

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554

In the Matter of

Stale or Moot Docketed Proceedings

1993 Annual Access Tariff Filings  
Phase I

CC Docket No. 93-193

1994 Annual Access Tariff Filings

CC Docket No. 94-65

AT&T Communications Tariff F.C.C.  
Nos. 1 and 2, Transmittal Nos. 5460, 5461,  
5462, and 5464 Phase II

CC Docket No. 93-193

Bell Atlantic Telephone Companies Tariff  
FCC No. 1, Transmittal No. 690

CC Docket No. 94-157

NYNEX Telephone Companies Tariff  
FCC No. 1, Transmittal No. 328

**Direct Case of Verizon  
April 11, 2003**

**EXHIBIT F**

**NYNEX Rebuttal  
filed Sept. 28, 1995**

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

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY

In the Matter of	)	
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1993 Annual Access Tariff Filings	)	CC Docket No. 93-193, Phase I
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NYNEX Telephone Companies	)	CC Docket No. 94-157
Tariff F.C.C. No. 1, Transmittal No. 328	)	

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**NYNEX REBUTTAL**

The NYNEX Telephone Companies<sup>1</sup> (NYNEX) submit this Rebuttal in response to MCI Telecommunications Corporation's (MCI's) September 13, 1995 Opposition to Direct Cases filed August 14, 1995 by NYNEX and other price cap LECs in the above-captioned matter.

**I. INTRODUCTION**

MCI is the only party to oppose NYNEX's request for exogenous treatment of additional costs of other postretirement employee benefits (OPEBs) incurred as a result of implementing Statement of Financial Accounting Standards No. 106 (SFAS-106). MCI fails to detract from our showing in the Direct Case that the OPEB tariffs under investigation are fully justified, satisfy the applicable standard for exogenous treatment

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<sup>1</sup> The NYNEX Telephone Companies are New England Telephone and Telegraph Company and New York Telephone Company.

and should be made permanent. MCI merely argues that the price cap LECs have submitted no new evidence, and that our evidence on the GNP-PI<sup>2</sup> double-counting issue (including the Godwins Study) was previously found to be inadequate by the Commission. MCI's arguments are totally without merit. MCI relies upon an OPEB Order<sup>3</sup> reversed by the U.S. Court of Appeals for the D.C. Circuit<sup>4</sup> and vacated by the FCC itself.<sup>5</sup> The Court found the OPEB Order's criticisms of the Godwins Study to be wanting, and Godwins fully responded to the FCC's prior concerns in any case. The Godwins Study continues to be fully valid and very conservative in demonstrating that approximately 84.8% of the NYNEX Telephone Companies' additional costs from the SFAS-106 accounting change would not be captured in the GNP-PI or recovered through a reduction in the national wage rate.

**II. MCI HAS FAILED TO EFFECTIVELY DISPUTE NYNEX'S JUSTIFICATION OF EXOGENOUS TREATMENT OF ADDITIONAL OPEB COSTS FROM SFAS-106**

NYNEX's Direct Case fully responded to the various issues designated for investigation in this matter.<sup>6</sup> We satisfied the standard for exogenous treatment expressed in the Court's OPEB Decision by showing that first, NYNEX's OPEB costs underlying the tariffs under investigation have been incurred as a result of the mandated SFAS-106

<sup>2</sup> The Commission recently began using GDP-PI instead of GNP-PI for calculating price cap indices. See Order Designating Issues For Investigation released June 30, 1995, by Chief, FCC Common Carrier Bureau (Designation Order) at n. 35.

<sup>3</sup> Treatment of LEC Tariffs Implementing SFAS-106, CC Docket No. 92-101, 8 FCC Rcd. 1024 (1993).

<sup>4</sup> Southwestern Bell Tel. Co. v. FCC, 28 F.3d 165 (1994) (OPEB Decision).

<sup>5</sup> CC Docket No. 92-101, FCC 95-219, Memorandum Opinion and Order released July 3, 1995.

<sup>6</sup> See Designation Order.

accounting change, over which NYNEX lacked control; and, second, as demonstrated by the Godwins Study, those costs have not been double-counted in the GNP-PI element of the price cap formula and, as a further conservative step, have been shown not to have been recovered through a suppression of wages. Furthermore, we demonstrated that we correctly, reasonably and justifiably calculated the OPEB costs subject to exogenous treatment.

In response, only one party, MCI, opposes NYNEX's Direct Case. MCI's Opposition is totally devoid of merit, as discussed below. Given such limited opposition and the multiple, detailed OPEB proceedings conducted by the Commission over the past 3½ years, the time has finally come to put this matter to rest and approve the exogenous treatment of OPEB costs reflected in the tariffs under investigation herein.

MCI asserts that the Direct Cases provide no new evidence but merely restate arguments previously found by the Commission to be inadequate.<sup>7</sup> MCI criticizes price cap LECs' continued reliance on the Godwins Study, arguing that the Commission previously found the following faults with that Study:<sup>8</sup>

- the Study yielded extremely wide ranging results of GNP-PI effects, depending upon the selection of assumptions chosen for certain key parameters;
- the Godwins and NERA Studies<sup>9</sup> have diametrically opposed assumptions which are unsupported by evidence and are unverifiable.

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<sup>7</sup> MCI at p. 2.

<sup>8</sup> MCI at pp. 2-5

<sup>9</sup> See Designation Order at ¶ 13 & n. 28.

MCI concludes that the choice of the correct GNP-PI double-count value is nothing more than a random and indiscriminate exercise.<sup>10</sup>

MCI's assertions should be summarily rejected for the following reasons. First, MCI's reliance on the Commission's January 1993 OPEB Order is unavailing. That Order denied price cap LECs exogenous treatment of OPEB costs, and criticized the Godwins Study. However, the FCC has vacated that Order. Second, the D.C. Circuit in its OPEB Decision reversed and remanded the OPEB Order.<sup>11</sup> Importantly, the Court firmly and explicitly rejected the same criticisms of the Godwins Study that MCI attempts to resurrect here. The Court not only faulted the FCC for "imposing impossible burdens as to GNP-PI double-counting"; the Court went on to suggest that the LECs' evidence on the double-counting issue was reasonable.<sup>12</sup>

The Court observed that any analysis of whether an exogenous change will be reflected in GNP-PI will involve some unproven, and likely unprovable, assumptions, but: "[t]o reject such a study, the Commission must at least express a reason for doubting some critical assumption."<sup>13</sup> MCI has utterly failed to refute Godwins' assumptions.

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<sup>10</sup> MCI at p. 5.

<sup>11</sup> MCI states that the Designation Order requested further submissions because the LECs' previous comments were "deficient". MCI at p. 6. MCI is wrong. The Bureau indicated the Designation Order was in response to the D.C. Circuit's remand. Designation Order at ¶ 8. The Bureau acknowledged it was seeking some of the same type of cost information as in prior OPEB proceedings. Id. at ¶ 15.

<sup>12</sup> 28 F.3d at 171-73.

<sup>13</sup> Id. at 172.

Furthermore, the Court found “illogical” the Commission’s criticism of the price cap LECs for presenting two studies (Godwins and NERA) that began with different assumptions:

Given the difficulty of verifying the assumptions that must underlie any such analysis, it was natural for the LECs to cover a range of possibilities. 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.<sup>14</sup> [Emphasis added.]

The Court went on to find “[e]qually troubling the Commission’s pointing to the number of ‘parameters’ for which the Godwins study suggested ranges of possible values...”<sup>15</sup>

Third, in any case, Godwins in its supplemental submissions fully responded to the FCC’s concerns. Indeed, in a previous Designation Order in Docket 93-193, the Bureau found that “[t]he record concerning double-counting in the GNP-PI has been enhanced by a second Godwins Study”<sup>16</sup> The additional Godwins evidence submitted by NYNEX showed:

- Godwins’ “best estimate” was that only 0.3% of SFAS-106 incremental costs are reflected in GNP-PI and 12.3% might eventually be recovered by a reduction in the wage rate and other macroeconomic adjustments, leaving more than 87.3% of the costs unrecovered.
- Godwins used conservative assumptions at every juncture (overstating recovery in GNP-PI), e.g. baseline value of price elasticity of demand, labor supply elasticity, direct impact of SFAS-106 on labor costs, etc.
- The Godwins estimate was built upon a sound foundation composed of actuarial and macroeconomic analyses

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<sup>14</sup> Id.

<sup>15</sup> Id.

<sup>16</sup> DA 93-762, released June 23, 1993, ¶ 29.

- Godwins performed a sensitivity analysis of 648 scenarios posed by the Commission Staff. This analysis showed that even under a "worst case" scenario, involving implausible parameters, the majority of SFAS-106 incremental costs are not recovered absent exogenous treatment. The sensitivity analysis thus confirmed the original Study's conclusions.
- Even though on a superficial level the Godwins and NERA studies appeared inconsistent in their assumptions, they both corroborated the same result: only a small piece of SFAS-106 additional costs will be in GNP-PI.
- The Godwins results were confirmed when tested under an illustrative example using NERA's assumptions.

Further, NYNEX's August 14, 1995 Direct Case in this matter provided a new affidavit from Mr. Peter Neuwirth and Mr. Andrew Abel, original co-authors of the Godwins Study, summarizing and placing into perspective the Godwins demonstrations. That affidavit showed 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 the original Godwins Study. Additionally, attached to the present NYNEX Rebuttal is an affidavit from Mr. Neuwirth and Mr. Abel detailing the infirmities of MCI's Opposition. Among other things, that affidavit shows that 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. Overall, the Godwins Study remains very conservative and reasonable.<sup>17</sup>

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<sup>17</sup> It is noteworthy that AT&T's direct case in this matter, in addressing AT&T's request for exogenous treatment of its own OPEB costs, contains no GNP-PI double-count offset adjustment. The FCC should not treat price cap LECs any more strictly than AT&T in regard to this common issue.

Finally, MCI offers the makeweight argument that some of the assumptions on which price cap LECs' calculations were based "appear suspect" by reflecting "overly generous programs."<sup>18</sup> MCI's argument should be rejected since the D.C. Circuit already ruled that exogenous treatment of SFAS-106 OPEB costs cannot be denied on the view that the carrier could "control" the underlying benefit expense.<sup>19</sup> In any event, NYNEX's request for exogenous treatment has been based on conservative and reasonable assumptions throughout and MCI fails to provide any evidence showing otherwise.

**III. CONCLUSION**

The Commission should reject MCI's Opposition and approve the exogenous treatment of NYNEX's SFAS-106 OPEB costs in the tariffs under investigation herein.

Respectfully submitted,

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Telegraph Company

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Their Attorney

Dated: September 28, 1995

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<sup>18</sup> MCI at p. 6. MCI does not attack any assumptions by NYNEX.

<sup>19</sup> OPEB Decision, 28 F 3d at 168-70.

## ***Supplemental Report***

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

September 28, 1995

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## 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.

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## 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

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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.

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## 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<sup>1</sup>. As we have emphasized elsewhere,<sup>2</sup> 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<sup>3</sup>. As explained elsewhere, large-scale econometric models fail to satisfy two of these criteria<sup>4</sup>, 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,"<sup>5</sup> we will revisit the issue of model design from a fresh perspective.

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<sup>1</sup> MCI, p. 5

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

<sup>3</sup> Analysis of Impact of FAS 106 Costs on GNP-PI, February 1992, pp. 26-27.

<sup>4</sup> Response to Paragraph 16 of FCC Order of Investigation and Suspension, May 26, 1992, pp. 1-2.

<sup>5</sup> MCI, p. 4

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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,<sup>6</sup> 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<sup>7</sup>.

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

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<sup>6</sup> Analysis of Impact of FAS Costs on GNP-PI, February 1992, p. 30.

<sup>7</sup> 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.

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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*.<sup>8</sup> 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.<sup>9</sup> 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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<sup>8</sup> 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.

<sup>9</sup> 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.

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## The Role of Sensitivity Analysis

In addition to comparing the best estimate and baseline results, we have performed extensive sensitivity analyses.<sup>10</sup> Our August 14, 1995 report<sup>11</sup> 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".<sup>12</sup> 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<sup>13</sup>. 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

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<sup>10</sup> Our original report contains a sensitivity analysis, and the March 1993 Supplemental Report contains a much more extensive sensitivity analysis.

<sup>11</sup> "Perspectives on Analysis of Impact of SFAS 106 on GNP-PI".

<sup>12</sup> MCI, p. 3

<sup>13</sup> MCI, pp. 3-4

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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<sup>14</sup> 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.

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<sup>14</sup> Analysis of Impact of FAS Costs on GNP-PI, Supplemental Report: Additional Sensitivity Analysis, March 1993, pp. 3-5.

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## 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.

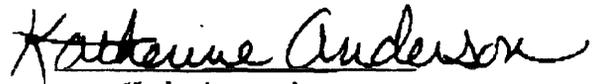
Our original report was designed to answer a "what-if" question: How much different would the GNP-PI have been if SFAS 106 were never adopted? As explained in our original report, the choice of a model was thoughtfully and deliberately based on a set of desirable criteria for a quantitative macroeconomic 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 certify that copies of the foregoing NYNEX REBUTTAL were served on the parties listed on the attached service list, this 28th day of September, 1995, by first class United States mail, postage prepaid.

  
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