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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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

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REBUTTAL

U S WEST Communications, Inc. ("U S WEST"), through counsel and pursuant to the Federal Communications Commission's ("Commission") Order Designating Issues For Investigation,[1] hereby files its Rebuttal in response to the Opposition to Direct Cases filed by MCI Telecommunications Corporation ("MCI") in the above-

[1] In the Matter of 1993 Annual Access Tariff Filings; 1994 Annual Access Tariff Filings; AT&T Communications Tariff F.C.C. Nos. 1 and 2 Transmittal Nos. 5460, 5461, 5462 and 5464; Bell Atlantic Telephone Companies Tariff F.C.C. No. 1, Transmittal No. 690; NYNEX Telephone Companies Tariff F.C.C. No. 1, Transmittal No. 328, CC Docket No. 93-193 (Phase I), CC Docket No. 94-65, CC Docket No. 93-193 (Phase II), CC Docket No. 94-157, Order Designating Issues For Investigation, rel. June 30, 1995 ("Designation Order").

captioned proceeding.[2] As MCI has failed to present any new or persuasive arguments which have not already been answered by previous filings or rejected by the U. S. Court of Appeals for the District of Columbia Circuit (or "Court"),[3] the Commission should find U S WEST's exogenous treatment of post-retirement employee benefits ("OPEB") costs to be appropriate and justified by the evidence previously presented.

I. INTRODUCTION

In its Opposition, MCI does its best to ignore the conclusions reached by the Court in the OPEB Appeal Order. In fact, in its filing, MCI never once references the Court's decision.[4] Because of this feigned ignorance, MCI appears to believe that it can raise issues rejected by the Court as though they were novel before the Commission. MCI also raises other arguments which have been demonstrated to be deficient by a multitude of previous filings. In no instance does MCI offer any evidence or studies of its own which would refute U S WEST's and the other LECs' well-supported claims for the exogenous treatment of previously included OPEB amounts. Nonetheless, U S WEST will once more respond to the issues raised by MCI.

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[2] MCI's Opposition to Direct Cases, filed herein Sep. 13, 1995 ("Opposition").

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

[4] This is curious as MCI fully participated as an intervenor in the appeal of the Commission's Memorandum Opinion and Order denying the local exchange carriers ("LEC") exogenous treatment of OPEBs before the U. S. Court of Appeals for the District of Columbia Circuit.

II. U S WEST HAS PRESENTED FACTS AND DETAIL SUFFICIENT TO JUSTIFY THE EXOGENOUS AMOUNTS FOR OPEBS INCLUDED IN PREVIOUSLY FILED TARIFFS

By its Direct Case, U S WEST has again provided voluminous detail and support for its calculation of OPEB costs. It has demonstrated with great specificity that the costs previously included as exogenous were conservative and justified. The Court in the OPEB Appeal Order reviewed the information and arguments previously provided by the LECs and found them to be compelling. MCI would prefer that the Commission ignore the Court's findings.

In its Opposition, MCI points out that "the LECs have merely restated the arguments which the Commission previously found to be inadequate."[5] MCI fails to note that the Court rejected the Commission's previous findings and remanded the issue back to the Commission "to consider the LECs' request for exogenous cost treatment of their SFAS-106 incremental costs in a manner consistent with this [the Court's] opinion[.]"[6] The Commission itself recognized in its Designation Order that the one issue left for its determination is the "[c]alculation of the specific amount of OPEB-related costs that are eligible for exogenous treatment."[7] Thus, as many of the arguments MCI raises in its Opposition, this one demonstrates that MCI has failed to recognize the Court's decision. Such an elementary failure in the

[5] MCI at 2.

[6] OPEB Appeal Order, 28 F.3d at 173.

[7] Designation Order ¶ 8.

recognition of legal authority necessarily results in a myriad of groundless arguments.

MCI refutes no specific details provided by U S WEST in its Direct Case. It simply labels them as "excessive"[8] and "suspect."[9] Neither label is appropriate. U S WEST has provided the Commission with up-to-date and detailed information with regards to the elements and calculations incorporated into its OPEB amounts. Significant detail with regards to pay-as-you-go amounts, actual cash expenditures, benefits provided, expense levels, allocations, separated costs, VEBA [Voluntary Employee Benefit Association] trusts, employee plans, actuarial assumptions, and much more has been provided on multiple occasions. MCI on the other hand has provided the Commission with nothing more than labels and statements with little or no substance to refute the legitimate amounts demonstrated by U S WEST and the other LECs. MCI's superficial comments in this proceeding should be ignored.

III. PARTICIPATION RATES ARE DETERMINED MAINLY THROUGH COLLECTIVE BARGAINING AND REPRESENT AN EQUITABLE BENEFIT PROGRAM FOR ALL U S WEST EMPLOYEES

In its Opposition, MCI raises the issue of employee participation rates and requests further explanation of how those rates are determined. MCI also questions the LECs' "overly generous program[s], when the generosity of the program is determined by a management decision."[10] MCI's questions again demonstrate its fun-

[8] MCI at 2.

[9] Id. at 6.

[10] Id.

damental ignorance of the LECs' employee structure and the function of represented employees in the determination of plan benefits. A significant portion of U S WEST's employee population is subject to collective bargaining. Every three years U S WEST management negotiates a new three-year contract with the unions which represent the majority of its employees. These negotiations are conducted in a manner consistent with labor laws and the regulations of the National Labor Relations Board and represent the results of difficult and lengthy bargaining by both sides. Management certainly does not dictate the results of this bargaining. The results represent a negotiated agreement which by its nature reflects a fair settlement of all employee issues between management and the represented employees. MCI's arguments concerning these negotiated employee benefit plans are unsupported by facts.

Furthermore, U S WEST management actively attempts to control the costs of employee-provided benefits. These cost control measures include a restructure of the "caps" -- or limits -- placed on healthcare costs for post-1990 retirees, implementation of a managed care network for the provision of employee medical benefits, premium cost sharing, deductibles, co-payments, generic prescription drug programs, capping of Medicare Part B benefits and health care case management. These cost saving programs are directly reflected in lower overall benefit costs and thus, SFAS-106 amounts are subject to exogenous treatment.

As discussed previously, plan participation is to a substantial extent dictated by negotiated agreement. All represented employees are covered by the agreement negotiated between management and labor. Out of equity and fairness, employees

not represented, including management, are provided substantially the same health care and other benefits as provided under agreement to the represented employees. Thus, participation in the plans is generally universal, dictated both by the results of collective bargaining and general employee equity. Any other methodology of plan participation would likely prove to be contentious. U S WEST, from its Bell System heritage, has a history of providing fair and equitable compensation and benefits to its employees. MCI's characterization of U S WEST's employee benefit plans as "overly-generous" is simply wrong.

IV. U S WEST IS PERMITTED TO TREAT SFAS-106 COSTS EXOGENOUSLY PRIOR TO JANUARY 1, 1993, PER THE COMMISSION'S OWN DIRECTIVE

MCI once again raises the issue of when exogenous treatment should be allowed for SFAS-106 costs. It argues that exogenous treatment should not be allowed prior to the mandatory adoption date of January 1, 1993. This argument must fail as the Commission, by its own directive, authorized all carriers to adopt SFAS-106 on or before January 1, 1993. Had the Commission not sanctioned or specifically authorized prior adoption, MCI's arguments might have merit. The facts, however, require the opposite conclusion.

In December 1990, SFAS-106 was adopted by the Financial Accounting Standards Board ("FASB"). On application by Southwestern Bell, the Commission found SFAS-106 consistent with Commission objectives and authorized the LECs to

adopt it on or before January 1, 1993.[11] The combination of these two events provides satisfaction of the control criterion described by the Commission in its initial discussion of exogenous treatment.[12] Therefore, under the Commission's Rules, exogenous treatment was justified and proper when SFAS-106 was adopted by the individual LECs, on or before January 1, 1993, not the last possible date of adoption as argued by MCI.

V. THE GODWINS STUDY DEMONSTRATES THE APPROPRIATENESS OF THE OPEB AMOUNTS INCLUDED BY U S WEST AS EXOGENOUS COSTS

U S WEST and several of the other price cap LECs utilized a study prepared by Godwins to demonstrate the appropriateness of the OPEB amounts calculated for inclusion as exogenous costs. MCI once again refutes the use of this study and a similar study prepared by the National Economic Research Associates, Inc. ("NERA"). MCI notes that "[t]he Commission has previously concluded that the Godwins study yielded extremely wide ranging results of GNP-PI effects, depending upon the selection of assumptions chosen for certain key parameters"[13] and that since "the NERA and Godwins studies started out with completely different assumptions . . . the Commission clearly could not arbitrarily conclude that one or the

[11] In the Matter of Southwestern Bell, GTE Service Corporation, Notification of Intent to Adopt Statement of Financial Accounting Standards No. 106, Employers' Accounting for Postretirement Benefits Other Than Pension, Order, 6 FCC Rcd. 7560 ¶ 3 (1991).

[12] See In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd. 6786 (1990); modified on recon., 6 FCC Rcd. 2637 (1991); further recon. dism'd, 6 FCC Rcd. 7482 (1991).

[13] MCI at 2-3.

other study was appropriate."[14] Here again, MCI has chosen to ignore the Court's discussion and findings in the OPEB Appeal Order. In that Order, the Court noted that "to the extent the FCC concluded that because the studies began with different assumptions, neither could be relied upon, its decision was quite illogical. . . .The substantial identity of results in the face of widely varying assumptions tended simply to show that the outcome was insensitive to this variation. That rendered the conclusions more robust, not less."[15] Thus, MCI's arguments here again have already been rejected by the Court.

MCI raises additional issues concerning the validity of the Godwins study including its use of a "what if" approach as opposed to a pure econometric model. As shown by the attached response of Godwins to the MCI Opposition, MCI's criticisms are without merit. Godwins finds nothing in the MCI comments which would cause it to modify any of the findings contained in its original report or subsequent reports filed with the Commission in this matter. Godwins concludes that "MCI's characterization of the calculations in that report as 'nothing more than a random and indiscriminate exercise' is irresponsible and reckless and reveals complete ignorance of the state of quantitative general equilibrium models that are an important part of modern macroeconomics."[16] A conclusion with regards to the totality of

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[14] Id. at 3.

[15] OPEB Appeal Order, 28 F.3d at 172.

[16] Attached hereto, Supplemental Report, Perspectives on Analysis of Impact of SFAS 106 on GNP-PI, dated Sep. 28, 1995 at 9 ("Godwins").

MCI's comments in this proceeding might contain similar findings. Nothing MCI has presented in its Opposition provides any evidence to refute the findings of either the Godwins or NERA studies.

VI. CONCLUSION

MCI has failed to provide any evidence or demonstrate sufficient reason why the Commission should not accept U S WEST's calculation of OPEB amounts submitted for exogenous treatment. U S WEST has shown with great detail and specificity that amounts it calculated were appropriate and conservative. Accordingly, the Commission should reject MCI's Opposition and find U S WEST's exogenous treatment of OPEB costs appropriate and terminate its pending OPEB-related tariff investigations.

Respectfully submitted,

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Its Attorney

Of Counsel,
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September 28, 1995

ATTACHMENT

Supplemental Report

Perspectives on Analysis of Impact of
SFAS 106 on GNP-PI

September 28, 1995

Towers Perrin

Introduction

Over the past four years, we have been working with various Price Cap LECs to analyze the impact of SFAS 106 on the GNP-PI. In February 1992, we issued our original report indicating that less than 1% of the Price Cap LECs' additional costs due to SFAS 106 would be reflected in the GNP-PI, and that approximately 85% of the LECs' additional costs would not be reflected in the GNP-PI or recovered through other macroeconomic effects.

Earlier this year, we were asked to provide an opinion as to the extent to which the findings of our original report, issued three years earlier, should still be considered valid. On August 14, 1995 we issued a report stating that we believe that the actual impact of SFAS 106 on the GNP-PI and the percentage of LECs' additional costs due to SFAS 106 that remain unrecovered were not materially different than indicated in our original report.

In September 1995, MCI submitted an opposition to our August 14, 1995 report. We find that MCI's criticisms in its opposition are completely without merit. There is nothing in MCI's opposition that would lead us to modify any of the findings in our original report or in subsequent reports we have prepared on this issue. This report provides a detailed response to MCI's submission.

Respectfully submitted,

Peter J. Neuwirth, F.S.A., M.A.A.A.

Andrew B. Abel, Ph.D.

Executive Summary

MCI's opposition is without merit and reflects a failure to understand the modeling and economic analysis in our reports. This report clarifies and further explains the motivation and implementation of the economic analysis underlying our reports. In addition, we discuss in detail MCI's various criticisms and show that they are baseless. The specific points discussed in the body of our report are summarized below.

1. Despite MCI's criticism of our model as a "what-if" model, the question of the impact of SFAS 106 on the GNP-PI is precisely a "what-if" question. To address this question quantitatively, we need to determine how much different the GNP-PI would have been if SFAS 106 had not been introduced.

2. Using a set of five criteria outlined in our original report, we decided to use a quantitative general equilibrium model to analyze the impact on the GNP-PI of the introduction of SFAS 106. The numerical values of the model's parameters were chosen by a method known as calibration, which uses existing econometric estimates to determine the numerical values of some parameters, and chooses the values of other parameters so that the values of certain variables in the model match the actual values of these variables in the economy. MCI's criticism of the choice of numerical values for parameters reflects an ignorance of calibration in quantitative general equilibrium models, a method that is widely used in modern macroeconomic analysis.

3. The specification and calibration of the macroeconomic model was guided by a conservative philosophy which, in this context, guards against understating the impact of SFAS 106 on the GNP-PI. It also guards against overstating the percentage of LECs' additional costs due to SFAS 106 that remain unrecovered after taking account of the GNP-PI and other macroeconomic effects.

4. The extensive sensitivity analyses performed earlier produce a wide range of numerical results, but the most extreme results are based on combinations of parameter values that are too implausible to be taken seriously. The sensitivity analyses support the conclusion that only a small fraction of LECs' increased costs due to SFAS 106 are recovered through the GNP-PI, and even taking account of other macroeconomic effects, the majority of additional costs will be unrecovered.

5. Despite the fact that the NERA study and our original report used different assumptions about the extent to which the accrual of future OPEB's is a factor in the determination of prices in the absence of SFAS 106, our model can be extended to include the NERA assumption. This extension was implemented in the March 1993 Supplemental Report. Despite some quantitative differences in the findings using the two assumptions, the results are consistent with each other in that for both sets of assumptions the effect on GNP-PI is tiny and a very large fraction of LECs' increased costs due to SFAS 106 remains unrecovered. Although MCI criticizes our model for its ability to incorporate the NERA assumption, we regard this flexibility and the

similarity of substantive findings as reinforcing the results in our original report.

6. In light of the findings above, the criticisms raised by MCI are entirely without merit and would not lead us to modify any of the conclusions of our previous reports.

Rebuttal to MCI

MCI Telecommunications Corporation's Opposition to Direct Cases reflects a continued misunderstanding of the basic economic approach underlying our original report and of quantitative economic analysis in general. In this report, we discuss the basic methodological issues underlying our original report and explain why MCI's criticisms of the methodology are confused and without merit.

"What-if" Analysis

A glaring example of MCI's misunderstanding is the criticism of our model as a "what-if" tool [1]. As we have emphasized elsewhere,[2] a "what-if" analysis is the only way to calculate the impact of SFAS 106 on the GNP-PI. The impact of SFAS 106 on the GNP-PI equals the actual value of the GNP-PI in a given year after the introduction of SFAS 106 minus the value of the GNP-PI that would have been observed in that same year if SFAS 106 had not been introduced. To estimate the value of GNP-PI that would have been observed in the absence of SFAS 106 we must ask "What would have been the value of the GNP-PI if SFAS 106 were not introduced?" This is precisely the sort of "what-if" exercise that is criticized by MCI. Although MCI seems to prefer the use of an econometric model, it appears oblivious to the fact that using an econometric model to address the impact of SFAS 106 on the GNP-PI is also a "what-if" exercise.

The Roles of Modeling and Econometrics

Any quantitative study of the impact of SFAS 106 on the GNP-PI must make a methodological decision about the type of model to use. In our original report we listed a set of five criteria to guide the choice of a model, and we explained why these criteria led us to use a quantitative general equilibrium model[3]. As explained elsewhere, large-scale econometric models fail to satisfy two of these criteria[4], and thus these models were deemed inappropriate for our study. Because MCI continues to criticize our model for not being "an econometric model capable of determining with some degree of statistical confidence the impact of SFAS 106 on GNP-PI,"[5] we will revisit the issue of model design from a fresh perspective.

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[1] MCI, p. 5

[2] Analysis of Impact of FAS 106 Costs on GNP-PI, Supplemental Report: Responses to Objections Raised Regarding Original Study, July 1992, p. 23.

[3] Analysis of Impact of FAS 106 Costs on GNP-PI, February 1992, pp. 26-27.

[4] Response to Paragraph 16 of FCC Order of Investigation and Suspension, May 26, 1992, pp. 1-2.

[5] MCI, p. 4

To see why MCI's criticism is misguided, it is helpful to understand the role of modeling and the role of econometrics in addressing the question of the impact of SFAS 106 on the GNP-PI.

The Role of Modeling. In order to determine the effect of SFAS 106 on the GNP-PI we need a macroeconomic model that takes account of the interactions of the demand for goods, the production function, and the supply and derived demand for labor, and uses these interactions to simultaneously determine prices, wages, and other labor costs. A model is a set of equations that represent various aspects of economic behavior. The general mathematical form of our model is presented in detail in Appendix C of our original report.

The Role of Econometrics. Once a general mathematical model is formulated, the numerical values of the model's parameters need to be selected. Econometric estimation is a statistical technique to choose these numerical values. Our original report does not produce its own econometric estimates of the parameters. Instead the report relies on the results of previous econometric studies in the literature for guidance in choosing the values of parameters. As discussed in our original report,[6] the value of the elasticity of labor supply was chosen based on a survey of the econometric literature on labor supply in Labor Supply by Mark R. Killingsworth. The value of the price elasticity of demand was chosen to be very conservative based on the summary of econometric estimates of price elasticities of demand reported in Economics by Michael Parkin[7].

There are two advantages to using previous econometric studies rather than producing a new set of econometric estimates for calculating the impact of SFAS 106 on the GNP-PI. First, these previous studies can be viewed as being truly unbiased with respect to the issue of the effects of SFAS 106 on the GNP-PI because they were conducted without any reference to this issue. Second, rather than rely on the results of any single econometric exercise, we have based our choices of parameters on a body of research comprised of many studies. Moreover, in using these previous econometric studies to determine the values of parameters, we have been conservative in the sense discussed in the next section.

As we have just discussed, our original report does not perform its own econometric analysis and the model used in that report is not an econometric model, though the model does rely on econometric estimates for some of its parameter values. The numerical values of other parameters are chosen so that the model produces values for some variables that

[6] Analysis of Impact of FAS Costs on GNP-PI, February 1992, p. 30.

[7] A brief summary of the findings reported by Parkin is contained in footnote 4 on page 12 of Analysis of Impact of FAS 106 Costs on GNP-PI, Supplemental Report: Additional Sensitivity Analysis, March 1993.

match the actual values in the economy. For instance, the parameters of the production function are chosen so that the share of labor cost in total cost in the baseline calculation matches the share of labor cost in total cost in the U.S. economy. This approach to choosing numerical values of parameters, which uses both previous econometric estimates and parameter values that allow the model to match certain data, is known as *calibration*[8]. Calibration is commonly used in modern macroeconomic analysis to select parameter values in quantitative general equilibrium models.

The Conservative Approach

As we have discussed, calculation of the impact on the GNP-PI of the introduction of SFAS 106 is a "what-if" exercise. This calculation necessarily involves estimation of how much different the GNP-PI would have been if SFAS 106 had not been introduced. Because we cannot rerun history and alter it to exclude SFAS 106, nor can we run a controlled experiment, any calculation of the impact of SFAS 106 is an approximation rather than an accurate and precise determination of the exact impact. Recognizing the approximate nature of any such calculation, we adopted a conservative approach to guide the analysis in our original report. In this context, "conservative" means that our calculations tend to overstate the impact on the GNP-PI and thus to understate the fraction of LECs' additional costs due to SFAS 106 that remain unrecovered.

The conservative approach guided both the actuarial and macroeconomic analyses in our original report.[9] The baseline findings of the original report are that ultimately the increase in GNP-PI (0.0124%) caused by SFAS 106 will provide recovery of 0.7% of the LECs' increase in costs due to SFAS 106, and that taking account of additional macroeconomic effects that might occur, 84.8% of the increase in costs remains unrecovered. The March 1993 Supplemental Report also presents a "best estimate" set of results, which are not subject to the conservative influence guiding the baseline calculations. For example, according to our best estimates, only 0.3% of the increase in LECs' costs due to SFAS 106 are recovered through the GNP-PI. Furthermore, a comparison of the "best estimate" and "baseline" findings supports our original report in two ways. First, the two sets of findings are not very different from each other. Second, the baseline calculations featured in our original report are indeed conservative relative to our best estimates.

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[8] Calibration is discussed in Analysis of Impact of FAS 106 Costs on GNP-PI, Supplemental Report: Responses to Objections Raised Regarding Original Study, July 1992, pp. 40-41. Response to Paragraph 16 of FCC Order of Investigation and Suspension, May 26, 1992, pp. 3-5, gives a complete description of the calibration of the parameters in our model.

[9] The conservative approach is explained in Analysis of Impact of FAS 106 Costs on GNP-PI, Supplemental Report: Responses to Objections Raised Regarding Original Study, July 1992. See footnote 4 on page 16 of that report for a discussion of conservatism in the actuarial analysis, and see page 32 of that report for a discussion of conservatism in the macroeconomic analysis.

The Role of Sensitivity Analysis

In addition to comparing the best estimate and baseline results, we have performed extensive sensitivity analyses.[10] Our August 14, 1995 report[11] discusses the purpose of sensitivity analysis and explains why many of the calculations in our sensitivity analyses should be ignored because they were based on combinations of implausible parameter values. This report clearly and emphatically states that the range of parameter values used in the extensive sensitivity analysis was chosen to make sure that all plausible combinations of parameter values were included, with the recognition that many of these combinations were implausible and should be ignored. It is important to keep in mind that the purpose of the sensitivity analysis is not to delineate the set of plausible combinations of parameter values, but is instead to explore the robustness of our findings and to illustrate the quantitative impact on our findings of various changes in the numerical values of the inputs. Despite this discussion, MCI continues to criticize our findings because they present "extremely wide ranging results of GNP-PI effects".[12] However, this criticism has already been addressed by the detailed discussion of this issue on pp. 4-5 of the August 14 report. Nothing in the MCI opposition addresses any of the substantive arguments on pp. 4-5 of that report, so there is no point in repeating the details of that argument, except for the closing sentence: "To reiterate, our sensitivity analysis presents the results for all combinations of parameter values, including many combinations too implausible to merit any attention."

Reconciliation with NERA's Analysis

MCI points out that our original report and the NERA study start with different assumptions about the pricing behavior of competitive (unregulated) firms[13]. The difference between the two studies relates to the extent to which firms take account of the current accrual of future OPEB's (other postretirement employee benefits) when pricing their products. To the extent that firms understand and calculate the actuarial value of future OPEB's, the accrual of these OPEB's would be factored into prices by rational forward-looking competitive firms. NERA has chosen to follow the conventional economic assumption that competitive firms are rational and forward-looking and thus assumes that prices would reflect the accrual of future OPEB's even without SFAS 106. However, many workers producing output on any given date will not receive OPEB's until decades later. The calculation of the accrual of these OPEB's is a detailed actuarial task, and some firms may not have the expertise, foresight or inclination to compute and take account of these far-off costs in the absence of SFAS 106. The introduction of SFAS 106 may force such firms to only then factor these costs into their

[10] Our original report contains a sensitivity analysis, and the March 1993 Supplemental Report contains a much more extensive sensitivity analysis.

[11] "Perspectives on Analysis of Impact of SFAS 106 on GNP-PI".

[12] MCI, p. 3

[13] MCI, pp. 3-4

pricing decisions. Consistent with the conservative approach, our original report is based on the assumption that firms ignore the accrual of OPEB's before SFAS 106 and take account of these accruals when SFAS 106 is introduced. Relative to the assumption adopted by NERA, this assumption leads to a larger (i.e., more conservative) impact of SFAS 106 on the GNP-PI and to a lower percentage of the LECs' increase in costs due to SFAS 106 that remains unrecovered.

While NERA's study and our original report used diametrically opposed assumptions about pricing behavior in the absence of SFAS 106, one might reasonably assert that the actual behavior of firms lies somewhere between these extremes. Our March 1993 Supplemental Report[14] recognizes that the assumptions used by NERA and by us are at opposite ends of a spectrum and presents calculations of the impact of SFAS 106 for assumptions at both ends of the spectrum (corresponding to the NERA assumption and our assumption) as well as for various intermediate assumptions. If the actual behavior of firms is somewhere between the opposite assumptions used by NERA and by us, then these intermediate assumptions may better reflect the actual behavior of firms. However, one must not lose sight of the conservative approach guiding our original report. According to our approach, when we are unsure about which of a set of potential assumptions to adopt, we will adopt the one that leads to the largest calculated impact of SFAS 106 on the GNP-PI. The results reported on page 5 of the March 1993 Supplemental Report illustrate that the assumption used in our original report is indeed conservative relative to the assumption used by NERA and relative to intermediate assumptions.

MCI (pp. 4-5) mentions the calculations in the March 1993 Supplemental Report that use the NERA assumption about pricing, and criticizes these calculations because they illustrate that our model is a "what-if" model. This criticism is entirely off target. First, we have already explained why a "what-if" model is needed to calculate the impact of SFAS 106 on the GNP-PI. Moreover, these calculations can be viewed as adding an extra dimension to the sensitivity analysis. Recall that a sensitivity analysis indicates the quantitative impact on the results of changing various parameters or equations in a model. The calculations reported on p. 5 of the March 1993 Supplemental Report constitute a sensitivity analysis focusing on the assumption underlying pricing behavior. This sensitivity analysis reinforces the major quantitative findings of our original report: the introduction of SFAS 106 has a minuscule effect on the GNP-PI; and an overwhelming share of LECs' additional costs due to SFAS 106 remain unrecovered. Rather than being a point of vulnerability, these calculations are a source of strength and reinforce the findings in our original report.

[14] Analysis of Impact of FAS Costs on GNP-PI, Supplemental Report: Additional Sensitivity Analysis, March 1993, pp. 3-5.

Conclusion

The criticisms raised by MCI are entirely without merit. There is no serious argument in MCI's statement that would lead us to modify any of the findings in our original report or in any of our subsequent reports. MCI's characterization of the calculations in that report as "nothing more than a random and indiscriminate exercise" is irresponsible and reckless and reveals complete ignorance of the state of quantitative general equilibrium models that are an important part of modern macroeconomics.

Our original report was designed to answer a "what-if" question: How much different would the GNP-PI have been if SFAS 106 were never adopted? As explained in our original report, the choice of a model was thoughtfully and deliberately based on a set of desirable criteria for a quantitative macroeconomic model. These criteria led to a quantitative general equilibrium model rather than a large-scale econometric macroeconomic model, and econometric estimates were taken from the economics literature to calibrate some of the key parameters of the model.

The philosophy that guided development and implementation of our model was one of conservatism. Recognizing the difficulty of precisely and accurately determining the exact effect of SFAS 106 on the GNP-PI, our model was designed to guard against understating the impact on the GNP-PI. Thus the baseline finding that the increase in the GNP-PI (0.0124%) will provide recovery of only 0.7% of increased costs due to SFAS 106 is designed to be an overestimate of the actual impact on the GNP-PI, and the baseline finding that 84.8% of the LECs' additional costs due to SFAS 106 remain unrecovered is meant to be an underestimate of the actual percentage.

Finally, MCI has pointed out that our August 14, 1995 report contains no new evidence. We did not present any new evidence because the conservatism in our original report was designed to guard against understating the impact of SFAS 106 on the GNP-PI even if new data turned out to be moderately different from the assumptions used in the study. Moreover, MCI has produced no substantive argument that would lead us to modify our findings in any way.

CERTIFICATE OF SERVICE

I, Kelseau Powe, Jr., do hereby certify that on this 28th day of September, 1995, I have caused a copy of the foregoing **REBUTTAL** to be served via first-class United States Mail, postage prepaid, upon the persons listed on the attached service list.

Kelseau Powe, Jr.

***Via Hand-Delivery**

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