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FEDERAL COMMUNICATIONS COMMISSION  
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Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

In the Matter of	)	
	)	
Treatment of Local Exchange Carrier	)	CC Docket No. 92-101
Tariffs Implementing Statement of	)	
Financial Accounting Standards,	)	
"Employers Accounting for	)	
Postretirement Benefits Other Than	)	
Pensions"	)	
	)	
Bell Atlantic Tariff F.C.C. No. 1	)	Transmittal No. 497
	)	
US West Communications, Inc.	)	Transmittal No. 246
Tariff F.C.C. Nos. 1 and 4	)	
	)	
Pacific Bell Tariff F.C.C. No. 1	)	Transmittal No. 1597

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REBUTTAL TO OPPOSITIONS TO  
THE DIRECT CASE OF  
THE SOUTHERN NEW ENGLAND TELEPHONE COMPANY

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I. INTRODUCTION.

The Southern New England Telephone Company (SNET) submits this Rebuttal to the Oppositions filed on June 1, 1992.<sup>1</sup> The Oppositions addressed issues concerning SNET's Direct Case, which was filed in response to the request

<sup>1</sup> Opposition parties included AT&T, MCI, Ad Hoc Telecommunications Users Committee ("Ad Hoc") and the International Communications Association ("ICA"). These filings were submitted to the Commission on July 1, 1992. The Ad Hoc and ICA filings jointly relied upon an analysis by Economic and Technology, Inc. ("ETI").

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issued by the Common Carrier Bureau of the Federal Communications Commission (Commission) in its Order of Investigation and Suspension.<sup>2</sup>

## II. BACKGROUND.

SNET demonstrated in its Direct Case that the mandated accounting change to implement SFAS-106<sup>3</sup> should be recognized as an exogenous cost under the Commission's price cap rules. Further, the assumptions made by SNET in calculating these costs are reasonable, the costs have been correctly calculated, and the allocations of these costs among the price cap baskets are consistent with Commission rules.

In the Commission's Order of Investigation, SNET was named as a party even though it is among those price cap local exchange carriers (LECs) who have not at this point sought exogenous treatment of the costs to implement SFAS-106.<sup>4</sup>

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<sup>2</sup> Order of Investigation and Suspension, CC Docket. No. 92-101, DA 92-540, released April 30, 1992 (Order of Investigation).

<sup>3</sup> The Financial Accounting Standards Board (FASB) issued its Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions ("SFAS-106") in December, 1990, which changes the way SNET and other companies must account for postretirement benefits other than pensions. See Order of Investigation at para. 2.

<sup>4</sup> Order of Investigation at para. 9, fn. 12 and App. A. Further, SNET has not yet selected the amortization period of the SFAS-106 transition obligation. See Responsible Accounting Officers (RAO) Letter 20, released May 4, 1992 (DA 92-520) by Chief, Accounting and Audits Division, p. 2.

SNET has not yet adopted SFAS-106, and is still in the process of determining its implementation date. Pursuant to the Commission's request in this matter, SNET was directed to submit good faith estimates of costs and did so as part of its June 1, 1992 filing.<sup>5</sup>

**III. IMPLEMENTATION OF SFAS-106 RESULTS IN AN EXOGENOUS COST CHANGE UNDER THE COMMISSION'S PRICE CAP RULES.**

Exogenous treatment should be granted under the Commission's price cap rules because: 1) the accounting change is outside the LEC's control; 2) the mandated accounting change has been ordered by the Commission to be reflected in regulatory accounting;<sup>6</sup> and 3) there would be no double-counting in the GNP-PI.<sup>7</sup>

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<sup>5</sup> Order of Investigation at fn. 14.

<sup>6</sup> See MCI Opposition at p. 8. MCI argues that SFAS-106 is "nothing more than an accounting change that alters the temporal recognition of costs on financial statements." This is precisely why SFAS-106 should be recognized as an exogenous change. What is changing is not the underlying cost but the change in the method of accounting, whereby there is a conversion to the accrual method of accounting from a cash method of accounting. This consequence gives rise to the transition obligation resulting from the implementation of SFAS-106. If exogenous treatment of these costs is not afforded by the Commission, then the local exchange companies will not have an opportunity for cost recovery.

<sup>7</sup> Order of Investigation at page 1, fn. 1 and 2 citing LEC Price Cap Order, 5 FCC Rcd 6786 (1990); LEC Price Cap Reconsideration Order, 6 FCC Rcd 2637 (1991); and AT&T Price Cap Reconsideration Order, 6 FCC Rcd 665 (1991). See also RAO Letter 20.

IV. USTA'S GODWINS STUDY PROPERLY DEMONSTRATES THAT THE INCREMENTAL COSTS OF IMPLEMENTING SFAS-106 IS AN EXOGENOUS COST CHANGE.

Despite the Oppositions' contentions to the contrary, SNET and the other price cap LECs have met the threshold burden of proof of demonstrating that exogenous cost treatment is appropriate.<sup>8</sup>

SNET and other price cap LECs have submitted the Godwins Study under USTA's auspices.<sup>9</sup> The Godwins Study demonstrates that the incremental costs of implementing SFAS-106 should be reflected as an exogenous cost change. SNET supports USTA's Rebuttal to Oppositions to Direct Case in its filing of July 31, 1992 in this matter in response to the objections of those who filed in opposition to the Godwins Study.<sup>10</sup>

This Rebuttal addresses the oppositions' comments specific to SNET. Further, SNET joins USTA's Rebuttal to

<sup>8</sup> MCI Opposition at p. 5; AT&T Opposition at p. 6; Ad Hoc Opposition at p. 5.

<sup>9</sup> See the Direct Case filings of Ameritech Operating Companies (Ameritech), Bell Atlantic Telephone Companies (Bell Atlantic), BellSouth Telecommunications, Inc. (BellSouth), GTE Telephone Operating Companies (GTE), NYNEX Telephone Companies (NYNEX), Southwestern Bell Telephone Companies (SWBT), United Telephone Systems (United) and US West Communications, Inc. (US West). See also Nevada Bell and Pacific Bell (PacBell) and Rochester Telephone Company (RTC) who relied upon the National Economic Research Associates, Inc. (NERA) Study. NERA's findings corroborate the Godwins Study demonstrating the need for exogenous cost recovery of SFAS-106 costs.

<sup>10</sup> SNET supports USTA's Rebuttal filing of July 31, 1992 in this matter that addresses the objections regarding the Godwins study on the double count issue, as well as the objections regarding the actuarial analysis and macroeconomic analysis contained within the Godwins Study.

Oppositions to Direct Case in its filing of July 31, 1992 in rebutting ETI's arguments about the economic consequences of postretirement benefits and the degree to which SFAS-106 effects are already considered in the Commission's prescription of rate return upon which the LEC price cap plan was based.<sup>11</sup>

V. SNET'S GOOD FAITH ESTIMATES OF INCREMENTAL SFAS-106 COSTS ARE PROPERLY BASED ON ITS OWN COSTS. THE USE OF UNIFORM ACTUARIAL ASSUMPTIONS BEAR NO RELATIONSHIP TO SPECIFIC SNET EXPERIENCE.

SFAS-106 requires a company to book its own costs. If uniform assumptions would produce more accurate results, then the Financial Standards Board would have adopted such standards within SFAS-106 itself.<sup>12</sup> Instead, SFAS-106 recognizes the different situations that different companies will find themselves relative to such factors as plan benefits, available discount rates, inflation rates and past efforts at controlling costs. For example, health care inflation rates vary state by state as a result of the cost of living and overall demographic characteristics in each state, and health care policies of state governments.

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<sup>11</sup> See ETI at p. 2.

<sup>12</sup> See AT&T Opposition at pp. 27-28. See Order of Investigation at footnote 14 which requires carriers that have not filed a tariff seeking exogenous treatment to provide a good faith estimate of its SFAS-106 costs.

Rather than developing good faith estimates based on individual company experience, the use of standard assumptions would produce less meaningful and more arbitrary results. SNET and its actuaries, using company specific data, should be the appropriate source of judgment about the level of SFAS-106 costs booked and ultimately, reflected in rates.

SNET believes that AT&T appears to be recommending actuarial assumptions which are designed to produce a lower level of SFAS-106 costs than SNET's true underlying costs. The use of these uniform assumptions would produce less reasonable results than those developed by independent actuaries, subject to review and audit by a company's external auditors. SNET believes that the Commission should allow each LEC to use company-specific actuarial assumptions as reflective of the SFAS-106 costs actually booked by each LEC.

SNET provided a good faith estimate in its Direct Case while indicating that costs would be subject to refinement as SNET implements SFAS-106. It is expected that an updated study will incorporate new data about separation, retirement and mortality of employees and retirees.<sup>13</sup>

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<sup>13</sup> See MCI Opposition at p. 28. This new study will include data about the structure of employment in recent years. However, SNET takes issue with MCI's implication that it would be appropriate to simply trend the experience of the 1980's forward. See also ETI at p. 8. SNET disagrees with ETI's

VI. THE SOURCE OF FUNDING DOES NOT IMPACT THE PROPER RECOGNITION OF SFAS-106 AS AN EXOGENOUS COST.

Whether a local exchange carrier chooses to fund its SFAS-106 obligation entirely through prefunding does not impact the recognition of SFAS-106 costs.<sup>14</sup> Funding this obligation is based upon management's decisions about the best use of corporate assets. Recognition of SFAS-106 costs flows from the adoption of the accounting change of an increased current period expense on the company's books.

AT&T indicates that LECs can enjoy the uncompensated use of ratepayer funds during the years between the accrual of the SFAS-106 cost and its subsequent payment.<sup>15</sup> This is a mischaracterization of the Commission's ruling that any accrued, but unpaid, SFAS-106 cost must be deducted from the rate base.<sup>16</sup>

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conclusions about the "substantive plan" standard. While SFAS-106 obligations are not binding upon the company, as "substantive commitment" changes, the resulting expense and liability calculations reflect the new commitment.

<sup>14</sup> See AT&I Opposition at p. 15, and Ad Hoc Opposition at p. 13.

<sup>15</sup> See AT&I Opposition at p. 15.

<sup>16</sup> See RAO Letter 20, at p. 2.

**VII. SNET HAS TAKEN STEPS TO MINIMIZE THE IMPACT OF IMPLEMENTING SFAS-106, INCLUDING THE IMPOSITION OF CAPS ON BENEFITS.**

SNET has defined the amount that it will contribute to the premium payments for all bargaining unit employees who retire after January 1, 1990, and for management employees who retire after January 1, 1992. These caps have been set at a level of claims cost for year 1992. There are no substantive plan increases assumed which would affect the good faith estimates submitted by SNET in its Direct Case.<sup>17</sup>

Despite statements to the contrary in the opposition filings,<sup>18</sup> SNET and other price cap LECs have incentives in place today to minimize the impact of SFAS-106. SNET is well aware that financial markets are cognizant of the Company's efforts to control costs as it affects the Company's postretirement benefit liability, and ultimately, the Company's credit rating and its cost of capital.

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<sup>17</sup> While these caps do not take effect until July 1, 1996, the calculation of the SFAS-106 obligation takes caps into consideration through the inclusion of future cash flows for benefits that would otherwise be larger in the absence of caps.

<sup>18</sup> See AT&T Opposition at p. 25, footnote \*; and EII at p. 8.

**VIII. CONCLUSION.**

In this Rebuttal, SNET has once again met its burden of proof for exogenous treatment, including the demonstration that there is no double-counting of SFAS-106 related costs that will be recovered through the GNP-PI. Therefore, SNET requests a favorable finding by the Commission that exogenous treatment is appropriate for costs attributable to SFAS-106 within price cap guidelines.

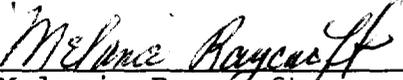
Respectfully submitted,  
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July 31, 1992

CERTIFICATE OF SERVICE

I, Melanie Raycroft, do hereby certify that on this 31st day of July 1992, a copy of the foregoing Direct Case was served by first class U.S. mail, postage prepaid, to the parties on the attached service list.

  
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