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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

**Before the**
**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, DC 20554**

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| **In the Matter of:** | ) | |
| | ) | |
| 1993 Annual Access Tariff Filings | ) | CC Docket No. 93-193, Phase I |
| | ) | |
| 1994 Annual Access Tariff Filings | ) | |
| | ) | CC Docket No. 94-65 |
| AT&T Communications Tariff F.C.C. Nos. 1 and 2 Transmittal Nos. 5460, 5461, 5462, and 5464 | ) | CC Docket No. 93-193, Phase II |
| | ) | CC Docket No. 94-157 |
| Bell Atlantic Telephone Companies Tariff F.C.C. No. 1, Transmittal No. 690 | ) | |
| | ) | |
| NYNEX Telephone Companies Tariff F.C.C. No. 1, Transmittal No. 328 | ) | |
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**Direct Case Filing of the United States Telephone Association**

## INTRODUCTION

The United States Telephone Association (USTA) submits this direct case filing in the above-referenced proceeding. USTA is the principal trade association of the local exchange carrier (LEC) industry. USTA's memberhip of approximately 1100 telephone companies includes the LECs identified as parties to the investigation, listed in Appendix A to the Investigation Order.[1] As the Commission notes, these LECs include those price cap LECs who have not yet sought exogenous treatment of the costs incurred in implementing SFAS-106. USTA participates in this proceeding pursuant to the Commission's invitation for participation from interested persons. See Investigation Order, para. 13.

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[1] Order Designating Issues for Investigation, CC Docket 93-193, Phase I; CC Docket No. 94-65; CC Docket No. 93-193, Phase II, CC Docket No. 94-157, released June 30, 1995 ("Investigation Order").

**DISCUSSION**

USTA commissioned the study submitted by numerous price cap LECs as support for their tariff transmittals: Godwins, "Post-Retirement Health Care Study Comparison of Telco Demographic and Economic Structures and Actuarial Basis National Averages" (1992).[2] The Godwins study may be referred to by several LECs in their direct cases in this proceeding. In the interest of simplifying the Commission's review of these issues by avoiding duplicative filings, USTA is hereby resubmitting the Godwins study for the Commission's reference, included here as Attachment C. See Investigation Order, para. 13 (noting that the Godwins and NERA studies will be included in this investigation).

USTA is also submitting additional materials to assist the Commission in calculating the amount of OPEB-related costs eligible for exogenous treatment, and to support the LECs' access tariff filings. These materials include Attachment A, a new affidavit from Andrew Abel, Ph.D., and Peter Neuwirth, the original co-authors of the Godwins study. The Abel/Neuwirth statement summarizes the available evidence, and affirms that the original Godwins study is still valid for calculating the extent to which the cost increases engendered by SFAS-106 will be recovered through the GNP-PI element of the price cap formula.[3]

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[2] See Investigation Order, para. 13, n.28. Two LECs had included the Godwins analysis as support for their 1992 tariff transmittals: Bell Atlantic Tariff F.C.C. No. 1, Transmittal No. 497; US West Tariff F.C.C. Nos. 1 and 4, Trans. No. 246. Subsequently, many price cap LECs submitted this study as part of their 1992 Direct Case filing: Ameritech, BellSouth, NYNEX, SBC, SNET and US West. GTE and Lincoln Tel. Co. submitted the Godwins study with their 1993 access tariff filing.

[3] Although the Commission has since adopted GDP-PI, rather than GNP-PI in the LEC Price Cap Performance Review (CC Docket No. 94-1), FCC 95-132 (released April 7, 1995), the court remand requires that the Commission apply the original price cap rules (47 C.F.R. § 61.45(c), adopted in the LEC Price Cap Order, 5 FCC Rcd 6786, 6792), which utilize GNP-PI as the measure of inflation. See Southwestern Bell v. FCC, 28 F.3d 165, 172 (D.C. Cir. 1994). Moreover, this change in methodology has no impact on the results of the Godwins study. Abel/Neuwirth Statement, Attachment A, at 5.

USTA also includes a narrative statement explaining the results of the original Godwins study as Attachment B ("Cosby Introductory Statement"). Attachment D is an explanation of the macroeconomic model prepared in response to paragraph 16 of the Commission's Investigation Order in CC Docket 92-101.[4] Attachment E is the rebuttal analysis to accompany the 1992 Godwins study, and Attachment F is an additional analysis to explain the conservative nature of the Godwins study and to show the results of an additional sensitivity analysis. Attachment G is further explanation of the macroeconomic model used in the Godwins study, while Attachment H is a USTA ex parte which responds to arguments that the adoption of SFAS-106 has not changed actual costs.

USTA is also including as Attachment I the study performed by National Economic Research Associates (NERA) which, though utilizing a different methodology, supports the same conclusion as that reached by the Godwins study - that exogenous treatment of SFAS-106 costs will not lead to "double-counting" these costs by their inclusion in GNP-PI. The NERA study demonstrates that in fact only de minimis amounts of SFAS-106 costs are likely to be reflected in GNP-PI. As the Court of Appeals noted, the fact that the NERA study relies on assumptions which are "in sharp contrast" to those of the Godwins study renders the conclusions of both the NERA and Godwins studies "more robust." Southwestern Bell v. FCC, 28 F.3d at 171-172.

USTA submits this information in response to the Commission's request that LECs provide supporting studies, and descriptions of the macroeconomic model utilized. Investigation Order, paras. 24-25. As the Commission notes, this investigation necessarily involves the same type of cost information sought in the initial investigation of OPEB costs. Investigation Order, para. 15. Accordingly, USTA re-submits this information as persuasive evidence that the LECs have made reasonable and fair assumptions in calculating the costs of

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[4]Bell Atlantic Tariff F.C.C. No. 1, Trans. No. 497, US West Tariff F.C.C. Nos 1 and 4, Trans. No. 246, and Pacific Bell Tariff F.C.C. No. 128, Trans. No.1579, Order of Investigation and Suspension, 7 FCC Rcd 2724 (Com. Car. Bur. 1992)("1992 Investigation Order").

post-retirement benefits sought to be recovered through the investigated tariffs.

As the Court of Appeals recognized, the Commission has presented no basis to conclude that the costs imposed by the adoption of SFAS-106 do not meet the criteria for exogenous treatment codified in the price cap rules. Investigation Order, para.8; see Southwestern Bell, 28 F.3d at 172. The adoption of SFAS-106 does change the actual costs incurred by the carriers. Individual LECs will be submitting direct cases which support the level of costs sought to be recovered through the investigated tariffs. The Godwins study shows that these costs (both ongoing and transitional) are not recovered through elements of the price cap formula other than the $\Delta Z$ exogenous cost element. See, e.g., Godwins, Attachment C, p, 11.

Specifically, the Godwins study identifies the impact of SFAS-106 on GNP-PI and allows it to be discounted. Godwins found that the impact of SFAS-106 on GNP-PI (0.0124%) would result in only 0.7% of the Price Cap LEC's additional costs being recovered through an increase in the GNP-PI.[5] Even when conducting a sensitivity analysis, utilizing extremely unlikely combinations of implausible parameter values, the authors of the Godwins study found that only a small percentage of SFAS-106 costs would be recovered through GNP-PI. See, e.g., 1993 Supplemental Report, Attachment F, at 14-38.

Additionally, Godwins shows that significant recovery of SFAS-106 costs through the macroeconomic effects on wages created by SFAS-106 is unlikely. Godwins demonstrates that such recovery will in fact only occur after all macroeconomic variables have adjusted to new equilibrium levels, a process which is likely to take a few years to complete. See, e.g., Abel/Neuwirth Affidavit, Attachment A, at 2; Godwins Study, Attachment C, p.11.

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[5]The NERA study supports a similar conclusion. The NERA study concluded that less than 6.26% of the exogenous cost change is reflected in the GNP-PI. NERA Study, Attachment G, at 32.

## CONCLUSION

The Commission should permit LECs to recover as exogenous an amount of SFAS-106 costs which is consistent with the amount demonstrated by the Godwins and NERA analyses to be not reflected in the GNP-PI component of the price cap formula.

Respectfully submitted,

UNITED STATES TELEPHONE ASSOCIATION

BY _____

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August 14, 1995

**CERTIFICATE OF SERVICE**

I, Mauricio Cifuentes, do certify that on August 14, 1995 copies of the Reply of the United States Telephone Association were either hand-delivered, or deposited in the U.S. Mail, first-class, postage prepaid to the persons on the attached service list.

Mauricio Cifuentes

# Table of Attachments


Attachment A - 1995 Abel/Neuwirth Affidavit

Attachment B - 1993 Cosby Introductory Statement

Attachment C - 1992 Original Godwins Study

Attachment D - 1992 Explanation of Macroeconomic Model

Attachment E - 1992 Rebuttal Analysis for Godwins Study

Attachment F - 1992 Godwins Additional Sensitivity Analysis

Attachment G - 1992 Further Explanation of Macroeconomic Model

Attachment H - USTA ex parte letter (1993)

Attachment I - NERA study (April 15, 1992)

# Attachment A - 1995 Abel/Neuwirth Affidavit

# *United States Telephone Association*

Perspectives on Analysis of Impact of
SFAS 106 on GNP-PI

August 14, 1995

*Towers Perrin*

## Introduction

In order to assist in responding to the FCC's recent Order Designating Issues for Investigation, the United States Telephone Association ("USTA") has asked us to provide a summary of our prior analysis of the impact of SFAS 106 on GNP-PI and to provide an opinion as to the extent to which that analysis should still be considered valid now that three years have passed since the original study was issued and SFAS 106 has now been adopted by all companies for whom it was required.

As discussed in this material, we believe that the actual impact of SFAS 106 on GNP-PI was not materially different than that estimated in our original analysis. Further, we believe that the actual portion of the Price Cap LEC's additional cost due to the adoption of FAS 106 in 1993 that recovered through the GNP-PI was not materially different than that reported in our original analysis.

The rest of this material reviews our prior analysis and discusses this conclusion in more detail.

**Determination of Impact of SFAS 106 on GNP-PI**

In our original study ("Analysis of Impact of FAS 106 Costs on GNP-PI") issued in February 1992, we provided an analysis of what percentage of the additional costs incurred by Local Exchange Carriers subject to Federal Price Cap regulations (hereinafter referred to as "Price Cap LECs") as a result of the Financial Accounting Standards Board's Statement No. 106 (SFAS 106) would be reflected in the GNP Price Index (GNP-PI) and what percentage would not be so reflected.

That study found that ultimately the increase in GNP-PI caused by SFAS 106 (0.0124%) would provide for recovery of only 0.7% of the additional costs incurred by Price Cap LECs. This result was produced by performing both an actuarial analysis and a macroeconomic analysis. The actuarial and macroeconomic analyses were performed in a very conservative manner to ensure that we did not understate the effect of SFAS 106 on the GNP-PI.

In addition to developing this basic result, the study included a sensitivity analysis to test the robustness of the result. That sensitivity analysis lent further support to our finding that any resulting increase in the GNP-PI would allow the Price Cap LEC's to recover only a very small fraction of their additional costs due to SFAS 106.

Subsequent to the submission of the study, we were asked by the FCC staff to extend our analysis in two ways. First, we were asked to develop a "best estimate" determination of the impact of SFAS 106 on the GNP-PI; secondly, we were asked to extend our sensitivity analysis to include every possible combination of parameter values regardless of how unreasonable or internally inconsistent those combinations might be. We performed the additional analysis and reported the results in a supplemental report issued in March 1993. In that report, we found that on a "best estimate" basis, only 0.3% of the Price Cap LEC's additional costs due to SFAS 106 would be recovered as a result of increases in the GNP-PI. As might be expected, for some of the parameter combinations examined in the extended sensitivity analysis, the percentage of additional SFAS 106 costs recovered through the GNP-PI was higher than in the original sensitivity analysis. However, even these higher values indicated that only a small fraction of additional SFAS 106 costs would be recovered through the GNP-PI. Moreover, these higher values resulted only from extremely unlikely combinations of parameter values. For example, the ten highest values were obtained only with a price elasticity of demand equal to 3.0, and with a direct impact of SFAS 106 on labor costs in sector 2 of 4.5%. As discussed in the March 1993 Supplemental Report, price elasticities of demand in sectors 1 and 2 are almost surely less than 1.0, and our baseline value of 1.5 for this elasticity was chosen to guard against understating the impact of SFAS 106 on the GNP-PI; a value of 3.0 for this elasticity is too high to be taken seriously. Also the value of 4.5% for the direct impact of SFAS 106 on labor costs in sector 2 is almost double the best estimate of 2.5% and is less plausible than the baseline estimate of 3.0%.

We want to emphasize that the original study was done in a very conservative manner and the baseline result of that study (0.7% of the Price Cap LEC's additional costs recovered through GNP-PI increases) is more than twice the value produced under a "best estimate" approach. Pages 34-38 of the original study provide a detailed discussion of the conservative nature of the analysis, including a discussion of the rationale behind the choice of each actuarial and macroeconomic parameter utilized in the study.

**Additional Macroeconomic Effect of SFAS 106**

Above and beyond the GNP-PI effect reported above, when the original study was done, our macroeconomic model indicated that, in response to the impact of SFAS 106, the wage rate in the national economy will, over time, reduce in relative terms by 0.93% (i.e., relative to what it would have been in the absence of SFAS 106). To the extent that a Price Cap LEC could also benefit from a relative reduction in its wage rate, this would help offset its increase in costs due to SFAS 106. If a Price Cap LEC's were able to achieve the full reduction of 0.93%, it would finance 14.5% of its additional SFAS 106 costs. As discussed in our report, this wage rate reduction reflects the **ultimate** effect of SFAS 106 after all macroeconomic variables have adjusted to their new equilibrium levels. This macroeconomic adjustment is unlikely to be completed within a year, and may indeed take a few years to complete. Thus, during 1993, the fraction of additional SFAS 106 costs financed by a relative reduction in wages is likely to be less than 14.5% — perhaps substantially less.

Thus, even after complete macroeconomic adjustment has taken place, the combined effect of the impact of SFAS 106 on the GNP-PI and on the wage rate would still leave 84.8% (i.e., 100% minus 0.7% minus 14.5%) of the Price Cap LEC's additional SFAS 106 costs unrecovered. The original study also included sensitivity analysis on how much of the Price Cap LEC's additional costs could potentially be recovered through the combination of increases in GNP-PI and this wage rate effect. That analysis lent additional support to our finding that 15.2% was a reasonable estimate of the fraction of additional costs that would be recovered through the combination of both sources.

Again, in response to the FCC staff requests, the analysis of the impact of the combination of GNP-PI increases and potential wage rate reductions was extended to produce a "best estimate" impact and a sensitivity analysis incorporating all combinations of actuarial and macroeconomic parameters. On a best estimate basis, we determined that 12.7% of the Price Cap LEC's additional costs would be recovered through the combination of GNP-PI increases and wage rate reductions; the additional sensitivity analysis again confirmed our finding that most of the Price Cap LEC's additional costs would not be recovered through the GNP-PI and other macroeconomic effects.

**Purpose of Sensitivity Analysis**

As noted above, our original report (February 1992) contained a sensitivity analysis. At the request of the FCC staff our March 1993 Supplemental Report contained additional sensitivity analysis (while this sensitivity analysis broadened the range of parameter values considered, many of these additional combinations of parameters were, as explained below, implausible.) In order to interpret and apply the results of these sensitivity analyses, it is important to keep in mind the purpose of these analyses and the conservative philosophy underlying their implementation. We have already discussed that our conservative approach produced a baseline calculation of the impact of SFAS 106 on GNP-PI that is larger than a calculation based on our best estimates. The comprehensive sensitivity analysis provides an additional degree of comfort that the baseline results are, in fact, conservative.

The primary goal of the sensitivity analysis was to explore the robustness of our findings and to illustrate the quantitative impact on our findings of various changes in the numerical values of the inputs. *The ranges of values used in the sensitivity analysis were not intended to represent the ranges of plausible parameter values.* Instead, our conservative approach led us to choose ranges of values so wide they include all plausible values, and then some. To guard against the risk of omitting some plausible values, we intentionally used ranges of values so wide they include implausible values as well. As a consequence, some of the extreme values of the calculated effect of SFAS 106 on the GNP-PI simply reflect implausible values for inputs.

As discussed earlier, our March 1993 Supplemental Report contains a best estimate of the impact of SFAS 106, as well as a conservative baseline estimate, and a comprehensive sensitivity analysis. Our best estimate (p. 14) is that only 0.3% of the increase in the Price Cap LECs' costs due to SFAS 106 are recovered through the GNP-PI. This finding illustrates that our baseline calculation of 0.7% is indeed conservative. The comprehensive sensitivity analysis, which included input values that are clearly implausible, produced some results for the impact on GNP-PI that are considerably larger. The sensitivity analysis considered three different values of each of four different inputs to the macroeconomic model, two different values of one input, and four different values of one input,[1] and computed results using all 648 (= 3 x 3 x 3 x 3 x 2 x 4) combinations of these values.

Finally, note that using two or more implausible values together heightens the degree of implausibility. For example, suppose there is only a one in a hundred chance that the price elasticity of demand is as high as 3.0 and there is only one in a hundred chance that the direct impact of SFAS 106 on labor cost in sector 2 is as high as 4.5%. Then there is only one chance in 10,000 that both values together are appropriate. To reiterate, our sensitivity analysis

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[1] Three values of the direct impact of SFAS 106 on labor costs in sector 2, 3 values of labor share in total cost in sector 1; 3 values of labor share in total cost in sector 2; 3 values of the fraction of labor employed in sector 2; 2 values of the price elasticity of demand; 4 values of the labor supply elasticity.

presents the results for all combinations of parameter values, including many combinations too implausible to merit any attention.

**Validity of Original Study**

Based on the discussion above, it is clear that our original study was done in a conservative manner, most likely overestimating the impact of SFAS 106 on the GNP-PI. In addition, comprehensive sensitivity analysis was performed to confirm the robustness of the result against the possibility of error in estimating one or more of the economic or actuarial parameters used in the study.

Three years have passed since the original study was issued. During that time, all companies providing postretirement welfare benefits adopted SFAS 106. Based on what we now know, we believe our estimate of the impact of SFAS 106 on the GNP-PI[2] and of the percentage recovery of the Price Cap LEC's additional costs incurred by their adoption of SFAS 106 is still reasonable. Furthermore, the conservatism inherent in our original study gives us confidence that the actual recovery of additional SFAS 106 costs through the GNP-PI when SFAS 106 became mandatorily effective in 1993 was not materially greater than the 0.7% in our baseline results.

Respectfully submitted,

Peter J. Neuwirth, F.S.A., M.A.A.A.

Andrew B. Abel, Ph.D.

2 Since our original report was issued, the measure used in the FCC's price cap methodology was changed from GNP-PI to GDP-PI. This change would have no impact on the results of our study. Not only does the formal mathematical model ignore any distinction between GNP-PI and GDP-PI, the actual data (presented in Table I) show only a minuscule difference between these two measures of the overall price level.

**Table 1: GDP-PI and GNP-PI**

| price index | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 |
|---|---|---|---|---|---|---|
| GDP-PI | 104.0 | 108.6 | 113.6 | 118.1 | 121.9 | 125.5 |
| GNP-PI | 104.0 | 108.6 | 113.6 | 118.1 | 121.8 | 125.4 |

Source: Survey of Current Business, August 1994. GDP-PI is from Table 7.1, p. 32, line 5, price index, fixed 1987 weights; GNP-PI is from Table 7.3, p. 40, line 5, price index, fixed 1987 weights.

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# Attachment B - 1993 Cosby Introductory Statement

# Best Estimate Increases

# TELCO's Unrecovered SFAS 106 Costs

March 1993

By Randy Cosby

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Note: This description was originally filed in Southwestern Bell Telephone Company's July 1, 1993 Annual Access Tariff Filing, Transmittal No. 2271, filed April 2, 1993, Description and Justification, Appendix B. As described on page 3-9 of SWBT's D&J: "Appendix B, titled "Best Estimate Increases TELCO's Unrecovered SFAS 106 Costs" is a description of the New Godwins analysis that was prepared by Randy Cosby, a[n] independent professional writer and editor. Randy Cosby's narrative is intended to cut through the technical writing style that has been typical of the actuarial and macroeconomic analysis presented on the formal record during the SFAS-106 debate. Cosby's description of the Godwins analysis has been thoroughly reviewed by the authors of the Godwins analysis, who concur that the Cosby narrative represents an accurate description of the current Godwins analysis."

## New Findings Prove Strength of Original Request

More than 87% of the cost of adopting the SFAS 106 accounting procedure will not be recovered by local exchange carriers subject to federal price caps (Price Cap LECs) without exogenous treatment, according to a "best estimate" prepared by Godwins for the United States Telephone Association (USTA).

The best estimate, and an expanded sensitivity analysis showing 648 potential scenarios that could change the amount of SFAS 106 costs recovered by Price Cap LECs, were requested by the Federal Communications Commission. (See the FCC's Jan. 22, 1993 Order in CC Docket No. 92-101, paragraphs 63 and 64).

The best estimate shows that only 0.3% of the costs are reflected in the GNP price index and 12.3% might be recovered by a reduction in the wage rate and other macroeconomic adjustments, leaving more than 87.3% of the costs unrecovered.

The finding underscores the conservative nature of the Price Cap LECs' request for exogenous treatment made last year. In that request, which was based on a study by Godwins, exogenous treatment was sought for only 84.8% of the costs of SFAS 106 -- 2.5 percentage points less than the best estimate now clearly indicates is reasonable.

The earlier calculation estimated that 0.7% of the costs would be recovered in the price index and 14.5% might be recovered by a reduced wage rate.

Given the philosophy followed in the Godwins study, it should come as no surprise that the best estimate is higher than the original estimate cited in the study. The study generally used conservative values when setting parameters for the actuarial and macroeconomic analyses used to gauge the impact of SFAS 106 on TELCO, a composite company constructed to more easily quantify statistics compiled from the 11 Price Cap LECs.

At every juncture, Godwins used values that avoided giving unwarranted benefits to TELCO. The intent was to avoid potential claims of double-counting by erring in the direction least favorable to Price Cap LECs.

For example, in the macroeconomic model Godwins overstated the impact on GNP-PI by using a baseline value of price elasticity of demand that is almost certainly too high. When this value was reduced to a more likely level for computation of the best estimate of recovery, it reduced the amount of costs TELCO would recover through the GNP-PI and other macroeconomic effects.

A similar result occurred when Godwins overstated a value for labor supply elasticity which, like price elasticity of demand, is among several economic parameters used to determine how much of SFAS 106 costs will be recovered through the GNP-PI.

The study's conservative bent also is shown in the actuarial analysis by use of a 3% figure to quantify the direct impact of SFAS 106 on labor costs for the portion of the economy that includes businesses providing post-retirement benefits. The best estimate places this value at 2.5%, fully a half-percent lower than

the conservative estimate.

It is with a firm belief in the Godwins study, and with steadfast support for the actuarial and macroeconomic analyses on which the study is based, that the 84.8% estimate used by the Price Cap LECs in their filings last year, is reaffirmed.

## Conservative Estimate Is Built On Sound Foundation

The conservative estimate developed by Godwins in this study is built on a firm foundation composed of an actuarial analysis, as well as a macroeconomic analysis that uses parameters derived from the actuarial study.

Using extensive demographic, economic and benefit program data collected from 11 Price Cap LECs, the actuarial analysis constructs TELCO, a composite company that closely reflects the entire industry's characteristics.

When compared to the average employer in the economy, the effects of SFAS 106 on TELCO's costs are disproportionately higher due to a combination of factors. Its work force stays on the job longer, retires earlier, has a higher ratio of retired-to-active workers and has a higher proportion of covered workers.

The situation is offset somewhat by the fact that TELCO's labor costs are a lower percentage of total costs than of the average employer in the GNP.

Given these circumstances, the average employer in the economy will experience only 28.3 percent of the cost increase from SFAS

106 that will hit TELCO.

Among the steps taken to obtain the results:

* A comparison of TELCO's benefits program to a "national average" benefit program developed through the use of a database of provisions of retiree medical plans sponsored by 830 private-sector companies employing 19 million workers, which is well over half of all covered employees in the United States.

* Adjustments for differences in programs and other factors, such as the average age of employees, length of service, retirement patterns, number of retirees and current level of pre-funding of benefits.

The actuarial analysis also utilizes a number of factors to develop a formula that quantifies the direct impact of SFAS 106 on labor costs for the portion of the economy that includes businesses providing post-retirement benefits. The best estimate places this value at 2.5%, fully half a percentage point lower than the 3% conservative estimate used in the Godwins study.

Through its examination of the impact of SFAS 106 costs on the economy as a whole, the macroeconomic analysis divides the 95.8 million private-sector workers in the national economy into two groups. They are:

* Sector 1: An estimated 65.1 million workers who have no post-retirement plan covered by SFAS 106 rules; and

* Sector 2, an estimated 30.7 million workers eligible for some type of retirement plan, the cost of which ultimately will be

reflected in SFAS 106 costs.

The macroeconomic model also finds that only 2.3% of the average employer's additional costs resulting from SFAS 106 is passed through to the GNP price index. Consequently, TELCO stands to recover only .7% through the GNP-PI because the actuarial analysis finds the price index will reflect only 28.3% of the additional costs incurred by the average Price Cap LEC due to SFAS 106.

Although it first appears that this means 99.3% of TELCO's additional costs are unrecoverable, the macroeconomic analysis determines that the national wage rate might be 0.93% lower than it would have been in the absence of SFAS 106.

Consequently, if TELCO can achieve a similar reduction in its wage rate, another 14.5% of SFAS 106 costs could be recovered, lowering its total unrecovered costs to the conservative estimate of 84.8% that is being sought for exogenous treatment.

## Some Outcomes Are Not Realistically Conceivable

As explained in the original Godwins study, the macroeconomic model for determining how much of the SFAS 106 costs are unrecoverable can, by adjusting the values of its parameters, be used to obtain numerous possible outcomes.

Godwins attempted to display the sensitivity of the results in

its original study by showing an extremely wide range of possible outcomes--as well as the conservative estimate believed to be a reasonable basis for exogenous treatment.

However, the Commission subsequently requested, and now has been provided, all 648 estimates, as well as an overall best estimate.

This list shows all outcomes associated with all "possible" parameter values. But it must be understood that results at either end of the spectrum are based on extreme values and simply are not realistically conceivable.

That is the case with at least three of the parameter values which show more than 40% of costs being recovered through GNP-PI and macroeconomic adjustments. This occurs because any attempt to display every combination of parameter values requires some of those values to be set at levels needed simply to fill out the "grid" of possibilities.

For example, the outcomes in question are based on unrealistic values for:

-- Price elasticity of demand. The flawed combinations of parameters use a value of 3.0, which is much too high to be plausible. The baseline calculation purposely uses a value of 1.5 that is too high in order to guard against the possibility of understating the impact of SFAS 106 on GNP-PI. The true value almost surely is less than 1.0.

-- The direct impact of SFAS 106 on labor costs in sector 2,

the segment of the economy encompassing covered workers. The 4.5% value applied here is much too high, as evidenced by the 2.5% value used to develop the best estimate and the 3% value used in Godwins original conservative estimate.

The foregoing is why all of the combinations of parameter values that show less than 60% of additional SFAS 106 costs being recovered without exogenous treatment simply are not worthy of consideration.

# Attachment C - 1992 Original Godwins Study

# UNITED STATES TELEPHONE ASSOCIATION

# Analysis of Impact of FAS 106 Costs on GNP-PI

Godwins

February, 1992