the incremental costs developed for the 1993 calendar year, as a result of the implementation of SFAS - 106 on a mandatory basis, are just and reasonable, and result in PCIs and rates that are just and reasonable.[12] The assumptions on which these incremental costs are based were derived using historical experience, reasonable estimates of future conditions, and macroeconomic and actuarial studies. And, based on these assumptions, the calculation of the cost changes and the allocation among the price cap baskets are reasonable and consistent with the Commission's rules and cost causative policies.

While the Companies will more fully address the Commission's specific questions in their answers outlined below, the information provided herein demonstrates that all of the Commission's requirements for exogenous treatment under price caps are met. Moreover, granting exogenous treatment does not compromise the incentive goals of price caps where a cost increase is due to a "regulatory" (in this case "accounting") change beyond the carrier's control. Refusing exogenous treatment will do nothing to encourage LECs to be more efficient, but would only penalize them in a way that would appear to be a gaming of the process. Consequently, the Commission should grant exogenous treatment for the costs of implementing SFAS - 106.

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[12] *See* Exhibits 2-4 explaining the development of the incremental costs, and Exhibit 1 explaining the PCI adjustments.

B. Specific Information Requests

1. The date the LEC has implemented or intends to implement SFAS-106

The Ameritech Operating Companies notified the Commission pursuant to a letter that it implemented SFAS - 106 for regulatory accounting purposes effective January 1, 1991.[13]

2. The costs by year and the allocation of costs to baskets each year

The Companies' total company SFAS - 106 cost for 1993 is calculated to be $384,089,000.[14] This amount is the sum of total company service costs, interests costs, and the TBO amortization, less the expected return on assets.

The total company *incremental* costs due to the implementation of SFAS - 106 for 1993 were calculated as described below. First, SFAS - 106 total company costs were split into a direct expense and capital component.[15] Next, an amount for the depreciation expense related to the capital component was calculated. Likewise, the estimated total company "pay-as-you-go" amounts for 1993 were split between a direct expense amount and capital component. Again, an amount for depreciation expense attributable to the capital component was calculated.[16] The "pay-as-you-go" direct expense, capital component, and depreciation expense amounts were subtracted from the corresponding total company SFAS - 106 direct expense, capital component, and depreciation expense amounts.[17] The 1993 total company

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[13] *See* Letter to Mr. Kenneth Moran, *supra* n. 7.

[14] Exhibit 2, line 1.

[15] Direct expense in this document refers to expense less depreciation.

[16] Exhibit 2, lines 1-10.

[17] Exhibit 2, lines 11-13.

incremental costs due to the implementation of SFAS - 106 are $108,488,000 for direct expense, $28,253,000 for the capital component, and $1,009,000 for depreciation expense.[18]

Once these incremental amounts were calculated, they were adjusted for any allocations to nonregulated services as required by Part 64 of the Commission's rules to arrive at the amounts subject to separations. These subject to separations amounts were then separated into interstate and intrastate components, according to the Commission's Part 36 rules, to arrive at the interstate incremental costs for implementing SFAS - 106. These incremental amounts for 1993 are $22,095,000 for direct expense, $6,665,000 for the capital component, and $243,000 for depreciation expense.[19]

The interstate incremental SFAS - 106 direct expense, capital component, and depreciation expense amounts were allocated to the price cap baskets based on each of the baskets' share of interstate direct expense, total plant in service, and depreciation expense as reported on the ARMIS 43-01 YTD 1991 Reports.[20] In this regard, the interstate incremental direct expense was allocated among the baskets based on the percentage of direct expense contained in each of the baskets. Next, the interstate incremental capital component was allocated among the baskets based on the percentage of total plant in service contained in each of the baskets. And finally, the interstate incremental depreciation expense was allocated among the baskets based on the percentage of depreciation expense contained in each of the baskets.

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[18] The capital component is computed only on the VEBA contribution for active employees which is recorded in the Companies' expense matrix. The retiree benefit payments are recorded in Account 6728. 47 C.F.R. § 32.6728.

[19] *See* Exhibit 3, lines 7-9.

[20] *See* Exhibit 4, lines 1, 2, and 4.

In addition to the incremental expenses, a return on the change in rate base was calculated in order to determine the appropriate incremental revenue requirement necessary for calculating the exogenous adjustment to the PCIs. The return on rate base was calculated by applying the Commission's authorized rate of return of 11.25 percent to the average rate base impact of SFAS - 106.[21] The net return was then grossed-up for federal and state taxes. The incremental direct expense, depreciation expense and (grossed-up) net return were then grossed-up for gross receipt taxes. The interstate total incremental revenue requirement impact for implementation of SFAS - 106 was calculated by adding the incremental direct expense, depreciation expense, net return, and appropriate grossed-up tax amounts. Finally, the interstate incremental revenue requirement amount was adjusted by the Godwins study's 84.8 percent factor, resulting in the SFAS - 106 incremental revenue requirement of $16,893,000 for which the Companies seek exogenous treatment.[22]

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[21] Several steps were involved in computing the change in average rate base. Exhibit 4, lines 3, 5-10 summarize the calculations. First, the change in average total plant in service and the average depreciation reserve were calculated by dividing the capital component and the depreciation expense by 2, respectively (lines 3 and 5). Second, the change in the average deferred tax reserve was computed by adding the state and federal deferred tax assets created by this accounting change (lines 6 and 7) and dividing by 2. Third, the average unfunded liability was computed by summing the incremental direct expense and capital component amounts and dividing by 2. The incremental impact on the average rate base was then calculated by subtracting the incremental change in the average balances of the depreciation reserve, deferred tax reserve and the unfunded liability from the change in the average total plant in service (line 10).

[22] Exhibit 4, lines 11-16.

3. The treatment of these costs in reports to the Securities and Exchange Commission and to shareholders

In its 1991 Form 10-K filing with the Securities and Exchange Commission (SEC), Ameritech Corporation (Ameritech) referenced its 1991 Annual Report in which it disclosed its estimate of the TBO as of January 1, 1993, to be approximately $2.5 billion before income taxes. Similarly, the SEC Form 10-K reports filed by each of the Ameritech Operating Companies, subsidiaries of Ameritech, disclosed an estimate of their individual costs for the TBO. The reports note that neither Ameritech nor the Companies have finalized their plans on when to implement SFAS - 106 for external reporting purposes, nor the manner in which the TBO will be recognized.[23]

4. All studies on which the LEC seeks to rely in its demonstration that these accounting changes should be considered exogenous cost changes, including all studies demonstrating that the change is not reflected in the current price cap formulas, factors for inflation, productivity, allowed exogenous changes, initial price cap rates, and the sharing and low-end formula adjustment mechanisms.

The study conducted by Godwins, Inc.[24] is compelling evidence that providing exogenous treatment for the cost changes due to the implementation of SFAS - 106 will not result in those costs being double counted. The Godwins study demonstrates that only 0.7 percent of the LECs' incremental costs due to SFAS - 106 would be recovered through an increase in the GNP-PI. In addition, the study finds that the implementation of SFAS - 106 will result, over time, in an overall wage rate less than it would be otherwise, thereby indirectly allowing LECs to recover 14.5 percent of their

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[23] Copies of the relevant pages from Ameritech's Form 10-K and Annual Report, and the Companies' Form 10-Ks are attached as Exhibit 5.

[24] Godwins Study, Exhibit 6.

incremental costs of SFAS - 106 through lower wage rates. Based on these two findings -- that the GNP-PI will recover only 0.7 percent of SFAS - 106 incremental costs and the overall wage level will decrease in future periods by a total of 14.5 percent -- the study concludes that LECs will be unable to recover 84.8 percent of their incremental costs of implementing SFAS - 106. Consequently, the Companies seek exogenous treatment for 84.8 percent of their incremental costs resulting from these accounting changes.

The Godwins study was performed in two stages: an actuarial analysis and a macroeconomic analysis. The actuarial analysis used demographic, economic and benefit program data collected from each price cap LEC to construct a composite Telco company. The composite Telco company was then compared to a "national average" benefit program which was derived from a data base of plan provisions for retirees medical plans covering 19 million employees. This comparison shows that the overall benefit level of the Telco composite company is 0.4390, compared to a national average of 0.2568.[25]

The comparative benefit analysis, however, was adjusted to account for differences in demographics, withdrawal and retirement patterns, number and impact of current retirees, and funding of benefits between the composite Telco company and the average employer. Another adjustment was made to take into account the substantial number of workers in the national economy that are not covered by OPEBs or are covered by programs not affected by SFAS - 106. Two final adjustments were made for the differences between per unit labor costs for the composite Telco company and for the average

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[25] Exhibit 6 at 7-9.

employer, and for the differences in the percentage of total output represented by labor costs for the Telco and other employers.

Based on those factors, the actuarial analysis section of the study concludes that the average employer in the economy will incur only 28.3 percent of the incremental costs of implementing SFAS - 106 that the composite Telco will incur. In other words, the composite Telco will incur more than 3.5 times the cost of implementing SFAS - 106 incurred by the average employer. The actuarial analysis also finds that SFAS -106 directly increases labor costs of companies offering OPEBs by 3 percent.[26]

Once the actuarial analysis section was completed, the study turned to the macroeconomic analysis in order to determine the effect implementing SFAS - 106 will have on prices of goods and services, and the overall wage rate. That analysis used a macroeconomic model for this purpose. The macroeconomic model treats the change in costs due to SFAS - 106 as an increase to labor costs at the time SFAS - 106 is adopted. Assuming that employers pass through *all* their increased expenses directly to increased prices, the GNP-PI for the private sector would increase 0.614 percent due to the implementation of SFAS - 106.[27] However, because an increase in labor costs will impact the demand for labor and an increase in prices will impact the demand for goods, in effect the GNP-PI for the private sector will increase by only .0138 percent. This .0138 percent increase in the private sector GNP-PI

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[26] Exhibit 6 at 9.

[27] Exhibit 6 at 10. This is a very conservative estimate because many companies in competitive industries will be constrained in flowing through increased costs to prices by competition as well as by other companies in the industry which do not provide OPEBs.

demonstrates that in actuality only 2.3 percent of the costs of implementing SFAS - 106 will be passed through to the GNP-PI.[28]

Consequently, since it is demonstrated through the actuarial analysis that the average employer will experience only 28.3 percent of the cost increase that the average LEC will experience as a result of SFAS - 106, and since it is demonstrated through the macroeconomic analysis that only 2.3 percent of the costs of the increase in SFAS - 106 will be passed through to the GNP-PI; it can be shown that only 0.7 percent (28.3 percent x 2.3 percent) of the LECs' incremental costs from SFAS - 106 will be recoverable through an increase in the GNP-PI.

In addition to the direct impact on GNP-PI, the Godwins study also finds through the macroeconomic model that the wage rate in the national economy will be 0.926 percent lower over the long run than it would be otherwise if SFAS - 106 had not been adopted.[29] As noted above, SFAS - 106 directly increases the costs of labor causing companies to substitute relatively cheaper capital for labor. The replacement of labor with capital results in

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[28] Exhibit 6 at 9-10. The macroeconomic model demonstrates that only 2.3 percent of the cost increases due to SFAS - 106 will be passed through to the GNP-PI, based on the following factors: a) only 32 percent of private employees are covered by OPEBs; b) labor costs amount to 64 percent of total costs of private employers; and c) SFAS - 106 directly increases the labor costs of companies offering OPEBs by 3 percent. Since only a small percentage of companies out of all private companies offer OPEBs and labor costs reflect only 64 percent of companies' total costs, if the companies passed through all of the costs of SFAS - 106 to prices, the private sector price index would only increase 0.614 percent. However, two additional adjustments must be made to accurately reflect the impact on GNP-PI. First, an increase in labor costs will result in some decrease in demand for labor and also impact the price of goods which will limit the actual impact to GNP-PI for the private sector to .0138 percent. Second, the government as an employer, which is not subject to SFAS - 106, accounts for 10.6 percent of GNP. Therefore, a change in the private sector price index accounts for only a 89.4 percent impact on the total GNP-PI which results in a total impact on the GNP-PI of .0124 percent.

[29] Exhibit 6 at 11 and 29-32.

decreased demand for labor. As the demand for labor decreases the price for labor (wages) similarly falls. Through the decrease in wages over the long term -- assuming that the LECs could achieve the full reduction in labor costs by the 0.926 percent -- the LECs could finance 14.5 percent of their additional expenses due to the implementation of SFAS - 106.

The combined effect of the impact of SFAS - 106 on the GNP-PI and the overall decrease in the wage rate is 15.2 percent (0.7 percent + 14.5 percent). Therefore, 84.8 percent of the LECs' incremental costs due to SFAS - 106 will not be recovered through an increase in the GNP-PI.

Moreover, there are no other methods through which the LECs will be able to recover these costs under price caps. The proposed exogenous cost change is not reflected in the sharing and low-end formula adjustment mechanisms. The role of the sharing mechanism is to share the LECs' productivity gains with its customers, and these productivity gains are caused mainly by actions and business decisions under the control of the LEC. The SFAS - 106 cost change, on the other hand, is an accounting change not controlled (exogenous) by the LEC.

In addition, in all previous cases in which exogenous treatment has been authorized (*e.g.*, separations changes, NECA support, inside wire and reserve deficiency amortizations, excess deferred taxes), the Commission has not required LECs to make any adjustment for the sharing or low-end adjustment mechanisms. All exogenous changes have been, and should continue to be, treated independently of the sharing mechanism. Any decision to the contrary will compromise the Commission's incentive goals of price caps. Thus, the exogenous treatment for SFAS - 106 costs should be approved without regard to whether a LEC's productivity performance has positioned it in the sharing, no-sharing or low-end adjustment ranges.

And, based on the foregoing, the Companies seek exogenous treatment for 84.8 percent of their incremental costs of implementing SFAS - 106.[30]

5. Describe each of the type of benefits being provided that is covered by the SFAS - 106 accounting rules, and for 1991 and 1992 the "pay-as-you-go" level of expense associated with these benefits

The SFAS - 106 accounting rule effects the postretirement medical and dental benefits, medicare part B reimbursement plan and group life insurance benefits provided by the Companies to retirees, their dependents, and beneficiaries. The specific medical benefit plans are: comprehensive health plan; medical expense plan; health maintenance organizations; dental plan; and Baxter prescription drug plan. The 1991 and 1992 "pay-as-you-go" amounts are listed on Exhibit 7. The amounts for medical and dental benefits included on Exhibit 7 are paid directly to the VEBA trust. The VEBA trust then pays the retirees for expenses incurred during the year, which is the "retiree" amount noted on Exhibit 7, and maintains a reserve for contributions to VEBA for active employees, which is the VEBA contribution for active employees amount noted on Exhibit 7.

6. Describe any Voluntary Employee Benefit Association (VEBA) trusts or other funding mechanisms for these expenses which were established prior to the adoption of SFAS - 106

In 1988, Ameritech established a VEBA trust to fund postretirement medical and dental benefits for current and future retirees. The Companies contribute an actuarially determined amount of postretirement health care benefits annually to the VEBA trust. In 1989, the VEBA trust was split into two trust accounts. One VEBA trust covers management retirees, and the

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[30] This is a conservative request. First, it assumes that the Companies will be able to achieve the complete decline in labor costs of 0.926 percent. Second, it does not make an adjustment for an increase in the rate base due to the substitution of capital for labor as a result of the increase in labor costs.

other covers non-management retirees (*i.e.* collectively bargained). The accumulated balances in these VEBA accounts were used to reduce the unfunded SFAS - 106 obligation as of the date of adoption.

The Companies also have a Retirement Funding Account (RFA) for providing group life insurance benefits. The RFA is a retired life reserves account established for the purpose of providing qualified basic life insurance for retired employees other than retired key employees. The RFA balances are allocated to separate accounts maintained by the insurance carriers with whom these reserves are held. As of the date of adoption of SFAS - 106, the balances in these accounts were used to reduce the unfunded liability in arriving at the TBO.

7. Describe the forms of postretirement benefit accrual accounting, if any, that were adopted within the regulated financial reporting before the adoption of price cap regulation

The Companies did not adopt any accrual accounting for OPEBs before the adoption of price caps. The Companies did expense and pay an annual cash contribution to the VEBA trust based on an actuarially determined amount. Since the Companies make a cash payment to the VEBA trust there is no liability accrued on the Companies' books for these expenses. The Companies notified the Commission regarding the formation of the Companies' VEBA trust in 1989, and have notified the Commission of the Companies' annual VEBA contribution since that time.[31]

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[31] Letter to Mr. Kenneth P. Moran, Chief, Accounting and Audits Division, Common Carrier Bureau, Federal Communications Commission, from Mr. Walter J. Wagner, Director, Federal Regulatory Accounting, Ameritech Services, Inc., dated January 29, 1989.

8. Describe what type and level of SFAS - 106 type expense is reflected in current rates, and what type and level of SFAS - 106 type expense is reflected in the starting rates for price caps

The initial rates under price caps were based on the revenue requirement filed by the Companies in the 1990 Annual Tariff Filing. That revenue requirement included the interstate "pay-as-you-go" expense for OPEBs of $47,265,000 along with the associated rate base impacts.[32] Since the Companies have been under price caps, their PCIs have been adjusted only to reflect changes in the GNP-PI, the Companies' productivity factor, and other exogenous cost changes unrelated to SFAS - 106. There has been no adjustment in the PCIs for additional "pay-as-you-go" costs.

9. Describe and justify the actuarial assumptions, and the assumptions unique to postretirement health care benefits, made in computing the SFAS - 106 expenses. These assumptions should include the time value of money, participation rates, retirement age, per capita claims cost by age, health care cost trend rates, Medicare reimbursement rates, salary progression, and the probability of payment

The Companies employed both Towers Perrin and Actuarial Sciences of America to assist in determining the underlying assumptions and in calculating the estimated costs for implementing SFAS - 106. As demonstrated in the attached tables, the assumptions are based substantially on telephone industry experience, the Companies' current and historical experience, and anticipated trends in economic factors.[33] In addition, the assumptions which are based on telephone industry experience, such as retirement age assumptions and probability of payments assumptions, are the

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[32] See Exhibit 8.

[33] Exhibit 9, 1991 Postretirement Medical Valuation Assumptions.

same assumptions used by the Companies to accrue for future pension payouts.[34]

With regard to specific assumptions, the discount rate of 7.5 percent was chosen based on an analysis of the Treasury bond rates during 1991. The participation rate for the plan is 100 percent since it is a non-contributory plan. The retirement age assumptions differ based on the sex and position (management/non-management) held by the employee and are based on telephone industry experience.[35] The per capita claims costs per age assumptions are based on an analysis of the Companies' experience in 1990 for each of the plans.[36]

The health care cost trend rates are based on an analysis of the Companies' recent experience and near term expectations.[37] Health care costs were assumed to grow 10 percent in 1991, and the rate of growth was assumed to decline 0.4 percent per year to level off at 4 percent growth after the year 2006. The assumed 4 percent growth rate is consistent with the underlying inflation rate represented in the discount rate and the extension of managed health care to retirees. The Medicare reimbursement rates are assumed to match the health care cost trend.[38] The assumptions underlying the probability of payment, such as mortality rates, turnover, *etc.*, are based on an analysis of

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[34] The assumptions underlying the accruals for pensions have been provided previously to the Commission.

[35] Exhibit 9, Tables 9, 10, 11 and 12.

[36] Exhibit 9, Table 3.

[37] Exhibit 9, Table 1.

[38] Exhibit 9, Table 2.

historical telephone experience.[39] Clearly, these assumptions represent reasonable expectations regarding future events and are sufficiently supported in the record to be used to determine the Companies' costs of implementing SFAS - 106.

10. 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

The Companies have adopted the Retiree Medical Assurance Program for its retirees. This program has a defined dollar amount which explicitly determines the amount of the employer commitment for retiree medical costs. The program has been implemented for management employees retiring on or after March 1, 1991, and will be implemented for non-management employees retiring on or after January 1, 1993. The amount of credit or defined limit provided under this program is established at the company's discretion for all management retirees in the program. The credit or limit for non-management retirees is subject to collective bargaining for non-management employees at the point of their retirement. For purposes of the SFAS - 106 cost calculation, the Companies assumed full inflation.

The possible advent of national health insurance was not reflected in the development of the Companies' costs under SFAS - 106. It is inappropriate to reflect possible legislative changes in developing costs under SFAS - 106. Paragraph 40 of SFAS - 106 states that "[f]uture changes in laws concerning medical costs covered by governmental programs and future changes in the plans of other providers *shall not be anticipated*." Furthermore, any attempt to anticipate the possibility of national health insurance would not result in

[39] Exhibit 9, Tables 4, 5, 6, 7, 13, 14, and 15.

meaningful costs. Many different proposals are being discussed. Some would affect the Companies' retiree medical costs, however, many other alternatives would not. There is no justification for selecting one alternative over another in attempting to estimate the effect of SFAS - 106 costs. The lower ultimate health care trend rates (years 2006 and later) do reflect the Companies' optimism that changes will occur in the U.S. that will bring the rate of increase in health care costs under control. At this time, the Companies anticipate that these changes will be within the current health care delivery structure.

11. Since part of the growth in the GNP-PI presumably occurs due to the growth in medical costs, we seek information on what adjustment, if any, should be made in the exogenous adjustment to avoid any double counting

The implementation of SFAS - 106 only changes the financial accounting and reporting practices of OPEB costs by companies. The adoption of SFAS - 106 will not affect the growth in medical costs. Exogenous treatment is being sought for the accounting change, not any anticipated change in medical costs. Therefore, no adjustment to the exogenous cost change is necessary due to the fact that medical costs are a component of the GNP-PI. The only relevant adjustment to the exogenous cost change is the change in the GNP-PI caused by companies increasing their prices for their goods and services due to their implementation of SFAS - 106. That adjustment is the subject of the Godwins study discussed above. In addition, the discount rate of 7.5 percent virtually eliminates the effect of the health care trend rates used in the computation of the SFAS - 106 unfunded liability.

12. Describe and quantify any wage changes which will be reflected in the GNP-PI that are expected to occur as a result of the introduction of SFAS - 106

As noted in the discussion on the Godwins study, the study concludes that an impact of the implementation of SFAS - 106 is a decrease in the overall wage rate level over time from what it would be absent the implementation of SFAS -106. Based on that study, the Companies are only seeking exogenous treatment for 84.8 percent of their incremental expenses for implementing SFAS - 106. They believe this to be a conservative request for recovery given that the 15.2 percent that could be realized through changes in the GNP-P1 and anticipated decreases in wages will not be recognized immediately.

13. Describe and document the macroeconomic model, including the method of estimation, parameter estimates, and summary statistics

Exhibit 10 provides information which supplements the information provided in the Godwins study regarding the macroeconomic model used in the study.

III. Conclusion

Based on the foregoing, the Commission should grant exogenous treatment for LECs' incremental costs resulting from the implementation of the financial accounting and reporting standards for OPEBs pursuant to SFAS - 106. As demonstrated in this direct case, the implementation of SFAS - 106 meets the Commission's requirements for exogenous treatment of the incremental costs. Moreover, the Companies' calculation of their incremental costs due to SFAS - 106 is based on reasonable and accurate assumptions as well as substantial historical experience. Thus, the Commission also should grant the Companies the authority to adjust their

PCIs effective January 1, 1993, as described in their illustrative tariff attached as Exhibit 1.

Respectfully submitted,

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EXHIBIT LIST

Exhibit 1	Illustrative Tariff
Exhibit 2	Development of Incremental SFAS-106 Costs
Exhibit 3	Subject to Separation and Interstate SFAS-106 Amounts
Exhibit 4	1993 Rate Base Components and Revenue Requirements
Exhibit 5	SEC Form 10-Ks and Ameritech Annual Report
Subpart A	Ameritech Corporation
B	Ameritech Corporation Annual Report 1991
C	Illinois Bell Telephone Co.
D	Indiana Bell Telephone Co., Inc.
E	Michigan Bell Telephone Co.
F	The Ohio Bell Telephone Co.
G	Wisconsin Bell, Inc.
Exhibit 6	Godwins Study
Exhibit 7	"Pay As You Go" Expense for 1991 and 1992
Exhibit 8	"Pay As You Go" Amounts in 1990
Exhibit 9	1991 Postretirement Medical Valuation Assumptions
Exhibit 10	Response to Paragraph 16

Exhibit 1

ILLUSTRATIVE

TARIFF

DESCRIPTION AND JUSTIFICATION

1. Introduction and Description of Filing

In this tariff filing the Ameritech Operating Companies (AOCs) make appropriate adjustments to the Price Cap Index (PCI) of each interstate service basket to reflect the incremental costs associated with the adoption of the Statement of Financial Accounting Standards (SFAS) No. 106. The tariff filing proposes that the increase in costs due to the implementation of SFAS-106 receive exogenous treatment pursuant to the Price Cap Order[1] and Sections 61.45 through 61.49 of the Commission's Rules. At this time, there is no intention to flow these adjustments through to rates. In their Direct Case, filed June 1, 1992, CC Docket No. 92-101, the AOCs demonstrate that exogenous treatment of these costs would be in the public interest.

The calculations of the exogenous cost amount and the allocation to the price cap service baskets are fully described in Exhibits 2 through 4 of the AOCs' Direct Case. Based on information provided in the Direct Case, the AOCs propose exogenous treatment for only 84.8 percent of the incremental costs due to SFAS-106.

The basis for the PCIs are those proposed in the AOCs' 1992 Annual Filing, Transmittal No. 617, filed April 2, 1992, which have not yet been adjusted for the 75-day GNP-PI in place of the 45-day GDP-PI. The basis for the Actual Price Indices (APIs) and Service Band Indices (SBIs) are those proposed in Transmittal No. 626, filed May 18, 1992. The proposed effective date of the PCI and rate changes is January 1, 1993. The interstate portion of this exogenous change is $16.9 million (see Direct Case, Exhibit 4, Line 16).

Section 2 describes the calculation of the price cap indices, and demonstrates that the rate revisions are in compliance with the Price Cap rules.

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1 Policy and Rules Concerning Rates for Dominant Carriers, CC Docket 87-313, Report and Order, FCC 900-314, released October 4, 1990, *Price Cap Order.*

2. Computation of Price Cap Indices

In accordance with Section 61.49 of the Commission's Rules, the AOCs have complied with the methodologies specified to calculate adjustments to the PCIs for the four baskets established by the Commission, to calculate upper and lower limits of the SBIs, to calculate the cap for CCL rates, and the requirements for supporting materials sufficient to calculate these adjustments.

Supporting details demonstrating the AOCs' compliance with Section 61.45 to reflect any mid-year exogenous cost changes on the PCIs for each basket are displayed in the Direct Case (Exhibits 2 through 4). Exhibit A, attached to this tariff filing, displays the PCI calculations for each basket.

The AOCs computed the cap for CCL rates pursuant to the methodology described in Section 61.46. The Common Line basket PCI and the cap for CCL rates were not adjusted due to changes in NECA support payments that may result as other LECs flow this exogenous change to CCL rates. When changes in NECA support payments are determined, the Common Line indices will be adjusted. Applying the formulas prescribed by Section 61.47, the AOCs computed the upper and lower limits for all service bands. The Tariff Review Plan (TRP), attached as Exhibit B, contains the information on the indices and the exogenous change amounts for each basket.

Base Period demand for 1991 (used in the 1992 Annual Filing) times the July 1, 1992 rates (proposed in the 1992 Annual Filing) determines the "R" value for each basket's PCI calculation. The "delta Z" (exogenous cost change) amount is each basket's share of the total incremental cost due to SFAS-106. These values are displayed on Exhibit 4 (Line 16) of the Direct Case.

PROPOSED PCIs
WITH
SFAS – 106 EXOGENOUS CHANGE

	Common Line Basket
Existing PCI (7/1/92)	91.1088
GNP–PI	N/A
Productivity Factor (X)	N/A
Delta Z	7,101,000
R(t–1)	969,515,535
Growth in Min./Line (G)	N/A
Proposed PCI (1/1/93)	91.7761

PROPOSED PCIs
WITH
SFAS – 106 EXOGENOUS CHANGE

	Traffic Sensitive Basket
Existing PCI (7/1/92)	95.1759
GNP–PI	N/A
Productivity Factor (X)	N/A
Delta Z	7,088,000
R(t–1)	855,986,902
Growth in Min./Line (G)	N/A
Proposed PCI (1/1/93)	95.9640

PROPOSED PCIs
WITH
SFAS – 106 EXOGENOUS CHANGE

	Special Access Basket
Existing PCI (7/1/92)	97.0046
GNP–PI	N/A
Productivity Factor (X)	N/A
Delta Z	2,512,000
R(t–1)	322,579,352
Growth in Min./Line (G)	N/A
Proposed PCI (1/1/93)	97.7600

PROPOSED PCIs
WITH
SFAS – 106 EXOGENOUS CHANGE

	Interexchange Basket
Existing PCI (7/1/92)	86.8268
GNP–PI	N/A
Productivity Factor (X)	N/A
Delta Z	192,000
R(t–1)	66,637,015
Growth in Min./Line (G)	N/A
Proposed PCI (1/1/93)	87.0770