Before the
**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, D.C. 20554**

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| In the Matter of | ) | |
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| 1997 Annual Access Tariff Filings | ) | Bell Atlantic Transmittal No. 970 |
| | ) | NYNEX Transmittal No. 455 |
| | ) | |
| Bell Atlantic Telephone Companies | ) | CC Docket No. 97-149 |
| Tariff F.C.C. Nos. 1, 2, 4, 5 and 8 | ) | |

# BELL ATLANTIC DIRECT CASE

Edward D. Young, III
Michael E. Glover
Of Counsel

Edward Shakin

1320 North Court House Road
Eighth Floor
Arlington, Virginia 22201
(703) 974-4864

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# BELL ATLANTIC[1] DIRECT CASE

## Introduction and Summary

As documented in this direct case, neither of the issues under investigation warrant any adjustment to Bell Atlantic's 1997 access tariffs.

First, Bell Atlantic's calculation of its projected base factor portion ("BFP") costs and its projected growth in demand are based on reasonable proxies, achieve reasonable results and are certainly more accurate than the facially flawed alternative suggested by AT&T. Moreover, by relying on historical growth rates, Bell Atlantic's method is self-correcting over time. Even if the Commission were to suggest a different basis for projecting these costs, however, any revised

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1 Since the access tariffs were filed, Bell Atlantic Corp. and NYNEX have merged. The Bell Atlantic telephone companies ("Bell Atlantic") are now 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.; Bell Atlantic-West Virginia, Inc.; New York Telephone Company; and New England Telephone and Telegraph Company. The first seven listed carriers will be referred to here as Bell Atlantic-South and operate subject to Bell Atlantic interstate tariffs. The other two carriers will be referred to here as Bell Atlantic-North and operate subject to NYNEX interstate tariffs.

projections should be applied on a prospective basis only, rather than retroactively adjust -- based on 20-20 hindsight --projections that were reasonable when made.

Second, the Commission should reject arguments that Bell Atlantic must adjust its rates to reflect the completion of the amortization of equal access costs by an amount that exceeds the actual amortization. To the extent the Commission does require an adjustment to reflect the impact of growth in demand during the period that these costs were being recovered, the exogenous adjustment should only reflect demand growth for those limited years where the amount of equal access costs that carriers recovered was actually increased by such growth.

## I. Bell Atlantic's BFP And Demand Forecasts Were Reasonable And Consistent With Commission Requirements

As the Commission recognizes, the price cap rules "do not prescribe any particular methodology" to calculate the BFP revenue requirement.[2] While local exchange carriers ("LECs") may have to show that their chosen method is reasonable,[3] the Commission has previously rejected a requirement for a standardized projection model.[4] As a result, there may be a variety of reasonable projection methods that are consistent with Commission rules.

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2 Order Designating Issues For Investigation at ¶ 14 (Com. Car. Bur. rel. July 28, 1997) ("Investigation Order").

3 *Id.* at ¶ 13.

4 ***Material To Be Filed In Support of 1997 Annual Access Tariff Filings***, Tariff Review Plans at ¶ 8 (Comp. Pricing Div. rel. Mar. 21, 1997) ("TRP Order").

**The basis for Bell Atlantic's projections are reasonable.**

Bell Atlantic applied the same basic methodology in its northern and southern affiliates -- it relied on the rate of growth from the prior year to predict the growth rate in the coming year.[5] This methodology has a number of significant advantages. First, it avoids complicated calculations that themselves can engender disputes. Second, by using a one-year measure, it relies on the most recent data and avoids distortions caused by old data that may no longer have any relevance to current growth rates. Third, used consistently, as Bell Atlantic has, it is a self-correcting measure. While any forecast method may miss significant changes in the rate of BFP growth from year to year, the Bell Atlantic methodology will capture those differences by using those growth rates as the basis for calculations in the following year. Finally, the Competitive Pricing Division required that the 1997 tariff filings "explain any forecast that deviates from the historical cost or demand trend."[6] By relying on the historical growth rate as the basis for its forecast method, Bell Atlantic has assured that there can be no significant deviation.[7]

In the workpapers and text supporting this direct case, Bell Atlantic has augmented its projections with the trend analyses required by the Commission. Nothing in those analyses calls into question the reasonableness of the Bell Atlantic methodology. While there is some difference between the forecasted and the actual results, the differences include both under- and

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[5] For Bell Atlantic-North, the prior year's growth rate was calculated based on 11 months of data.

[6] TRP Order at ¶ 8.

[7] Bell Atlantic-South's forecast for demand growth used the same basic methodology and benefits from the same advantages as its BFP calculation. The Bell Atlantic-North methodology also was based on historical data. ***See*** Detailed Response to paragraph 32-1.

over-forecasts.[8] Moreover, regardless of direction, in the most recent years, the differences are relatively small.[9]

In its Investigation Order, the Common Carrier Bureau characterizes a difference in the percentage change of more than 10% as significant.[10] Regardless of whether such a definition is appropriate for the purpose used -- isolating those differences about which the Commission sought additional detail -- the Commission should not use such a definition for a determination of reasonableness of the forecasts. Because the definition is on the basis of the percentage ***change***, a forecast could fall within the threshold of significance while still being a very accurate predictor of actual demand and cost ***levels***. For example, in tariff year 1996, the difference in the percentage ***change*** in BFP revenue requirement was more than 10% from the actual.[11] But the difference between the ***total*** projected BFP and the actual was only 2.6% for the combined company.[12] Moreover, even where the difference between the projection and the actual result is large, it does not indicate that the methodology is unreasonable. In the detail of its direct case, Bell Atlantic explains the cause for every year in which there is a deviation defined by the Commission to be significant.[13]

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8 ***See*** Exhibits 17N-1-A and 17S-1-A for comparison of actual and projected revenue BFP requirements; and Exhibits 31N-1 and 31S-1 for comparison of actual and projected end-user demand.

9 ***See*** Exhibits 17N-1-A and 17S-1-A, 31N-1, and 31S-1.

10 Investigation Order at ¶ 17.

11 ***See*** Exhibits 17N-1-A and 17S-1-A.

12 ***See*** Exhibit 17-1-C.

13 ***See*** Detailed Response to paragraph 17-1.

In contrast, AT&T's proposed alternative methodology is clearly unreasonable. AT&T relies on a simple average of BFP changes for the last six years and ignores the fact that the growth rate has been declining over time. As a result, AT&T's methodology overstates expected BFP growth. Indeed, despite AT&T's claim that Bell Atlantic and other LECs have understated BFP growth, Bell Atlantic's 1997 projections are ***above*** the level projected through a six-year trend analysis. Because a multi-year growth trend is not a demonstrably better predictor than Bell Atlantic's method, there is no basis to require a change in methods.

**The Commission should no longer require forecasts.**

While Bell Atlantic's forecast methodology is reasonable, like any forecast, it cannot be a perfect substitute for the actual results. As a result, parties have relied on after the fact analyses to object to forecast methods. Such objections are likely to be a continuing regulatory cost for so long as the Commission continues to require forecasted data. In other price cap calculations, however, the Commission has relied on historical data rather than projections. For example, historical demand is used in all price cap index calculations, and exogenous costs are measured at the base period level of operations.[14] Use of historical data avoids the regulatory costs of proceedings like the present that address details of forecasting. Moreover, no customer will suffer as a result of historical information. As with Bell Atlantic's forecast methodology, any changes in costs or demand underlying the BFP calculation will be captured over time.

**Any change in methodology should be prospective only.**

Should the Commission decide to retain forecasts, but modify the requirements, it should only require a prospective adjustment. Bell Atlantic's calculations reflected actual historical

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14 47 C.F.R. §§ 61.45-61.47.

experience and were consistent with the requirements imposed by the Commission at the time of the filing. Taken as a whole, for the most recent year Bell Atlantic's BFP results varied from actuals by less than 3%.[15] Similarly, the Company's demand projection varied from actuals by less than 1%.[16] If, in the context of this proceeding the Commission were to provide additional detail that clarified how the forecasts should be calculated going forward, Bell Atlantic should not be required to make an adjustment to past rates in order to reflect the new forecasting methodology.

This is especially important because the BFP and demand are not used to set overall rate levels. Rather, the forecasts determine the allocation of rate recovery between end-user and carrier charges. Any theoretical over-forecast could not result in any financial benefit to Bell Atlantic.[17] Therefore, if the Commission were to require a retroactive adjustment to the BFP or demand calculations, which it should not, it should at least allow an adjustment to both access and end-user rates.

## II. The Commission Should Reject AT&T's Proposed Increases to The Amortization of Equal Access Costs

In its exogenous adjustments, Bell Atlantic removed the full amount of amortized equal access costs from its price caps. The investigation order, however, tentatively concludes that

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15 *See* Exhibit 17-1-C.

16 *See* Exhibit 33-1-D.

17 Indeed, deviations between projected and actual amounts often have no impact on any individual rate either. For example, in tariff years 1995 and 1996 all Bell Atlantic-North subscriber line charges were priced at the cap for both business and residential customers. As a result, an increase in the BFP or demand projections could not have had any impact on the apportionment of recovery between the subscriber line and the carrier common line charges.

more than the actual amount of equal access costs should be removed from rates by adjusting the actual amount upward based on growth in demand. This conclusion should not be adopted.

Bell Atlantic's adjustment was consistent with Commission rules and practice. The Access Reform Order merely directed LECs to make a downward adjustment "to account for the completed amortization of equal access expenses,"[18] and did not include any requirement to augment the removal of equal access costs by demand growth. Indeed, the only methodology in the record is the one AT&T originally proposed and Bell Atlantic followed.[19] In doing so, Bell Atlantic followed its own and Commission past practice in not including an adjustment for demand growth. As the Investigation Order acknowledges, when OPEB costs were removed no augmentation for demand changes was required.[20]

The Commission cannot create a new requirement here. The investigation fails to address the fact that, as with OPEB, the Commission's underlying order in the Access Reform proceeding did not explicitly require that the equal access amortization take into account any changes in revenue that results from growth in demand. The Commission cannot, in the context of a resolution of petitions against a compliance tariff filing, create new requirements that did not

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18 ***Access Charge Reform***, CC Docket 96-262, First Report and Order at ¶ 314 (rel. May 16, 1997) ("Access Reform Order").

19 In the access reform proceeding, AT&T proposed the same methodology for calculation of exogenous adjustment as was relied on by Bell Atlantic in its tariff. ***Access Charge Reform***, CC Docket 96-262, Comments of AT&T at Appendix F, page 1 (filed Jan. 29, 1997).

20 Investigation Order at ¶ 40. Moreover, in its Access Reform Order, the Commission drew analogies from its treatment of the exogenous decrease imposed for the completion of the amortization of depreciation reserve deficiencies and the completion of the amortization of inside wire costs as grounds for requiring that adjustment. Access Reform Order at ¶ 302. Again, in both those situations, no R value adjustment was required. ***See*** Bell Atlantic Transmittal Nos. 579 (filed June 29, 1993); 513 (filed June 29, 1992).

appear in the underlying order. It would violate the Administrative Procedures Act to impose a new requirement here.[21]

If the Commission nonetheless were to require an adjustment to reflect growth in demand, which it should not, it would be unreasonable to augment the adjusted amount by changes in local switching revenues from the start of price cap regulation, as sought by AT&T. At the start of price caps, equal access costs were collected as a separate per-line rate element. Growth in local switching revenues had no impact on the total amount collected for that rate element. It would be arbitrary to require that the removal of those costs from rates should reflect a factor for growth in local switching revenues for the period when such growth was irrelevant to the rate element.

The Commission asks whether the reversal here is similar to the reversal of sharing.[22] It is not. In the context of sharing, the so-called "R adjustment" is intended to adjust the sharing amount so that the impact on the price caps when sharing is reversed is the same as the impact on the caps when sharing was put into indices a year earlier, thereby assuring that sharing is a one-time adjustment.[23] For the equal access amortization, an R adjustment would remove more costs than are actually recovered, and would thereby penalize the LECs.

Starting in the 1993 tariff year, the separate rate element for the equal access costs was set to zero and cost recovery occurred through other elements in the Traffic Sensitive price cap

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[21] ***See*** 5 U.S.C. § 556(d).

[22] Investigation Order at ¶ 42.

[23] ***See Policy and Rules Concerning Rates for Dominant Carriers***, 5 FCC Rcd 6786, 6803 (1990) ("Price Cap Order").

basket.[24] If the Commission were to require an R value adjustment, the only reasonable starting point for the adjustment would be the start date of such recovery.[25]

Prior to that date, equal access recovery was only augmented by growth in lines -- which grew at a much slower rate than the growth in the interstate local switching revenues relied on by AT&T.[26] Even that slower growth was offset by ***reductions*** in equal access cost recovery as a result of the annual price cap adjustment. In fact, from the inception of price cap regulation through the period there was a separate equal access charge, the total ***reductions*** in equal access cost recovery ***are larger*** than the gains from the growth in demand for lines.[27]

## Conclusion

For the reasons set forth in this direct case, the Commission should promptly conclude the investigations without any adjustment to the tariffs.

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24 NYNEX Telephone Companies' Transmittal No. 207 (filed June 29, 1993). For the Bell Atlantic-South companies the elimination of a separate rate element began in at the start of the 1992 annual access tariff. ***See*** Bell Atlantic Transmittal No. 513 (filed June 29, 1992).

25 In Exhibit 43-1-A, Bell Atlantic provides data on local switching revenue at the start of price cap regulation as requested in ¶ 43 of the Investigation Order. As explained above, because such data includes minutes of use demand growth for a time period when it had no impact on equal access cost recovery, it would be arbitrary to use such data in the calculation of the exogenous adjustment. Accordingly, the exhibit also provides data for just before the point in time that the Company's equal access rate was reduced to zero.

26 ***See*** Exhibit 43-1-B. AT&T's methodology is also internally inconsistent. AT&T bases its adjustment on the growth in revenues for local switching going back to the start of price cap regulation. Petition of AT&T Corp. on Price Cap LEC Tariff Filings at 11-12 (filed June 23, 1997). But prior to local transport restructure, the Traffic Sensitive Price Cap Basket that recovered the equal access costs also included local transport revenues, which grew at a much slower rate. By only including the fastest growing service in its calculation, AT&T methodology isn't even consistent with its own flawed arguments.

27 ***See*** Exhibit 43-1-B.

Respectfully submitted,

Edward Shakin

Edward D. Young, III
Michael E. Glover
Of Counsel

1320 North Court House Road
Eighth Floor
Arlington, VA 22201
(703) 974-4864

Attorney for the
Bell Atlantic Telephone Companies

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# DETAILED RESPONSES

# BELL ATLANTIC DIRECT CASE
# CC DOCKET No. 97-149

**Issue A: Common Line Issues**

**I) Actual and Projected BFP Revenue Requirements**

**Paragraph 16-1**

Submit actual BFP revenue requirements, computed using ARMIS data, for each calendar and tariff year between the 1991-92 tariff and calendar years and the 1996-97 tariff and calendar years, and projected BFP revenue requirements filed in each year's TRP for the same period.

**RESPONSE - Combined Company**

See Exhibits 16N-1-A and 16S-1-A for 1991 through 1996 actual calendar year BFP revenue requirements; Exhibits 16N-1-B and 16S-1-B for 1991/92 through 1996/97 actual tariff year BFP revenue requirements; and Exhibits 16N-1-C and 16S-1-C for 1991/92 through 1996/97 projected tariff year revenue requirements. The Company's actual BFP revenue requirements are based on ARMIS 43-01 data as required in paragraph 16 and Appendix B of the Commission's 1997 Annual Tariff Filing Designation Order.

**Paragraph 16-2**

Submit a list of any changes in its BFP revenue requirements caused by any revisions to the Commission's rules over this period.

**RESPONSE - Combined Company**

See Exhibits 16N-2 and 16S-2.

**Paragraph 16-3**

Submit documentation that explains in detail the methodology that each LEC used to compute its BFP revenue requirement projection for tariff year 1997-98.

**RESPONSE - Introduction**

The Company adjusted its BFP revenue requirement projection to reflect the impact of three Commission rule changes that became effective in 1997 - 1) deregulation of pay telephones; 2) Part 36 allocation of Other Billing & Collection (OB&C) Expense; and 3) Part 65 treatment of Account 4310, Other Long Term Liabilities. Following are explanations of how these adjustments were calculated.

Deregulation of Pay Phones:

Determining the impact of deregulation of pay telephones on the Company's BFP revenue requirement was a three step process. The first step was to calculate the 1996 pay telephone revenue requirements by using Bell Atlantic's ARMIS 43-04 reports. The payphone station investment subject to separations, per Part 32.2351 of the Commission's rules, was allocated to interstate based upon Part 36.142(a) of the Commission's rules, as reflected on ARMIS 43-04, row 1424, Col. D. Interstate pay telephone costs are displayed on Exhibits 16N-3-C and 16S-3-C.

The second step was to calculate the portion of the total pay telephone rate element revenue requirements relating to payphone station investment. This was done by identifying the type of operation (coin or telco operations) each plant item (COE, IOT, Cable & Wire. General support facilities were apportioned between coin and telco operations based on the combined distribution of COE, IOT, and Cable & Wire. The payphone station impact on expenses, reserves and taxes associated with the station investment was driven by plant distributions pursuant to Part 69 of the Commission's rules. The impact of these amounts are displayed on Exhibits 16N-3-C and 16S-3-C.

The third step was to calculate the loop portion of the pay telephone rate element revenue requirements. This step mirrors step 2, such that pay phone loop costs = total pay phone costs as filed in ARMIS - pay phone station costs developed in step 2. Pay phone loop costs are displayed on Exhibits 16N-3-C and 16S-3-C.

Total Common Line revenue requirement using ARMIS 43-04, Col. I, is also provided on Exhibit 16N-3-C and 16S-3-C . The amount of Long Term Support expense for 1996 was included with the total revenue requirements. The total common line revenue requirement is displayed on Exhibits 16N-3-C and 16S-3-C.

OB&C:
Effective 4/30/97, the Commission's Other Billing & Collection ("OB&C") Order required Bell Atlantic to allocate its OB&C expenses evenly among three types of services - exchange, intrastate toll and interstate toll.[1] Also, although the Commission's order did not revise its Part 69 rules for allocating OB&C expenses to access, it recognized that it is reasonable for carriers to use an allocation factor of five percent to cover the costs of billing the federal SLC.[2] These expenses are reported on row 7259 of the ARMIS 43-04 report.

Using 1996 ARMIS data, Bell Atlantic changed the allocator for OB&C expenses and allocated one-third of these expenses to interstate. Bell Atlantic then allocated these expenses in Part 69 so that the End user (Common Line) received five percent and Billing & Collection received twenty eight and one-third percent (the five percent allocation had no impact on Bell Atlantic - North, as the former NYNEX companies were already allocating five percent of OB&C expenses to common line).

1 Report and Order In the Matter of Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, FCC 97-30, ¶ 16 (rel. Feb. 3, 1997) ("OB&C Order").
2 OB&C Order at ¶ 17.

Although the Commission's rule change directly impacted only the Common Line and Billing & Collection categories in Part 69, all access categories are affected by the rule change. The change in interstate allocation of OB&C expense impacted the Big 3 Expense allocator which is used in Part 36 to apportion General Support Facilities and Corporate Operations expenses.

Account 4310

In its February 20, 1997 Report and Order in CC Docket No. 96-22, [3] the Commission required LECs to deduct accrued liabilities recorded in account 4310 from the rate base. In compliance with this order, Bell Atlantic restated its 1996 ARMIS data to reflect the impact of deducting account 4310 from the rate base. This account is allocated in Part 36 based on the distribution of corporate operations expenses (the account in which the expenses that give rise to the liability is recorded). These costs are allocated in Part 69 (Section 309) based on the Big 5 investment.

Prior to the Commission's order, Bell Atlantic - North and South treated the accrued SFAS 106 (OPEB) liability differently. Bell Atlantic - North deducted the liability from its rate base. While Bell Atlantic - South did not. As a result, the Commission order had significantly different impacts on the North and South.

**RESPONSE - Bell Atlantic - North**

The development of the Company's forecasted BFP revenue requirement was a five-step process: (1) calculate historical growth and apply it to 1996 BFP revenue components of expenses (less depreciation) and other taxes, depreciation, Federal Income Tax (FIT), and miscellaneous operating revenues and uncollectibles. (2) Add in amounts associated with Commission rule changes and the anticipated effects of planned new separations studies. (3) Calculate the BFP portion of Excess Deferred Taxes (EDT). (4) Calculate the BFP portion of Investment Tax Credit (ITC). (5) Add amounts from steps (3) and (4) to amounts from (1) and (2). These steps are explained in detail below.

**Step 1 COST GROWTH RATES**

In calculating its 1997/1998 BFP revenue requirement, the Company first multiplied 1996 BFP data times an 18 month subject to separations (STS) 1996 over 1995 growth rate. Data used for this purpose was obtained by annualizing 11 month amounts from the Interstate Separations and Access Charge System (ISAACS). This process was used for expenses (less depreciation) and other taxes, and ANI. Net return was calculated by multiplying 11.25% times the ANI forecast.

[3] See Report and Order, Responsible Accounting Officer Letter 20, Uniform Accounting for Postretirement Benefits Other Than Pensions in Part 32, AAD 92-65; and Amendments to Part 65, Interstate Rate of Return Prescription Procedures and Methodologies, Subpart G, Rate Base, CC Docket No. 96-22 (released Feb. 20, 1997).

In calculating FIT, the FIT components of fixed charges, ITC amortization, IRS income adjustment were forecasted using BFP growth rates. Additionally, BFP growth rates were also used for miscellaneous operating revenues and uncollectables.

Depreciation expense was forecasted by taking the ratio of the 1997 interstate company budget to the 1996 11 month annualized interstate amount and multiplying by the 1997 budget, which produced the 1998 interstate forecast. The 1997/1998 projection was calculating by taking the average of the 1997 and 1998 forecasts. The ratio of 1996 11 month annualized BFP depreciation expense to interstate expense was multiplied by the 1997/1998 interstate projection to produce the 1997/1998 BFP depreciation expense forecast.

The above calculations are provided in Exhibit 16N-3-A and 16N-3-B.

**Step 2 RESTATEMENT OF PRIOR PERIOD COSTS**

The second step was to add in revenue requirement component amounts for the anticipated effects of planned separations studies and Commission rule changes. These rule changes include: (1) inclusion of public pay phone line revenue requirements;(2) new Part 36 separations procedures applicable to Other Billing and Collecting (OB&C) expense; and (3) rate base adjustments associated with accrued liabilities recorded in Account 4310, Other Long Term Liabilities. Bell Atlantic - North did not add in amounts for OB&C because as shown in Exhibit 16N-3-E, the CL-BFP portion of OB&C for the test period was $.7M which would not have changed the projected SLC rate. The Company also did not have cost changes related to rate base adjustments in Account 4310, as Bell Atlantic - North voluntarily deducted these amounts from its rate base in 1996, the base period for its 1997/98 BFP forecast.

These calculations are provided in Exhibits 16N-3-C and 16N-3-D.

**Step 3 PROJECTED BFP REVENUE REQUIREMENT**

The third step was to adjust the prior period costs for the expected growth during the test period. To do this, the restated 1996 costs described in Step 2 were multiplied by the growth rates developed in Step 1. The results provided the preliminary projected BFP revenue requirements adjusted for the impact of public pay phone and overall growth. These results are calculated in Exhibit 16N-3-A.

**Step 4 EXCESS DEFERRED TAX IMPACT**

The fourth step was to estimate the impact of the excess deferred tax (EDT) changes from the prior period to the test period. The calculation of EDT changes included in Bell Atlantic - North's 1997 Annual Tariff Filing are provided in Exhibit 16N-3, column F of

EXG-1. The estimated impact of EDT changes on the BFP costs was determined by multiplying the impact on Common Line by the ratio of BFP TPIS to total Common Line TPIS, using 11 month annualized data.

**Step 5 INVESTMENT TAX CREDIT IMPACT**

The fifth step was to estimate the impact of the investment tax credit (ITC) amortization changes from the prior period to the test period. The calculation of ITC amortization changes included in Bell Atlantic - North's 1997 Annual Tariff Filing are provided in Exhibit 16N-3, column G of EXG-1. The estimated impact of ITC changes on the BFP costs was determined by multiplying the Common Line impact by the ratio of BFP TPIS to total Common Line TPIS, using 11 month annualized data.

**Step 6 PROJECTED BFP REVENUE REQUIREMENTS FOR THE TEST PERIOD**

The sixth and final step in determining the projected BFP revenue requirements for the test period was to adjust the preliminary projected BFP revenue requirements -- which already include the impact of cost changes associated with public pay phones, separations study changes, and overall growth (see Step 3) -- for the impact of EDT (Step 4), and the impact of ITC amortization (Step 5). The final projected BFP revenue requirements for the test period are calculated in Exhibit 16N-3-A

**RESPONSE - Bell Atlantic - South**

The development of the Bell Atlantic - South's most recent annual forecasted BFP revenue requirements was a six-step process: (1) Determine total company cost growth rates for total operating expenses and average net investment; (2) Restate prior period BFP costs for separations and other Commission rule changes; (3) Develop preliminary BFP costs projections by applying growth rates computed in Step 1 to the restated base period costs calculated in Step 2, including rule changes; (4) Determine the impact of Excess Deferred Tax (EDT) changes on BFP costs; (5) Determine the impact of Investment Tax Credit (ITC) amortization changes on BFP costs; and (6) Determine the projected BFP revenue requirements for the test period, including the amounts calculated in the first three steps. These steps are explained in detail below.

**Step 1 COST GROWTH RATES**

The first step in developing the forecasted BFP revenue requirements was to determine the expected growth rates in BFP costs. In estimating these growth rates, the Company assumed the growth in BFP costs would be consistent with the current growth in total company unseparated costs. Bell Atlantic estimated that the growth rates for BFP operating expenses, telephone plant in service, and total reserves would follow the historic 1995 to 1996 total company (subject-to-separations) growth rates. The annual growth rates were calculated by using data from column f, rows 1190 (total operating expenses), 1690 (total plant-in-service), and 1890 (total reserves) of the ARMIS 43-01 Reports. The Subject to Separations amounts for the relevant cost items for 1995 were subtracted from the 1996 amounts. These differences were then divided by the 1995 amounts to determine the annual growth rates. The annual (12 month) growth rates were then grossed-up for an 18 month period to reflect the difference in time between the base period (1996) and the tariff period (1997/98). To determine the 18-month growth rates, the annual growth rates were multiplied by 18 and then divided by 12. The calculation of the growth rates is provided in Exhibit 16S-3,[4] Work papers 8-9A-1 through 8-9H-1.

**Step 2 RESTATEMENT OF PRIOR PERIOD COSTS**

The second step was to restate the prior period costs for separations and other Commission rule changes. These changes include: (1) inclusion of public pay phone line revenue requirements; (2) new Part 36 separation procedures applicable to Other Billing and Collecting (OB&C) expense[5] and (3) rate base adjustments associated with accrued liabilities recorded in Account 4310, Other Long Term Liabilities. The prior period costs (displayed on workpapers 8-9A-2 through 8-9H-2 of Exhibit 16-3) were restated using Bell Atlantic's 1996 ARMIS 43-01 and 43-04 data as the base year. The revenue requirement impacts of the three changes (as itemized on Exhibit 16S-3-A) was then overlaid on the base year. Workpapers 8-9A-3 through 8-9H-3 of Exhibit 16S-3 display the restatement of the 1996 BFP costs.

**Step 3 PROJECTED BFP REVENUE REQUIREMENT**

The third step was to adjust the prior period costs for the expected growth during the test period. To do this, the restated 1996 costs described in subsection Step 2 were multiplied by the growth rates developed in Step 1. The results provided the preliminary projected BFP revenue requirements adjusted for the impact of public pay phone, OB&C expense, other long term liabilities, and overall growth. These results are calculated in Work papers 8-9A-4 through 8-9H-4 of Exhibit 16-3.

**Step 4 EXCESS DEFERRED TAX IMPACT**

The fourth step was to estimate the impact of the EDT changes from the prior period to the test period. The calculation of EDT changes included in Bell Atlantic's 1997 Annual Tariff Filing are provided in Exhibit 16-3, column F of EXG-1. The estimated impact of EDT changes on the BFP costs was determined by multiplying the impact on Common Line by the ratio of BFP Average Net Investment to total Common Line Average Net

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4 Exhibit 16S-3 consists of work papers excerpted from Bell Atlantic - South's 1997 Annual Price Cap Tariff Filing.

5 See Report and Order, Amendment of Part 36 of The Commission's Rules and Establishment of a Joint Board, CC Docket No. 80-286 (released Feb. 3, 1997).

6 See Report and Order, Responsible Accounting Officer Letter 20, Uniform Accounting for Postretirement Benefits Other Than Pensions in Part 32, AAD 92-65; and Amendments to Part 65, Interstate Rate of Return Prescription Procedures and Methodologies, Subpart G, Rate Base, CC Docket No. 96-22 (released Feb. 20, 1997).

Investment, as reported on Bell Atlantic's 1996 ARMIS 43-01 reports. The EDT impact on BFP is calculated on Work papers 8-9A-5 through 8-9H-5 of Exhibit 16S-3.

**Step 5 INVESTMENT TAX CREDIT IMPACT**

The fifth step was to estimate the impact of the ITC amortization changes from the prior period to the test period. The calculation of ITC amortization changes included in Bell Atlantic's 1997 Annual Tariff Filing are provided in Exhibit 16S-3, column G of EXG-1. The estimated impact of ITC changes on the BFP costs was determined by multiplying the Common Line impact by the ratio of BFP Average Net Investment to total Common Line Average Net Investment, as reported on Bell Atlantic's 1996 ARMIS 43-01 reports. The ITC amortization impact on BFP is calculated in Work papers 8-9A-6 through 8-9H-6 of Exhibit 16S-3.

**Step 6 PROJECTED BFP REVENUE REQUIREMENTS FOR THE TEST PERIOD**

The sixth and final step in determining the projected BFP revenue requirements for the test period was to adjust the preliminary projected BFP revenue requirements -- which already include the impact of cost changes associated with public pay phones, OB&C expense, other long term liabilities, and overall growth (see Step 3) -- for the impact of EDT (Step 4), and the impact of ITC amortization (Step 5). The final projected BFP revenue requirements for the test period are calculated in Work papers 8-9A-7 through 8-9H-7 of Exhibit 16S-3.

**Paragraph 17-1**

Explain fully any significant differences between each annual BFP revenue requirement projection and the LECs' actual BFP revenue requirement.

**RESPONSE - Bell Atlantic - North**

Exhibit 17N-1-A compares actual and projected BFP revenue requirements for the 1991/92 through 1996/97 tariff periods.

Bell Atlantic - North's 1992/1993 actuals BFP revenue requirement[7] was $1,013M and its projection was $914M. The underforecast of $99M was caused by underforecasts in expenses and other taxes, depreciation, and net return. The Company adjusted its revenue requirement forecast by the anticipated effects of exogenous adjustments, workforce reduction plans, the completion of inside wire amortizations in Massachusetts and Rhode Island on December 31, 1992. In addition, the 1992/1993 actuals include approximately $24.7M for the New York State Gross Income Tax (GIT), which is a gross receipts tax that the Company does not include in EUCL rate development. The GIT is recovered as a

7 Tariff year actuals are the sum of July through December and January through June ARMIS 43-01 results.

surcharge on rates. This tax does not impact reported net income; the Company is merely acting as an agent on behalf of the state of New York (i.e., the tax impacts expenses and revenues equally).

Bell Atlantic - North's 1993/1994 actuals were $1,237M and its projection was $1,038M. The underforecast of $200M was caused by an underforecast in expenses and other taxes. For its forecast The Company used its STS growth from 1991 to 1992, which did not reflect certain one time events such as costs relating to the special pension enhancement booked in the second quarter of 1994. In addition, the 1993/1994 actuals include approximately $28.7M for the New York State GIT which the Company does not include in EUCL rate development.

Bell Atlantic - North's 1994/1995 actuals were $1,273M and its projection was $1,174M. The underforecast of $99M was caused by an underforecast in expenses and other taxes. For its forecast the Company used its STS growth rate from 1992 to 1993, which did not capture the full effect of cost increases in 1994/1995. The main reason for this is that the Company began a special pension enhancement offer in mid-1994 which continued in 1995, and increased expenses in the 1994/1995 time frame. The special pension enhancement expenses during that period were $83M. Absent these amounts, the disparity was $16M. In addition, the 1994/1995 actuals include approximately $29.7M for the New York State GIT which the Company does not include in EUCL rate development.

Bell Atlantic - North's 1995/1996 actual BFP revenue requirement was $1,378M and its projection was $1,211M. The underforecast of $167M was caused mainly by an underforecast in expenses and other taxes. For its forecast, the Company used its growth rate for STS expenses and taxes from 1993 to 1994 and then it reduced its forecast by $70M for a reduced number of employees as a result of the Company's expense reduction plans. This period also included $59M in one-time nonrecurring special pension enhancement expenses and $106M in contingent liabilities. In addition, the 1995/1996 actuals include approximately ($1.3M), which includes a refund back to 7/96, for the New York State GIT which the Company does not include in EUCL rate development.

Bell Atlantic - North's 1996/1997 actual BFP revenue requirement was $1,191M and its projection was $1,243M. The overforecast of $52M was caused mainly by an overforecast of the Company's rate base and net return. For its forecast, the Company used the change in rate base from 1994 to 1995. This resulted in a small forecasted decrease in rate base which did not fully reflect the much larger change in rate base that occurred from 1995 to 1996. In addition, the 1996/1997 actuals include approximately $9.2M for the New York State GIT which the Company does not include in EUCL rate development.

**RESPONSE - Bell Atlantic - South**

The Commission defines significant difference as "...a projected percentage change that is greater or less than 10 percent of the percentage change actually realized."[8] Under this stringent definition, the Company's projected BFP revenue requirement was "significantly" different than its actual BFP revenue requirement in each tariff period. The FCC's definition belies the fact that for every year Bell Atlantic - South's projection of BFP revenue requirement was within 4.0% of actual BFP revenue requirement.

Exhibit 17S-1-A compares actual and projected BFP revenue requirements for the 1991/92 through 1996/97 tariff periods. In the 1992/93 tariff period, the Company's actual BFP revenue requirement was $942,392K compared to a projection of $915,634K. The $26.7M overrun in revenue requirement was driven by higher than anticipated expenses due to one-time retirement incentive offers in fourth quarter 1992 that totaled approximately $83.3M on a total company basis.

During the 1993/94 tariff period, the Company's actual BFP revenue requirement was $1,111,974K compared to its projected BFP revenue requirement of $1,135,171K. As displayed on attachment 17S-1-B, this $18.9M revenue requirement underrun is due to lower than forecasted telephone plant in service coupled with higher than forecasted reserves. In both cases, the Company's forecast differed from actuals by only 2%. The Company's records are not sufficiently detailed to specifically identify primary contributing factors to the 2% variances.

During the 1994/95 tariff period, Bell Atlantic - South's actual BFP revenue requirement was $1,204,652K compared to its projected BFP revenue requirement of $1,159,884. As displayed on attachment 17S-1-B, this $44.8M revenue requirement overrun is due to higher than forecasted BFP operating expenses and telephone plant in service.

Bell Atlantic - South's actual BFP revenue requirement of $1,235,126K during the 1995/96 tariff period underran the $1,259,843K projection by $24.7M. As displayed on Exhibit 17S-1-B, this variance is due to a combination of an overforecast of telephone plant and an underforecast of reserves.

In its forecast, the Company assumed its reserves would be consistent with 1994 levels, as 1994 reserves were artificially inflated due to the inclusion of accrued OPEB liabilities.[9]

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8 1997 Annual Tariff Investigation Designation Order at par. 17.

9 RAO Letter #20, released May 4, 1992, required LECs to deduct unfunded OPEB amounts from the rate base. Effective 7/1/93, coincident with its exogenous SFAS 106 rate increases, Bell Atlantic began deducting this liability from the rate base. The impact of unfunded OPEB amounts are reflected on the rate base as filed in the Company's 1993 and 1994 Form 492A reports, filed on 3/31/95, as well as the Company's 1994 ARMIS 43-01 report filed the same day. Consistent with the Commission's order that rescinded the rate base treatment portion of RAO 20, the Company ceased deducting unfunded OPEB amounts from the rate base effective 7/1/93 and refiled its 1993 and 1994 Form 492A reports (3/29/96) to reflect the Commission's order.

Therefore, use of 1994 over 1993 growth in reserves would have overstated 1995/96 reserve levels, possible resulting in an underforecast of BFP revenue requirement for the period.

During the 1996/97 tariff period, Bell Atlantic - South's actual BFP revenue requirement was $1,293,245K compared to its projected BFP revenue requirement of $1,304,709, reflecting an underrun in revenue requirement of $11.5M (or .89%). This underrun is due to higher BFP reserve levels.

**Paragraph 17-2**

Explain fully any patterns of significant and consistent over- or under-estimation of the BFP revenue requirements.

**RESPONSE - Introduction**

While there have been differences between actual BFP revenue requirements and forecasted BFP revenue requirements, these differences have been small in recent years. As displayed on Exhibit 17-1-C, the difference between the total projected BFP and the actual was only 2.6% for the combined company. Moreover, the Company's continued reliance on year-over-year growth produces forecasts that are self-correcting over time, ensuring that trends that may underlie actual results are captured in the forecast.

**RESPONSE - Bell Atlantic - North**

A comparison of the forecasted versus actual BFP revenue requirements from the 1991/1992 to the 1995/1996 tariff years shows the forecasts to be under the actuals, largely due to overruns in expenses and other taxes. A major contributing factor to the underforecasts was significant increases in actual operating expenses due to force reduction and service improvement initiatives. Additionally in some years, such as 1995, other one time expenses contributed to the underforecast.

In Bell Atlantic North, since 1991 approximately 25,000 employees have left the company under work force reduction and pension enhancement programs. These programs included expense accruals for downsizing costs and costs for special pension enhancements that totaled approximately $70 million in 1991 and ranged from $111 million to $42 million between 1994 and 1996 for the Base Factor Portion of Common Line.

In the tariff filing process, the BFP forecasts were developed in February of each year, and information on expected work force plans for the projected tariff period were often not available, or preliminary, creating more potential variability around meeting the actual expense target in the projected tariff period. The projections were subject to variability around both the restructuring or special pension enhancement expense associated with the plan, as well as how close expected expense savings due to workforce reductions were to actual expense savings.

Additionally, in 1996 Bell Atlantic - North began a program to add 1,000 employees to meet service improvement initiatives. These initiatives, many of which involved significant one time costs, were a major contributing factor to the differences between actual revenue requirements and forecasts.

**RESPONSE - Bell Atlantic - South**

As explained in the Company's response to paragraph 16-3, the Company's BFP forecast is based on growth in cost during the base period compared to the prior period, with adjustments for known events and Commission rule changes. As unanticipated events arise during the course of the tariff period, actual BFP revenue requirements are impacted; however, the Company's forecast remains unchanged. Notwithstanding these events (detailed in the Company's response to paragraph 17-1), the Company's forecasts of BFP revenue requirement have been close to actuals. Moreover, the Company never consistently over- or under-projected BFP revenue requirements.

**II) Adjusted BFP Revenue Requirements**

**Paragraph 19-1**

Develop calendar year BFP revenue requirement series that are adjusted for the effect that changes in Commission rules had on actual BFP revenue requirements.

**RESPONSE - Combined Company**

See Exhibits 22N-2-A through 22N-2-F and 22S-2-A through 22S-2-F.

**Paragraph 19-2**

Each price cap LEC must submit an itemized list of each change in Commission rules that affected BFP revenue requirements, including (a) the date each change became effective and its impact on the BFP revenue requirement for the calendar year in which the changed rule became effective; and (b) the actual BFP revenue requirements, adjusted for all such changes in Commission rules for calendar years 1991-96.

**RESPONSE - Combined Company**

See Exhibits 16N-2 and 16S-2 for an itemized list of each change in Commission rules that affected BFP revenue requirement; the date each change became effective; and the impact on the BFP revenue requirement for the calendar year in which the changed rule became effective.

See Exhibits 22N-2-A through 22N-2-F and 22S-2-A through 22S-2-F for the Company's 1991-96 actual BFP revenue requirements adjusted for changes in Commission rules.

**Paragraph 20-1**

For each change in the Commission's rules that became effective on or before December 31, 1996, and that affected the LECs' BFP revenue requirement, we require each LEC to identify the change, state its effective date and calculate the effect, in dollars, that the change had on its BFP revenue requirement.

**RESPONSE - Combined Company**

See Exhibits 16N-2 and 16S-2.

**Paragraph 20-2**

We also require the LEC to calculate the effect that each rule change would have had on BFP revenue requirements in previous years, back to 1991, had the revised rule then been in effect.

**RESPONSE - Combined Company**

See Exhibits 22N-2-A through 22N-2-F and 22S-2-A through 22S-2-F.

**Paragraph 20-3**

For changes that became effective after December 31, 1996, LECs must submit data that show the effect, in dollars, that these changes had on projected BFP revenue requirements prepared for their annual access tariff revisions filed to become effective July 1, 1997.

**RESPONSE - Combined Company**

As explained in the Company's response to paragraph 16-3, the BFP revenue requirements included in the Company's 1997 Annual Access Tariff filing include adjustments for three Commission rule changes that became effective in 1997 - (1) inclusion of public pay phone line revenue requirements; (2) new Part 36 separation procedures applicable to Other Billing and Collecting (OB&C) expense and (3) rate base adjustments associated with accrued liabilities recorded in Account 4310, Other Long-Term Liabilities. See Exhibits 16N-3-A and 16S-3-A for the effect these changes had on projected BFP revenue requirements.