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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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

DIRECT CASE

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August 14, 1995

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SUMMARY

In this proceeding, U S WEST Communications, Inc. ("U S WEST") files its Direct Case in support of its claims for exogenous treatment of amounts associated with implementation of SFAS-106. SFAS-106 requires that other postretirement employee benefits ("OPEB") be accounted for using an accrual rather than a cash methodology. Prior to SFAS-106, U S WEST used a cash -- pay-as-you-go -- method for OPEBs. The Federal Communications Commission ("Commission") adopted SFAS-106 and mandated that U S WEST and other local exchange carriers ("LEC") implement its requirements on or before January 1, 1993. SFAS-106 also required that companies make a one-time or amortized adjustment of previously unfunded OPEB obligations for retirees and active employees equal to what would have been accrued had the companies been operating under SFAS-106.

Upon the adoption by the Commission of SFAS-106, U S WEST included as an exogenous cost change a portion of the costs associated with SFAS-106 in its 1993 Annual Access Tariff Filing. The Commission suspended and subsequently rejected that filing and other filings which included exogenous SFAS-106 costs. The LECs appealed the Commission's decision to the D.C. Circuit Court of Appeals which reversed and remanded the case. The Court held that the costs associated with SFAS-106 were appropriately treated as exogenous under the Commission's then existing rules and directed the Commission to determine the amounts consistent with the Court's decision.

The Commission issued the instant Order in response to the Court's remand and required the affected LECs to file Direct Cases in support of their OPEB costs to be treated as exogenous. In this case, U S WEST provides the detailed supporting information requested by the Commission. U S WEST also shows that almost no double counting has occurred between what is reflected in the LECs OPEB costs and the overall GNP-PI due to the distinct characteristics of telephone company employees and their benefits. Finally, U S WEST demonstrates that the conservative amounts it calculated and included as exogenous as a result of SFAS-106 are appropriate and reasonable. Exogenous treatment for SFAS-106 costs is therefore warranted and the Commission should terminate any pending OPEB-related tariff investigations.

Before the
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Tariff F.C.C. No. 1, Transmittal No. 328	)	

DIRECT CASE

U S WEST Communications, Inc. (or "U S WEST"), through counsel and pursuant to the Federal Communications Commission's ("Commission") Order Designating Issues For Investigation,[1] hereby files its Direct Case in response to that Order.

[1] In the Matter of 1993 Annual Access Tariff Filings, 1994 Annual Access Tariff Filings, AT&T Communications Tariff F.C.C. Nos. 1 and 2, Transmittal Nos. 5460, 5461, 5462 and 5464, 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, CC Docket No. 93-193 (Phase I), CC Docket No. 94-65, CC Docket No. 93-193 (Phase II), CC Docket No. 94-157, Order Designating Issues For Investigation, rel. June 30, 1995 ("Designation Order" or "Order").

I. INTRODUCTION

The issues surrounding the implementation of SFAS-106, concerning other post-retirement employee benefits (or "OPEB"), have been presented and reviewed in a multitude of previous proceedings. From the date of initial adoption of SFAS-106 by the Commission, the issue of the exogenous treatment of these costs has been contentious. U S WEST's arguments as to the merits of exogenous treatment have been presented previously and in the interest of brevity many of those arguments will not be included again here, but are incorporated by reference.[2]

This latest foray into SFAS-106 is based upon the Commission's initial denial of exogenous treatment of these costs.[3] Following that decision, the price cap local exchange carriers ("LEC") appealed the matter to the U. S. Court of Appeals for the District of Columbia Circuit. The Court reversed the Commission's denial and concluded that OPEB costs were indeed eligible for exogenous treatment based upon the Commission's Rules which existed at the time.[4] Therefore, the primary remaining issue with regards to U S WEST's 1993 and 1994 Annual Access Tariff

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[2] Please see Attachment 15 which chronologically lists the 13 filings U S WEST has made in OPEB related proceedings.

[3] In the Matter of Treatment of Local Exchange Carrier Tariffs Implementing Statement of Financial Accounting Standards, "Employers Accounting for Postretirement Benefits Other Than Pensions," Bell Atlantic Tariff F.C.C. No. 1, Transmittal Nos. 497, 536, US West Communications, Inc. Tariff F.C.C. Nos. 1 and 4, Transmittal No. 246, Pacific Bell Tariff F.C.C. No. 128, Transmittal No. 1579, Memorandum Opinion and Order, 8 FCC Rcd. 1024 (1993) ("OPEB Order").

[4] Southwestern Bell Telephone Co. v. FCC, 28 F.3d 165 (D.C. Cir. 1994) ("OPEB Appeal Order").

Filings is simply the determination of the amount of OPEB costs that are applicable for exogenous treatment.

II. ARGUMENTS IN SUPPORT OF U S WEST's DIRECT CASE

A. U S WEST's OPEB Calculations Are Reasonable

During the pendency of the OPEB issue, U S WEST has consistently provided the Commission conservative accurate and reasonable information as to the amount of OPEB costs incurred and projected. It has been assisted in these efforts by professional actuaries and consultants who have provided guidance and input into the information compiled. The methods used and assumptions made have been carefully selected to conform to industry practices, generally accepted standards, and/or the Commission's Rules.

B. Double Counting Between SFAS-106 and GNP-PI Is De Minimis

The Commission's second test for exogenous treatment -- that the exogenous cost is not "double counted" by its prior inclusion in the GNP-PI -- has been met by the LECs for OPEBs as effectively demonstrated by both the Godwins and NERA studies previously submitted. Both of these studies concluded, through the use of separate methodologies, that double counting was not a significant factor in the OPEBs of large telephone companies due to their unique employee and benefit characteristics.

Additionally, the Court in the OPEB Appeal Order also reached the same conclusion. The Court noted several ways in which SFAS-106 costs might be duplicated in LECs GNP-PI adjustments:

> [if] (1) the SFAS-106 cost increase represented the same fraction of total costs for all employers as for LECs (which would depend on such matters as (a) whether the average firm offered OPEBs of the same cost and character as LECs, (b) whether the demographic profile of workers as a whole were the same as that of LEC workers, and (c) whether labor costs were the same fraction of total costs for the average firm as for the average LEC), and (2) all SFAS-106-induced cost increases were passed forward to consumers in price increases, then a 1% SFAS-106 increase in LECs' OPEB costs might be matched by a 1% increase in prices generally.[5]

In the case of the LECs, the Court found none of the above listed assumptions valid and noted that "[t]he most obvious difficulty is that a far lower fraction of private sector employees is eligible for OPEBs compared to telephone company employees."[6]

Finally, to the limited extent double counting has been shown, it would only exist in the pay-as-you-go ("PAYGO") amounts or current service cost of OPEBs. It certainly does not exist in the incremental or transition benefit obligation ("TBO") amounts imposed as a result of SFAS-106. None of these costs were taken into account or included in any employer's costs prior to the adoption of SFAS-106. Therefore, no double counting with regards to these amounts is possible.

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[5] Id. at 171.

[6] Id.

III. RESPONSES TO DESIGNATED ISSUES AND SPECIFIC INFORMATION REQUIREMENTS

In support of granting SFAS-106 costs as exogenous, U S WEST responds to the Commission's Designation Order and provides the following in response to the Commission's information requests:

1. General Information on OPEB Costs Claimed

Issue A: Have AT&T and the 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?

Yes. U S WEST has correctly, reasonably, and justifiably calculated the gross amount of SFAS-106 costs that may be subject to exogenous treatment. U S WEST provides, and has previously provided, significant documentation and evidence to that effect. Please see the response to Issue C, Designation Order Paragraph 20, Questions (1) and (2) for specific detail as to how these OPEB amounts were derived.

Issue - Designation Order Paragraph 17

We direct the LECs and AT&T 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;

U S WEST adopted SFAS-106 effective January 1, 1992.

(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;

U S WEST's initial price cap rates were established using July 1, 1990 rates. The cost basis of U S WEST's pay-as-you-go amount for calendar year 1990 was $87,200,000.

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

U S WEST had included $59,304,000, as shown on Attachment 1A, in its interstate rates which became subject to price cap regulation. The price cap formula effect on the amount is displayed on Attachment 1C.

(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; and

As noted above, U S WEST's initial price cap rates were established using July 1, 1990 rates and U S WEST implemented SFAS-106 in January, 1992. Listed below are U S WEST's actual cash expenditures related to SFAS-106 for the calendar years 1990 and 1991:

		(000's)
	1990	1991
PayGo Costs	87,200	106,500
Current Service Costs Funded in the Voluntary Employee Benefit Association ("VEBA") Trusts	50,162	55,775
Total Cash Expenditures	137,362	162,275

(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.

Provided as Attachments 2-7 hereto are U S WEST Communications, Inc.'s and U S WEST, Inc.'s 10K filings with the SEC for 1992, 1993, and 1994. Provided as Attachments 8-10 hereto are U S WEST's Annual Reports to Shareholders for those same three years. The primary reference to SFAS-106 costs is in the employee benefits footnote to the audited financial statements. Other references in these documents to SFAS-106 can also be found on the face of the income statement and balance sheet.

Issue - Designation Order Paragraph 18

The LECs and AT&T are directed to:

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

U S WEST's benefits to retirees that are covered by SFAS-106 are as follows:

- Medical coverage, including Medicare Part B and mail-order prescription drugs. Retirees after January 1, 1990, are covered under the U S WEST-managed medical care program. The medical program generally reimburses inpatient medical care at 80% to 100%, depending on the coverage selected by the employee. Outpatient care is generally reimbursed at 70% to 90% after a deductible. Health Maintenance Organizations ("HMO") are also available for retirees.

- The dental program provides reimbursement of preventative care based on the actual charges of providers. Reimbursements for other services are based on a schedule.

- Reduced Life Insurance Coverage from age 65 on.

(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;

Listed below for calendar years 1992, 1993, and 1994 are what the pay-as-you-go amounts would have been had the company not implemented SFAS-106 methods.

			(000s)
	1992	1993	1994
PAYGO w/o SFAS-106	127,637	124,000	128,200

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

Prior to implementation of SFAS-106, U S WEST used cash basis accounting for postretirement benefits. This included payments for medical costs incurred in each year and funding of a portion of its postretirement health care benefits (i.e. current service cost) using VEBA trusts. This amount was expensed for Part 32 accounting, financial reporting to shareholders, and included in U S WEST's initial price cap submission.

(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; and

All OPEB expenses reflected in rates before the implementation of SFAS-106 were "SFAS-106 type" expenses. SFAS-106 merely required the method of determining expenses to be based on the liability generated by employee service rather than pay-as-you-go. Please see the response to Issue A, Designation Order Paragraph 17, Question (4) for the level of SFAS-106 type expenses reflected in rates.

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

The level of SFAS-106 expenses included in the rates in effect on the initial date of price cap regulation was $59,304,000 as displayed in Attachment 1A.

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

As previously noted, on December 26, 1991, the Commission authorized all carriers to adopt SFAS-106 on or before January 1, 1993 (the mandatory adoption date).[7] Since these costs were allowed to be reflected before January 1, 1993, it only follows that the costs should be afforded exogenous cost treatment.

2. Regulatory Separations and Allocations

Issue C: Have AT&T and 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?

U S WEST believes that it has correctly and reasonably allocated and separated amounts associated with the implementation of SFAS-106 in accordance with the Commission's Rules and RAO letters. U S WEST's allocation of the exogenous costs associated with adopting SFAS-106 among price cap baskets is consistent with the Commission's Rules. Section 61.45(d)(4) of the Commission's Rules requires that exogenous costs changes be allocated on a "cost-causative" basis. U S WEST has allocated exogenous costs associated with SFAS-106 on the basis of

[7] In the Matter of 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, Order, 6 FCC Rcd. 7560 ¶ 3 (1991).

Part 69. The Commission has stated that an allocation methodology based on Part 69 is a reasonable proxy for cost causation.[8]

Issue - Designation Order Paragraph 20

The following information shall also be provided in the direct cases:

(1) the amount associated with implementation of SFAS-106 for the total company (including telephone operations and non-telephone operations);

Please see Attachment 1B hereto for detail on the amounts associated with the 1992 implementation of SFAS-106 for U S WEST.

(2) an explanation of how the carrier arrived at the total company SFAS-106 amounts;

The incremental OPEB costs were determined by U S WEST as outlined below:

1. The service cost, interest cost, accumulated postretirement benefit obligation ("APBO"), and return on plan assets were compiled by the actuarial firm of Towers Perrin. Using U S WEST's plan participant information, estimates were calculated by applying standard actuarial assumptions including separation and retirement rates, mortality tables, and medical cost assumptions. The actuarial estimates are based upon the assumption that the OPEB obligation was funded on December 31, 1992. The funded amounts are assumed to earn a 9% return (reflected in the return on plan assets component of the expense). For additional detail, please see Attachment 11, U S WEST Communications, Retiree Benefit Plans, 1992

[8] In the Matter of 1992 Annual Access Tariff Filings, National Exchange Carrier Association, Universal Service Fund and Lifeline Assistance Rates, Memorandum Opinion and Order Suspending Rates and Designating Issues for Investigation, 7 FCC Rcd. 4731, 4743 ¶¶ 39-40 (1992).

Actuarial Study of Expense Under the Financial Accounting Standards Board's Statement No. 106, Employers' Accounting For Postretirement Benefits Other Than Pensions.

2. The TBO amortization was calculated by dividing January 1, 1992 APBO less expensed plan assets, by 17.3 years to obtain the annual amount. The plan assets are the accumulated funding and plan earnings as of January 1, 1992 related to service costs expensed prior to the adoption of SFAS-106. The amortization period of 17.3 years represents the average remaining service period of active U S WEST employees, and is in accordance with the amortization guidelines of SFAS-106.

3. The depreciation expense was determined by applying standard depreciation rates to the amounts capitalized in the plant accounts.

4. For purposes of calculating the net incremental expense, U S WEST subtracted 1990 Medical Payment PAYGO and 1992 medical current service costs.

5. Each component of U S WEST's OPEB cost was adjusted downward to reflect amounts allocated to U S WEST's deregulated activities.

(3) [provide] the amounts allocated to the telephone operating companies, including the specific Part 32 Accounts used and the amounts allocated to each of those accounts;

Below are the U S WEST 1992 OPEB costs listed by Part 32 Account:

Account	(000s) Amount
2001	12,777
6124	17,823
6212	9,527
6232	12,097
6362	4,993
6423	23,404
6533	18,044
6534	22,843
6535	17,651
6561	818
6621	13,385
6622	19,883
6623	52,415
6724	33,097
Total Costs	258,757

(4) the method of allocating amounts to the telephone operating companies (head counts, actuarial studies, *etc.*);

OPEB costs were calculated for U S WEST via an actuarial report as described in the previous response to Issue C, Designation Order Paragraph 20, Question (2) above.

(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

The allocation between regulated and non-regulated activities for U S WEST's 1992 OPEB costs are listed below and additionally displayed in Attachment 1B:

	(000's)
Regulated Costs	245,937
Non-Regulated Costs	12,820
Total OPEB Costs	258,757

When U S WEST recorded the impact of OPEBs in its 1992 financial results, it first determined the appropriate Part 32 accounts in which to classify the costs. These accounts were then allocated in Part 64 between regulated and non-regulated operations based on the U S WEST Cost Allocation Manual ("CAM") as filed with the Commission. Therefore, any OPEB costs which were allocated to non-regulated operations were allocated appropriately based on the cost pool tables specified in the CAM.

(6) the allocation of costs to baskets, by year.

Please see Attachment 1D hereto.

3. <u>VEBA Trust Information</u>

Issue D: How should Voluntary Employee Benefit Association 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?

For VEBA trusts and other funding mechanisms created before the implementation of price caps, the trust creation is irrelevant as to the question of exogenous treatment as further discussed in Issue E below. In regards to the expenses that were allowed in rates prior to the implementation of price caps, it

would be appropriate to remove these costs from the incremental calculation of SFAS-106 expenses subject to exogenous treatment. U S WEST has used this methodology for all filings in which it included SFAS-106 expenses as exogenous costs.

For VEBA trusts created after price caps, but before the change required by SFAS-106, no exogenous treatment would be applicable. The implementation of a VEBA trust is not a required accounting change outside of the control of the LEC. Therefore, its creation would not be an exogenous event.

For VEBA trusts created after the adoption of SFAS-106, trust creation is irrelevant as to the question of exogenous treatment. SFAS-106 expenses not already included in price cap rates are to be afforded exogenous treatment per the Court. Creation of a VEBA trust to fund such expenses is simply an internal business decision.

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

No. Funding is an entirely distinct issue from the determination of exogenous treatment for price cap purposes. Funding is determined by business needs based upon issues such as the availability of cash, the limitations on tax advantaged funding vehicles, and alternate investment opportunities. The decision of when and through what means an entity funds such benefits is irrelevant to the accounting issue of how the costs of such benefits should be apportioned to accounting periods. The Financial Accounting Standards Board ("FASB") and the Commission determined that the proper apportionment is accrual accounting under SFAS-106.

The Commission mandated adoption of this accounting policy consistent with its treatment of pension costs. The issue of funding was not a part of the Commission's existing test for exogenous treatment. Therefore, limiting exogenous treatment to the amounts funded would be an illegal modification of the Commission's exogenous treatment rule.

Issue - Designation Order Paragraph 21

The following information shall be provided by companies that have Voluntary Employee Benefit Association (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;

Prior to the adoption of SFAS-106, U S WEST established in 1989 two VEBA trusts as funding mechanisms for postretirement health care benefits. Separate trusts were established for management and nonmanagement employees. Both trusts qualify for tax deductible contributions under Section 501(c)(9) of the Internal Revenue Code (or "IRC"), and are managed externally by the Boston Safe Deposit and Trust Company.

Additionally, beginning in the late 1950s, AT&T began pre-funding retiree life insurance benefits. Under the arrangement that AT&T established with its life insurance carriers, surplus active life insurance premiums were deposited into Retiree Life Insurance Funding Accounts ("RFA"). Each year, AT&T would pay premiums to the insurance companies for employee life insurance benefits. The insurance company would subtract benefit payments and expenses from these

premiums. Positive balances were added to the RFAs and negative balances were subtracted from the RFAs. After divestiture, U S WEST continued this practice until 1988 when contributions to the RFAs were terminated.

(2) provide the amounts, placed in these funds for each year since they were implemented, including the 1990-91 tariff year for LECs and the 1989-90 tariff year for AT&T;

Listed below are the amounts placed in U S WEST's VEBA trusts since their inception:

Year	Amt Funded
1989	59,400,000
1990	50,161,690
1991	55,775,000
1992	55,775,000
1993	246,098,000
1994	288,460,000
1995	256,475,000
Total to Date	1,012,144,690

(3) describe and provide the amounts in the trust that were for ongoing OPEBs and those that were for TBO;

Listed below is the allocation of the amounts funded to the trusts that were for ongoing OPEBs and those that were for TBO:

Year	(A) Amt Funded for On-going Costs	(B) Amt Funded for TBO Amort.	(C) Total Amt Funded to Med. VEBA
1989	59,400,000	-	59,400,000
1990	50,161,690	-	50,161,690
1991	55,775,000	-	55,775,000
1992	55,775,000	-	55,775,000
1993	233,209,000	12,889,000	246,098,000
1994	202,566,000	85,894,000	288,460,000
1995	182,940,000	73,535,000	256,475,000
Total to Date	839,826,690	172,318,000	1,012,144,690

(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;

Please refer to Attachment 11.

(5) state the purpose of the VEBA funds and describe what SFAS-106 benefits packages are covered by each VEBA fund; and

The purpose of the VEBA trust is to establish a funding mechanism for postretirement benefits. A VEBA trust is a tax exempt organization which is allowed to accumulate income producing reserves for the payment of future employee benefits. The Internal Revenue Code Section 419(b) permits a contribution deduction in an amount equal to the actual welfare benefit expenses incurred for the taxable year, plus an amount necessary to fund the various reserves for benefit claims incurred but unpaid as of the end of the taxable year.[9]

U S WEST established VEBA trusts in 1989 through 1992 to fund postretirement health care benefits.

[9] The maximum contribution limits of the IRC §§ 419 and 419(A) do not apply when the benefits were subject to collective bargaining.

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

Each of the U S WEST VEBA trust agreements contain language similar to the following:

> Except for the payment of trustee expenses which are specifically permitted by the trust Agreement, no part of the net earnings or any other property of the Trust, or any contributions made by the Employer, pursuant to the terms of any of the Plans, shall ever revert to or be used or enjoyed by the Employer or be used for any purpose other than the payment or provision of life, sickness, accident and other covered benefits for eligible employees and retirees of the Employer, their eligible dependents, and/or their designated beneficiaries.

U S WEST VEBA trust agreements also prohibit the payment of "disqualified benefits." Disqualified benefits are those which would subject U S WEST to tax under Section 4976 of the Internal Revenue Code of 1986.[10] Included specifically as a disqualified benefit is "any portion of the Trust Fund reverting to the benefit of the Employer."

Additionally, the law under which VEBAs are granted their tax exemption effectively prevents the funds from being used for other purposes. Section 501(c)(9) of the IRC provides for the tax exemption of VEBAs so long as "[n]o part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual."[11]

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[10] IRC § 4976 (1986).

[11] Id. at § 501(C)(9).

4. Vesting of OPEB Interests

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

No. As described in the summary plan descriptions distributed to all plan participants, employees who retire with a service or disability pension are eligible to receive postretirement medical and life benefits. In calculating the actuarial liability and the amount of annual expense, U S WEST's outside actuaries include factors for employee turnover and other factors of employment separation in calculating the liability attributable to employees not fully eligible for benefits. Accordingly, the amount recorded for expense and the related liability reflect the present value of benefits earned by employees who are already eligible and those employees expected to be eligible for postretirement benefits.

The issue of vesting was addressed by the FASB in its deliberations on SFAS-106. Recognizing expense only when an employee vests results in a mismatch of employee service and the related benefit cost. As a result, this approach was rejected in SFAS-106 as it was in SFAS-87 on pension costs.

In any case, the issue of vesting is not relevant to this proceeding. Both the FASB and the Commission have adopted SFAS-106 as the appropriate method of accounting. The issue of vesting was not a part of the Commission's existing test for exogenous treatment. Therefore, limiting exogenous treatment to the amount vested would again be an illegal modification of the Commission's exogenous treatment rule and violative of the Court's directive in the OPEB Appeal Order.

Issue - Designation Order Paragraph 22

We direct the LECs and AT&T to provide documentation showing when the employees' interests in the OPEBs vest. Also, companies must explain how they determine when an employee's interest vests in the OPEBs.

Please see Attachment 13, Relevant Sections from "Your U S WEST Benefits Handbook."

5. Treatment of Deferred Tax Benefits

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

The deferred tax benefit applicable to OPEBs should be treated consistently with the Commission's existing Part 65 Rules. Section 65.830 requires that other deferred credits, including deferred taxes, be deducted from the interstate rate base.[12] The interstate rate base is used by the Commission in its calculation of sharing.

Issue - Designation Order Paragraph 23

AT&T and the LECs are directed to describe on a year-by-year basis any exogenous adjustments made to reflect any deferred tax benefit associated with their OPEB accrual amounts. Companies are also directed to provide an explanation if there are no such adjustments.

The deferred tax benefit applicable to OPEB was reflected in the Net Return portion of the exogenous cost adjustment. The interstate portion of deferred income tax was deducted from the interstate rate base in accordance with the Commission's Rules.

[12] 47 CFR § 65.830.

The deferred tax amounts embedded in the Net Return portion of the OPEB exogenous cost adjustments were:

	Accum Def Tax	ROR	Net Return
1993	$704,420 (1)	11.25%	$79,247
1994	($178,250) (2)	11.25%	($20,053)

(1) Source: 1993 Annual Filing TRP EXG-1, Col. K, Lines 200, 400, 600, 800
(2) Source: 1994 Errata to 1994 Annual Filing, Section 1, Workpaper 8, Rate Base, Accum Deferred Inc. Tax Total.

6. Supporting Studies and Models

Issue - Designation Order Paragraph 24

We require 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 an exogenous cost adjustment. This includes studies demonstrating that the change is not reflected in the current price cap formulas, factors for inflation, productivity, allowed exogenous changes, the rates in effect on the initial date that the carrier became subject to price cap regulation, or, for the LECs, the sharing and low-end formula adjustment mechanisms.

U S WEST relied on the studies and support the United States Telephone Association ("USTA") will place on record with its Direct Case Filing on August 14, 1995. The USTA attachments are as follows:

Attachment A.	Neuwirth Affidavit (1995)
Attachment B.	Narrative Explaining OPEB Results (1993)
Attachment C.	Godwins Study (1992)
Attachment D.	Godwins Response to Question 16 (1992)
Attachment E.	Godwins Rebuttal Analysis (1992)
Attachment F.	Godwins Additional Sensitivity Analysis - 618 Scenarios (1993)