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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

OPINION NO. 94-2

CASE 92-C-0665 - Proceeding on Motion of the Commission to Investigate Performance-Based Incentive Regulatory Plans for New York Telephone Company.

CASE 92-C-0001 - Petition of New York Telephone Company for Permission to Defer its Share of the Costs Resulting from Two Recent Settlements of Tax Issues Involved in an Internal Revenue Service Audit of American Telephone and Telegraph Company Covering the Years 1981 to 1983, Filed in Case 8579.

CASE 92-C-0150 - Petition for Approval, Pursuant to Public Service Law, Section 113(2), of a Proposed Allocation of Certain Tax Refunds between New York Telephone Company and Ratepayers.

CASE 92-C-0228 - Petition for Approval, Pursuant to Public Service Law, Section 113(2), of a Proposed Allocation of Certain Tax Refunds between New York Telephone Company and Ratepayers.

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OPINION AND ORDER ADOPTING
TRACK 1 RECOMMENDED DECISION WITH MODIFICATIONS
AND RESOLVING TAX REFUND AND ASSESSMENT PROCEEDINGS

Issued and Effective: January 28, 1994

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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

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OPINION AND ORDER ADOPTING
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(Issued and Effective January 28, 1994)

BY THE COMMISSION:

INTRODUCTION

Track 1 of Case 92-C-0665

By order issued December 24, 1993, we directed New York Telephone Company (New York Telephone or the company) to reduce its rates by $170 million as of January 1, 1994 and set aside an additional $159 million to benefit consumers in a variety of ways.[1] That abbreviated order, which represented the outcome of the inquiry into the company's 1994 revenue requirement that had been conducted in Track 1 of this proceeding, was issued on an expedited basis to permit prompt implementation of the rate decrease. As promised in that order, this opinion describes in detail the basis for the decision.

The context for Track 1 is a broader proceeding looking toward a new regulatory framework consistent with the important changes throughout the telecommunications industry. Track 2,

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1 Case 92-C-0665, Order Requiring Reduction in Revenues and Directing Changes in Rate Design (issued December 24, 1993) (the December Order). As explained below, the amount of the set-aside has been changed.

already under way, is designed to develop that new regulatory framework. The purpose of Track 1 was to determine the company's 1994 revenue requirement as a step in the transition to the longer-term ratemaking plan that is expected to emerge from Track 2. In effect, the 1994 rates should serve as a bridge between the company's 1994 rate plan and the more comprehensive, longer-term plan that is anticipated.

The context and procedural history of the proceeding need not be repeated here, having been fully set forth in the recommended decision of Administrative Law Judges J. Michael Harrison and Joel A. Linsider, issued December 2, 1993.[1] Suffice it to say that this is Track 1 of a proceeding whose primary purpose is to consider a performance-based incentive regulatory plan for New York Telephone; that Track 1 has examined the company's 1994 revenue requirement, which is to be used in the design of any such plan; that this track was conducted pursuant to Section 97 of the Public Service Law (PSL), following a directive to the company to show cause that its rates in 1994 would be just and reasonable; that the Judges conducted full evidentiary hearings at which the company and all parties were given the opportunity to advance their own positions and challenge others'; that a novel public information process

1 That recommended decision refers to a record comprising 106 exhibits. Several additional exhibits have since been admitted; the total is now 113.

enhanced the ability of the public at large to make its views known on the matters at issue; that the recommended decision, whose reasoning and results we adopt except as here modified, sets forth an exhaustive discussion of the parties' positions and the Judges' resolution of the issues; and that the Judges' resolution of the issues, which reasonably balances the interests of shareholders and ratepayers, provides the basis for our decision here.

The Judges recommended that the company's annual revenue allowance be reduced by $296,751,000, and that recommendation served as the starting point for our consideration of the case. Accepting many, but not all, of the Judges' recommendations (and correcting some initial computations of the effects of those recommendations), we found in the December Order that the company's allowed revenues were $300 million greater than necessary and took the steps previously noted.[1] Further refinements and corrections since then establish excess revenues of $294,300,000, as shown in the Appendix to this opinion. (Those further refinements and corrections will be applied only to the "set-aside"; the immediate rate reductions of $170 million

[1] The figures in the first paragraph ($170 million and $159 million) do not sum to $300 million because the $170 million rate reduction anticipates the effects of stimulation, i.e., the increase in usage associated with the decrease in rates. The net revenue reduction, after stimulation, comes to $141 million and that figure, subtracted from $300 million, leaves $159 million in set-asides.

will be left unchanged, and the company's compliance filing with respect to new rates is unaffected by this change in the figures.)

The following sections of this opinion discuss the issues as to which our result or rationale differs from the Judges'; with respect to issues not here commented on, the Judges' resolution and reasoning are adopted. The decisions on the individual issues provide the basis for the overall finding that the company's allowed revenues may be reduced by $294.3 million ($323.3 million including the effect of revenue stimulation from the immediate rate reductions). The opinion sets forth the reasoning behind the allocation of that amount between immediate rate reductions and set-asides for incentives and improvements and considers the rate structure implications of that allocation.[1]

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[1] Two interlocutory appeals from the Judges' Ruling on Miscellaneous Matters, issued October 18, 1993, were filed after the close of the evidentiary record. One, by the Department of Law (DOL), sought reversal of the Judges' rulings precluding from Track 1 evidence relating to the accuracy of New York Telephone's service quality reporting and denying DOL's motion to compel New York Telephone's response to certain information requests (AG-62.G) concerning quantification of NYNEX's legal expenses allocated to New York Telephone. The other, by the Ad Hoc Committee of Independent Information Providers, sought reversal of the Judges' ruling that all issues related to Mass Announcement Service were properly considered outside of this proceeding in Case 93-C-0451. We have reviewed both filings, and neither provides any basis for reversing the Judges' procedural determinations. Both interlocutory appeals are denied.

The Tax Cases

Also resolved in this opinion are four proceedings involving various tax assessments imposed on the company and refunds received by it. The company sought to defer the assessments for later recovery and requested authority, pursuant to PSL §113(2), to retain the refunds and use them to reduce ratepayer amounts owed to the company. Three of the proceedings (Cases 92-C-0001, 92-C-0228, and 92-C-0342) involve the results of Internal Revenue Service (IRS) audits of the company's federal income tax filings for 1975 and the years 1979 through 1986. The fourth (Case 92-C-0150) involves a property tax refund from the City of Buffalo.

The cases were set for hearing in July 1992, but staff was granted a postponement until mid-1993 to work on other matters. Staff filed its testimony on April 30, 1993 and the company filed its responsive testimony on May 15, correcting it on May 19.

A hearing before Administrative Law Judge William Bouteiller was held on July 27, 1993. At that time, staff stated that it did not contest the company's proposal to use federal income tax refunds to offset the additional income tax assessments, nor did it disagree with the company over the City of Buffalo property tax refund. These cases are discussed further below; the results of the agreement between the company and staff are reflected in the overall decision here.

REVENUE REQUIREMENT ISSUES

Late Payment Charge Revenues

The Judges agreed with staff that it would be premature to recognize the effect of a proposed rule likely, if adopted, to reduce the level of late payment revenues. They suggested, however, that it would be reasonable to provide, if and when the rules are adopted, for deferral and later recovery of their effects.[1]

The rules, if adopted, might indeed reduce revenues, but not by an amount material enough to warrant the administratively burdensome remedy of deferral. Allowing deferral here would set a troublesome precedent, and that aspect of the Judges' recommendation is rejected.

Royalty Imputation

During the course of this case, the Rochester Telephone Corporation royalty proceeding was decided. That decision established a rebuttable presumption that a 2% royalty would be imputed with respect to other utilities' investment in

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1 R.D., pp. 24-25.

competitive enterprises.[1] The company argued, on a variety of procedural, legal, policy, and factual grounds, that no royalty should be imposed here, and staff and the Consumer Protection Board (CPB) vigorously contested that position.

The Judges found that the rebuttable presumption announced in Rochester did apply, contrary to New York Telephone's view; that the Commission had determined the royalty to be lawful and had denied requests for a stay; and that withholding action pending court review as the company had requested would be tantamount to assuming that the Commission would be reversed. In making the imputation, however, the Judges determined that the company had succeeded in rebutting the presumption to a degree that warranted waiving one-third of the presumed 2% royalty, and they imputed a royalty of 1.33%.[2] They applied that percentage to the company's competitive affiliates, exclusive of NYNEX Mobile Communications Company and NYNEX Information Resources Company; and they adopted staff's proposal to recognize only half of NYNEX's recent investment in Viacom, Inc. (Viacom), rejecting CPB's assertion that the full amount should be reflected. The Judges' conclusions on the legal and procedural issues are adopted, as is the 1.33% result they

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1 Case 28959, Rochester Telephone Corporation - Royalty, Opinion No. 93-11 (issued July 6, 1993); reh. den., Opinion No. 93-11(A) (issued October 1, 1993).

2 R.D., pp. 62-68.

reached, but several aspects of the manner in which they reached and applied that result require comment.

First, while the Judges properly resolved the parties' dispute over whether the rebuttable presumption applied to "upstream" affiliates, the entire debate on that point was somewhat misplaced. The primary effect of the rebuttable presumption is not to modify the way in which evidence on the issue is weighed; rather, it is to put utilities and other parties on notice that the matter should be addressed. On this issue as on others, the company's burden of proof flows directly from the Public Service Law (in this case, §97(1)), and that burden is one the company bears regardless of the presumption.

Second, several decisions since Rochester have made clear that the presumably imputed 2% comprises two elements, each valued at 1% and each separately subject to refutation in a specified manner.[1] The first imputes compensation to the regulated utility for the transfer to non-regulated affiliates of intangible assets; it can be avoided if the utility agrees that non-regulated affiliates will not be allowed to use such assets, including name, logo, reputation, financial support, or transferred employees. The second element imputes reimbursement for costs imposed on the regulated utility by its relationship

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1 E.g., Case 93-M-0453, Niagara Mohawk Power Corporation - Cogeneration and Other Subsidiaries, Order Authorizing Additional Investment (issued November 18, 1993).

with non-regulated affiliates, including financial risk and the risks of improper cost allocations. It therefore can be avoided if the utility agrees not to transact business of any kind (other than transactions necessary for corporate governance) with any non-regulated affiliate and affirms that every reasonably available measure has been taken to account for and obtain reimbursement for all direct and indirect costs of affiliation.

The company has not met the standard for avoiding the first element of the royalty. As the Judges found, NYNEX and its affiliates have benefited from their affiliation with a well-known company that provides services to most of the State. And while the NYNEX name is now to receive greater prominence on its own under the new "one-enterprise" approach, New York Telephone has certainly conveyed to the joint operation the good will and reputation that were developed with ratepayer funding. (Indeed, in establishing itself, NYNEX has relied heavily on the reputation of New York Telephone.[1]) There is thus no basis for waiving this element of the presumed imputation.

As for the second element, the NYNEX Restructuring Plan restricts transactions only between New York Telephone and affiliates not in the NYNEX telecommunications group;

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[1] Recent full-page advertisements carried in major newspapers associate NYNEX with New York Telephone and the former Bell system. They demonstrate the value NYNEX sees in associating itself with the reputation and logo of New York Telephone and the Bell system.

transactions with non-regulated affiliates in the telecommunications group are not so restricted. Strict application of the standard cited above would warrant imposing the full 1% on account of the latter transactions alone. Because this is Track 1 of a proceeding ultimately looking toward new forms of regulation, however, and in view of the limitations on affiliate transactions that are included in the Restructuring Plan, some conservatism is warranted; and, in the context of our overall balancing of shareholder and ratepayer interests, the second element of the royalty will be limited to 0.33%.[1] Should the company demonstrate that it will engage in no transactions with any non-regulated affiliates, that 0.33% imputation will be waived. For present purposes, however, the overall royalty imputation comes to 1.33%, the result reached by the Judges, albeit on the basis of further analysis.

In determining the investment base to which the 1.33% royalty should be applied, the Judges adopted staff's reasoning and included only one-half of the Viacom investment because it appeared that NYNEX had the opportunity to reduce its investment. Recognition of the entire investment is proper, since it involves active participation by NYNEX in the enterprise, not merely the purchase of preferred stock. Moreover, NYNEX, regardless of the

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[1] This limited adjustment is particularly conservative in the context of NYNEX history, recounted in other proceedings, of questionable dealings with its affiliates.

success of Viacom's offer to Paramount, may still maintain its investment in Viacom. Accordingly, recognition of the entire investment in the royalty base is proper since it represents not merely a passive investment in preferred stock but the beginning of a partnership arrangement between NYNEX and a major entertainment provider. And while the rate reduction effective January 1, 1994 recognizes only one-half of the investment, the full investment should be taken account of in determining the company's revenue requirement.

Interest on Overpayments

Staff proposed to disallow $6 million of expense attributable to a 1992 increase in the interest required to be paid when erroneous overbillings are returned to customers. The Judges rejected the adjustment on a variety of grounds, including the absence of any evidence of the egregious carelessness in billing that might warrant disallowing interest on the returned overpayments.

The Judges correctly held that the record in this proceeding does not support staff's adjustment. The Consumer Services Division's files, however, contain a number of examples of overbilling and overpayment, including some instances in which the refund was so delayed that the interest exceeded the overbilled amount. These files suggest an unacceptable laxity.

The company should improve its efforts to prevent, detect, and timely remedy such errors and should provide within 60 days a detailed report to staff as to its efforts to minimize such billing errors. In future cases, staff should examine the company's performance in this area and, if necessary, introduce evidence that could support a disallowance.

Rate of Return

As a step in the transition to a longer-term ratemaking plan, the Track 1 rate of return allowance takes the form of a range. To determine the low point of that range, we applied the Judges' discounted cash flow (DCF) analysis, suitably updated and adjusted. An earnings incentive allows the company to earn above that level, but equity earnings above 12.0% will be shared equally between shareholders and ratepayers.

In taking this approach, we agree with the Judges that the decision on rate of return in this proceeding should not prejudge the outcome of the Generic Finance Case (GFC) and that the method proposed in that case by staff and the company therefore should not be applied here.[1] The Judges also expressed concern about the alleged "staleness" of the data stemming from the use of the GFC method by staff and the company;

[1] Case 91-M-0509, Financial Regulatory Policies. We expect to receive a recommended decision regarding telecommunications companies this winter.

but that issue will be addressed in due course. For now, we use our current best estimate of the company's 1994 capital costs (which, as noted, is used as the low end of the authorized return range).

Before being adopted as the "baseline" allowed return for purposes of this transition year, the Judges' return must be updated, as they recommended, for changes in capital costs; an adjustment to capital structure is also required.

With respect, first, to capital structure, the Judges used an equity ratio of 55.6%. The traditional Commission approach, however, is to use NYNEX's consolidated capital structure, with competitive operations removed 60% from equity and 40% from debt. That produces an updated equity ratio of 51.8%.

This higher leverage and risk require an upward adjustment to the equity return. In addition, a diminution is needed in the adjustment applied by the Judges and CPB to remove the risk of competitive operations from the regulated return. They applied a 40-basis-point reduction to the market return, based on the assumption that the cost of equity for diversified operations is in the 13.8%-14.6% range; yet that assumption is internally inconsistent with CPB's point that the cost of equity for the market as a whole is 11.9%. On the other hand, NYNEX has substantially increased diversification with its Viacom investment. For these reasons, a 20-basis-point adjustment, which is consistent with past practice, is appropriate.

Updating CPB's and the Judges' DCF analysis using current data, and considering as well DCF data for all seven Bell Regional Holding Companies, leads to the conclusion that the NYNEX cost of equity using a 51.8% capital structure is about 11.0%. The 20-basis-point adjustment discussed above implies a 10.8% cost of equity for NYNEX's regulated operations. The overall required return comes to 9.15%, as shown in the following table:

	Ratio	Cost Rate	Wtd. Cost
Long-term Debt	43.2%	7.81%	3.37%
Short-term Debt	5.0[1]	3.8	.19
Common Equity	51.8	10.8	5.59
	100.0%		9.15%

Although the investors' required equity return and the overall cost of capital for New York Telephone has been estimated in this way, this does not necessarily constitute our final finding of the allowed equity return. This finding of required return is a fundamental element of the revenue requirement determining the amount of rate decreases and set-asides adopted

1 NYNEX currently has significant levels of short-term debt that it has issued in funding acquisitions. The short-term debt level in this capital structure has been constrained to 5%, on the assumption that NYNEX will eventually convert some of that short-term debt to long-term debt, or bear the interest risk of not converting it.

here; however, as explained in the December Order, the company will be afforded an opportunity to earn more than 10.8% on equity, depending upon its performance in relation to a short-term, $31 million earnings incentive for improved service and a longer-term performance incentive, comprising the remaining $122.3 million of the total set-aside, to be developed in Track 2. In addition, any earnings above 12.0% will be subject to equal sharing between shareholders and ratepayers.

Tax Assessments and Refunds

1. Federal Income Tax

In Case 92-C-0001, New York Telephone requested deferral accounting and rate recovery for a net income tax assessment of about $2.0 million plus related interest expense of about $100,000.[1] The assessment pertains to 1975 and 1981-1983. In Case 92-C-0228, the company sought deferral and recovery of an income tax assessment of $4.9 million for 1984-1986, offset by some $600,000 of interest. In Case 92-C-0342, the company reported its receipt of an income tax refund of $1.2 million for 1979 and 1980, and it proposed to use related interest income of $1.5 million to offset the foregoing assessments. Overall, the company sought rate recovery of $3.7 million, representing a

[1] All amounts have been rounded; the exact figures appear at Case 92-C-0001 et al., Tr. 34.

deferral of $5.75 million of intrastate income expense, reduced by $2.0 million of intrastate interest income.

Staff at first opposed the company's request, believing the ratemaking allowances for federal income taxes in the years at issue to have been adequate. After reviewing the company's testimony, however, staff satisfied itself that New York Telephone, and AT&T before it, had properly challenged questionable income tax assessments. Staff concluded that its initial objection to the deferrals had been overly aggressive, given the interest in encouraging utilities to keep their taxes to a minimum.

New York Telephone will be permitted to defer and recover its net federal income tax assessment of $3.75 million. The company reasonably challenged the IRS with regard to these taxes, and ratepayers would have benefited had it prevailed. As it turned out, the challenge proved unsuccessful; and the resulting tax deficiency should now be allowed, consistent with the policy of encouraging utilities to take responsibly aggressive tax stances.

While the parties agreed that New York Telephone should recover these costs, they did not specify a method of recovery. To eliminate the $3.9 million deferred asset from the company's books, this amount will be amortized in our calculation of the revenue requirement, reducing the amount of the revenue decrease that otherwise is warranted here. Once this deferral is fully amortized, the revenue stream that had been applied to it should be used to reduce other regulatory assets that have been approved by the Commission. This treatment is consistent with the accounting plan already submitted by the company and accepted by staff.

2. City of Buffalo Property Tax

In Case 92-C-0150, New York Telephone reported receipt of a property tax refund of $1.5 million (intrastate) from the City of Buffalo. At first, the company proposed to use the refund to offset deferred inside wire costs; but inside wire was fully amortized as of February 1993. The company and staff therefore agreed that the refund could be used to reduce deferred costs associated with the Uniform System of Accounts (USOA) re-write. However, this balance, like the federal income tax assessments, should be amortized in the calculation of the revenue requirement and, thus, eliminated from the company's books.

REVENUE ALLOCATION AND RATE DESIGN

The Judges adopted the essential features of staff's revenue allocation plan, which was to allocate the first $52.5 million to reductions in toll, Regional Calling Plan (RCP), and carrier access charges, the next $22.5 million to complete the elimination of locality charges, and the next $75.0 million to a 50% reduction in residential and business TouchTone rates; any additional revenue reductions would be applied to toll, access, and RCP rates.

The Judges' recommendations, which we adopt with some modifications, will advance several existing goals during the transition to new regulatory arrangements. The usage charge reductions will enhance competition, by pricing these services close to cost. The reductions in locality and TouchTone charges will advance universal service and improve customers' access to gateway communications services.[1] These reductions also compensate consumers for the fact that their rates--long among the nation's highest--have included excess costs. As the company has commendably reduced these costs, it is only fair that all customers shall share in the reduction.

The allocation of the $170 million decrease among the various services should be faithful to all of these goals. On balance, $52.5 million will be allocated to reductions in toll, RCP, and carrier access charges; $22.5 million to completing the elimination of locality charges; and $95 million to TouchTone reductions. This result fairly serves the objectives of

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[1] Our commitment to phasing out the locality charges was made in Case 90-C-0191, New York Telephone Company - Rates, Opinion No. 91-4 (issued March 7, 1991), mimeo p. 276.

furthering competition, ensuring universal service, and addressing the needs of rural customers for access.

With respect to specific rate design steps, the residence TouchTone monthly charge has been reduced from $1.35 to $.50, as the December Order directed;[1] this permits a reduction of the monthly business TouchTone rate from $2.73 to $1.43. TouchTone is increasingly becoming a gateway to other services, and the historic surcharge is not cost based. A substantial divergence from basic rates is not justified.

With respect to usage charges, the December Order authorized reductions in toll rates of up to twice the percentage reduction applied to RCP and access, in recognition of the greater amount of contribution included in toll rates. The company's compliance filing provides for the following reductions in charges for these services:

Category	Annual Reduction	% Reduction
Toll	$14.25 million	9.9
Access	$12.75 million	5.0
RCP	$25.50 million	5.0
Total	$52.50 million	

The Judges determined that the reductions in access charges should be assigned to the Carrier Common Line Charge

[1] December Order, p. 5.

(CCLC), a fixed charge element. The commitment to cost-based pricing, however, requires that time-of-day (TOD) discounts for off-peak periods also be increased. Access charges are a major cost of service for the interexchange carriers (IXCs), and the inadequacy of these discounts in the past created perverse incentives for the IXCs to eliminate or at least reduce the TOD discounts in their own toll rates. In October 1992, in the first phase of access and toll rate reductions in Case 28425, TOD discounts were partially implemented, but more needs to be done now. Staff was directed to confer with the company and the IXCs as to the proper TOD discounts to be implemented now, and the compliance filing includes increases in TOD discounts for intraLATA access from 10% during evening hours and 20% during night hours to 40% and 65% respectively; these discounts match those in effect for RCP and intraLATA toll and account for $1.4 million of the decrease allocated to access charges. InterLATA access TOD discounts have also been increased from 10% in the evening and 20% at night to 15% and 30%, respectively; this change accounts for $10.8 million. A remaining balance of $0.5 million of the $12.75 million[1] has been used to reduce the CCLC. AT&T has been directed to pass along to its customers the reductions in usage charges.

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[1] The components sum to only $12.7 million because of rounding. Each element reflects a Gross Revenue Tax multiplier of 1.0622.

The compliance filing eliminates the locality mileage charges in the 158 exchanges where they remain. The elimination of the locality mileage charges will produce monthly savings ranging from $1.38 to $9.80 for customers who have been paying these charges. The company computes the total revenue reduction to be $22.2 million rather than the $22.5 million reflected by the Judges; the additional $0.3 million was assigned in the compliance filing to the TouchTone rate reduction. That result is reasonable.

The rate changes discussed above became effective January 1, 1994, on a temporary basis, subject to refund. These rates will be further reviewed in February after the parties in this proceeding have had an opportunity to comment on the compliance filing, and they will be made permanent then if found to be in compliance with our decisions.

Finally, account must be taken of the fact that the $170 million of rate reductions produces additional revenues through stimulation of demand for telephone services. The company requested an opportunity to update the staff computation of the TouchTone portion of this stimulation, using a novel comprehensive estimation technique which incorporates, among other things, such factors as the asymmetric response of markets to the direction of a price change. The Judges thought that request to be reasonable; but while the new technique may prove worthy of serious consideration, it remains at this juncture under development and untested. For this case, at least, we will rely on the more traditional econometric models, developed in previous cases and applied by staff here, for the elasticity of demand and cost effects.

Final application of those models, given the exact revenue changes in specific service categories described above, suggests an estimate of stimulation in the use of telephone services, net of the increased cost to serve that demand, in a range centering around $27.5 million. We have used, for the purpose of calculating the set-aside in this case, net stimulation of $29 million as a reasonable estimate approximating the final result of the models.

When the stimulated revenues are added to the identified level of excess revenues, the total to be disposed of comes to $323.3 million, and the amount to be set aside to $153.3 million.

SERVICE QUALITY

The Judges adopted a "1994 Service Quality Plan" submitted by staff, CWA, PULP, New York City, and the company. As the Judges noted, the plan provides for up to $90 million in penalties in 1994, $50 million of which would be assessed regardless of the company's level of earnings, for failure to meet defined aggregate objective and surveillance levels (as defined in our Regulations) of certain key service quality standards. The plan also factors into revenue requirements a $20 million allowance to be earmarked and spent specifically on efforts to meet these standards.

We agree with the Judges that this plan is reasonable for 1994 and requires the company to improve its performance materially over 1993 target levels. Accordingly, the plan is accepted, and the company is directed to abide by it and carry it out and to submit, by the end of January 1995, a report documenting the expenditure of the $20 million earmarked for service improvements pursuant to the plan.

The plan, of course, is based on the service standards in the Commission's rules (16 NYCRR 603.12). If staff's audit of the company's service quality measurement practices leads to changes in the practices or standards, those changes may be incorporated into the 1994 service quality plan to the extent they do not materially modify the degree of effort needed to meet the plan's target.

Finally, as noted in the December Order,[1] the company will be required to file in Track 2 of this proceeding a comprehensive plan to reform its service quality report monitoring.

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[1] December Order, p. 4.

More broadly, the Track 1 decision reflects a commitment to encouraging improvements in the quality of New York Telephone's service and network, particularly in those areas of its service territory where the incurring of expenses and the making of investments may not be as attractive as elsewhere. That commitment to utilize incentives to encourage improvements in performance underlies the determination to set aside for later disposition a portion of the revenue requirement decrease that would otherwise have been applied to immediate rate decreases. This includes both $31 million we have set aside for service quality improvements in areas of the State such as Brooklyn-Queens-Bronx, and others where service quality consistently has been below reasonable standards, as to which we have required the company to submit a service quality plan; and the balance of the set-aside amount, which will be used, in the manner to be decided in Track 2, to provide incentives, for such purposes, described below, as network and service quality improvement, core customer[1] price and service plans, strategies for competition, maintenance of universal service, and the marketing of new services with due regard to the Commission's privacy principles. All of these efforts will complement, and not displace during 1994, the 1994 Service Quality Plan accepted here.

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[1] I.e., customers of basic services.

APPLICATION OF EXCESS REVENUE REQUIREMENT

As already noted, our resolution of the various revenue requirement issues suggests that the company's revenues could be reduced by $300 million. Ordering so large a rate reduction now, however, could impair the company's efforts to improve the quality of its service and its network. Instead, our approach in this case is to provide substantial immediate rate reductions while setting aside some of the revenues to facilitate improved performance by the company in several key areas. That approach strikes an appropriate balance between short- and long-term benefits.[1]

In the transition to a more competitive telecommunications environment, it is important for regulators to ensure that the less profitable markets, or those more costly to serve, benefit from reliable and adequate service levels. Therefore, the set-aside revenues are available for both short- and long-term incentive plans. These include targeted short-term service improvements to be undertaken immediately (i.e., those to which the $31 million set-aside is to be applied), and longer-term incentives, to be developed in Track 2 of the proceeding.

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[1] That conclusion is bolstered by the results of the public involvement process in this case, which showed an eagerness on the public's part for improved service, enhancement of basic service at current price levels, access to technological advances that may offer other social benefits, and the maintenance of privacy protection.

Reserving some of these revenues for disposition in Track 2 could enhance the parties' ability to develop a plan that would advance the goals we have set by earmarking specific amounts for designated incentives. It would thus benefit ratepayers in the long run even more than immediate rate decreases, since network and service incentives are likely to result in better service at lower cost. The total amount allocated to rate reductions should be large enough to be meaningful and to achieve important rate design goals, while the set-aside amount should be large enough to promote real and long-lasting service and other improvements, particularly in the areas of the State identified below. A wide range of allocations would satisfy these criteria; a reasonable position within that range, which we adopt, reduces rates now by $170 million. Recognizing associated usage stimulation of $29 million yields a net revenue reduction of $141 million, leaving $153.3 million as the amount set aside for incentives and improvements--an amount substantial enough both to allow for short-term incentives and to play a role in the Track 2 process.

The set-aside will be applied to both short-term and long-term programs. Usually, short-term incentives are best avoided, for they entail a risk that the utility will skew its allocation of resources in an attempt to earn the available short-term reward. Nevertheless, several areas of below-average service require New York Telephone's special attention during

1994, and the availability of incentives can make expenditures and investments for network and service improvements in these locations more attractive than they otherwise might be. The most prominent of these is the greater metro area (Brooklyn-Queens-Bronx), but several upstate areas, including the Westchester-South Maintenance Center and the Elmwood and Waterfront Maintenance Centers in western New York, also need extra attention. (That some areas need extra attention, of course, implies neither that service obligations elsewhere may be disregarded nor that improvements in some areas should be accomplished at the expense of others.)

Overall, our concern is with the quality of service to New York Telephone's customers, and not with the manner by which the company achieves service improvements. Where traditional regulatory oversight might prescribe technological criteria or even approve a utility construction program, regulation in a competitive era should focus on results. In an emerging competitive arena, there will be situations like those presented above, where customers do not have a competitive alternative. Our regulatory response in those instances will be directed at the results of New York Telephone's efforts to improve service.

The company was directed to file, after consulting with staff, a short-term plan that identifies service improvements goals and suitable incentives; the amount available for this purpose is $31 million, equivalent to 50 basis points of return on equity.[1] To insure the integrity of the incentive process, the company was also directed to address concerns that had been raised about its service quality reporting and the monitoring of those data. Accountability with respect to these service improvements is of crucial concern, and the company will be required to measure and demonstrate the reasonableness of the improvements, as well as their incremental cost and nature, by not later than the end of the first quarter of 1995.

The remainder of the set-aside, $122.3 million, will be available to fund a comprehensive incentive program, consistent with the regulatory plan to be developed in Track 2. Any such plan must take account of the many groups and entities having an interest in it: customers (with and without competitive alternatives); shareholders; the company's work force; competitors; and the State as a whole (whose interests are both economic and social). The interests affected thus include, among others, fair competition and regulatory flexibility, universal service and protection of customers who cannot benefit from competition in the short term, quality service, and modernization

[1] The $31 million that has been targeted for service improvements in the greater metro area and several upstate areas shall not be considered in the calculation of earnings sharing approved herein.

of the communications network consistent with sound economic investment practices.

As already noted, this decision provides the foundation for a longer-term, more comprehensive regulatory framework that will be appropriate for New York Telephone in a changed market place. To that end, the parties in Track 2 should direct their efforts to developing a plan that considers the following elements: improved efficiency and service; relevant incentives and the extent of those incentives; the removal of barriers to competitive entry in New York Telephone's service territory; reallocation of subsidies while maintaining universal service; incentives to market new services to willing customers; increased price flexibility in competitive markets; investments in technology to meet privacy concerns; and increased accessibility of telecommunications services to persons with disabilities. The parties are free to consider other matters that may be pertinent to a comprehensive regulatory plan. The plan that emerges from the set-aside should be an integral part of the move to a new regulatory framework for New York Telephone.

Achieving collaborative progress toward a more flexible and competitive telecommunications marketplace will require some mutual trust among the parties. To this end, it will be important that the company resolve outstanding issues concerning its service quality report monitoring, the ongoing audit of its transactions with affiliates and its practices in the marketing of wire maintenance services. Ultimately, of course, a fully competitive telecommunications market backed by adequate fair trade and consumer protection strictures is the best assurance that improper practices will be unprofitable and will be punished. The road to such a marketplace will be substantially easier if all parties approach the Track 2 proceeding in good faith.

It is our intention to conclude the Track 2 proceeding during 1994. This is intended to allow for a process that is both comprehensive and expeditious. We hope to be able to consider a collaboratively developed plan by mid-1994. If no such plan is in prospect, the Judges should proceed with a schedule that contemplates conclusion of hearings on a basis that still permits a Commission decision during 1994. The Administrative Law Judges and senior staff should report to us on the progress of this proceeding periodically and should inform us promptly of any serious problems that arise.

OTHER ISSUES

Under the heading "Other Issues," the Judges discussed several matters that do not have an immediate impact on 1994 revenue requirements. For the most part, their conclusions on those issues are adopted; only the exceptions are discussed here.

New York Telephone has deferred recovery of $392 million of early retirement costs claimed to have resulted from adoption of Statement of Financial Accounting Standards (SFAS) No. 88. Staff proposed to disallow $75 million, which staff had computed to be the amount of offsetting savings not captured in rates. Staff argued that the company should have obtained Commission authorization for the deferral, in which event the Commission would have required the company to offset its deferrals by the amount of these savings.

The Judges rejected staff's proposal, relying heavily on the company's reporting of the deferrals in its annual reports. These reports, however, do not constitute a request for accounting treatment nor do they provide sufficient notice to the Commission of the company's position. Further, it is our long-standing policy to reflect anticipated savings when a utility requests deferral accounting of costs, and we do not agree with the Judges' conclusion that long-term savings associated with the early retirements in question are not clearly identified. Denying deferral altogether now would be excessively punitive, but the company should certainly be no better off than it would have been had it filed for approval, in which event the offset would have been applied. Accordingly, the staff adjustment is adopted.[1]

In a related matter, the Judges rejected a staff proposal that there be a further review of the company's pension/OPEB accounting plan in Track 2 of this proceeding. Given that staff has found the company's plan to be generally reasonable, and in light of the fact the Commission's Statement of Policy on pensions and OPEBs accounting contemplates a review of the accounting after a five- to seven-year period, the Judges determined that further review in Track 2 would be unnecessary. It appears, however, that pension costs may now be significantly overfunded, and staff is concerned that the company's excessive recognition of pension gains might flow to earnings and thus be lost to ratepayers. That concern warrants immediate further review of the plan, and the company is directed to address in Track 2 the effect of its accounting plan in these respects.

The Commission orders:

1. To the extent they are consistent with this opinion and order, the recommended decision of Administrative Law Judges J. Michael Harrison and Joel A. Linsider and the order issued in

[1] There is no 1994 revenue requirement effect, as noted, but the $75 million is to be written off in 1993, reducing reported earnings.

Case 92-C-0665 on December 24, 1993 are adopted as part of this opinion and order.

2. New York Telephone Company (the company) is directed to expense the costs for procurement services provided by its subsidiary, Telesector Resources Group, Inc.

3. The company is directed to recognize the cost of Post-Employment Benefits in accordance with SFAS No. 112. The incremental intrastate expense relating to the implementation of SFAS No. 112 is $21.960 million and shall be phased in over a four-year period.

4. The company is authorized to defer $77.0 million related to SFAS No. 43 - Compensated Absences. SFAS No. 43 deferred costs shall be recovered consistent with the company's filed accounting plan which is herein adopted.

5. Upon completion of the amortization of regulatory assets as contained in New York Telephone's accounting plan, the company is directed to file a plan using this existing revenue stream to reduce other Commission approved regulatory assets.

6. The company is authorized to defer $317 million related to early retirement costs that resulted from the adoption of SFAS No. 88 - Employers' Accounting for Settlements and Curtailments of Defined Benefit Plans and for Termination Benefits. The company shall write off $75 million of deferred early retirement costs to Account 7620 - Extraordinary Income

Charges. The company is also authorized to use this account for that purpose and to make any related federal income tax entries that may be required.

7. The company is directed to account for Pensions in accordance with SFAS No. 87, and for Post Retirement Benefits Other than Pensions in Accordance with SFAS No. 106. Any net credit resulting from the implementation of these accounting standards shall be applied to the deferred costs resulting from the preceding paragraph.

8. The company is ordered to begin deferring on a monthly basis $153.3 million in annual revenue requirement (plus carrying charges) as described in this opinion. The company is also authorized to make any related federal income tax entries that may be required.

9. The company shall account for expenses associated with charitable contributions below the line, consistent with the rate treatment of disallowances contained in the recommended decision.

10. The company shall file a plan showing how it will calculate its 1994 earnings subject to the 12% cap. The method should be identical to that used in Ordering Paragraph 5 of Opinion No. 92-26. In addition, New York Telephone may make recommendations for the treatment of any extraordinary charges

(e.g., restructuring costs) that may occur during the period the earnings cap is in place.

11. New York Telephone Company (the company) is authorized to defer $5,751,000 in federal income tax expense and $2,015,000 in net interest earnings (net of tax). The company is authorized as well to defer a refund from the City of Buffalo of $1,528,000 in real property tax and make any related federal income tax entries that may be required. The foregoing deferrals shall be amortized in the manner described in the foregoing opinion.

12. Within 30 days of the date of this opinion and order, the company shall file with the Office of Accounting and Finance, for audit and review by the Director of that office or a designee, an accounting plan for carrying out the provisions of the preceding ordering clauses.

13. The company shall comply with the 1994 service quality plan. Within 30 days of the date of this opinion and order, the company shall file, with the Director of the Communications Division, a compliance and implementation plan including earmarking of the $20 million provided under that plan for wage-related expenditures for targeted service improvements.

14. Within 60 days of the date of this opinion and order, the company shall file with staff a detailed report on its efforts to minimize overbillings, as described in this opinion and order.

15. These proceedings are continued.

By the Commission,

(SIGNED)

JOHN J. KELLIHER
Secretary

NEW YORK TELEPHONE COMPANY

Commission Opinion

Index to Appendix A

New York Telephone Company
Allocation of Revenue Reduction
Per Commission
For the Rate Year ended December 31, 1994
(Millions)

Immediate Rate Change	
Total Rate Reduction	($170.0)
Effects of Stimulation	(29.0)
Net Revenue Reduction	($141.0)
Track II Set Aside Account	
Total Reduction Indicated	($294.3)
Less: Net Revenue Reduction (From Above)	(141.0)
Set Aside Account (Revenues Deferred)	($153.3)

NEW YORK TELEPHONE COMPANY
Income Statement - Intrastate
Per Commission
For the Rate Year ended December 31, 1994
($000)

	Per ALJ 9/17/93	Adj#	Commission Adjustments	As Adjusted by Commission	Revenue Requirement	After Revenue Requirement
Local Service Revenues	$4,867,593		$0	$4,867,593	($141,000)	$4,726,593
Toll Service Revenues	500,886		0	500,886		500,886
Misc. Operating Revenues	470,160	1.	(145,713)	324,447		324,447
Less: Uncollectibles	50,089		0	50,089	(1,211)	48,878
TOTAL OPERATING REVENUES	5,788,550		(145,713)	5,642,837	(139,789)	5,503,048
Plant Specific Operation	1,272,464	2.	5,009	1,277,473		1,277,473
Plant Non-Specific Operation	490,593	3.	2,147	492,740		492,740
Depreciation	1,059,097		0	1,059,097		1,059,097
Customer Operations	731,398	4.	2,894	734,292		734,292
Corporate Operations	491,600	5.	645	492,245		492,245
TOTAL OPERATING EXPENSES	4,045,152		10,695	4,055,847	0	4,055,847
NET OPERATING REVENUES	1,743,398		(156,408)	1,586,990	(139,789)	1,447,200
Federal Income Tax	264,771	6.	(54,682)	210,089	(45,857)	164,232
Other Operating Taxes	616,793	7.	(174)	616,619	(8,770)	607,849
OPERATING INCOME	861,834		(101,552)	760,282	(85,162)	675,119
Other Income	(7,812)		0	(7,812)		(7,812)
EARNINGS AVAILABLE	854,022		(101,552)	752,470	(85,162)	667,307
Earnings Available Adjustments:						
Customer Deposit Interest	1,623		0	1,623		1,623
Tax Deduction for Imputed Interest	(7,484)	8.	5,326	(2,158)		(2,158)
TOTAL EARNINGS AVAILABLE	$848,161		($96,226)	$751,935	($85,162)	$666,772
RATE BASE	$7,286,234	9.	$896	$7,287,130	$0	$7,287,130
RATE OF RETURN	11.64%			10.32%		9.15%

NEW YORK TELEPHONE COMPANY
Rate Base - Intrastate
Per Commission
For the Rate Year ended December 31, 1994
($000)

	Per ALJ 9/17/93	Adj# 9.	Commission Adjustments	As Adjusted by Commission	Revenue Requirement	After Revenue Requirement
Telephone Plant In Service	$14,431,665		$0	$14,431,665		$14,431,665
Property Held For Future Telephone Use	0		0	0		0
AVERAGE GROSS PLANT	14,431,665		0	14,431,665	0	14,431,665
Less: Depreciation Reserve	5,788,218		0	5,788,218		5,788,218
Less: Accumulated Deferred Income Taxes	1,528,896		0	1,528,896		1,528,896
NET PLANT	7,114,551		0	7,114,551	0	7,114,551
Materials and Supplies	59,877		0	59,877		59,877
Cash Working Capital	292,985	A.	896	293,881		293,881
Other Rate Base Adjustments	83,926		0	83,926		83,926
Less: Section 38 Unamortized ITC	492		0	492		492
Less: Earnings Base over Capitalization Adjustment	264,613		0	264,613		264,613
RATE BASE	$7,286,234		$896	$7,287,130	$0	$7,287,130

NEW YORK TELEPHONE COMPANY
Summary of Adjustments - Intrastate
Per Commission
For the Rate Year ended December 31, 1994
($000)

Appendix A
Schedule 3
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	Adj#1 Correct Incentive Pay	Adj#2 Correct Directory	Adj#3 Correct Special Event	Adj#4 Royalty Payment	Adj#5 Imputed Interest	Adj#6 Tax Petitions	SEE NOTE Adj#7 Track II Set Aside Acct	0 0 0
Seperation Code	0	0	1	0	0	0	0	
Income Statement								
Local Service Revenues	0	0	0	0	0	0	0	0
Toll Service Revenues	0	0	0	0	0	0	0	0
Misc. Operating Revenues	0	(2,800)	0	3,800	0	(4,300)	(142,413)	0
Less: Uncollectibles	0	0	0	0	0	0	0	0
TOTAL OPERATING REVENUES	0	(2,800)	0	3,800	0	(4,300)	(142,413)	0
Network Support	97	0	0	0	0	0	0	0
General Support	330	0	0	0	0	0	0	0
Central Office Equipment Exp.	1,118	0	0	0	0	0	0	0
Central Office Transmission Exp.	434	0	0	0	0	0	0	0
Information Origination/Termination	929	0	0	0	0	0	0	0
Cable & Wire Facilities	2,103	0	0	0	0	0	0	0
Total Plant Specific	5,009	0	0	0	0	0	0	0
Network Operations	2,117	0	0	0	0	0	0	0
Other Plant Related	30	0	0	0	0	0	0	0
Total Plant Non-Specific	2,147	0	0	0	0	0	0	0
Depreciation & Amortization Expense	0	0	0	0	0	0	0	0
Marketing	54	0	0	0	0	0	0	0
Oper., Num., & Customer Services	2,840	0	0	0	0	0	0	0
Total Customer Operations	2,894	0	0	0	0	0	0	0
Executive & Planning	65	0	0	0	0	0	0	0
General & Administrative	485	0	95	0	0	0	0	0
Total Corporate	550	0	95	0	0	0	0	0
TOTAL OPERATING EXPENSES	10,600	0	95	0	0	0	0	0
NET OPERATING REVENUES	(10,600)	(2,800)	(95)	3,800	0	(4,300)	(142,413)	0
Federal Income Tax	(3,710)	(919)	(33)	1,330	0	(1,505)	(49,845)	0
Other Operating Taxes	0	(174)	0	0	0	0	0	0
OPERATING INCOME	(6,890)	(1,707)	(62)	2,470	0	(2,795)	(92,568)	0
Other Income	0	0	0	0	0	0	0	0
EARNINGS AVAILABLE	(6,890)	(1,707)	(62)	2,470	0	(2,795)	(92,568)	0
Earnings Available Adjustments:								
Customer Deposit Interest								
Tax Deduction for Imputed Interest	11	0	0	0	5,315	0	0	0
TOTAL EARNINGS AVAILABLE	(6,879)	(1,707)	(62)	2,470	5,315	(2,795)	(92,568)	0
Rate Base								
Telephone Plant In Service	0	0	0	0	0	0	0	0
Property Held For Future Telephone Use	0	0	0	0	0	0	0	0
AVERAGE GROSS PLANT	0	0	0	0	0	0	0	0
Less: Depreciation Reserve	0	0	0	0	0	0	0	0
Less: Accumulated Deferred Income Taxes	0	0	0	0	0	0	0	0
NET PLANT	0	0	0	0	0	0	0	0
Materials and Supplies	0	0	0	0	0	0	0	0
Cash Working Capital	888	0	8	0	0	0	0	0
Other Rate Base Adjustments	0	0	0	0	0	0	0	0
Less: Section 38 Unamortized ITC	0	0	0	0	0	0	0	0
Less: EBC Adjustment	0	0	0	0	0	0	0	0
RATE BASE	888	0	8	0	0	0	0	0

NOTE: $142,413 imputation equates to $153,300 in revenue requirement.

NEW YORK TELEPHONE COMPANY
Summary of Adjustments - Intrastate
Per Commission
For the Rate Year ended December 31, 1994
($000)

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Schedule 3
Page 2

Separation Code

	0 0 0	0 0 0	0 0 0	0 0 0	0 0 0	0 0 0	0 0 0	Total Adjustments
Income Statement								
Local Service Revenues	0	0	0	0	0	0	0	0
Toll Service Revenues	0	0	0	0	0	0	0	0
Misc. Operating Revenues	0	0	0	0	0	0	0	(145,713)
Less: Uncollectibles	0	0	0	0	0	0	0	0
TOTAL OPERATING REVENUES	0	0	0	0	0	0	0	(145,713)
Network Support	0	0	0	0	0	0	0	97
General Support	0	0	0	0	0	0	0	330
Central Office Equipment Exp.	0	0	0	0	0	0	0	1,116
Central Office Transmission Exp.	0	0	0	0	0	0	0	434
Information Origination/Termination	0	0	0	0	0	0	0	929
Cable & Wire Facilities	0	0	0	0	0	0	0	2,103
Total Plant Specific	0	0	0	0	0	0	0	5,009
Network Operations	0	0	0	0	0	0	0	2,117
Other Plant Related	0	0	0	0	0	0	0	30
Total Plant Non-Specific	0	0	0	0	0	0	0	2,147
Depreciation & Amortization Expense	0	0	0	0	0	0	0	0
Marketing	0	0	0	0	0	0	0	54
Oper., Num., & Customer Services	0	0	0	0	0	0	0	2,840
Total Customer Operations	0	0	0	0	0	0	0	2,894
Executive & Planning	0	0	0	0	0	0	0	65
General & Administrative	0	0	0	0	0	0	0	580
Total Corporate	0	0	0	0	0	0	0	645
TOTAL OPERATING EXPENSES	0	0	0	0	0	0	0	10,695
NET OPERATING REVENUES	0	0	0	0	0	0	0	(156,408)
Federal Income Tax	0	0	0	0	0	0	0	(54,682)
Other Operating Taxes	0	0	0	0	0	0	0	(174)
OPERATING INCOME	0	0	0	0	0	0	0	(101,552)
Other Income	0	0	0	0	0	0	0	0
EARNINGS AVAILABLE	0	0	0	0	0	0	0	(101,552)
Earnings Available Adjustments:								
Customer Deposit Interest								0
Tax Deduction for Imputed Interest	0	0	0	0	0	0	0	5,326
TOTAL EARNINGS AVAILABLE	0	0	0	0	0	0	0	(96,226)
Rate Base								
Telephone Plant In Service	0	0	0	0	0	0	0	0
Property Held For Future Telephone Use	0	0	0	0	0	0	0	0
AVERAGE GROSS PLANT	0	0	0	0	0	0	0	0
Less: Depreciation Reserve	0	0	0	0	0	0	0	0
Less: Accumulated Deferred Income Taxes	0	0	0	0	0	0	0	0
NET PLANT	0	0	0	0	0	0	0	0
Materials and Supplies	0	0	0	0	0	0	0	0
Cash Working Capital	0	0	0	0	0	0	0	896
Other Rate Base Adjustments	0	0	0	0	0	0	0	0
Less: Section 38 Unamortized ITC	0	0	0	0	0	0	0	0
Less: EBC Adjustment	0	0	0	0	0	0	0	0
RATE BASE	0	0	0	0	0	0	0	896

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NEW YORK TELEPHONE COMPANY
Explanation of Commission Adjustments
For the Rate Year Ending December 31, 1994
(000)

Appendix A
Schedule 3A

Schedules 1 & 2	Description	Sched. 3	Amount	
1. Misc. Operating Revenues				
	A. To correct the Judge's calculation of directory publishing revenues.	Adj (2)	($2,800)	
	B. To adjust the royalty payment to reflect the Commission imputation.	Adj (4)	3,800	
	C. To reflect the amortization of regulatory assets (i.e. tax audit costs).	Adj (6)	(4,300)	
	D. To defer revenues to reflect a rate decrease of $141 million ($142,413 equates to $153,300 in revenue requirement).	Adj (7)	(142,413)	
	TOTAL			($145,713)
2. Plant Specific				
	To correct the Judge's calculation of the incentive compensation plan.	Adj (1)	$5,009	
	TOTAL			$5,009
3. Plant Non-Specific				
	To correct the Judge's calculation of the incentive compensation plan.	Adj (1)	$2,147	
	TOTAL			$2,147
4. Customer Operations				
	To correct the Judge's calculation of the incentive compensation plan.	Adj (1)	$2,894	
	TOTAL			$2,894

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NEW YORK TELEPHONE COMPANY
Explanation of Commission Adjustments
For the Rate Year Ending December 31, 1994
(000)

Appendix A
Schedule 3A

Schedules 1 & 2	Description	Sched. 3	Amount	
5. Corporate Operations				
	A. To correct the Judge's calculation of the incentive compensation plan.	Adj (1)	$550	
	B. To correct the Judge's calculation of the special events.	Adj (3)	95	
	TOTAL			$645
6. Federal Income Taxes				
	To reflect the impact of adjustments made by Commission.		($54,682)	
	TOTAL			($54,682)
7. Other Operating Taxes				
	To reflect the impact of adjustments made by Commission.		(174)	
	TOTAL			($174)
8. Tax Deduction for Imputed Interest				
	A. To reflect the change in the debt component.	Adj (5)	$5,315	
	B. To reflect Commission's other adjustments.		11	
	TOTAL			$5,326
9. Rate Base				
	A. Cash Working Capital			
	To reflect the impact on Cash Working Capital that results from Commission's adjustments.			$896

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Appendix A
Schedule 4

NEW YORK TELEPHONE COMPANY
Calculation of Revenue Requirement
Per Commission
For the Rate Year ended December 31, 1994
($000)

1. Rate Base	$7,287,130
2. Rate of Return	9.15%
3. Required Earnings (L.1 * L.2)	666,772
4. Earnings Available Before New Rates	751,935
5. Earnings Shortfall (Excess) (L.3 - L.4)	(85,162)
6. Retention Factor	60.40%
7. Revenue Increase (Decrease) (L.5 / L.6)	($141,000)

Proof of Revenue Requirement Calculation

Revenue Increase (Decrease)	($141,000)
Uncollectibles	(1,211)
Operating Revenues	(139,789)
Gross Receipts Tax	(8,770)
Operating Income before Federal Income Taxes	(131,019)
Federal Income Taxes	(45,857)
Earnings Available	($85,162)

Development of the Retention Factor

Revenues	100.00%
Uncollectibles	0.86%
Operating Revenues	99.14%
Gross Receipts Tax	6.22%
Net Income before Federal Income Tax	92.92%
Federal Income Taxes	32.52%
Earnings Available	60.40%

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 92-C-0665 - Proceeding on Motion of the Commission to Investigate Performance-Based Incentive Regulatory Plans for New York Telephone Company, Track 1, 1994 Revenue Requirement.

HAROLD A. JERRY, JR., Commissioner, and
RAYMOND J. O'CONNOR, Commissioner, dissenting:

We dissent on the royalty issue.

1. The corporate structure of NYNEX and New York Telephone Company (NYT) is a significant fact in determining whether a royalty should be imputed to the company. NYT does not run or supervise the operations of the non-telephone affiliates because they are subsidiaries of NYNEX, NYT's parent. The possibility of cost shifting and intangible benefits (logo, name, reputation, etc.) found to exist in prior cases of utility subsidiaries cannot exist in this case. Thus, a royalty should not be imputed to the Company under the principles established in the Rochester Telephone decision (Case 87-C-8959).

2. NYNEX's investment in Viacom should not be subject to a royalty imputation since it was made with NYNEX funds, not NYT funds. Since NYNEX's investment is in non-voting stock, there is no possibility NYNEX can control or operate Viacom. Again, the Rochester Telephone decision was directed towards the potential harm that could result when a utility parent owns a non-regulated subsidiary. There is no evidence, or even possibility, that cost shifting or the unreimbursed use of NYT's name and reputation could happen in this case and, thus, the royalty imputation should be rejected.

C92-C-0342