

11.4 Immediately after a new contract for the purchase by SWBT from an affiliate, or an amendment or addendum to an existing contract has been signed, the following process must begin.

11.41 Step 1

If this case involves a new contract, the Contract Administrator must prepare an SW-1161 as described in Exhibit B of this Operating Practice. The SW-1161 and a copy of the signed contract must be forwarded to the Contract Coordinator as listed in Attachment 2 of this Operating Practice. If this case involves an addendum or an amendment to an existing contract only a signed copy of the document must be forwarded to the Contract Coordinator.

11.42 Step 2

If an addendum or amendment to an existing contract is received, the Contract Coordinator will review the documents, update the CAM if necessary, and forward the documents for presentation to the appropriate regulatory bodies. If a new contract and the SW-1161 are received the Contract Coordinator will review the contract for the mandatory affiliate clause, sign the space noting concurrence with the information of the SW-1161 and forward the SW-1161 and contract to the CAM Attorney.

11.43 Step 3

The CAM Attorney reviews the documentation and after any questions are answered, signs the SW-1161 indicating the contract has been reviewed. The signed SW-1161 and contract is returned to the Contract Coordinator.

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11.44 Step 4

The Contract Coordinator updates the CAM from the contract if necessary, returns a copy of the SW-1161 to the Contract Administrator, files a copy in the master file for completed SW-1161's and forwards the copy of the contract for presentation to the appropriate regulatory bodies.

11.5 Goods/Services purchased for use in the SWBT nonregulated activities and to be booked in nonregulated accounts or using nonregulated function codes are not subject to the FCC Affiliate Transaction rules and are therefore not subject to 11.6 through 11.8

11.6 The Affiliates are required to maintain the records to support the methodology used for costing each item invoiced to SWBT. Contract clauses (such as are described in item 11.1) which will require the Affiliates to maintain cost information records and to allow representatives from SWBT to review such records must be included in the affiliate contracts to ensure compliance by the Affiliates.

11.7 The organization of the District Manager-State Regulatory Issues is responsible for performing FCC affiliate transaction compliance reviews. These reviews include the verification of the FDC and Return On Investment (ROI) studies for services provided by affiliates to SWBT. If upon review of the charges to SWBT a true-up is necessary, i.e., the charges to SWBT exceeded the combined FDC/ROI, this organization is also responsible for the adjustments to SWBT books. When charges exceed FDC/ROI the excess must be removed from SWBT regulated expense accounts and placed in below the line accounts, i.e., subaccounts of Account 7360, Other Nonoperating Income. This assures these excess charges are not included in rate making activity.

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- 11.8 The compliance reviews also include reviewing transaction for those services or products provided to SWBT at Prevailing Price (PP). These transactions are tested to assure the requirement for PP are present, i.e., a substantial number of transactions with nonaffiliates. As with FDC/ROI, if the charges to SWBT books need to be adjusted because the charges were higher than PP, excess charges are moved from regulated expense and asset accounts to the subaccounts of Account 7360.
- 11.9 SWBT purchases of telecommunications equipment (assets) from Southwestern Bell Telecommunications, Inc. (SBT) are unique. That is because SBT equipment may be purchased at PP, or net book value (NB). If the PP criteria is not met for each item purchased from SBT, NB is the valuation methodology (NB and fair market value are considered to be the same since the equipment is on SBT books at their purchase price). Each invoice from SBT for telecommunications equipment is required to provide the cost, the cost methodology (PP or NB), the price and the difference between the cost and price if the price is higher for each item on the invoice, or the statement that all items are prevailing price unless otherwise noted. This provides an audit trail for identifying cost methodology for yearly FCC reports.
- 11.10 To assure SBT telecommunications equipment purchases are booked correctly at SWBT, SBT generates quarterly reports. These reports list all equipment sales to SWBT showing the item description the number of items sold to SWBT, the item price to SWBT, the CAM computed cost (PP or NB) and the difference between price and cost if applicable. If the cost exceeds the price on any of these items, the SWBT books will be adjusted as noted in 11.7 above. A compliance review is performed on SBT sales records to assure the validity of the quarterly reports. A page of the quarterly report is presented as an example in Attachment 7.

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- 11.11 SWBT Management strongly discourages booking charges for goods/services used in the regulated business activities below-the-line. Early contract negotiations should consider this when discussing prices to be paid for affiliate goods/services. Instructions for preparation of the vouchers are in Operating Practice 56, Bill Payment Practices.
- 11.12 The Area Manager-Affiliate Transactions receives monthly reports detailing the amounts being booked to the sub-accounts of Account 7360.3 which are reserved for recording below-the-line amounts described above. These reports are used to monitor and control those amounts and for reporting the amounts and sources to external auditors and regulatory bodies.
- 11.13 The FCC state regulatory bodies and external auditors will perform audits to assure SWBT compliance and to assure the Affiliates have the back-up information necessary to substantiate the costs and cost methodology that they have provided to SWBT. Additionally the Area Manager-Affiliate Transactions performs the compliance reviews noted above, reviewing the affiliates cost and billing records to assure SWBT is booking the transactions in compliance with the FCC accounting safeguards.

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**12.0 OTHER OCCASIONAL ASSET PURCHASES FROM AFFILIATES**

**12.1** As stated in 11.2 above there are occasional asset purchases by SWBT from affiliates. An example is when an employee transfers from an affiliate to SWBT and brings his/her microcomputer equipment which is on the books of the affiliate from which the employee transferred. These occurrences must be handled as purchases from the affiliates (If the asset to be purchased is considered "Plant-in-place" see 10.1 of this Operating Practice). The following steps must be taken to account properly for these transactions.

**12.101 Step 1**

As soon as an SWBT employee (buyer) agrees to the purchase of an asset(s) from an affiliate, the employee must contact the seller (affiliate) and request the following:

- a. That the affiliate issue an invoice to SWBT for the purchase of the equipment, furniture, etc.
- b. That the affiliate provide on the invoice for each item of the invoice:
  - A complete description
  - The net book value from the affiliates books
  - The fair market value which can be obtained by the affiliate from new or used equipment dealers.
  - The purchase price (which should be no higher than the lower of net book value or fair market value).
  - The difference between the lower of net book value or fair market value and the purchase price to SWBT, if applicable.
- c. - That the affiliate include with the invoice the documentation on the development of net book value and fair market value.

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12.102 Step 2

Upon receipt of the invoice from the affiliate the buyer must assure that the requested information is present on the invoice and the back-up documentation from (c) above has been included. If all the requested documentation is not present or the requested information is not on the invoice the invoice must be returned to the seller rather than processed for payment. If all the requested information is present on the invoice and the documentation is present the buyer should proceed to Step 3.

12.103 Step 3

Prepare the documents for payment of the invoice. There is no special accounting as these items are booked just as the purchases of other assets are booked. However, if the lower of net book value or fair market value is higher than the purchase price on the invoice the difference must be booked in the below-the-line account 7360 other nonoperating income. If this becomes necessary the Area Manager-Affiliate Transactions can provide the proper sub-account of Account 7360 to which to book the below-the-line amounts.

12.104 Booking any amount below-the-line for these asset purchases is strongly discouraged by SWBT management. However, on occasion, it may make good business sense to do so. As an example, if an affiliate were to sell SWBT furniture that was purchased and expensed by an affiliate, rather than capitalized, it has no book value. The fair market value of such used furniture may be \$1,000 as appraised by used furniture dealers. Therefore the lower of net book value and fair market value is \$0 since there is no net book value, and SWBT must book the entire purchase price below-the-line. If the purchase price was well below the market price for purchasing the furniture elsewhere, the purchase from the affiliate may still make good business sense.

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12.105 Step 4

The buyer must forward copies of payment documents and the invoice and any back-up to the invoice that documents the net book value and fair market value of the items on the invoice to the Area Manager-Affiliate Transactions as listed in Attachment 3 of this Operating Practice.

12.106 Step 5

The Area Manager-Affiliate Transactions will provide this documentation and report transaction amounts to the regulatory bodies as necessary.

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## 13.0 AFFILIATE SERVICES

### 13.1 General

Affiliate services are a collection of activities that SWBT performs internally that are provided to SBC and SBC's subsidiaries (affiliate companies) utilizing primarily existing resources. The guiding strategy of affiliate services is to maximize benefit to SBC while maximizing contribution to SWBT. This strategy operates within the given of full and complete compliance with Federal and State regulatory requirements.

13.101 Divestiture established a new and different environment for SWBT and that environment has continued to change. The need for an effective and efficient way for SWBT to provide certain services to its affiliated companies became readily apparent.

13.102 SWBT provided a large number of administrative services for its own use pre-divestiture and continues to provide them for its use today. Since many cost benefits accrue from economies of scale, it was apparent that it would be efficient for SWBT to provide services to the affiliates. This environment is governed not only by the Modification of Final Judgment (MFJ) and Federal Communications Commission (FCC) guidelines but also by state regulatory requirements.

13.103 Many SWBT groups and individuals are now involved with affiliate companies for the first time. This section of the Operating Practice will give an overview of the affiliate service process, outline the audit trail that is used to verify compliance with the FCC affiliate transactions accounting safeguards, and assist in facilitating the provision of services to affiliates.

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13.104 A contract process is required for the provision of affiliate services. The contract process defines all SWBT affiliate services in service elements (i.e. per hour, per employee, etc.) that are tracked and billed by unit. Each billable unit has an identifiable cost and a price. This simple easily audited contract process has allowed for the continuous and immediate review of all affiliate services sales to ensure that each transaction complies with the applicable FCC accounting safeguards, and thereby ensures the absence of cross-subsidization of non-regulated affiliates by SWBT's regulated operations.

13.105 The contract process and the audit trail is coordinated by the Area Manager-Affiliate Services in the State Regulatory Issues District of the External Affairs department.

13.2 Process for Sale of Affiliate Services

13.21 The FCC affiliate transactions accounting rules for affiliate services sales states that SWBT must record, as revenue, no less than its fully distributed cost of providing the service. Since affiliate services are not tariffed and are not offered to third parties, neither tariffed rate nor prevailing price is appropriate cost methodology. The FDC requirement is in place to ensure the absence of cross-subsidization by the regulated company to the unregulated affiliate. The basis of the audit trail is this Operating Practice which requires all sales to affiliates to be reduced to writing. These contract documents form the basis for SWBT's ongoing relationship with the affiliate and forms the foundation for the audit of the affiliate services process. See Attachment 8 of the Operating Practice for the flow chart of this activity.

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13.22 The elements of the affiliate services sales process that must take place in order to document compliance with the FCC affiliate transactions accounting rules are outlined by responsible organization and include the four primary elements of: incremental unit cost (IUC), fully distributed cost (FDC), price and units sold.

13.221 STEP 1 SERVICE PROVIDER As soon as the service provider determines a service might be offered the service provider must estimate the appropriate recurring and non-recurring labor, expense and/or capital required to provide a specific service to an affiliated company. The service provider will also provide a brief description of the service. This information must be forwarded to Manager-Affiliate Services, 38-T-06, One Bell Center, St. Louis, MO. 63101, prior to any substantive conversations with the affiliated company.

13.222 STEP 2 AFFILIATE SERVICES GROUP The Manager-Affiliate Services will provide this information to the Manager-Cost Analysis, within three work days of receipt from the service provider. At the same time new contract documents are created or existing documents modified and sent for legal review, if required (see step 4).

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13.223 **STEP 3 COST STUDIES** All cost studies will be forward looking and shall be for a period of time from 12 to 60 months. In addition to IUC's, FDC studies are developed to determine the cost that must be recovered by price in order to comply with the FCC affiliate transactions accounting safeguards contained in CC Docket 86-111. Manager-Cost Analysis will coordinate directly with the service provider to resolve any questions or omissions in the cost input. Cost study results will be sent to Manager-Affiliate Services as soon as completed, but no later than 21 work days from receipt.

- a. IUC, while not required for compliance with the FCC standards is an integral element in defining the benefit to SWBT of providing a service to an affiliate company. The IUC identifies the direct cost incurred by SWBT to provide the service. When that IUC is compared to the price for the service the difference, contribution, is the amount left over that is applied to common cost. This contribution from affiliate services helps reduce upward pressure on local service rates by producing revenue from previously non revenue producing resources.

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- b. FDC is the calculation of all direct and indirect cost associated with the provision of an affiliate service and is the cost that is required by the FCC to be recovered from an affiliate to ensure the absence of cross-subsidization. When the FDC is compared to price for each billing unit provided to an affiliated company it is immediately apparent that SWBT is complying with the FCC affiliate transactions guidelines.

13.224 **STEP 4 LEGAL REVIEW** If the service requires a new General Services Agreement and/or a new Schedule and pricing addendum the Affiliate Services Group will draft and submit those documents for review and approval. If the service is a change to an existing Schedule no additional legal review is required.

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13.225 **STEP 5 AFFILIATE SERVICES GROUP** Pursuant to the Schedule of Authorizations the Area Manager-Affiliate Services will in each case, with the assistance of the Manager-Affiliate Services, set a market comparable price, if appropriate and available, that recovers IUC plus a contribution on each service rendered to an affiliated company. As an input to the pricing decision, service provider provided market comparables, if available, are utilized along with marketing judgement to determine a final price. The final order in CC Docket 86-111 requires that services to affiliate companies recover all direct and indirect cost. Therefore, the final prices established must equal or exceed FDC. If market comparable prices are less than FDC SWBT charges FDC. The affiliated company must then decide if SWBT is the best source of service. Price, of course, immediately documents that the service provided to an affiliate has recovered at least the FDC for that service on an item by item basis.

13.226 **STEP 6 AFFILIATE SERVICES GROUP** After the price is set and the contract documents are approved by legal, the documents are signed, by SWBT, in accordance with the Schedule of Authorizations. Upon signing by SWBT the documents are sent to the affiliated company coordinator to be signed by the affiliated company.

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If the contract documents are not received in 30 days and services are being provided, the affiliate services group will send a copy of the documents signed by SWBT to the service provider to start billing. Upon receipt of the fully executed documents copies will be sent to the service provider (see step 8).

- 13.227 **STEP 7 AFFILIATE COMPANY COORDINATOR**  
The affiliate company coordinator is the single point of contact in the affiliated company that is responsible for the signing of the contract documents.
- 13.228 **STEP 8 AFFILIATE SERVICES GROUP** Upon return of the properly signed documents the affiliate services group distributes copies to the service provider, the affiliate billing group and legal.
- 13.229 **STEP 9 SERVICE PROVIDER** The service provider has the responsibility and must ensure that accurate quantities of service are reported and billed each month. The service provider organization must have in place a means to capture the units sold, and a departmental procedure that instructs employees in how service will be provided, documented and submitted for billing. The Service Provider must supply accurate billing information to the Manager-Affiliate Billing as directed in Attachment 5, **AFFILIATE BILLING CONTRACT ADMINISTRATOR GUIDE.**

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13.3 SWBT's audit trail of affiliate services has for every single element of affiliate service, documented, the IUC, FDC, contract price, and billing record. This straight forward audit trail allows for an immediate verification of compliance with the FCC affiliate transaction rules.

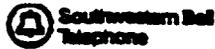
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Southwestern Bell Telephone Company  
 Operating Practice 125  
 Nontariffed Activities and Affiliate Transactions

Exhibit A  
 Page 1  
 August 1990



SW-1151  
 (Rev. 5-89)  
 Ref: Operating Practice 125

CONTRACT CLASSIFICATION FORM

Retain 10 years, unless \_\_\_\_\_

<b>To be completed by the Contract Administrator:</b>	
Title of Contract/Agreement: _____	
Description of Service: _____	
_____	
_____	
Term Of Contract: From ____ / ____ / ____ To ____ / ____ / ____ Estimated Start of Billing: _____	
Costing Methodology: IJC _____ CAM _____	Cost Study Comment: _____ Date Requested: _____
Service Provided To: _____	
Estimated Financial Impact: _____	
CONTRACT CLASSIFICATION: Regulated: _____ Institutional: _____ Nontariffed: _____	
Rationale Supporting Classification: _____	
_____	
<b>Completed By &amp; Return To:</b>	
Name: _____	Contract Administrator: _____
Title: _____	Service Provider: _____
Dept: _____	Product Manager: _____
Address: _____	Clear: _____
_____	_____
Telephone No.: _____	_____
Signature: _____	Date: _____
<b>To be completed by BND or State Contract Coordinator:</b>	
CONCURRED: AGREE _____ DISAGREE _____ (See Reverse)	
Name: _____	Additional Classification Information:
Title: _____	Manufactured: _____ SMPA: _____
Dept: _____	BELLCORE: _____ Affiliates: _____
Address: _____	Domestic: _____ Tariffed: _____
_____	ISIS: _____
_____	Other: _____
Telephone No.: _____	Contract ID No.: _____
Signature: _____	Date: _____
<b>This is to indicate that the Legal Department has reviewed this contract:</b>	
Signature: _____	Date: _____

Original File Copy, unless reproduced

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Letter of Notification Example

**AREA MANAGER-NONREGULATED ACCOUNTING: (OBC,33-D-07)**

This is to inform you of a new activity that has been identified as a potential offering by southwestern Bell Telephone Company. Attached is a detailed description of this activity. Please notify me if there are special time reporting or cost tracking requirements. The other employees working on the activity and I will keep track of all costs and time spend on investigation, development and other work for this activity until I am notified of the appropriate reporting procedures.

Questions may be referred to \_\_\_\_\_ on  
\_\_\_\_\_.

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Dept.: \_\_\_\_\_

Address: \_\_\_\_\_

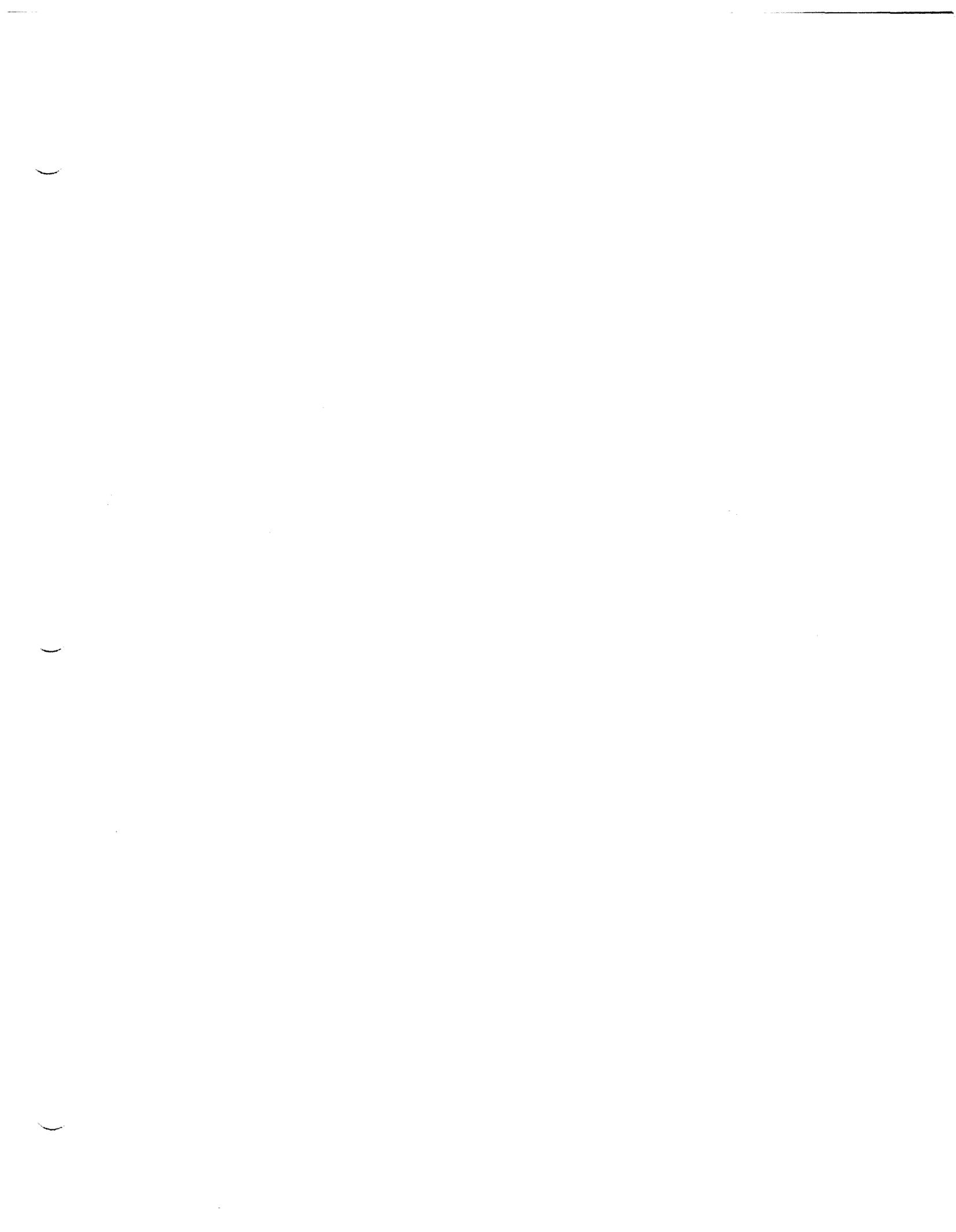
Telephone: \_\_\_\_\_

**Attachment**

CC: Legal (CAM Attorney, OBC, 3522)  
Area Manager-Affiliate Transactions (OBC, 38-S-05)  
Area Manager-Nonregulated Accounting (OBC, 33-E-07)

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**PREPARATION OF FORM SW-1161 AND  
PRELIMINARY LETTER OF NOTIFICATION**

As soon as an employee becomes aware of a new service offering, a Letter of Notification must immediately be sent to the Cost Allocation Manual Contact listed in Attachment 3. Exhibit B provides an example of the Letter of Notification. Please attach a detailed description of the Activity (or a copy of the request for assessment required by Section 5.4 of this Operating Practice). Copies of the Letter of Notification must also be sent as identified in Exhibit B.

The Contract Classification Form, SW-1161, must be prepared for all contracts covering Nontariffed products, services or other Activities that Southwestern Bell Telephone Company (SWBT) provides to outside entities on a Nontariffed basis.

The Form SW-1161 must also be prepared for all contracts with Affiliates regardless of whether SWBT is receiving or providing the asset/service.

The section of Form SW-1161 containing items A through L must be completed by the designated Contract Administrator for each contract. This is usually the Product Manager, a Contract Manager or the Service Provider for the Activity.

The section of the Form SW-1161 containing items M through Q will be completed by the Contract Coordinator.

**CONTRACT ADMINISTRATOR**

**Initial Contract Classification Data**

- A. Enter the title exactly as it appears on the contract.

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- B. Enter a brief description of the service, product or other Activity being provided. If the activity is an Affiliate Transaction, also state whether the Affiliate Transaction is associated with an Activity that SWBT has classified as Nonregulated.
- C. Enter the beginning date (From) and the ending date (To) of the contract. If the activity occurs only once, enter the completion date in both the From and To spaces. If the contract is open-ended, enter the beginning date in the From space and 'OPEN' in the To space.
- D. Enter the date that billing should begin for the contract, if the Activity is new.
- E. Enter a check mark for the costing method used. For Regulated and Incidental Activities, this is normally the Incremental Unit Costing method. For Nonregulated Activities and Regulated Affiliate Transactions the Federal Communications Commission (FCC) requires the methods outlined in SWBT's Cost Allocation Manual (CAM). Please provide the name of the person who provided cost study or cost method advice and the date when that advice was requested. For Nonregulated Activities, this could be the date the Letter of Notification was sent.
- F. Enter the name of the entity that SWBT has contracted with to provide the Activities. Also provide the name of the company receiving the Activities if different from the contracting company, and indicate an (R) after the company receiving services and a (C) after the contracting company. All names should be written exactly as they appear on the contract. If no written contract exists, use the name of the entity being billed and indicate a (B) after the name.

Enter additional names in the spaces provided on the reverse side of Form SW-1161 if more than one company is covered under this contract. For those contracts covering all customers or end users, indicate 'All Customers' or 'End Users' in this space.

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- G. Enter the estimated financial impact on SWBT in terms of the total projected operating revenues if this is a purchasing contract, the operating expenses this activity will generate in the current year.
- H. Enter a check mark to indicate that this contract should be classified as a Regulated, Incidental or Nonregulated Activity. This affects both accounting and cost allocation treatment. Your decision should be based on the following criteria:
- All Activities considered to be common carrier communications for purposes of Title II of the Communications Act of 1934, as amended, will be classified as Regulated.
  - Most Activities that are not considered to be common carrier communications for purposes of Title II of the Communications Act of 1934, as amended, will be classified as Nonregulated Activities.
  - Any common carrier offerings subject to forbearance, streamlined or other decreased regulation in the future will be classified as Regulated activities.
  - Activities regulated in the interstate jurisdiction that may be Detariffed or Deregulated in the states will be classified as Regulated for accounting purposes.
  - Activities Deregulated only in the interstate jurisdiction that are not preemptively Deregulated will be classified as Regulated until such time as the FCC specifically decides otherwise.
  - Non-incidental Activities that have never been Tariffed or otherwise regulated by the FCC or any state commission must be classified as Nonregulated.

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- Activities that have been preemptively Deregulated by the FCC must be classified as Nonregulated.
- Nontariffed Activities considered to be incidental to Tariffed services will be classified as Incidental provided they are:
  - Outgrowths of regulated operations; and
  - Non-line-of-business activities; and
  - Traditionally treated as incidental; and
  - The revenues from Incidental activities, in the aggregate, fall within one percent of the total company annual regulated operating revenues.
- I. Enter the rationale to support the classification decision in item H. Use the terminology provided in the criteria list in item H. Also, provide a copy of any other documentation, such as legal decisions, that impact the classification.
- J. The person preparing the form should enter his or her name, title, department, address and telephone number.
- K. If you are the Contract Administrator, place a check next to Contract Administrator. If you have the primary responsibility for providing the services, place a check next to Service Provider. If you are the Product Manager for this contract, place a check next to Product Manager. If you are none of the above, state your role in the contract process next to Other.
- L. The person preparing the form should sign the date the form in the spaces provided.

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Distribution of the Completed SW-1161 Form

The Contract Administrator should retain a copy of the SW-1161 for the files and send the original SW-1161 form, and a copy of the contract to the Contract Coordinator listed in Attachment 2 of this Operating Practice.

Concurrence Review Contract Coordinator

All initial contract classification data should be reviewed for reasonableness, accuracy, proper costing methodology and compliance with recent FCC decisions. If clarification is needed, the Contract Coordinator will contact the Contract Administrator to request additional information.

- M. Enter a check mark next to Agree if the classification is appropriate. If the classification is inappropriate, check Disagree, write 'See Reverse' and on the reverse side of Form SW-1161, enter the reasons for nonconcurrence. A copy of the form should then be sent to the person in item J for further investigation.
- N. Enter the Contract Coordinator's name, title, department, address and telephone number.
- O. Enter the check mark next to the contract category that further classifies the type of contract:
- BELLCORE - Contracts administered by the Bellcore Administration District in Southwestern Bell Services. Examples include services such as STARS, and SMS.
  - Affiliate - Services provided to or received from SBC and its affiliates or SWBT Nonregulated subsidiaries.

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