Joseph Mulieri
Vice President
Federal Regulatory Advocacy

1515 N. Court House Road
5th Floor
Arlington, VA 22201

703 351-3096
703 351-3652 fax

April 27, 2004

Ex Parte

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, D.C. 20554

Re: Verizon Telephone Companies Petition For Reconsideration, "In the Matter of Stale or Moot Docketed Proceedings", CC Docket Nos. 93-193, 94-65 and 94-157

Dear Ms. Dortch:

On April 26, 2004, on behalf of Verizon, Ed Shakin, Joe Dibella, Fred Moacdieh, Susanne Guyer, and the undersigned met with William Maher, Tamara Preiss, Deena Shetler, Jane Jackson, and Margaret Dailey of the Wireline Competition Bureau to discuss the above captioned proceeding. The meeting addressed all of the pending issues in this proceeding with the attached presentation used during the discussion.

Please do not hesitate to contact me with any questions.

Sincerely,

/s/Joseph Mulieri

Attachments

cc: W. Maher
T. Preiss
D. Shetler
J. Jackson
M. Dailey

April 26, 2004

RAO 20

RAO 20 – CRITICAL EVENTS

5/92	→	93-95	→	1996	→	1996	→	1997
RAO 20 Issued		Followed RAO 20		RAO Rescinded		Tariffs Filed and Investigated		FCC Completes RAO Rulemaking

Prior to 1997 The Commission's Rate Base Rules Did Not Deduct OPEB Liabilities

- Prior to 1997, the Commission's Part 65 rules left no discretion for the LECs to deduct OPEB liabilities from the interstate regulated rate base for purposes of calculating earnings.
- § 65.800 of the Commission's rules stated that the rate base shall consist of the accounts in § 65.820 minus deductions computed in accordance with §65.830.
- The Commission addressed this issue twice, finding that prior to 1997 § 65.830 did not permit accrued OPEB liabilities to be deducted from the rate base.
- In 1997, the Commission changed § 65.830 on a going-forward basis only to deduct OPEB liabilities from the rate base.

verizon

RAO 20 Order and Rescission

- On May 4, 1992, the Common Carrier Bureau issued RAO 20, which required the LECs to deduct accrued OPEB liabilities from their regulated interstate rate base despite the fact that § 65.830 did not address OPEB liabilities. This reduced the average net investment in the LECs' rate of return calculations and therefore increased their reported rates of return, resulting in increased sharing obligations.
- In 1996, the Commission reversed RAO 20 insofar as it applied to the rate base treatment of OPEB liabilities. The Commission stated that "Under our current Part 65 rules, unfunded accrued pension costs recorded in Account 4310 are removed from the rate base, although other items recorded in Account 4310, such as accrued OPEB liabilities, are not removed from the rate base." *RAO 20 Rescission Order,* ¶ 32.
- The Commission found that RAO 20 exceeded the scope of the Bureau's delegated authority to explain and interpret the accounting rules. The Commission stated that "Sections 65.820 and 65.830 of our rules define those items to be included, or excluded from, the interstate rate base. The Bureau cannot properly address any additional exclusions in an RAO letter, which under section 32.17 of our rules must be limited to explanation, interpretation, and resolution of accounting matters." *RAO 20 Rescission Order,* ¶ 25.
- In 1997, the Commission found that even the Commission itself could not "interpret" § 65.830 to apply to OPEB liabilities; "We are not persuaded by MCI's argument that the Commission can amend Part 65 through an interpretation . . . ." *RAO 20 Order,* 12 FCC Rcd 2321, ¶ 28. It initiated a notice of proposed rulemaking to consider amending the rate base rules with regard to OPEB liabilities on a going-forward basis.

verizon

1996 Annual Access Filings And Subsequent Commission Action

- In response to the *RAO 20 Rescission Order* and as required then by § 65.830(a), the LECs adjusted their reported earnings for 1993 to 1995 to reverse the OPEB deductions that had been made under the RAO 20 letter. *1996 Annual Access Tariff Filings, 11 FCC Rcd 7564 (1996), ¶ 19.*
- This increased the LECs' rate base and reduced their interstate rate of return and their sharing obligations under the price cap rules. In their 1996 annual access tariff filings, the LECs calculated the required exogenous cost adjustments for sharing to reflect the corrected 1993 and 1994 rate base calculations after reversal of RAO 20 and to properly calculate the rate base for 1995.
- The Bureau suspended and investigated the tariff filings to determine if it was consistent with the Commission's rules not to exclude OPEB liabilities from the rate base.
- In 1997, the Commission completed the rulemaking proceeding it had initiated in the *RAO 20 Rescission Order*. The Commission amended Section 65.830(a)(3) to explicitly deduct all long-term liabilities in account 4310, including the unfunded accrued OPEB liabilities, from the rate base. As with all rule changes, this change had only <u>prospective</u> effect.

The Commission's Price Cap Rules Required Carriers To Reflect Changes In the Rate Base In Their Sharing Adjustments

• Reversal of RAO 20 was not an exogenous adjustment for OPEB costs. It was a change to the rate base calculations caused by reversal of the Bureau's incorrect RAO 20 order. The resulting change in earnings impacted the sharing amount in an automatic exogenous adjustment under the Commission's price cap rules

• Contrary to AT&T's claims, Verizon's sharing adjustment in its 1996 access tariff filings did not require prior Commission approval. The price cap rules required the carriers to make an exogenous adjustment for sharing. *See* 47 CFR Section 61.45(d)(2) (1990) ("Local exchange carriers . . . shall also make temporary exogenous cost changes as may be necessary to reduce PCIs to give full effect to any sharing of base period earnings required by the sharing mechanism . . . ").

• The sharing adjustment had to be calculated in accordance with the Commission's Part 65 rate base rules. The effect of the reversal of RAO 20 on the rate base had to be reflected in the rate of return calculations that were used to compute sharing and lower formula adjustments. Absent the sharing obligation or lower formula adjustment, rate base adjustments had no impact on the price cap indices.

1993-1995 Rate Base Treatment

- 1995 rate of return had to be calculated for the first time in accordance with reversal of RAO 20 to calculate sharing for the 1996 tariffs.
- Section 65.600(d)(2) required the carriers to include the effects of RAO 20 reversal in their revised rate of return report for 1994 and in a revised sharing adjustment in 1996
- Section 65.600(d)(2) did not prohibit revisions to rates of return for previous years.
- Corrections to the 1993 sharing amounts were warranted in light of the Commission's 4 year delay in addressing the requests for review of RAO 20.

Add-Back

Add-Back; 1993 & 1994 Access Tariff Filings

- Prior to the 1995 rule change, add-back was neither required nor prohibited – "this issue was neither expressly addressed in the LEC price cap orders nor clearly addressed in our Rules." 8 FCC Rcd 4415, para. 4. The Court noted that the 1995 rule change was not impermissibly retroactive because it was prospective only. 79 F.3d 1195, 1206.
- Either add-back of revenue changes to the period in which the sharing or lower formula adjustment amounts were incurred, or reporting revenue changes in the year that they were applied, were reasonable interpretations of the accounting rules prior to the time that the Commission adopted the add-back rule.
- Neither approach was guaranteed to maximize a carrier's revenues – it would depend on whether a carrier would be in an under-earning or over-earning situation in the future. Since a carrier cannot predict its earnings, either approach is reasonable.
- Most LECs did not apply add-back prior to the rule change and reported their earnings without adjustment.

OPEB COSTS

OPEB ISSUES – CRITICAL EVENTS

12/26/90	12/26/91	12/31/91	2/92	1993	1994
FASB Adopts SFAS 106	FCC Approves SFAS 106 ("on or before 1/1/93")	BA Notifies Bureau Adopting 106 Eff. 1/1/91	BA Files Tariff (FCC Rejects)	BA Annual Filing TBO Only	Court Reverses FCC

OPEB Issues

- **There are two issues -**
  - **Bell Atlantic's adoption of OPEB accounting in 1991 and 1992.**
  - **Reversal of RAO Order excluding OPEB liabilities from the rate base.**
- **The 2/25/03 order stated that the FCC would terminate the investigation for any OPEB issues that are not raised in response to the order.**
- **No party raised any additional issues.**

1993 Access Tariff Filing Direct Case

- **OPEB related costs incurred prior to January 1, 1993 are eligible for exogenous treatment.**
  - Verizon should not be penalized for complying with an approved accounting practice prior to the last date for adoption.
  - Not only did Verizon adopt OPEB within the period authorized by the Bureau's order, but the Bureau specifically noted that "earlier implementation is encouraged." Therefore, adoption of OPEB was "mandatory" regardless of when a carrier implemented it.
  - A cost change resulting from a change in generally accepted accounting practices approved by the Commission is beyond a carrier's "control" and eligible for exogenous treatment regardless of whether a carrier has control over the timing or amount of the underlying costs. *(Southwestern Bell v. FCC)*
    - The Common Carrier Bureau's order approving the OPEB change leaves no doubt on this issue, since it required the carriers to implement the change "on or before January 1, 1993," not "on January 1, 1993" or "no earlier than January 1, 1993."
    - The delay in seeking exogenous treatment until 1993 was due to the Commission's own error in rejecting the previous tariff filings seeking exogenous treatment of OPEB costs (reversed in Southwestern Bell).

1993 Access Tariff Filing Direct Case

- No Refunds Would Be Appropriate Even If The Commission Disallowed The Exogenous Cost Adjustments For Pre-Jan. 1, 1993 OPEB Costs.
  - In any event, any required refunds will also have to apply to AT&T's rates under investigation in this proceeding.
- Verizon's total cost exogenous adjustments for pre-1993 OPEB costs during the 1993-95 tariff period were less than the amount by which Verizon's interstate access rates were below cap.
- Disallowance Of These Costs Would Still Leave Customers With Rates Below Cap During The Two-Year Period For Recovery Of Pre-1993 OPEB Costs.

Summary

- Prior to 1997, the Commission's Part 65 rules left no discretion for the LECs to deduct OPEB liabilities from the interstate regulated rate base for purposes of calculating earnings.
- Prior to 1995, add-back was neither required nor prohibited.
- OPEB costs prior to January 1, 1993 are eligible for exogenous treatment.
- The Commission's resolution of all these issues should be decided in a final comprehensive decision.