

Issue - Designation Order Paragraph 25

Parties and commenters relying on a macroeconomic model shall fully describe and document the model, including the method of estimation, parameter estimates, and summary statistics. These same data should be submitted for any alternate functional forms that were modeled, including the data used to estimate the model, the data used in making forecasts from the model, and the results of any sensitivity analyses performed to determine the effect of using different assumptions.

Please see response to Paragraph 24 above.

Issue - Designation Order Paragraph 26

AT&T and the LECs shall provide a complete copy of all actuarial reports and studies used to determine SFAS-106 amounts and should provide descriptions and justifications of the actuarial assumptions, and the assumptions unique to postretirement health care benefits, made in computing the SFAS-106 expenses. These assumptions should include, but are not limited to, the time value of money, expected rate of return on plan assets, participation rates, retirement age, per capita claims cost by age, health care cost trend rates, medical reimbursement rates, salary progression (if a company has a pay-related plan), and the probability of payment (turnover, dependency status, mortality, etc.). Parties and commenters should also discuss what assumptions, if any, were made about other future events such as capping or elimination of benefits, or the possible advent of national health insurance.

Attachment 11 is a copy of U S WEST's 1992 Actuarial Study for SFAS-106.

All appropriate actuarial assumptions are listed in this report. The actuarial assumptions used in SFAS-106 have been audited annually by U S WEST's external auditors and determined to be appropriate assumptions under the requirements of SFAS-106. The SFAS-106 statement requires "the use of explicit assumptions, each of which individually represents the best estimate of a particular future event"

U S WEST's assumptions on the capping of benefits are contained in Attachment 11. U S WEST did not explicitly include an assumption on national

health care insurance as SFAS-106 prohibits assumptions concerning prospective legislative changes.¹³ As a result, U S WEST's actuarial study implicitly assumes that national health insurance will not exist over the life of the study.

Issue - Designation Order Paragraph 27

We also direct AT&T and the 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 downsizings in the workforce that have occurred since the adoption of SFAS-106. Carriers should give full details of these adjustments.

SFAS-106 is specific in its requirements concerning assumptions for determining annual expense and liabilities. As noted previously, the statement requires "the use of explicit assumptions, each of which individually represents the best estimate of a particular future event" Assumptions involving retirement rates, mortality, health care costs, turnover and pay increases are all consistent between SFAS-87, SFAS-106 and SFAS-112 valuations. For a further description of specific actuarial assumptions, please see Attachment 11. In addition, U S WEST is

¹³ See Financial Accounting Series, Special Report, A Guide to Implementation of Statement 106 on Employers' Accounting for Postretirement Benefits Other Than Pensions, Questions and Answers, Financial Accounting Standards Board, Kenneth L. Dakdduk and Jules M. Cassel (Aug. 1993):

13 A. Changes in Medicare coverage should be projected only if those changes result from currently enacted legislation or regulations. . . . Future legislation that would change the position of costs covered by Medicare should not be anticipated even though a historical trend of those changes may be apparent.

required to use its own active and retiree census data so that there is no flexibility in assumption of average age or service of the workforce.

SFAS-106 does not allow assumptions concerning future extraordinary unannounced events, such as downsizings. Downsizings are accounted for when they are announced according to the design of the downsizing. SFAS-106 requires specific accounting treatment of widow plans, curtailments and actuarial gains from higher than expected turnover. All workforce reductions have been accounted for in accordance with the explicit rules established in SFAS-106.

U S WEST adopted SFAS-112 in 1993¹⁴ and has not included any portion of the expenses associated with SFAS-112 as exogenous costs in its price cap indexes.

Issue - Designation Order Paragraph 28

Further, since part of the growth in Gross Domestic Product Price Index (GDP-PI) presumably occurs due to growth in medical costs, we seek information on what adjustment, if any, should be made in the exogenous adjustment to avoid any double-counting. If an adjustment has been made, parties and commenters shall document how the adjustment was computed. Moreover, parties and commenters should describe and quantify any wage changes that will be reflected in the GDP-PI that are expected to occur as a result of the introduction of SFAS-106. In particular, parties and commenters should discuss what adjustment, if any, should be reflected in the exogenous adjustment for this change.

U S WEST does not disagree with the assertion that the GDP-PI will be impacted by growth in medical costs. But this does not necessarily lead to the conclusion that an adjustment should be made in the exogenous expense to avoid

¹⁴ See Letter to Mr. Kenneth P. Moran, Chief, Accounting and Audits Division from G. Michael Crumling, Executive Director-Federal Regulatory dated July 8, 1993, regarding Notification of U S WEST Communications' Intent to Adopt Statement of Financial Accounting Standards No. 112.

“double counting.” U S WEST believes that there will be little, if any, “double counting” and that any such “double counting,” if it exists, will be de minimis.¹⁵ This conclusion flows from the fact that U S WEST and other price cap LECs had a very large amount of medical expense built into initial price cap rates as a result of the PAYGO accounting which existed prior to the adoption of SFAS-106. In computing the exogenous cost of SFAS-106, price cap LECs have removed the PAYGO amounts in order to determine the incremental cost associated with adopting SFAS-106 (the additional funding required for the future OPEBs of current employees and the TBO amount). Thus, the impact of medical cost inflation on the GDP-PI in the price cap formula will only cover the increased cost of PAYGO medical costs embedded in initial price cap rates (plus 0.7 percent as determined by Godwins). It will not cover the remaining 99.3 percent of the incremental costs associated with SFAS-106.

The Godwins study found that SFAS-106 would have a downward impact on the average wage rate. If the price cap LECs actually experienced the lower wage rates estimated in the Godwins study, they would recover an additional 14.5 percent of their SFAS-106 costs through this indirect effect.¹⁶ The net effect, using the very conservative assumptions in the Godwins study, is that 84.8 percent of a price cap

¹⁵ In fact, the Godwins study determined that only 0.7 percent of the additional SFAS-106 costs to price cap LECs would be reflected in the GNP-PI. See United States Telephone Association, Analysis of Impact of FAS 106 Costs on GNP-PI, prepared by Godwins, dated Feb. 18, 1992 at Executive Summary ¶ 2.

¹⁶ This wage reduction realization is questionable in the case of U S WEST and the other LECs as the substantial portion of LEC employees are covered under collective bargaining agreements negotiated in 1992. These agreements cover the period 1992-1995. It is unlikely that SFAS-106 impacts were considered in the wage negotiations or factored in during that time.

LEC's direct SFAS-106 costs will not be recovered through the price cap mechanism.

U S WEST has therefore previously advocated that 84.8 percent of its SFAS-106 costs be treated as exogenous.

7. Miscellaneous Supporting Information

Issue - Designation Order Paragraph 29

Each carrier shall provide information on its average total compensation per employee and the amount of this total compensation represented by OPEBs. We ask parties and commenters to provide similar data for the economy as a whole for comparison. This comparison is consistent with the Commission's price cap formula, which includes a productivity factor. By using this factor, the price cap index takes into account the productivity of the carrier regulated under price caps as compared to the economy as a whole. Historically, the telecommunications industry has had a higher level of productivity than the economy as a whole.

U S WEST has included as Attachment 14 an average total compensation per employee calculation. Also included is information contained in the Godwins Study providing data for the economy as a whole for comparison.

Issue - Designation Order Paragraph 30

Because the accruals for OPEBs generally represent non-cash expenses that may never be paid, we direct parties to describe the provisions they have made, if any, to return to ratepayers the over-accrual, if any, of the non-cash expenses if exogenous treatment is given for these amounts. Parties should describe any plans they have to return such monies to customers through voluntary PCI reductions or other means. Parties shall also describe how they recognize these gains from such over-accruals on their books of account.

Over-accruals are unlikely given U S WEST's OPEB accounting methodology as dictated by SFAS-106. The SFAS-106 standard requires annual measurements of the obligation using actuarial and substantive plan design assumptions that

represent the best estimate of future experience. Each of these assumptions must be reviewed and updated annually, as appropriate. These annual measurement, true-up and amortization requirements are designed to prevent over-accruals from occurring.

From a practical standpoint, U S WEST does not foresee any reasonable possibility that an over-accrual will occur due to the following factors:

- the transition benefit obligation is being amortized over 17.3 years and, therefore, the majority of U S WEST's past liability has not been recognized as an obligation.
- U S WEST's funding policy and restrictions on plan assets effectively prevent over-accruals. Currently, U S WEST's obligation is significantly under-funded and is anticipated to be under-funded well into the next decade. All assets funded by U S WEST are restricted to provide benefits to employees and cannot be returned to the company. Accordingly, it is not practical for U S WEST to eliminate benefits below the amount of plan assets.
- the majority of U S WEST's obligation is subject to collective bargaining and past history has demonstrated that the union will adamantly oppose any reduction in benefits.

Normally no true-up provision would be necessary for an exogenous expense. The OPEB expense is unique enough to mandate a limited true-up provision. Most exogenous adjustments are easily quantifiable and occur over a relatively short period of time. OPEB cost is incurred over an employee's lifetime and is subject to the health of the employee and the cost of medical care. Of the \$2.8 billion liability U S WEST had on January 1, 1993, \$1.5 billion relates to past employees who have already retired. The true-up performed ensures that significant changes in assumptions will not result in large cost fluctuations.

However, a true-up of the entire OPEB expense would not be appropriate since the liability grows each year due to the cumulative nature of employee service. The cost associated with future service should most appropriately be subject to price cap incentives. This can be accomplished by having the true-up apply to the amortization of the TBO and the associated interest cost and investment return. Additionally, to ensure that the price cap mechanism continues to be simple, U S WEST has recommended that a true-up occur only when assumptions have moved greater than 10% cumulatively.¹⁷

Issue - Designation Order Paragraph 31

The accrual calculations used by the companies to develop their claims for exogenous treatment for SFAS-106 amounts are, in part, based on the OPEBs provided pursuant to contracts between the companies and their employees. These contracts are currently being renegotiated. The OPEB benefits represent a significant issue in these negotiations. Any change in OPEBs will affect future accrued amounts and will be useful to compare prior calculated accruals to the new OPEB contracts to aid in determining whether the former calculations were reasonable. In particular, we are interested in determining whether the underlying actuarial assumptions have changed. Therefore, on an ongoing basis, parties shall document any and all changes made in OPEBs offerings to employees. Any new contracts with employees and their representative unions shall be submitted as they are negotiated.

Included as Attachment 12 is U S WEST's current labor contract including relevant benefits provisions. As new contracts are negotiated and finalized, U S WEST will supplement the record and forward a copy of those agreements on to the Commission.

¹⁷ See U S WEST's Rebuttal in CC Docket No. 92-101, Transmittal No. 246, filed July 31, 1992.

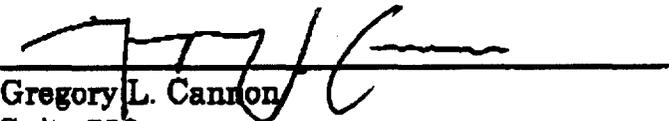
IV. CONCLUSION

The Court in the OPEB Appeal Order found that OPEB costs should be treated exogenously. It remanded to the Commission to determine, in a manner consistent with its opinion, the amount of OPEB costs of each LEC appropriate for exogenous treatment. U S WEST has shown that the information and studies relied upon for its OPEB calculations are well-supported. By this Direct Case, U S WEST has sufficiently demonstrated that the OPEB amounts it has calculated for exogenous treatment are reasonable and justified. Accordingly, the Commission should find U S WEST's exogenous treatment of OPEB costs appropriate and terminate its pending OPEB-related tariff investigations.

Respectfully submitted,

U S WEST COMMUNICATIONS, INC.

By:


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Its Attorney

Of Counsel,
Dan L. Poole

August 14, 1995

ATTACHMENTS

ATTACHMENT 1A	Post-Retirement Benefit Expenses Budget Assumption
ATTACHMENT 1B	SFAS 106 Costs
ATTACHMENT 1C	Effect of the Price Cap Formula
ATTACHMENT 1D	Allocation of Costs to Baskets
ATTACHMENT 2	U S WEST Form 10-K - 1992
ATTACHMENT 3	U S WEST Form 10-K - 1993
ATTACHMENT 4	U S WEST Form 10-K - 1994
ATTACHMENT 5	U S WEST Form 10-K - 1992
ATTACHMENT 6	Securities and Exchange Commission - U S WEST, Inc. Form 10-K - 1993
ATTACHMENT 7	Securities and Exchange Commission - U S WEST, Inc. Form 10-K - 1994
ATTACHMENT 8	U S WEST Annual Report - 1992
ATTACHMENT 9	U S WEST Annual Report - 1993
ATTACHMENT 10	U S WEST Annual Report - 1994
ATTACHMENT 11	U S WEST Communications Retiree Benefit Plans 1992 Actuarial Study of Expense Under the Financial Accounting Standard Board's Statement No. 106 Employers' Accounting For Postretirement Benefits Other Than Pensions
ATTACHMENT 12	Agreement between U S WEST Communications & CWA
ATTACHMENT 13	U S WEST Employee Handbook
ATTACHMENT 14	U S WEST Compensation Per Employee

ATTACHMENT 15

Events Associated With OPEB Filing Activity

ATTACHMENT 1A

POST-RETIREMENT BENEFIT EXPENSES
BUDGET ASSUMPTION
INCLUDED IN 1990/1991 TARIFF PERIOD

(\$000)

Arizona	\$9,084	Iowa	\$3,888	Idaho-PNB	\$ 72
Colorado	9,696	Minnesota	7,692	Oregon	5,004
Idaho-MTN	1,488	Nebraska	2,364	Washington	8,640
Montana	1,644	No.Dakota	1,140		
NewMexico	2,952	So.Dakota	1,128		
Utah	3,240				
Wyoming	1,272				
TOTAL	<u>\$29,376</u>		<u>\$16,212</u>		<u>\$13,716</u>
GRAND TOTAL		\$59,304			

* This data was included in U S WEST's 1990 Annual Access Charge Filing, Description and Justification, Volume 2-1, Pages 3-5.

ATTACHMENT 1B

**SFAS 106 COSTS
SUBJECT TO SEPARATIONS**

COST CHANGE DEVELOPMENT	USWC TOTALS (A)	DEREG AMOUNTS (B)	STS REGULATED (C)=(A)-(B)	STS INCREMENTAL EXPENSES (D)	CAPITAL COMPONENT (E)
1. APBO	3,038,216,000	158,899,000	2,879,317,000	2,879,317,000	N/A
2. Plan Assets	463,966,000	24,265,000	439,701,000	439,701,000	N/A
3. Total TBO Amount (Lines 1 – 2)	2,574,250,000	134,634,000	2,439,616,000	2,439,616,000	N/A
4. TBO Amortization (Line 3/17.3 years)	148,801,000	7,782,000	141,019,000	141,019,000	N/A
5. Service Cost	54,391,000	2,659,000	51,732,000	48,192,000	3,540,000
6. Interest Cost	227,290,000	11,112,000	216,178,000	201,387,000	14,791,000
7. Return on Assets	(39,138,000)	(1,913,000)	(37,225,000)	(34,678,000)	(2,547,000)
8. Depreciation Expense	818,000	0	818,000	818,000	N/A
9. Total OPEB Costs (Sum of Lines 4 through 8)	392,162,000	19,640,000	372,522,000	356,738,000	15,784,000
10. Paygo	87,200,000	4,561,000	82,639,000	82,639,000	N/A
11. Medical Current Service Cost	46,205,000	2,259,000	43,946,000	40,939,000	3,007,000
12. Incremental OPEB Costs (Lines 9 – 10 – 11)	258,757,000	12,820,000	245,937,000	233,160,000	12,777,000

ATTACHMENT 1C

EFFECT OF THE PRICE CAP FORMULA
(000)

ATTACHMENT 1C
PAGE 1 OF 2

	<u>INTERSTATE</u> (A)*	<u>COMMON LINE</u> (B)=(A)*41.73%	<u>TRAFFIC SENSITIVE</u> (C)=(A)*46.69%	<u>SPECIAL ACCESS</u> (D)=(A)*9.75%	<u>INTEREXCHANGE</u> (E)=(A)*1.83%
ARIZONA	9,084	3,791	4,241	886	166
COLORADO	9,696	4,046	4,527	945	178
IDAHO-S	1,488	621	695	145	27
MONTANA	1,644	688	768	160	30
NEW MEXICO	2,952	1,232	1,378	288	54
UTAH	3,240	1,352	1,513	316	59
WYOMING	1,272	531	594	124	23
IOWA	3,888	1,623	1,815	379	71
MINNESOTA	7,692	3,210	3,591	750	141
NEBRASKA	2,364	986	1,104	231	43
NORTH DAKOTA	1,140	476	532	111	21
SOUTH DAKOTA	1,128	471	527	110	20
IDAHO-NORTH	72	30	34	7	1
OREGON	5,004	2,088	2,336	488	92
WASHINGTON	8,640	3,605	4,034	842	159
TOTAL	59,304	24,748	27,689	5,782	1,085

PART 69 RATIOS	INTERSTATE	COMMON LINE	TRAFFIC SENSITIVE	SPECIAL ACCESS	INTEREXCHANGE
Operating Expense**	272,695	113,803	127,322	26,579	4,991
Percent to Total	100.00%	41.73%	46.69%	9.75%	1.83%

* Attachment 1A

** U S West 1990 Annual Access Tariff Filing, COS-7(P), row 7331, Col (i), (n), (o), (r)

EFFECT OF THE PRICE CAP FORMULA

<u>LINE</u>	<u>DESCRIPTION</u>	<u>SOURCE</u>	<u>COMMON LINE</u>	<u>TRAFFIC SENSITIVE</u>	<u>SPECIAL ACCESS</u>	<u>INTEREXCHANGE</u>	<u>TOTAL</u>
1	EXPENSE PRIOR TO EXOG. TREATMENT	ATTACH. 1C PG. 1 ('000)	24,748	27,689	5,782	1,085	59,304
2	1/1/91 PCI	U S WEST TRANSMITTAL 125	0.977757	0.985829	0.982260	0.984489	
3	7/1/91 PCI	U S WEST TRANSMITTAL 169	0.873214	0.979918	0.998407	0.977244	
4	7/1/92 PCI	U S WEST TRANSMITTAL 273	0.798628	0.948778	0.987442	0.952150	
5	DIFF. 1/1/91 & 7/1/91	1-(L2-L3),SPEC. 1+(L2-L3)	0.895457	0.994089	0.983853	0.992755	
6	DIFF. 7/1/91 & 7/1/92	1-(L3-L4)	0.925414	0.968860	0.989035	0.974906	
7	EXPENSE AS OF 1/1/91	L1*L2 ('000)	24,198	27,297	5,679	1,068	58,242
8	EXPENSE AS OF 7/1/91	L7*L5 ('000)	21,668	27,135	5,588	1,060	55,451
9	EXPENSE AS OF 7/1/92	L8*L6 ('000)	20,052	26,290	5,526	1,034	52,902

ATTACHMENT 1D

ALLOCATION OF COSTS TO BASKETS

<u>YEAR FILED</u>	<u>INTERSTATE</u>	<u>COMMON LINE</u>	<u>TRAFFIC SENSITIVE</u>	<u>SPECIAL ACCESS</u>	<u>TRUNKING</u>	<u>INTER EXCHANGE</u>
1. 1993	46,791,461	18,855,912	23,004,719	4,673,429		257,401
2. 1993	46,791,461	18,855,912	12,076,719		15,601,429	257,401
3. 1994	(15,254,707)	(6,394,454)	(3,949,855)		(4,784,704)	(125,694)
4. 1995	25,849,316	10,683,357	6,729,367		8,198,266	238,326
5. 1995	(57,386,070)	(23,144,815)	(14,856,231)		(19,014,991)	(370,033)

Sources

1. U S West 1993 Annual Access Tariff Compliance Filing, Transmittal 376, EXG-1
2. U S West 1993 Annual Access Tariff Compliance Filing, Transmittal 376, restated for new Trunking basket
3. U S West Errata to 1994 Annual Access Tariff Filing, Transmittal 472, EXG-1
4. U S West PCI Adjustment, Transmittal 584, EXG-1
5. U S West 1995 Annual Access Tariff Compliance Filing, Transmittal 645, EXG-1

ATTACHMENT 2

Mary

FORM 10-K

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

(X) ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the fiscal year ended December 31, 1992

AS FILED

OR

[] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 OF THE SECURITIES EXCHANGE ACT OF 1934 For the transition period from _____ to _____

Commission file number 1-3040

U S WEST Communications, Inc.

A Colorado Corporation

IRS Employer No. 84-0273800

1801 California Street, Denver, Colorado 80202 Telephone Number (303) 896-3099

Securities registered pursuant to Section 12(b) of the Act:

Title of each class		Name of each exchange on which registered
Forty Year	3 1/4% Debentures due February 1, 1996	New York Stock Exchange
Thirty-Three Year	7 1/2% Debentures due April 1, 2005	New York Stock Exchange
Forty Year	8 5/8% Debentures due October 1, 2010	New York Stock Exchange
Forty Year	7 7/8% Debentures due January 1, 2011	New York Stock Exchange
Forty Year	7 3/8% Debentures due November 1, 2011	New York Stock Exchange
Thirty-Seven Year	8 5/8% Debentures due June 15, 2012	New York Stock Exchange
Thirty-Seven Year	9 % Debentures due November 1, 2012	New York Stock Exchange
Forty Year	7 3/4% Debentures due June 1, 2013	New York Stock Exchange
*Thirty-Six Year	9 1/4% Debentures due December 15, 2014	New York Stock Exchange
Forty Year	7 7/8% Debentures due November 15, 2016	New York Stock Exchange
Forty Year	8 1/8% Debentures due March 15, 2017	New York Stock Exchange
Forty Year	8 % Debentures due September 15, 2017	New York Stock Exchange
Forty Year	8 5/8% Debentures due April 1, 2018	New York Stock Exchange
Forty Year	8 3/4% Debentures due August 1, 2018	New York Stock Exchange

* Redeemed in full on January 15, 1993

Securities registered pursuant to Section 12 (g) of the Act: None.

THE REGISTRANT, AN INDIRECT, WHOLLY-OWNED SUBSIDIARY OF U S WEST, INC., MEETS THE CONDITIONS SET FORTH IN GENERAL INSTRUCTION J(1)(a) AND (b) OF FORM 10-K AND IS THEREFORE FILING THIS FORM WITH REDUCED DISCLOSURE FORMAT PURSUANT TO GENERAL INSTRUCTION J(2).

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrants knowledge in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ***

*** Not applicable in that registrant is an indirect, wholly-owned subsidiary.

The total number of pages contained in this report, including exhibits, is 36 and the exhibit index is on page 27.

U S WEST COMMUNICATIONS, INC.
FORM 10-K
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U S WEST COMMUNICATIONS, INC.
FORM 10-K

PART I

ITEM 1. BUSINESS

General

U S WEST Communications, Inc. (the "Company") is incorporated under the laws of the State of Colorado and has its principal offices at 1801 California Street, Denver, Colorado, 80202, telephone number (303) 896-3099. The Company is an indirect, wholly-owned subsidiary of U S WEST, Inc. ("U S WEST").

The Company was formed January 1, 1991, when Northwestern Bell Telephone Company ("Northwestern Bell") and Pacific Northwest Bell Telephone Company ("Pacific Northwest Bell") were merged into The Mountain States Telephone and Telegraph Company ("Mountain Bell"), which simultaneously changed its name to U S WEST Communications, Inc. U S WEST acquired ownership of Mountain Bell, Northwestern Bell and Pacific Northwest Bell on January 1, 1984, when American Telephone and Telegraph Company ("AT&T") transferred its ownership interests in these three wholly-owned operating telephone companies to U S WEST. This divestiture was made pursuant to a court approved consent decree entitled the Modification of Final Judgement ("MFJ"), which arose out of an antitrust action brought by the United States Department of Justice against AT&T.

Company Operations

The Company provides telecommunications services in the states of Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington and Wyoming (the "14 state region"). The Company serves approximately 80% of the population in these states and approximately 40% of the land area. At December 31, 1992, the Company had approximately 13,345,000 telephone network access lines in service, a 3.2% increase over year end 1991.

Under the terms of the MFJ, the 14 state region was divided into 29 geographical areas called local access and transport areas ("LATAs") with each LATA generally centered on a metropolitan area or other identifiable community of interest. The principal types of telecommunications services offered by the Company are (i) local service, (ii) intraLATA long distance service and (iii) exchange access service (which connects customers to the facilities of interLATA service providers). For the year ended December 31, 1992, local service, exchange access service and intraLATA long distance service accounted for 44%, 33% and 17%, respectively, of the sales and other revenues of the Company. In 1992, revenues from a single customer, AT&T, accounted for approximately 14% of the Company's sales and other revenues.

Regulation

The Company is subject to varying degrees of regulation by state commissions with respect to intrastate rates and service and access charge tariffs. Under traditional rate of return regulation, intrastate rates are generally set on the basis of the amount of revenues needed to produce an authorized rate of return. (See pages 11 and 12 of Management's Discussion.)

PART I

ITEM 1. BUSINESS (continued)

Regulation (continued)

The Company is also subject to the jurisdiction of the Federal Communications Commission ("FCC") with respect to interstate access tariffs (that specify the charges for the origination and termination of interstate communications) and other matters. The Company's interstate services have been subject to price cap regulation since January 1991. Price caps are a form of incentive regulation and, ostensibly, limit prices rather than profits. However, the FCC's price cap plan includes sharing of earnings in excess of authorized levels. The Company believes that competition will ultimately be the determining factor in pricing telecommunications services. (1)

In October 1992, the FCC adopted an order requiring that certain telephone companies, including the Company, allow competitive access providers to collocate their equipment in telephone company central office facilities. The order, which is effective in May 1993, applies only to interstate special access (i.e., private line) services generally provided to large business users. It is expected that the order will increase competition and result in lower prices for special access services, which accounted for about 11 percent of the Company's interstate access revenues during 1992. Under the order, the Company would obtain additional flexibility in pricing these services. The FCC is considering whether a similar order should be extended to switched access services.

In August 1992, the FCC adopted an order allowing telephone companies to deliver video programming developed by others and to provide certain other video services including video gateways, billing and collection services and video customer premise equipment. The FCC also recommended that Congress repeal the "in-region" cable ownership restriction imposed on telephone companies. These recent and proposed actions would allow the Company access to provide cable television and other services within its telephone service area.

Also, in August 1992, the FCC issued a Notice of Proposed Rulemaking to establish Personal Communications Services ("PCS"). PCS offers users mobile voice and data communications capabilities similar to existing cellular service, though usage may be limited to local communities or within a business complex. PCS is viewed as a potential competitor to both the local exchange and cellular businesses.

The FCC has adopted a regulatory structure known as "Open Network Architecture," under which the Company is required to unbundle its telephone network services in a manner which will accommodate the service needs of the growing number of information service providers.

add major customer - see note 7

(2)

PART I

ITEM 1. BUSINESS (continued)

Competition

Regulatory, legislative and judicial actions have been leading to a more competitive environment for local exchange companies. Perhaps even more importantly, as a result of rapid technological change, the computer, cable television and telecommunications industries are starting to converge, a development which will lead to more competition and new strategic alliances in the future. With respect to local exchange service, competition is expected from a host of potential players, including cable television companies, competitive access providers ("CAPS"), cellular companies, providers of PCS and the interexchange carriers.

Currently, competition from long distance companies is eroding the Company's market share of intraLATA long distance services such as wide area telephone service ("WATS") and "800" services. These revenues have steadily declined over the last several years as customers have migrated interexchange carriers who have the ability to offer these services on both an intraLATA and interLATA basis. U S WEST and its affiliates are prohibited from providing interLATA long distance services.

Competition from CAPS is currently limited to providing large business customers (with high volume traffic) private line access to the facilities of interexchange carriers. In coming years CAPs could also become significant competitors for other local exchange services.

The planned entrance of AT&T into the cellular arena through its proposed investment in McCaw Cellular Communications Inc. ("McCaw") creates a new competitor for providers of cellular and, potentially, local exchange services. The AT&T/McCaw alliance would include a nationwide long distance network, equipment manufacturing, research expertise and national branding. This alliance could ultimately lead to a reduction in revenues, including access charges. A substantial portion of AT&T's operating costs are represented by such access charges.

In addition to CAPS and providers of wireless services, including PCS, a major potential source of future competition includes cable television companies which may offer telecommunications and other information services in addition to existing video services.

The impact of increased competition on the operations of the Company will be influenced by the future actions of regulators and legislators.