaratory judgment that AT&T Missouri owed back taxes). The origin of the claims settled in the tax collection actions was a claim for back taxes alleged due. The payment AT&T Missouri made to settle these actions, accordingly, was a tax payment.

B. Complainants' interpretation of the pass-through provision subverts legislative intent and leads to an absurd result.

Even if Complainants were correct that the tax compromises were not tax payments, the tariff nonetheless requires a pass-through. Complaints believe that since the tax payments are the result of a settlement, the amounts were voluntarily paid and argue that a voluntary settlement cannot be "equated with an actual tax." Complainants' Response 2. Complainants concede that if AT&T Missouri had "involuntary" paid the taxes as part of a judgment, then the tariff would allow a pass-through. *Id.* Complainants' position is that because AT&T Missouri chose to pay the cities less than the entire amount of taxes they were seeking, the tariff is no longer applicable. But such a construction of the tariff would subvert the intent of the pass-through provision and lead to an absurd result.[7]

1. *Pass-through of tax settlements supports legislative intent.*

Complainants agree that when interpreting AT&T Missouri's tariff "'the primary rule is to consider words in their plain and ordinary meaning.'" Complainants' Response 12. But in interpreting statutes, courts must "ascertain[] the intent of the legislature by the plain and ordinary

[7] Complainants' argument that there is no "logical endpoint" for AT&T Missouri's position and that surcharges covered under the tariff might apply if AT&T Missouri were sued by its workers for violation of labor laws is absurd. Complainants' Response 2. Clearly, the tariff in question here is self-limiting by its own terms and applies to a "tax, fee or charge…imposed by any taxing body or authority."

meaning of the law. [Courts use] rules of statutory construction that subserve rather than subvert legislature intent. In addition, [courts] will not construe the statute so as to work unreasonable, oppressive, or absurd results." *Elrod v. Treasurer of Mo. as Custodian of the Second Injury Fund*, 138 S.W.3d 714, 716 (Mo. banc 2004).

AT&T Missouri's tariff mandates that it pass-through to its customers business license taxes it pays. The purpose of this pass-through provision is to avoid the discrimination that results when customers in cities **without** business license taxes are forced to pay a rate increase to offset part of the burden sustained by those customers in cities **with** business license taxes. *State ex rel. City of West Plains v. Pub. Serv. Comm'n*, 310 S.W.2d 925, 931 (Mo. banc 1958). *See also* A.J.G. PRIEST, PRINCIPLES OF PUBLIC UTILITY REGULATION: THEORY AND APPLICATION 54 (1969) ("discrimination results when all of a utility's customers are made to assume the burden of special taxes exacted by a particular municipality for its own purposes"). Complainants' interpretation of the tariff would subvert this purpose because it would result in the discrimination the pass-through provision is designed to avoid—customers residing in the hundreds of cities that did not impose a business license tax on AT&T Missouri would bear the burden of the payments AT&T Missouri made to the two hundred plus cities that did impose a business license tax on the company.

2. *Forcing AT&T Missouri to litigate its tax liability would lead to an absurd result.*

Complainants' position that taxes paid through settlement cannot be passed-through, while taxes resulting from a judgment can be passed-through, would lead to an absurd result. In the tax collection actions, Missouri cities were seeking hundreds of millions of dollars in back taxes from AT&T Missouri. Complainants essentially concede that had the cities won these tax collection actions at trial, AT&T Missouri's customers would have ended up having to pay the back tax judgment. Rather than risk having its customers assessed hundreds of millions of dollars, however,

AT&T Missouri reached a compromise with the cities, whereby it agreed to pay a fraction of the back taxes the cities alleged were owed. Under Complainants' interpretation of the tariff's pass-through provision, AT&T Missouri was required to risk a staggering back tax judgment, ultimately borne by its customers due to the mandatory nature of the pass-through provision. Such a result would be illogical and absurd.

Furthermore, Complainants' implication that interpreting the pass-through provision to encompass payments made to compromise back taxes would encourage AT&T Missouri to "haphazardly settle, for any amount" tax disputes is likewise absurd. Complainants' Response 15. The business license tax ordinances at the center of this dispute are decades old (as is the pass-through provision). *See generally City of Wellston, Mo., et al. v. SBC Communications Inc., et al.*, Case No. 044-02645 (filed December 30, 2004, St. Louis City Cir. Ct.); *City of Springfield v. AT&T Missouri., et al.*, No. 04-4099-cv (filed May 14, 2004, W.D. Mo.); *St. Louis County, Missouri v. AT&T Corp., et al.*, No. 08SL-CC00125 (filed Jan. 11, 2008, St. Louis County Cir. Ct.). Since the inception of those ordinances and up until settlement, AT&T Missouri had consistently taken the position that the ordinances did not reach the services at issue in the back tax litigation. *Id.* Indeed, AT&T Missouri had resisted the cities' informal efforts to expand the tax base since at least the early 1990s. *Id.* Then, it litigated for nearly six years to avoid payment, briefing issues relating to municipal tax collection authority all the way to the Supreme Court of Missouri. AT&T Missouri even went so far as to petition the Missouri Legislature for relief. It was only after a decision by the Supreme Court striking down the legislation, extensive discovery (consisting of hundreds of pages of interrogatory responses, production of thousands of documents, dozens of depositions, and the exchanging of detailed expert reports), and expansive briefing on both the merits and the propriety of class certification that the parties were at a point where they could meaningfully engage in

supervised, arms-length mediations, which ultimately led to the settlements at issue. *Id.* It would have been irresponsible for AT&T Missouri, after all it had learned over the course of this intensive litigation, to risk a tax judgment for hundreds of millions of dollars, the burden of which it knew its customers would ultimately bear. Yet, that is exactly what Complainants are asking the Commission to find. Both the *Wellston* Court and Circuit Court emphatically rejected such a finding and the tariff supports no such result. Ex. A to Complaint at 7.

3. *AT&T Missouri's losses are not hypothetical, and therefore are permitted to be passed-through to its customers.*

Complainants suggest that the holding in *State ex rel. Capital City Water Co. v. Pub. Serv. Comm'n*, 252 S.W. 446 (Mo. banc 1922) invalidates the tariff's pass-through provision insofar as it permits the pass-through of back taxes. Complainants' Response 17. It does not. The Court there held that it was not confiscatory rate-making for the Commission to refuse to let a utility company include in its future rates hypothetical losses based on an unsupported presumption that the utility's past earnings should have reached a certain rate of return. *Id.* at 449-50. But its decision is limited to such hypothetical losses. *Id.* at 450 (holding that the Commission has no authority to consider "past losses of **this** character" in setting maximum rates) (emphasis added). AT&T Missouri is not passing through hypothetical losses based on an unrealized rate of return. Rather, it is passing through a tax obligation AT&T Missouri paid to the various municipalities to settle the tax litigation—and the underlying tax obligation was one that its ratepayers would have been responsible for had it paid the taxes from the beginning—in order to avoid discriminatory rate-making. *Capital City* has no bearing on the propriety of pass-through here.

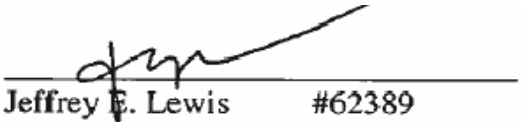
Conclusion

There can be no genuine dispute here that AT&T Missouri's payment to compromise the tax collection actions must be passed through to its customers as tax payments. For each of the reasons

stated herein, AT&T Missouri respectfully requests that the Commission grant summary disposition in its favor and find that the settlement payments made by AT&T Missouri are to be passed-through to AT&T Missouri customers pursuant to 17.11 General Exchange Tariff 35 or similar and related tariffs.

Respectfully submitted,

SOUTHWESTERN BELL TELEPHONE COMPANY
d/b/a AT&T MISSOURI



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CERTIFICATE OF SERVICE

Copies of this document were served on the following parties by e-mail on September 6, 2011.

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