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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 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	)	
	)	
NYNEX Telephone Companies	)	DA 95-1485
Tariff F.C.C. No. 1, Transmittal No. 328	)	

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BELL ATLANTIC DIRECT CASE

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Bell Atlantic Telephone
Companies

August 14, 1995

Before the
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NYNEX Telephone Companies Tariff F.C.C. No. 1, Transmittal No. 328	)	DA 95-1485

SUMMARY OF BELL ATLANTIC DIRECT CASE

The sole issue before the Commission on remand from the court of appeals is whether Bell Atlantic[1] and other companies subject to price cap rules properly avoided double counting costs associated with the adoption of Statement of Financial Accounting Standards 106 ("SFAS 106") that are also included in the GNP-PI index used in the price cap formula. In Bell Atlantic's case, the answer is straightforward -- Bell Atlantic's calculations were appropriate and correct. All required offsets were incorporated -- including a conservative calculation of potential GNP-PI double counting. To the extent issues designated by the Commission go beyond this limited question, they have no bearing

[1] The Bell Atlantic telephone companies ("Bell Atlantic") are Bell Atlantic-Delaware, Inc.; Bell Atlantic-Maryland, Inc.; Bell Atlantic-New Jersey, Inc.; Bell Atlantic-Pennsylvania, Inc.; Bell Atlantic-Virginia, Inc.; Bell Atlantic-Washington, D.C., Inc.; and Bell Atlantic-West Virginia, Inc.

on the decision here. Consequently the Commission should close its investigation of Bell Atlantic's tariffs.

1. The Issue Before the Commission is Narrowly Limited.

The Commission's order designating issues concerning exogenous treatment for costs associated with the implementation of SFAS 106[2] is not written on a blank slate. As the Investigation Order recognizes, there is a long procedural history concerning exogenous treatment of SFAS 106 costs,[3] culminating in the remand order of the DC Circuit Court of Appeals.[4]

The court of appeals order clarified that, under Commission rules at the time these costs were incurred, there were only two requirements for exogenous treatment of costs associated with a change in Generally Accepted Accounting Principles ("GAAP"). Such accounting changes must be adopted by the Commission -- "the 'control' test" -- and the associated costs "must be shown not to involve double counting with the GNP-PI adjustment."[5]

The appeals court found that the local exchange carriers ("LECs") had met the control test. "[A]n FASB change adopted by

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2 Order Designating Issues for Investigation (Com. Car. Bur. rel. June 30, 1995) ("Investigation Order").

3 Investigation Order, ¶¶ 2-13.

4 ***Southwestern Bell Telephone Company v. FCC***, 28 F.3d 165 (D.C. Cir. 1994).

5 ***Southwestern Bell***, 28 F.3d at 168.

the Commission" -- as SFAS 106 was[6] -- "is not a change under control of the carrier. . . ."[7] The change therefore satisfies the control criterion.

Thus, on the remand of the appeals court decision, the ***only*** question before the Commission is the second test for exogenous treatment of costs -- whether exogenous treatment of SFAS 106 costs would double count impacts already reflected in the price cap formula through the GNP-PI component.

2. There is No GNP-PI Double Counting.

The amount of SFAS 106 adoption costs afforded exogenous treatment in Bell Atlantic's tariffs was properly calculated to eliminate double counting. Specifically, in order to include any appropriate offset for the impact of the transition to SFAS 106 on GNP-PI -- ***i.e.*** the amount that would constitute double counting if also included in an exogenous adjustment -- Bell Atlantic relied on studies performed by Andrew Abel and Peter

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6 *See Southwestern Bell, GTE Service Corp., Notification of Intent to Adopt Statement of Financial Accounting Standards No. 106*, 6 FCC Rcd 7560 (Com. Car. Bur. 1991) ("Adoption Order").

7 *Southwestern Bell*, 28 F.3d at 170.

Neuwirth.[8] Using conservative parameters supported by actuarial and macroeconomic analyses, these studies show that "the increase in GNP-PI caused by SFAS 106 (0.0124% would provide for recovery of only 0.7% of the additional costs incurred by Price Cap LECs."[9] To put it another way, only 0.7% of the additional costs from the implementation of SFAS 106 would be double counted if also included in an exogenous adjustment. As a result, Bell Atlantic removed the GNP-PI impact in calculating its tariff adjustments.

Significantly, these calculations likely overstate the amount of any double counting. Because of the confluence of conservative assumptions, the studies' authors explain that the studies most likely overestimated the impact of SFAS 106 on the GNP-PI and therefore overestimated the amount of any double

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[8] ***See Treatment of Local Exchange Carrier Tariffs Implementing Statement of Financial Accounting Standards, "Employers Accounting for Postretirement Benefits other Than Pensions***, CC Docket No. 92-101, Direct Case of Bell Atlantic at 6 (filed June 1, 1992) ("Bell Atlantic Initial Direct Case"). At the time of the initial studies, Professor Abel and Mr. Neuwirth were affiliated with Godwins, Inc. In addition, a study performed by National Economic Research Associated ("NERA") and attached to the United States Telephone Association ("USTA") filing here provides supports the conclusion that only ***de minimis*** amounts of SFAS-106 adoption costs would be reflected in GNP-PI. As the Court of Appeals recognized, the sharp contrast in methodologies of the two studies only makes the ultimate conclusion "more robust." ***Southwestern Bell***, 28 F.3d at 172.

[9] Direct Case Filing of the USTA, Attachment A at 2 (filed August 14, 1995) ("Abel/Neuwirth Update"). The Abel/Neuwirth studies performed various sensitivity analyses -- many of which intentionally used unrealistic assumptions to test their results -- that confirmed their conclusion. It would be an improper use of those sensitivity analyses to substitute those results for the conclusions of the actual studies. ***See*** Abel/Neuwirth Update at 4.

counting.[10] Moreover, although the projected GNP-PI impact would take time to filter through the economy, Bell Atlantic conservatively reflected the entire impact in the first year.[11] Thus, if anything, Bell Atlantic has erred by ***overcompensating*** for the minuscule GNP-PI impact of SFAS 106. No further adjustments are necessary.

3. Additional Inquiries are Irrelevant.

Despite the single remaining issue to determine whether there has been any double counting of the exogenous costs, the Investigation Order strays into a variety of irrelevant inquiries. Indeed, only a few of the Commission data requests deal with the relevant issue of double counting.[12] While Bell Atlantic responds to all of the Commission's requests in the attached materials, the bulk of these requests clearly exceed the scope of the court of appeals' remand order. Whatever the intrinsic merits of other potential requirements for exogenous treatment, they are a "basis for ***amending*** [the Commission's]

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[10] Abel/Neuwirth Update at 5.

[11] Bell Atlantic Initial Direct Case at 27.

[12] ***See*** Investigation Order, ¶¶ 24, 25, 28.

current rule, not for concocting a new rule in the guise of applying the old."[13]

For example, Issue E questions whether exogenous treatment should be limited to those benefit costs that are funded. Effectively, this asks whether to abandon the accrual accounting underlying SFAS 106 and limit exogenous treatment to actual payments (either to employees or to a benefit fund). Such a limitation cannot be found in Commission rules, and was clearly rejected by the court of appeals' when it found that SFAS 106 costs qualify as exogenous costs because they are real costs beyond the control of the LECs.[14]

Issue F, which asks whether exogenous treatment should be limited to accruals for vested benefits, also invites new limitations that do not exist in the rules. If the Commission had wanted to limit the type of benefits that could be accrued under SFAS 106, it could have rejected the GAAP accounting change and prospectively mandated an alternate change in Commission

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[13] ***Southwestern Bell***, 28 F.3d at 173. The Commission has amended its rule for exogenous treatment of accounting changes and in doing so has selectively removed exogenous treatment of these costs for the price cap regulated LECs, starting with their 1995 annual tariffs. ***See Price Cap Performance Review for Local Exchange Carriers***, First Report and Order, CC Docket No. 94-1, ¶¶ 292-314 (rel. April 7, 1995); ***but see*** Petition for Review, ***Bell Atlantic v. FCC***, No. 95-1217 (D.C. Cir. Apr. 19, 1995). Regardless of whether that change is a lawful amendment of the price cap rules, there can be no dispute that the tariffs under investigation here were not affected by the subsequent rule change.

[14] Such a requirement would also provide incentive to make uneconomic decisions concerning appropriate levels of pre-funding benefits. Such uneconomic decisions ultimately harm both the companies and their customers.

accounting rules. Having adopted the change without modification however,[15] the Commission is precluded from considering such limitations in its determination of exogenous costs.

The Commission also seeks data concerning benefit changes subsequent to adoption of SFAS 106.[16] These changes are under the control of the company and are ***endogenous*** costs. The ***exogenous*** costs at issue are the additional costs associated with the transition from pay-as-you-go accounting to the accrual accounting required by SFAS 106. As the court of appeals understood, the event creating the exogenous costs was not the requirement to pay benefits. Rather, it was the change in accounting rules that was beyond the companies' control.[17] Thus, all questions that relate to benefit changes subsequent to adoption of SFAS 106 are irrelevant to the exogenous costs that are the subject of the Commission review.[18]

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15 ***See*** Adoption Order.

16 ***See*** Investigation Order, ¶ 31.

17 ***See Southwestern Bell*** 28 F.3d at 169-170. Indeed, a significant amount of the costs at issue are the "transition obligation" costs. The transition obligation is actually a one-time cost that reflects the unfunded liability for benefits earned prior to implementation of SFAS 106. Despite the Commission's order to amortize the impact of these costs, those costs were fully incurred as of the time of SFAS 106 adoption.

18 Price cap regulation already accounts for future changes in benefit costs. On an industry-wide basis, future adjustments to the price cap formula's productivity factor would be reflective of industry productivity growth which implicitly reflects, among other things, various endogenous changes, including future changes in benefit-related expenses.

In addition, the Commission questions whether exogenous treatment may be limited to SFAS 106 costs incurred on or after January 1, 1993.[19] While that date was the latest date by which SFAS 106 adoption was allowed, LECs were "encouraged" to implement the rule change "earlier".[20] Bell Atlantic's adoption was consistent with the Commission Adoption Order. The order could have been date restrictive, but it was not. Having failed to make such restrictions at the time, however, the Commission cannot now adjust its rules and suggest that such adoption was not authorized by the Commission.

The Commission also seeks quantification of the impact of wage changes.[21] To the extent the Commission seeks information on the general impact of SFAS 106 on wages without regard to the impact on the GNP-PI, it is again going beyond the scope of its legitimate inquiry. A change in wage levels for the LECs is an endogenous change that requires no adjustment to the price cap formula. Like benefits levels, wage changes are under the control of the individual regulated companies. In contrast to GNP-PI changes, wage rates are not part of the price cap formula, and there can be no issue of double counting with respect to expected impact on wage rates.

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[19] Investigation Order, Issue B.

[20] Adoption Order, ¶ 2.

[21] Investigation Order, ¶ 28.

Conclusion

Bell Atlantic's request for exogenous treatment of SFAS 106 costs is consistent with the Commission requirements in place at that time. The Commission should close its investigations without modification to the tariffed rates.

Respectfully submitted,

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August 14, 1995

BELL ATLANTIC
TELEPHONE COMPANIES

Direct Case
OPEB Investigation Order

Tariff F.C.C. No. 1, Transmittal No. 690
CC Docket No. 94-157

Issued August 14, 1995

BELL ATLANTIC DIRECT CASE
CC DOCKET No. 94-157

Table of Contents

Issue A . . . . Tab 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?

Paragraph 17
Paragraph 18

Issue B . . . . Tab B

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

Issue C . . . . Tab 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?

Paragraph 20

Issue D . . . . Tab D

How should Voluntary Employee Benefit Association trusts or other funding mechanisms for these expenses be treated.

Issue E . . . . Tab E

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

Paragraph 21

BELL ATLANTIC DIRECT CASE
CC DOCKET No. 94-157

Table of Contents

Issue F . . . . Tab F

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

Paragraph 22

Issue G . . . . Tab G

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

Paragraph 23

Supporting Studies and Models . . . . Tab H

Paragraph 24
Paragraph 25
Paragraph 26
Paragraph 27
Paragraph 28

Miscellaneous Supporting Information . . . . Tab I

Paragraph 29
Paragraph 30
Paragraph 31

EXHIBITS and WORKPAPERS . . . . Tab J

A

BELL ATLANTIC DIRECT CASE
CC DOCKET No. 94-157

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?**

RESPONSE

Bell Atlantic has followed prevailing Generally Accepted Accounting Principles (GAAP) in calculating the total SFAS 106 costs that underlie the exogenous cost calculations provided in our 1993/94 and 1994/95 annual and mid-year tariff filings. These tariff filings reflect exogenous recovery of 1991 incremental SFAS 106 expenses, associated with Bell Atlantic's adoption of the SFAS 106 accounting methodology in 1991.

The adoption of SFAS 106 was an accounting change for Bell Atlantic, since the Company previously accounted for retiree postretirement health benefits on a modified cash basis composed mainly of a pay-as-you-go expense recognition for management retirees and trust contributions based upon actuarially determined accruals for associate retirees. Management and associate retiree group life insurance benefits were also accounted for on a modified cash basis, based on trust contributions using actuarially determined accruals.

The original SFAS 106 costs were derived in conformance with the guidelines specified by the Financial Accounting Standards Board (FASB) in its publication of SFAS 106. Postretirement benefit cost calculations were derived by Bell Atlantic Corporation's independent actuaries using a population consisting of the participants in the Bell Atlantic management and associate pension plans. In addition, an audit of Bell Atlantic's 1991 financial statements by the Company's external auditors did not evidence any SFAS 106 concerns.

In calculating the incremental SFAS 106 expense subject to exogenous treatment, Bell Atlantic properly removed pay-as-you-go amounts (i.e. VEBA funded trust contributions) and previously recognized amounts from its total SFAS 106 expense. This ensured that Bell Atlantic would not "double-recover" costs that were embedded in rates at the inception of price caps, or recover costs that could be considered endogenous.

The specific methodology employed by Bell Atlantic to fairly distribute these costs to interstate price cap baskets for exogenous ratemaking is addressed in the response to Issue C and paragraph 20

<u>Paragraph 17-1</u>

Provide the date the company implemented SFAS-106.

BELL ATLANTIC DIRECT CASE
CC DOCKET No. 94-157

RESPONSE

The Company notified the Commission on December 31, 1991 of its intended adoption, pending Board of Directors' approval, of SFAS 106, *Employers' Accounting for Postretirement Benefits Other than Pensions,* effective January 1, 1991 for both regulatory and external reporting purposes. On January 7, 1992, Bell Atlantic confirmed with the Commission the Board's authorization to adopt SFAS 106, retroactive to January 1, 1991.

Paragraph 17-2

Provide 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.

RESPONSE

The rates in effect on January 1, 1991, the initial date the company became subject to price cap regulation, were based on prospective 1990/1991 tariff year costs. Essentially, the rates reflected the prospective costs that supported the 1990 annual access tariff filing with adjustments for exogenous costs related to 1) the reduction in the authorized rate of return from 12.00% to 11.25%, 2) the change in Long Term Support, and 3) FCC Erratum. Please see column (G) of Exhibit 17-2-A for the split year pay-as-you-go amounts that supported the company's initial price cap rates.

Paragraph 17-3

Provide the effect of the price cap formula on that amount up to the date of conversion to SFAS-106.

RESPONSE

Since Bell Atlantic adopted SFAS 106 effective January 1, 1991, the price cap formula (GNP-PI and productivity) had no effect on pay-as-you-go costs. The only impact on price cap indices at that time was for exogenous costs detailed in the company's response to paragraph 17-2.

Paragraph 17-4

Provide 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.

RESPONSE

Since Bell Atlantic adopted SFAS 106 on January 1, 1991, coincident with the implementation of interstate price cap regulation, this data request is not applicable to Bell Atlantic.

Paragraph 17-5

Provide 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.

RESPONSE

Excerpts from Bell Atlantic Corporation's 1991 Annual Report and Report on Form 8K dated June 9, 1992, as filed with the Securities and Exchange Commission, are attached. These reports describe the accounting treatment employed by Bell Atlantic in calculating the current year costs and the accumulated postretirement benefit obligation. These disclosures reflect all Bell Atlantic employees covered by OPEBs, whereas interstate regulatory reports and exogenous cost workpapers reflect only regulated network services group employees.

Upon adoption of SFAS 106 for external reporting purposes, Bell Atlantic exercised the FASB's option of recognizing the entire transition benefit obligation (TBO) in calendar year 1991. However, in conformance with the FCC's December 19, 1991 Order authorizing adoption of SFAS 106, Bell Atlantic is amortizing the TBO over the expected remaining service life of its employees for interstate regulatory reporting purposes.

Exhibits

Exhibit 17-5-A -- 1991 Annual Report - Pages 9 and 28 - 30
Exhibit 17-5-B -- Form 8K, filed June 9, 1992 - Pages 8 and 17 - 19

Paragraph 18-1

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

RESPONSE

The Bell Atlantic Management and Associate Retiree Health Plans provide medical and dental benefits and payment towards Medicare Part B Premiums for eligible retirees and their beneficiaries. Please see Plan Provisions detailed in Appendices B, C, and D of the 1991 management and associate actuarial reports (attached as Exhibits 26-A and 26-B, respectively).

The Bell Atlantic Retiree Life Insurance Plan provides life insurance benefits as stated in Appendix A of the 1991 actuarial report (attached as Exhibit 26-C).

Paragraph 18-2

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.

RESPONSE

Exhibit 18-2-A provides the company's pay-as-you-go amounts for the years 1987 through 1994.

Since Bell Atlantic adopted SFAS 106 effective January 1, 1991, pay-as-you-go amounts incurred by the company prior to and subsequent to 1991 are irrelevant to the exogenous treatment of SFAS 106. The company removed all 1991 OPEB related pay-as-you-go and previously recognized amounts from the total 1991 SFAS-106 accrued expense in determining the incremental SFAS 106 exogenous cost. Subsequent to the exogenous adjustment for this incremental SFAS 106 expense, all of the underlying cost components became endogenous under price cap regulation. Consequently, changes in OPEB-related expenses that occurred in later years are endogenous to the company's operations, and are not eligible for exogenous treatment, regardless of whether the post-1991 OPEB-related expenses increased or decreased.

In addition, the pay-as-you-go expenses used to offset the total SFAS 106 cost are endogenous. Had the Company not adopted SFAS 106, as the Commission asks in this data request, these cash benefit costs, which were embedded in cost of service at the onset of price caps, would not qualify for exogenous treatment, and the Company would have absorbed any increased costs under the prevailing price cap plan. Since SFAS 106 **was** authorized for adoption by this Commission, and exogenous recovery did occur, this exogenous change reflected prevailing expenses at the time of adoption. The exogenous event is the change in the accounting methodology, and the amount subject to exogenous recovery is the expense using the new methodology, less pay-as-you-go expenses embedded in rates at that time.

Paragraph 18-3

Describe the forms of post-retirement benefit accrual accounting, if any, that were utilized before the effective date of price cap regulation

RESPONSE

Beginning January 1, 1989 the company began recording associate OPEB costs on the aggregate cost actuarial method (an IRS approved method). It should be noted that the company also made contributions to the Bell Atlantic Retiree Health Trust based upon the aggregate cost actuarial method. Effective January 1, 1991 Bell Atlantic adopted SFAS 106, an accrual method of accounting for postretirement benefits.

<u>Paragraph 18-4</u>

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.

RESPONSE

Bell Atlantic provided retiree medical, dental, and life insurance benefits to eligible plan participants and made payments towards Medicare Part B premiums for eligible retirees and spouses. The company did not have any SFAS-106 type expenses reflected in rates before they were adjusted for exogenous SFAS-106 expenses. As stated in the company's response to Issue A, prior to adoption of SFAS 106, Bell Atlantic accounted for postretirement health and life insurance benefits on a modified cash basis. The company properly removed these cash expenses from its total SFAS 106 expense in calculating the incremental SFAS 106 expense subject to exogenous treatment. See Exhibit 18-2-A for pay-as-you-go costs.

<u>Paragraph 18-5</u>

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.

RESPONSE

SFAS-106 expenses were not reflected in the company's rates that were in effect on January 1, 1991, the initial date the company became subject to price cap regulations. Although the company adopted SFAS-106 effective January 1, 1991, it did not seek exogenous treatment for these expenses until February, 1992.

B

BELL ATLANTIC DIRECT CASE
CC DOCKET No. 94-157

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

RESPONSE

Exogenous claims for SFAS-106 prior to January 1, 1993 should be permitted. These are real costs that would otherwise be excluded. The Commission authorized the change to SFAS 106 accounting, and early adoption was encouraged. Bell Atlantic complied and adopted SFAS-106 effective January 1, 1991. On December 31, 1991, Bell Atlantic notified the Commission of its intent to adopt SFAS-106 and filed for exogenous treatment in February 1992. Because the incremental costs resulting from this new accounting standard were not reflected in the base period costs for Price Cap Indices, the costs fell under the Commission's treatment of exogenous within the Price Cap guidelines.[1] To meet the requirements of exogenous treatment, such costs must be mandated by the Commission (outside the carrier's control) and must be shown not to involve double counting with the GNP-PI adjustment.

There is no basis for the Commission to disallow these costs as exogenous. The D.C. Circuit of the United States Court of Appeals agreed that this accounting change approved by the Commission is a mandatory change outside the control of the LECs and should be treated as exogenous. The Court's remand to the Commission required that the final decision on the level of exogenous treatment of SFAS-106 costs be consistent with that conclusion.

[1] Section 61.44(c) of the Commission's rules identified exogenous cost changes that the Commission will permit or require under Price Cap rules.

C

BELL ATLANTIC DIRECT CASE
CC DOCKET No. 94-157

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?**

RESPONSE

Bell Atlantic properly allocated and separated amounts associated with SFAS-106 costs as demonstrated on Exhibit 20-1-A[2]. First, Bell Atlantic developed the total company annual amount of SFAS-106 costs for 1991. The Pay-As-You-Go amounts and previously recognized amounts were deducted from the SFAS-106 amount to arrive at the basic incremental costs for SFAS-106 (Workpaper 6-20). The basic incremental costs were then split into expense and capital components (Workpaper 6-21).

The expense component was multiplied by the ratio of subject-to-separations (STS) to total company Total Operating Expenses (less depreciation and amortization) per the ARMIS 43-01 report (Workpaper 6-22). The interstate (IS) portion was then derived by multiplying the STS expense amount by the ratio of IS to STS, less depreciation and amortization, per the ARMIS 43-01 report to determine the final interstate SFAS-106 expense amount, less depreciation and amortization (Workpaper 6-24).

The capital component was multiplied by the ratio of STS to total company plant in service (TPIS) (Workpaper 6-23). Interstate capital was derived by multiplying the STS capital amount by the ratio of IS to STS plant in service from the ARMIS 43-01 report (Workpaper 6-25). Using the IS capital amount, Bell Atlantic calculated the interstate depreciation expense associated with the incremental SFAS-106 expense. The depreciation rate was determined by dividing the interstate depreciation and amortization expense amounts by interstate plant in service developed from ARMIS. The depreciation rate was applied to the interstate capital amount to determine the interstate depreciation expense associated with the incremental SFAS-106 costs (Workpaper 6-26).

Next, Bell Atlantic computed the interstate portion of average state deferred tax expense by adding the interstate expense to the interstate depreciation expense and multiplying this total by the applicable state rates, thereby deriving the state deferred tax amounts. These amounts were then divided by two to provide the interstate portion of average state deferred taxes (Workpaper 6-27). The next step was to calculate the interstate portion of average federal income tax expense (FIT), in which the total interstate expense less state deferred taxes was multiplied by the FIT rate and divided by two (Workpaper 6-28).

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[2] Exhibit 20-1-A consists of Workpapers 6-19 through 6-33, as excerpted from Bell Atlantic Transmittal No. 497 filed on February 28, 1992

Bell Atlantic then calculated the unfunded liability amount for use in the rate base calculation. The total interstate expense, less depreciation and amortization, was multiplied by the ratio of interstate expense to total expense, less depreciation and amortization, from ARMIS to arrive at incremental unfunded liability allocated to interstate (Workpaper 6-29).

Bell Atlantic then computed the revenue requirements (Workpaper 6-30) and removed the portion of the revenue requirement associated with Billing and Collection from its calculation (Workpaper 6-32).

To eliminate any potential of double counting in the GNP-PI (Workpaper 6-31) of the incremental SFAS-106 expenses, Bell Atlantic removed from its price cap revenue requirement an amount for the increase in GNP-PI caused by the adoption of SFAS 106 (Workpaper 6-32).

The above steps are set forth in Bell Atlantic's Transmittal No. 497, Section 4.

Paragraph 20-1

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

RESPONSE

The total company amount associated with implementing SFAS-106 is $403.4 million, see Workpaper 6-20 of Exhibit 20-1-A.

Paragraph 20-2

Provide an explanation of how the carrier arrived at the total company SFAS-106 amount.

RESPONSE

Total Bell Atlantic SFAS-106 accrual amounts were developed by Actuarial Sciences Associates (ASA). In developing the SFAS-106 costs, ASA used actual telecommunications industry experience to develop Bell Atlantic's retirement, disability and mortality assumptions. Bell Atlantic's medical and dental claims input and demographic data were based on its own experience. All assumptions about future events, with the exception of health care trends which are unique to SFAS-106, are the same assumptions used in determining Bell Atlantic's pension costs.

In order to determine the SFAS-106 costs, it was necessary to calculate the postretirement benefits that were expected to be paid in future years for currently active employees and retirees (including benefits to be paid for their eligible dependents) and to allocate benefits for active participants to the current year and to years of service rendered before the valuation date. The allocated benefits were then discounted for survivorship and interest to determine their present values.

The actuarial assumptions were segregated into five categories: demographic, average health care claims per retiree, pay growth, health care trends, and discount rate and rate of return on plan assets.

Demographic Assumptions

The demographic assumptions used by Bell Atlantic were based on actual historical telecommunications industry experience including the experience of Bell Atlantic.

Average Health Care Claims Per Retiree

The average claims per retiree were based on actual claims experience of Bell Atlantic. The average claims data were developed for the most part by gender and five year age groups to increase the accuracy of the data. Average claims per retiree were also developed separately to reflect plan benefit or cost sharing provisions which vary within the same plan. For example, the average claim data varied depending upon whether a management participant retired: 1) before April 1, 1986, 2) between April 1, 1986 and December 31, 1991; or 3) after 1991.

For management retirees who retire after 1991, future cost sharing is expected to differ based upon whether retirement occurred before or after age 65. There are also differences resulting from the retiree only, the retiree with one dependent, and the retiree with more than one dependent. Declining participation rates were assumed for the dependents to reflect higher anticipated cost sharing.

For associate retirees, the average medical claims per retiree were broken down by five year age groups for those retirees who retired before 1990. For retirees after 1990, the average claims per retiree were determined for those retiring before age 65 and those retiring after age 64 in order to reflect the 1989 negotiated settlement regarding company costs.

Pay Growth Assumptions

Pay growth assumptions only affect postretirement group life insurance benefits, which are less than 2% of Bell Atlantic's total SFAS 106 costs. A pay growth assumption of 5.25% was used.

Health Care Trends

Health care cost trend rates were developed for medical and dental benefits. Medical trend assumptions were developed based on an analysis of the expected medical inflation rate, the impact of medical inflation on different types of medical spending, and the