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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	)	CC Docket No. 93-193 Phase II
Bell Atlantic Telephone Companies Tariff F.C.C. No. 1, Transmittal No. 690	)	CC Docket No. 94-157
NYNEX Telephone Companies Tariff F.C.C. No. 1, Transmittal No. 328	)	

**GTE's DIRECT CASE**

GTE Service Corporation and its affiliated  
domestic telephone operating companies

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## SUMMARY

The SFAS-106 accounting change qualifies for exogenous treatment as it is an administrative action beyond the control of carriers. The record has shown over a period of almost four years that the issues underlying this claim have been continuously and consistently supported by carriers in Notices to Adopt, Direct Cases, Rebuttals, and Tariffs and by the Court. In order to refresh the record, this filing reexamines why exogenous treatment is appropriate, answers questions put forth by the Commission and allegations by entities opposing exogenous treatment, and reestablishes the exogenous request. Exogenous treatment is warranted because:

1. The issuance of SFAS-106 by the Financial Accounting and Standards Board ("FASB") and subsequent adoption by the Commission significantly altered the recognition of the costs of employer-provided benefits to retirees in a manner beyond the control of the carriers.
2. The Godwins study demonstrated that, at the time of the initial exogenous claim, the adoption of SFAS-106 would have minimal impact on the Gross National Product - Price Index ("GNP-PI") used for price cap purposes. This impact was taken into account by GTE in its tariff filing. Further analysis demonstrates that the passage of time has not altered the initial results of the Godwins study.
3. The Godwins study demonstrated that there will be a disproportionate impact of SFAS-106 on price cap exchange carriers compared to employers generally. GTE concurred in the results of the Godwins study. This study showed that 84.8 percent of the costs resulting from the impact of SFAS-106 on the GNP-PI and on the wage rate will uniquely and disproportionately affect exchange carriers as

a class, if not individually. GTE's exogenous claim was accordingly reduced to incorporate this 84.8 percent factor. Indeed, a recent analysis of the Godwins study concludes that the original estimate was very conservative and nothing has occurred since SFAS-106 adoption that would change this factor.

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**GTE's DIRECT CASE**

GTE Service Corporation and its affiliated domestic telephone operating companies ("GTE") hereby submit their Direct Case with regard to the issues designated for investigation by the Commission's Order Designating Issues for Investigation (the "*Order*"), DA 95-1485 (released June 30, 1995).

**BACKGROUND**

The Financial Accounting Standards Board ("FASB") prescribed that Statement of Financial Accounting Standards Number 106 ("SFAS-106") be effective for fiscal years beginning December 15, 1992. SFAS-106 recognizes Other Postretirement Employee Benefits ("OPEBs") as a form of deferred compensation earned by employees as they provide service to the employer. Recognition of OPEBs over the relevant employee service period is accomplished under the principals of accrual

accounting. Previously the employer accounted for benefits provided to retirees on a Pay-As-You-Go ("PAYGO") basis where an expense is recorded only as claims are paid.

The amount accrued as the cost of OPEBs for a period is the net periodic postretirement benefit cost. The components of net periodic costs defined by SFAS-106 are Service Cost, Interest Cost, Actual Return on Plan Assets, Amortization of the Transition Obligation, Amortization of Unrecognized Prior Service Costs, and Amortization of Gain or Loss Deferred.

On December 26, 1991, the Commission approved the requests of GTE and Southwestern Bell Telephone Company to adopt SFAS-106 accounting for OPEBs and authorized all subject carriers to adopt SFAS-106 accounting on or before January 1, 1993, using the amortization method of recognizing the transition obligation.<sup>1</sup>

Bell Atlantic, U S WEST, and Pacific Bell filed tariffs on February 28, 1992, April 3, 1992, and April 16, 1992, respectively, to increase the limits set on their rates under the price cap plan in order to recognize accounting changes for postretirement benefits. On April 29, 1992,<sup>2</sup> the Commission suspended the Bell Atlantic and U S WEST tariffs for five months and designated for investigation issues arising from the carriers' claims

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<sup>1</sup> Southwestern Bell/GTE Service Corporation, Notification of Intent to Adopt Statement of Financial Accounting Standards No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions, AAD 91-80, Order, 6 FCC Rcd 7560 (1991) ("*SFAS-106 Order*").

<sup>2</sup> Treatment of Local Exchange Carrier Tariffs Implementing Statement of Financial Accounting Standards, "Employers Accounting for Postretirement Benefits Other than Pensions," CC Docket No. 92-102 ("*D. 92-101*"), Order of Investigation and Suspension, 7 FCC Rcd 2724 (1992) (by Chief, Common Carrier Bureau) ("*OPEB Investigation*").

that the incremental change in accounting cost should be treated as a one-time exogenous cost change under price caps. Since the issues raised in the tariff filings affected all price cap LECs, the Commission designated all price cap LECs as parties to the proceeding.

On January 22, 1993, the Commission released its Memorandum Opinion and Order in CC Docket No. 92-101 (the "*OPEB Order*").<sup>3</sup> The Commission found that the price cap LECs "have not met their burden of demonstrating that implementation of SFAS-106 should be considered an exogenous cost change under the Commission's price cap rules."<sup>4</sup> In addition, the Commission stated that it did "not foreclose these carriers or others from making a more persuasive showing in the context of the 1993 annual access tariff filings."<sup>5</sup> The *OPEB Order*<sup>6</sup> specifically left the door open for further review of exogenous treatment of the Transition Benefit Obligation ("TBO") and suggested the annual 1993 access tariff filings as a possible forum for such consideration: "Our decision in this case is not intended to foreclose further consideration of exogenous treatment of TBO amounts...."<sup>7</sup>

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<sup>3</sup> Treatment of Local Exchange Carrier Tariffs Implementing Statement of Financial Accounting Standards, "Employers Accounting for Postretirement Benefits Other than Pensions," Memorandum Opinion and Order, 8 FCC Rcd 1024 (1993) (the "*OPEB Order*"), *remanded*, *Southwestern Bell Tel. Co. v. FCC*, 28 F.3d 165 (D.C. Cir. 1994) ("*Southwestern Bell*").

<sup>4</sup> *OPEB Order*, 8 FCC Rcd at 1024-1025.

<sup>5</sup> *Id.*, 8 FCC Rcd at 1025.

<sup>6</sup> *Id.*, 8 FCC Rcd at 1037.

<sup>7</sup> *Id.*

Based on this decision, GTE filed its 1993 Annual Access Tariff Filings on April 2, 1993.<sup>8</sup> Included in these filings was a request to include the incremental portion of the amortization of the TBO plus interest cost on the accumulated postretirement benefits obligation as an exogenous cost.

Southwestern Bell sought judicial review of the *OPEB Order* in the United States Court of Appeals for the District of Columbia Circuit. The Court in *Southwestern Bell* found that the Commission had not adhered to its own criteria for exogenous cost treatment and remanded "to the FCC to consider the LECs' request for exogenous cost treatment of their SFAS-106 incremental costs in a manner consistent with this opinion and with the LEC Price Cap Order and the LEC Price Cap Reconsideration."<sup>9</sup>

The *Order* (at para. 15) seeks to determine whether the assumptions that individual LECs made in calculating the costs of postretirement benefits are just and reasonable, in accordance with the Commission's rules, and in the public interest; and "[b]ecause the record in that proceeding [*D. 92-101*] is also stale," the Commission seeks "in the current investigation to refresh the record on the various issues...."

## I. DESIGNATED ISSUES

**Issue A: Have individual LECs correctly, reasonably and justifiably calculated the gross amount of SFAS-106 costs that may be subject to exogenous treatment under price cap regulation?**

GTE has properly and justifiably calculated its exogenous amounts based on the impact of implementing SFAS-106. Conservative, reasonable, and justifiable estimates

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<sup>8</sup> See GTE Telephone Operating Companies 1993 Annual Access Tariff Filing Transmittal No. 781 and GTE System Telephone Companies 1993 Annual Access Tariff Filing Transmittal No. 38 dated April 2, 1993 (the "1993 GTE Filings").

<sup>9</sup> *Southwestern Bell*, 28 F.3d at 173.

of economic and demographic events as suggested by an outside actuarial agency<sup>10</sup> were used to calculate the gross impact of providing current and future retiree benefits. Included in the estimated impact are significant factors unique to GTE, such as contractual obligations and employee demographics that if altered by the Commission in an attempt to create an industry standard would dramatically affect the integrity of the estimated impact.

**Issue B: Should exogenous claims be permitted for SFAS-106 costs incurred prior to January 1, 1993, the Commission's date for mandatory compliance?**

Since the FASB and the Commission encouraged adoption of SFAS-106 prior to January 1, 1993, exogenous claims for the impact of SFAS-106 not otherwise included in an annual access tariff filing should be permitted.

**Issue C: Have the individual LECs correctly and reasonably allocated and separated amounts associated with implementation of SFAS-106 in accordance with the Commission's rules and Responsible Accounting Officer (RAO) letters?**

To the gross amount noted in Issue A, GTE allowed for the proper assignment of nonregulated results, separation of expense and capital components, separation into a state and interstate component (Part 36) and allocation of costs to baskets (Part 69). The effects of *RAO Letter 20*<sup>11</sup> were followed as the rate base was reduced by the unfunded SFAS-106 liability. A further adjustment to reduce the exogenous claim was made based on an estimate of the amount already included in the price cap formula by the Godwins study.

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<sup>10</sup> GTE uses Towers Perrin as its actuary.

<sup>11</sup> Uniform Accounting for Postretirement Benefits Other Than Pensions in Part 32, RAO Letter 20, 7 FCC Rcd 2872 (1992) ("*RAO Letter 20*").

**Issue D: How should Voluntary Employee Benefit Association (VEBA) trusts or other funding mechanisms for these expenses be treated: (1) if implemented before price caps; (2) if implemented after price caps, but before the change required by SFAS-106; and (3) if implemented after the change in accounting required by SFAS-106?**

**Issue E: Should exogenous treatment for SFAS-106 amounts be limited to costs that are funded?**

Issues D and E will be addressed together since the issue of funding is in both. Funding is a logical step in the accounting and provisioning of retiree benefits. GTE has consistently maintained that the decision on when and how much should be funded must rest with the management of a company. The use of VEBA trusts was deemed a prudent business decision by management to gain the benefits granted by existing tax regulations even before the implementation of SFAS-106. Exogenous treatment should not be limited to only costs that are funded.

**Issue F: Should exogenous treatment be given for amounts associated with employee interests that have vested?**

SFAS-106 benefits vest only upon retirement. Unlike pension benefits accounted for under SFAS-87, employees do not earn a right to SFAS-106 benefits before retirement that travels with them should they leave the Company. The calculation of the impact of SFAS-106 includes estimates of how many employees actually will reach retirement, vesting is already a factor in calculating the exogenous claim. Therefore, significant changes affecting the estimate of future numbers of retirees can be handled by a true-up to the exogenous claim as advocated by GTE in numerous filings.

**Issue G: How should the deferred tax benefit applicable to OPEBs be treated for purposes of exogenous adjustments?**

SFAS-106 requires that the expenses related to providing retiree benefits be recognized as they are earned rather than as they are paid. Current tax regulations

only allow actual cash payments to be recognized when computing current taxes payable. In the years immediately after SFAS-106 recognition, these differences will create temporary deferred tax assets on the books of GTE when SFAS-106 accruals exceed PAYGO amounts. GTE properly noted this effect in its *1993 GTE Filings* and volunteered a method to true-up this claim in future years as this temporary difference reverses over time.

## II. SPECIFIC INFORMATION REQUIREMENTS

### (1) Responding to paragraph 17 of the *Order*, the required data for GTE is furnished.

Paragraph 17 of the *Order* calls for each Local Exchange Carrier ("LEC") to "explain the derivation of the gross amount of incremental costs that is the basis of the exogenous claim including: ...."

#### (1) The date the company implemented SFAS-106.

GTE formally implemented SFAS-106 on January 1, 1993.

#### (2) The cost basis of the pay-as-you-go amounts that supported the rates in effect on the initial date that the carrier became subject to price cap regulation.

For GTE Telephone Operations, the pay-as-you-go amount in 1990 was \$10.9 million. GTE became subject to price cap regulation on October 4, 1990.<sup>12</sup> In the *LEC Price Cap Order*, the FCC adopted a set of final rules to begin price cap regulation of LEC interstate access services effective January 1, 1991.

#### (3) The effect of the price cap formula on that amount up to the date of conversion to SFAS-106.

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<sup>12</sup> Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd 6786 (1990), and *erratum*, 5 FCC Rcd 7664 (1990) ("*LEC Price Cap Order*"), *modified on recon.*, 6 FCC Rcd 2637 (1991) ("*LEC Price Cap Reconsideration Order*"), *aff'd sub nom.* National Rural Telecom Association v. FCC, 988 F.2d 174 (D.C. Cir. 1993).

Assuming that the PAYGO amounts were inherent in the beginning rates that established the Price Cap Index ("PCI") at 100, the amount would increase or decrease as the PCI increased or decreased over time. Rates have generally decreased under price caps much more than the 1990 \$10.9 million PAYGO amount, however, it is impossible to determine if the PAYGO amounts in the initial rates have been eliminated or at least reduced to a lower amount.

- (4) The carrier's actual cash expenditures related to SFAS-106 for each year since the implementation of price caps, but prior to the implementation of SFAS-106 accounting methods.

GTE's PAYGO amounts for 1991 and 1992 were \$14.4 million and \$19.5 million respectively.

- (5) The treatment of these costs in reports to the Securities and Exchange Commission (SEC) and to shareholders, including specific citations to or excerpted materials from, such reports to indicate the amount of liability each party has projected for OPEBs.

The annual report for each of the GTE legal entities contains a reference to SFAS-106 in the footnote section addressing retirement plans. An example of the disclosures for GTE South and GTE Florida are included as Attachment I. In addition, the 10-K filing with the Securities and Exchange Commission contains a complete copy of the annual report. There is no additional verbiage related to SFAS-106 in the 10-K filing. The financial statements for the former Contel legal entities contain a reference to SFAS-106 in the footnote section. (See Attachment I.)

- (2) Responding to paragraph 18 of the *Order*, GTE furnishes the required data. GTE maintains that the PAYGO amounts would be the same regardless of the implementation of SFAS-106.**

Paragraph 18 of the *Order* directs the LECs to:

- (1) Describe each type of benefit being provided that is covered by the SFAS-106 accounting rules.

GTE provides its retirees medical and life insurance benefits, dental coverage and reimbursement of Medicare Part B premiums. The level of benefits varies by jurisdiction, employee group, and age group.

- (2) Provide on a year-by-year basis what the pay-as-you go amounts would have been had the company not implemented SFAS-106 methods.

The amounts requested are included in the response to paragraph 17. These amounts would not have changed due to the adoption of SFAS-106.

- (3) Describe the forms of postretirement benefit accrual accounting, if any, that were utilized before the effective date of price cap regulation.

Prior to the effective date of price cap regulation, GTE accounted for postretirement benefits on a cash basis. No form of postretirement benefit accrual accounting existed. Former Contel entities recognized life insurance benefits in the year paid by expensing the annual life insurance premiums. Contel also adopted accrual accounting for health care costs beginning in 1987, which equates to a partial recognition of additional cost as defined by SFAS-106.

- (4) Describe the type and provide the level of SFAS-106 type expenses reflected in rates before they were adjusted for any exogenous treatment related to SFAS-106.

See the answer to question 5 below.

- (5) Provide the level of SFAS-106 expense that was reflected in the rates in effect on the initial date that the carrier became subject to price cap regulation.

GTE's interstate access rates did not reflect any SFAS-106 type expenses before the 1993 adjustment for exogenous treatment. The starting interstate access rates of former Contel companies were based on partial accrual accounting adopted by Contel in 1987. Contel's starting access rates reflected \$12 million of expense representing partial recognition of SFAS-106.

- (3) Responding to paragraph 19 of the *Order*, GTE points out that the *SFAS-106 Order* specifically stated that carriers could implement SFAS-106 on or before January 1, 1993.**

Paragraph 19 of the *Order* notes that some LECs have included, in their claims for exogenous treatment of SFAS-106, costs incurred before January 1, 1993, which is prior to the date that the Commission authorized adoption of SFAS-106 accounting methods. LECs are asked to comment on whether such costs should be permitted for exogenous treatment. The *SFAS-106 Order* (at para. 3) very explicitly stated that carriers could "implement SFAS-106 on or before January 1, 1993." Those LECs that chose to follow that authorization and reflect SFAS-106 accruals in 1991 and 1992 results should not be penalized by not receiving exogenous treatment for those accruals.

- (4) Responding to paragraph 20 of the *Order*, GTE furnishes the required data except for those items detailed below.**

Paragraph 20 of the *Order* requests the following information: (1) the amount associated with implementation of SFAS-106 for the total company (including telephone operations and nontelephone operations); (2) an explanation of how the carrier arrived at the total company SFAS-106 amounts; (3) the amounts allocated to the telephone operating companies, including the specific Part 32 Accounts used and the amounts allocated to each of those accounts; (4) the method of allocating amounts to the telephone operating companies (head counts, actuarial studies, etc.); (5) the amounts allocated between regulated and non-regulated activities of the telephone company, with a description and justification of the methodology for the allocations; and (6) the allocation of costs to baskets, by year.

In Attachment III (Summary of Exogenous OPEB Costs) of the 1993 GTE Filings, each request included in this paragraph except for the specific Part 32 Accounts used is detailed.<sup>13</sup> The Part 32 data is not supplied as it would be extremely voluminous.

As noted on the Summary of Exogenous OPEB Costs, a separate expense and rate base impact of SFAS-106 adoption is calculated. A discussion of the methodology used in determining the SFAS-106 impact and the assumptions used is included *infra*. Lines 1 and 2 are the summation of the TBO amortization and interest costs for each business unit on a total company basis.

Line 3 reduces the estimated expense amounts by the return on assets prefunded into VEBA trusts by GTE. The rate of return used was 8.0 percent.

Line 4 further reduces the SFAS 106 estimated impact by the PAYGO amount estimated for 1993. Thus only the incremental impact of the adoption of SFAS 106 is included in the claim for exogenous treatment.

Line 5 is the total of Lines 1 through 4.

Line 6 reduces the total company SFAS 106 impact by an amount estimated to reflect the portion attributable to nonregulated operations. The factor used is based on a study of the historical impact of nonregulated transfers on each business unit. These impacts are weighted to achieve a composite factor for this purpose.

Line 7 contains a similar historical study (as in Line 6) of activity to estimate the proper amount attributable to capital accounts.

Line 8 is Line 5 less Lines 6 and 7.

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<sup>13</sup> Attachment VII of this document contains the 1993 GTE Filings Attachment III.

Line 9 reduces the regulated incremental expense impact of adopting SFAS-106 by the percentage calculated in the Godwins Study<sup>14</sup> to be reflected in the GDP-PI.

Line 10 is the amount subject to separations (Line 8 time Line 9).

Line 11 represents the composite factor of interstate access expense to total company amounts subject to separation.

Line 12 is the interstate access expense resulting from adoption of SFAS-106 and is the product of Lines 10 and 11.

Line 13 begins the rate base impact calculation. The capitalized portion of the expense impact as calculated on Line 7 is included on Line 13.

Line 14 is the unfunded liability as calculated above on Line 8.

Line 15 is the balance of current deferred income taxes which will have an asset balance in years immediately after SFAS-106 adoption.

Line 16 sums Lines 13 through 15 and represents the total unseparated rate base impact.

Line 17 represents the composite factor of interstate access rate base to totally company amounts subject to separation.

Line 18 is the separated rate base impact.

Line 19 is the authorized rate of return.

Line 20, the product of Lines 18 and 19, is the net income effect of rate base impacts.

Line 21 represents the composite factor of the gross to net multiplier for determining the tax impact of rate base.

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<sup>14</sup> See USTA's Direct Case Attachment C in this proceeding for a copy of the original Godwins study.

Line 22 is the product of Lines 20 and 21.

Line 23 is the same adjustment used in Line 9 and is multiplied by Line 22 to achieve the recovery of rate base sought.

Line 26 represents the net recovery sought.

The gross SFAS-106 amounts reflected on Lines 1 and 2 are calculated for each GTE Telephone Operating Company and GTE System Telephone Company business unit. This calculation is segregated into management and nonmanagement groups. The calculations are based on actuarial studies prepared by GTE's outside actuary. These calculations are based on many factors that are common to each business unit and particular contractual obligations and demographic factors of that unit.

Specific factors common among business units are included in Attachment II, Summary of Plan Provisions for January 1, 1993 Retiree Welfare Valuation. These assumptions can be grouped into three different types: demographic assumptions; economic assumptions; and medical claims cost assumptions.

Demographic Assumptions: The demographic assumptions with respect to rates of retirement, termination, and mortality were adopted by GTE based upon the recommendation of its actuary. GTE seeks to use conservative estimates of these factors to reduce the potential for future changes, thereby reducing volatility of SFAS-106 results. To the extent that future studies reveal a change in the pattern of experience, revisions to these assumptions will be made as deemed appropriate.

Economic Assumptions: The economic assumptions are: the interest discount rate, the expected rate of return on plan assets and the salary increase assumption, and the health care cost trend rate.

1. The interest discount rate under SFAS-106 and the Statement of Financial Accounting Standards No. 87 (Employers' Accounting for Pensions), is evaluated each year to reflect prevailing interest rates on long-term high quality fixed income investments.
2. The expected rate of return on plan assets and the salary increase assumptions reflect GTE's best estimate of long term future experience with respect to each of these assumptions.
3. The health care cost trend rate assumption is graded by calendar year. The short term trend rate assumption was selected to reflect actual trend rate experience over the most recent years and that expected over the next few years.

**Medical Claims Cost Assumptions:** The final important assumption is the medical claims cost assumption. The 1993 claims cost assumption was adopted by GTE based upon the recommendation of its actuary. This assumption was based on an evaluation of actual GTE experience giving the greatest weight to the most recent years' experience.

Certain factors specific to an individual business unit such as demographics and benefit levels are included. Demographic factors include employee and retiree headcount for each unit. Benefit levels include a review of each bargaining unit contract in the case of nonmanagement employees and GTE benefit policies for management employees.

Since GTE SFAS-106 results are specific to each telephone business unit, and only these results were used to calculate the respective requests for exogenous

treatment, no results of any non-telephone operations entities were included in this response.

- (5) Responding to paragraph 21, the required VEBA trust documents are supplied. GTE as noted above maintains that funding SFAS 106 benefits should be at management's discretion.**

Paragraph 21 of the *Order* requests information from companies that have VEBA trusts or other funding mechanisms for SFAS 106 expenses that were established prior to the adoption of SFAS 106.

- (1) Describe any VEBA trust or other funding mechanisms for the expenses that were established prior to the adoption of SFAS 106.

Copies of Trust Agreements between GTE Service Corporation and State Street Bank and Trust Company are provided (See Attachments III and IV). These are trusts filed under Section 501(c)(9) of the Internal Revenue Code of 1986 (the "Code"). GTE maintains two separate trusts. One Trust is specifically for the benefit of employees who are subject to collective bargaining. The second Trust is for noncollective bargaining groups and management employees. The purpose of a Trust is to receive amounts funded by GTE, pay benefits as described by each business unit's Plan, pay the expenses of the Trust, and properly invest any excess funds. The principal benefit of this Trust arrangement is that it will be exempt from federal income tax under Section 501(a) of the Code.

- (2) Provide the amounts placed in these funds for each year since they were implemented, including the 1990-91 tariff year for LECs.

See Attachment V.

- (3) Describe and provide the amounts in the trust that were for ongoing OPEBs and those that were for TBO.

Funding amounts provided to the Trust and amounts held by the Trust are not segregated by TBO and Service Cost. Neither SFAS-106 nor the *SFAS-106 Order*

required that a separate accounting for TBO and Service Cost be maintained. Since liabilities established by SFAS-106 are not separately accounted for and funding is not calculated on a dollar for dollar relationship with the SFAS-106 accrual, this information is not available.

- (4) Describe the assumptions made when the funds were set up, including, but not limited to, the time value of money, expected long-term rate of return on plan assets, future compensation levels, and retirement age factors affecting the amount and timing of future benefits.

Discussion of each of the factors listed above is pertinent in a discussion of the calculation of the SFAS-106 impact. As such, please refer to GTE's response to paragraph 20.

Funding levels are driven by a different set of criteria than mentioned in the question. First, funding levels must be of a substantial nature in order to provide enough assets to pay claims of the Trust. Second, and of most importance, in order to receive favorable tax treatment under Code, funding levels must not exceed certain levels established by Code. Finally, it is important to understand that funding is not necessarily in the best interests of the ratepayer. The rate base treatment prescribed in *RAO Letter 20* calls for the interstate portion of unfunded accrued postretirement benefits recorded in Account 4310 to be deducted from the rate base and the interstate portion of any prepaid postretirement benefits recorded in Account 1410 to be added to the rate base. This rate base treatment actually results in an increase in sharing, if sharing is present. Also the return earned on funds reinvested in the company is typically greater than that placed in other investment vehicles.

Since *RAO Letter 20* accounting procedures will be implemented upon adoption of SFAS-106 to track the liability and this procedure is favorable to the ratepayer, GTE recommends that a request for full funding be rejected.

(5) State the purpose of the VEBA funds and describe what SFAS-106 benefit packages are covered by each VEBA fund.

As described by the Trust document, the purpose of VEBA funds is to pay the benefits and other liabilities of the Plan. The benefit packages were described in the answer to paragraph 18 *supra*.

(6) Describe the restrictions, if any, that prevent these VEBA funds from being used for other than SFAS-106 benefits.

As described in Section 14 of the Trust, it shall be impossible for any part of the Trust fund to inure to the benefit of any private shareholder or individual other than through the payment of benefits under the Plan and the payment of reasonable administrative expenses of the Plan. (*See* Attachment III at 15 and Attachment IV at 17.) *See* Section 14 of the Trust for a discussion of any assets remaining on Plan termination.

(6) **Responding to paragraph 22, vesting inures to the benefit recipient under SFAS-106 at the time of retirement. Thus, as currently calculated, the exogenous claim is only for vested benefits.**

Paragraph 22 directs the LECs to provide documentation showing when the employees' interests in OPEBs vest. Also, companies must explain how they determine when an employee's interest vests in OPEBs.

SFAS-106 is commonly referred to as "PBOP" which is a derivation of Postretirement Benefits Other Than Pensions. The important factor to consider is that these benefits are available only to employees reaching a designated definition of retirement. *See* the Plan (Attachment II at 1) where eligibility for retirement is

described. Retirement ages and an estimate of the number of employees is a factor built into the valuation conducted by the actuary when estimating GTE SFAS-106 impacts. Thus vesting is already a factor built into the SFAS-106 impacts used as a basis for the exogenous claim.

**(7) Responding to paragraph 23, the deferred tax impact applicable to OPEBs is noted in the GTE calculation of the exogenous adjustment.**

Paragraph 23 directs LECs to describe on a year-by-year basis any exogenous adjustment made to reflect any deferred tax benefit associated with their OPEB accrual amounts.

The impact of the accrual of SFAS-106 expenses will be recorded for financial reporting purposes only. For tax purposes only PAYGO amounts will be deductible in calculating the companies current year tax liability. Thus the effect of this temporary timing difference on taxes will be the creation of deferred tax assets. The estimate of the effect of creating these deferred tax assets was included in the *1993 GTE Filings*.

The implication of deferred tax benefits being temporary and subject to reversal over time brings up the potential need to revisit exogenous adjustments over time. In the *1993 GTE Filings* (at 23), GTE proposes to eliminate the Commission's concern regarding changes in valuation assumptions (and the resulting deferred taxes). Under the proposal, any significant decrease in the TBO and associated costs, regardless of the cause, would be reflected in future annual price cap filings as an adjustment to the exogenous amount granted. This true-up would adequately address the Commission's concerns regarding changes in underlying assumptions and the related tax impact.

- (8) Responding to paragraph 24, GTE concurs with the concurrent USTA filing.**
- (9) Responding to paragraph 25, GTE concurs with the concurrent USTA filing.**

Paragraph 24 directs each company to include in its direct case "all studies upon which the company seeks to rely in its demonstration that these accounting changes should receive exogenous cost adjustment."

Paragraph 25 directs that each company relying on a macroeconomic model to "describe and document the model, including the method of estimation, parameter estimates, and summary statistics."

GTE refers to USTA's Direct Case, Attachment A, "*Perspectives On Analysis of Impact of SFAS 106 GNP-PI*," in this proceeding. This affidavit is provided by Andrew Abel, Ph.D. and Peter Neuwirth, who prepared the Godwins study filed in response to the *OPEB Investigation*. See also USTA's Direct Case, Attachments C, D, E, F, in this proceeding for further affirmation of the validity of the original study.<sup>15</sup>

- (10) Responding to paragraph 26, GTE provides the actuarial reports used to determine SFAS-106 amounts and the related actuarial assumptions.**

Paragraph 26 requests that LECs provide a complete copy of all actuarial reports and studies used to determine SFAS-106 amounts and descriptions and justifications of the actuarial assumptions. Parties are to comment on future events such as capping or elimination of benefits, or the possible advent of national health insurance.

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<sup>15</sup> GTE adopts by reference the Attachments listed above in addition to USTA's Direct Case, Attachments B, G, and H in this proceeding.

The actuarial study used to support GTE's exogenous adjustments is included as Attachment II. A discussion of assumptions is included in GTE's response to paragraph 20.

Future events such as capping or eliminating benefits or a change in governmental policies could affect future SFAS-106 costs. As pointed out in GTE Rebuttal Testimony,<sup>16</sup> LECs have the incentive to control costs. Under price caps, GTE clearly has assumed the responsibility to manage the rising level of expenses without a guaranteed revenue offset from the Commission, as was previously available under rate of return regulation.

GTE has accepted this responsibility by exercising many available options within its control. This includes pursuing cost savings measures such as: adjusting retiree copayment levels; contracting with Health Maintenance Organizations ("HMOs"); Preferred Provider Organization ("PPOs"); and establishing a Patient Advocate System. This list, while not exhaustive, is indicative of GTE's efforts.

While the efforts listed above are important steps in adjusting benefits expense, LECs do not have the unilateral ability to reduce or eliminate such benefits. The efforts of GTE in adjusting benefits and benefit levels must be weighed against the requirement to obtain the highest quality employee at a reasonable price. Also, GTE is constrained by existing labor contracts in its attempts to reduce cost levels.

While GTE's diligence can help control costs, GTE cannot be held responsible for the increasing level of overall medical costs. Factors which significantly affect the

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<sup>16</sup> D. 92-101, Rebuttal of GTE dated July 31, 1992, at 22.

cost of benefit plans can only be included in SFAS-106 valuations as estimates by the actuary. Health care inflation is a primary factor that must be considered in any benefit price out. Since factors beyond GTE's control have significant impacts on the actual benefit cost, GTE, as suggested *supra*, would be willing to consider an annual true-up of the exogenous claim.

**(11) Responding to paragraph 27, GTE maintains that its response to paragraph 26 provides the Commission with all information related to assumptions used to derive SFAS-106 amounts. GTE did not request exogenous treatment for the impact of SFAS-112. Therefore, GTE has not included details related to the SFAS-112 impact.**

Paragraph 27 instructs LECs to submit all options provided by actuaries from which information was selected to derive SFAS-106 amounts including, but not limited to: the ranges of data on the age of the workforce; the ages at which employees will retire; mortality rates; the gross eligible charge table by age; and the length of service of retirees. For comparison purposes, carriers should also provide the actuarial assumptions and data used for SFAS-112 computations. Carriers should provide information on whether they took into account the possibility of future downsizing of the workplace. Carriers should provide information on what adjustments they have made to their SFAS-106 amounts for downsizing in the workforce that have occurred since the adoption of SFAS-106.

First, this question is difficult to answer, as it involves an interpretation of what issues are interwoven and combines issues that should have been separated. GTE's response will address the issues individually.

The availability of "options" for demographic information, such as described, suggests the ability of management to pick and chose the results of the valuation process. The demographics submitted with GTE's answer to paragraph 26 are those