The second possible justification for an offset -- the existence of the sharing and the lower end adjustment mechanisms -- actually is no justification at all. When the Commission adopted its price cap plan for exchange carriers, that plan contained provisions governing both exogenous cost treatment for certain externally imposed changes and the sharing and lower end adjustments. Thus, the Commission could not have intended the sharing and lower end adjustment mechanisms to supplant exogenous treatment of expense changes that qualify for such treatment. Indeed, these two mechanisms are intended to address very different concerns. The sharing and lower end adjustment mechanisms are designed to constrain an exchange carrier's earnings -- which generally result from items within its control -- within certain broad parameters. The Commission designed the exogenous cost adjustment to accomplish an entirely different purpose -- namely, to flow those expenses over which exchange carriers have no control to their customers. Thus, there is no basis for using the sharing and lower end adjustments as substitutes for exogenous cost adjustments.

The third possible offset -- to account for the fact that GNP-PI reflects changes in medical costs -- would also be improper. As the NERA Study demonstrates, actual 1993 OPEB expenses reflect future medical costs. Thus, if the 1993 exogenous cost adjustment is done correctly, it would merely place Rochester in the same position it would have been had it been permitted to utilize accrual accounting for OPEBs in the first instance.[28/]

Moreover, this type of adjustment would effectively ignore increases in medical care costs. GNP-PI is a broadly-based measure of price changes in the national economy and includes within it changes in medical care costs. Indeed, the Commission chose GNP-PI as the measure of inflation because of the breadth of its coverage.[29/] Disaggregating this measure and examining one of its components would simply remove that component from the equation. Thus, far from recognizing the general medical cost trend, this proposed adjustment would effectively ignore it and thus understate the rate of inflation measured by GNP-PI.

In addition, the theory of causation underlying the proposed adjustment is flawed. It assumes that the conversion from cash to accrual accounting will itself have an effect of medical care costs. That assumption is incorrect. As described at length above,[30/] this accounting change will have

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28/ NERA Study at 24.

29/ Second Report and Order, 5 FCC Rcd. at 6792-93, ¶ 50.

30/ *See supra* at 12-13.

no effect on the economic costs of providing goods and services, including medical care and, therefore, will have no effect on the medical care component of GNP-PI. Hence, no adjustment is warranted.[31/]

The final possible offset posited by the Bureau[32/] -- a change in the national wage level to reflect the implementation of SFAS 106 -- is also inappropriate. Like the proposed adjustment for medical inflation, the theory of causation underlying this proposal is wrong. There is no reason to believe that the implementation of SFAS 106, because it does not change the cost of providing OPEBs, will have any effect on the national wage level. Because a firm's costs of providing OPEBs is not affected by the implementation of SFAS 106, and because SFAS 106 does not affect the amount or timing of benefits payments, there are no factors that will cause a change in the supply or demand for labor in the national

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31/ It is important to remember the nature of the exogenous cost adjustment being proposed -- a one-time adjustment to the price cap indices to place Rochester in the same position as if it had been permitted to utilize accrual accounting for OPEBs prior to the initiation of price caps. Once that has been accomplished, OPEB expense becomes just another input cost that an exchange carrier must manage. On an ongoing basis, changes to OPEB expenses are within an exchange carrier's control and further exogenous adjustments to reflect this one-time event would be inconsistent with price cap regulation, except at the time the TBO becomes fully amortized.

32/ Designation Order, ¶ 15.

economy. Consequently, there will be no effect on wage levels resulting from the implementation of SFAS 106.

The Godwins Study, which posited the potential existence of an effect on wages, assumed that the implementation of SFAS 106 represented a direct increase in the costs of labor facing employers.[33/] This assumption is incorrect. SFAS 106 causes no such increase; it merely changes the accounting method to be used to recognize those costs on companies' financial statements.[34/]

Even assuming that this wage effect occurs in the national economy, the Godwins Study provides no assurance that the same effect would be experienced by exchange carriers.[35/] It would constitute an exercise in speculation to recognize an offset for an event that may never occur.

Because the implementation of SFAS 106 will increase GNP-PI only by 0.12%, the Commission should permit Rochester to recover the remainder of the increase to its revenue requirement that it will experience as an exogenous cost adjustment to its price cap indices. Thus, 95.8% of

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33/ Godwins Study at 9.

34/ However, as explained above (*supra* at 14-17), this fact provides no basis for the assertion that the effects of this accounting change should not be reflected in exchange carriers' rates.

35/ Godwins Study at 5.

Rochester Telephone's and 93.6% of Vista's incremental exogenous OPEB expenses allocable to interstate access services qualify for exogenous treatment.

II. ROCHESTER'S INCREMENTAL OPEB EXPENSES ARE PROPERLY QUANTIFIED AND BASED UPON REASONABLE ACTUARIAL ASSUMPTIONS.

Rochester's SFAS 106 expense forecasts were developed in conjunction with its actuaries, Buck Consultants. The generally applicable assumptions, e.g., time value of money, medical cost trends, Medicare reimbursement rates and the like, represent Rochester's and Buck's best estimates of the future experience with respect to these items. Similarly, those assumptions that are specific to Rochester, e.g., participation rates, salary progression, possibility of payout and the like, are based upon company-specific data, where available, and appropriate surrogates where they are not. As such, the assumptions underlying Rochester's forecast of its OPEB expenses are reasonable and, indeed, are the "best estimates" required by SFAS 106. The remainder of this section of the Direct Case describes those assumptions.[36/]

A. External Assumptions

The actuarial cost method utilized is the projected unit credit with benefits attributed ratably to service from date of hire until date of full eligibility for benefits. This is the

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36/ See Designation Order, ¶ 14.

attribution method specified in SFAS 106. The study assumed a discount rate of 8% per annum, compounded annually. In addition, medical plan costs were assumed to increase 13.0% in 1992 with the rate of increase gradually decreasing to 6.8% by the year 2006. Moreover, because benefits costs will increase faster than the medical cost trend due to the erosion of fixed dollar deductibles, the valuation assumes that the effect of double leveraging will increase the initial medical cost trend by 0.81%. The study further assumes that this leveraging effect will decrease geometrically by 10% per year.

For those companies that reimburse retirees for Part B Medicare costs, the study assumes that Part B premiums would rise to $46.10 per month by 1995 and then increase 5% per year thereafter.

Finally, Rochester made no assumptions regarding the possibility of capping or the creation of a national health insurance plan. It would be far too speculative to predict the occurrence of either approach or the form that one or the other might take.

B. Internal Assumptions

The following assumptions, which relate to the operations of Rochester, were also utilized.

Dependents -- For current retirees of the Rochester, New York telephone operations, representative values of the percentage assumed married is shown on Exhibit V-A. For current retirees of Rochester's subsidiaries (including Vista), actual spousal information was used where available. Where that information was not available, the study assumes that husbands were 4 years (3 years for Vista) older than their wives. The costs for any dependent children were assumed to be included in the costs per spouse.

Participation Rates -- Except for Vista, the study assumes that all employees, both current and former, who were eligible to participate did so. It further assumes that future retirees of Vista would participate as shown in Exhibit V-B.

Separations from Active Service -- Exhibits V-C and V-D show representative values of the assumed annual rates of termination, disability, death and retirement for Rochester Telephone and Vista, respectively.

Salary Progression -- Assumptions regarding salary progression are set forth in Exhibit V-E.

C. Per Capita Claims Costs

The final item for which the Bureau seeks data is per capita claims cost by age.[37/] Rochester's actuarial study did not contain any assumptions regarding per capita claims costs, nor should it have. The claims experience of the group being insured is most appropriate for self-insured medical arrangements or for experience-rated insurance contracts. Projecting the expected claims for the Rochester, New York

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37/ Designation Order, ¶ 14.

operating company, however, would not give an accurate representation of the costs of the benefits covered. That entity does not pay premiums based upon its own claims experience. Rather, the cost of coverage is based on the experience of a large community based pool. Actual claims costs for that entity's individual retirees would have virtually no impact on the cost that it would be paying for the coverage. Since the ultimate goal of the calculation is not to measure the actual claims costs of the group, but rather to project the expected costs of coverage to the employer, use of the community rated premiums is more appropriate and was employed in this study.

On the other hand, Rochester's subsidiaries (except Vista) are generally experience rated and have few or no retirees. For these companies, the study used the current premiums actually paid as the best surrogate for their claims experience.

Rochester's projections are reasonable and are based on actuarial assumptions, developed by experts, that are reasonable.

III. ROCHESTER WILL ALLOCATE ITS EXOGENOUS COST INCREASES AMONG THE PRICE CAP BASKETS IN A COST-CAUSATIVE MANNER.

The Bureau has designated for investigation whether price cap carriers have correctly allocated the exogenous expense increase among the baskets in a manner consistent with the

Commission's rules.[38/] For carriers that have not yet filed tariff revisions to implement an exogenous adjustment, the Bureau has requested that they provide good faith estimates of the amounts of the expense increase that they intend to allocate to each of the price cap baskets.[39/]

Because Rochester has not yet filed its tariff revisions, it provides herewith the methodology that it proposes to utilize to perform this allocation and its estimate of the results of that allocation.

Rochester's proposed allocation method is based upon the "Big Three" expense allocators described in section 69.2(f) of the Commission's rules. The vast majority of Rochester's wage expenses are captured by the Big Three allocators. Its exogenous OPEB costs are plainly wage related and, hence, Rochester's proposed methodology meets the Commission's requirement that these expenses be allocated on a cost-causative basis.[40/]

For Rochester Telephone, this allocation process will assign approximately $802,100 to the traffic sensitive switched basket, $1,140,800 to the common line basket, and $409,300 to the special access basket. The corresponding figures for Vista

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38/ Designation Order, ¶ 10 (issue II(d)).

39/ Id., ¶ 11 n.14.

40/ See 47 C.F.R. § 61.44(c).

are $133,800, $176,500, and $34,400. This exogenous adjustment is net of Part 64 allocations to nonregulated activities and reflects the capitalization of a portion of the accrual.

Conclusion

For the foregoing reasons, the Commission should permit Rochester to reflect exogenous cost adjustments to its price cap indices as set forth herein.

Respectfully submitted,

JOSEPHINE S. TRUBEK
General Counsel

ROCHESTER TELEPHONE CORPORATION
180 South Clinton Avenue
Rochester, New York 14646
(716) 777-6713

Michael J. Shortley, III
of Counsel

May 29, 1992

(1805K)

EXHIBIT I

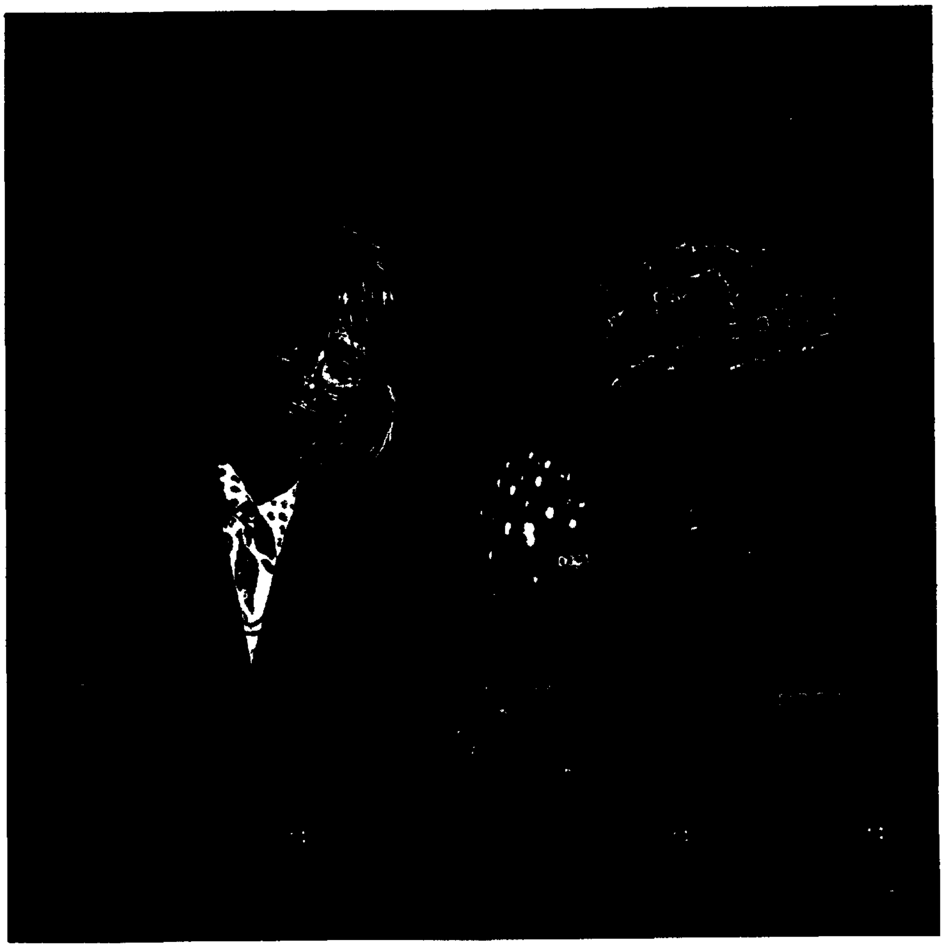
ROCHESTER TELEPHONE CORPORATION
SUMMARY OF RETIREE NONPENSION BENEFITS

COMPANY	LIFE INSURANCE	HEALTHCARE INSURANCE	MEDICARE PART B REIMBURSEMENT	HEALTHCARE REIMBURSEMENT	TELEPHONE DISCOUNT
AUSABLE VALLEY	X	X	X		X
BREEZEWOOD					
CANTON		X			
CC&S: (2)		X			
ENTERPRISE					X
HIGHLAND	X	X	X		X
INLAND		X			
LAKESHORE: (1)	X	X			
LAKESIDE		X			
LAKEWOOD					
MIDLAND		X			
MIDWAY					
MONDOVI		X			
MONROEVILLE					
MT. PULASKI		X			
ONTONAGON		X (1)			X
ORION: (1)		X	X		
OSWAYO: (3)	X	X			
PRAIRIE		X			
ROCHESTER	X	X	X	X	X
S & A		X (1)			X
SCHUYLER		X			
SENECA GORHAM		X			X
SOUTHLAND	X (3)	X			
SYLVAN LAKE	X	X	X		X
THORNTOWN		X	X		
URBAN		X (4)			
VISTA	X	X			

(1) Contract Employees Only
(2) Management Only
(3) Grandfathered Group Only
(4) Provides Lump Sum Benefit @ Retirement

EXHIBIT II

ROCHESTER TEL 1991 ANNUAL REPORT



Today's Rochester Tel—Innovative in its application of advanced technology and focused on meeting customer needs.

benefits for five years or until age 65, whichever is earlier. Accordingly, pension costs for the fourth quarter of 1990 include a one-time charge of $1.9 million. Payments are being made from pension plan assets.

10. Postretirement Life and Health Benefits

In addition to providing pension benefits, the company provides health care and life insurance benefits for retired employees. Substantially all of the company's employees may become eligible for those benefits if they reach normal retirement age while working for the company. For the Rochester company, the life insurance benefit for employees who were retired or pension-eligible on September 1, 1981 is provided through a Retired Life Reserve that became fully funded in 1982. With this exception, the health care and life insurance benefits for both the 4,559 active employees and the 1,667 retired employees at December 31, 1991 are provided through insurance companies whose premiums are based on the benefits paid during the year. The company recognizes the cost of providing those benefits by expensing the portion of the insurance premiums it pays during the year, which was $11.7 million for 1991, $10.5 million for 1990 and $8.3 million for 1989.

In December 1990 the Financial Accounting Standards Board issued Statement No. 106 (FAS 106), "Employers' Accounting for Postretirement Benefits Other Than Pensions," which is required to be implemented by January 1, 1993. FAS 106 requires that projected future costs of providing postretirement benefits, such as health care and life insurance, be recognized as an expense as employees render service instead of when the benefits are paid. Companies can elect to record the previously unrecognized amount (transition obligation) as a charge against income in the year that FAS 106 is adopted, or to amortize the amount over the average remaining service period of active participants, or 20 years, whichever is greater.

The company has not yet decided when it will adopt the new standard nor, because of its complexities, determined the effect that its adoption will have on the financial position and results of operations. However, the company believes that its annual postretirement benefit expense, computed in accordance with FAS 106, will be three to four times the current level of expense estimated to be approximately $3.5 million. Virtually all of the increase would relate to the Telephone Group which is subject to rate regulation. Because of this, the accounting method and ultimate impact on net income will largely depend on rate making treatment as authorized in future federal and state regulatory proceedings. The company also believes that the new rules will not impact its net cash flow relating to retiree benefits.

11. Leases and License Agreements

The company leases buildings, land, office space, fiber optic network, computer hardware and other equipment, and has license agreements for rights-of-way for construction and operation of a fiber optic communications system. Total rental expense amounted to $15.4 million in 1991, $12.2 million in 1990 and $12.4 million in 1989.

Minimum annual rental commitments under non-cancellable leases and license agreements in effect on December 31, 1991 were as follows:

In thousands of dollars	Non-Cancellable Leases		Licens
Years	Buildings	Equipment	Agreement
1992	$ 7,247	$ 4,602	$ 4,48
1993	7,224	4,083	4,68
1994	6,259	3,421	4,68
1995	5,600	3,107	4,68
1996	5,150	1,548	5,06
1997 and thereafter	32,355	2,118	36,88
Total	$63,835	$18,879	$60,49

12. Business Segment Information

Revenues and sales, operating income, depreciation, construction expenditures and identifiable assets by business segment are set forth in the Business Segment Information included on page 36 of this report.

13. Commitments and Contingencies

In 1984 the New York State Public Service Commission (NYSPSC) initiated a proceeding to investigate the appropr ateness of royalty payments from the subsidiaries to Rochester Telephone Corporation for the alleged benefit affiliat gain from using the Rochester Tel name. Prefiled testimon hearings and briefs were submitted and concluded in the royalty proceeding during 1985. On August 13, 1985, the Administrative Law Judge, in his Recommended Decision concurred with the royalty concept and indicated that further investigation was necessary to quantify the payme amounts. The royalty proceedings were reopened on May 1990. The company filed a motion for a rehearing of the NYSPSC's May 2, 1990 order reopening the hearings, but the NYSPSC declined to reverse its determination that it possessed the authority to impose a royalty. Nevertheless, the NYSPSC stated that its May 2 order was not final for purposes of judicial review, and it provided additional gui ance to the Administrative Law Judge on the scope of hea ings on remand. In testimony filed on December 7, 1990, the NYSPSC Staff requested the NYSPSC impose a royalt the amount of approximately $11 million per year. The St Consumer Protection Board advocated a royalty of appro mately $14 million per year. These amounts would be treated as an offset to the Rochester company's regulated revenue requirement for ratemaking purposes. On Januar 15, 1991, the company filed its direct testimony in which disputed both the justifications for and quantification of t royalty proposals. The Administrative Law Judge released Recommended Decision on February 3, 1992. Although t Judge concluded that a royalty could be justified as a resu of the use of the Rochester Tel name and reputation by Rochester's unregulated subsidiaries, she concluded that the royalty proponents failed to quantify the amount of th royalty. The Judge has recommended that no specific roya

Interstate Regulated
Pay-As-You-Go Amounts

($ in 000s)

Rochester Telephone

	1991	1992
Life Insurance	$ 11	$ 13
Med. Ins. & Reimbursement	350	514
Part B Medicare Reimbursement	70	85
Discounted Tel. Service	20	24
Total	$451	$636

Vista

	1991	1992
Life Insurance	$ 4	$ 7
Medical Ins.	78	127
Discounted Tel. Service	5	8
Total	$ 87	$142

(2397Z)

Incremental Interstate SFAS 106
106 OPEB Revenue Requirement

($ in 000s)

Rochester Telephone

		Year			
		1993	1994	1995	1996
1.	Total SFAS 106 Accrual	$3632	$3941	$4258	$4623
2.	Pay-As-You-Go Amount	652	719	798	881
3.	Incremental Expense	2980	3222	3460	3742
4.	Incremental Rate Base Effect	(117)	(366)	(637)	(927)
5.	Incremental Revenue Requirement	$2863	$2856	$2823	$2815

Vista

		Year			
		1993	1994	1995	1996
1.	Total SFAS 106 Accrual	$ 570	$ 600	$ 631	$ 662
2.	Pay-As-You-Go Amount	158	175	193	213
3.	Incremental Expense	412	424	437	450
4.	Incremental Rate Base Effect	(23)	(70)	(119)	(168)
5.	Incremental Revenue Requirement	$ 388	$ 354	$ 319	$ 281

Explanation of Incremental Interstate Revenue Requirement Calculations for SFAS 106

Exhibit III (page 2) provides the results of Rochester's incremental revenue requirement study and associated assumptions for interstate operations. This study was based on a model developed by the United States Telephone Association ("USTA") to calculate industry-wide revenue requirement effects. USTA presented this model and industry-wide results to the Commission staff on several occasions.[1/]

Rochester's study determined the incremental interstate revenue requirement of SFAS 106 accrual amounts over amounts currently paid on a cash basis. It should be emphasized that the amounts reflected on Exhibit III were based on various actuarial and economic assumptions. These assumptions, which are similar to Rochester's pension assumptions, reflect Rochester's best current estimates and are subject to change with the passage of time. The SFAS 106 accrual amounts for the year 1993 were determined by Rochester's actuary, Buck Consultants. The SFAS 106 accruals for the years 1994 through 1996 were determined based on future economic assumptions and actuarial assumptions included in the 1993 actuarial valuation. The total company accrual amounts were then split between regulated, nonregulated, capital and expense based on the company's projected labor distribution. All costs allocated to nonregulated operations were eliminated from further computations. The regulated expense and capital components were then split between interstate and intrastate operations based on the Commission's Part 36 rules. Other than the retiree life reserve of $3,994,000, Rochester Telephone assumed no additional funding of the OPEB liability for the years 1993 through 1996 as projected for this study.

Line 1 of Attachment III reflects SFAS 106 expense plus depreciation of the capitalized OPEB amounts. Subtracted from these amounts are the "Pay-As-You-Go" amounts currently allowed in rates to arrive at the incremental expense on line 3 of Attachment III. Line 4 shows the incremental rate base effect of SFAS 106 net periodic costs. This amount is negative because of the liability that will accumulate from the company funding at a level less than its entire OPEB obligation. Offsetting the rate base reduction described above are the capitalized SFAS 106 amounts and the deferred tax asset that will reside in Account 4340. The net rate base impact is then multiplied by the pre-tax authorized return to arrive at the amounts on line 4.

1/ Meetings were held with FCC staff on May 19, 1989, July 13, 1990, August 10, 1990 and February 14, 1991.

Derivation of Exogenous Cost Adjustment

Rochester Telephone

			Source
(1)	Interstate Access Revenue Requirement	$85,649,000	Tr. 166
(2)	Incremental SFAS 106 Revenue Requirement	$ 2,863,000	Ex. III
(3)	Amount Allocated to Access	$ 2,455,300	Part 69
(4)	Required Percentage Price Increase	2.87%	1. 3 / 1. 1
(5)	Impact of SFAS 106 on GNP-PI	0.12%	NERA Study
(6)	Percent to Be Recoverd As Exogenous	95.8%	1 - (1. 5/1. 4)
(7)	Amount To Be Recovered As Exogenous	$ 2,352,200	1. 1 x 1. 6

Vista

			Source
(1)	Interstate Access Revenue Requirement	$19,586,000	Tr. 8
(2)	Incremental SFAS 106 Revenue Requirement	$ 388,000	Ex. III
(3)	Amount Allocated to Access	$ 368,300	Part 69
(4)	Required Percentage Price Increase	1.88%	1. 3 / 1. 1
(5)	Percent Recovered in GNP-PI	0.12%	NERA Study
(6)	Percent to Be Recovered As Exogenous	93.6%	1-(1. 5/1. 4)
(7)	Amount To Be Recovered As Exogenous	$ 344,700	1. 1 x 1. 6

EXHIBIT V-A

Rochester, New York Telephone Operations
Dependency Assumptions
Percent Assumed Married by Age

Age	Male Retirees	Female Retirees
55	83%	60%
60	84	49
65	86	36
70	81	27
75	75	16
80	66	8
85	53	5
90	37	3
95	14	1

(2739Z)

EXHIBIT V-B

Percent Participation - Vista

Service at Retirement	% Participate
< 15 years	NA
15-19 years	63.2%
20-24 years	77.5%
25-29 years	89.4%
30+ years	94.2%

(2739Z)

EXHIBIT V-C

Rochester Telephone

Annual Rate of

Age	Withdrawal and Vesting	Disability	Retirement	Death
		Men		
25	15.7%	0.1%	-	0.1%
30	9.0	0.1	-	0.1
35	5.7	0.1	-	0.1
40	3.0	0.1	-	0.2
45	1.6	0.2	0.1%	0.2
50	1.2	0.4	7.5	0.3
55	0.7	0.7	9.4	0.5
60	0.7	1.3	13.1	1.0
65	0.7	2.0	20.0	1.8
69	0.7	3.7	20.0	2.8
		Women		
25	12.6%	0.1%	-	-
30	8.8	0.1	-	-
35	5.8	0.1	-	0.1%
40	4.0	0.1	-	0.1
45	2.9	0.2	2.9%	0.1
50	4.3	0.4	12.1	0.2
55	3.4	0.7	13.2	0.3
60	2.8	1.3	16.3	0.5
65	2.6	2.0	20.0	1.0
69	2.5	3.7	20.0	1.6

(2739Z)

EXHIBIT V-D

Vista

Annual Rate of

Age	Withdrawal*	Withdrawal**	Death	Disability
		Men		
25	11.6%	5.8%	.1%	.1%
30	7.6	3.5	.1	.1
35	4.4	2.2	.1	.1
40	4.4	2.2	.2	.1
45	4.2	2.1	.3	.2
50	4.0	2.0	.5	.4
55	3.6	1.8	.7	.7
60	3.2	1.9	1.2	1.2
64	2.9	2.0	1.8	1.6
		Women		
25	20.0%	9.0%	.03%	.1%
30	13.0	6.5	.04	.1
35	9.5	4.8	.06	.1
40	7.4	3.7	.09	.1
45	4.3	2.2	.13	.1
50	4.0	2.0	.19	.4
55	4.5	1.8	.30	.5
60	5.0	1.6	.51	.6
64	5.4	1.4	.79	.9

* First ten years of service

** After ten years of service

(2739Z)

EXHIBIT V-E

Rochester
Salary Progression

Age	Annual Rates of Salary Increase
25	8.7%
30	6.7
35	6.6
40	6.5
45	6.5
50	6.4
55	6.4
60	6.4
65	6.3
69	6.3

(2739Z)

Certificate of Service

I hereby certify that, on this 29th day of May, 1992, copies of the foregoing Direct Case of Rochester Telephone Corporation were served by first-class mail, postage prepaid, upon the parties on the attached service list.

Michael J. Shortley, III
Attorney for Rochester
Telephone Corporation

SERVICE LIST

Floyd S. Keene
JoAnne G. Bloom
Ameritech Operating Companies
2000 West Ameritech Center Dr.
Hoffman Estates, IL 60196-1025

John Thorne
Michael Lowe
Bell Atlantic
1710 H Street, N.W.
Washington, D.C. 20006

William B. Barfield
M. Robert Sutherland
BellSouth Corporation
1155 Peachtree St., N.E.
Suite 1800
Atlanta, GA 30367-6000

Gail L. Polivy
GTE Service Corporation
Suite 1200
1850 M Street, N.W.
Washington, D.C. 20036

John B. Rooney
Southern New England
Telephone Company
227 Church Street
New Haven, CT 06506

Dana Rasmussen
U S West, Inc.
1020 19th Street, N.W.
Suite 700
Washington, D.C. 20036

Mary McDermott
Campbell L. Ayling
NYNEX
120 Bloomingdale Road
White Plains, NY 10605

James P. Tuthill
Jacqueline P. Minor
Nancy K. McMahon
Pacific Bell/Nevada Bell
Room 1526
140 New Montgomery Street
San Francisco, CA 94105

William C. Sullivan
Richard C. Hartgrove
Patricia J. Nobles
Southwestern Bell Telephone Co.
1010 Pine Street
Room 2114
St. Louis, MO 63101

Jay C. Kiethley
United Telephone
1850 M Street, N.W.
Washington, D.C. 20036

(2830P)