Before the
Federal Communications Commission
Washington, D.C. 20554

CC Docket No. 86-125,
Phase I

In the Matter of

Annual 1985 Access Tariff Filings

MEMORANDUM OPINION AND ORDER

Adopted: September 30, 1988; Released: October 5, 1988

By the Chief, Common Carrier Bureau:

I. INTRODUCTION

1. This Order resolves issues designated for investigation in connection with the first general update of local exchange carriers' (LECs) access tariffs.[1] The switched access tariff revisions at issue were filed July 2, 1985, to become effective October 1, 1985. While the effectiveness of some carriers' revisions was briefly deferred pursuant to the Bureau's *September 30 Order*,[2] most of those revisions became effective as scheduled on October 1, 1985. The *September 30 Order* also instituted a broad investigation. The specific issues with respect to switched access rates were described in a subsequent *Designation Order*. [3] This Order addresses issues discussed in that *Designation Order*.

II. BACKGROUND

2. The *Designation Order* tentatively determine that pervasive defects in many exchange carriers' ratemaking methods, including deficiencies in support material, rendered their cost and demand projections and the associated rates unreasonable. Relying on our own econometric models to test the exchange carriers' projections of costs and demand, this Bureau tentatively decided that the effective rates should be reduced to avoid future excess earnings.

3. While the basis for the Bureau's tentative determination that refunds and rate adjustments were necessary was the divergence of the rates that went into effect October 1, 1985, from the rate levels indicated by the Bureau's own analysis of cost and demand trends, the Bureau also subsequently requested rate of return data for the last quarter of 1985 in its *May 9 Order* in this docket.[4] We expected that these actual results would facilitate comparison of the competing test year cost and demand projections at issue in the *Designation Order*, and enable us to determine whether the Bureau's prototype mechanism for initial review of proposed rate levels was generally reasonable. The actual results could also help us to determine whether, in specific cases, our tentative determinations with respect to individual carriers' filings had been confirmed.

4. An important, related purpose of the *Designation Order* was to create and solicit comments on an econometric model by which the Bureau could initially evaluate the annual access tariff filings before they become effective. This annual review is a major commitment of the Bureau, and consumes considerable resources. The implementation of computer-supported analysis is essential to an expeditious and effective review of these filings, and its refinement has been a continuous process since the initial prototype was proposed in the *Designation Order*. In addition to refining our forecasting process, this Bureau has monitored various historical operating statistics in order to evaluate retrospectively the accuracy of LEC and Bureau forecasts. The initial "report-card" analysis, contained in the *Designation Order* (at paras. 91-93 and App. E), indicated that the National Exchange Carrier Association (NECA) substantially underestimated test year demand and overestimated test year costs, and that in both respects the Bureau's forecasts had proven more accurate. This analysis, however, declined to draw any conclusions respecting the quality or accuracy of NECA's forecasting process compared to our own forecasts. More recently, in Annual 1988 Access Tariff Filings, Memorandum Opinion and Order, 3 FCC Rcd 1281 (1988) *(1988 Access Tariff Order)*, this Bureau noted NECA's forecast for 1987 had likely underestimated 1987 demand by a significant amount and that AT&T demand forecasts for 1988 were more credible.

III. DISCUSSION

5. Although the actual results confirm that many of the LECs did not do an adequate job of forecasting demand or costs or both for particular access rate elements, we do not find a sufficient correlation between actual results and the tentative adjustments that we proposed to justify using those adjustments as a basis for remedying carrier errors. This does not mean that this proceeding has not served a useful purpose. The effort that Bureau staff devoted to the development of this model and the pleadings filed in response to the *Designation Order* have been of great value in developing more refined procedures that we have used in reviewing subsequent annual access filings. These eforts have also undoubtedly contributed to some improvements in the processes that carriers have used and will use to prepare their access filings.

6. We have concluded, however, that it would not be appropriate to use this docket to remedy the effects of pervasive forecasting deficiencies upon rates that were in effect during the October 1985 - December 1986 period.[5] The support materials and supplemental data received since the *Designation Order* are insufficient to support the imposition of refunds grounded on comparisons between cost and demand projections of competing economic models. A fundamental premise of the tentative conclusions of the *Designation Order* was the pervasive deficiencies of support evident in the exchange carriers' explanation of their rate development. *See, e.g., Designation Order* at paras. 46-49. While this Bureau's use of statistical forecasting methods has demonstrated its validity in more recent access tariff review cycles, no such mechanism can surmount deficiencies in the underlying data from which projections are developed. Although the RBOCs' excess revenues realized in the switched access category demonstrate that some of the rates questioned by the *Designation Order* were excessive to some degree, these results do not establish that the reductions proposed by

the *Designation Order* would have produced consistently preferable results while avoiding undeserved repression of earnings.

7. Our decision to terminate this phase of this investigation does not mean that we have found these 1985-86 rates to be just and reasonable.

We are terminating this proceeding without prejudice to any Section 208 complaints relating to 1985-86 rates that have been or may be filed and without prejudice to any refunds that may result from rate of return enforcement procedures.[6]

IV. ORDERING CLAUSES

8. Accordingly, IT IS ORDERED, pursuant to Section 204(b) of the Communications Act, 47 U.S.C. § 204(b), that the portion of Ohio Bell Telephone Company's interstate revenue requirement for the period October 1, 1985, to December 31, 1986, that reflects9.1 million in expenses and the revenue requirement associated with28.7 million of net investment (the amounts questioned in Appendix B, discussion of Issue 1), IS DISALLOWED.

9. IT IS FURTHER ORDERED that Ohio Bell Telephone Company, within 30 days of the release of this Order, SHALL CALCULATE the excess earnings associated with these expenses for the period October 1, 1985 to December 31, 1986, and specify the procedure by which it proposes to implement either refunds or rate adjustments in that amount.

10. IT IS FURTHER ORDERED, pursuant to Section 204(b) of the Communications Act, 47 U.S.C. § 204(b), that the portion of Southwestern Bell Telephone Company's interstate revenue requirement for the period October 1,1985, to December 31, 1986, that reflects expenses for a revenue lag period greater than 45 days, IS DISALLOWED for the reasons stated in Appendix B, discussion of Issue 5.

11. IT IS FURTHER ORDERED that Southwestern Bell Telephone Company, within 30 days of the release of this Order, SHALL CALCULATE the excess earnings associated with these expenses for the period specified in the discussion of Issue 5, and specify the procedure by which it proposes to implement either refunds or rate adjustments in that amount.

12. IT IS FURTHER ORDERED, pursuant to Section 204(b) of the Communications Act, 47 U.S.C. § 204(b), that the portion of the National Exchange Carrier Association's revenue requirement for the period October 1, 1985 to December 31,1986 that reflects CPE phasedown expense in excess of 232 million, IS DISALLOWED.

13. IT IS FURTHER ORDERED, that the National Exchange Carrier Association, within 30 days of the release of this Order, SHALL SPECIFY the procedure by which it proposes to implement either refunds or rate adjustments reflecting the disallowance of CPE phasedown expense and the corresponding revenue adjustment of48.3 million (Issue 10 in Appendix B).

14. IT IS FURTHER ORDERED, that the General Telephone Operating Companies submit revised Forms 492 reflecting the adjustments required in Appendix B, discussion of Issue 11.

15. IT IS FURTHER ORDERED that Contel Corporation's motion for late acceptance of its Direct Case IS GRANTED.

FEDERAL COMMUNICATIONS COMMISSION

Gerald Brock
Chief, Common Carrier Bureau

FOOTNOTES

[1] The carrier-specific issues described by the *Designation Order* in modular form are presented here in a similar manner. *See* Appendix B for our resolution of those issues.

[2] Annual 1985 Access Tariff Filings, Memorandum Opinion and Order, Mimeo No. 7401, released Sept. 30, 1985 (*September 30 Order*).

[3] Annual 1985 Access Tariff Filings, CC Docket No. 86-125, Phase I, Order Designating Issues for Investigation, Mimeo No. 3643, released Apr. 14, 1986 (*Designation Order*).

[4] Annual 1985 Access Tariff Filings, CC Docket No. 86-125, Phase I, Order, Mimeo No. 4383, released May 9, 1986 (*May 9 Order*). This request was slightly modified and the date for submission extended by a subsequent Order released May 19, 1986.

[5] We are, however, resolving some carrier-specific rate questions in Appendix B.

[6] Those procedures are, of course, the subject of ongoing litigation. The decisions to initiate and to terminate this phase of this investigation do not depend upon and should not affect rate of return enforcement.

APPENDIX A

DIRECT CASES[1]

American Telephone and Telegraph Co. (Submission)
Ameritech Operating Companies
Bell Atlantic
BellSouth Corporation[2]
 South Central Bell Telephone Company
 Southern Bell Telephone and Telegraph Company
Centel Telephone Companies
Cincinnati Bell Telephone
Contel Corporation[3]
General Telephone Operating Companies
Mountain States Telephone and Telegraph Company
 Northwestern Bell Telephone Company
 Pacific Northwest Bell Telephone Company
National Exchange Carrier Association
Nevada Bell
NYNEX Telephone Companies
 New England Telephone and Telegraph Company
 New York Telephone Company
Pacific Bell
Rochester Telephone Corporation[4]
Southern New England Telephone Company

Southwestern Bell Telephone Company
United Telephone System Inc.
(Consolidated Direct Case)

RATE OF RETURN SUBMISSIONS
Ameritech Operating Companies
Cincinnati Bell Telephone[5]
NYNEX Telephone Companies
New England Telephone and Telegraph Company
New York Telephone Company
Pacific Bell
Southern New England Telephone
Company[6]
Southwestern Bell Telephone Company[7]

COMMENTS
American Telephone and Telegraph Co.
GTE Sprint Communications Corporation
MCI Telecommunications Corporation
NYNEX Telephone Companies
New England Telephone and Telegraph Company
New York Telephone Company

REBUTTAL
Ameritech Operating Companies[8]
Bell Atlantic
BellSouth Corporation
South Central Bell Telephone Company
Southern Bell Telephone and Telegraph Company
Cincinnati Bell Telephone
General Telephone Operating Companies
Mountain States
Northwestern Bell Telephone Company
Pacific Northwest Bell Telephone Company
National Exchange Carrier Association
NYNEX Telephone Companies
New England Telephone Company
New York Telephone and Telegraph Company
Pacific Bell
Southern New England Telephone Company
Southwestern Bell Telephone Company
United

FOOTNOTES FOR APPENDIX A

1 Indented parties filed jointly with the entity listed immediately above.

2 The same parties also filed an erratum.

3 Contel Corporation's motion for late acceptance is granted.

4 Rochester also submitted a clarification and revision.

5 Cincinatti Bell separately submitted corrected investment amounts associated with CPE.

6 SNET separately filed an erratum to its data submission.

7 SWB separately filed revisions to the supporting materials submitted July 2, 1985.

8 Ameritech separately filed revised pages to Att. A of the rebuttal.

APPENDIX B

RATE ISSUES RAISED BY COMMENTERS[1]

Below we consider the issues raised by commenters with respect to individual carriers' rates. When originally set out in Appendix B to the *Designation Order* these issues were not numbered; they are presented below in the same sequence and numbered for convenience.

ISSUE 1: Recovery of investment and expenses in both state and interstate rates by Ohio Bell Telephone Company.

Summary. The *Designation Order* recounted AT&T's contention in its petition on the 1985 annual access tariffs that Ohio Bell apparently sought to recover9.1 million of expenses and27.8 million of net investment through its access tariff filings and also in a state ratemaking proceeding. AT&T developed these figures by comparing state and interstate separations factors and applying them to Ohio Bell's expense and investment items (with adjustments to recognize customer premises equipment (CPE) phasedown costs in the interstate separations factors). Ameritech stated in response that the state rate case relies on a time period that includes part actual and part projected data, so that some amounts must be adjusted to reflect foreign exchange (FX) allocation to the interstate jurisdiction, and the difference between five- and seven-day holding time studies. An additional adjustment noted by Ameritech revises CPE to reflect a lower level of intrastate investment. Ameritech also states that the interstate filing reflects a later test period and so incorporates differences from retroactive separations adjustments not incorporated in the state proceeding, as well as the transition to a 25 percent interstate allocator for non-traffic sensitive (NTS) outside plant that is not reflected in the state proceeding. Further, Ameritech asserts, the adjustments to interstate allocation factors mandated by the Commission in Docket No. 19129 do not apply to intrastate factors, and different sets of assumptions were used to calculate separations factors for the access and state proceedings.

The *Designation Order* asked AT&T to further explain the "company amounts" from which state separation factors were supposedly derived, and expand on its contention that CPE costs are reflected in the intrastate separations factors. For its part, Ohio Bell was charged with supporting its arguments that various considerations preclude the comparison of interstate and intrastate separations factors. The *Designation Order* also required Ohio Bell to detail the adjustments referred to by Ameritech in its reply; to document any discrepancies in its use of five and seven day holding time studies, and explain the extent to which they affect separations factors; to quantify the purported impact of several issues on the separations factor;[2] and to specify the effects on separations calculations of adjustments established in Docket No. 19129, as well as other assumptions.

Direct Case. Ameritech first describes the adjustments that were necessary in Ohio Bell's intrastate rate case to reflect separations changes ordered in CC Docket No.

80-286. Ameritech Direct Case, Attachment C at C-5 ff. By adjusting for the allocation associated with the open end of an FX line and the use of seven day holding time studies, Ameritech contends, Ohio Bell conformed its intrastate rate case test period basis with that included in the access filing. As to the holding time studies, Ameritech states the effects of seven day holding time studies were quantified in the intrastate rate case and included in the July 2, 1985 interstate filing. The FX minute of use and seven-day holding time study adjustments in the intrastate rate case are presented in Attachment C to Ameritech's Direct Case.

With respect to the issues enumerated in note 2, *supra*, Ameritech states in its two-paragraph response that retroactive adjustments include changes made to expense, investment, traffic or other data for a prior period, which cause actual results to differ between the jurisdictions. Ameritech provides an example of retroactive adjustments only by reference to a line item in Attachment D to its Direct Case. A more quantitative explanation of retroactive adjustments is not provided. Ameritech also describes recycle adjustments as including minor revisions to separations procedures "to reflect current conditions" which may cause variations in separations factors developed in interstate filings, but states the differences are not quantifiable. Ameritech does not attempt to define the class of revisions that would be treated as recycle adjustments. Its answer thus sheds little light on the respective contribution of these several factors to the discrepancies that originated the Bureau's inquiry.

As to Docket No. 19129 adjustments, Ameritech states that the adjustments mandated there are described in Vol. 2-2, Section 5 of Ohio Bell's filing, but are not allowed for in the development of intrastate allocation factors by the Public Utilities Commission of Ohio. Ameritech did not include this item, amounting to112,000 in expense and 67,511,000 in investment, in explanatory Attachment D because AT&T did not rely on such adjustments in its analysis.

Finally, Ameritech considers the effect of different assumptions on the separations factor calculations. It identifies several differences between the intrastate and interstate jurisdictions that, it asserts, AT&T has ignored. Specifically, Ameritech states that interstate CPE investment is at a lower level in the intrastate jurisdictional filing. According to Ameritech, it made an incremental adjustment to include CPE at the average level beyond the test period year (958,000 expense and 2,271,000 investment) to recognize the declining nature of interstate CPE and correspondingly increased intrastate investment and expense (with its associated effect on intrastate allocation factors). These adjustments are said to reflect that Ohio Bell's intrastate separations factors are based on lower interstate CPE costs for the state proceeding, so that AT&T's assertion that Ohio Bell does not need to make such adjustments is incorrect. Ameritech Direct Case, Attachment D at Line 2.

Ameritech further states that the interstate percentage for directory expense was adjusted to recognize the exclusion of yellow page expense, producing an increase of1,460,000 that should be subtracted from the difference asserted by AT&T. According to Ameritech, a corresponding adjustment was not required for the intrastate rate case due to the different test periods. *Id.*, Attachment D at Line 3.

Intrastate separations factors based on a 40 percent sample of central offices, Ameritech continues, have been supplanted in the Ohio Bell state rate case by factors developed from separations procedures that entail a 20 percent sample. AT&T's use of outdated sampling-based factors is said to produce an expense error of226,000 and an investment error of381,000. *Id.*, Attachment D at Line 4.

Finally, Ameritech argues that assumptions respecting circuit equipment vary significantly between the jurisdictions. It asserts that the intrastate rate case includes equipment leased under Shared Network Facility Agreements (SNFA), while the interstate filing does not. In addition, Ameritech states, different basic separations studies were in effect during the two different test periods. *Id.*, Attachment D at Line 5.

Ameritech concludes that given the inherent differences in the two regulatory jurisdictions and the consequent need for adjustment, Ohio Bell's allocation factors are within fractions of a percentage point, as shown in Attachment D at Line 9. These small residual differences, it claims, reflect historical month-to-month variations and their effect in two different test periods.

AT & T Submission. In a pleading captioned "AT&T Submission," filed May 22, 1986, AT&T reiterates that Ohio Bell, in its July 2 access filing, added interstate CPE amounts to total interstate expenses and investments *after* separations factors had been used to derive the base interstate amounts, but in the state ratemaking proceeding added interstate CPE amounts to total interstate expenses and investments *before* the factors were used to derive the base interstate amount. Determining the prospect of overrecovery, AT&T states, required derivation of the separations factors by a consistent method. It employed the method used by Ohio Bell for the state proceeding and developed the figures of9.1 million of expenses and the revenue requirement associated with some28.7 million of net investment.

As to the divergent samples of central offices, AT&T notes that an Ohio Bell study submitted to the Ohio Commission comparing a 20 and 40 percent sample resulted in a staff determination that the different sampling methods were "too close to distinguish any significant difference" in the resulting separations factors.

With regard to Ohio Bell's contention that Docket No. 19129 adjustments preclude a meaningful comparison of the sort attempted by AT&T, AT&T states that its analysis was based on interstate factors developed in Ohio Bell's tariff support before Docket 19129-driven adjustments were made.[3] AT&T's comparison is thus consistent with the state ratemaking proceeding (which made no such adjustments) in this respect. Similarly, AT&T states that the supposed distinction drawn by Ohio Bell between separations factors used in the current proceedings, and those used in the state proceeding (based on different adjustments for subscriber plant factor (SPF) and equal access costs), is misplaced because its analysis was based on interstate amounts from Ohio Bell's July 2 filing, calculated before these adjustments were made.

Finally, AT&T reiterates the contention made in its Petition that the different test periods employed for the state and access filings are irrelevant to the comparison it asserts.

AT & T Comments. In its Comments on Ameritech's Direct Case, AT&T states that Ohio Bell's direct case "effectively concedes" its analysis, but criticizes the Ohio Bell adjustment of7.5 million to expenses and30.4 to net investments, to reflect asserted differences in "circuit equipment" between state and access filings. AT&T Comments at 8. While these changes offset the overrecoveries identified by AT&T, Ohio Bell provides no supporting documentation or references for these adjustments, so that there is no basis for determining the propriety of these revisions.

Ameritech Rebuttal. Ameritech argues that different time periods in the respective proceedings produced differences in expense (958,000) and investment (2,271,000) for CPE phasedown that were documented in Ohio Bell's initial reply and for which AT&T's analysis failed to adjust. Ameritech Rebuttal at 15-18. Ameritech does not, however, rebut AT&T's contention that interstate CPE amounts were added to the interstate and intrastate accounts at different points in the rate development process. Ameritech further states that AT&T should reduce its interstate expense by 1,460,000 to recognize that the intrastate rate case did not reflect the exclusion of Yellow Page expenses for 1986. Similarly, Ameritech notes that the actual basis for its intrastate rate development was a 20 percent sample of central offices, explaining differences in expense (226,000) and investment (381,000) that AT&T's calculation fails to recognize. As to the largest adjustment, for circuit equipment, Ameritech again contends the differences due to SNFAs were discussed in its direct case, as was the effect of a different basic separations study.

Discussion and Analysis. The *Designation Order* emphasized our dissatisfaction with the conclusory, unquantified, and unsupported assertions on which Ohio Bell premised its arguments against the comparison of state and access separations factors. Ohio Bell's direct case essentially consists of generic efforts to distinguish the state and access contexts, often lacking the supporting particulars sought by the *Designation Order.* This is particularly problematic with respect to the substantial adjustments to "circuit equipment" accounts that, if accepted, would resolve the apparent overrecovery -- but which are explained only by conclusory language, and unsupported by any quantification of the basis for the adjustment.[4]

The deficient explanation provided for Ohio Bell's adjustments to "circuit equipment" accounts fails to resolve the questions raised by AT&T and described by this Bureau in the *Designation Order.* Accordingly, Ohio Bell's expenses are disallowed in the amount of9.1 million, and its investment in the amount of27.8 million, as specified in the designation of this issue. Ohio Bell should specify within 30 days of the release of this Order whether it intends to refund these amounts or to propose a prospective rate adjustment, and describe the method and schedule it proposes for implementing this disallowance.

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ISSUE 2: Improper inclusion in interstate revenue requirement of expenses related to takeback of intrastate, intraLATA operator services by Pacific Bell, Southwestern Bell, and possibly other carriers.

Summary. AT&T asserted in its petition on the 1985 annual access filing that, as Pacific Bell (Pacific) had stated that the major cause of increased total company traffic expenses was the return from AT&T Communications of operators for intraLATA toll calls, Pacific apparently included operator wages and other expenses arising from the takeback in the interstate revenue requirement. AT&T contended that because operator services will be provided by the BOCs only for intraLATA traffic, these expenses should not be included in the interstate revenue requirement. Similar increases in the Southwestern Bell traffic expense account (for Kansas, Oklahoma, and Texas) apparently were due to preparation for operator services takeback.

Pacific replied that takeback would not commence until June 1986, after the test year period, and that costs related to takeback were not included in the test year revenue requirement. It maintained that the language relied on by AT&T referred to projected annual data, and thus indicated increases expected during the second half of 1986; startup costs in the test year would be small, and only 5.31 percent of these costs would be allocated to interstate.

In the *Designation Order,* the Bureau accepted Pacific's explanation that the costs referenced by AT&T were not included in the test year's revenue requirement, but refused to accept as insignificant the startup costs that Pacific conceded would be incurred in the test year. Pacific was instructed to quantify and support any such costs allocated to the interstate revenue requirement, and to explain the 5.31 percent allocation ratio used to compute those costs. In contrast, as Southwestern Bell Telephone Company (SWB) did not reply to AT&T's contentions, the Bureau tentatively accepted AT&T's arguments that these expenses should be removed from the SWB interstate revenue requirement.[5]

Direct Cases. Pacific states that it did not propose deliberate allocation of any identifiable takeback costs to the interstate test period revenue requirement, but that some small portion of startup expenses may have been unintentionally included in the budget and not specifically identified as such. Even such inadvertently included startup expenses would have an insignificant impact on the interstate revenue requirement, Pacific contends, because, as noted, the interstate allocation ratio for overall traffic expense is 5.31 percent. Pacific explains that the allocation ratio is developed by dividing its traffic expenses actually assigned to the interstate jurisdiction by the total operations traffic expenses subject to separations for the same period.[6]

SWB states that it included approximately350,000 of operator takeback expenses in the interstate revenue requirement, including operational expenses in Kansas for April and May 1986. It states further its willingness to remove this amount from the interstate revenue requirement, while urging that the effect on rates would be minimal.

AT & T Comments. AT&T maintains that while Pacific explained the development of the interstate allocation factor it applied to these expenses, it failed to justify any allocation of takeback expenses to interstate access rate elements. AT&T also contends that SWB's minimal adjustment cannot be assessed without adequate cost support, and reiterates that other carriers' tariff support materials are inadequate to determine whether a comparable, possibly inappropriate allocation to the interstate jurisdiction was made.

Rebuttal. Pacific responds that it intends no allocation of identifiable operator takeback costs to the interstate revenue requirement, and has complied with the Commission's request for explanation of the allocator. Pacific Rebuttal at 4-5. SWB explains that in the test year period it took back operator services only in Kansas, and this occurred in April 1986; because SWB's test year was June 1985 - May 1986, the remainder of its operator takebacks fall outside the test year period. In any case, SWB concludes, it has already quantified the takeback expense properly excludable from the interstate revenue requirement filed July 2, 1985. SWB Rebuttal at 15.

Discussion and Conclusion. We conclude that the submissions by Pacific and SWB satisfactorily explain the circumstances that led to the allocation imprecisions identified by AT&T. The impact on rates, moreover, is modest compared to the issues of general rate development. In these circumstances, an adjustment would not be warranted. Accordingly, the investigation is terminated with respect to this issue.

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ISSUE 3: Apparent overstatement of uncollectible revenues included in the interstate revenue requirement by Michigan Bell Telephone Company.

Summary. In its petition on the 1985 annual filing, AT&T argued that Michigan Bell's proposed uncollectibles ratio was considerably higher than reported by other BOCs -- .0148 compared to a BOC average of .0026. The highest uncollectible ratio reported by an Ameritech company other than Michigan Bell for the test year was half its level. Ameritech replied that Michigan Bell had estimated its uncollectibles ratio on the basis of experience with other services, in the absence of fully developed data collection procedures for switched access. It argued that the differences in economic conditions between study areas explain the relatively high rate for Michigan. In the *Designation Order* the Bureau stated that Michigan Bell had not justified the proposed ratio in terms of its experience with other services, and tentatively required Michigan Bell to recalculate its revenue requirement to reflect an uncollectibles ratio equivalent to the average of the other Ameritech companies.

Direct Case. Ameritech states it considers the proposed average uncollectibles ratio reasonable and undertakes to adjust its revenue requirement accordingly.

Conclusion. While Michigan Bell did not alter its uncollectibles ratio until its next annual access filing in October 1986, it filed a mid-course correction August 15, 1986, that relied on eight previous months' actual experience with uncollectibles to revise its rates to avoid excess earnings for the period concluding December 31, 1986. Letter from Anthony M. Alessi to Tariff Division, Common Carrier Bureau, Sept. 29, 1988. In these circumstances, Michigan Bell has established its good faith compliance with the undertaking stated in its direct case, and the investigation is therefore terminated in this respect.

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ISSUE 4: Overstatement of revenue accounting expenses (Account 2296) by Ohio Bell.

Summary. In its filing on the 1985 access tariffs, AT&T contended that Ohio Bell's inclusion of5.21 million in revenue accounting expenses attributable to billing customer access line charges represented 42 percent of Ohio Bell's total revenue accounting expenses, while the comparable figure for other Ameritech companies averaged to approximately 1.7 percent. AT&T argued that the overstatement was compounded because Commission Rules require the allocation of other commercial expenses to rate elements in the same proportion as revenue accounting expenses. Ameritech agreed that some misallocation occurred, and that the errors misallocated expenses between various cost categories, but asserted that these errors did not result in an overstatement of the overall interstate revenue requirement. The *Designation Order* required Ohio Bell to make the necessary corrections and show the changes resulting in all cost categories.

Direct Case. Ohio Bell maintains that the overstatement of its common line revenue requirement was11.5 million, rather than the 17.8 million estimated by AT&T, and asserts that it is exactly offset by understatements in other access cost elements so that the total revenue requirement is correct. To implement the corrections ordered in the *Designation Order*, Ohio Bell states that it reduced its Multi-line Business End User Charge to reflect the Common Line Base Factor Portion revenue requirement, as corrected for the revenue accounting expense allocation. *Id.* at Appendix C, C-2 to C-4. According to Ohio Bell, the corrected Billing and Collection revenue requirement was used in Ameritech's April 1, 1986 Billing and Collection tariff filing, and no further adjustment was needed to recover the understatement.[7]

Discussion and Conclusion. Ohio Bell's implementation of corrections tentatively required by the *Designation Order* resolves the concerns raised there. As the misallocations to the common line revenue requirement have been rectified, no further action is necessary. The investigation is therefore terminated with respect to this issue.

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ISSUE 5: Overstatement of working capital stemming from miscalculation of access revenue lag period by Southwestern Bell.

Summary. AT&T contended in the 1985 filing that SWB's access revenue lag periods substantially exceed those used by other LECs, inflating SWB's cash working capital needs and consequently its interstate revenue requirement. The tariff support information indicated that the lag was based on a 1980 study, and was inconsistent with data supplied by SWB to AT&T in 1982 and 1983. The latter, recent data indicated lag periods of 42 to 47 days, compared to the range of 55 to 63 days used in the access filings. SWB replied that it did not intend to imply that all lead/lag factor data came from the 1980 study, and that updated information was included in the tariff filing -- specifically, a three-month study of 1984 interstate revenue collections.

The *Designation Order* found SWB's explanation both unsupported and a contradiction of the detailed explanation of the calculation that had originally been provided in its cost support. Absent justification for the proposed lag periods, the Bureau tentatively concluded that the SWB companies should use a revenue lag period of 45 days, reflecting the average lag reported by SWB to AT&T in 1982 and 1983. The Bureau noted that because the lag period at least partially reflects collection practices subject to managerial action, lag periods that depart significantly from industry averages would be scrutinized.

Direct Case. SWB reiterates that lag factors in its tariff filing were based on a 1984 study of interstate revenue collections, and maintains that its 1980 study data was updated with 1984 revenue collection data. Southwestern contends that analysis of the largest interstate revenue stream, interexchange carrier (IC) access charges, in terms of its 1984 study data, justifies a 54 day lag factor.[8]

Discussion and Conclusion. SWB continues to state that its July 1985 filing was premised on the 1984 study of collection periods, but has not explained the contrary statement in the 1985 support materials. Nor do general statements that its 1980 study data was "updated" by the 1984 study adequately clarify the extent to which the later data underly the projections for 1985. Nor does SWB suggest any reason why the increased importance of direct payments from ICs should entail a lag factor that is substantially longer in its region than in others. Given this record, we adopt the tentative conclusion in the *Designation Order*, and disallow that portion of SWB's interstate revenue requirement that reflects a lag factor beyond 45 days. SWB is required to calculate the excess earnings associated with these expenses for the 15-month period under review, and propose either refunds or rate adjustments in that amount.

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ISSUE 6: Apparent attempt to recover pre-test period presubscription expenses by Bell Atlantic Telephone Company.

Summary. AT&T contended in the 1985 filing that Bell Atlantic apparently included in its interstate revenue requirement presubscription expenses that were incurred prior to the test period. Bell Atlantic replied that the questioned expenses were incurred from January to May 1985 and were amortized during the test period. It claimed that because the cash outlay was made during that period, the expenses were properly included in the test period revenue requirement. The *Designation Order* required Bell Atlantic to explain why the costs were not expensed in the period in which they were incurred, and why the period of cash outlay should determine when costs are included in the revenue requirement. Specifically, Bell Atlantic was asked to indicate whether it attempted to include in its revenue requirement costs that are not recoverable because incurred during a period in which Bell Atlantic did not have a tariff in effect.

Direct Case. Bell Atlantic states that these presubscription expenses were not "associated" with prior periods. Rather, notwithstanding the characterization in its workpapers of presubscription expenses as "pre test period expense," the referenced expenses were associated with balloting to occur during the test year for customers whose traffic was defaulted to AT&T prior to the test period. Thus, Bell Atlantic contends, these amounts do not include any out-of-period expenses. Further, because these costs are to be amortized by Commission direction,[9] the total disputed amount in the test year revenue requirement is1.162 million rather than the4.116 million asserted by AT&T.[10]

Discussion and Conclusion. It appears from Bell Atlantic's direct case that the proper attribution of these expenses was hindered by their imprecise identification in workpapers. Further, Bell Atlantic's initial effort to justify these expenses as incurred in the first several months of 1985 and amortized during a subsequent period was neither helpful nor persuasive. However, as finally explained, it appears this issue arose from failures of exposition rather than rate development. Bell Atlantic's deficient initial explanation of the treatment of these expenses has been rectified. That corrected and supplemented explanation leads us to conclude that an adjustment would not be warranted.

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ISSUE 7: Overrecovery of gross receipts taxes by New York Telephone, Chesapeake and Potomac (D.C.) and Northwestern Bell Telephone Company.

Summary. AT&T contended in the annual filing that the referenced carriers included gross receipts taxes for revenues from access service though they were not liable for such taxes. The *Designation Order* tentatively determined that NYT's access receipts, because determined not taxable by that state's Department of Taxation and Finance, should be removed from its revenue requirement for the portion of the test period subsequent to the state authority's ruling. These receipts should be retained in the revenue requirement for the portion of the test period prior to that ruling only if actually paid (and not subject to subsequent refund). Chesapeake and Potomac Telephone Company (C&P) had contended that a similar determination in its favor by the D.C. Superior Court might be reversed on appeal. The Bureau found this prospect too speculative to justify allowing the proposed expenses, absent a showing that the taxes were actually paid and would not be refunded. The order permitted Northwestern Bell Telephone Company (NWB) to continue including these amounts in the access revenue requirement pending a formal determination by the Minnesota Department of Revenue.

Direct Cases. NYT states that it has already removed the appropriate expenses from its revenue requirements, and that this change was first reflected in its revised rates filed October 7, 1985 (Transmittal No. 724) that removed the gross income tax expense related to resold access service for the entire test year. NYT Direct Case at Appendix A. The workpapers submitted with Transmittal No. 724, NYT asserts, explain the removal of a revenue requirement of34.199 million rather than62 million because the advisory opinion of the New York Department of Taxation and Finance addressed only the tax's applicability to access service purchased for resale to end users, leaving receipts tax expense for billing and collections, and for corridor traffic billed directly to end users, unaffected. More specifically, starting from the test year expense associated with the gross receipts tax of69.418 million, filed on July 2, 1985, NYT removed the billing and collection and corridor amounts (1.007 million), and expenses for services unrelated to the tax (7.079 million). The October 7, 1985 revisions further reflected the removal of34.199 million in expense associated with the switched traffic sensitive and special access rates. The balance,27.134 million, included 7.432 million of expense unaffected by the opinion; the adjusted balance of19.702 million was reported by NYT to NECA on October 2, 1985 as gross income tax expense associated with the Carrier Common Line Charge and still is in controversy.[11]

C&P states only that it should not be required to bear the risk of unrecoverable earnings in the event its liability for the gross receipts tax is upheld on appeal. C&P Direct Case at 14-15. NWB did not comment further on this issue in its direct case.

Discussion and Conclusion. The explanation supplied by NYT in its direct case of subsequent revisions reflecting the state's treatment of gross receipts taxes, as clarified, satisfies the concerns raised in the *Designation Order.*

NWB agreed in September 1986 to pay gross receipts taxes on interstate access revenues and such taxes have been paid for the period at issue, consistent with the assumption of NWB's rate development. Letter from Robert H. Jackson, US West, to Tariff Division, Common Carrier Bureau, Aug. 15, 1988.

As to C&P, its exemption from the gross receipts tax was subsequently affirmed,[12] effectively confirming the basis for the Bureau's tentative disallowance of the proposed expenses in the *Designation Order.* In response to staff inquiry, C&P stated that its final report of interstate access earnings (Form 492) for the period under review included adjustments to the rate of return that reflected its receipt of gross receipts taxes refunded by the District of Columbia. Letter from William B. Campbell, Bell Atlantic, to Tariff Division, Common Carrier Bureau Aug. 23, 1988.

The explanations and actions described above satisfactorily resolve the Bureau's concerns respecting overrecovery of gross receipts taxes by the carriers involved. Accordingly, the investigation is terminated with respect to this issue.

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ISSUE 8: Double-counting of investment amounts associated with central office equipment and outside plant by Continental Telephone and United Telephone.

Summary. AT&T initially contended in the 1985 filing that these carriers assigned amounts associated with various types of central office equipment (COE) and interexchange outside plant (OSP) to their interstate revenue requirement, although the facilities involved are leased to AT&T. According to AT&T, because the amounts recovered from AT&T under the lease arrangements are greater, as a percentage of interstate investment, than the amounts identified as non-access by the carrier, the excess represents an unjustified overstatement of the access category revenue requirement.

Continental Telephone Company (Contel) responded that its costs are characterized, not by reference to the lease's assignment of investment to the non-access category, but according to AT&T's "POP migration plan." Under this plan, AT&T can discontinue its interexchange use of Contel facilities by notifying Contel of its intention to stop using the LEC's facilities as an AT&T POP. Until such notice is received, Contel characterizes the investment as "all other" under Part 69, *i.e.*, as non-access interexchange investment. After AT&T notifies Contel of its intent to discontinue use of the affected facilities as a POP, Contel states that it treats the affected investment as "exchange equipment" under Part 69, *i.e.*, as access investment. Contel maintains it has recognized this shift only for locations at which AT&T has specified a planned exit date, and has never charged for the facilities both by lease and tariff.[13]

United Telephone Company (United) challenges AT&T's assumption that the various United companies included all interstate costs for Category 1 and 3 COE as non-access. Rather, it states, the amounts characterized by AT&T in its comments as "total interstate" reflect only the non-access portion of United's total interstate costs, so that the ratios developed for comparison with the July 2 filing are incorrect. The *Designation Order* the Bureau generally accepted Contel's explanation, but required Contel to revise its test-year forecasts to include projected POP migrations by AT&T (*i.e.*, beyond those with specified exit dates) on the basis of its historical experience with the POP migration plan. The assignment of OSP and COE was to be adjusted accordingly. The Bureau required United to supply the documentation necessary to support its contention that AT&T's figures reflect only the non-access portion of total interstate costs. United was instructed to identify both access and non-access components of its COE and OSP costs in its response.

Direct Cases. Contel states that it used its best judgment in concert with AT&T's POP exit notification dates in formulating projections regarding the recognition of investment as access or non-access. Contel based its projections on discussions with AT&T of its network projections as well as the limited historical experience available, and contends that subsequent history demonstrates the individual migrations for which it recognized a revenue shift were in fact accurate projections of the POP locations exited by AT&T before or during the test period. Contel urges that on this basis no further adjustment of OSP and COE assignments is indicated. Contel Direct Case at 40-41.

United asserts that the primary category involved in AT&T's contention is Category 3 COE (Intertoll Dial Switching Equipment), which accounts for 88 percent of the alleged overstatement. This equipment performs an access function when the associated Class 4 central office is used as an access tandem, and an intertoll switching function when AT&T maintains a switched POP at that office and leases the interLATA facility from the LEC. As these offices' toll routing and switching functions are gradually taken back by AT&T (and provided at its facilities), United avers it must cease charging AT&T through the interexchange lease and instead recover investment in these facilities entirely through the local transport element. It accordingly sets rates for switched access premised on projected AT&T "POP migration" actions. United Direct Case at 20-22.

While accepting AT&T's contention that investment allocated entirely to non-access for the development of the lease rate should be characterized in the same way for the interstate filing's separation factor, United contends this holds only when no POP migration is scheduled. However, United argues, POP migration was scheduled for the test period in areas served by the three operating companies cited in AT&T's argument. United asserts that AT&T's analysis fails to recognize that prospective access costs must, in anticipation of POP migration, recognize certain Category 3 costs as access even though the interexchange leases were originally developed assuming all Category 3 costs to be non-access.

Discussion and Conclusion.[14] In effect, the ratemaking treatment accorded these facilities attempts to fit two distinct pricing bases to their proportionate segment of the tariff period. While the lease arrangements are based on a full allocation of non-access costs, the termination of lease obligations for a particular facility ends that liability by AT&T. By allocating Category 3 investment for access tariff ratemaking purposes between access and non-access on a proportional basis that reflects anticipated POP migration schedules, the exchange carrier establishes rates that recognize the facilities' investment will be recovered, during the test year, in part from each category. The carriers' expanded explanations support the questioned ratemaking practices. Accordingly, no disallowance is warranted.

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ISSUE 9: Alleged miscalculation of the CPE phasedown and related overstatement of the CPE revenue requirement for the independent telephone companies.

Summary. AT&T alleged in its 1985 petition that while most carriers calculated the revenue requirement associated with CPE phasedown[15] as a portion of the original CPE investment frozen on January 1, 1983, pro-rated by a linear progression based on the 60-month phasedown period, NECA simply subtracted the BOC requirement from the industry total to yield a considerably higher figure (300 million versus232 million). NECA answered that AT&T erred in using the CPE revenue requirement for ICOs from the March 1984 filing, and that in any case the 1984 figure is not directly comparable to the revenue requirement at issue because of intervening changes in the Part 69 allocation rules that affect the apportionment of CPE (and related indirect investment and expense items). The *Designation Order*, noting that NECA failed to fully document the development of the CPE revenue requirement for ICOs, required that NECA explain the computation of its300 million CPE revenue requirement, and specify how Part 69 changes and other purported distortions would create a non-linear CPE phasedown. NECA was also required to explain its use of data from average schedule and smaller ICOs, and why projections for the latter relied on 1982 historic trends.

Direct Case. NECA contends in its direct case that the CPE phasedown amount evidences a linearly decreasing trend only with respect to total CPE plant and total directly assigned expenses, while indirectly allocated expenses such as Revenue Accounting, Land and Buildings, and Materials and Supplies "could somewhat offset the expected CPE decrease over time." NECA also notes that 1984 changes to Section 69.303 of the Commission's Rules separately operate to dislocate what would otherwise be a linear relationship between CPE investment and common line.[16] NECA also reiterates its contention, noted in the *Designation Order*, that its reliance on the larger independents' test year forecasts of CPE revenue requirements, and derivation of smaller ICOs' requirements from the total common line revenue requirement, developed data more representative of the actual ICO cost characteristics than AT&T's use of 1981 data projected through 1984 on the basis of industry average growth rates.[17] At the same time, NECA states that it used 1982 cost studies from smaller LECs because this was the most recent data available.

AT & T Comments. AT&T states in its comments on the direct cases that NECA's response fails to quantify the effect increases in accounts indirectly allocated to CPE, such as materials and supplies, will have, or even to show that the increases have a significant effect on the phasedown. Nor, AT&T adds, does NECA attempt to show the specific overall impact on the phase-down of a 1984 rule change in the Part 69 allocator that apportions CPE between the Common Line and special access rate elements. AT&T contends that NECA only shows that the majority of its CPE amounts were provided directly by the independent companies, while the March 1984 test period data that AT&T cited in its initial petition were developed from actual statistics contained in its Individual Company Actual Statistics (ICAS) data base. Thus, AT&T states, NECA has not only failed to demonstrate that AT&T's ICAS data did not adequately reflect independent company costs, but has failed to specify whatever differences may exist between the independent companies' actual 1984 CPE revenue requirements and the test period amount for 1984 developed by AT&T.

NECA Rebuttal. In rebuttal, NECA contends the *Designation Order* did not require that it specify the effects of the Part 69 rule change on CPE revenue requirements, but only that it demonstrate how the revisions affected that requirement. As to AT&T's reiterated advocacy of the ICAS-based data, NECA asserts that AT&T's data only shows separated costs and selected demand quantities at a high level of aggregation, while the NECA study is more current and shows investment and expense by access element.

NECA states that it did not compare the 1984 actual results with the 1984 test period because this was not required by the *Designation Order* or normal filing support requirements. Finally, NECA states the allocation of CPE phasedown for average schedule companies and smaller LECs would have no bearing on the CCL rate development as it is derived from the total common line revenue requirement.

Analysis and Discussion. NECA's two-page response to this issue fails to "document fully the development of the CPE revenue requirement for the ICOs" as required by the *Designation Order*, an instruction followed by the direction that NECA "show and explain how its300 million CPE revenue requirement was computed." *Designation Order*, Appendix B at 15. The Bureau believes these instructions pose no interpretive difficulty; as the premise of our concern over NECA's treatment of CPE is the300 million revenue requirement that results instead of the232 million figure that more conventional (and common) rate development would have produced, a quantitative explanation is essential.

The *Designation Order* makes clear that this explanation should include the method by which NECA calculated CPE phasedown for the test period and how Part 69 changes implicate its supposedly non-linear characteristics. However, NECA's response fails to discuss the method by which NECA calculated its test period CPE phasedown, and absent such an explanation, the record contains no basis for accepting NECA's claim that its new data are more accurate than those relied on by AT&T. Nor does NECA mention, much less establish, how the cited changes in Part 69 (or other factors) would cause the phasedown to be non-linear over time.[18] These absent showings are central to the instructions in the *Designation Order.*

The *Designation Order* also asked how data from the average schedule companies and smaller ICOs were used in NECA's CPE calculations. NECA simply responds that the common line revenue requirement for smaller LECs, including average schedule companies, was developed from a combination of individual forecasts and average growth rates from a sample of LECs. The common line revenue requirement then was disaggregated to the various cost elements. This fails to establish the relation between the data from smaller companies and the overall CPE calculations.

Conclusion. Without comparing these companies' actual 1984 revenue requirements with the 1984 test period amounts developed by AT&T, NECA cannot persuade us to discount AT&T's analysis. More fundamentally, without quantifying and justifying the supposed impact of Part 69 changes and other factors affecting its CPE revenue requirement, NECA cannot establish a requirement above the232 million figure that more straightforward procedures would support.

Accordingly, the68 million increment for CPE phasedown (above232 million) is disallowed. Had this disallowance been determined during the period these rates were in effect, a corresponding rate adjustment would have been indicated, targeting annualized CCL category earnings at2,243 million to achieve the authorized 12.75 percent return. In the present, retrospective context, however, NECA's Form 492 for the period October 1, 1985 -December 31, 1986 reports annualized earnings for the CCL category of2,264 million.[19] The difference of20.9 million, representing the extent to which NECA's earnings exceed the effect of the disallowance, must be refunded by NECA to recognize excess earnings above the target rate of return. Since NECA's CCL rate was in effect for 15 months, we adjust this amount by 1.25. The resulting amount is26.1 million. Including federal income tax effects, NECA must refund excess revenues associated with the disallowance of48.3 million.[20] NECA is also required to submit an amended Form 492 for this period to reflect the effect of this disallowance upon its rate of return.

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ISSUE 10: Incorrect computation and application of SPF by GTE of California, Florida, and Illinois.

Summary. Starting January 1, 1986, the SPF for each carrier is to be phased up or down to 25 percent from the level frozen in 1981. Excepted from this adjustment process is Category 6 COE, which was allocated at the unchanged 1981 level during the relevant period. AT&T initially contended that GTE had apparently miscalculated SPF generally applied for the test period, and had not used 1981 frozen SPF as required to allocate NTS category 6 COE. The effect of these deficiencies, AT&T contended, was to misallocate the referenced amounts of gross investment to the interstate jurisdiction. AT&T also asserted that GTE had incorrectly used seven-day traffic studies to determine the frozen 1981 SPF for Florida and Illinois, increasing the interstate allocation.[21]

GTE responded that because it had insufficient time to implement a mechanized system to effectuate varying SPF factors, it developed a time-weighted, "composite SPF" by first calculating interstate NTS plant for the distinct plant categories during the test year, and then using that result to develop a ratio of interstate to total NTS plant. As to the seven-day studies, GTE states that those studies represent the original computations performed in 1981 for Florida and in 1977 for Illinois.

The *Designation Order* tentatively determined that application of a composite SPF by the GTE operating companies using allocated amounts to calculate a SPF effectively reversed the method of the prescribed SPF methodology, with the result that Category 6 COE was understated and All Other NTS was overstated. The result is a misallocation of these costs between the line termination and common line rate elements, and consequently incorrect rates for these elements. The *Designation Order* therefore instructed GTE to calculate the interstate revenue requirement misallocated between the line termination and common line rate elements for each company that employed the composite SPF methodology.

Direct Case. The headings in the following summary of GTE's direct case reflect the specific showings required by the Commission in the *Designation Order.*

(1) *SPF recomputation; revised Category 6 COE and All Other NTS allocations; consequent revisions to test year revenue requirements and respective rates.* While GTE concedes in its direct case (at 35) that its composite SPF methodology has the shortcomings described in the *Designation Order*, it contends these distortions are introduced only where the frozen SPF exceeds 25 percent. GTE Direct Case at 35. GTE asserts that unless a study area's frozen SPF is considerably above 25 percent the understatement of COE 6 and overstatement of All Other NTS is minimal, and states that the frozen SPF is below 25 percent in eight of the 31 GTOC study areas; in these areas the composite SPF actually overstates Category 6 COE and understates All Other NTS. GTE's detailed explanation and recalculation of SPFs by the separate use of frozen and transitional SPFs, in Attachments 2A, 3 and 4, to its direct case results in a line termination revenue requirement increase of1,409,933 for all the GTOC study areas combined.

(2) *Adjustments to line termination and carrier common line rate elements.* These adjustments were urged to correct an arithmetic error overstating interstate costs by23.5 million, and the consequent overallocation of8.6 million to GTE's interstate revenue requirement. GTE states in its direct case that its corrected SPF calculation (based on the original composite SPF method) reduces the line termination revenue requirement by833,134 for Florida. GTE Direct Case at 34 and Attachments 1 and 2.

(3) *Use of seven - day traffic studies in Florida and Illinois.* The *Designation Order* instructed GTE to submit information detailing whether GTE of Florida and Illinois actually received settlements on the basis of seven-day studies at the time SPF was frozen in 1981. GTE states in its direct case that GTE of Florida has used seven-day traffic studies for monthly settlement purposes since Janu-

ary 1, 1981 and computed its 1981 frozen SPF on the same basis, thus excluding any effects from seven-day studies conducted after 1981. GTE Direct Case at 28-31.[22] With respect to GTE of Illinois, it began to use seven-day studies in 1977, and was using this method of settlements with Illinois Bell's consent when the SPF was frozen in 1981. GTE of Illinois thus contends the use of seven-day studies in the computation of its 1981 frozen SPF is appropriate and should be allowed.

(4) *Effect of Zoned Usage Measurement (ZUM) service on California SPF.* GTE had argued that AT&T's initial challenge to its California SPF calculation was flawed by AT&T's failure to consider ZUM service. According to GTE, Category 6 costs for ZUM are allocated differently from other Category 6 COE costs. The *Designation Order*, however, tentatively rejected GTE's contention, noting that GTE had submitted an example of the ZUM allocation process but failed to show the actual SPF calculation -- a requisite of determining this issue on its merits.

In its direct case, GTE concedes that the ZUM calculation does not directly affect the calculation of interstate SPF, but asserts it does affect what the mechanized GTE Part 67 system reports as Total COE Category 6 NTS. Thus, GTE contends, the amount this Part 67 system reports as total COE Category 6 NTS cannot be multiplied directly by the interstate SPF to verify interstate COE Category 6 NTS. Indeed, GTE states, the two Cat 6 amounts should not be equal as one reflects the requirements of the Separations Manual and the other, not employed for interstate apportionment, reflects ZUM apportionment in accord with California regulatory requirements. As the interstate category 6 NTS amount is correct, GTE asserts, AT&T's supposed discrepancy is erroneous. GTE supports these contentions with a sample calculation of COE Category 6 NTS at ZUM locations. GTE Direct Case at 32-34.

2. *AT & T Comments.* AT&T asserts that GTE's documentation supporting the recalculation of revenue requirements for Line Termination and CCL rates is incomplete, in that it fails to substantiate the difference between Total Category 6 NTS and the Total Reflecting ZUM. Further, AT&T states, the correction of the arithmetic error in Florida has not been fully implemented because NTS costs associated with Station Equipment have not been adjusted and nothing in GTE's filing indicates that error, which affects the CCL rate, has been reflected by NECA. Finally, AT&T argues that while GTE recites the history of its litigation with Southern Bell respecting settlements, those settlements were made on the basis of five-day studies during 1981, and all adjudications to date have confirmed the use of five-day studies. AT&T Comments at 9-10.

GTE Rebuttal. GTE states that Attachment 2A of its direct case calculates and lists by all 31 GTE study areas the change in Line Termination revenue requirement effected by the use of a single composite SPF rather than separate frozen and transitional SPFs -- a total increase of 1.4 million in GTE's revenue requirement. GTE Direct Case at 11-12. GTE also iterates its explanation in the direct case that ZUM does not affect the COE Category 6 investment actually assigned to interstate, but rather what the carrier's mechanized Part 67 system reports as Total COE Category 6 NTS. *Id.* at 32-33.

As to the correction of the arithmetic error affecting Florida, GTE notes that the error is described in its direct case (at 34 and Attachments 1 and 2), and suggests that AT&T has confused the correction of the arithmetic error with the separate change replacing the composite SPF with separate frozen and transitional SPFs (GTE Direct Case at 34-35, Attachment 2A, 3 and 4), which resulted in the1.4 million adjustment described above. Finally, GTE states that the Florida arithmetic error would not change the nationwide CCL revenue requirement sufficiently to entail a change in the NECA CCL rate. Similarly, the total GTOC Line Termination increase (netting the0.8 million decrease occasioned by the arithmetic error and the1.4M increase entailed by the shift to reliance on separate frozen and transitional SPFs) represents less than half of one percent, so that Line Termination rates were not increased.

Unlike the situation in Illinois, where GTE had employed seven-day studies for settlement purposes since 1977 without controversy, in Florida Southern Bell initially disputed this approach. GTE of Florida brought an action for breach of the carriers' 1969 contractual agreement governing such settlements in the U.S. District Court for the Middle District of Florida. This litigation has since been settled,[23] with Southern Bell accepting GTE's use of an aggregate interstate frozen SPF of .43542674 for purposes of predivestiture interstate settlements. This SPF reflects a calculation based upon GTE's use of seven-day studies for calendar 1981, and Southern Bell has advised NECA that it does not dispute GTE's use of the specified SPF factor. As under the settlement terms GTE has effectively received 1981 settlements from Southern Bell premised on its use of seven-day studies, it contends its disputed SPF and access element development methods have been validated in this respect.

Discussion and Conclusion. With respect to issue (1), GTE's direct case is sufficiently detailed to satisfy the requirements of the *Designation Order* respecting the altered SPF calculation. As noted, the aggregate effect of employing separate frozen and transitional SPF elements is to increase the Line Termination revenue requirement by1.4 million for all GTE study areas combined. While the *Designation Order* tentatively concluded that GTE and NECA should modify their revenue requirement estimates and associated rates to reflect this revision, such an adjustment cannot now have the timely effect on current rates that the *Designation Order* sought and, as GTE notes, the adjustment is significantly offset by the correction of the arithmetic error in Florida. As any refund liability for excess earnings is not predicated on individual rate elements, and there is no question of disallowance in this regard, no purpose would be served by pursuing this issue further.[24] Accordingly, the investigation is terminated with respect to this issue.

As to issue (2), it appears that GTE has adequately corrected its arithmetic error in Florida. It also appears that the combined magnitude of this error and the SPF recalculation would not warrant revision of the NECA CCL rate.[25] Accordingly, the investigation is terminated with respect to this issue.

With respect to issue (3), the use of seven-day studies for settlement purposes in Florida has been established by the settlement of GTE's litigation with Southern Bell, and requires no further investigation. The SPF developed from these studies comports with the Commission's procedure in freezing SPF in 1981. Similarly, GTE's Illinois SPF reflects the SPF that was actually used in 1981.

Finally, as to issue (4), GTE's explanation of the difference between Total Category 6 NTS developed for separations purposes and Total Reflecting ZUM developed for California regulatory purposes establishes that the ZUM factor questioned by AT&T does not affect the COE Category 6 investment assigned to interstate.

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ISSUE 11: Disparate ratios of revenue requirements to access minutes of use in corridor and non-corridor traffic by New York Telephone.

Summary. The *Designation Order* reported AT&T's development of the ratio of revenue requirements to access minutes of use (MOU) for both NYT's corridor (.0559) and non-corridor (.0378) traffic, and the contention that corridor revenue requirements were inaccurately high. NYT replied that AT&T had incorrectly used projected billing and collection expenses from NYT's April 5 filing rather than historic expense included in the same filing. This selective combination of projected and actual data understates the billing and collection expense that should have been included in AT&T's analysis. Similarly, NYT contends AT&T erred in neglecting to include Traffic Service Position System (TSPS) revenue requirements in the interexchange component of the non-access revenue requirements, or to include any private line element in estimating the interexchange component of the non-access other revenue requirement. These corrections, if implemented, would result in ratios of .041 for corridor traffic and .0378 for non-corridor traffic. The *Designation Order* asked AT&T to describe any differences in facilities, and any distortions in its computations, that could cause the two ratios to differ at all, and to specify a significant variation for purposes of its analysis.

Discussion and Conclusion. In its supplemental submission (filed May 22, 1986), AT&T accepts NYT's proposed methodological corrections and agrees that the ratios are "reasonably close." AT&T does not specify a significant variation for purposes of its analysis, nor does it address facility differences or computational distortions that might affect the analysis. NYT does not comment further on this issue in its direct case. Accordingly, we consider this issue resolved by the methodological corrections proposed by NYT.

FOOTNOTES FOR APPENDIX B

[1] The issues are presented and numbered in the sequence in which first set out in the *Designation Order*. Issue 8, the recovery of antitrust expenses, was referred to a separate proceeding by the *Designation Order* but to enable consistent reference the numbering sequence has not been altered.

[2] These include the impact of investment and cost associated with FX minutes of use allocated to interstate; retroactive adjustments; "separations recycle" adjustments; and any others needed to reflect different levels of CPE investment in the interstate and intrastate jurisdictions.

[3] Specifically, AT&T states it relied on interstate amounts from Vol. 2-2, Sec. 5, Workpaper 4.1 of Ohio Bell's July 2 tariff support, while the 19129-based adjustments were made by Ohio Bell afterward and are set out in Workpaper 4.4.1.

[4] In contrast, certain smaller adjustments are essentially undisputed. Thus, the adjustment by Ohio Bell to reflect central office sampling relies on the actual practice employed for the state ratemaking process.

[5] For purposes of determining excess earnings, the present Order embraces the 15-month review period from October 1, 1985, to December 31, 1986. Similarly, any such expense disallowance, while initially identified on the basis of a test year deficiency, will be imposed for the entire effective period of the associated rates.

[6] This is explained, Pacific notes, in its Development of Interstate Separations Factors, Vol. 2-2, Sec. 3 of the support materials submitted with its July 1985 filing.

[7] AT&T did not comment on Ohio Bell's direct case in this respect.

[8] AT&T did not comment on this issue in any of its pleadings.

[9] Chesapeake and Potomac Telephone Companies *et al.*, CC Docket No. 85-93, Mimeo No. 3575, released Apr. 3, 1985; Petitions for Recovery of Equal Access and Network Reconfiguration Costs, FCC 85-628, 50 Fed. Reg. 50910, Dec. 13, 1985.

[10] AT&T does not further address this issue in its pleadings.

[11] NYT has since clarified that the tax expense "in controversy" has in fact been withdrawn as a claim against the NECA pool, so that any residual dispute over the effect of the19.702 million balance on Carrier Common Line (CCL) rates is between AT&T and NECA, and outside the scope of this investigation. Letter from G.R. Evans, NYNEX, to Tariff Division, Common Carrier Bureau, Sept. 19, 1988.

[12] District of Columbia v. Chesapeake and Potomac Tel. Co., 516 A.2d 181 (D.C. App. 1986).

[13] As Contel notes, the *Designation Order* inadvertently transposed "access" and "non-access" in describing the accounting changes made under the POP migration plan. *Designation Order*, Appendix B at 12.

[14] AT&T did not address the carriers' direct cases in its pleadings.

[15] The phased removal of CPE investment and expense from exchange carriers' books was required by the Commission's action detariffing customer premises equipment. *See* Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, 89 FCC 2d 1 (1982).

[16] MTS and WATS Market Structure, 99 FCC 2d 708, (1984). The effect of this revision was to apportion CPE between common line and special access on the basis of surchargeable lines, rather than on the basis of total equivalent lines, which increases the CPE allocation to common line.

[17] NECA states the forecast methodology for smaller LECs is explained in Vols. 2 and 3 (at 3-15) of its July 2 filing.

[18] As AT&T notes, NECA mistakenly contends the *Designation Order* recognized that the Part 69 change dislocated the linear relationship of the phasedown. That Order in fact simply summarized NECA's contention without accepting it, and the explanatory requirement placed on NECA confirms this. *Designation Order*, Appendix B at 15.

[19] 2243 = [18,126,728 thousand (NECA's average rate base per the March 31, 1987 Form 492)] * [.1275].

2264 = [18,126,728 thousand] * [.1249]. It is our understanding that NECA's reported 12.49 percent return reflects an add-back for refunds.

[20] 48.3 million =26.1 million * (F.I.T. gross-up factor of 1.851852).

[21] *See* Establishment of Interstate Toll Settlements and Jurisdictional Separations Requiring the Use of Seven Calendar Day Studies by the Florida Public Service Commission, 93 FCC 2d 1278 (1983).

[22] The *Designation Order* recognized the pending litigation between GTE and Southern Bell over the interpretation of settlement contracts, which has since been resolved by settlement. *See* discussion of sub-issue (3), *infra*.

[23] Stipulation and Order of Dismissal, General Telephone Company of Florida v. Southern Bell Telephone and Telegraph Company, Case No. 83-907-Civ-T-13, U.S. District Court for Middle District of Florida, June 23, 1986 (unpub.).

[24] However, we expect that GTE will submit a revised Form 492 for this period to reflect the effect on its rate of return of the adjusted revenue requirement.

[25] As with the adjustments under issue (1), *supra*, however, GTE should reflect these adjustments in a revised Form 492.