BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,	)	
	)	
PACIFIC BELL TELEPHONE COMPANY, BELLSOUTH CORPORATION & AFFILIATES,	)	OTA NO. 21047581, 21047582
	)	
APPELLANT.	)	
	)	
	)	

TRANSCRIPT OF PROCEEDINGS

Sacramento, California

Tuesday, September 10, 2026

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,	
PACIFIC BELL TELEPHONE COMPANY, BELLSOUTH CORPORATION & AFFILIATES,	OTA NO. 21047581, 21047582
APPELLANT.	

Transcript of Proceedings, taken at 400 R Street, Sacramento, California, 95811, commencing at 9:50 a.m. and concluding at 5:10 p.m. on Tuesday, September 10, 2026, reported by Ernalyn M. Alonzo, Hearing Reporter, in and for the State of California.

APPEARANCES:

Panel Lead:	ALJ SARA A. HOSEY
Panel Members:	ALJ JOSH LAMBERT ALJ KENNETH GAST
For the Appellant:	JEFFREY M. VESELY ANNIE H. HUANG
For the Respondent:	STATE OF CALIFORNIA FRANCHISE TAX BOARD
	LAURIE MCELHATTON DELINDA TAMAGNI

I N D E X

E X H I B I T S

(Appellant's Exhibits 1-59 were received into evidence at page 6.)

(Department's Exhibits A-A - J were received into evidence at page 6.)

PRESENTATION ON ISSUE NO. 1

	PAGE
By Ms. Huang	7
	57
By Ms. McElhatton	68

REBUTTAL ON ISSUE NO. 1

	PAGE
By Ms. Huang	109
By Ms. McElhatton	127

PRESENTATION ON ISSUE NO. 2

	PAGE
By Mr. Vesely	152
By Ms. Tamagni	188

APPELLANT'S WITNESSES:	DIRECT	CROSS	REDIRECT	RECROSS
J. Biry	8	39	52	
			112	
			148	

Sacramento, California; Tuesday, September 10, 2026

9:50 a.m.

JUDGE HOSEY: We are now on the record.

This is the hearing of the Appeal of Pacific Bell Telephone Company, OTA Case No. 21047581. Today is September 10th, 2026, and it is 9:50 a.m. We're here in Sacramento, California, and I'm the lead Administrative Law Judge Sarah Hosey; and on my panel today are Judge Kenny Gast and Judge Josh Lambert.

Can I have the parties identify themselves for the record, starting with Appellant.

MR. VESELY: Yes. Jeffrey M. Vesely, with Pillsbury Winthrop Shaw Pittman, representing Appellants.

MS. HUANG: Annie Wong, with Pillsbury, also representing Appellants.

JUDGE HOSEY: And then Franchise Tax Board.

RIGHT one: Laurie McElhatton, Franchise Tax Board, representing Respondent.

MS. TAMAGNI: Delinda Tamagni, Franchise Tax Board.

JUDGE HOSEY: Thank you.

The issues on appeal today are whether BellSouth Corporation and affiliates was unitary with AT&T in 2007; whether AT&T's dividend income from its minority

investments in Telmex, America Móvil, and Telmex Internacional are business income; whether AT&T was unitary with Cingular/AT&T Mobility; whether Appellant is entitled to additional enterprise zone sales and use tax credits; whether royalties paid by non-partner affiliates to AT&T's intellectual property partnerships should be included in AT&T's sales factor denominator; whether Appellant has shown error in FTB's determination that Appellant's interest in capital gain income from rabbi trust investments are business income; and whether the accuracy-related penalty may be abated.

We marked Exhibits 1 through 59 for Appellant and AA through J for Respondent FTB at the prehearing conference; an exhibit log and hearing binder prepared and sent to the parties. Exhibits 1 through 59 and AA through J are now admitted as evidence into the record.

(Appellant's Exhibits 1-59 were received into evidence by the Administrative Law Judge.)

(Department's Exhibits AA-J were received into evidence by the Administrative Law Judge.)

We're going to move to Appellants to begin their presentation. We will begin by having Ms. Biry swear in as a witness.

Can I please have you raise your right hand.

///

J. BIRY,

produced as a witness, and having been first duly sworn by the Administrative Law Judge, was examined, and testified as follows:

JUDGE HOSEY: Thank you.

Ms. Huang, you may begin when ready.

MS. HUANG: Thank you for your time, Your Honors.

PRESENTATION ON ISSUE NO. 1

MS. HUANG: I want to bring out -- so, the first issue today before as whether -- as you know, that AT&T and BellSouth were instantly unitary on January 1, 2007, three days after the close of the largest telecommunications merger in history at that time. As Appellants will demonstrate, given the size and complexities of this merger, it was impossible that AT&T and BellSouth were instantly unitary on January 1st, 2007. There was no premerger integration planning between the companies, as it was prohibited by the Hart-Scott-Rodino Act or the HSR Act. The HSR Act prohibited companies from sharing sensitive information --

JUDGE HOSEY: I'm sorry. Can you move a little closer. I'm getting notes.

MS. HUANG: How's this?

JUDGE HOSEY: Better.

MS. HUANG: Okay.

JUDGE HOSEY: Thank you.

MS. HUANG: So, the HSR Act prohibited companies from sharing sensitive data or coordinate business decisions premerger. As such, there was no integration planning between the two companies prior to the merger close on December 29th, 2006. After the merger, the two companies were then able to talk to each other and begin the integration process. As will be demonstrated by Ms. Biry's testimony, given the complexities of the two companies, it was impossible for them to be integrated on day one or even in year one.

Now, I would like to turn to Ms. Biry as she will explain. Ms. Biry was intimately involved in the merger planning process and also the integration process after the close of the merger.

DIRECT EXAMINATION

BY MS. HUANG:

Q So, Ms. Biry, can we -- well, can we start with you telling us what your role was at AT&T during the 2006 and 2008 years?

A Yes. In 2006, I was Assistant Vice President of Merger Integration planning. In 2007 and 2008, I was

Assistant Vice President Executive Support.

Q And what was your role in connection with the merger of AT&T and BellSouth in 2006?

A In 2006, I was the lead for AT&T to start doing some premerger planning for the three-way merger of AT&T, BellSouth, and Cingular.

Q And what were your responsibilities as the lead for the merger planning team?

A It was my responsibility to assemble a small team on the AT&T side to start thinking through what needed to happen after the deal closed. I was responsible for identifying all of the integration activities that would need to take place after the deal closed and also identify a potential path to achieving the $3 billion in run rate synergies that the company had committed to its shareholders that would be achieved by year three after the deal closed. And I documented that potential path to achieve those synergies in merger play books.

Q So, speaking of the merger play books, how did you and your team put together the merger play books?

A The merger play books were assembled using public information that was available on things like BellSouth's website. It was also put together based upon mine and my team's industry knowledge and work that we had done on prior mergers. And then there was also a legally

monitored process in which we were able to have some meetings with BellSouth before the deal closed where they were able to share with us information that was not competitively sensitive. So, it would be general information like, who was your auditor, so that we could start our thinking for the integration activities that would have to happen after the deal closed; but no BellSouth competitively sensitive information was allowed to be shared during those meetings.

All meetings were monitored by outside counsel because of the HRS considerations that you mentioned. And all documents were reviewed to ensure that no specific information about the BellSouth employees, customers, or contracts were disclosed to us.

Q So, as part of the process for putting together the Merger Playbook, you were not able to get any information that was not publicly available or that wasn't -- that was confidential. This is, you could not get any confidential information. And even the general information you said was prohibited by -- I mean, was monitored. All that sharing was monitored by antitrust lawyers?

A That's right. Third-party outside counsel from both sides actually; BellSouth team had outside counsel in the meeting, and AT&T had outside counsel in the meeting.

And if they thought the details of the conversation were too specific, they would stop the conversations from happening. So, as I mentioned, general things; you know, what type of payroll system do you have? How do you think about -- you know, how do you think about certain topics? So, general industry-type knowledge was able to be shared, but no specific employee data or names; no specific customer data or names; no contract information of any time -- of any kind was able to be shared.

Q And during this process, did you even know who at BellSouth would be part of their integration process?

A There was a -- a small handful of people on the BellSouth side who participated in these meetings, but we were not able to know who the specific employees were who led all the various functions that we would later be responsible for integrating.

Q So, in the meetings you just mentioned, they were, as you explained in detail earlier, the meetings that were monitored by the counsel, and they were basically meetings on general topics; right?

A That's correct. General -- general topics related to things that we were thinking about for the Playbooks but no specific information was exchanged.

Q So, when did you share the Playbooks with the BellSouth employees?

A On January 1st of 2007 was when the Playbooks were printed, and that week of January 2nd, the first week after the deal closed. The CEO and the direct reports to the CEO were named that week, and we were able to start sharing the Playbooks with -- with those leaders and with the BellSouth employees once we identified who they were. In the coming weeks, we were able to start sharing the Playbooks with them then. Before that time, they had no knowledge of the Playbooks and no knowledge of what was in them, which was actually a very frustrating point because we were trying to have this be seen as a -- a joining together of three, not a takeover of two. And so, it was a very frustrating point to them that they had not been able to see or be part of the integration planning until after the deal closed, and we came back to the office after the holidays in January of 2007.

Q So, would you say the Playbooks were one-sided documents only -- with only the input from AT&T team lead by you based on general -- or based on, I guess, assumptions based on general knowledge?

A That's right. The -- the -- it was not based on any internal knowledge of BellSouth or Cingular. It was based on our knowledge of the industry, our knowledge of prior deals, and the things that we had assumed in our deal thesis would have to happen for integration and to

achieve that $3 billion in synergies by 2009.

Q And when you -- you kept saying by 2009. Was this a -- a -- a three-year process in your mind from the very start?

A Yes. Given the complexity and the size and scale of the business, it was always anticipated to be a three-year integration process. The Playbooks laid out a potential path for that three-year process. It was also communicated to shareholders that it would be a three-year process and that it be substantially not 100 percent complete, but substantially complete by 2009, the third year after the deal closed.

Q And so, turning back to the Playbooks, how were they received by the BellSouth team once you shared them?

A They were very quick to point out everything that was wrong with them because they had not been part of the process. They -- so, they took the Playbooks. It took them months to digest them and to come up with what the initiatives were. In some cases, they thought they were directionally correct, but needed more information. In some, we just had assumptions that were just flat-out incorrect because we didn't have knowledge. And so, the Playbooks very quickly became irrelevant, and the team started putting together operational plans on how they thought we should complete the integration over the next

three years and where they thought we would get the synergies that were committed to.

Q And so, once the operational plans were put together by the BellSouth team -- and you said the Playbook became irrelevant. So, can we -- will we -- would it be correct to say the dates that were in the Playbook were thrown out as well? It was instead, what you looked to as the leader of the -- the integration team, was the operational plans put together by the BellSouth team?

A That's right. I would consider the Playbooks to have been a roadmap on one-sided view of how I thought the three companies could integrate together. I didn't even know what date the deal would close. So, like the minute the dates were written they were wrong because we didn't know -- we didn't know when the FCC and the DOJ would approve the deal. Once they did, we closed within 24 hours, but we had no idea. I mean, honestly, when I left for Christmas holiday, I had no idea the deal would close over the holiday break. So, the dates were irrelevant when they were written down, particularly once the operational teams got in there and scoped out the work that had to be done, once we had full information on the other side of the house what had to be done.

That's -- so the -- the Playbooks were just a

roadmap for the teams to consider as they created their operational plans. They were discarded early in 2007. The teams created operational very detailed roadmaps, which we later turned to for our -- for our actual integration, tracking, and score carding.

Q And you mentioned a few minutes ago about how you would take months for the BellSouth team to review sort of the -- the guidepost as you call them -- the Playbook, you know, the guidepost, and then come back with what they thought would work. Why do you think it took them so long to even get to that first step?

A I -- I think the -- the first thing is, as I mentioned, we didn't know who all the people were. So, you have to realize there was, I believe, around 300,000 employees between BellSouth, AT&T, and Cingular, and we didn't have names of those employees until after the deal closed. So, the first thing we had to do was actually find the people and -- and find out who was going to be the person responsible for these, literally, thousands of projects that had to be completed. So, it took us time to find the people. It took us time to share information and learn each other's processes, and then we had to start prioritizing what we thought was the most important pieces of work and got us the highest return. At the same time, people still had to do their day jobs.

Q So, it was -- it was a long process? There's no way it could have been done in the first week, the first month, you know, because -- just simply because of what you just explained?

A It would be physically impossible for it to have been done in the first month, and it was always and publicly shared that it would be a three-year integration process.

Q So, we've been talking about integration here. What does the term integration mean to you in connection with this merger?

A I -- I think about integration in four different buckets of really large complex bodies of work that had to be completed. The first is the people. You've got to figure out how to integrate the people. The second is the company's policies on how do things. Third, are all of your IT systems that have to communicate, and fourth are the company networks.

Q So, with these four, if we can take some time to go through them, you mentioned people as being the first component of -- of -- of this integration process. So, why -- why was it difficult to meet this part of the process?

A So, the -- the people -- the people process are several things that -- that took us time on this. So,

first, as I mentioned, we did not know who all the people were, what their roles and responsibilities are; and those roles and responsibility didn't organizationally match up exactly. So, just as an example, real estate was in finance at AT&T, but was in operations at BellSouth. So, we had to really understand the org charts, what the people were, what they did, what their roles and responsibilities are in order to match them up.

Because Cingular was so complex, because their culture was so incredibly different, and because they resisted the merger so much, we decided not to integrate Cingular that first year. Cingular was left as a stand-alone separate entity. So, we focused only on -- because the task was so overwhelming on the people piece, the first year we focused only on the AT&T, BellSouth people integration.

Further, what complicated matters is that both AT&T and BellSouth have unionized non-management employee basis. We were on separate union contracts under multiple labor unions. In the -- in the premerger Playbooks, we had assumed that we would be able to negotiate some of those contracts and be able to do work sharing in that first year. That did not come to fruition. The Communication Workers of America were adamant that they wanted to retain their BellSouth contracts, which were not

set to expire until August of 2009. And so, until that agreement was renegotiated, which didn't happen until the end of 2009, we were not allowed to do any work sharing of any sort.

So, as an example, if I wanted -- if I had a consumer customer who had a BellSouth landline and AT&T long distance, and you called in and you had a question about both, because we were on two separate unionized contracts that had very specific clauses on what work each person could do, we had to transfer that customer to two separate reps. We were not able to integrate until 2010.

Q And it was because the -- the restrictions put in by the union contracts --

A That's right.

Q -- that you can -- you basically could not, you know, interchange the employees for different duties, you know, move somebody from BellSouth to AT&T or have somebody at AT&T answer -- basically, do BellSouth jobs and vice versa. That was not allowed because you were -- you were legally was it -- were you -- was AT&T legally restricted from doing that?

A We were restricted, given the separate contract language. So, as an example, if I had a job that needed to be done, I would have to roll two separate trucks until we were on one unionized contract. We rolled two separate

trucks, one with a BellSouth logo, one with an AT&T logo, until we were able to get all of the systems processes and finally, the labor contracts harmonized.

Q So, how -- how did you -- how did AT&T resolve the labor issues? When you said, you know, you had -- you had to wait for them to be harmonized, how did they resolve?

A The contract was up for -- the BellSouth contract was up in August of 2009. We had a very, very long negotiation, and we even went without a contract for several months. It wasn't renewed until December 2009.

Q And after that, would you say then the people part of the integration process could really begin?

A That's right.

Q Okay.

A For the non-management. Management was able to be started -- was able to be started earlier, but for non-management we were not able to complete -- to start integration until we had the harmonized contracts.

Q Okay. And for the non-management workforce, was that a big part of AT&T and BellSouth, or is it a minority part -- insignificant part?

A In my recollection, it was approximately two-thirds non-management.

Q So, two-thirds of the workforce were subject

to --

A Unionized contracts.

Q -- the union. Okay. And so now, we will move on to policies, you know, the other component of -- of the integration you mentioned. Why -- how long did the policies take place?

A Throughout 2007, we were able to complete the majority of the policy work. So, think about policy work as company -- company guidelines. So, what's your -- what's your vacation schedule going to be? How many holidays do -- you know, what are the company holidays? The company holidays between the companies were different. What are the vacation limits? If I have to go to the -- raise capital, do I issue more stock, or do I issue more debt?

So, the general guidelines of those policies were completed throughout 2007. Some of the policies on how we did work and how we directed work forces were dependent upon those labor contracts. So, that could not be completed until after the labor contracts in 2009. But general company policies were completed mostly throughout 2007.

Q But they certainly were not on day one?

A Absolutely not. We didn't even -- as I -- as I mentioned before, we were not allowed to see the sensitive

information of the other company, so we couldn't even analyze what the differences in policies were until after the deal closed. So, we came up with those general policies throughout 2007, but then they couldn't be implemented until systems work was done, or the labor contracts were complete.

Q Okay. And then -- then now, we can go to -- you -- you mentioned systems. Can you please explain what connecting systems, like payroll and HR, you know, the -- the two, as an example, cannot happen soon after the merger?

A Sure. So, first of all, telecoms are notoriously famous for having very complex and antiquated IT systems. And so, you are bringing together the largest telecom merger that ever happened. So, there was going to be a lot of complexity and a lot of technical debt that had to be worked through. The other thing that I would tell you is that there are a lot of, what I would call tentacles or feeder systems that would go into it. So, as an example, if you wanted to integrate the payroll system, which is one of the first things we desired to do because we wanted to be able to have one database and -- and one policy and procedures implemented for all employees. It was one of the first things that we wanted to do.

Well, in order to do that, you have different

feeder systems that have to go in there; and there's one or more for each one of the union represented contracts. There's different tax tables based upon the different entities. So, it was very complex in order to get the feeder systems integrated, and then also to convert the actual IT systems.

Further, what complicated it when you think from a customer perspective, we all as consumers general think of AT&T as a consumer company. But actually, AT&T also serves enterprise customers. Think of the top Fortune 1000, and it is a very complex set of network assets that we manage on behalf of those customers. And if we have a misstep, those customers have network problems, and we can't risk having someone like a Delta Airlines have a network problem in the -- in the middle of things.

And so, the IT systems, when I think about a billing perspective, it's really -- it's really complex just for the two companies; but also, when you layer on the fact that you are serving such large enterprise customer base.

Q Okay. So -- so the systems as you explained, just the complexities themselves, and how to prevent it, any kind of true integration early on or even in 2007?

A There were very few IT systems integrated in

2007. The vast majority happened in 2008. The complex billing happened in 2009. Very -- very little of the actual integration of systems was completed in '07. I think some very, very simple things, like your treasury cash management that didn't have all of those what I call tentacles, all those feeder systems. Only simple tasks like cash management that didn't have those tentacles were completed in 2007.

Q Okay. So now, if we can move on to the last component of -- of -- of -- of the meaning of integration to you. You mentioned networks, and how long did it take to basically integrate network between the two companies?

A The material portion of network was completed in 2009, but you can see when you read our operational plans that some of that work took 10, 11, 12 in order to complete. But substantially, I would say it was complete in 2009. As I mentioned, bringing together these three companies -- I mean, we are net -- we are a network company. It's what we do. We all had nationwide footprints. We all had different technologies that had to be integrated and therefore, it took -- it took quite a bit of time to do that.

You have to think, first of all, there had to be a lot of engineering and planning that had to be done. Secondly, you had to order all the hardware. Third, you

had to find the labor who had time and capacity to go and reconfigure the network to be as one. And then one of the things that we had not anticipated in the Playbook was the impact on these enterprise customers. We had naively assumed that we would be able to do some of the engineering hardware and capacity ourselves.

As we got into some of the integration in 2008, we -- we realized that some of these enterprise customers were impacted, and we had to actually go get customer consent and coordinate with their network operations teams so that we didn't take down any customer or building networks as we completed the integration of the networks.

Q So, as you explained it, you know, both for the systems and for networks, and since, you know, AT&T and BellSouth are really network companies, it wasn't something that you can like, flip a switch and things would just connect?

A No. No.

Q So, while things were, you know, in a process of being planned for integration or some of the -- the few items as you noted were starting to be integrated in 2007, during this time, how was BellSouth operating?

A BellSouth was operating independently during that time. In January, that first week, the CEO of the combined companies was announced. He announced each of

his direct reports. So, as an example, there were two CFOs. He announced who would be the one CFO. And then the two CFO teams organizations reported to that CFO while we started coming up with our integration plans.

So, during that time, the BellSouth organization operated independently. There was no systems integrations completed. There was no process completed. There were no policies that had been integrated. So, the people operated independently under their legacy BellSouth policies on their legacy systems using all of their legacy processes and contracts on day one.

Q So, would you say that BellSouth was managed -- like, the day-to-day management of BellSouth remained the same pre- and post-merger?

A Yes, I would.

Q And now, I know we talked quite a bit about systems integration. Can I then turn you to the -- if -- the Exhibit 2, to your declaration that we submitted to the OTA.

MS. HUANG: And this is Exhibit 47, Judge Hosey and, you know, for -- in the hearing binder.

BY MS. HUANG:

Q So, if we can -- first we'll note, this was prepared -- this document was -- when was it prepared?

A This document was prepared January 25th, 2008,

approximately 13 months after the deal completed.

Q And who would have prepared this document?

A This was my responsibility and my team's responsibility. So, during the years 2007 and 2008, I was responsible for making sure that the operational integration plans were documented, completed, tracked, and driven to completion. I had to meet with the CEO and his direct report team every two to four weeks and give a detailed readout on what the status was of the merger integration, what the challenges were, when we thought we would be substantially complete, and what the dollar amount was of the $3 billion synergy goal.

Q And looking at this document, and I think you, know you, called it sort -- I think you mentioned earlier it -- called it a scorecard. Why would you call it the scorecard?

A It's a score -- I -- I call it a scorecard because it's the tracking. It tell us if we're winning or losing. So, we had green, yellow, red, blue status: Blue meaning something is complete; green meaning it's on track relative to the operational plans that were completed after the merger closed; yellow if there was a jeopardy; and red if we were off track. So, it was really a quick scorecard to know, are we on track operationally with the colors, and then dollar -- dollars are mentioned, so if we

knew if we were on track for the synergies committed to our shareholders by 2009.

Q Okay. And then so, if we can take a few moments to look at some of the pages in here just to clarify some points and to explain what some of these mean. If I can turn you to page 36 of Exhibit 47. So, what does this page tell us?

A So, I'm looking at summary of a TO, which is Technology Organization. This is the status, the scorecard for the BellSouth/Cingular merger program. Again, this was dated January 25th of 2008, approximately 13 months after the deal closed. The operational project names are on the left-most column of the chart. The finish date of the initiative, when we expected the finish date to be complete is the second column of the scorecard. The third is the status of the initiative. As I mentioned, blue means it's complete. Green means it's on track for the -- for the date in the second column. Yellow means it has a risk, whether it be to dollars or timeline, and red means it's off track.

The synergy target is in the fourth column. That was the target that was aligned with the operational teams in 2007 that they were tracking to. Once we were in 2008, the current view of that synergy is in the fifth column. Sixth has the notes that would give you explanations, if

something was off track as to why. And then the page numbers had more detailed operational plans in the appendix in case the executives wanted to see that.

So as an example, if I just go across the first initiative, this was one work stream that the teams had to complete for the enterprise network migration for Cingular. It wasn't expected in our operational plans to be complete until 12/31/2011. It had a current status of red, timeline jeopardy, because there was an initiative -- or because there was the -- the teams thought that they were going to miss. But they thought once they did deliver, they would be able to overachieve the savings, but they thought they would miss the 2011 timeline.

So as you flip -- as you look down that page, you can see nothing -- nothing was complete at that time relative to these major integration programs.

Q Okay. Then if I could flip you to page 38 of the same exhibit. Can you then tell us what this page shows us?

A This is a summary of product movements that had network components that were being worked on in 2008. If I look at this, this is the -- these are the detailed work steps that had to be completed. So, the project name is in the first column. The second column is the unit. So, this was the unit of measure that I was holding the

integration teams accountable to, to measure their progress on my scorecard. The third column is 2007, so what of that unit what was completed in 2007.

Again, remember, this was in 2008. So, I had actual completed results for 2007 at that time. I had -- of that unit of measure, I had what was the 2008 forecast, what was actually completed as of that January 25th date. And then I had the 2009 forecast for that project.

Q In looking at this page, we see that the right column -- the -- the column on the right where it says percent of total completed.

A Yes.

Q We see that several of them you -- you -- they were obviously far from being completed. And in fact, many has zero started even. But then you do see some that's 78 percent. You have, you know, a couple that are 100 percent. Do -- and even looking at these numbers, do you think with these numbers they show you that all -- that means these projects -- well, let's take the 100 -- the 100 ones. They'll probably be easier to say. Would you say these projects were completed just because they show they were 100?

A I think I -- I should have clarified. If you look at the legend on the left, these were individual work steps. In order -- these were individual work steps that

needed to be completed in order to complete the blue project on the left. So, as an example, in order to integrate layer one of Cingular -- one, two, three, four, five -- these six projects had to be completed. So, six projects in total had to be completed in order for the layer one of the Cingular network to be migrated to the AT&T network. So, of these individual projects, a few of the steps may have been completed in 2008, but the overall programs were not done, or they would not have been part of my scorecard.

Q I see. So then, if we could just, you know, further using this as an example here. If we look at layer three, we can see how we have Bell -- Bell -- Cingular -- let me see -- Cingular IP Transit Consolidation. In here it says it's 100 percent completed. And if we -- if I could turn you to page 42 of the exhibit. In the top line on that page, page 42 of Exhibit 47, it is the same one. And what date does it show as the baseline finish date?

A March 1st, 2008.

Q Even though on this one, as of January 2008, it shows that it's 100 percent complete. And then I think this -- if we also flip to page 69 of the scorecard, which is again, the same project. You can see the -- there was still a lot to be done. And --

A That's right. So, what we're looking at on this page are the operational programs that the team put together in 2007 and laid out all of the steps that they would have to take on the BellSouth and AT&T side in order to complete the program, which they -- you can see it started in March of 2007, but wasn't anticipated to complete until March 31 of 2008.

Q And -- and looking -- even looking at this, you can see other -- can you explain why there's so many little steps, even as you complete one -- completing one part of this project doesn't mean this project was complete; correct?

A That -- that's -- that's correct. So, I would say again, they were different units of completion for an overall program that had to be completed. And you can see the timeline and sequencing of what had to actually happen. This demonstrates clearly about the complexity of the work that had to happen. You can see that they had to get different hardwares and install them different circuits and install them. They had to study the traffic. They had to take different network and system steps in order for the program to be complete.

Q I see. And then now, if I can turn you to another item -- another project. If I can turn you to page -- I mean, 42 of the exhibit?

A Which is it?

Q I know. I'm sorry. There's internal page numbers, and then there's the -- the -- the binder -- hearing binder numbers. So, looking at this one, can you explain what -- towards the bottom, there's the BellSouth Customer Matching. What -- what is that project?

A BellSouth customer matching I believe that was enterprise customers. I'm not sure. I -- I don't know if this was enterprise or consumer based on the summary. But we had a project that we launched in 2007 to try to match up the -- who were the common customers between AT&T and BellSouth. It was very complex because customers used different names, different addresses. They had different type of products. And so, doing that match between BellSouth customers and AT&T customers wasn't expected to be completed until February 20th, of 2008.

Q And then I -- if I can flip you to the very next page, we have I think -- yes. So, if you can look at this page on page 42 -- 43 of the -- of Exhibit 47, we have the In-Region Single Bill. What -- what does this project tell us?

A This project was designed to offer a consolidated billing system so that we could have one -- one bill per customer rather than sending them separate AT&T and BellSouth bills as we did in 2007. The systems worked in

order to have a consolidated bill for a customer was expected to deliver on June 20th, 2008. It was in jeopardy in January 2008.

It was in jeopardy for two different reasons. And it -- there were defects that were discovered during the system tests. So some of the work was underway, but when we tested it in the test environment, it was more complex than we had anticipated. And the teams did not think that they would be able to deliver on June on June 20th as originally planned.

Q Okay.

A Again, that was of 2008.

Q And now, if we could look at a couple of -- just a couple more examples here. Not to take up too much time here, but -- just to get an idea of other systems, if I can turn you to page 45 of the Exhibit 47. And here we have the payroll system at the very bottom. What -- what does that say in terms of when it was expected to be completed?

A The payroll system was expected to be completed January 31st of 2008. This presentation of this scorecard was given the week prior. So, I was indicating with green that I thought it would actually be complete the next week, but it wasn't complete yet.

Q And why was the payroll system important?

A Because --

Q -- integrating them?

A -- integrating the payroll system is foundational to integrating the people in the workforce. So, when we were on different payroll systems, as an example, I couldn't approve, even though it would -- it was the expectation that I would have people from BellSouth working for me, I could not approve their time off. I could not approve their pay raises. I couldn't see any of their historical information until we were on one payroll system. So having a consolidated payroll system is foundational to that people component that I talked about as one of the four integration pillars.

Q Okay. And then going to another system here, now we're gonna go to the top of the same page, which is page 45 of -- of Exhibit 47. We had the tax system integration. When was that expected to finish?

A The tax system integration was expected to finish December 31 of 2008. And as of January, when I gave the scorecard presentation, it was on track to complete at the end of that year.

Q Why do you think the tax system took so long to finish?

A Because generally, as I talked about before, what I would refer to as the tentacle systems, in order for the

tax system to be complete, you would have to have one financial system that was feeding common information into the tax system. So, if you had a tax system integrated, but you had, you know, revenue in different accounts or expense in different accounts, you would have incorrect tax filing.

So, the tax filings were handled separately until the financial systems work could be done in 2008, which were some of the tentacle feeder systems into the tax system. So, that tax work happened after and was expected to complete at the end of 2008.

Q And speaking of the financial systems, I -- I think on the same page, we also have the financial systems?

A That's right. The third row down --

Q Right.

A -- is financial reporting MR2000, which is -- was the AT&T Management Reporting Financial System, which was created after Y2K, so that's MR2000. Our financial system integration was expected to complete December 31 of 2008, but it had a yellow jeopardy because we were dependent upon Accenture to complete some of the work for us, and Accenture was -- was behind. And they thought that some of their work would -- would be late. And so, we were trying to work with them at the time to see how they could

get back on track.

Q Okay. Then let's see one last example. And this one is the sort of the -- relating to internal communications on page 47 of Exhibit 47, Instant Messaging. So what -- what -- when was this project expected to finish?

A Instant messaging was expected to complete March 31 of 2008. You have to remember at -- so instant messaging is the way for employees at a company to share messages with each other over the company's secured intranet. Today we do that through Teams or through Slack. But you have to remember 20 years ago there weren't -- there weren't software as a service platforms like that. So large companies developed their own instant messaging systems. So, I was not able to instant message as an AT&T employee with a BellSouth employee before March 31 of 2008.

Q Okay. So, in all the examples we looked at, the various projects, you know, we see that -- as you can see, most of them did not finish in 2007 and/or even 2008 and -- but some did. And would you say that of -- of the one -- of the few projects that were finished, do you think these projects meant that AT&T and BellSouth were -- were integrated because of the completion of some of these projects in 2007?

A Absolute -- absolutely not. The projects that were completed in 2007 were those that were very, very simple, did not have a lot of tentacles or feeder systems, and in no way enabled me to manage or direct BellSouth employees.

Q And so, then we can move to sort of the bigger question. What did you think were the biggest obstacles to integrating companies as big as AT&T and BellSouth?

A Again, I go back to this was the largest merger in telecommunications history. So it was -- it was a three-way merger, which had never been done. It was very, very large, very complex. Some of the systems were old. As I mentioned before, there's a lot of technical debt in telecom. We had very large customer basis that had different products, and our goal when we integrated was to have common products. It made it even further complicated by the fact that we had both consumer and enterprise customers. The enterprise customers were much more resistant to change. And so, it was very complex to try to manage their networks at the same time we were trying to integrate ours.

The network was very complex to integrate. And then as I mentioned, the union contracts ended up being a long pole in the tent that did not enable us -- even after systems work was done, didn't enable us to integrate the

workforces until we had common -- or harmonized union contracts.

Q So, with all that, in your opinion, when do you think AT&T and BellSouth were acting as one, that they were integrated?

A My responsibility was to make sure that the companies were substantially integrated, and I was not released from my duties until 2009. So, as a company, we did not believe that there was substantial integration complete until I was released from my responsibilities. We weren't 100 percent complete at that time, but there was enough work done that we would have said we substantially complete, and the rest of the work that needed to be done was clearly documented and integrated into people's operating rhythms.

Q So, one last question, Ms. Biry. Based on everything you just testified to today, you may know that -- that we filed as unitary with BellSouth on January 1, 2008. Would you agree with that date as the date that the two companies were integrated and operating as one?

A In my opinion, 2008 is incredibly conservative. We still had massive integration to complete in 2008. We were not on common financials. We were not on common billers. We weren't even on a common payroll system. And

so, in my opinion, as the person responsible for the integration, I was still reading out to executives on the status of integration until 2009. I believe we were not substantially complete until 2009.

MR. VESELY: Okay. Thank you.

Thank you, Judge Hosey. I am done.

JUDGE HOSEY: Thank you.

Thank you, Ms. Biry.

I'm gonna move to the Franchise Tax Board to see if you have any questions for the witness.

MS. MCELHATTON: We have just a few.

JUDGE HOSEY: Okay.

CROSS-EXAMINATION

BY MS. MCELHATTON:

Q If you would turn to Exhibit 47, page 8 of 77. It's also OTA -- OTA's binder number 3597, if that helps. And then go to the line that says "Procurement".

A I'm sorry. I don't think I'm on the right page. I apologize.

Q Page 8 of exhibit --

MS. HUANG: Oh, I'm sorry, Counsel. Are you on a different -- which exhibit is this?

MS. MCELHATTON: Exhibit 47.

MS. TAMAGNI: Exhibit 47.

MS. HUANG: Okay.

MS. MCELHATTON: Page 8.

MS. HUANG: You're talking about this one.

MS. BIRY: Okay.

MS. HUANG: Okay. Thank you.

BY MS. MCELHATTON:

Q Okay. And then in the second box, if you could look at procurement, and -- here we go. Okay. And so we have Non-Labor Expense Synergies. Do you see that box?

A Yes, I do.

Q Okay. Thank you. And then how much of non-labor expense synergies were achieved during 2006?

A So, first, I think we should clarify what we're looking at here. You have to remember that AT&T and SBC had merged in 2005. So, what we're looking at here is a scorecard relative to a different merger, and it has absolutely nothing to do with the BellSouth/Cingular merger.

Q Just go to the top. Oh, okay.

A The header says, "T. Merger synergy."

Q Oh, okay. Sorry. Okay.

A That would be referencing -- I was responsible for that merger, which was a three-year integration. And so here in 2008, I was giving a status.

Q I'm sorry. Go to the next page.

A Okay.

Q I'm sorry. You're correct on that. Okay. So, the procurement line on -- on the next page where it says non-labor, the second box for non-labor expense synergies?

A Yes.

Q Procurement. So, we have a 2007 plan of $42 million and a 2007 achieved of $47 million; is that correct?

A That is correct.

Q Thank you. Okay. If we can move to Exhibit D, page 16 of 26. And of the OTA binder, it's No. 4709?

MR. VESELY: I'm sorry Exhibit D?

MS. MCELHATTON: Exhibit D as in dog. I'm sorry.

BY MS. MCELHATTON:

Q This is a January 12, 2007, AT&T press release, and --

MS. HUANG: I'm sorry. Can you please hold on a second just to find it. We actually don't have a digital copy, so we're -- we have to flip to the paper copy.

MS. MCELHATTON: It's Exhibit D, page 16 of 26, and OTA binder No. 4709.

MS. HUANG: Okay. I think we're there.

MS. MCELHATTON: You're there?

Thank you.

MS. MCELHATTON: Okay. All right.

BY MS. MCELHATTON:

Q So, from the second paragraph and I, quote -- this is a January 12th, 2007, press release -- "AT&T Incorporated will begin on January 15, the rebranding of Atlanta-based Cingular as simply AT&T. As part of the rebranding, a new ad campaign will launch on Monday." Is that correct?

A That's what this says.

Q Thank you. Okay. Can you move now to same exhibit page 26 of 26. Are you there?

A Yes.

Q Okay. Okay. Where it states, and I quote, "This is to advise" -- do you see where it starts with that?

A Yes, I do.

Q Okay. "This is to advise that in connection with the recently closed merger of BellSouth and AT&T, BellSouth is in the process of changing its retail directory assistance, DA, and total branding and greeting announcements in all nine BellSouth states in order to reflect the merger," is that what it says?

A That is what it says.

Q Thank you. Now, if you can move to same exhibit page 17 of 26. And of the OTA binder it's No. 4710. This is a bill. If you can look at the very top of the bill, it says, "AT&T BellSouth is now the new AT&T." Is that

correct?

A That is what it says on a BellSouth bill.

Q Thank you. Now, if you can move to page 21 of 26 and OTA No. 4714. The -- are you --

MS. HUANG: I'm sorry. Which one.

MS. MCELHATTON: I'm sorry. Yeah. No. 21 of 26, and the OTA No. Is 4714. It's -- so, I don't know if that's easier for you or what.

MR. VESELY: No. It's helpful.

MS. MCELHATTON: So, I -- I give both numbers in case one is easier for you. Okay.

BY MS. MCELHATTON:

Q Are we there?

A Yes.

Q Okay. Okay. Where the title says, "BellSouth is joining AT&T," the paragraph states, "Today the local commitment you've come to expect from BellSouth has joined AT&T, the nation's largest provider of broadband. The result, you'll be able to connect to your world like never before on America's most complete and secure network. Now your home phone, internet, TV, and wireless services are going to be available from one trusted provider. Welcome to the new AT&T. Your world delivered." Is that correct?

A That is correct.

Q Thank you. Now, if you can move to page of the

same exhibit, page 22. This is from the February 2nd BellSouth 2007 bill. We're looking at the third paragraph. Are you there?

A Yes.

Q Okay. It says, "With the merger of AT&T and BellSouth, starting March 1st, you will begin to receive the name and number of Cingular wireless customers on your BellSouth landline caller ID. There is no charge for this service." Is that correct?

A Correct.

Q Thank you. Now, page 13, same exhibit. This is a May 21st AT&T press release, and I'm looking at the third paragraph. Are you there?

A Yes.

Q Okay. Where it states, "Consolidating BellSouth and Cingular under the AT&T brand was based on extensive market research and is proving to be the right decision, said Randall Stevenson, AT&T's chief operating officer. Our branding campaign is performing at and above projected levels, and customer response has been very positive. We are excited to move to the next phase of transforming AT&T into the only communication provider our customers will ever want." Is that correct?

A Correct.

Q Thank you. Can you please turn, same exhibit,

page 9, second sentence. "Starting Monday January 15th, AT&T is launching a new multimedia campaign to begin transitioning the Cingular brand to AT&T and advertising a customer communications throughout websites in nationwide retail stores and on company buildings and vehicles."

This is dated January 12, 2007. Is that correct.

A Correct. Thank you. Okay. Okay. Please turn to Exhibit 47. That's the January reports with all the orange on it. I think you have one of those printed out. I think I saw a paper copy.

MS. HUANG: Thank you.

BY MS. MCELHATTON:

Q If you can turn to page 19 of 77. For OTA, that's 3608, center column. We're looking at reductions in staff by the end of 2007 for worldwide customer service. It was 1,877 positions. Is that correct? Center column, page 19 of 77. Okay. It's -- it's right underneath the graph, the center column.

MS. HUANG: Can you read it again so she can find it?

BY MS. MCELHATTON:

Q For world customer service, 1,877 positions were eliminated?

A One moment. Let me read the footnote. That's what the bullet says, but I don't see the footnote to be

able to know what the nuance of that number is.

Q Okay. Thank you. Now, can you turn to page 30 of 77, also Exhibit 47, right column. This is a labor tracking report for 2007, and we're looking at Customer Information Services. Are you there?

A Yes, I am.

Q Okay. It shows an employee reduction of 909 for 2007; is that correct?

A Correct.

Q And then at the bottom it state, "As of end of year 2007, 45 percent of the wireless directory assistance traffic from Verizon Live Source has been moved to AT&T." Is that correct?

A Correct.

Q Thank you.

A It also says 55 percent wouldn't move until 2008.

Q Thank you.

A Forty-five percent was done at the end of 2007. The majority of the traffic, 55 percent, wasn't done until March of 2008.

Q Okay. Let's see. Okay. For Exhibit A-B, if you could turn to pages 34 through 36?

MS. HUANG: AB?

MS. MCELHATTON: A-B.

MS. BIRY: D as in dog.

MS. MCELHATTON: A as in apple, B as in boy.

MS. BIRY: Oh, sorry.

MS. MCELHATTON: A dash B. And for OTA binder it starts on page 4020.

MS. BIRY: Okay.

MS. HUANG: I'm sorry. Which page of A-B?

MS. MCELHATTON: Thirty-four. It starts on page 34. This -- these are questions and responses regarding Communication Workers of America. AT&T posted its answers to questions.

MS. HUANG: Judge Hosey, if -- if I may -- may I explain to Ms. Biry what this document is so she understands what she's looking at?

JUDGE HOSEY: Sure. Yeah. Go ahead.

MS. HUANG: Okay. So this is Exhibit A-A -- I mean A-B, which is a document that Respondent prepared during the protest of this matter. So, what Counsel is -- is asking, is asking you to look at the quotes from -- I think you said Workers Communication --

MS. MCELHATTON: It's from --

MS. HUANG: -- Communication Workers?

MS. MCELHATTON: -- the Communication Workers of America.

MS. HUANG: Okay. So that they found -- and we don't have a copy of, but she's gonna ask you about what's

quoted in here.

MS. BIRY: Okay.

MS. HUANG: So it's page --

MS. MCELHATTON: Thirty-four, 35, and 36.

MS. HUANG: Thirty -- okay. So here we are.

BY MS. MCELHATTON:

Q Okay. Now, according to this regarding BellSouth, AT&T was going to make decisions on 401(k) plans, pension benefits, medical benefits, executive benefit plans, retirement benefits, vacation rollover, and salary structure. All those decisions would be made by AT&T; is that correct?

A I'm having to read it. I apologize. I've never seen this before. So, am I understanding that this was a draft of a document from 2006 that was not distributed?

MS. HUANG: This was -- if -- if, you know, counsel may explain better, but my understanding is that this was put out by the Communications Workers of America. So, it's a union website addressing certain questions posed by the members?

MS. MCELHATTON: Yes, and -- yes, they were.

MS. BIRY: I mean, that's what -- that's what it says.

MS. MCELHATTON: Okay. Thank you.

BY MS. MCELHATTON:

Q Okay. Also same exhibit, if you can turn to page 42 of 98. These are December 29, 2006, consent of board of directors of BellSouth corporation to action taken in lieu of special meeting. The merger agreement is the title?

A I'm sorry. I'm not sure where we are.

Q Page 42 of 98.

MS. HUANG: We are on that page, but where -- where on the page are you reading from?

BY MS. MCELHATTON:

Q Okay. This is -- this is all the minutes here. Okay. The paragraph after the names there, and I believe it's bolded. It says, "The position of chairman and chief executive officer of the company shall be eliminated." These are from the board of director minutes of BellSouth and a consent to the board of director minutes. Is that what it says?

A Yes, that's what it says, and --

Q Okay. Thank you.

A -- [INAUDIBLE] CEO.

Q Thank you. All right. Okay. Please turn to Exhibit A-B, page 54. So it's the same exhibit, page 54 of 98. Okay. Okay. And there's the response to IDR No. 059. Do you see that?

A Yes.

Q Okay. And it's -- it says, "When BellSouth and Mobility were acquired on December 29, '06, their existing insurance was canceled, and they were immediately endorsed onto both AT&T casualty and property insurance programs effective that date." Is that what it says?

A It does.

Q Thank you. Okay. And then back to page 42 -- sorry -- of A slash B, 42 of 98. Sorry. Okay. We're there. I'll go up a little more. Oops. There it is. Okay. The next to last paragraph that's right underneath the names that are listed, do you see that?

A Yeah.

Q Okay. And I'm not going to read the first part of it, but it says, "The position of chairman and chief executive officer of the company shall be eliminated." Is -- is that correct?"

A Correct. Same as you asked me before.

Q Oh, is this the second time? I'm sorry?

A That's okay.

MS. MCELHATTON: Okay. Let's see. I'm not going to do that. Okay. Okay. That's it for our questions. Thank you.

JUDGE HOSEY: Okay. Thank you.

Ms. Biry, I'm going to see if there's any questions from the panel, and then we'll take a break.

MS. BIRY: Okay.

JUDGE HOSEY: Starting with Judge Lambert, any questions for our witness?

JUDGE LAMBERT: I don't have any questions. Thanks.

JUDGE HOSEY: Okay. Thank you.

And Judge Gast?

JUDGE GAST: Yeah. I as well don't have any questions at this time. Thank you.

JUDGE HOSEY: I don't have any questions for you either, right now. I really do appreciate your testimony today, though. You are free to leave if you'd like, but you're welcome to stay as well. I know your plans might have changed, your travel plans. But we will take a 10-minute recess and we will return at 11:10.

We're off the record. Thank you.

(There is a pause in the proceedings.)

JUDGE HOSEY: We are now back on the record.

I'm moving to Appellants to begin arguments on Issue One, I believe.

Is that correct?

MS. HUANG: If -- if I may, Judge Hosey. If I could spend just a couple of minutes to ask Ms. Biry about some of the exhibits that Respondent went through.

JUDGE HOSEY: Yes.

MS. HUANG: I promise it'll be short.

JUDGE HOSEY: No. No problem. Go ahead.

MS. HUANG: Thank you. If you can give me one more minute, 'cause I'm trying to organize it so we don't have to flip back and forth. Let me see. Okay. Just a couple of questions.

REDIRECT EXAMINATION

BY MS. HUANG:

Q So, Ms. Biry, Counsel showed you many documents in here -- several documents I should say, where she wanted you to confirm that's what it said. But we -- we will not go through all of them, but I just wanted to kind of go through some of them and maybe have you explain how -- what this means to you. So, looking at -- this is Exhibit D as in David, page 13 of that exhibit. This was something that counsel mentioned earlier about the branding issue.

A Yes. So, I -- I think it's important to note in this memo that this was dated May 21st of 2007, so six months after the deal had closed, and we were -- we had begun our rebranding efforts. It was a multiyear effort. We were taking our time to make sure we had no adverse customer impacts because of the rebranding. And you could see in the quote that I was asked to confirm that Randall,

our chief operating officer said that, "The campaign is performing above levels. The responses are good, and we're moving forward to the next phase."

So the rebranding was not complete. We were testing our way into it, even six months after the merger had closed.

Q Thank you. And now if we can turn you to the next one that was -- that was shown to you, which is still Exhibit D as in David, page 17 of 26.

A This is another example of how we were testing our way into the branding. So, as you can clearly see in February 2007, about 45 days after the deal had closed, the BellSouth bill remained exactly the same as it would have previously; the same BellSouth logo, the same customer charges, the same remittance address. Everything is exactly the same with one small cosmetic change that says, "BellSouth is now the new AT&T," was -- you can see imprinted on the bill even in a different font. So, there was no system integration that had taken place. It was one small cosmetic change in case people had read about that in the press that they would have some sort of connecting point.

Q Okay. Thank you. Let me switch binders here. If I may now turn you to Exhibit A-B as in boy. This is page 42. And earlier Counsel read this part to you

about --

A The position of chairman --

Q Right.

A -- and CEO of the office shall be eliminated.

Q Yes, that's the section. And I believe you were starting to add something to your response?

A Yes. It -- it is very common practice, I believe, probably only -- it's legally required that every publicly traded company can only have one chairman and CEO. So, it's to be expected that the day the deal closed that there would be only one chairman and CEO, and that one would be eliminated when two companies are coming together. It -- it takes no integration for that.

Q Okay. And then if I can turn you to another page of the same Exhibit A-B, page 54, where it talks about insurance. Can you explain to us what this means, the kind of insurance this is?

A Yes. Yes. The policies here that were canceled and consolidated the day that the deal closed are all corporate general liability-type policies. None of the insurance policies that impacted employees were impacted that first year. So, when we talk about things like, Workers' Compensation, it's not individual health care or any individual benefits of employees that were impacted. These are just corporate liability type policies that

would have been consolidated the day -- the -- the -- immediately after the deal closed.

Q Okay. One last question. If I can turn to -- this is Exhibit 47, page 9, where Counsel earlier asked you about the procurement number. If you can explain what that means?

A Yes. So, as I mentioned, we began the integration planning in 2007, and there was some low-hanging fruit that we were able to identify. Some of the things that we just simply stopped doing, like the IT projects on this page. We just found things that didn't have to be done. When three companies come together, you don't have to do three things. So, there was some low-hanging fruit where we just stopped doing things you didn't have to integrate, and we were able to get some cost savings.

Vendors also proactively approached us, and that's what you see here as the procurement savings. Knowing the size and scale of the three companies coming together, there were some vendors that approached us and offered us volume discount type savings because they wanted to attract more of our purchasing -- more of our purchases, and gave us unit cost savings because of that. And that's what you're seeing here. It does not indicate that we had any systems, network, people, or policy

integrations early in 2007.

Q And -- and that actually leads to the next final question. Overall question is, with all the things that Counsel showed you earlier, would that change your -- your view about how little integration there was in 2007?

A It does not change my opinion whatsoever. It is physically impossible that we were integrated in 2007. The scorecards that I've shown to you that I presented in 2008 clearly reflect that the integration was not complete, and I was not dismissed from my position of integration responsibilities until 2009.

MS. HUANG: Thank you.

Thank you, Judge Hosey.

JUDGE HOSEY: Thank you.

Were there any other questions from the Franchise Tax Board before we move on?

MS. MCELHATTON: No. Thank you.

JUDGE HOSEY: Okay. Thank you.

I don't think we have any other questions for you either. Thank you for the clarification, though.

Did you want to go ahead and move on with oral arguments on Issue One?

MS. HUANG: Yes, if you can a few minutes.

JUDGE HOSEY: Yeah. Go ahead. Just go ahead and begin when you're ready. Thank you, Ms. Huang.

MS. HUANG: Thank you, Your Honors.

CONTINUATION OF PRESENTATION ON ISSUE NO. 1

MS. HUANG: So, now we will turn to the -- the argument. As I -- I want to repeat again, that it is important to keep in mind that Respondent is arguing that they were -- that AT&T and BellSouth were instantly unitary on January 1, 2007. And I -- I keep emphasizing that date because that's what they have consistently argued. And this is even in light of the fact that this was the largest telecommunications mergers in history as of that time. Each company itself was a multibillion dollar company. AT&T had close to 190,000 employees, and BellSouth had roughly 63,000 employees. Between the two companies, they had 67.5 million phone lines, 11.5 million broadband users. Yet, Respondent is arguing that these two companies were instantly unitary or operating as one three days after the close of the merger.

This was, as Ms. Biry said, this was just simply impossible. The -- there was no premerger planning. The HSR Act prevented any integration activities between the companies. The law required that they remain separate and independent competitors until regulatory clearance. The FCC did not give its approval until the end of 2006 -- December of 2006. As Ms. Biry said, she did not expect it

to be approved when she went off to -- for the holidays in 2006, but it was. You know, the regulatory process took a while. And during all that time, AT&T and BellSouth had to continue to operate as separate companies. They could not share any competitive, sensitive customer information or about their operations. And this was all because of antitrust laws.

So, as I said or as Ms. Biry testified, there was no premerger planning between the two companies because any discussion would have violated antitrust laws. The merger Playbook that she and her team put together was one side, and it was done without any input from BellSouth. There were many assumptions used, and the assumptions were based on their own industry knowledge or public or non-confidential information. While there were some meetings -- general meetings between AT&T and BellSouth premerger, they were high -- they were strictly monitored by both, you know, antitrust counsel on both sides. And to -- not only what was discussed but any documents shared.

So, they could not discuss forecast, future plans, employees, compensation, employee contracts, vendor contracts, marketing plans, or any other non-public confidential information. In other words, AT&T and BellSouth were not legally allowed to share during the

premerger period any information that they would need to plan for operational integration of the two large-scale telecommunication companies that each on their own had extensive and complicated networks.

AT&T recognized the risk associated with this integration. In its Form 10-K for the fiscal year end of December 31st, 2006, AT&T noted that, quote, "The following factors would cause our future results to different materially from those expressed in the forward-looking statements. The impact of our acquisition of BellSouth, including the risk that the businesses will not be integrated successfully, the risk that the cost savings and other synergies from the acquisition may take longer than -- longer to realize than expected or may not be fully realized, and that the disruptions from the acquisition may take -- may make it more difficult to maintain relationships with customers, employees, or suppliers."

So, even back then, the company itself recognized, sure, they have forward-looking statements. But they recognize they were serious risks because they were trying to merge these two huge taxpayers. AT&T's concern regarding the ability to maintain customer relationships was a real one. In a 2005 survey of voice service categories, BellSouth was one of the two companies

that was cited as inspiring customer loyalty. In internet access, BellSouth was one of the three main leaders in the industry. Therefore, it was vital that the transition from BellSouth to AT&T was carefully planned and smoothly executed, so that the disruptions were minimal too, in order to maintain the reputation long nurtured by BellSouth.

And once the merger closed, the Playbook was then shared with their BellSouth counterparts. As Ms. Biry testified, because the merger was prepared without any input from BellSouth, after their review, disagreements arose regarding the suggested timeline, anticipated savings, or even just the tentacle issues needed to accomplish some of those projects. Once these disagreements arose, the BellSouth team was then asked to come up with workable operational plans. And with those plans in place, Ms. Biry then measured all progress against those plans put together by the BellSouth team. Then the -- the Playbook essentially became irrelevant.

The integration process was always planned for a three-year -- as a three-year process. Again, they were trying to integrate two multibillion dollar companies. Ms. Biry talked about integration for these two companies required four components: People, policies, systems, and networks. The people part of it faced an unanticipated

problem, given how huge of their workforce -- I think Ms. Biry said was about two-thirds. In both companies were unionized labor. It added a layer of complications and delays. The operational policies also took time to integrate and implement. The systems also took more than a year to integrate because telecom companies have notoriously integrated -- antiquated systems that face many technical issues and, of course, the physical networks. This is the backbone of the companies, and it took several years to complete, even well beyond 2009.

And also, as Ms. Biry testified, even just the plans to integrate the people, policy systems, and networks took several months. Then the actual -- then after that, the actual integration process took even longer. Before the four components were integrated, BellSouth had to operate independently and separately. They had to manage their own workforce because the contracts were with BellSouth. They were subject -- you know, those contracts were also subject to their own very specific union -- I guess restrictions, I should call it that -- and, you know, which employees could work on which projects. And they -- they were not interchangeable. And BellSouth had run their own systems as they were not integrated with AT&T. As Ms. Biry also testified, she did not even have visibility into who the BellSouth employees

were until a payroll system was integrated on January 30th, 2008.

Based on all the evidence that Appellant has provided and Ms. -- you know, Ms. Biry's declaration as well as her testimony today, it all demonstrates that organizational integration between AT&T and BellSouth did not occur immediately on January 1, 2007, or, in fact, any time in 2007. While the integration planning between AT&T and BellSouth began in 2007, the actual integration of the important corporate and administrative functions did not occur and did not finish until 2008 and beyond. For instance, as -- as we went through with Ms. Biry in Exhibit 47, the BellSouth customer service, payroll, billing, procurement, were not integrated until after 2007. And until the necessary people system networks integration was in place, BellSouth -- BellSouth had to operate independently, and they did. In fact, the day-to-day operations did not change at all on day one or even year one.

So, now in terms of the -- the legal authorities, you know, in Butler Brothers, the U.S. Supreme Court approved the three units test -- three unities tests in determining a unitary -- whether a unitary business exists. Under the test, a business is considered unitary if three units exists: unity ownership, which nobody

disputes; unity of operation; and unity of use. Well, all the evidence and Ms. Biry's testimony here demonstrate that there was no unity of operation or unity of use.

As stated many times, Respondent has said that these two huge, gigantic companies, AT&T and BellSouth were instantly unitary on January 1, 2007. However, even Respondent, in its own Multistate Audit Technique Manual, section 3090 states that, quote, "When a corporation acquires another corporation, a period of time often elapses before enough ties are establishes between the activities to constitute unity." Respondent further states that, "For unity to occur," quote, "the new subsidiary must be integrated with its parents immediately upon acquisition, and integration must have been planned or commenced well before the actual acquisition date."

Did this not happen with the merger of AT&T and BellSouth for all the reasons we've already stated. Under Butler Brothers, unity of operational refers -- generally refers to the centralization of -- or central sharing of administrative and logistical functions. And the unity of use to being said to be the existence of centralized executive force and general system of operations. As discussed, the integration of corporate and administrative functions did not occur until 2008 and beyond. Thus, the unity of operation requirement was not satisfied. The

unity of use was also not satisfied as there was no centralized management.

Regulation 25120(b)(3) states that the centralized management exist when the central executive officers are normally involved in the operations at the various divisions. Centralized management also require that that the central executive officers, quote, "Play a regular operation role in the business activities of the various divisions or affiliates," end quote. At the -- at the level of full time management, this is -- you can find this in Sierra Production and Woolworth.

Then going back to the Multistate Audit Technique Manual, we're now look at section 3075. Respondent also interprets authorities to require, quote, "Their involvement of managers in the significant operation decision with some regularity when it comes to centralized management." None of these requirements existed on January 1, 2007, or at any time through 2007. Rather, what Ms. Biry has testified shows the opposite.

Now, we would like to -- I would like to turn to -- to Tenneco. So, the our -- the finding of the non-unity is supported by Tenneco. In Tenneco, as you may remember, the Court rejected centralized management claim despite the following activities, and there are many. Corporate-Wide Policy and Procedures Manual existed.

Corporate-wide performance planning and evaluation system was in place. Each division had an assigned executive VP with -- with authority over its overall affairs. There was an annual planning process. There was internal audit, financial strategy with targets and dividend payout ratios, approval of major capital expenditures, external financing, cash management, real property in disposition, guarantees of loans, advances to and from divisions, overruling subsidiary ideas, common employee benefit plans, common legal, tax, insurance, and advertising departments, maintenance of contracts, rental car discounts, flee auto leasing, corporate travel discounts, maintenance of scholarships, and matching gift programs.

All these things we do not have in AT&T and BellSouth in 2007 and certainly, not on January 1, 2007. And despite all these, the list of ties between the entity, you know, that -- the activities here, the centralized management activities listed by the Tenneco court. The Court found that the -- the activities to be the kind of behavior that one would expect to find in any parent subsidiary or parent division relationship.

In this case, the connections between AT&T and BellSouth on January 1, 2007, or any time in 2007, pales in comparison to those in Tenneco. The courts have consistently held that businesses cannot be combined

merely on the basis of any contacts between the companies in question. Rather, the businesses must be truly integrated in a way that is meaningful in light of their sizes, and that they must exhibit substantial interdependence and flow of value. AT&T and BellSouth could not and were not integrated on January 1, 2007, a mere three days after the close of the largest communications merger in history.

BellSouth continued to operate independently throughout 2007, as Ms. Biry testified. And they were in charge of their own day-to-day operations. Things did not change. They couldn't change because the systems weren't in place. The people weren't in place. The networks weren't in place. In sum, while AT&T did begin its integration process in 2007 with BellSouth, due to the size and complexities of the two businesses, it was simply impossible for there to be instant unity or even unity within a year of the merger.

Thank you.

JUDGE HOSEY: Thank you.

Okay. It's currently almost 11:40.

Franchise Tax Board, did you want to begin your oral arguments on Issue One and maybe take a little bit of a later lunch break, or would you like to break for lunch now and then start oral arguments on Issue One? We're

planning to take about an hour break. So --

MS. MCELHATTON: Excuse me. Our argument is about an hour.

JUDGE HOSEY: So, that put it us at like 12:37 for a lunch break.

MS. MCELHATTON: That's -- that's fine for me, but I don't know about everyone else.

JUDGE HOSEY: Well, let me check with Appellants.

What would you prefer, to take a break now, or we have about another hour argument and then a longer lunch break?

MS. HUANG: I think we're okay as well.

JUDGE HOSEY: You'd like to continue?

MS. HUANG: If it's -- if it's okay with the panel.

JUDGE HOSEY: Let me check with my hearings team too.

I'm hearing no objections. So, let's go ahead, and we'll start with Franchise Tax Board's oral arguments Issue One. If we do need to take a break, please just let me know, and we can reconvene.

Ms. McElhatton, you can begin when you're ready.

MS. MCELHATTON: Okay. Great.

JUDGE HOSEY: Thank you.

MS. MCELHATTON: Thank you.

PRESENTATION ON ISSUE NO. 1

MS. MCELHATTON: Okay. As you know, we have a number of issues today, and I -- I'd like -- before I get going I'd like to point out that Issue One and Issue Three are related to each other. They're related to the December 29, 2006, merger of AT&T and BellSouth. Appellant filed three separate group returns: One for AT&T, one for BellSouth, and one for Cingular Wireless. Respondent, after an audit, put all three companies into the AT&T group return as one unitary combined reporting group.

Issue One is whether AT&T and BellSouth were unitary during 2007, and it is FTB's position that AT&T and BellSouth were unitary. And this is supported by both its pre-acquisition 10 months of planning activities that are extensively detailed in the merger Playbook, and also the dashboards and tables from January of 2008 that looked back at what was accomplished during 2007, and also document the merger activities that occurred in the days immediately following the acquisition. Both the facts and law support a finding that BellSouth and AT&T were unitary immediately after the merger took place and at the very latest by January 1st, 2007.

Before the merger, AT&T and BellSouth each owned and operated Cingular Wireless with AT&T owning 60 percent

and BellSouth owning 40 percent. As one would expect, AT&T and BellSouth were operating the business together. After the merger, BellSouth essentially disappeared into AT&T, and AT&T owned 100 percent of Cingular Wireless. Thus, ownership of Cingular was consolidated under one owner. As a result, AT&T explained in its 2006 SCC Form 10-K that it was able to expand its service offerings into an additional nine states that were formally serviced by BellSouth.

JUDGE HOSEY: Ms. McElhatton.

MS. MCELHATTON: I'm sorry.

JUDGE HOSEY: You can slow down a little bit. We have some time. So, I don't want you to --

MS. MCELHATTON: Oh, am I going fast?

JUDGE HOSEY: Yeah.

MS. MCELHATTON: Sorry.

JUDGE HOSEY: Just following along. We have the slides and everything out here but --

MS. MCELHATTON: Okay.

JUDGE HOSEY: Thank you.

MS. MCELHATTON: Okay. In its 2007 combined report, AT&T excluded its recently acquired 40 percent interest in Cingular. As mentioned earlier, as reported, there were three separate combined reports: One for AT&T, one for BellSouth, and one for Cingular, sometimes

referred to as AT&T Mobility or AT&T Wireless. Starting in 2008, all entities were included in one combined report. So, the issue of unity is only for the year 2007, and the question is whether these three combined reports should really be one combined report.

So first, let's talk about the law briefly. There are a number of presumptions that apply on these facts. First, FTB's determinations are presumed to be correct, and it is Appellants's burden of proving by a preponderance of the evidence that FTB's conclusions are incorrect. Then we have presumptions at Regulation 25120(b) as in boy, two of which apply here. There's a presumption of unity when the two businesses at issue are in the same general line of business, and there's also a presumption of unity if there's a showing of strong centralized management. If either of these two presumptions are shown with specific concrete evidence, then the businesses are presumed to be unitary.

The opposing party may overcome the presumption with the showing of concrete evidence that a single integrated economic unit did not exist. Once rebutted, the presumptions under Regulation 25120 disappear, though, the presumption that FTB's determinations are correct, it remains. Since Respondent has established, through extensive briefing and exhibits, that AT&T and BellSouth

were in the same line of business, and AT&T and BellSouth had strong centralized management, the presumptions under section 25120(b) had been met, and the burden is on Appellant to prove that a single unitary enterprise did not exist.

Then we have two alternative tests for unity. They largely overlap, and these are the same tests that will be applied for Issue Three, unity of AT&T and Cingular. So, first we have the three unities test, which looks at unity of ownership, unity of operation, which is centralized purchasing, management, accounting, and unity of use, which is centralized executive force, and general system of operation.

Then we also have the contribution or dependency test. This is explained at Regulation 25120(b) where it states that the activities of the Appellant will be considered a single business if there is evidence to indicate that the segments under consideration. So, here, that would be BellSouth and AT&T -- are integrated with dependent upon or contribute to each other, and the operations of the Appellant as a whole. For our purposes, we will focus on the contribution or dependency test, but the same facts go into both tests.

Now, here's a brief outline of my argument. First, I'll have a short summary, and then I'll discuss

why AT&T and BellSouth became instantly unitary upon merger or at the very latest by January 1st, 2007, and the many ways that AT&T contributed to BellSouth during 2007. The evidence provided establishes that significant planning for the merger took place during 2006 and starting on the date of the merger, operational integration occurred between BellSouth and AT&T, supporting a finding that they were unitary during 2007. AT&T was contributing to BellSouth by consolidating operations and capitalizing on efficiencies, and BellSouth was depending on AT&T. BellSouth and AT&T were in the same line of business, and were governed by strong centralized management during 2007, giving rise to presumptions of unity.

AT&T had experience in the telecommunications industry, the same industry as BellSouth. And, in fact, AT&T had recently gone through a merger with SBC. What happened there? SBC purchased AT&T, and then it changed its name to AT&T. So, it had experience integrating with another business. I have listed a sampling of the immediate changes that took place after the merger. BellSouth CEO and chairman positions were left vacant. Authority over BellSouth moved to AT&T on day one.

They had bundled billing, instant messaging and email between the three combined companies, renegotiated

and shared contracts, merger of corporate functions, including legal, finance, labor relations, external affairs, corporate development, human resources, and corporate communications, merger of departments and IT systems, workforce integration, consolidation of financial and workforce data, merger of BellSouth into AT&T staffing and hiring systems, integration of BellSouth, so BellSouth could use AT&T's systems and facilities for training, consolidation of diversity, affirmative action, equal opportunity, and ethics departments, consolidation of payroll of systems, consolidation of benefit plans, benefit programs, benefit practices and procedures, all under the purview of the AT&T vice president and chief financial officer and the senior executive vice president of human resources and communications of AT&T. This AT&T executive had the power and the authority to administer, amend, merge, or terminate the plans to appoint and remove members of the administrative committees and claims administrators for the plans, and to allocate plan administrative responsibilities, all as of January 1st, 2007.

Now, we're going to look at instant unity. This simply means that AT&T and BellSouth were unitary, either as of the acquisition date, December 29, 2006, or by no later than January 1st of 2007. And first we'll take a

look at some of the case law. We have appeal of Atlas Hotels, and this case is also going to be discussed for Issue Three. This is an instant unity case where the State Board of Equalization found the newly acquired Picnic 'N Chicken, which I will refer to as P 'N C, to be instantly unitary with Atlas Hotels. Atlas was both a hotel and a restaurant business and thus, acquiring another 20 restaurants for Picnic 'N Chicken was an operation that was in the same line of business as Atlas.

Atlas immediately assumed the top two positions at P 'N C, took over control of the P 'N C board of directors, took full control over P 'N C expansion activities. The duties of the P 'N C holdover management were limited. Atlas immediately took charge and combined several service functions, providing for a substantial transfer of intercompany services. In addition, there was also an immediate infusion of capital. Atlas and P 'N C pension plans were consolidated. P 'N C legal and accounting was moved to the firm that Atlas was using, and common insurance was obtained.

There was minimal intercompany product flow, but the board found substantial transfer of intercompany services. In addition, an important point to make is that some of the changes that occurred when Atlas Hotels took over P 'N C did not happen immediately, but they occurred

over time.

Now, here we have a comparison of the facts on appeal to those in Atlas Hotels. I've included some examples from the facts in the right-hand column as they compare to the facts of Atlas regarding instant unity. There are many more instances than I had room on the table, so this is just a sampling.

First, Atlas integrated its executive force with common officers. We have similar integration in the present appeal with the CEO and the chairman positions at BellSouth being left vacant. And both BellSouth and AT&T executives were appointed to executive positions for the new AT&T Southeast, which was formally the BellSouth operation. There was a large exodus of BellSouth executives, which left vacancies that were filled by AT&T. Then Atlas assumed the top two executive positions at P 'N C. For the case on appeal today, the CEO and chairman positions were left vacant, and all authority over BellSouth was delegated to AT&T immediately upon merger.

Atlas and P 'N C had intercompany financing. In the present appeal, AT&T provided BellSouth with funding on a daily basis, which BellSouth used to fund its subsidiaries. In addition, the BellSouth treasury department was combined into the AT&T treasury operation

during 2007. Atlas and P 'N C shared intercompany services. There were too many shared services between BellSouth and AT&T to list them all on this table, but I have just a few examples. Accounts payable for the three companies were consolidated soon after the merger, and there was immediately offered combined billing and shared billing statements.

Atlas expanded its business by acquiring P 'N C. In the present appeal, AT&T expanded into the former BellSouth territory and provided broadband access in remote and rural areas there. Atlas had control over the P 'N C board of directors. In the present appeal, AT&T executives were appointed to be directors of BellSouth, and BellSouth board of directors delegated authority over BellSouth to two AT&T executives. Thus, AT&T had control over BellSouth and its board of directors.

For the Atlas acquisition, the holdover P 'N C management had limited duties. In the present appeal, the top positions at BellSouth were left completely vacant. So, there was no upper management for BellSouth. Atlas changed P 'N C operations. In the present appeal, there were 22 consolidation projects that were completed during 2007. There are too many changed operations to list them here, but I included a sampling.

We have Atlas immediately taking charge of

P 'N C. In the present appeal, the CEO and chairman positions at BellSouth were left vacant, which means that AT&T completely took over the management at BellSouth. In addition, all authority over BellSouth was immediately delegated to AT&T.

Atlas combined service functions. In the present appeal, there are too many combination of services to list them all, but I have a few examples. Branding and advertising were combined. BellSouth traffic was moved from third-party carriers to AT&T networks. Cingular traffic was moved to the AT&T backbone. AT&T access in the Southeast was moved to BellSouth networks. AT&T labs where research was done became a shared department immediately.

For Atlas, pension plans, legal and accounting, and insurance were combined. For the current appeal, BellSouth delegated all authority for benefit plans, programs, practices and procedures to AT&T senior executive vice president and chief financial officer. Also, the AT&T CEO was appointed as the only member for the HR committee and the BellSouth merger committee, and was delegated authority to make all decisions regarding options, restricted stock, performance shares, terms of all benefit plans for BellSouth. BellSouth and Cingular insurance policies were canceled as AT&T added them to

their own existing policies.

Now, let's discuss another instant unity case, and that's Appeal of Dr. Pepper Bottling of Southern California. And I will return -- refer to Dr. Pepper Bottling company as DPC. So, what we have here is Dr. Pepper Bottling Company acquired DPSC. DPSC had formally been a licensee of DPC. While DPC manufactured soft drink concentrates, DPSC manufactured bottles and cans and distributed soft drinks. So, the two entities were vertically integrated and already conducting business together prior to the acquisition. There was a small amount of intercompany sales. And in addition, after the acquisition, DPC replaced DPSC's officers and directors, and put in its own plant manage as DPSC president.

The State Board of Equalization found DPC and DPSC to be instantly unitary and specifically held that the determining factor for when a combined report is required is the date when sufficient unitary ties exist. In Dr. Pepper, there was unity as of the date of acquisition because the entities had already been operating a business together. The Board also found it significant that DPC had replaced DPSC's officers and directors with its own people and used its own plant manager to serve as the DPSC president.

Now, I have another comparison for the facts on

appeal to those in the Dr. Pepper Bottling Company case. As you can see the facts are far more compelling in today's appeal on the right side, because the underlying facts at AT&T and BellSouth directly fall within two of the Regulation 25120 presumptions, same line of business, and strong centralized management. Whereas, Dr. Pepper had just the one presumption, which was vertical integration. For Dr. Pepper, there was a small amount of intercompany sales. But in the present appeal, BellSouth and AT&T were literally merged together so the departments and operations were shared, which is a step beyond intercompany transactions since they were literally operating together.

I listed out a few examples of how BellSouth and AT&T operations were merged, such as AT&T taking over the BellSouth licenses, co-branding and shared advertising, renegotiating vendor contracts, sharing communications between AT&T, Cingular, and BellSouth, and more. Another fact that the Board found significant was that DPC and DPSC were already operating a business together. We have that same situation here on appeal. AT&T and BellSouth jointly operated Cingular and also the Yellow Pages.

For Dr. Pepper, officers and directors were replaced with DPC executives. The same occurred in the present appeal. The CEO and chairman positions at

BellSouth were left vacant, and AT&T executives were put in charge of BellSouth operations as of the merger date. As we've documented, AT&T was making the major policy decisions for BellSouth as soon as the merger was executed.

These instant unity cases focus on three things: Integrated executive force, intercompany financing, and intercompany services. The facts established in today's appeal demonstrate that there was an integrated executive force with strong centralized management during 2007. AT&T was investing millions of dollars to integrate BellSouth, spending $183 million during 2007 alone. There was significant reduction of personnel in some areas, and then there was an addition of personnel in other areas where more labor was required to merge and enhance operations. However, overall for the AT&T and BellSouth merger, the savings and labor was $360 million for 2007. AT&T provided funding to BellSouth on a daily basis starting on January 2nd, 2007, which BellSouth used to provide funding to its subsidiaries. These amounts were expended to make AT&T and BellSouth more efficient as a merged operation. To cover BellSouth's financial needs, AT&T increased its revolving credit from $6 billion to $10 billion before the merger even took place.

For intercompany services, there was

consolidation of BellSouth with AT&T for many segments of the combined operation as will be discussed in more detail in a moment. By consolidating BellSouth with AT&T, the newly combined AT&T was able to eliminate several thousand staff positions during 2007.

Now, let's take a look at premerger planning. Premerger planning is evidenced in the merger playbook, also SCC filings, AT&T press releases, and board of director minutes. The easiest part of BellSouth to immediately integrate as Cingular because AT&T was already a 60 percent owner of Cingular and had already been jointly operating that wireless business. When AT&T originally acquired its 60 percent interest in Cingular in 2004, AT&T's SCC filing testified that AT&T and BellSouth worked together to maximize the business strength and value of Cingular as a complement to the AT&T and BellSouth business operations. This was dated May 10th of 2006, AT&T SCC Form S-4/A.

Appellant argues that premerger planning was statutorily prohibited under the Clayton Act. However, if you read that Act, it does not prohibit communications between the merging parties or prohibit integration planning. It simply cautions parties about the risk of sharing information. The Act recognizes a legitimate need to access detailed information about the other party's

business in order to negotiate the deal and implement the merger. Accordingly, AT&T was able to engage in an integration planning during 2006.

Appellant also cites to section 272 of the Communications Act of 1934 as restricting in-region long distance services between calling areas, and that they had to be provided through separate corporate affiliates. However, this Act sunset prior to the merger and therefore, did not provide the asserted restriction. In addition, only limited projects were held in abeyance for Section 272 concerns. Hence, extensive planning occurred during 2006. There are voluminous facts that had been provided during briefing regarding the amount of planning that occurred prior to merger. To be instantly unitary, there must be significant planning prior to the merger, which we have seen.

Integration planning started March 6, 2006, 10 months prior to merger in a joint AT&T and BellSouth phone call. You can see the items that were discussed in that call on the slide. Thus, while AT&T would have us believe that they were not planning the integration prior to the merger, interactions were taking place and these integration activities were clearly documented. Also, on March 6, 2006, AT&T notified the SCC that it would be integrating BellSouth in early 2007 and leveraging its

experience from recent mergers that required integration. The estimated cost synergies were at $600 million. You can see the areas of synergies on the slide.

Three weeks later, at the end of March 2006, AT&T filed a more detailed integration list with the SCC BellSouth also provided its reasons for entering into the merger as you can see on the slide. In another March 31st, 2006, SCC filing, a request was made to transfer control of AT&T licenses and authorizations that were held by BellSouth. Note the date, March 31st, 2006, transfer of control of AT&T licenses and authorizations that were held by BellSouth also transfer control of Cingular and its subsidiaries to AT&T. This preplanning allowed for a smooth transition December 29, 2006. Even as early as May 10, 2006, the AT&T SCC form S-4/A explain the governance of Cingular.

Prior -- prior to this merger when AT&T originally acquired its 60 percent share of Cingular in 2004, Cingular executives from AT&T and BellSouth worked together to maximize the business strength and value of Cingular both on its own and as a complement to the AT&T and BellSouth business operations. This was the situation before the merger. BellSouth and AT&T were already in business together running Cingular and also the Yellow Pages joint venture that was also -- that was established

in 2004.

The level of integration planning is evidenced by the merger Playbook, which lays out what AT&T expected to accomplish, and it sets out the time frames. So, it has day one, first week after the merger, 30, 60, and 90 days after the merger. The detail is too voluminous to all be included in oral argument, however, I encourage you to review the merger Playbook which is at Exhibit B as in boy, and all the details are there; but I'll provide some highlights. On day one after the merger, the corporate communications plan, there were involved emails to all employees, links to an intranet web page, news releases announcing the transition and rebranding of BellSouth and Cingular and a special merger media web page, a customer FAQ web page, a broadcast from BellSouth headquarters to 185 BellSouth locations, and unveiled the new AT&T logo on the BellSouth building. This is day one.

For financial plan, as soon as the merger closed AT&T began receiving historical data from BellSouth and Cingular, ports MR2000 reporting system. Current data was also to be transmitted and then both historical and current data would be stored in the AT&T enterprise data warehouse so reports could be generated. Also on day one, AT&T had an HR merger plan that required BellSouth to use AT&T's approved process for internal and external

management for all new positions after the merger. Compensation for BellSouth employees was to follow AT&T's process after the merger. For HR service delivery and HR merger website was operational day one to provide guidance on new policies and procedures.

Also for day one, BellSouth, AT&T, and Cingular were allowed access to the different platforms. Training paths were designed for each individual employee with AT&T facilities to be used for training to the extent possible. AT&T was also to track all course completions across the merged entities. For diversity affirmative action and equal employment opportunity and ethics programs were merged as set forth on this slide. For EEO Ethics on the first day, current investigations of complaints were to be transferred to AT&T's EEO managers and HR, so all three companies had the same process and reporting.

For policy, BellSouth and Cingular were to follow the AT&T paid time-off policy right away. Management surplus guidance were to be called -- consolidated. Out-placement career transition functions were to be standardized across the merged entities. For a surplus, BellSouth's surplus operations were to move to AT&T's management surplus guidelines with consolidated procedures by January 1st of 2007.

Now, let's talk about week one after the merger.

The chief technology officer provided a detailed timeline on how integration would work. For network operations and planning, there were job aids to address misdirected calls and how-to questions for several areas laid out on the slide, a phone message announcing the new company and leadership visits to BellSouth and Cingular. For IT, milestone management, budget oversight, and scope management were to be aligned between the three merged companies. In addition, a tracking or reporting mechanism for leadership was to be completed in the first week after the merger. For online activities, prior to the merger, the three companies were coordinated for email and internet and intranet content.

In the first week after the merger, AT&T implemented its co-branding for the AT&T and BellSouth websites. There was also cross branding for BellSouth enterprise customers informing them that BellSouth was now a part of the AT&T group. BellSouth was able to use AT&T platform such as presales tools allowing BellSouth access to AT&T customers. BellSouth and Cingular employees were able to AT&T's instant messenger platform.

All three companies had access to the combined global address list. Contract renegotiation occurred to extend AT&T's contracts to include BellSouth. And also by the end of week one after the merger internet voice

protocol systems were merged into one system. BellSouth data was added to the AT&T marketing campaign tools.

Now, let's talk about 30 days after the merger. We have an entire list of projects to be completed within 30 days after the merger. These include network operations and planning, network planning and engineering. Also, within 30 days after the merger, there were IT projects, a project for AT&T online, and a billing operations project with details on the slide. Also, during the first 30 days after the merger, the BellSouth website was integrated into the AT&T platform which required a greater capacity and sufficient hardware. For IT operations within 30 days after the merger, there was one incident change management process for all three companies. And Cingular's IT personnel were mapped to the AT&T structure to allow for layoff of surplus.

Continuing on with what would occur in the first 30 days, security functions of the combined companies were to have one point of contact and the new organization structure published. Management processes and threat patch procedures were to be aligned across all three companies, and business continuity functions were to be consolidated. For procurement, supplier contracts for all three companies were to be merged. For strategic sourcing the organizational plan to merge sourcing was to be

completed and training for BellSouth and Cingular to learn the AT&T sourcing process was to be completed. Plans were to be finalized to integrate logistics, warehousing, and fleet operations.

BellSouth and Cingular were to be granted access to travel benefits enjoyed by AT&T. At BellSouth/Cingular, suppliers were to be incorporated into the AT&T supplier tables. Finishing up the items completed -- to be completed in 30 days, the combined real estate departments were to have a new general manager. All three companies were to be connected by a shared network with shared drives.

Now, let's move to 60 days after the merger. The IT common process plan was to be executed. The SBC platform was to takeover AT&T and BellSouth customers for a common bundle merchandising page and a 50 stage routing tool. Other activities to be completed in 60 days are listed on this slide, along with ones to be completed within 90 days. This slide finishes up the tasks to be completed in the first 90 days.

Now, I'd like to discuss post-merger integration activities starting with executive management integration. The top positions at BellSouth were left vacant. BellSouth delegated all authority over benefits to an AT&T officer. The CEO was the only member of an HR in

BellSouth merger committees with sweeping authority to make decisions for BellSouth. AT&T directors were added to the BellSouth board of directors, and then BellSouth delegated authority over BellSouth matters to two AT&T executives, including the power to vote, enter into agreements, exercise all rights and powers as the owner of BellSouth. There was also a large exodus of BellSouth executives. And AT&T announced it would be making all decisions regarding 401(k) plans, retirement plans, BellSouth vacation rollover, and BellSouth compensation structures after the merger.

These changes illustrate how AT&T was contributing to BellSouth and also, how BellSouth was depending upon AT&T for its executive management. BellSouth was not operating independently during 2007. Corporate functions for BellSouth were combined with those of AT&T and extensive progress was made on network integration. We know this as after 2007 ended, AT&T reported $149 million savings from merging networks and $129 million in savings for non-labor expense synergies. Other savings are listed on this slide along with measures of what integration was completed.

This slide provides actual integration accomplishments during 2007 with amounts that were saved. Each of these is highly technical, so I'm not going to

read them to, but you can see that significant progress was made integrating BellSouth during 2007. More integration achievements are listed here. One standout was that BellSouth had previously deployed a substantial fiber-rich broadband network through its territory, which AT&T leveraged for its U-verse telecommunication service during 2007. In fact, AT&T had to add 917 employees to implement U-verse for the merged companies. The BellSouth chairman and CEO testified that the merger would streamline and enhance management operations at Cingular. The three companies could combine into a single IP network. A network's operation center consolidation effort took place so that there was only one network operation center rather than the three separate ones with a workforce reduction of 179.

Now, let's discuss customer service and customer experience integration that is confirmed to have taken place. There was an employee reduction by 1,877 positions in the worldwide customer service department. This huge workforce reduction occurred as the merged companies sought to eliminate redundancies and to become more efficient. Call centers were consolidated. AT&T acquired access to BellSouth digital subscriber line systems. A cohesive online user experience was created so customers could find and purchase products and management accounts

online which incorporated co-branding. Customer information services had an employee reduction of 909 for 2007. The reduction for Wireline, Relay, and Coin department was 1,319 full time positions in 2007.

Conversions of AT&T and BellSouth networks into a single long distance network for international traffic. At the end of 2006, so prior to the merger, the DSL IVR Voice Tones and System of Execution project was completed so that legacy AT&T acquired the definition of the BellSouth footprint and obtained access to the BellSouth DSL systems. This integration allowed customers to be transferred between entities. An AT&T splash page was created with links between the different websites for external customer access from day one. Also, for customer service during 2007, BellSouth's system was upgraded so it would notify customers of order completions and appointment reminders to improve customer experience. This was completed in the second quarter of 2007.

During the end of 2006 and early 2007, BellSouth and AT&T teams dealing with hardware at a subscriber's premises that connected to a carrier network were consolidated into a new organizational structure. For finance, there was a workforce reduction of 489 during 2007, and there was finance reporting and workforce data consolidation soon after the merger. AT&T's management

reporting system MR2000 was interfaced with BellSouth and Cingular systems so that it could accept historical and current data. For legal, there was a workforce reduction of 31 in the legal division for 2007 and 9 for 2006.

Continuing on with post-merger integration activities, for treasury, after the merger AT&T provided funding to BellSouth daily. And in fact, took out a larger credit facility moving their previous credit facility from $6 billion to $10 billion in revolving credit to replace BellSouth's existing credit facility. BellSouth was depending on AT&T for its daily financing. For human resources, also a significant workforce reduction occurred during 2007. For management staffing, after the merger, BellSouth management staffing was integrated into AT&T management staffing, and BellSouth was required to use the AT&T approval process. For out-placement and career transition, the existing BellSouth contract was expanded to incorporate AT&T, which was to expire at the end of 2006. For training, AT&T provided access to its training curriculum websites for BellSouth.

AT&T was to track course completions for all the merged companies. For benefits, decisions regarding 401(k) plans, retiree benefits, and compensation structures were made by AT&T. And medical benefits were

consolidated into a single plan for the merged entities during 2007. This is -- was said in the November 17th, 2006, AT&T board of director meeting minutes. BellSouth was depending on AT&T to make all decisions in these many areas, and AT&T was contributing to BellSouth by taking over the decisions for these many items.

Continuing on with post-merger integration activities and human resources. AT&T incorporated BellSouth's best practices for its own diversity and inclusion strategy goals and initiatives. In addition, BellSouth's networking groups were merged into existing AT&T resource groups. AT&T's guidelines were to govern all employee resource group activities. BellSouth diversity training was incorporated into AT&T's training as was BellSouth's affirmative action planning. As far as managing content, during late 2006 and 2007 a single tool for managing content was created so that all three companies could share content across sights.

Now, the chief technology officer had its own report in January 2008 regarding what was accomplished to date. Some of the items are listed on the slide, and I'll just point out a few examples. One of the first departments to be integrated was AT&T labs, which performed research. There was significant workforce reduction during 2007 with a savings of $1 million.

Global network operations had a workforce reduction of 1,205 for 2007 with a savings of $2.4 million through consolidations and organizational design efficiencies. There was a large savings of $124.8 million for 2007 for network, property, and equipment, and a significant workforce reduction.

For corporate emergency management, BellSouth was immediately brought into the AT&T corporate business continuity emergency management and response process. In addition, BellSouth was incorporated into AT&T's executive counsel emergency communication center and NSEPP, which means National Security Emergency Preparedness Processes. For information technology, IT was another area with significant integration savings of $130 million for 2007 with a workforce reduction of 1,538. For IT projects, BellSouth and Cingular combined their interconnection development and support teams into an existing AT&T interconnection organization during 2007. On day one the three companies were connected for corporate email WIN, which is Wireless Intelligent Network, active directory, and global address.

Architecture infrastructure was completed September 30th, 2007. Technology standards alignment was completed during 2007 as well. Corporate development and corporate communications and advertising also reported

successful integration during 2007. For insurance, when BellSouth and mobility were acquired on December 29, 2006, their existing insurance was canceled, and they were immediately endorsed on both AT&T casualty and property insurance programs effective as of that date. Through these combinations, integrations, and alignments, we can see that AT&T was contributing to BellSouth by bringing it into AT&T systems.

Now, let's look at procurement. AT&T saved $47 million during 2007 with a workforce reduction of 165 positions. For supply chain, AT&T spent a time during 2006 obtaining the BellSouth and Cingular contracts for major vendors along with other information. By combining supplier volumes purchasing standard products and consolidating suppliers, $166 million in non-labor expense supplier savings occurred.

For logistics, BellSouth fleet systems and purchasing moved to AT&T supply chain fleet operations during February of 2007. This is in response to IDR 037 at audit. For sales, both the consumer and business sales operations met their workforce reduction goals during 2007 with a savings of $42.5 million. In addition, each company was added to the other two company's sales tools so that personnel could cross sell products. In addition, AT&T and BellSouth marketing and sales organizations were

given access to each other's intranet tools.

Continuing on with sales, there were many confirmed consolidations regarding sales, which are listed on this slide, and I'm not going to read them all for you. Some highlights are that BellSouth was provided with a more robust sales assistant tool provided by AT&T for $3.5 million in savings. Also, Cingular was moved to the AT&T and BellSouth's ordering tool for savings of $4.3 million. BellSouth was added to the AT&T sales and care system so that the BellSouth call centers could handle calls no matter where the calls originated from. And finally, in early 2007, the mass market sales operations across all three companies were merged, cutting workforce in half.

For price standardization, a single long-distance products that was provided for the three companies with a shared pricing structure. Broadband pricing was simplified so it aligned with BellSouth's pricing. Also, BellSouth was added to the AT&T fast discounting engine so that it no longer had manually calculate E-rate discounts. For security integration, user and access management, architecture and infrastructure was standardized. And in fact, BellSouth mainframe security was moved to AT&T security system. AT&T's infrastructure had to be expanded so that BellSouth and Cingular users could be added. All

three companies were put on the same security policies, standards and guidelines, and the workforce was reduced.

For perimeter and platform security, there was license savings from having the three companies use the same software. For billing in January 1st, 2007, AT&T press release, AT&T explained that customers could have combined billing for wireline and wireless as of January 1st, 2007. For customer matching, in addition, BellSouth customers matching project mapped BellSouth enterprise customers against AT&T's common customer IDs during 2007. For advertising and rebranding, this began immediately on the day of the merger. On January 1st, 2007, AT&T press release explained that the AT&T name would be heard on Cingular voice greetings.

There would be co-branding on envelopes for bills, and checks would be made out to AT&T. AT&T estimated that about 20 percent of operating expense savings from the merger was going to be from combined advertising. As before the merger all three companies had their own advertising budgets. Retail outlets and employee uniforms were switched to the AT&T brand, and this rebranding began right after the merger.

Continuing on with advertising and rebranding, the BellSouth logo was changed to the AT&T logo on buildings. The nine-state region for -- from premerger,

BellSouth was changed over to AT&T for retail directory assistance, toll branding, and greetings announcements. In addition, on January 12, 2007, AT&T announced a multimedia campaign to transition the Cingular brand to AT&T for all websites, retail stores, company buildings, and vehicles; and that this effort would start with co-branding to transfer Cingular's brand equity to the new AT&T. The AT&T CEO announced in the same January 12th, 2007, press release that AT&T BellSouth and Cingular are now one company, and that they would go to market with their services under one brand. If you review the timeline provided by Appellant at Exhibit D, page 2 of 26, it shows BellSouth co-branding started to be phased out April of 2007 and that the BellSouth name was no longer used as of July of 2007.

Continuing on with -- excuse me -- advertising and rebranding, AT&T announced rebranding success on April 1st, 2007, so that the campaign was able to move the next step in combination of brands. While AT&T began by using ABL south and -- BellSouth and AT&T together in advertisements, it started in April to have AT&T be more prominent. For consumer marketing, flight operations, knowledge ventures, mass markets, intellectual property, and real estate, these were all consolidated between the companies with significant force reductions. BellSouth

was depending on AT&T to make these consolidations for a more efficient merged operation, and AT&T was contributing to BellSouth by integrating these departments.

Continuing with post-merger integration, we have the merger integration update report. During early January of 2008 there was a merger update report. And from this report, we can see that there were significant savings overall of $1.3 billion for 2007. The left table is total overall savings for 2007, and the right table is the non-labor expense savings. Both have what was projected and then what was actually achieved for 2007. As you can see for both tables, the actual figure exceeded what was originally planned for synergy savings for 2007. Understand that there would be no synergy and no integration savings of $1.3 billion during 2007 if BellSouth was operating independently. AT&T's own reports support a finding that BellSouth and AT&T were integrated during 2007.

Let's see how the facts on appeal line up with some of the case law facts. We have Appeal of Sierra Production Service. Appellant cites to this case for a purported requirement that central managers play a regular operational role in the business activities of various divisions or affiliates at the level of full-time management. However, while Sierra managed flights

day-to-day operations, the board never said that such a level of management is required for a finding of unity. That is simply the facts of this particular case. Such day-to-day management is less likely in a larger merger, such as we are addressing today, and is not required for a finding of unity. We have already shown how the chairman and CEO positions at BellSouth were left vacant and how AT&T took over the decision making of BellSouth from the highest levels down to departments that were merged. So the Sierra Production Services case does not support Appellants position.

Let's look at Container Corporation of America versus Franchise Tax Board. This is from 1983. Appellant cites to this U.S. Supreme Court case. However, in Container, a finding of unity between Container and its overseas affiliates was upheld even though the day-to-day management of the foreign subsidiaries was provided by the local managers, and the overall directors and officers did not play an active role in managerial decisions. The Court in Container held that when a corporation invests in a subsidiary that engages in the same line of work as itself, it becomes much more likely that one function of the investment is to make better use, either through economies of scale, or through operational integration, or sharing of expertise of the parent's existing business

related resources.

The -- the difference, and I quote, the Court said, "The difference lies in whether the management role that the parent does play is grounded in its own operational expertise and its overall operational strategy. Mere decentralization of day-to-day management, responsibility, and accountability cannot defeat a unitary finding." Thus, one can conclude from these two cases that day-to-day management is merely one factor to be looked at but is not required for a finding of unity. The evidence supports a finding that AT&T played an operational role for BellSouth as it went much further than establishing general guidelines.

Looking at the role that AT&T played in BellSouth operations, AT&T took over high-level BellSouth executive positions. AT&T filled vacant BellSouth officer positions. BellSouth -- BellSouth left the BellSouth CEO and chairman positions vacant. And meanwhile AT&T appointed executives to AT&T Southeast, which was formally the BellSouth territory. AT&T was making major decisions for BellSouth as of the day of the merger regarding 401(k) plans, pension benefits, medical benefits, executive benefit plans, retirement benefits, vacation rollover, and salary structure.

AT&T merged many departments together

consolidating legal, finance, corporate development, human resources, treasury, and accounts payable during 2007. This does not account for the merger projects that were trimming staffer and aligning the BellSouth operations with those of AT&T. AT&T's operational role contributed to BellSouth, and BellSouth was depending on AT&T for managerial guidance.

Now, let's look at F.W. Woolworth Company versus Taxation Revenue Department of New Mexico. This is a U.S. Supreme Court case. Appellant relies on the Woolworth case where the finding was a lack of unity where each subsidiary operated as a distinct business enterprise at the level of full-time management. It was found that Woolworth had no department or such devoted to overseeing the foreign subsidiary operations. The Court found neither the parent corporation, nor any of the subsidiaries consolidates its tax return with any of the other companies.

The tax manager for Woolworth stated that he did not review the subsidiaries' tax returns or consult with them on decisions effecting taxes. There was no policy of the parent that all the managers of all the operations get together periodically to discuss the over Woolworth operations. The facts on appeal of are very different from those in Woolworth as AT&T took over upper management

and had made plans for 10 months prior to merger how the integration would take place and merged many of its corporate departments.

Now, let's look at Exxon Corp versus Wisconsin Department of Revenue. This is a 1980 U.S. Supreme Court case. The U.S. Supreme Court referred to Exxon in the Woolworth case, and it found that Woolworth differed from Exxon on the facts. In Exxon it said, "The corporation's coordination and services management office was found to provide for the asserted unitary business. Long-range planning for the company, maximization of overall company operations, development of financial policy and procedures, financing of corporate activities, maintenance of the accounting system, legal advice, public relations, labor relations, purchase and sale of raw crude oil and raw materials, and coordination between the refining and other operating functions so as to obtain an optimal short range operating program."

AT&T's facts are more inline with the Exxon's facts where unity was found. AT&T engaged in both short and long-range planning as we have already demonstrated. AT&T literally took over the upper management of BellSouth as we have explained. The merger plan was put into action starting on day one as explained earlier. Thus, AT&T's facts fall inline with the Exxon case where unity was

found.

Now, let's look at Tenneco West Incorporated versus Franchise Tax Board. This is an appellate court case from 1991. Appellant relies on Tenneco for a California -- excuse me. Appellant relies on Tenneco West. Tenneco was in the oil and gas business and argued it was unitary with certain of its subsidiaries that were engaged in ship building, packaging, automotive parts manufacturing, and manufacturing and selling of construction, and farm equipment. FTB's position was lack of unity, which was upheld by the court. In Tenneco the Court found that the excluded subsidiaries had a high degree of autonomy, and Tenneco's policy control was neither strong nor uniform. The Tenneco's president explained that the reason for the autonomy was because the different divisions were in such diverse businesses.

The Court found that Tenneco had only minimal common advertising, with the excluded subsidiaries producing their own product related advertising under their own trade names mentioning Tenneco only incidentally. The Court held that strong centralized management is important to the unitary business concept. The integration of major executive functions is a factor of great importance pointing toward unity; the integration of executive forces as an element of exceeding importance.

It is top level management which is credited or in the case of failure or in different results debited with the effects of corporate enterprises. The major policy matters are what count in our estimation of integration.

The evidence was that there were insubstantial amounts of intercompany sales and insubstantial amounts of common purchasing of raw materials. Subsidiary presidents had authority to enter purchasing arrangements with vendors and to negotiate collective bargaining agreements with unions. In addition, there was a policy that subsidiaries handle procurement of engineered equipment, including mechanical equipment, electrical equipment, instrumentation, valves, packaging equipment, oil well equipment, and farming equipment. The subsidiaries had legal counsel who were employed at the operating division level, with each major division having its own legal staff and addressing its own legal issues. Subsidiaries were to handle their own accident claims, litigation arising out of their operations, and Workers' Compensation claims.

The excluded subsidiaries maintained their own accounting departments and filed their own separate state franchise and income tax returns. The subsidiaries' accounting and financial activities were subject to review by Tenneco and an outside auditing firm, but the Court found that centralized accounting without more is not a

significant unitary factor. The facts in Tenneco are very different from the facts in the current appeal, which we have reviewed in detail. Tenneco can be distinguished on that basis. In the present appeal, AT&T took over and consolidated procurement contracts. AT&T input all intellectual property into a combined database, combined corporate departments, combined insurance policy, and combined operations.

What do all these facts on integration mean? They mean that BellSouth depended upon AT&T, and AT&T contributed to BellSouth in a multitude of ways. I have provided some of the standout integration facts on the slide. If BellSouth was operating independently of AT&T, then why were the CEO and chairman positions left vacant? And why did the BellSouth Board of Directors delegate decision making authority over BellSouth to AT&T executives? If BellSouth was operating independently of AT&T, then AT&T would not be announcing that it was making all major decisions for BellSouth. If BellSouth was independent of AT&T, there would not be co-branding going on during 2007. The BellSouth name would not have been removed from retail stores and office buildings. Names on uniforms and trucks would not be changed to incorporate the AT&T name.

If BellSouth was operating independently from

AT&T, then BellSouth corporate functions would not be transferred over and combined with AT&T's corporate functions. If BellSouth was independent of AT&T, then BellSouth would not be required to use AT&T's hiring and approval system, and supplier contracts would not have to be renegotiated to include BellSouth along with AT&T. If BellSouth was independent of AT&T, then there would be no reason to migrate BellSouth over to the instant messaging system that AT&T was using, nor would there be any reason to combine email systems and global address lists.

Ultimately, AT&T was contributing to BellSouth through all of its consolidation by making the combined operation more efficient. During 2007 BellSouth was dependent upon AT&T for major decisions of consolidation and reorganization of policies, procedures, infrastructure and departments. AT&T contributed to BellSouth by providing upper management, major policy decisions, infrastructure system merger, and many more benefits.

As set forth in the Atlas case, the attributes in the left column are what was present for the finding of instant unity in that case. In the right column is a small portion of what has been established in the present appeal. All the facts would not fit in the table, so this is just a sampling. Respondent has established that these attributes and more were present during 2007, such that

BellSouth and AT&T should be found to be unitary for 2007. AT&T has not established that BellSouth was acting independently of AT&T during 2007, which is what is needed to be shown for a finding of lack of unity.

Instead, we have established shared departments, shared operations, shared executives, shared financing, shared service operations, shared infrastructure, control over BellSouth decision-making, vacant BellSouth leadership, AT&T decision making over BellSouth 401(k) plans, retirement benefits, BellSouth roll over and compensation procedures, shared insurance policies and medical benefits, and AT&T control over BellSouth financing. AT&T was formally operating Cingular together with BellSouth. And after the merger, AT&T simply took over the Cingular operations as the 100 percent owner rather than the 60 percent owner. As in the Dr. Pepper case, AT&T and BellSouth were already operating a business together, which makes a finding of unity more likely. For all these reasons, we urge this panel to find that BellSouth and AT&T were unitary during 2007.

Thank you.

JUDGE HOSEY: Thank you.

All right. I think now it's time for a lunch break. So, we will be taking a one hour recess until 1:40. The hearing room doors will be open 15 minutes

before the scheduled return time of 1:40.

And we are now off the record.

(There is a pause in the proceedings.)

JUDGE HOSEY: We are now back on the record in the Appeal of Pacific Telephone Company.

We are in oral arguments in Issue One. I'm going to rebuttal with Appellants.

Ms. Huang, are you --

MS. HUANG: Yes. I'm sorry.

JUDGE HOSEY: Okay.

MS. HUANG: Trying to turn on the mic.

JUDGE HOSEY: Oh, yes. Thank you. I appreciate that. Please begin when ready.

MS. HUANG: Thank you, Judge Hosey. And if I may just at the start -- if I may ask Ms. Biry to -- to testify to some of the points as well in rebuttal.

JUDGE HOSEY: Yes. Ms. Biry, you are still under oath. So, we appreciate any testimony you can add. We may have other clarifying questions.

MS. BIRY: Okay.

JUDGE HOSEY: Thank you.

MS. HUANG: Thank you.

REBUTTAL ON ISSUE NO. 1

MS. HUANG: So, the first thing we want to

emphasize again, and I know we've said this repeatedly, but I think it's worth repeating is that we are talking about the size of the two companies. These were two massively big telecom companies. They had, you know, had -- AT&T had over 190,000 employees. And like I said previously, that BellSouth had about 63,000 employees. You have, you know, complex networks and antiquated systems that had to be integrated. But they were huge. They -- you know, as -- as I've said many, many times this was the biggest telecom merger in history. And for there to be instant unity, they had to be operating as one, and I should know.

One of the things that Counsel said was that, oh, it's okay, you know, you look -- you choose -- you have instant unity, but you look to beyond that date, you know, sometime in 2007. And -- but I would like to point to once again, the Multistate Audit Technique Manual section 3090. The new subsidiary must be integrated with its parent immediately upon acquisition. And integration must have been planned or commenced well before the actual acquisition date. And to determine -- this is later on in the same section. To determine the point in time when the integration between two activities has developed to the extent that the unity test were met, you must determine the changes have taken places and the dates upon which

those changes occurred.

A lot of the items that counsel mentioned were sometime in 2007, you know. And -- and as Ms. Biry testified earlier and -- and she will confirm again, is that a lot of these things didn't even happen until 2008, and Exhibit 47 shows that. Exhibit 47 was -- what was shown to management when Ms. Biry had to update them on a biweekly basis to see the progress of the integration. So, that is what we should look at. Exhibit 47 is what I would ask Your Honors to really take a closer look.

One of the things also is the Playbook. I know a lot of the items listed by counsel, you know, we have pages and pages and pages of them, and they refer to Exhibit B. Exhibit B is the merger Playbook. And the merger Playbook is something that is, you know, Ms. Biry explained earlier. That was something that was like a guidepost, and it was -- it became irrelevant as soon as the BellSouth team was -- was engaged in a -- in a -- in an integration process, right. So before the merger, there was no input, no discussions. And on that point I maybe should also point out, I know Counsel said that the law did not prevent them from doing it. It only caution against it.

I will point to Exhibit 6, and if I can take just a few seconds to read from this. It says here, "The

antitrust agencies have taken action against companies for unreasonable information sharing." And Exhibit 6 is a document from the Federal Trade Commission. It also goes on to say, "Because sharing too much information during the premerger period could violate the antitrust laws, it is important to have a plan in place to monitor and to control the flow of information." So, this is not just a caution. They could get in -- they could be penalized. Action could be taken against the companies. So, it is completely untrue that they were not prohibited.

As Ms. Biry testified, you had counsel on both the AT&T side and BellSouth side present at all meetings. They reviewed every word spoken. They reviewed every document shared. And if -- if anything was too sensitive, it would go to a clearing room, and it would only be revealed if merger went through. And I should also say that this merger -- while the plan merger was announced in March of 2006, it took quite a long time, nine months, for it to actually be approved. The FCC did not approve it until December -- late December. And then if I -- you know, if I understood correctly, it was, you know, the merger closed within 24 hours. So, there was no premerger planning. There could not be premerger planning.

So, now if I could turn to Ms. Biry again to ask her some questions about what was discussed in counsel's

presentation.

REDIRECT EXAMINATION

BY MS. HUANG:

Q So, one of the things we talked about -- or counsel talked about was BellSouth, and whether BellSouth was operating independently. So, Ms. Biry, if I could, I know we talked about this in your -- your testimony earlier. Could you explain again having heard what Counsel said, do you still believe BellSouth was operating independently in 2007?

A Yes, I do. In 2007 in the beginning of 2007, only minimal activities took place. There was a legal entity combination, which caused us to have one company CEO and chairman of the board. The board of directors was integrated, and the CEO named his direct report team. Every other -- which would be less than maybe 10 people out of 300,000. All of the other 300,000 people kept operating business as usual during 2007.

And the four things that I mentioned before, the things that I would point to, the people operated in their own payroll systems, hiring, firing, and the majority of employees that were non-management retained under their existing union contracts. In a large company like BellSouth and AT&T, its policies that are the governing documents of how people operate, all policies remained

independent at day one.

How you enforce those policies is through systems and controls. All systems remained independent in 2007, and the network as you saw very complex to integrate took several years. So, in my opinion we were operating independently in 2007.

Q And so if they were operating independently, BellSouth was operating independently in 2007, were -- were the benefits consolidated; benefits like medical for instance?

A Employee -- employee benefits were not consolidated in 2007; only the corporate insurance policies that we talked about. If you just think about how normal benefits cycles work, employees start benefit cycles the first of the year. You make your benefit elections in the fall of the prior year. So, the BellSouth employees' medical decisions for 2007 were actually made by BellSouth in 2006. Employees signed up for those in 2006, and they had those benefits for the full year of 2007. There was no employee benefit consolidation.

Q Okay. And then if we could turn to the Playbook. As I noted a few minutes ago, a lot of what was presented by Counsel was, you know, refers to the Playbook. Can you explain again what the Playbook was?

A The -- the Playbook was my work product from my and my team's knowledge of the industry, knowledge from the past merger that we were in the middle integrating, and any information that we could get publicly about BellSouth or nonsensitive information from the lawyer monitored meetings. We were never given any sensitive information. We were never given operating details like people's names, or workflows, or contracts. We were never provided any of that information until the deal closed. These were my aspirations of what timelines would look like, and they are not the way that integration actually happened.

In January of 2007, we printed the Playbooks, shared those with BellSouth employees. They did not see them until 2007. When they did, they found many flawed assumptions that were in our work product. They then started creating operational plans, which they planned to deliver; the integration of the four pillars that we talked about and also achieve the merger synergies. After they created operational plans, we no longer used those merger Playbooks. We used the scorecards that I shared with you. Those are the facts of what actually happened.

Q Okay. Then if I could go to some of the -- couple of other items. And I -- I will not go through the entire deck. I know -- but I would like to talk about

some of those. But first before we start on some of these items, I would like to ask you, Ms. Biry, in terms of the workforce re -- workforce reduction that counsel mentioned, what -- how would you explain that?

A Look, workforce reductions are difficult and an unfortunate part of doing business. Whenever there was an opportunity identified for synergies between the companies, the first thing that we would do is close any job openings so that we didn't hire people if we thought ultimately there would be synergy once the integration functions were completed. The second thing that we would do is not backfill attrition if we thought there was an organization where there would be synergies later. And as a last resort, if it was necessary, there could be workforce action.

What I would tell you is that the workforce -- the reduction was that we talked about earlier from plan of approximately 1,000 employees was a combination of those three factors in areas where we saw once the integration happened in 2008 and 2009 we would be having to take workforce action. So, we tried not to fill vacant positions during that time, such that we wouldn't have to take action later.

When you think about the materiality of this, it is normal for companies, even not in an integration period

to have changes in their workforce. The thousand positions that we talked about is 0.3 percent of the entire company's workforce. It's immaterial and not related to large integration activities.

Q Thank you. Then the other issue that Counsel mentioned was also funding for BellSouth. She mentioned that funding was -- for BellSouth, was on a daily basis. Do you agree that?

A I -- I don't have any recollection of daily funding. What I can tell you is that BellSouth was a solvent company that had positive free cash flow each year. I believe that they were cash flow positive on most days. If there was a day that they needed cash, I'm sure AT&T would have funded them. But it's -- it's not like they were insolvent. They were a very lucrative company that was operating standalone before the merger, was cash flow positive, and was generating cash and managing working capital on their own long before.

Q Thank you. So, if I can just take a few more minutes just to go very quickly through some of these items mentioned by Counsel. Is -- I -- I know this is not evidence but just to make it easier, I'm looking at page 8 of Respondent's PowerPoint. So, here we have what mentioned here what says at the top summary, immediate changes to BellSouth by AT&T; and a list of items here.

And we're gonna go through a few of them to show that these things could not have happened because of the Exhibit 47, which as you explained was prepared -- was your deck where you had to show the -- the -- the progress of all these various projects.

So, I know we talked about this before. So, I will not go deep into detail. But for instance, if we start with instant messaging. You know, we talked about it before about instant messaging where -- if I could find it -- here. This is -- this is page 47 or Exhibit 47. And if I could refer you to that again, if you can remind us. When is instant messaging was supposed to be completed?

A Instant messaging for employees between the companies was supposed to be completed March 31 of 2008. In January of 2008, it was not complete but was on track for the March completion.

Q Okay. So despite the fact that on list -- on this list it says immediate changes to BellSouth, you would completely disagree based on the deck or the scorecard that you have prepared back in 2008?

A If it was completed before 2008, it would have been marked in blue. It was not marked in blue. It was marked in green, which meant that it was on track for the date on the page, which is March 31, 2008.

Q Okay. And I'll just do another one on this page. At the -- the last -- toward the bottom, second to the last bullet point. It says, "Interface of payroll systems." If I can turn you to page 45 of Exhibit 47, at the bottom here. When does it show payroll was supposed to be completed?

A Payroll was supposed to be completed on January 31st of 2008. The program is marked in green, which meant the week prior when I created this scorecard, it was not completed yet but was still on track to be completed January 31st of 2008.

Q Thank you. So this is justice an example of how the list here. We can certainly go through them all, but I'm sure you'd prefer that we don't because you have all this evidence in front of you. This is just a few examples. We think it would be good for Your Honors to see.

And the other thing is I'm looking at page 10 of Respondent's PowerPoint. This is -- looking at this, we're in the middle of No. 8. It says there were 22 consolidated projects for Cingular in 2007. Just as a general comment, does that even seem possible to you?

A It -- it doesn't seem possible. And when I look at the scorecard from 2008, it shows, I think, three projects completed.

MS. HUANG: Yes. And so this is one of the things that we -- I -- Respondent has put this in the PowerPoint, but we have -- we don't know which projects these were. We cannot show that they were not completed. But as Ms. Biry just testified, just base on her knowledge of back then when she was very involved, this was her full-time job tracking these projects, that this could not have happened.

So, then if I can flip again to page 12 where it says, "AT&T and BellSouth were already operating Cingular together as well as Yellow Pages, and Respondent used this as -- as -- as proof or as an argument, as support that there was unity."

BY MS. HUANG:

Q So, Ms. Biry, would it be correct -- is it correct to say when -- when Counsel said that AT&T and BellSouth were running Cingular?

A That is not correct. As the -- the org -- as the ownership chart showed in the PowerPoint, AT&T owned 60 percent of that entity. BellSouth owned 40 percent. It was run as an independent company. AT&T and BellSouth did have seats on the board of directors, but Cingular had its own appointed CEO, CFO, all corporate functions, all their own benefit plans, all their own systems, their own network. As evidenced by some of the merger synergies

they chose business -- not to even do business with AT&T and BellSouth. They did business with other parties because they were run independently.

When the deal closed in December of 2006, we did not integrate any of the Cingular functions with -- with the other corporate units. The Cingular CEO retained his CEO title, and he retained all operating decisions of the company. Nothing was integrated into the other organizations.

Q Thank you. Okay. If I can turn to page 36 of the PowerPoint. Over here in sort of the middle of the page, IT operations day one. IT network connectivity between the three companies, could that have happened?

A It's -- it's physically impossible that that happened on day one. If you look at the scorecard, you will see that very little of the IT work was done until 2008.

Q Would -- and I think you had said this in your prior testimony or earlier testimony as well is that something on network projects could not physically be done so quickly; correct?

A That's right. If you look at the operational scorecard, sometimes just the engineering work took almost a year. So, you have to engineer the network design. You have to order the hardware. You have to find the network

employees who can actually do the work. And then when customers or other systems are impacted, you ever to coordinate with those entities to make sure no one has downtime. Most of the network integration was not complete until 2009.

Q Okay. And one of the last things I'd like you to address, Ms. Biry, is page 41 of the PowerPoint. It says, you know, in -- in this -- in this section talking about advertising, customer communications, and also Counsel mentioned about uniforms at retail stores changing so quickly. It says here on January 12, 2007, they were planning to do this. Do you think all this could have happened within a month of the merger?

A No, it could not have happened within a month. Also, as I mentioned, Cingular retained their own CEO, their own retail store people. Nothing was integrated whatsoever with AT&T. There was also disputes between the companies on branding, logos, colors. If you'll recall, Cingular wireless was a very young and hip brand. They were orange colors. They had the jack that jumped around. They had their own identity.

They were not excited about becoming a big blue globe at the time. And so, there were no -- there were no uniform or decisions like that made because we were even disputing what the logo would be in the store and what the

colors of the store would be because Cingular had their own CEO and their own operations.

Q And then in terms of BellSouth, would you say BellSouth also retained their -- their own retail branding in month one?

A In month one, as I recall, I believe that we changed the sign on the BellSouth headquarters building, but we did not make any changes to the tens and thousands of trucks, thousands of buildings. The bills, as you saw, we just added a "Welcome to the AT&T Family" message. So, substantially they were still operating under the BellSouth logo.

MS. HUANG: Okay. Thank you.

So, now if -- if I may turn back to what we talked about before in terms of centralized management. I know Counsel mentioned in -- in her presentation about how there was centralized management. As Ms. Biry testified, there was no such thing at BellSouth. BellSouth ran on their own. And they operated independently. They did their own day-to-day operations. And sure, the CEO was vacant. As Ms. Biry testified, you -- you have two combined companies. You could not have two CEOs. And, you know, in terms of -- I know counsel also mentioned -- tried to compare it to Atlas.

Atlas is nowhere near the scale of AT&T and

BellSouth. I mean, the -- the -- night and day, right. So, you have two gigantic multibillion dollar telecommunications companies, and we are comparing it to fast-food restaurants and small hotel chain. And -- but even if you look at the facts, even at Atlas, right. So what they had was they -- the -- the -- the business was -- the Chicken and Picnic, C 'N P., they were small enough that when -- when Atlas acquired them, right, they -- the CEO went right in. Like, physically moved into the C 'N P's offices and ran the business.

They immediately started changing things. They changed their menu. They changed it from a drive-through, basically, or take out into a sit-down restaurant. They completely overhauled their business. And prior to that, they -- they had communications. They talked about it, they -- the integration planning. And then, you know, in terms of funding if you recall, in Atlas, you know, C 'N P was near bankruptcy. And so Atlas took over infused capital.

And so this is not what we have, you know. We're not talking about the -- the CEO of AT&T now all of a sudden moving into BellSouth headquarters, and sitting right there, and now running the business. You know, you had combined over 300,000 employees. You know, two-thirds of them still tied to contracts that they could not

change. They had specific jobs that they were allowed to do. And then you have, as repeated many times, systems, networks, policies, people. All these things, these four things had to happen.

And Ms. Biry who was in charge of this whole process said that from the very, very start it was meant to be a three-year integration process, and she was not let go of her position or that role of the -- the full-time role until 2009. And even in 2009, she still continued to do, you know, this and that in terms of integration process. So, in terms of how comparing it to Atlas is very, very different.

And in terms of Dr. Pepper, I know Counsel mentioned how well, you know, they were running business together, and here you have Cingular. The two BellSouth and AT&T were running a business together, and so it's similar. No. Again, very different. Dr. Pepper vertically integrated, you know. So, here we don't have that. And not only that, Cingular, as Ms. Biry just explained, they were not running -- neither AT&T nor BellSouth was running Cingular. Cingular was on its own. It was doing well. It had its own CEO. He has -- it -- it was a separate company. It was a joint venture, but it was a separate company.

And so, comparing it to Dr. Pepper, again, in

ap -- you know, it's -- it's just -- it's inapplicable to -- to our case. And I -- I think I would end would this. It is very -- I -- I would you have the ask Your Honors, if I could say this for the 20th time, we are talking about two massively huge telecommunication companies that there was just no way, impossible, physically impossible logistically impossible to have them combined, and operating one -- as one on January 1, 2007, or any time in 2007.

Where there -- you know, was there some kind of integration going on? Sure. As noted in Exhibit 47 as Ms. Biry explained, some of those things did come -- finish, but they were small percentage of things. And some of those things were, you know, steps in a multistep process. So there was no integration in 2007, and there was certainly no integration in two -- on January 1, 2007.

Thank you.

JUDGE HOSEY: Great. Thank you.

I'm gonna move to Franchise Tax Board. Did you have any --

MS. MCELHATTON: Just a couple.

JUDGE HOSEY: -- response --

MS. MCELHATTON: Just a couple of short comments --

JUDGE HOSEY: -- before we -- okay.

MS. MCELHATTON: -- that won't take but a minute or two.

JUDGE HOSEY: Go ahead.

REBUTTAL ON ISSUE NO. 1

MS. MCELHATTON: Okay. First, I would just like to point out that the Multistate Audit Technique Manual is an internal guideline for auditors and is by no means law. It's not case law. It's not a statute. It's not a regulation. So I would like to point that out. The facts that we have here line up with the instant unity cases that we gave. And so, we would like to point that out again.

And Appellant repeatedly keeps saying that the merger Playbook is irrelevant, and that it doesn't matter. However, it does show 10 months of detailed planning. And I believe, if I'm not mistaken, Ms. Biry was hired in March of 2006, which is right when all of this started in terms of getting -- ramping up for the merger.

MS. BIRY: That's --

MS. MCELHATTON: Correct me if I am wrong.

MS. BIRY: That is in correct. I was hired --

MS. MCELHATTON: I'm sorry. When did you --

MS. BIRY: -- in 1999.

MS. MCELHATTON: No, but I mean moving into the

integration position, I mean. I'm sorry.

MS. BIRY: No. I was already doing the integration from the AT&T merger.

MS. TAMAGNI: According to the declaration that is part of the exhibit folder, it says that Ms. Biry, as of 2006, was part of the integration team. It does not specify what integration team that is. That was part of her role was doing --

MS. HUANG: And -- and that's why she's --

MS. TAMAGNI: -- any integration.

MS. HUANG: Oh, sorry.

JUDGE HOSEY: Can you go ahead and clarify, Ms. Biry.

MS. BIRY: I would love to. I was already in the integration role. My declaration states that after it was announced I was assigned as the lead for this time. I was already in the integration position for AT&T SBC. I think we're splitting hairs.

MS. MCELHATTON: Okay.

MS. BIRY: I think we're splitting hairs.

MS. MCELHATTON: That's fine.

MS. BIRY: I -- I just -- I was already doing merger integration for the prior merger. But when this deal was announced, I was also assigned as the lead for this team.

MS. MCELHATTON: Okay. Thank you for clarifying.

I would like to also clarify that all of the decision making on BellSouth benefits were made by AT&T as of the date of the merger. Okay. And we have heard from Ms. Biry that there could not be two CEOs. So, therefore, BellSouth had no CEO and no chairman. So, then it would appear that AT&T would be acting in that role. And also, AT&T appointed executives to AT&T Southeast, which is the former BellSouth territory. And then I would also like to say that it is not insignificant that the BellSouth sign from the headquarters was removed and an AT&T sign was put up immediately upon merger.

Thank you. That's it.

JUDGE HOSEY: Thank you.

Yes, Mr. Vesely.

MR. VESELY: May I have a word?

JUDGE HOSEY: Of course. Go ahead.

MR. VESELY: I think there's a -- there's a number of things here that we have to keep in mind, and Ms. Huang has mentioned it a number of times. We are talking about two companies that were not only huge, they were complex with businesses that were not exactly the same as the Picnic 'N Chicken business and the Atlas Hotels. There's never been a case decided in California, or anywhere else that I can find, that has an instant

unity been found when you had two companies the size of these two getting together. The argument that the FTB wants to make about this is, frankly, incredibly disingenuous because this is not the same thing whatsoever.

The evidence before the panel here is not only do we have Ms. Biry's testimony, which indeed she was on the ground. She did it there. She was involved from day one and even day one before that. She's talked about that no preplanning of why it couldn't be, et cetera. And the only preplanning was on one-sided preplan, if you will. That is what she has testified. They didn't give the Playbook to -- to BellSouth until after the merger occurred, and then they discarded it.

That's -- that's part of the evidence that's in before you here. And I think that that's really quite important because then it was BellSouth coming up with their own -- I'll call it their plans or operational plans. Those didn't happen overnight. Those happened throughout the months after the merger in -- in 2007 and maybe beyond for all I know. The fact of the matter is I think you got to focus on what are really the facts. What are -- what's the evidence? And I think that we get into all of this. We have Ms. Biry's testimony. We have that scorecard. That scorecard is a wonderful tool for you to

understand when things happened here because the Playbook doesn't do that.

Ms. Biry took her best shot of when things might aspirationally occur when they put together that Playbook. That's -- that's far different, and it's far different to say hey, I started the project here in 2007. But when was it completed? That scorecard gives you dates going all way into 2012 and beyond even for certain of these items. And I think it's really important to go through it, and go through it page by page. Read it. Whatever. And I think Ms. Biry, you know, has tried to give you some sense of all of this.

But I think you got to keep in mind there's no authority that FTB can come up with here about an instant unity finding with businesses this size, this complex. Atlas Hotels, nowhere the same. Dr. Pepper -- to argue that the two companies jointly operated Cingular to get -- to try to fit it into the Dr. Pepper argument, that -- that doesn't make any sense. And Ms. Biry has testified again under oath that no, no, Cingular ran its own shop here. They owned interest in it. No question about it.

But I think you got to really step back and look at what is really the evidence in this case, and you've had an opportunity -- and please ask away to Ms. Biry here because she was there. None of us were there. So, I

think that's really important to keep that in mind. That merger Playbook, wonderful document, but it doesn't tell you when things occurred. It was aspirational.

Thank you.

MS. HUANG: If -- if I may just unrelated point 'cause -- about exhibits. I know at the start of the hearing you had -- Judge Hosey, you mentioned that if we wanted to talk about the weight given to the exhibits. We would still like to object to those exhibits of Respondent's exhibits that Jeff mentioned -- Mr. Vesely mentioned earlier today because they are FTB's own -- they're basically their -- their positions. You know, they're not evidence.

They're -- I mean, many of those documents in there like Communication Workers of America that Respondent quotes quite a bit in their determination letter, we cannot find it, you know. And it wasn't attached to the brief. It wasn't attached to the exhibit. So, things like that, you know, we still believe that no weight should be given to those exhibits, you know, exhibits A-A, A-B, C, and G, because they are documents prepared by the FTB. One is an AIPS prepared by the auditor, and then the other two were prepared by Counsel during the protest process.

And to then to turn around and try to use it as

evidence, that's basically like us submitting something during protest and now we're saying hey, this is our position. Look -- look at the support, you know. That would not be allowed. Why should the FTB be allowed to do that? So, we do not -- we -- we would still object to those documents -- those exhibits being submitted as evidence. And I -- that's it.

Thank you.

JUDGE HOSEY: Thank you.

I'm gonna go to the panel and see if we have questions.

Starting with Judge Lambert, any questions for the parties?

JUDGE LAMBERT: Hi. Yes. I just had one question for FTB that the Appellants were just noting the -- the events in the slides. Some of them occurred like in 2007 or later, and the slides noted how Atlas discussed the changes were, you know, made after the day of acquisition. So, I was just wondering to how should those events after the date be examined, and like what's their significance in terms of determining unity on January 1st?

MS. MCELHATTON: The significance is that Atlas came in and they wanted to change the operations of P 'N C. And so, they could add seating to a few of the

restaurants because they had adequate room, but some of the other restaurants there was not adequate room. So, they had to, you know, change the buildings and add on and those sorts of things. So, that -- those are all changes that took time. And so, that would be our point that everything does not have to be on day one.

JUDGE LAMBERT: Okay. So, but you're saying that the things that happened later, like how do they show that there's unity on day one?

MS. MCELHATTON: Well, there -- we can -- we can look at all of the planning that was done, and then we can also look at what happened immediately, and we can also look at CEO statements. Those -- those are all through our exhibits. And explaining that this was all one company, we're gonna operate as one and then providing the two, the unity program and the universal program that rolled in a Cingular wireless services in -- into a bundled service that AT&T was selling as its own service. These things happened early on. And so, there was enough integration that they should be found unitary for the entire year.

JUDGE LAMBERT: Okay. Thanks. No more questions. Thank you.

JUDGE HOSEY: Thank you.

Okay. Judge Gast, any questions for the parties

on Issue One?

JUDGE GAST: Yeah. This is Judge Gast. For FTB, kind of similar what Judge Lambert was saying. Is there -- if we don't find instant unity on January 1st, 2007, is there another date in 2007 that you think they were unitary?

MS. MCELHATTON: NO. We believe they were unitary on January 1st.

JUDGE GAST: Okay.

MS. MCELHATTON: Like it would I -- it would be arbitrary to choose another date, I think.

JUDGE GAST: All right. Because Appeal of Signal, I think chose a different date. I think it was like three months after the acquisition. I'll ask the same question of Appellants.

If we don't find January 1st, 2008, as the unitary date, is there a date in 2007 that you've -- that you could point to?

MS. HUANG: No. I mean, we -- as we noted earlier, we filed 1/1/08, as you know, because we felt that there was sufficient integration by them prior to 2008. And as Ms. Biry testified and also looking at Exhibit 47, there was -- there were just simply not enough integration. Integration, there has to be -- it has to be meaningful and significant, you know. It -- the law does

not say you cannot have any kind of integration, you know.

You -- you have to have significant -- significant integration for it to be operationally integrated, and we weren't. So that was why we chose 1/1/08. And even as of that day, Ms. Biry who was, you know, on the ground during that time, she thought that was conservative date, you know. So, you know, if -- if it was up to her, she would have picked even a later date.

So, I -- I hope that answers your question, Judge Gast.

JUDGE GAST: Yeah, that -- yes, that does. And then I have a few more follow-up questions. So, what -- I -- I think if I heard correctly, what was a unitary factor as of January 1st, 2007, that was -- was it common insurance? What -- what -- what was integrated as of that date or, let's say, a month after. Because FTB has a lot of facts in their -- or alleged facts I should say, in their PowerPoint presentation. I know you've disagreed with a few of them. Are there any others that you would disagree with or -- you know, because ultimately we have to come to a decision as to what the facts are here.

MS. HUANG: Right.

JUDGE GAST: And it seems like both parties are kind of far apart on that, or at least the significance of them. So, in FTB's PowerPoint presentation, other than

what you've pointed out, do you agree with the other facts in there?

MS. HUANG: No. We do not. We definitely do not. If -- if -- if you'd like us to go through all of them, we can. But I am looking at your faces, and you probably prefer that I don't. But if you'd like us to address anything that really is of concern to you, we can certainly do it now or in a later submission. We do not agree with a majority of the -- of the quote, unquote, "Facts." You know, we only -- I only pointed out to some of them for, you know, in the interest of time.

And -- but, you know, I just want to be very clear. We -- we definitely do not agree with that. And in terms of -- of the insurance, I think Ms. Biry testified that was sort of a common -- you know, sort of corporate insurance, you know, some of that. That -- like I said earlier, you may have some integrating factors, you know, that the law does not say zero. But really, was a significant -- was it sufficient for -- for, you know, instant unity. And I want to bring back to -- to that, you know. Counsel just confirmed once again, January 1, 2007, these two multibillion dollar companies in her mind were operating as one.

MR. VESELY: Judge Gast, if I may too? I mean, I -- I couldn't agree with Ms. Huang more. Excuse me. I

think a couple of things are quite telling. If you go through Counsel's PowerPoint that they just did, and you go through this and you now compare it with what the merger Playbook said, it's remarkable. Now, we didn't go page-by-page on this, but it's remarkable how many of those are in the merger Playbook which were aspirational times of when we'd like to get things done. Ms. Biry can kind of -- I mean, she had explained it great to us earlier. She might have even said it here. You know, these are dates that we wanted to do it. Yeah, as fast as possible. We wanna make, you know, the savings and all this other stuff, but those are not facts of what occurred when of what the FTB is putting into that PowerPoint.

I would -- we would welcome the opportunity to walk you through every fricken' page -- excuse me -- every page of this and tell you that that is not a fact. The book -- the scorecard I -- I have to admit. I never really quite appreciated it until we started digging and getting ready for this hearing quite as much in talking to Ms. Biry. That scorecard has got a tremendous amount of information that's incredibly relevant. For FTB to say that, you know, that they could look to dates after, you know, 1/1 to determine its unitary as of 1,1, that -- there's no law supporting that. There's nothing that supports that whatsoever.

Judge Lambert's question was right on the money. You know, how -- how do you pick a date later on to say that that's unitary than an earlier time. That's not the way the law works here. And that's -- that's -- that's really the flaw in FTB's position throughout this case. And I -- I think that -- and I'm gonna repeat myself, but I really think that it's very critical to go back and hear how Ms. Biry testified. Look at her written declaration. Look -- look at this scorecard there, compare it with the Playbook, et cetera.

And I think those are all the things the facts to take a look at. I don't think just making an assertion that something happened when it -- when FTB says it is. That's not a fact. So, I think that's the part that really bothers us on this frankly.

MS. TAMAGNI: Judge Gast, can I -- I also answer your question? I apologize. Thank you. Just three quick things.

One is we have not presented anything new today. Everything we've presented, everything that's in our slides has been in our briefings. So, to the extent that Appellant disagrees or takes issue with it, you could probably find the response in the briefings. I would direct you to -- to look at that. The second thing I wanted to point out was that in Appeal of Signal, the

company was acquired in May of 1975, and the FTB argued that it was -- the merger should've be -- actually, be in January of 1975.

The Board of Equalization disagreed, and they decided it should be October of 1975. And the reason they picked October of 1975 was because that is when the executive was appointed as the president. And so, it was that change in the executive management. So, that is how the Board of Equalization got to -- to that decision. And when you look at what we're looking at here today, I mean, the executives, that was a point that we've raised is that that happened immediately. So, that is one of the facts that we're looking to in making that instant unity determination.

And then finally, I'd like to point out that there is no threshold requirement under the law that a merger meet a certain number of employees or dollars or the size of the company has to be a certain size. Yes, this was very, very big; the biggest, in fact. But that does not mean that the rules and the law of instant unity do not apply to it.

So that is all. Thank you.

MS. HUANG: Judge Gast, I'm sorry. I hate to keep going back and forth, but if I could -- excuse me. Very short.

I'd like to address the point that Counsel just made about if we didn't object to -- you know, she seemed to imply we should have objected to some of the facts in the briefs. We did not intend on filing a 300-page brief objecting to everything, you know, especially things that we weren't sure where they got it from. So, you know, just because you don't object to something doesn't mean you agree. We certainly said things today, the FTB didn't object either. Can we assume they agree with our facts, you know, with our statements with everything Ms. Biry said? You know, I would -- I would think they would not concede to that point.

The other thing is about the -- the -- the Signal case, again very different, very different cases. You know, you have the executive. Just because they had one executive and the BellSouth executive position was open, that alone itself would not decide this -- that they were unitary on day one. We had -- we have evidence -- submitted evidence, Ms. Biry's testimony today, and it's plenty, you know, evidence here showing that they were not integrated in any way -- any way on day one or even in year one.

And lastly, about the threshold, sure. We're not saying, oh, because these two companies were big so the law should be different. No, we're saying the law should

be the same, absolutely. But not all cases apply, you know. Dr. Pepper, Atlas, you cannot use those facts against these. We're not -- you know, in Atlas they did not have 300,000 employees. They did not have multibillion dollar businesses. That by itself indicate a complex business structure with complex systems. They had millions and millions of customers that they had to switch over. You know, they could not disrupt it. They would suffer reputational harm.

So, when you add all that together, there was simply impossible. You know, regardless of what Counsel argues, you cannot take Atlas, you cannot Dr. Pepper and say, okay, this is how you should decide because over there it was -- there was instant unity. The -- the facts are simply too different. And -- and you cannot ignore the size of these companies, not because they're big so they should be treated differently; but because they were big, they could not possibly be integrated on day one or year one.

Thank you.

JUDGE GAST: Thank you. Thank you. I just have one other question. Hopefully, that this is probably not controversial. So the -- when we say there was a merger, this is not a stock acquisition. This is a merger of BellSouth into AT&T?

MS. BIRY: No. We call it a merger, but it was a stock acquisition.

JUDGE GAST: Okay. So, we're dealing with two separate C corporations for --

MS. BIRY: Exactly.

JUDGE GAST: -- tax --

MS. BIRY: Exactly.

JUDGE GAST: Okay. Thank you. That's all my questions. Thank you.

JUDGE HOSEY: Thank you.

Okay. I might be opening it back up.

So, just to clarify, to evaluate whether instant unity exists, where you consider, you know, extensive or not, premerger integration planning centralized management, intercompany financing, centralized departments, preexisting relationships, right, and we have Dr. Pepper, and we have Atlas Hotels. So, my question is for both parties. How are we supposed to weigh -- are we -- is one suppose weigh more, or are we supposed to look at a bigger picture of these issues?

Or I just want to kind of know kind of -- I think we touched on them a little bit. You know, are we looking at the size of the entities? Are -- are we concerning it all? Is it a facts and circumstances weighing test? Or what is your position on how we take all of these things?

And is one more significant than the other, if that makes sense; starting with Appellants?

MR. VESELY: Yeah. I'll -- let me -- let me start. I -- you can't guarantee that I'm not gonna double team you on this one. I -- you know, obviously it depends on the facts, and that's what we're stressing here, the facts of having these two companies operate as one, 'cause that's really what we're talking about when we're talking about unitary businesses. That's why when you look at something that is -- you know, like the Atlas Hotels, those operations were -- they are what they are, but they're certainly not as complex as we have here. So, the facts are -- are different to look at here.

What -- what we would suggest is that we need to look at what are the key elements of these businesses? Okay. And for, you know, AT&T and BellSouth, clearly the integration of the networks is huge, because they're -- they're gonna have to be able to operate as one in that area and that -- and Ms. Biry can probably speak to this much better than I can. But that's a critical thing to be looking at.

I think it's also looking at the -- as she was mentioning some of the systems there. I think the idea of the HR issue that she's mentioned struck us saying that in January of '08 they're finally are able to -- you know,

who's -- who's making what, and how you do all -- these -- these are important issues. That's what we've to look at. What's the important issues here that would make you want like that? So, I don't think there's -- there's a one size fit all, Judge. I completely agree there.

But I think that it does have to do with what are the facts that have been proven by -- by both sides? What are they? And you know, we do have to weigh them. And I think, you know, our position as you can well expect, is that when we weigh these facts, it ain't happening on 1/1/07, nor is it happening really in '08 -- or excuse me -- '07 all the way to 1/1/08.

That -- that -- that document -- I'm gonna repeat myself for the hundredth time. That document is a great tool to kind of get your arms around what is happening, what's important here, like that. And I think that's why I think the -- the pendulum should go in this direction to be candid with you because this just didn't get to be operating as one that quickly. It couldn't. We've interviewed a lot of people at AT&T in preparation for this hearing and for other things, and the answer has been, "Oh, no way did it happen on 1/1/07. You kidding? How complicated was it?" These are people that worked under the merger under Ms. Biry, actually.

I -- I really think if -- if you would like to

really dig into it, you've got the perfect person to ask the questions to. She lived it. She lived this merger. And I -- I love the fact when she finally said what do you think is the date that we became unitary. So we're not saying we didn't become. I mean, we filed as 1/1/08 as you know. Well, I was kind of relieved of my duties to now go onto do something else like that. Well, that was kind of a nice indicator to us that that's -- you want to pick a date there, Judge Gast? I would say it's probably after 1/1/08, frankly. We're not asking for that. We're just saying 1/1/08.

But I -- I think it's -- it's facts and circumstances. I think you got to look at each case on its own, and that's why, you know, I try to dig into this. I think it's critical -- critical to look at what has been testified to today, and what is actually in the documents there that say the dates things occurred, or when they were going to occur, not -- not the merger Playbook. Merger Playbook is a great document, but that's not the tool here.

JUDGE HOSEY: Thank you.

Franchise Tax Board.

MS. MCELHATTON: Okay. I would say that the standard is of course if there are sufficient unitary ties. That come from the case law. So, then the question

is what you're asking, well, okay, what's sufficient? And yes, you definitely have to look at the facts, but I would not discount the high-level management changes, the fact that BellSouth CEO and chairman positions were left vacant, and that AT&T was basically taking over, and they appointed the CEO and chair for AT&T Southeast, which is the former BellSouth territory. So, who -- who do we have here who's deciding who's in charge? Well, AT&T. That's who we have who's in charge.

And Mr. Vesely said we need to look at the key elements. Well, I would say some of the key elements are the services that were provided to their customers. And I would encourage you to look at the press releases in terms of all the bundled services that were provided during 2007, and that's significant. They were now operating as one company. We have wireless. We have wireline, and we're gonna give you -- we're gonna give it all to you on one bill. And I will say probably looking at the Exhibit 47, the final integration on the billing may have occurred later in 2008, but they -- they were able to do the combined billing. I don't know how they jerry-rigged it or what they did, but they were able to have their systems have combined billing because they -- they offered it, and they announced it to people early in 2007. So the -- this is something that was happening.

And also the data, we know they were combined in their data. They filed together their financial reports. And while the absolute coming into one single system may be happened in 2008, they were feeding that data together from Cingular and BellSouth. They were feeding it into their system so that they could have -- they could compare performance. They could do their financial reports and all those sorts of things. So, the fact that maybe their final system wasn't operational until a little bit later, they were still able to function together. And so I think these are some of the key elements we need to take into account.

Thank you.

MS. HUANG: Judge Hosey --

JUDGE HOSEY: Okay. Thank you.

MS. HUANG: -- if -- if I may?

JUDGE HOSEY: Sure. Go ahead.

MS. HUANG: So, Counsel just made some points that I think we'd like Ms. Biry to explain to be incorrect. So, if I can turn to Ms. Biry.

REDIRECT EXAMINATION

BY MS. HUANG:

Q Counsel, just mentioned about BellSouth, they're Southeast Region and how it was run by AT&T; was that

correct?

A That's not correct. The Southeast Region was run by BellSouth employees.

MS. MCELHATTON: May I interject? And who -- who appointed those executives?

MS. BIRY: Most of them were in place prior to the deal closing.

MS. MCELHATTON: But who -- who appointed those executives after the merger?

MS. BIRY: Most of them were in place prior to the merger.

JUDGE HOSEY: Okay. Thank you. I think I understand where we're going.

MS. HUANG: Then a couple more, if I may?

JUDGE HOSEY: Okay. Go ahead.

MS. HUANG: So, counsel also mentioned that there was one bill because it was announced. A lot of these press releases, I -- I can't imagine that we would use that instead of what actually happened, you know. The Exhibit 47 shows you that the one bill integration could not be done until 2008. And Counsel tried to explain that away by saying oh, maybe the final integration couldn't be done, but they could, you know, jerry-rigged it to make it work.

The bill again, was they -- BellSouth had a great

reputation. They had loyal customers. As I said earlier, they were one of the two companies that inspired the -- the most customer loyalty. If you were a business, would you risk that? You would not. And as -- as -- I would turn to Ms. Biry again.

BY MS. HUANG:

Q Like, why was it -- was it a reputational issue or customer issue if you all of a sudden, you know, had AT&T name on the BellSouth bill?

A Well, I mean, there could be reputational issues, but what would have concerned me more is that people wouldn't have paid their bill. So, most consumers, if -- if you had been paying a bill from BellSouth for years and some day a bill showed up from AT&T, would think I don't think have an AT&T bill that I owe and you may throw it away. So, we would never have changed a bill that quickly. We would have taken time, as the evidence shows, that we would have started introducing the concept BellSouth now part of the AT&T family.

Q And so, was it possible that you could have jerry-rigged something to do it one bill before the -- the billing system was integrated between the two companies? Like, you know, have it say -- have let's say BellSouth bill or AT&T bill containing information from BellSouth and vice versa and sending it to their customers?

A No, we were not -- we were not doing that.

Q And -- and lastly, on the financial reports, Counsel mentioned how maybe can see that that maybe the financial systems were not in place until 2008 but that somehow they were feeding the -- the data. How -- do you know anything about that?

A Yes, I do. The SCC requires as -- as -- Judge, you mentioned that it's a stock exchange. The SCC requires post-deal close that all companies in this situation have to file consolidated financials. And so our SCC reporting team got Excel files -- we had to stitch it together -- got an Excel file at a very high level. Here's my revenue. Here's my expense, and we added those together outside of the financial systems. As my scorecard would show, the financial systems were not integrated to where I could see, analyze, use BellSouth data until 2008, and I think it was near the end. But all companies are required to file consolidated financials when you are one -- SCC, you know, when you are one publicly traded company. And so there was some manual work around done in order to add one and one together.

MS. HUANG: Thank you.

JUDGE HOSEY: Thank you.

All right. Let's go ahead and move onto Issue Two. We will reserve questions for the very end on

all issues for the panel, just if we wanted to revisit some items, but we're gonna try and go ahead and move on to the business income issue. We're gonna go ahead and start with Appellants' argument, if that is --

MS. HUANG: Judge Hosey --

JUDGE HOSEY: Go ahead.

MS. HUANG: -- if I can ask for 30 seconds.

If, Ms. Biry, do you want to -- I don't know if she's comfortable with sitting up here.

JUDGE HOSEY: You can stay. You're more than welcome to stay. Excuse me.

MS. HUANG: I just wasn't sure.

MR. VESELY: Give me a second, Your Honor.

JUDGE HOSEY: Go ahead.

MR. VESELY: Okay. Thank you.

PRESENTATION ON ISSUE NO. 2

MR. VESELY: This -- this issue is an interesting one, to put it lightly, not that the first one wasn't. This is definitely an interesting one.

The -- the question before the panel is, you know, did Respondent err in classifying the dividend income that AT&T received from its minority investments in Mexican entities as business income? Our -- our answer to that is definitely they did. They erred big time.

The -- a little bit of background on this one. In 2011 the Board of Equalization decided the precise issue presented in this case; whether AT&T's dividend income in 2001 and '02 from its minority investments in seven foreign entities should be considered business income. One of those foreign entities is Telmex, which is one of the three Mexican investees in this case. In that case the BOE concluded that the dividend income from these seven entities, including Telmex, should be classified as non-business income wholly allocable to AT&T's commercial domicile in Texas.

Telmex, like I said, is one of the three dividend payors here. The actual decision -- and we've cited it in our briefs -- is actually cited as Appeal of Pacific Bell Telephone and Company and Affiliates, and it was SBE Case No. 521312, and it was decided September 22, 2011. As I indicated, one of the seven entities in that old case is Telmex. It -- interesting thing is that after that decision came down in 2011, the FTB and AT&T entered into a closing agreement for the years 2003 through 2006. The closing agreement covered a bunch of issues. One of the issues was whether the dividend income that AT&T received from Telmex and a related entity, America Móvil -- who we will talk about at length here -- should be classified as non-business income wholly allocable to Texas. And the

answer was yes, it should be classified as non-business income, and the agreement was consistent with the 2011 BOE decision.

For 2007 and '08, the Franchise Tax Board has changed its position and classified the dividends that AT&T has received from Telmex, Telmex Internacional, a third entity, and America Móvil as business income. Now, we've written lengthy briefs on this, and I'm -- I -- we have a lot of paper in this case, and you guys have had the pleasure of reading it. But what we're gonna show today is to not repeat everything we've said, but we will basically show that the FTB has erred. Their position really has no bounds when you start to peel away the outside of the onion here. And it's been rejected by the U.S. Supreme Court, the California Supreme Court, and the BOE. Similar to the BOE's 2011 decision, AT&T's dividends from these three entities do not satisfy the business income requirements under California law, as well under the decisions of the U.S. Supreme Court.

So, the -- to give a bit of a background here of some of the facts, if you will. AT&T Inc. -- and this is where it gets a little confusing. AT&T Inc. and AT&T Corporation -- but let me give -- give you how we got here. AT&T Inc., formally known as SBC Communications, was formed as one of the several regional holding

companies created to hold AT&T Corp's, ATTC local telephone companies. On January 1, 1984, AT&T was spun off from ATTC pursuant to an antitrust agreement. We all may remember that one here.

At formation, AT&T primarily operated five southwestern states. Its subsidiaries merged with the Pacific Telesis Group in California here in 1997, Southern England Telecommunications Corporation in 1998, and Ameritech in 1999, thereby, expanded its wire land -- wireline operations as the incumbent local exchange carrier into a total of 13 states. In November of 2005, one of its subsidiary merged with ATTC. In connection with that merger, AT&T changed its name from SBC Communications to AT&T Inc., the entity that we're talking about today.

During 2007 and '08, the years in question, AT&T had four reportable segments. It had the wireless segment. It had the wireline segment. Those two segments were the most significant for revenue purposes. They accounted for approximately 95 percent of the revenue of the consolidated group. The third segment was the advertising and publishing segment, which had about 5 percent of the revenues. And then they had a four segment that was labeled other. Other is -- consisted of essentially, AT&T's international equity investments,

which would be Telmex, America Móvil, and Telmex Internacional; and they accounted for the remaining one percent of the revenues. So, not really the operational revenues, if you will of the other segments.

Let's talk about the investments in -- in these three entities. They're very interesting. Telmex first was in 1990 AT&T, then SBC, first invested in Telmex as part of its consortium organized with the goal of privatizing and modernizing the Mexican telephone system. It acquired a 5 percent in Telmex at that time. Telmex's by-laws provided that its shares could only be held by Mexican individuals and certain other Mexican institutions. As such, AT&T placed its shares in an irrevocable trust. Under the terms of that trust, it -- its trustee was directed to vote AT&T's shares in accordance with another entity, Carso Global Telecom -- and I'll call it Carso Global today -- and an entity controlled by a gentleman by the name of Carlos Slim Helú, on all matters except for the election of the members of Telmex's board of directors and executive committee.

Mr. Helú, you may have read about him for years. He is -- continues to be the chairman of the board of America Móvil today. He was, at one time, the richest man in the world under Forbes magazine. He is the richest man in Mexico. His family has run these companies for years.

We'll talk about it more.

So, the -- under Mexican law, a foreign investor such as AT&T could not control a Mexican telecommunications carrier. And during -- and during the appeal here, AT&T held a 9.3 percent interest in Telmex. In 2001 and '02 of the years of the BOE decision, it held a 8.1 percent interest. During the appeal here, Telmex was governed by a 14-member board of directors. Carso Global had the right to appoint the majority of the board. AT&T had the right to appoint 2 members out of the 12. The -- majority of the members of the board had to be of Mexican nationality. The director general of Telmex, who was appointed by the Telmex board, was responsible for the day-to-day administration of the board -- of the business of Telmex, excuse me. In light of Carso Global's control of the board, the director general was a Carso Global designee.

Telmex's by-laws also provided for the creation of an executive committee to review the strategic operational financial and investment decisions and to make recommendations to the Telmex board of directors. Pursuant to a joint venture agreement, between Carso Global and AT&T, the executive committee had the power to operate and manage Telmex, except for those powers that the board expressly reserved to itself. The executive

committee of Telmex consisted of four members, three of which were appointed by Carso Global, one of whom was appointed by AT&T.

The types of decisions reserved by the executive committee included major acquisitions, dispositions, entry into new lines of business, capital dispositions, and entry in business plans, budgets, incurring major indebtedness, appointment of the director general, affiliate transactions, dividend policies, among other things. As with the board, the executive committee was controlled by Carso Global again. AT&T had a minority and had non-controlling interest in Telmex. One of the exhibits we have in this case is the Form 20-F, which is a foreign entities counterpart to the 10-K. In Telmex's Form 20-F for these years, the company explicitly acknowledged the control by Carso Global and by Carlos Slim Helú.

The company stated the following in the 20-F, "We are controlled by one shareholder. Carso Global Telecom has the effective power to designate a majority of the members of our board and to determine the outcome of other actions requiring a vote of the shareholders. The protections afforded to minority shareholders in Mexico are different from those in the United States. As a result, it may be more difficult in practice for a

minority shareholder of Telmex to enforce their rights against us or our directors or controlling shareholder, Mr. Helú, than it would be for shareholders in a U.S. company." In all, we talk about one heck of a lot of control in the hands of Carso Global and Mr. Helú.

The second entity in question is Telmex Internacional. In December 26th -- the December 26th of 2007, the Telmex board of directors and shareholders approved a strategic initiative to spin off the Latin American businesses and its Mexican yellow pages business to a new holding company and called it Telmex Internacional. As part of the spin off, AT&T acquired a 9.8 percent interest in Telmex Internacional. AT&T's investment in Telmex Internacional was subject to the same restrictions as its investment in Telmex. For example, pursuant to the Telmex Internacional's by-laws, AT&T shares were required to be put into an irrevocable trust, just like in Telmex.

The trustee was directed to vote all AT&T shares in accordance with Carso Global on all matters except for the appointment of Telmex Internacional's board of directors and its executive committee. As with Telmex, Telmex Internacional was controlled by Carso Global and Carlos Slim Helú. Telmex Internacional's always board of directors consisted of 12 members. Carso Global had the

right to appoint a majority, while AT&T had the right to appoint 2 of the 12 members, just like Telmex. Similar, the executive committee of Telmex Internacional was controlled by Carso Global, who appointed its director general, who in turn was responsible for the day-to-day administration of Telmex Internacional's business. And again, similar to Telmex, in light of Carso Global's control of the board, the director general was a Carso Global designee.

The third entity in question is America Móvil. In September 2000, America Móvil was established when it was spun off from Telmex. The shares were delivered to Telmex shareholders on February 7, 2001. AT&T acquired an 8.3 percent minority interest it America Móvil based upon its preexisting minority ownership interest in Telmex. Again, AT&T's investment in America Móvil was subject to the same restrictions as its investment in Telmex. For example, pursuant to America Móvil's by-laws, AT&T shares were required to be put into an irrevocable trust again. The trustee was directed to vote all of AT&T's shares in accordance with Carso Global in all matters, except for the appointment of America Móvil's board of directors and executive committee. As with Telmex and Telmex Internacional, America Móvil was controlled by Carlos Slim Helú and Carso Global.

During 2007 and '08, America Móvil's board of directors consisted of 12 and 11 members respectively. Carso Global had the right to appoint a majority of the board. And again, AT&T had the right to appoint 2 members out of the 12 and 11 members respectively. Similarly, the executive committee of America Móvil was controlled by Carso Global, who appointed the chief executive officer, who in turn was responsible for the day-to-day management of America Móvil. And again, as with Telmex and Telmex Internacional, given Carso Global's control of the board, the chief executive officer was a Carso Global designee.

Let's take a look at the law here in this area. It is AT&T's position, as I said at the beginning, that its dividend income from its investments in these three entities should be classified as non-business income under the Revenue & Taxation Code and the Regulations there under. Section 25120(a) of the Revenue & Taxation Code defines business income as income arising from transactions and activity in the regular course of the taxpayer's trade or business. It includes income from tangible and intangible property, such as shares of stock, if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

You're gonna hear a lot about integral parts and

integration and things here. Non-business income is defined in section 25120(d) as all income other than business income. Regulation 25120 provides further guidance as to the difference between business and non-business income. It states that business income is defined as income arising from transactions and activity in the regular course of the taxpayer's trade or business, and it includes income from tangible and intangible property if the acquisition, management, and disposition of the property, the shares of stock, constitute integral parts of the taxpayer's regular trade or business operations.

Under both the statute and the regulations, the key inquiry for purposes of determining whether dividend income is business or non-business income, is whether the intangibles, the shares of stock, are integrally related to the unitary business activities of the taxpayer. In this case, as was demonstrated in our briefs that we've filed and as will be shown today, there's a complete absence of the requisite integral relationship between the shares of stock held by AT&T and Telmex, Telmex Internacional, and America Móvil, and AT&T's unitary business. AT&T's holdings in each entity were pure long-term investments. Decisions by the California Supreme Court, the U.S. Supreme Court -- excuse me -- and

the Board of Equalization compelled non-business treatment of these dividends.

Let's look at the California Supreme Court first. The key case in this area is the Supreme Court's decision in Hoechst Celanese versus the FTB in 2001 in which the Court set forth the very clearly the analysis which must be undertaken under the functional test -- transactional test is not in question here, it is the functional test -- to determine whether income from intangibles is business or non-business income. As the Supreme Court stated in analyzing the functional test, the term "integral" provides, quote, "The touch stone for determining whether the property, the shares of stock, has a close enough relationship to the taxpayer's unitary business income, the activities to satisfy the functional test."

The Supreme Court further explain that the term integral in section 25120(a) requires an organic unity between the property -- taxpayer's property and the business activities whereby the property, the shares of stock, contributes materially to the taxpayer's production of business income. The Supreme Court went and then concluded in the -- by saying in the context of the business income definition, the word integral therefore, refers to an organic unity between the income producing property and the taxpayer's business and activities. The

properties must be so interwoven into the fabric of the taxpayer's business operations that it becomes indivisible and inseparable from the taxpayer's business activities with both giving value to each other. In other words, there must be flows of value going on in both directions.

Such a relationship exists -- okay -- exists when the taxpayer controls and uses the property to contribute materially to the taxpayer's production of business income. This is all from the Supreme Court's decision in Hoechst Celanese. Back in -- few years ago, the OTA decided the -- in case on rehearing, and it was a very interesting statement made by Judge Johnson. He said, "The OTA noted that the terms interwoven, inseparable, and indivisible were not sparingly used by the Supreme Court as they appear in the context of defining the functional test, a collective dozen times throughout the decision." Footnote 8 is where that comes from here in that decision.

So, in Hoechst Celanese, it's very important to look at the facts again here. The Supreme Court found that the income producing property in that case was the pension plan and trust. And they concluded -- the Court concluded that it satisfied the functional test because the taxpayer, Hoechst Celanese, created control and maintained the pension plan and trust to retain its current employees and to attract new employees and

disposed of the pension plan assets by reverting the excess funds into his business operations.

Hoechst Celanese's control and use of the pension plan assets contributed materially to the taxpayer's production of business income since they improved the efficiency and quality of the workforce, which in turn generated Hoechst's business income. Thus, the Court concluded the pension plan assets were integral to Hoechst Celanese's business operations because those assets were interwoven into and inseparable from Hoechst's employee retention and recruitment efforts. Obviously, an essential part of any business operation.

Continuing Hoechst Celanese, the Court went onto conclude that not only did the taxpayer receive an operational benefit -- those are its words -- from the pension plan trust, but also the income from those assets served an operational function for the taxpayer; and thus, subjecting the apportionable share of the personal -- excuse me -- pension reversion assets to taxation in California did not violate the due process or commerce clauses. The Court -- the Court said the following, "Here, the income producing asset, the pension plan and trust, undoubtedly served an operational function for Hoechst." The Court went on to say that, "Indeed, Hoechst can hardly claim that the pension plan and trust were

separable from its employee recruitment and retention efforts, a crucial part of its business operations in California."

Accordingly, according to the Court, subjecting an apportionable share of the reverted pension plan assets to taxation in California did not violate the federal due process or commerce clause. So, the requirement that there must be an integral relationship between the stockholding and the taxpayer's unitary business operations before dividends may be clarified as business income is not only based on section 25120(a) and Regulation 25120(a), but also, importantly on a number of decisions by the U.S. Supreme Court, it is that integral relationship which is absent in the instant appeal. Those decisions include Mobile Oil, ASARCO, Woolworth, and Allied Signal.

Let's look at ASARCO first. It's a 1982 decision. It was ASARCO versus The Idaho State Tax Commission. The U.S. Supreme Court rejected Idaho's attempt to tax its business income. ASARCO's dividends were received from five corporations in which it owned between 34 percent and 52.7 percent of the stock, far greater than AT&T's ownership interest in this case. As I said, Telmex 9.3, America Móvil, 8.3, and in Telmex Internacional 9.8 percent. Far greater.

In ASARCO, in addition to the major ownership interest held by ASARCO, there were significant intercompany sales between ASARCO and each of its investees. For example, Southern Peru was one of the entities, and it sold approximately 35 percent of its output to ASARCO, representing between $44 million and $65 million in sales for the years in issue, which in that case were 1968 to 1970. Imagine what those numbers would be today. Another entity, General Cable's purchases from ASARCO, accounted for approximately 6 percent of ASARCO's overall sales and ranged between $31 million and $47 million of ASARCO 's sales. A third entity, Revere Copper had purchases from ASARCO, averaged about 3 to 4 percent of ASARCO's sales. It totaled $17 to $25 million a year. Again, all of these are 1968 to 1970.

In ASARCO, the U.S. Supreme Court specifically rejected the state of Idaho's argument that income from intangibles should be considered business income when the acquisition, management, or disposition of the intangible property, shares of stock, was merely for purposes relating to or contributing to the taxpayer's unitary business activities. In -- in looking at Idaho's arguments, the Court said, "Idaho's proposal is that the corporate purpose should define a unitary business." It argues that intangible income should be considered part of

its unitary business if the intangible property, the shares of stock, is acquired, managed, or disposed of for purposes relating to or contributing to the taxpayer's business.

The taxpayer is arguing that the income from intangible property must be considered to be part of the unitary business when the intangibles contribute or relate to the -- in some way, the furtherance of the unitary business of the taxpayer. In Idaho, in that case, it asserted that that's integration between the business use of the intangible asset, the shares of stock in ASARCO's mining, smelting, and refining businesses, which makes the income part of the unitary business. The Supreme Court says, "No, no, no, no, no. That -- that's far, far too broad." The Court said, basically, this definition of unitary business would destroy the concept. The business of a corporation requires that it earn money to continue operations and to provide a return on its invested capital. Consequently, all of its operations, the Court said, including any investment made -- any investment made in some sense can be said, quote, "For purposes relating to or contributing to the corporation's business."

The court said, "When pressed to its logical limit, this conception of the unitary business limitation becomes no limitation at all, and was less" -- "when less

ambition, interpretations are employed, the result is simply arbitrary."

1982 was a big year for the Supreme Court because they had a second case that year, and that's Woolworth. In Woolworth, the Supreme Court concluded that New Mexico could not tax as apportionable income dividends the taxpayer received from four foreign subsidiaries, three of which were wholly owned by Woolworth, and one of which the taxpayer held a 52.7 percent interest. In such action, according to the Court, failed to meet the established due process standards. All four subsidiaries were engaged in the same chain store retailing business as we all remember, and that's what the taxpayer was engaged in.

In language very similar to the holding in ASARCO, the Supreme Court stated the State Court's reasoning would trivialize this due process limitation by holding it is satisfied if the income in question, quote, "Adds to the riches of the corporation, the entity that's receiving the dividends."

Okay. As the court said, income from whatever source always is a business advantage to a corporation. Our case demand more. In particular, the Court said they specified the proper inquiry looks to the underlining unity or diversity of the business enterprise, not to whether the non-domiciliary parent deserve -- derives some

economic benefit, as it virtually always will from its ownership of stock in another corporation.

The third court -- the third case here -- I have -- I have not mentioned. Mobile that led -- that was first. The third one is 10 years later. The Court was reaffirming the decisions in ASARCO and Woolworth, and that was in Allied Signal, and that's a New Jersey case. In rejecting New Jersey's attempt to tax as apportionable income, the gain realized in the sale of Bendix's 20 percent stock interest in ASARCO of all entities. The Supreme Court stated the following, "Application of the foregoing principals and from ASARCO and from Woolworth to the present case yields a clear result. The stipulated factual record before us presents an even weaker basis for inferring a unitary business that exist in either ASARCO or Woolworth, making this an a fortiori case. There's no serious contention that any of the three factors upon which were relied in Woolworth were present. Those three factors were functional integration, economic -- excuse me -- economies of scale, and centralized management."

The Court went onto say more, "Because Bendix only owned 20 percent of ASARCO's stock. It did not have the potential to operate ASARCO as an integrated division of a single unitary business. And of course, even the potential to control is not sufficient," quoting from

Woolworth. There was no centralization of management the Court said. Furthermore, contrary to the view expressed by the New Jersey Supreme Court, the mere fact that an intangible asset, stock, was acquired pursuant to a long corn -- long-term corporate strategy of acquisitions and dispositions does not convert an otherwise passive investment into an operational one -- or integral operational one.

Indeed, in -- in Container, we noted this important distinction between a capital transaction that serves an investment function and one that serves an operational function. The Court went on to say, "Apart from semantics, we see no distinction between the purpose test that we rejected in ASARCO and the, quote, 'ingrained acquisition divestiture policy,' unquote, approach adopted by the New Jersey Supreme Court." The hallmarks of an acquisition that is part of the taxpayer's unitary business continue to be functional integration, centralization of management, and economies of scale. It's undisputed that none of these circumstances existed here.

Stepping back, the common theme through all of these Supreme Court decisions is that in determining whether income from intangibles may be classified as business income are apportionable income, the focus must

be on the income producing property itself. In the present case, the income producing property is the shares of stock AT&T held in Telmex, Telmex Internacional, and America Móvil. As we discussed further below, those shares were not integral part of AT&T's business -- unitary business operations. They merely represented a passive long term investment. They served an investment function not a -- not an operational function.

So, moving from the Supreme Court to the Board of Equalization. There had been a long, long line of BOE decisions addressing the proper clarification of dividends. In these decisions, the BOE followed the mandate of the U.S. Supreme Court, i.e., there must be an integral relationship between the stockholding and the taxpayer's unitary business before dividends can be clarified as business income. The following statement by the BOE in a -- in appeal of 20th Century Fox Film Corporation from 1989 provides a very good summary of some of the key decisions. In -- in 20th Century Fox it's important to note too is that the taxpayer was arguing for business income treatment of dividends, dividends it received from 100 percent owned entity.

The BOE said in 20th Century, the decisions of the Board have applied a rule consistent with the requisites of the U.S. Supreme Court, and that of an

integral relationship between the stockholding and the taxpayer's unitary business. Appellants' position totally ignores the operative language of Appeal of Standard Oil -- and I'm not going to go through all of what they mentioned, but they all say the same thing -- integrally related to the unitary business activities of the taxpayer.

Appeal of Occidental Petroleum says virtually the same. Appeal of Johns-Manville, virtually the same. Appeal of Westlake Petroleum, the same. Appeal of Fiberboard, the same. And Appeal of Louisiana Pacific, the same. Decisions from 1983 to 1987. These -- these decisions also follow the statutory standard of the functional test of section 25120, namely that the intangible must constitute an integral part of the taxpayer's regular trade or business operations.

Now, in 20th Century Fox, the taxpayer failed to demonstrate that there was this requisite integral relationship between its 100 percent interest in Coca-Cola and its unitary business activities. The taxpayer in that case relied on Regulation 25120(c)(4), and it really sounds an awful like the purpose test that Idaho was talking about. In 20th Century Fox, the BOE says Appellant relies on the second part of the subdivision arguing the stock of Coke was acquired and held for a

purpose related to or incidental to the taxpayer's trade or business.

The taxpayer interpreters the language of (c)(4) in setting a very broad rule, including virtually all dividends as business income. It is -- it argued, in the case, all that's required is that the stock only be managed and utilized in its regular course of the taxpayer's trade or business, not that it be an extension of the principal business. BOE says, "Wait a minute, no. Appellant's position was rejected long ago in Mobile Oil and ASARCO." The decision in Mobile, BOE indicated, was based on the dividends or business income where they reflect profits from a functionally integrated operation. And then they said given -- given the clear language in these cases, Appellant's interpretation following (c)(4) of the Regs there, are far too broad. We cannot accept it as a standard of determining business income.

The BOE went on and concluded that dividends from Coca-Cola, notwithstanding being wholly owned, could not be classified as business income because there was no showing that the stock was integrally related to the taxpayer's unitary business. BOE went on to say, "An integral relationship with the unitary business must still be demonstrated. Clearly the mere flow of funds from Coca-Cola to Appellant does not make the stock integrally

related to the unitary business or cause the dividends to be business income." Ironically, the position that the BOE rejected in 20th Century Fox is precisely the position the FTB is putting forth in this case.

Now, at the other end of the spectrum, talking about how do you show this integrally relate relationship, is Standard Oil. And Standard Oil is a classic case of showing the -- how do you prove an integral relationship. This case was 1982, '83. The BOE held that the dividends received by the taxpayer and its subs from affiliated joint venture company corporation were business income. As we know, Standard Oil was an integrated oil company engaged in all aspects of the petroleum business throughout the world. It owned 30 percent of the stock in Aramco, which held and operated major oil producing fields in Saudi Arabia and 50 percent interest in CPI, Caltex Pacific Indonesia, which held and operated major oil producing fields in Indonesia.

The taxpayer's equity interest in Aramco and CPI entitled it to a share of production from those ventures. For example, for the years at issue, 52 percent of Standard Oil's worldwide supply of crude oil and natural gas came from its Aramco and CPI entitlements. The taxpayer received the dividends from Aramco, which is treated as business income, and the BOE upheld this

treatment. The BOE held the following: The purpose for creating and maintaining Aramco and CPI as affiliated joint venture supply companies was to ensure an available supply of crude oil and natural gas, and that this was an essential element in the taxpayer's worldwide petroleum operations. The dividends were therefore, found to be business income.

Plainly, the stock that was integrally related to Standard Oil's unitary business operations. A few minutes after Standard Oil was the decision in Appeal of Occidental Petroleum. And this one dealt with kind of the -- as they describe it as one step removed from what the Appeal of Standard Oil. This one involved the sale of stock, not dividends. And again, they repeated what they said in Standard Oil. And they said we -- we went on to hold that the classification of all types of income from intangibles under the functional test must be made in the basis of the relationship of those intangibles, the stock, and the taxpayer's unitary business operations. Thus, if the income producing intangible is integrally related to the unitary business activities, the income is business income subject to formula apportionment. If the intangibles unrelated to those activities, the income is non-business income subject to specific allocation.

A third BOE case that's important in this matter

is nine years after Standard Oil in American Biltrite. And it was again, involved a sale of stock. There, the taxpayer owned a 39 percent interest in American Synthetic Rubber Corporation, ASRC. And the purpose for holding the stock was to ensure that ASRC operated as a critical source of supply for Appellant. Under the shareholders agreement, Appellant was entitled to purchase ASRC's production of -- in direct proportion to its stock ownership in ASRC similar to Standard Oil. ASRC supplied over 90 percent of the synthetic rubber used by Appellant in its operations in that case.

In concluding the gain from the sale of ASRC stock was business income, the -- the BOE stated the following: This appeal involves the application of the functional test for determining business income under 25120. This statute provides a gain from the sale of the ASRC stock is business income if the acquisition, management, and disposition of the stock are integral parts -- same phrase, one more time -- of the taxpayer's regular trade or business. And they cited to Allied Signal there. And they actually quoted from Allied Signal, the investment must serve an operational rather than an investment function.

In this case, there is no doubt that the BOE said that the acquisition and management on the asset was

clearly a crucial part, integral part of the taxpayer's business. ASRC was a crucial source of supply of synthetic rubber for Appellant. The very purpose of acquiring ASRC was to ensure a supply of synthetic rubber and to prevent manufactures from controlling this source of raw material -- tire manufactures -- excuse me.

A fourth case here, and it's important to look at is one that goes a little bit differently, and it's Mark Controls. Mark Controls came in 1986. In that case, the BOE held that the gain from the sale of stock in a 49.5 percent owned affiliate, with which significant intercompany sales occurred under a licensing agreement, was non-business income. In dismissing the importance of the intercompany transactions, the BOE stated the failure to integrate Weir -- excuse me -- W-e-i-r, into Appellants business operations was also evident with regard to the intercompany sales. Nothing in those transactions describe any specific economic advantage gained by Appellant by choosing either a buyer or supplier of goods.

There was no guaranteed purchases or sales, the BOE said, between the corporations. Nor was there any -- either company given any specials for price break for its purposes -- for its purchases. Furthermore, there's nothing in the record to indicate that the sales were part of a guaranteed supply of raw materials or finished

products to either company. In Mark Controls, unlike Standard Oil and American Biltrite, it was not proven that the stock had an integral relationship with the taxpayer's business. Unlike both cases -- excuse me -- the stock did not provide any special operational benefit or economic advantage to the taxpayer. As was noted by the BOE, it was simply a sound investment.

So, we look at this in the instant appeal. Unlike Standard Oil or American Biltrite or Hoechst Celanese, the stock AT&T held in Telmex, Telmex Internacional, and America Móvil did not provide any operational benefits to AT&T, such as guaranteeing a source of supply, or a market for its services, or to attract or retain employees. As such, the stock in each entity did not contribute materially to AT&T's unitary business operations. Rather, the stock was purchased and held for purely investment purposes. Thus, under these authorities, Hoechst Celanese in particular, the dividends must be classified as non-business income.

Let's explore a little bit of the facts of what we've presented in this case here which support this treatment. AT&T has provided substantial documentary and testimonial evidence that its minority stock investments in Telmex, Telmex Internacional, and America Móvil were not interwoven into or is separable from AT&T's unitary

business operations. In the present appeal, the evidence is far different from Hoechst Celaneses. For example, AT&T has proven the following uncontroverted facts. First, AT&T owned less than 10 percent in each of the Mexican investees; far different than ASARCO, far different than -- than Woolworth, and any of the others that I've already mentioned.

As a -- number two, as a foreign investee -- foreign investor -- excuse me -- AT&T could not and did not control any of the Mexican investees. Carso Global held a majority interest in each entity and controlled all operations for each entity. And clearly, Carlos Slim Helú controlled Carso Global. And clearly, he still is active in it with respect to these entities in question. Carso Global had the ability to appoint the majority of the board of directors in each of these entities. AT&T was able to appoint only two members to each of the boards.

Fifth, since Carso Global controlled the respective board of directors -- excuse me -- it had the ability to appoint the majority of the executive committee and members. And of each entity, the executive committee had the power to operate and manage each of the investees.

Sixth, since Carso Global controlled the respective boards of directors, it had the ability to appoint the director general or chief executive officer of

each entity. Excuse me -- the director general's chief executive officer was responsible for the day-to-day administration of each of these three entities.

Seven, there was no centralization of management between AT&T and the investees. There couldn't be, not with -- not with this ownership control by Carso Global.

Eight, there was no meaningful functional integration between AT&T and Telmex, and Telmex Internacional, and America Móvil.

Number 9, there were minimal transactions between AT&T and Telmex, Telmex Internacional, and America Móvil. The only such transactions mentioned in the investees respective forms 20-F were the providing of consulting services by AT&T on an arms-length basis to each entity. The revenues which AT&T received from the three entities were insignificant and represented 0.008 percent. So 0.008 percent of AT&T's total revenues between 2007 and '08. On the other hand, Carso Global provided consultant services to these entities, and the revenues it received went -- went well in excess of what AT&T received. No significant flows of value existed between AT&T and the Mexican investees.

And I would call it to your attention that when I talked about testimonial evidence here, we -- we submitted three declarations here. One is from George Moreira who

was -- I don't remember which brief -- I'm sorry -- which one it is. It's laid out. Mr. Moreira was directly involved with the Mexican investees. Another -- another declaration was of Simon Xu who also had direct firsthand knowledge of the relationships. And the a third is Steven Taylor.

What I'm gonna talk about right now are various items from their declarations. So, during -- during the -- tenth item to list here is, during the years in issue, AT&T made no purchases of network to network services from Telmex, Telmex Internacional, or America Móvil in Mexico and Brazil. We have an Exhibit 40 is where that document is. The Framework Agreement between AT&T and Telmex and America Móvil was an arms-length agreement and was explicit that there was no exclusivity between the parties. Neither party was obligated to purchase services from the other party. AT&T had similar agreements with all the major carriers, and the terms were comparable. AT&T selected carriers based on a competitive bidding process based on pricing and quality. There were no price breaks here. This -- this was a similar approach that America Móvil did for a minute, and had talked about that in a second.

Number 12, AT&T leased access and capacity from other telecommunications carriers besides Telmex and

America Móvil. AT&T could use any number of other carriers there besides Telmex and America Móvil and had relationships in place with other telecommunication carriers in the region, Latin America's Mexico. AT&T and Telmex were competitors. As for AT&T and America Móvil, they sought the same customers. Indeed, there was a level of distrust, as Mr. Moreira said, between AT&T and both Telmex and America Móvil.

Number 14, AT&T had local access agreements and backbone agreements with many other carriers in the region, which allowed it to create what's called the AT&T Global Network, AGN, in Latin America. Mr. Moreira, Mr. Xu testify to that.

Fifteen, the Framework Agreement contained language regarding potential opportunities to collaborate, such as joint sales opportunities, joint marketing strategies, joint account planning, and a joint service and collaboration agreement, JSCA. These opportunities however, never came to fruition and were largely aspirational in nature. In fact, the JSCA was never adopted by the parties. Mr. Moreira testified to that.

Sixteen, AT&T was not dependent upon Telmex or America Móvil to service its customers. AT&T already had its own network, the AGN, which I just mentioned, and already had the ability to put customers on its own

network.

Seventeen, the Framework Agreement did not create any new customers for AT&T. It simply provided another way of serving -- servicing customers that AT&T already had. That's Mr. Moreira again.

Eighteen, the Framework Agreement did not create new business within the United States for AT&T. Telmex and America Móvil did not purchase a significant amount of net NNI services from AT&T because AT&T was more expensive than the other U.S. carriers, and AT&T could not compete with the selected carriers. Similar to AT&T, AT&T -- America Móvil selected carriers, including AT&T using competitive bidding process basing on processing -- pricing and quality. Declarations of all three individuals confirm that point.

There's another agreement called the International Telecommunications and Service Agreements between AT&T and Telmex and America Móvil, and they were typical bilateral agreements for the exchanges of voice traffic. AT&T had similar agreements with similar arms-length terms for the approximately 200 carriers throughout the world. There was no exclusivity under these agreements. No special deal. No special advantage.

There was an agreement that AT&T had with TracFone Wireless to which the FTB has made reference.

It's called a Reseller Agreement. That agreement though, in looking at it, was a non-exclusive arms-length agreement. And then also the agreement was virtually insignificant and was not even mentioned in AT&T's 10Ks or America Móvil's form 20-Fs.

Number 21, similar to 2000 -- 2001 and '06 -- through '06, those are the years in which the decision by the BOE and the closing agreement, any transaction -- excuse me. AT&T seconded a small number of employees to Telmex and America Móvil. They seconded 17 employees in 2007 and '18 -- and 2008. They represented an insignificant number of AT&T employees. Indeed, it was 0.008 percent. Again, as we heard a lot about employees before, again, similar thing here. And of the investees of these entities, America Móvil, Telmex, 0.0135 percent, very few employees.

Similar to 2001 through '06, any transaction between AT&T and Telmex and America Móvil and Telmex Internacional were insignificant. Indeed, the Forms 20-F for each entity include a section labeled "Related Entity Related Party Transactions." The transactions are mentioned in the 20-Fs, however, where with Carso Global and the other Mexican investees, i.e., Telmex, Telmex Internacional, and America Móvil, not with AT&T. There were no economies of scale between AT&T and any of the

investees. And then finally, as conceded by the FTB, there was no unitary relationship between AT&T and any of the Mexican investees.

Finally, subsequent to the appeal years, AT&T disposed of its stock in each of the Mexican investees, and they did it over a number of years. Finally, in 2014 when AT&T sold its last remaining shares in America Móvil, it no longer owned any stock in any of the Mexican investees. Nevertheless, AT&T continued to have bilateral telecommunications services agreements with America Móvil; similar to the agreements it had during the years in issue here. And also, the same agreements it has with other unrelated parties. So what we have here is unlike American Biltrite, Standard Oil, Hoechst Celaneses, AT&T's ownership of the stock in its Mexican investees did not entitle AT&T to any operational benefits, such as ensuring a source of supply, or a guaranteed market for services, or attracting or retaining employees.

Indeed, as the OTA noted in Bank of America, again, the ease of divestment, which this certainly was easy because they didn't lose any of these benefits, if you will, may be an indicator whether the stock was interwoven into and inseparable from the taxpayer's business and its Mexican investees. That is certainly the case here. In sum, the facts in this appeal are

completely distinguishable from the facts in Hoechst Celanese. Whereas, the income producing property activity in Hoechst Celanese, the pension plan and trust were inseparable from taxpayer's employee recruitment and retention efforts and thus, provided a crucial operational benefit to the taxpayer and served an operational function in that case.

There was no similar organic unity between the shares of stock which AT&T held in Telmex, Telmex Internacional, and America Móvil, and AT&T's unitary business operations. The shares provided no such operational benefit to the AT&T, and the shares were held purely for investment purposes, and the dividends there from serve as an investment function, not an operational function. As such, consistent with the BOE decision in 2011, the dividends must be classified as non-business income.

Thank you.

JUDGE HOSEY: Thank you.

I'm gonna go ahead and take a break, a 10-minute recess. It's 3:48, yeah. Okay. So let's be back at 3:58.

So, we are off the record. Thank you.

(There is a pause in the proceedings.)

JUDGE HOSEY: Okay. We are now back on the

record in the Appeal of Pacific Bell Telephone Company. We are moving to the Franchise Tax Board for their arguments on Issue Two.

MS. MCELHATTON: Yes. Thank you. And Delinda Tamagni will be presenting Issue Two.

JUDGE HOSEY: Great. Thank you. Begin when ready.

MS. TAMAGNI: Thank you.

PRESENTATION ON ISSUE NO. 2

MS. TAMAGNI: So before I started on the substantive issue of business income, I just wanted to briefly address the BOE decision in the closing agreement that had been brought up by the Appellant. There's just a few things I'd like to highlight.

So, one, the BOE decision was for tax years '01 and '02, and it was a summary decision. So, there was no analysis provided for why the board voted the way that it did. And as a summary decision there's no -- it has no precedential value, and it should not be relied on or cited to.

Two, the business income issue before the Board of Equalization, that they had their summary decision on, did not involve either America Móvil or Telmex Internacional. So it would be improper to apply the

decision to the current facts here today.

In regard to the closing agreement for tax years 2003, 2006, the agreement is not relevant to the legal analysis for the current tax years. As shared by the Appellant, the agreement covered many issues, and it shouldn't have no weight on a business income analysis for tax year '07 and '08.

And then finally, as you've already heard and could tell from Appellant's presentation, business, non-business issues are very fact specific, and it is an issue that has to be decided after performing an analysis on the facts and the law provided. So, Respondent is not asking you to overturn the Board of Equalization decision. We're not asking you to invalid the closing agreement. The instead, we respectfully request that you just take into account the facts that we're going to share with you today.

So, with that, let's begin with some background information. So, at the end of 1990, telecommunications in Mexico became privatized, and as part of the privatization, Southwestern Bell acquired a minority stake in Telmex as part of a consortium with other investors. Telmex then spun off its mobile in international operations into the newly formed America Móvil in 2001. So, during 2007 and 2008, AT&T owned a minority stake in

Telmex, America Móvil, and Telmex Internacional.

At issue is whether dividends issued by Telmex, America Móvil, and Telmex Internacional to AT&T should be clarified as business income. AT&T received approximately $393 million dividends in 2007 and $1.6 -- I'm sorry -- $164.7 million in 2008. Appellant reported the dividends from these three companies as non-business income, and FTB has re-characterized these dividends as business income. An item is considered business income when it meets one of the two tests set forth in Revenue & Tax Code 25120(a). First, there's the transactional test, which says business income means, one, income arising from transactions and activity in the regular course of the taxpayer's trade or business. Then there is the functional test which says business income means income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

Our focus will be whether the stock held by AT&T was acquired and managed in such a way that the dividends received should be considered business income. However, for Appellant to prevail with the characterization of non-business income, it must show that the dividends paid by these Mexican companies did not meet the transactional test or the functional test.

There are three elements to the functional test under Rev and Tax Code 25120. They are the acquisition. For acquisition, Appellant must have controlled and used its Mexican company shares to generate business income. Appellant purchased these shares for the business purpose of expanding its market for telecommunication services into Mexico. There is management. For the management prong, Appellant must have controlled and directed the use of these shares. What is required is that Appellant must have had the power to direct the use of the property. As we will detail in a moment, Appellant was deeply involved in the telecommunication business of the Mexican companies and thus, it used its ownership interest to develop its business in Mexico.

There's also disposition. For the disposition prong, Appellant must have the power to transfer control of the shares in some manner. Under Revenue & Tax Code 25120(d), non-business income is defined as all income other than business income. The corresponding regulation provides that the income of the taxpayer is business income unless it is clearly classified as non-business income. This means there's a presumption towards business income, and it is Appellant's burden to prove that the dividends are not business income.

The landmark case for the functional test is the

California Supreme Court's decision in Hoechst Celanese. The Court explained the key terms integral, acquisition, management, and disposition. To be business income under the functional test, a taxpayer must obtain an interest and control over the property, which in this case would be the shares of Telmex, America Móvil, and Telmex Internacional. They must control or direct the use of the property and they must have power to transfer control of the property. Each of these three, the acquisition, the management, and the disposition must be integral to the taxpayer's regular trade or business operation.

So, one may ask, what does it look like when a taxpayer owns a minority interest in an entity, and then sells the stock or receives dividends from that entity? What does the relationship look like between the owner of the shares and the entity paying the dividends that would meet the functional test? We can answer this by looking at some prior case law. We will start with a 1983 case of Appeal of Occidental Petroleum where the taxpayer sold five stockholdings, three of which were unitary entities. For the two that were not unitary, the Board of Equalization found the gain from the sale was not non-business income because there was only a mere potential for integration.

It is noteworthy that the Board of Equalization

explains that we don't look at the paper the stock is printed on. Instead, we look at the assets and activities that are represented by the stock. Then we analyze the relationship between those assets and the activities and the taxpayer's operations.

Another Board of Equalization case is the Appeal of Standard Oil, also from 1983. In this case, the Appellant was an oil company taxpayer who owned interest in entities that operated oil fields. The Appellant sold those interests, and the Board found the dividends paid by these entities to be business income. While the stock secured a raw material for the Appellant, this is not required for business income. In addition, it's not important that in the Appeal of Standard Oil these interests were 30 percent and 50 percent. The functional test analysis is the same for minority holdings. The Board held that the interest were, quote, "Acquired and maintained in furtherance of and as an integral part of its unitary business operations," end quote. It also held that these interests were so integrally related to the taxpayer's operation, they could not be viewed as extraneous investments separate and apart from its unitary business operations.

Contrary to Appellant's arguments, there's no requirement that a stockholding be used to secure a supply

of raw materials before income from the shares is considered business income. For example, in Hoechst Celanese, there were no raw materials involved. Rather, that was an over-funded pension. The Board of Equalization also had -- has the Appeal of Standard Oil in which it found that the concept of business income concerns differentiating between a truly passive investment and income that is integrally related to the taxpayer's unitary business activities. The Board held that Appellant must show that the dividends were earned in the course of activities unrelated to the conduct of its business. As will be shown in a moment, the facts support the finding that the Mexican company shares were not passive investments. The Board rejected the assertion that dividends from minority investments cannot be included in apportionable business income.

There's also Allied Signal where Appellant repeatedly espouses that unity test must be met, but this is incorrect. In this U.S. Supreme Court case, the Court said the payor and payee need not be engaged in the same unitary business as a pre-req to apportionment. The U.S. Supreme Court recognizes that a unitary relationship between a dividend payor and a dividend payee is not required for the underlying stock and the dividends paid to be business income under the functional test.

As we will discuss, AT&T stock interest in the companies resulted in operational relationships that became integrally related to the taxpayer's unitary business activities. AT&T and the Mexican companies were selling products to each other. They were finishing each other's phone calls. AT&T was purchasing, testing, and installing equipment for the companies, all while they were participating in joint technical teams with members from each of the companies.

There's also the Appeal of Mark Controls, and it -- in this case, the Board found there were two interests that gave rise to non-business income. One interest was the Weir stock, which the Board found was purchased with a goal of ultimate control, which never occurred. And so thus, the holding was found to be merely preparatory for integration. The other stock, Walthon, was found to have been purchased for the required dividends and was thus, a passive investment. Mark Controls is easily distinguishable from the present appeal as there was nothing preparatory or passive about what AT&T was doing for these companies at issue.

In addition, there's no case law that requires there be an operational benefit before there can be a finding of business income from a minority holding. Rather, the relevant test is the functional test. Even

so, AT&T's ownership of stock in the Mexican companies it allowed it to be a part of a consortium to privatize and modernize telecommunications in Mexico, which in turn allowed AT&T to expand into another market. Without the stock ownership, AT&T would not have been able to enter into the Mexican telecommunications market. Thus, the stockholdings were integrally related to AT&T's unitary business, and these assets served an operational function, rather than an investment function.

Through its stock ownership, AT&T was able to further its business because it was able to form relationships and synergies that allowed AT&T to expand its global telecommunication business into foreign markets. In Appeal of CTS Keen, the Appellant had a relationship with an entity called AB. It then sold one of its subsidiaries to AB and then revamped licensing agreements, which it gave AB manufacturing and selling rights in Europe. CTS then used the agreements to expand its influence in Europe. CTS sold the AB stock for a gain, and the gain was found by the Board of Equalization to be business income.

The Board distinguished the Appeal of Mark Controls -- it's okay. The Board distinguished Appeal of Mark Controls. It found that the AB stock was not preparatory to full integration, and that it was not a

passive investment. CTS was able to expand its influence in Europe and thus, its goals were established. The SBE pointed out that it was not necessary for CTS to have control over AB before the income from the stock could be business income.

The CTS appeal is directly on point with the present appeal, as a minority holdings held by AT&T were not preparatory but rather, they assisted in the goal of expanding into the Mexican telecommunications market; and that was achieved by having the minority holdings and all the related operational contracts that we're gonna discuss in just a moment. AT&T would not have been able to expand into this market in Mexico unless it owned shares in these companies. As we will discuss, AT&T made the purchase as part of a consortium when Mexico sought to privatize the industry.

Now, we're gonna look at more of specific facts on this appeal and show how AT&T was involved in developing telecommunications in Mexico. So, there was Southwestern Bell, and Southwestern Bell's growth had stagnated, and its profits were primarily from local phone services. Mexico was looking to privatize its national phone company Telmex and was looking for investors. The plan was for the winning bidders to provide a basic phone service and construct a national wireless network in

Mexico that would include wireless licenses.

The CEO of AT&T explained, and I quote, "The chance to diversify our asset base and start the process of moving Southwestern Bell in the correction of becoming bigger, more stable, and global." Appellant concedes that if it first invested -- that it first invested in Telmex as part of the consortium that was, quote, "Organized with the goal of privatizing and modernizing the Mexican telephone system." So, Southwestern Bell was combined with Grupo Carso. They bid $1.76 billion and received a minority in Telmex with majority voting rights, 51 percent of voting control as part of the consortium. Southwestern Bell contributed $486 million, while Grupo Carso contributed $860 million. Telmex was essentially turning its company over to investors who could bring the service up to international standards, and AT&T had a goal of acquiring more customers so it could grow its company.

So, we're gonna review some facts related to common ownership. There was Telmex and Telmex Internacional. They were deemed to be under common control with America Móvil. Telmex was the only nationwide provider of fixed line telephone in Mexico. Telmex Internacional offered voice, data, and internet services in Latin America, pay cable and satellite television in some of Latin America, and print and

internet-based yellow page directories in Mexico, the U.S., Argentina, and Peru. America Móvil was the largest provider of wireless communication services in Latin America based on subscribers. And because Telmex, Telmex Internacional, and America Móvil provided telecommunication services in some of the same geographic markets, they had extensive operational relationships with each other.

Appellant has asserted that AT&T must meet the requirements of unity before dividends can be considered business income. However, this is not required. There's no case law or statutory or regulatory requirement that there must be a unitary relationship between a stockholder and the corporation issuing the stock. What is required is that AT&T must have used its stockholdings in these companies as an integral part of its own regular telecommunications business. This is not require that AT&T have control over each of the Mexican companies. It does not require that AT&T be unitary with these companies. The Board of Equalization was clear in the Appeal of Standard Oil when it explained that a unitary finding is not required for there to be business income. Under Standard Oil the question is whether the activities represented by the shares are integrally related to the taxpayer's business activities.

So, let's take a quick look at the voting and decision making facts that are available. For Telmex, while AT&T owned 9.3 percent of the AA shares, it held 21 percent of the voting shares -- excuse me -- and 3 positions on the 14-member board of directors. For the executive committee, AT&T had the right to nominate 1 out of the 4 members. For America Móvil, while AT&T owned 8.2 percent of the total shares, it owned 23 percent of the voting shares, and it had the right to nominate 2 of the 12 directors on the board. AT&T was also able to nominate 1 to the executive committee. During 2007, there were three members on the executive committee.

So, the board of directors, the CEO, and the executive committee, they managed America Móvil. However, the executive committee was tasked with exercising the power of the board and making all major decisions. For this purpose, AT&T had one out of three votes. And it was only if the executive committee could not reach a decision that the board of directors were to take action without the opinion of the executive committee. So, having directors on the board and members on the executive committee, that is significant because those executives were put into place for a reason, as it allowed for a mutually beneficial exchange of information and know how.

Let's continue to look at a little more at the

voting and decision making. We also have AT&T International owned $1.8 million or 22.2 percent of the AA shares of Telmex Internacional, which resulted in 21.1 percent of voting shares. And Telmex Internacional's business was managed by its board and its CEO. Two of the 12 directors were nominated by AT&T.

We're gonna take a look now at the operational connections between AT&T and the companies, starting with the Master Service Agreements, or I will call them MSAs for short. So, there was MSAs between AT&T and each of the companies that allowed AT&T -- or which allowed AT&T to provide services for compensation. Some of the compensation was paid to have AT&T employees work at the Mexican companies' facilities. For example, AT&T and America Móvil had an MSA which provided for management, consulting, and technical services to be provided to America Móvil for which America Móvil paid $7.5 million per year. The FCC found that there was not an arms-length relationship between AT&T and America Móvil, but rather there was, quote, "An extensive corporate interrelationship between the companies."

Another MSA was between AT&T and Telmex that had AT&T providing the same list of services for management, consulting, and technical services. In addition, AT&T was to provide counseling on how establishing network

construction procedures and counseling concerning re-orgs, modernization, and the restructuring of Telmex. Telmex paid AT&T each year for these services. And you can see that AT&T was teaching Telmex how to run a telecommunications business. Telmex Internacional paid amounts to Telmex for services under the Telmex MSAs.

Appellant argues that these MSAs allowed AT&T to provide consulting services to the companies on an arms-length basis to the entities. But it is well established that where a unitary business is present, arms-length transactions between the business does not negate unity. In addition, the amount of business income that AT&T earned from these MSAs in comparison to AT&T's total income is also not relevant for anything other than the fact that AT&T was earning business income from the companies that it owned stock in. And yet, it tries to characterize the dividends from the same entities as non-business income, even though it clearly was operationally connected to each of the agreements -- or I'm sorry -- for each of the entities.

So, now we're going to look at the internet -- interconnect agreements. The interconnect agreements allowed international direct dial services between the U.S. and Mexico. It is important to understand that there is no requirement that the agreements be exclusive before

they're considered operational. It's also not relevant that AT&T had similar agreements with other carriers. Rather, what is required is that the activities that they -- of the Mexican companies must be interconnected with those of AT&T's operations rather be -- rather than being passive investments.

AT&T was able to gain control over the last mile so it could finish calls into Mexico. Again, it's not relevant that perhaps it had other options for that last mile. It had these agreements, and then it used them to finish its calls in Mexico. Through these interconnect agreements, the activities of the Mexican companies and those of AT&T were operationally intertwined, such that AT&T stock ownership in these companies was an integral part of AT&T's telecommunication businesses. AT&T and Telmex also had an interconnect agreement with certain requirements that help to illustrate how this was an operational activity shared between the entities -- excuse me things like, monthly statements, standard bill format. There were audits and there were also netting of balances due, and those are all ongoing operational activities.

America Móvil or TELCEL and AT&T also had an interconnect agreement. TELCEL provided mobile telecommunication services in all nine regions of Mexico. TELCEL was the same entity that operated TracFone, and

TracFone is the one that sold AT&T cellular minutes. The agreement itself explains that TELCEL and AT&T desire to jointly furnish direct telecommunication services between Mexico and the U.S. Each party prepared monthly statements of minutes to be settled. They were required to allow audits and were paid after a netting of monthly balances, similar to the Telmex interconnect agreement. Both TELCEL and AT&T paid for their own facilities and their own regions that completed the calls for the other parties. All of these facts indicate that AT&T and TELCEL were operationally interconnected with each one helping the other to complete calls in their own regions. Telmex Internacional and AT&T had interconnect agreements, and those were similar to those with TELCEL and Telmex. This provided the same operational connections as it did with the other companies.

Now, let's look at Framework Agreements. AT&T and Telmex entered into a Framework Agreement July 6, 2007. The purpose of the agreement was to establish a mutely beneficial framework for current and future efforts between the parties. There was also a Framework Agreement between AT&T and America Móvil, but first we're gonna look at the one between AT&T and Telmex. This agreement covered network architecture, service features, and engineering guidelines. The Framework

Agreement also provided for network to network interconnections. It required that joint technical teams discuss technology, the difference between networks, and upgrades. The parties were required to meet periodically to discuss each party's future plans for network upgrades, development, and evolution.

AT&T and Telmex were also to have direct access to all MPLS-based network's owned by the other. There was the Alliance Governance Structure of the Framework Agreement that set out the collaboration between AT&T and Telmex and how it would work. Under it, there would be a single point of contact, a coordinating team, and an executive oversight team. This Alliance Governance Structure involved a single point of contact which is important. That single point of contact was to implement the agreement and identify potential problems. There was to be a once-a-month meeting between the single point of contact from each side and then the coordinating team. On top of that, there would be quarterly meetings between the coordinate team and the executive oversight team to advise on any arising problems, and they were also to set goals. This governance structure supports a finding that the Mexican company interest were business asset serving an operational function.

Under article 7 of the Framework Agreement, there

was discussion covering the mutual sell of the MPLS base services between AT&T and Telmex. Here, the parties promise to work together on marketing, account planning, sales support, and technical support to facilitate the completion of calls between Mexico and the U.S. There was also something called a Statement of Work. Under the Statement of Work, AT&T was to provide services to Telmex. There was an entire list of responsibilities, task, and deliverables, which included a global router project in which AT&T was to purchase equipment from Sysco Systems, sell it to Telmex, and then install the equipment for Telmex.

And then there were services or responsibilities that AT&T had, and that was that an AT&T project manager was to interface with Telmex project managers. AT&T was to conduct a formal project kickoff meeting where a project schedule would be created. AT&T was to develop, manage, and track the project schedule. AT&T was to develop and maintain a contact list, communication plan, and track and monitor, prioritize action items and issue list. And AT&T was also to process and track purchased equipment orders, implement agreed upon processes, and then coordinate with Telmex personnel.

In addition to what we've already discussed, there was an entire list of AT&T's responsibilities under

the Statement of Work. I'm not gonna read all of them to you, but you can see them here on the slide. And what you can see is that AT&T was required to provide -- or what I should say, what AT&T was required to provide to Telmex goes into minute detail, even down to opening boxes to inspect the contents and powering on the equipment to make sure it worked. AT&T installed the equipment and then had to test it. This is the epitome of operational connections as AT&T was literally operating the Telmex business in some areas.

To accomplish these activities, AT&T sent its employees to work at the Telmex facilities. These are not activities that are passive in nature. Rather, these are examples of how operational the relationship was between AT&T and Telmex. There was also a global master carrier agreement. This was setup so the parties could then finish the calls for each other for that last mile that they did not own. There were also other required activities regarding periodic meetings, placing of orders by AT&T, and forecast of AT&T's requirements for Telmex services. These activities, again, illustrate the operational nature of the relationship between AT&T and Telmex. Also, in the Framework Agreement, there was a service order attachment. This set out the services that were to be provided to AT&T by Embratel, covering things

like pricing, order management, service maintenance, billing, service level agreements, and service-level objectives.

So, we're now gonna look at the Framework Agreement between AT&T and America Móvil. It's quite similar to the one between AT&T and Telmex. So, I'm not gonna go into as much detail, but I did want to point out a few things. One, is by the time this agreement was entered into, Telmex was a wholly owned subsidiary of America Móvil. This agreement covers MPLS network activities with AT&T and America Móvil, both owning and operating MPLS networks in many countries. The purpose of the agreement was to further expand on the existing relationship and create networks that were interconnected across the world. And under the agreement, the parties sought to collaborate and coordinate on many activities and projects.

Some of the activities and projects they collaborated on included network-to-network interconnections, undersea cable and landline connectivity, MPLS base services, and VPN services. In addition, they agreed to a governance process to manage customer and commercial issues. And then also, they agreed to marketing strategies and sales opportunity processes. The agreement also states that the parties

shared a long-term vision of quote, "Providing market-leading global services to their enterprise customers through further harmonization of network infrastructure, support systems, operational process, and a go to market approach," end quote. These are all operational activities that illustrate that America Móvil was not a passive investment but rather, AT&T and America Móvil were operating together to provide telecommunication services.

For the AT&T and America Móvil Framework Agreement, it explicitly states its purpose was to, quote, "Establish a mutually beneficial framework," end quote, for the efforts between the parties to fulfill local, regional, and global requirements for each party's respective customers. So, the purpose was to provide the best possible telecommunication service for both AT&T and America Móvil customers but working together to achieve this goal. The intent of the Framework Agreement was also clearly set out to, quote, "Enhance the efficiency of each party," end quote, by implementing certain initiatives together.

So, the agreement was in place to have the parties work together to create a more efficient business for both AT&T and America Móvil. This means the parties were working together to create a better telecommunication

service. Again, this is not a passive activity but rather, one where each party was actively involved and improving both businesses through a specific joint projects. The agreement then list out areas where the parties intended to work together. Within the Framework Agreement, there was an interconnect technical agreement and agreement to collaborate on joint opportunities. They intended to work together on the -- they intended to increase the technical and process cooperation for MPLS services, an increase in reciprocal procurement of resources and services with specific mention of the undersea cable and landline connectivity from the other party.

This item specifically refers to connectivity between the parties which again, is operational rather than passive. The parties also intended to jointly develop advanced enterprise services for both groups -- or for both parties, and to give each other preferred rates and charges, and to work together to reach each party's technology and service reach objectives. These are all operational objectives where the parties intended to work together to achieve a certain goal. Again, this is not a passive activity.

The Framework Agreement also goes into some of the initiatives the parties agreed to collaborate on. The

first was the network-to-network interconnection. This agreement acknowledged that there were already network-to-network interconnections in place between the parties in Brazil and in the U.S. But through the agreement, the parties were going to broaden and deepen the existing network-to-network interconnections by jointly designing a regional network-to-network system, which is not a passive activity. This is an operational exercise with the parties working together. The parties agreed to jointly conduct a partner certification test to verify network operational readiness in each country with each party providing their own personnel and equipment.

And then you have America Móvil agreeing to provide AT&T with access to the last mile through either of its own arranged third-party facilities. Also regarding the network to network interconnection, the parties they agreed that the design of their network interconnections for AT&T and America Móvil should be parallel. And to achieve this goal, they were to form a joint technical team that would analyze the differences between the networks, develop a roadmap and a timeline, and then minimize those differences. If this was a passive investment, there'd be no need for AT&T and America Móvil to have their networks be similar to each other. There'd be no need for a joint technical team to

work together, and no need to iron out those differences between the networks.

In regard to governance, the parties setup a governance structure to implement the Framework Agreement and the overall relationship between the parties. This structure was designed to serve, again, the joint commercial activities for AT&T and America Móvil. And the structure of this governance model, it was a little bit different than the Framework Agreement between AT&T and Telmex, in that there was only an executive steering committee, and alliance management board, and then subgroups for particular operational areas.

So I'll -- I'll briefly set out what those are. The executive steering committee was to include the CEO of America Móvil, and then also the group president and chief strategy officer of AT&T operations. The Executive Steering Committee was to meet semiannually and set the vision and future direction of the relationship between AT&T and America Móvil. A committee to work together to set the future direction of joint efforts is an operational committee. A passive investment would not have a joint committee to work on vision and future direction of the cooperative efforts between AT&T and America Móvil.

The alliance management board was to include

senior executives from each party, and it was explained as being the primary decision forum, or the AT&T and America Móvil relationship. This was an operational joint tax -- excuse me -- joint task force that would work together for the many joint projects that the parties contemplated achieving. Again, a joint decision making committee is not needed for a passive investment. And again, this shows the operational nature of AT&T's stockholding in America Móvil.

The alliance management board also had designated responsibilities. They were to work to move priorities of AT&T and America Móvil down to the alliance teams. They were also tasked with setting targets for the joint activities and then review the progress towards those performance targets. And then this board was also assigned the responsibility to address conflicts or issues with customer-facing activities. The agreement also set out some key partnership areas where there would be four subteams with subject matter experts from each party. And these subteams were enterprise commercial alliance subteam, customer experience operations and process subteam. There was a wholesale roaming and commercial supply subteam, and then there was also a network and product development subteam.

So, the areas that these four subteams were to

facilitate were the exchange of information. The collaboration -- they were supposed to collaborate on development and operation. They were to exchange processes and procedures, and then they were deal with any exceptional customer support needs or sales request; and then they were to take those to the alliance management board and the Executive Steering Committees. And then in addition to these subteams, there was also to be a group of alliance business directors who were to resolve the issues that could not be resolved at the business director level. These issues were to be worked through the commercial alliance subteam.

After governance, the Framework Agreement goes into sales opportunity process. The parties were to identify joint opportunities called alliance opportunities regarding customers that would benefit from having both AT&T and America Móvil work together on providing services. This might mean adding more network-to-network interconnections, and it might involve joint account planning, management, design, and provisioning of services. Permission was to be acquired from the customer to have both AT&T and America Móvil working on the services to that particular customer.

And the agreement also setup what it referred to as account leads that put either AT&T or America Móvil who

was contracting directly with the customer in charge of the service, and then the other party would act as a subcontractor also providing services to the same customer. This is the epitome of an operational connection and is in no way resembles a passive relationship. In addition, also for these sales opportunity processes, the parties did agree to work together to provide services to particular customers, and AT&T was authorized to sell America Móvil unmanaged MPLS based and other services. The parties recognized they could be more effective working together than each party would be acting alone.

Finally, there was a joint service and collaboration agreement where the parties would set up a process to jointly manage customer and commercial issues. Again, these are operational connections with AT&T and America Móvil working together to provide services to specific customers.

So, now I'm going to address the shared operations that were present between AT&T and the various companies. So, we have the Reseller Agreement. In this, AT&T and TracFones, the TracFone was owned by America Móvil. They entered into a Reseller Agreement for prepaid wireless. TracFone was largely owned by America Móvil, and it sold and distributed prepaid wireless services and

phones in the U.S., Puerto Rico, and the U.S. Virgin Islands, and they had 9.5 million subscribers.

However, the critical point here is that TracFone didn't own any wireless communication facilities. It didn't have any wireless licenses of its own. And because it didn't have these items, it entered into a contract with AT&T so that TracFone could sell AT&T Wireless minutes in the U.S. Effectively, TracFone was providing staff to market and sell AT&T Wireless minutes to TracFone customers. TracFone would then submit a transaction to AT&T Mobility for activation for a new number and then the minutes. And then AT&T Mobility would then assign the numbers and the minutes to TracFone.

So, TracFone was selling services that it could not provide to its own customers. It needed AT&T Mobility to provide the cellular minutes to its customers. And AT&T Mobility invoice TracFone monthly, and then TracFone maintained the staff to market these services and also support and train the end users. For the needed SIM cards, AT&T would approve which vendors could provide SIM cards for use on its AT&T Mobility wireless systems. It's significant that the TracFone customers were added to the AT&T Mobility billing system. That means effectively TracFone customers counted as AT&T customers. And in fact, AT&T sent out the bills to the TracFone customers.

So, TracFone was not free to just open up new markets. It first had to form testing required by AT&T, and it had to provide or obtain prior written approval from AT&T Mobility. In this way, AT&T had a significant impact on America Móvil operations, and in turn, TracFone contributed materially to AT&T's business income by selling cellular minutes for AT&T.

And finally, if there were issues with TracFone services, there was a process that had to be followed. First, AT&T Mobility would request the problem be addressed, and then TracFone had to respond and report on a resolution of the problem. This means AT&T reviewed, analyzed, and then suggested changes to TracFone operations; and TracFone was required to respond to AT&T. These are not activities of a passive investor or a passive investment. Instead, this shows this was an operational asset that was controlled and used to materially contribute to AT&T's business income.

Now, we're gonna look at the advertising sales and commercial agreement between AT&T and Telmex. So, during 2007, Telmex spun off all of its Latin American businesses and its Mexican yellow page business. They spun them into a holding company called Telmex Internacional. Then also during 2007, Sección Amarilla was a subsidiary of Telmex that published Yellow Pages for

Mexico. Sección Amarilla was transferred to Telmex Internacional at the end of 2007.

During 2008, AT&T advertising solution sales representatives were to sell advertising space in these certain directories. This agreement and sales arrangement allowed AT&T to offer its own customers an option for advertising in a Spanish language directory. This was an operational connection and indicates that AT&T stock ownership was not a passive investment. And these directories, they were to display the AT&T logo. The agreement again, shows the operational nature of the relationship between AT&T and its stockholding.

In conclusion, for these dividends to be non-business income, Appellant must show that the activities of these companies were unrelated to the operational business activities of AT&T and that both the transactional and functional test for business income were not met. Appellant has not done this. In fact, the activities of Telmex and America Móvil were integrally related to the AT&T telecommunication business operation. There's been no showing that the activities of these companies constituted a discrete or separate business enterprise. It had nothing to do with AT&T's telecommunication business. Accordingly, the dividends paid are business income to AT&T.

The Board of Equalization held in Appeal of Standard Oil that ownership and control of a minority business asset is not required. What is required is that the dividend payor contribute in some meaningful way to the recipient's business enterprise. Here, the Mexican companies were part of the AT&T operation through its interconnection agreements, the Reseller Agreements, the master service agreements, the advertising sales, and commercial agreements. But more importantly, through AT&T's stock ownership, it was able to expand into the telecommunications market in Mexico. And in this way, those companies contributed to AT&T's business operations.

Due to the many interlocking projects, committees, boards, service agreements, interconnect agreements, governance agreements, Reseller Agreements, joint operation activities, and the AT&T employees working on the premise -- premises of the Mexican companies, Appellants stock ownership was not a discrete separate business enterprise. In fact, evidence points to a contrary conclusion.

I've shared many details with you today. But that is because the evidence and support of FTB's position is immense. To summarize, AT&T had interconnect agreements with each of these companies that it owned stock in. And in each instance, the parties were

finishing each other's calls in their respective regions for that last mile of service. America Móvil, through TracFone, was reselling AT&T cellular airtime to TracFone customers who were then counted as AT&T customers with AT&T sending out the bills. AT&T and the companies had an agreed upon governance structure with joint committees and AT&T employees located at the Mexican company facilities to carry out the responsibilities under the many service contracts.

These were extensive operational connections, much more than in most of the business income case law that we've looked at today. In Hoechst Celanese, the asset at issue was a pension which paid a reversion of access funds. Because the pension helped to attract employees, it was found to be a business asset, and the reversion was business income. Here, AT&T had much more involvement in the asset than there even was in Hoechst Celanese.

And finally, returning to the case that is most similar to the facts today. We have Appeal of CTS King. If you recall, the Appellant there had a group that manufactured and sold electronic components and subsystems, and there was the existing licensing agreements with AB; and then CTS acquired 10 percent for a total of 20 percent of the AB stock. When they sold the

stock, they reported the gain to be non-business income. The Board of Equalization disagreed and found the gain to be business income because CTS reached its goals through acquiring a minority interest. CTS was not seeking control over AB, but was rather trying to expand its influence in Europe.

The Board found that CTS's acquisition of AB stock was not merely a preparatory to obtain control over AB. These facts are similar to the current appeal where AT&T sought to expand its telecommunication business into Mexico. It was able to do that by bidding on the contract offered by the government of Mexico and making these minority investments. AT&T setup the Mexican telecommunication system so that it could be brought current and be more effective in providing services to its customers. AT&T and the companies were operating together to provide telecommunication services to AT&T customers and the customers of these Mexican companies. This demonstrates that the shares in America Móvil, Telmex, and Telmex Internacional were business assets to AT&T. And thus, the income from these dividends were business income to AT&T under the functional test.

That concludes my presentation. Thank you.

JUDGE HOSEY: Thank you.

I'm gonna see if there's any questions from the

panel before we go into rebuttal.

Starting with Judge Lambert, any questions for the parties on Issue Two?

JUDGE LAMBERT: No questions. Thanks.

JUDGE HOSEY: Thank you.

Judge Gast, any questions for the parties on Issue Two?

JUDGE GAST: No questions as well. Thank you.

JUDGE HOSEY: I don't have any questions at this time either, but I will move to Appellants if you would like to make a rebuttal.

MR. VESELY: We -- [INAUDIBLE]

JUDGE HOSEY: We have. [INAUDIBLE]

MS. HUANG: What are we doing? [INAUDIBLE]

JUDGE HOSEY: I was hoping to finish this issue today, but if you think you're gonna need more than like 15 minutes, then we'll have to push things for tomorrow.

MR. VESELY: It -- it's gonna take me more than 15 minutes. [INAUDIBLE]

JUDGE HOSEY: Okay. Then I guess we can break for today and start with rebuttal on Issue Two tomorrow. And then we can finish questions up and then move to Issue Three. We will begin at 9:00 a.m. tomorrow here. Any questions before I close for today?

Okay. We are ending our hearing for today. The

hearing will be continued tomorrow at 9:00 a.m., and we are now off the record. Thank you.

(Proceedings concluded at 5:10)

HEARING REPORTER'S CERTIFICATE

I, Ernalyn M. Alonzo, Hearing Reporter in and for the State of California, do hereby certify:

That the foregoing transcript of proceedings was taken before me at the time and place set forth, that the testimony and proceedings were reported stenographically by me and later transcribed by computer-aided transcription under my direction and supervision, that the foregoing is a true record of the testimony and proceedings taken at that time.

I further certify that I am in no way interested in the outcome of said action.

I have hereunto subscribed my name this 23rd day of October, 2026.

_____

ERNALYN M. ALONZO
HEARING REPORTER