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

In the Matter of	)		FCC 93-452
	)		
Simplification of the	)	CC Docket 92-296	
Depreciation Prescription	)		
Process	)		

REPORT AND ORDER

Adopted: September 23, 1993; Released: October 20, 1993

By the Commission: Commissioners Barrett and Duggan issuing separate statements.

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I. INTRODUCTION AND EXECUTIVE SUMMARY

1. On December 10, 1992, this Commission adopted a Notice of Proposed Rulemaking seeking comment on four distinct proposals to simplify the depreciation prescription process.[1] We also asked whether, under any of the proposed options, we should remove one step, the determination of future net salvage, from that same process to attain even more simplification. We currently prescribe depreciation rates for 33 LECs, AT&T, and Alascom. By this Order, we adopt two of those depreciation simplification plans. We adopt a modified form of the proposed basic factor range option for the local exchange carriers (LECs) regulated under our price cap regulatory scheme and a modified form of the price cap carrier option for AT&T.[2] However, at this time, we will not adopt any of the simplification proposals for Alascom or LECs currently regulated under a rate of return regulatory scheme. We also conclude that we will not now adopt a change in the determination of future net salvage.

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[1] Simplification of the Depreciation Prescription Process, Notice of Proposed Rulemaking, 8 FCC Rcd 146 (1992) (Notice).

[2] In so doing, we amend Section 43.43 of the Commission's Rules to reflect the changes we adopt herein. 47 C.F.R. § 43.43.

2. A total of 43 parties filed comments, reply comments, and ex parte comments.[3] Twenty-one state commissions, 6 state consumer advocates,[4] and the regulatory association, NARUC, expressed their views on the proposed simplification options. The LECs were represented by the Bell Operating Companies (BOCs), GTE, CBT, SNET, United, and the telephone association, USTA. Also, two interexchange companies, MCI and AT&T, a cable association, an accounting firm,[5] GSA, and ICA submitted comments. In all, we received comments reflecting a wide range of views from state regulators, LECs, IXCs, and consumers.[6]

3. In the Notice, we listed a number of factors that led us to open this docket. We recognized that regulatory, technological, and market changes may have dated the current depreciation prescription process. We hoped to achieve three goals in this proceeding: simplification of the process, administrative savings, and flexibility, while continuing to ensure just and reasonable tariffed rates to consumers. We therefore sought comment on four distinct depreciation simplification options: the basic factor range option, the range of rates option, the depreciation schedule option, and the price cap carrier option, discussed infra. Each option was designed to simplify and to

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[3] Lists of the parties filing each type of pleading are contained in Appendix A. Hereinafter, parties will be referred to by the short names indicated for each in the Appendix.

[4] Four state consumer advocates filed jointly, the District of Columbia, Florida, Indiana, and Pennsylvania (the SCA). The Iowa Consumer Advocate and the Colorado Consumer Counsel each filed comments separately.

[5] Deloitte & Touche originally submitted comments favoring adoption of a modified basic factor range option. Deloitte & Touche Comments at 2-3,4. However, Deloitte & Touche later withdrew those comments. Deloitte & Touche Reply at 1.

[6] We note that CCTA filed a motion seeking leave to file its pleading late. CCTA filed its comments in this proceeding on March 11, 1993, one day after the comment deadline, but prior to the reply deadline. Also, the New Jersey Commission Staff and the South Dakota Commission filed their comments after the comment deadline, but prior to the reply deadline. Finally, the Iowa Consumer Advocate filed comments after the reply deadline. We accept these comments as part of the record in this proceeding. We believe that acceptance of these comments will enable us to make a decision that gives full consideration to the important issues in this proceeding. Moreover, we find that no party to this proceeding is prejudiced by our action. Therefore, we grant CCTA's motion, and accept the other late-filed comments as part of this record.

make less burdensome the depreciation prescription process.[7]

4. For LEC depreciation simplification, the commenters were predictably divided: the state commissions, consumer groups, and MCI urged the Commission to take a measured step like the basic factor range option, while the LECs urged the Commission to take a more dramatic step like the price cap carrier option. We received less comment on AT&T generally, but did have some implicit and explicit support for adopting the price cap carrier option for AT&T.[8] Comments on implementation issues for the options were not so clearly delineated among parties, but a general consensus among state commissions and consumer groups was to continue a tighter rein on the LECs than the LECs believed was warranted.

5. Our careful consideration of the record and our own knowledge and experience in these matters have led us to conclude that streamlining the depreciation prescription process for price cap LECs will benefit those LECs, consumers, and this Commission by reducing administrative burdens associated with this process. However, we are unable to conclude that the LECs are yet in a position that justifies a depreciation prescription process as flexible and streamlined as the price cap carrier option.[9] We therefore adopt a basic factor range approach for price cap LECs in the depreciation prescription process. In reaching our conclusion, we viewed depreciation reform on a regulatory spectrum. As circumstances for the LECs change, we will revisit this issue to consider whether LECs should be farther along that spectrum.

6. We believe, however, based on the record before us and our own knowledge and experience, that the basic factor range approach as proposed must be modified. Under the basic factor range approach we adopt today, we will: (1) over time, establish ranges for all accounts, to the extent feasible and as soon as possible; (2) establish ranges for two of the basic factors comprising the depreciation rate formula: the projection life and future net salvage estimates; (3) allow price cap LECs to use company-specific survivor curves for range accounts; (4) allow price cap LECs the flexibility, as described herein, to select basic factors from within the established ranges; and (5) require price cap LECs to continue to submit the same analyses as now required for accounts for which no ranges have been set (non-range accounts) and accounts for which the carrier's basic factors do not

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[7] The options were not however, generally designed to change the depreciation methodology currently embodied in our rules and practice. See 47 C.F.R. § 32.2000 (g)(2) (requiring carriers to "apply such depreciation rates, ... as will ratably distribute on a straight line basis the difference between the net book cost of a class or subclass of plant and its estimated net salvage during the known or estimated remaining service life of the plant").

[8] The California Commission, GSA, and NARUC imply that this option may be appropriate for AT&T, stating that under a pure price cap system, one without sharing, the price cap carrier option has merit. California Commission Comments at 8-9; GSA Comments at 3; and NARUC Comments at 12-13. The Virginia Commission Staff expressly supports the price cap carrier option for AT&T. Virginia Commission Staff Comments at 3.

[9] We also reject the range of rates and depreciation schedule options. See infra paras. 30-37.

fall within the ranges.

7. We will not adopt any of the proposed simplification options today for the two rate of return LECs for which we prescribe depreciation rates. We find that, because of the direct relationship between depreciation expenses and rates to consumers and the general competitive position of these LECs, we must maintain our current process. While we are cognizant of the burden this process places on these carriers, we believe that, in balancing ratepayers' and carriers' interests, careful scrutiny of all the data supporting such carriers' proposed depreciation rates continues to be necessary. Again, should regulatory and/or market circumstances change, we would revisit our decision.

8. Careful consideration of the record and our own experience and knowledge also lead us to conclude that an even more streamlined and flexible depreciation prescription process is reasonable for AT&T, given its regulatory scheme and competitive position. Therefore, we adopt the price cap carrier option, modified to require some information submissions, for AT&T. We believe the additional information that we will require will aid us in our continuing evaluation of AT&T's price cap plan. Thus, under the price cap carrier approach we adopt for AT&T, in addition to the required information submissions set forth in the Notice, we will require AT&T to provide: (1) generation data; (2) a summary of basic factors underlying proposed rates by account, and (3) a short narrative supporting those basic factors, including forecasted retirements and additions, and recent annual retirements, salvage, and cost of removal.

9. We will not adopt any depreciation simplification for Alascom at this time. The Alaska interexchange market is currently in transition, as evidenced by the Alaska Joint Board's recent tentative recommendation regarding the Alaska interstate interexchange market structure.[10] We find that we cannot evaluate the appropriateness of any of our options until there is a final recommendation in that proceeding. Thus, we will defer depreciation simplification for Alascom.

10. Finally, we must address the issue of whether we plan to eliminate the future net salvage determination from the depreciation prescription process and consider it in current period accounting. We conclude that we will not change the accounting of salvage amounts based on the record before us. The record is mixed, and is replete with suggestions that there be further study of issues, such as whether current period accounting of salvage amounts is consistent with Generally Accepted Accounting Principles (GAAP), to determine if the change could and should be made. We find that delaying this simplification proceeding for further study of an accounting change is unwarranted. Therefore, we will continue to determine the future net salvage value in the depreciation process at this time.

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[10] Integration of Rates and Services for the Provision of Communications by Authorized Common Carriers between the Contiguous States and Alaska, Hawaii, Puerto Rico and the Virgin Islands, Tentative Recommendation and Order Inviting Comments, 8 FCC Rcd 3684 (1993) (Tentative Recommendation).

II. BACKGROUND

11. Pursuant to Section 220(b) of the Communications Act of 1934, as amended,[11] this Commission prescribes depreciation rates for AT&T, Alascom, and 33 LECs on a triennial basis.[12] For each carrier, the Commission prescribes a depreciation rate for each individual plant account. Depreciation expense for any individual account is calculated by applying the account's depreciation rate to the average account balance. The purpose of this process is to allocate plant costs to depreciation expense on a straight-line basis over the useful life of the plant.

12. Rates are determined by a depreciation rate formula:

$$\text{depreciation rate} = \frac{100\% - \text{accumulated depreciation}\%^{13} - \text{future net salvage}\%}{\text{average remaining life}}.$$

This formula requires forecasting two parameters: future net salvage (FNS) and average remaining life (ARL). The FNS is the estimated gross salvage of plant less any estimated cost of removal.[14] The ARL is the estimated average of the future life expectancy of plant. The ARL is derived from two basic factors: a projection life and a survivor curve.

13. Because depreciation rates necessarily incorporate estimates, the Commission requires carriers to submit the underlying data supporting estimates used by carriers in developing their proposed depreciation rates. These data are carefully analyzed to ensure that the estimates are reasonable, and thus that the Commission prescribes reasonable depreciation rates. The result of this process is that a carrier typically submits a depreciation study totalling, on average, 600 pages, with approximately 20-25 pages of analyses per account. The LEC industry has claimed that the current depreciation prescription process costs $35-50 million annually, industry-wide.[15]

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[11] 47 U.S.C. § 220(b).

[12] We prescribe new depreciation rates for approximately one-third of the carriers each year.

[13] Accumulated depreciation is the amount of plant investment that has been depreciated for a particular plant account. On average, upon retirement of plant, the accumulated depreciation will be equal to the cost of the plant less any net salvage. As is explained _infra_, the purpose of having accumulated depreciation as a component of the rate formula is to allow for the correction of any over or under depreciation resulting from past over or under estimates of life and salvage factors.

[14] Gross salvage is the amount a carrier receives from disposing of retired plant. Cost of removal is the cost the carrier incurs to retire plant through the removal and disposition of the plant.

[15] _See_ _Notice_, 8 FCC Rcd at 147-148, para. 8 and n. 9.

III. DISCUSSION

A. Simplification of the Depreciation Prescription Process

1. Introduction

14. As we stated in the Notice, our current depreciation process was born during the 1940's when there was no competition and little technological change in the telephone market. It evolved during a period in which the Commission regulated telephone earnings on a rate of return/rate base model. Under rate of return/rate base regulation, reasonable operating expenses are routinely passed on to ratepayers through tariffed rates. Therefore, careful scrutiny of data supporting proposed depreciation rates was necessary to ensure that ratepayers were charged "just and reasonable" tariffed rates.[16]

15. Much has changed since the early development of this depreciation prescription process. Most notably, we now regulate AT&T and the largest LECs, including 31 of the 33 LECs for which we prescribe depreciation rates, under a price cap regulatory scheme.[17] Both AT&T's and the LECs' price cap plans place caps on prices carriers may charge ratepayers, and thus attempt to replicate the restraint competition has on prices. Under our price cap plans, increased depreciation expense is not, as a general rule, passed on to ratepayers.[18]

16. In addition, the telecommunications market has changed significantly since the development and refinement of the current depreciation

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[16] Higher depreciation rates lead to higher depreciation expenses, and thus higher prices under rate of return regulation.

[17] We note however that AT&T's price cap plan differs significantly from the LECs' price cap plan. Most notably, AT&T's price cap plan does not include a sharing obligation component. See Policy and Rules Concerning Rates for Dominant Carriers, Report and Order, and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873 (1989) (AT&T Price Cap Order), recon., 6 FCC Rcd 665 (1991) (AT&T Price Cap Recon. Order), remanded in part AT&T v. FCC, 974 F.2d 1351 (D.C. Cir. 1992); and Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd 6786 (1990) and Erratum, 5 FCC Rcd 7664 (1990) (LEC Price Cap Order), modified on recon., 6 FCC Rcd 2637 (1991), petitions for further recon. dismissed, 6 FCC Rcd 7482 (1991), further modified on recon., 6 FCC Rcd 4524 (1991) (ONA/Part 69 Order), petitions for recon. of ONA/Part 69 Order pending, appeals of LEC Price Cap Order affirmed sub nom. National Rural Telecom Association v. FCC, 988 F.2d 174 (D.C. Cir. 1993).

[18] The general price cap formula limits rate increases to the rise in inflation and exogenous costs offset by a productivity factor. The inflation component is measured by the Gross National Product- Price Index (GNP-PI). The exogenous costs are generally considered to be costs outside the control of the carriers that are not otherwise reflected in the price cap formula. The productivity factor is an annual productivity growth target. Depreciation costs and rates are directly affected by a carrier's plant deployment and retirement decisions, and thus are not considered exogenous.

prescription process. Not only has AT&T divested itself of the BOCs, changing the dynamics of the telephone industry, but it also faces significant competition in the interexchange market.[19] Recently, we have also seen emerging competition for LECs in certain areas of service.[20] As stated previously, we have also been told by the telephone industry that the depreciation prescription process is costly; it estimates annual costs of $35 -$50 million industry-wide.[21] In light of the regulatory and market changes, we must consider whether the current process is unnecessarily burdensome.

2. Positions of the Parties

17. Although a majority of commenters endorse the idea of simplification,[22] many express concerns about aspects of our proposed simplification options,[23] and others propose alternative simplification ideas.[24] Some parties believe simplification is unnecessary.[25] MCI argues that before simplification issues can be addressed, the Commission must consider who should bear the cost of accelerated depreciation of certain categories of plant. MCI also claims that simplification should not occur until the Commission evaluates the effectiveness of its LEC price cap plan. Specifically, MCI believes that any increased depreciation flexibility should be tied to an increase in the productivity factor.[26]

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[19] See e.g., Competition in the Interstate Interexchange Marketplace, CC Docket 90-132, Report and Order, 6 FCC Rcd 5880 (1991), recon., 6 FCC Rcd 7569 (1991), further recon., 7 FCC Rcd 2677 (1992), pets. for recon. pending; see Competition in the Interstate Interexchange Marketplace, Memorandum Opinion and Order, 8 FCC Rcd 2659 (1993).

[20] See generally Expanded Interconnection with Local Telephone Company Facilities, CC Docket 91-141, Report and Order and Notice of Proposed Rulemaking, 7 FCC Rcd 7269 (1992), recon., 8 FCC Rcd 127 (1992).

[21] See Notice, 8 FCC Rcd at 148, para. 8 and n.9.

[22] See e.g., AT&T Comments at i; Bell Atlantic Comments at 1; CBT Comments at 1; California Commission Comments at 2; Colorado Consumer Counsel Reply at 2; NARUC Comments at 5; NYNEX Comments at 1; and Tennessee Commission Staff Comments at 1.

[23] See e.g., California Commission Comments at 1-2 (expressing doubt that significant administrative savings will result under any of the proposed options); Texas Commission Comments at 1 (expressing concern that the benefits from simplification may not outweigh the loss in data analysis).

[24] CCTA Comments at 1-2 and GSA Comments at 2.

[25] See e.g., MCI Comments at 1; and Utah Commission Comments at 1. Although these parties believe our simplification proposals are unnecessary, they nevertheless endorse one of the simplification options. See MCI Comments at 2; and Utah Commission Comments at 2.

[26] MCI Comments at 9. In reply, GTE states that while anticipated cost savings from depreciation simplification are not trivial, in the recalculation of the productivity factor, the "impact of [expected industry-wide savings]

3. Discussion

18. We conclude that simplification of our current depreciation process is warranted at this time for price cap LECs and AT&T. We disagree with those parties suggesting that, because the current depreciation prescription process yields reasonable rates, the current depreciation process should be maintained without simplification.[27] While we cannot quantify the precise dollar cost our current process imposes on carriers, we find that regulatory and market changes allow us to simplify and make the process less burdensome for price cap carriers without sacrificing protection for consumers.

19. We believe that, for telephone companies, scrutiny of depreciation rates should be most intense when a carrier is regulated primarily under a cost-plus system and faces little or no competition. At the other end of the spectrum, scrutiny of depreciation rates for telephone companies should be least intensive for a carrier facing significant competition and a less burdensome regulatory scheme than the cost-plus system. However, we must, pursuant to Section 220(b), prescribe reasonable depreciation rates for these carriers. Price cap LECs are somewhere between these two extremes because of their current regulatory model and the emerging competitive forces they now face. AT&T, on the other hand, is much closer to the end of our spectrum; again because of its regulatory model and the significant competitive forces it faces.

20. Price cap regulation allows us to reduce the level of scrutiny applied to data submitted by carriers to support their proposed rates by shifting the regulatory focus from carrier costs to prices charged ratepayers. Because price cap regulation prevents carriers from automatically recouping increased depreciation expense from ratepayers, carriers have less incentive to seek depreciation rates that are not representative of actual plant consumption.[28] Moreover, our price cap plans directly provide an added degree

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would be hard to find." GTE Reply at 14. NYNEX claims that delaying simplification until the LEC price cap review has taken place in order to include any savings from simplification in the productivity factor is contrary to the purpose of price caps; efficiency and savings should be encouraged. NYNEX Reply at 7.

27 We also disagree with MCI that we must defer simplification until we conduct our LEC price cap review so that we can incorporate the savings that should result from simplification into the LECs' productivity factor. MCI has presented no evidence that a change in our depreciation prescription process will have so great an impact on the LECs' productivity factor that it requires deferral of this proceeding. While we anticipate savings in the long run, we recognize that the immediate future is unlikely to produce such a significant level of savings that the productivity factor should be adjusted. We will certainly consider any evidence of the impact this savings will have on the productivity factor in the LEC price cap review.

28 We note however that, for the price cap LECs, the incentive is not perfect because of the sharing mechanism incorporated in the LEC price cap model, <u>see infra</u>, para. 27, and because LECs do not yet face significant competition. For these reasons we will not adopt the price cap carrier option

of consumer protection from increased prices that rate of return/rate base regulation does not: carriers are not routinely allowed to pass along increased depreciation expense through tariffed rates to ratepayers, although the level of their sharing obligations or the need for a low-end adjustment can be affected by the level of their depreciation expense. Given the nature of our price cap plan, we thus conclude that the public interest will continue to be served with less regulatory scrutiny of data supporting proposed depreciation rates.

21. We also believe that, as carriers face increasing competitive pressures, they should have less incentive to seek depreciation rates that are not in line with company operations. For example, we believe that competitive pressures now faced by AT&T in the interexchange market offer additional protection against unreasonably high prices for ratepayers. Emerging competitive pressures in certain LEC services such as special access should offer similar protection against high prices for ratepayers as it grows more robust. Streamlining the depreciation prescription process is also in the public interest because it can reduce the costs associated with that process without reducing consumer protections. For these reasons, we believe that we can now reevaluate the level of scrutiny we apply in prescribing depreciation rates for price cap carriers.

22. The reforms we adopt for price cap LECs are not appropriate for rate of return/rate base LECs at this time. Because rate of return/rate base regulation necessarily will result in increased prices to consumers with increased depreciation rates, we conclude that adoption of any of the simplification options for rate of return LECs would not serve the public interest. Moreover, these LECs are not in such a competitive posture that there are sufficient disincentives to dissuade them from passing on to ratepayers all increased depreciation expense which may be unreasonable. We are ever cognizant of our mandate to ensure that ratepayers are charged "just and reasonable" rates.

B. Price Cap LEC Simplification

23. In this section, we evaluate each of the proposed options in terms of three goals: simplification, administrative cost savings, and flexibility. Simplification and administrative cost savings go hand in hand with our goal of reducing unnecessary burdens of the depreciation prescription process. Flexibility, however, addresses our desire to complement the LEC price cap plan we have in place to the extent possible.[29] We also are mindful that these goals must not conflict with our obligation to consider the public interest.

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for the price cap LECs. See infra. at paras. 42-48.

[29] In this section of our Order, and the Implementation section for price cap LEC depreciation simplification, infra at paras. 57-87, any decisional language referring to "LECs" or "carriers" refers to price cap LECs only. These references should not be interpreted to include rate of return LECs.

1. The Options

a. The Basic Factor Range Option

(1) Introduction

24. As proposed, under the basic factor range option, the Commission would establish ranges for the basic factors that determine the parameters used in the depreciation rate formula: the FNS, the projection life, and survivor curve. If a carrier used basic factors from within established ranges for a range account, that carrier would not be required to submit the detailed supporting data.

(2) Comments

25. An overwhelming majority of state commissions and state consumer advocates support this option as the best proposed simplification option.[30] They argue that this option strikes the best balance between consumer and LEC interests. The LECs contend that, although this option is not as simple, flexible or savings-focused as other options, it is better than the current process.[31] CCTA opposes this option, however, stating that a range based on "averaging" will not produce basic factors reasonably representative of those currently underlying prescribed rates.[32]

(3) Discussion

26. We conclude that the basic factor range option is the most reasonable option for the LECs. It fulfills the objectives of this proceeding: simplification, savings, and flexibility. It is simpler than the current process because it eliminates the need for LECs to file and the Commission to review extensive data submissions for range accounts. We expect this approach to produce significant savings over time, especially if the state commissions implement the same or similar processes.[33] This option also has an element of flexibility because it allows a carrier to determine, within a specified reasonable range, the life and salvage factors it uses in prescribed depreciation rates without undergoing the expense of submitting

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[30] See e.g., Idaho Commission Comments at 3; Indiana Commission Comments at 4; Michigan Commission Staff Comments at 4; SCA Comments at 12; and Wisconsin Commission Comments at 1-2. See also, Florida Commission ex parte Comments at 2; ICA Reply at 2; Iowa Consumer Advocate Reply at 1; NARUC Comments at 6; and MCI Comments at 2.

[31] See e.g., BellSouth Comments at 34; GTE Comments at 11-12; and US West Comments at 9.

[32] CCTA Comments at 14. GSA also opposes this option, arguing that ranges increase the LECs' opportunities to avoid their sharing obligation. GSA Comments at 6-7.

[33] We note that USTA estimates that this option will produce administrative savings of 31.5% if adopted for all accounts and "across all jurisdictions." See USTA comments at 8.

studies to justify its specification of those factors. For example, this option would allow a carrier to exercise its final judgment over whether, for the Conduit Systems account[34], a life of 55 years is more consistent with its operations than a life of 60 years.[35]

27. We also agree with the state commissions that this option most adequately addresses both the LECs' desire for a more streamlined and flexible process and the regulators' and consumers' concerns that there continue to be adequate oversight of depreciation, the LECs' largest single expense. As mentioned previously, the LECs' price cap plan includes a rate of return-based backstop. Under this backstop, LECs choosing a productivity factor of 3.3 must share 50% of earnings in excess of 12.25% with ratepayers (the sharing obligation).[36] Also, under this backstop, the price cap limits are raised when a LEC's earned return falls below 10.25% (the lower adjustment threshold). Without adequate oversight, LECs, by taking greater depreciation expense for any given year, could lower their rates of return, potentially moving themselves outside the sharing zone or below the lower adjustment threshold. As long as the backstop is a part of our LEC price cap plan, we must ensure that LECs cannot manipulate that mechanism to ratepayers' detriment. We do not imply, however, that the rate of return-based backstop forecloses any additional streamlining in the depreciation prescription process. If we have reason to conclude later that other forces will ensure that LECs cannot manipulate the rate of return-based backstop to ratepayers' detriment, we would revisit the issue.

28. Moreover, the competitiveness of the LECs' markets overall are not sufficiently robust to warrant any additional flexibility that might be afforded by other proposed options. Although the LECs face emerging competition in certain services, competitive pressures are not such that we can rely on them to provide an adequate check on LECs' depreciation choices. If we determine in the future that the rate of return-based backstop is no longer necessary and/or competition in the LECs' markets is sufficiently vigorous, we would be prepared to revisit this issue.

29. We reject CCTA's objection that "averaging" basic factors will not result in representative basic factors.[37] First, as described infra, carriers

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[34] See 47 C.F.R. § 32.2441.

[35] Any factor selected by a carrier should reflect that carrier's operations. Moreover, the carrier should have support for any selected range factor. The carrier will not need to submit such data, but must maintain it.

[36] If a carrier selects a productivity factor of 4.3, the carrier begins to share with ratepayers when its earned return exceeds 13.25%.

[37] We also reject CCTA's proposal that we merely lengthen the current depreciation prescription process from three to four years. See CCTA Comments at 27-28. CCTA's proposal does not address our simplification goal. We also reject GSA's proposal that we simplify the depreciation prescription process by eliminating the three-way meeting process and prescribe depreciation rates on a holding company level. See GSA Comments at 5-6, 7-8. GSA has presented no evidence that its proposal will meet our cost savings goal more effectively than the basic factor range option we adopt today.

that initially will be allowed to use ranges must currently be using basic factors that fall within the established ranges for a specific account. If a carrier's current basic factors do not fall within the established ranges, that carrier must submit sufficient information, consistent with the current depreciation analysis requirements, to demonstrate that its basic factors should fall within the established ranges to be free from a requirement of filing supporting data. LECs would need to continue to analyze underlying basic factors to assure the reasonableness of their depreciation expense and maintain such analyses. In addition, we will consider, in the depreciation prescription proceedings, any data presented on the record that a carrier's proposed basic factors do not reflect that carrier's plans and operations.[38] Thus, carriers must use basic factors that reflect their operations in their proposed depreciation rates.

b. The Range of Rates Option

(1) Introduction

30. Under the range of rates option, the Commission would establish ranges of acceptable depreciation rates. Again, carriers would not file the extensive data submissions now required if they select rates from within the established ranges.

(2) Comments

31. With the exception of the staff of one state commission,[39] all commenting state commissions urge the Commission to reject this option.[40] Their primary objections are that this option: (1) will result in the demise of the matching principle for LECs' depreciation accounting[41] and (2) cause significant reserve imbalances.[42] MCI underscores the matching principle objection, stating that this option eliminates safeguards needed to "retain some relationship between the factors that determine an asset's depreciable life and the depreciation expense level carriers may select."[43] NARUC also

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[38] Moreover, if a LEC is not fulfilling this obligation, we have the authority to take appropriate action against such carrier. For example, we have the authority to fine any carrier that fails or refuses to keep its books of account in the manner prescribed by the Commission. See 47 U.S.C. § 220(d). See also 47 U.S.C. §§ 220(c), (e), and (g), and 154(i) and (j).

[39] Oklahoma Commission Staff Comments at 1.

[40] See e.g., Colorado Commission Comments at 20; Missouri Commission Comments at 4; and South Dakota Commission Comments at 2. See also GSA Comments at 4-5; and MCI Comments at 8.

[41] The matching principle holds that plant costs should be allocated to depreciation expense at a rate representative of the actual consumption of plant.

[42] See e.g., Colorado Commission Comments at 20; and South Dakota Commission Comments at 2.

[43] MCI Comments at 8.

claims that "[e]stablishing a rate range based on present rates would include effects of growth, ELG, and reserve, all of which vary among companies. The result would have little meaning as an average."[44]

32. Generally, the LECs favor this option as a second choice.[45] USTA claims that the depreciation rate range option is preferable if the price cap carrier option is not adopted because the range of rates option requires establishing only one set of ranges as opposed to establishing two sets of ranges under the basic factor range option. USTA also concludes that the savings in administrative costs would be slightly greater for this option.[46] The LECs also argue that the state commissions' concerns are unwarranted. According to Southwestern, GAAP will require LECs to comply with the matching principle, and FCC rules and procedures will prevent significant reserve problems.[47]

(3) Discussion

33. We have reviewed current depreciation rates and found that, were we to adopt ranges of depreciation rates based on these current rates, in order to accommodate any significant number of carriers, the ranges would need to be so wide that effective regulatory oversight would be severely compromised.[48] Moreover, even if we could adopt ranges based on currently prescribed rates, we would eliminate the remaining life concept now embodied in our prescribed rates. We find that this is unwise.

34. Remaining life is important because it allows for the correction of any past imprecision in depreciation rates by incorporating an individual carrier's reserve ratio into its depreciation rates.[49] Under the range of rates option, remaining life would be eliminated because the ranges of rates would necessarily include an industry-wide implied reserve ratio instead of a company-specific reserve ratio. We do not believe that removing the remaining life concept from the depreciation prescription process would serve the public interest or, for that matter, the carriers' interests. Ranges of rates which incorporate an industry-wide reserve ratio would not reflect individual

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[44] NARUC Comments at 8, n. 5. See also California Commission Comments at 4-5.

[45] See e.g., BellSouth Comments at 34; NYNEX Comments at 14; and SNET Comments at 16-17. See also, USTA Comments at 15. Bell Atlantic and United would select the basic factor range option as a second choice. Bell Atlantic Comments at 2; and United Reply at 7.

[46] USTA Comments at 16. USTA estimates administrative savings under this option to be 33.2% of costs incurred under the current process. Id. at 7.

[47] Southwestern Reply at 26.

[48] This is due to carriers' disparate reserve ratios. Reserve ratios are determined as accumulated depreciation divided by gross plant investment.

[49] Depreciation rates cannot be determined with absolute accuracy until the assets are retired because life and salvage factors are forecasts. Thus, there is necessarily an element of imprecision in the process.

companies' reserve positions and might lead to large reserve deficiencies, which place carriers at risk of not fully depreciating their plant. Although we recognized the potential for this problem in the Notice, and sought comment on whether a different mechanism could be used in place of the remaining life concept, no party to the proceeding offered a solution. Without a solution to this problem, we believe that the depreciation prescription process could become more burdensome and costly because of the potential need for Commission action in every individual case where large reserve imbalances occur. This would not fulfill our simplicity and administrative savings goals, and thus, we reject this option for the LECs.

c. The Depreciation Schedule Option

(1) Introduction

35. Under the depreciation schedule option, the Commission would establish a depreciation schedule for each plant account. The schedule would be based on a Commission-specified service life, retirement pattern, and salvage value for each account. Carriers would apply the schedule to their investment by vintage.

(2) Comments

36. The parties to this proceeding unanimously state that the Commission should reject this option. They argue that this option destroys the matching principle and provides no simplification or savings because it would require tracking plant by vintage.[50]

(3) Discussion

37. When we proposed this option, we recognized that it was more rigid than other options. However, we raised the question of whether it would be simpler because, with set depreciation schedules, carriers would have to conduct much less depreciation analysis than under any of the other options. Nonetheless, we agree with the parties that this option undermines the matching principle underlying our depreciation process. Moreover, for many of the same reasons that the range of rates option might lead to reserve imbalances, this "one size fits all" option might also lead to reserve imbalances. Thus, we reject this option for LECs.

d. The Price Cap Carrier Option

(1) Introduction

38. Under the price cap carrier option, carriers would file proposed depreciation rates with the Commission. Those rates would not be supplemented with supporting data. The Commission would propose to adopt the carriers' proposed rates and seek comment on their reasonableness. Prescription of rates would be based on the proposed rates and any comments made thereon.

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50 See e.g., California Commission Comments at 6-7; NYNEX Comments at 19; New York Commission Comments at 11; Pacific Comments at 15-16; US West Comments at 12; and Washington Commission Comments at 4.

(2) Comments

39. The LECs are unanimous in their support of this option.[51] They argue, both separately and collectively, that this option: (1) is the most consistent with price cap regulation;[52] (2) will result in more accurate rates;[53] (3) is necessary for carriers to be in a position to compete against new market entrants;[54] and (4) will provide an incentive for carriers to develop the infrastructure.[55] CBT, regulated under a rate of return/rate base scheme, argues that this option should be adopted for all LECs.[56] USTA supports this option but would "redefine" it.[57] USTA states that the option should: (1) require carriers to file the "major data elements" used to calculate their depreciation rates; (2) allow carriers to file for new depreciation rates no more than annually, but no less than triennially; (3) require carriers to follow the current depreciation methodology, straight-line, remaining life; (4) allow three-way meetings when beneficial; and (5) require carriers to provide states with the same information provided this Commission.[58]

40. State commissions and consumer advocates are unanimous in their opposition to this option for LECs.[59] They argue that this option: (1) provides LECs with the ability to manipulate their earnings through depreciation expense;[60] (2) would eliminate valuable data necessary to the analysis of proposed depreciation rates;[61] and (3) would eliminate the three-

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[51] See e.g., Ameritech Comments at 5-7; SNET Comments at 12-16; US West Comments at 6-7. See also USTA Comments at 7-9 and 12-14. USTA estimates that administrative cost savings should approach 50% of current costs.

[52] See e.g., Bell Atlantic Comments at 2.

[53] See e.g., USTA Comments at 14.

[54] See e.g., Southwestern Comments at 9-10.

[55] See e.g., BellSouth Comments at 20.

[56] CBT Comments at 3.

[57] USTA Comments at 8. See also Bell Atlantic Comments at 7.

[58] USTA Comments at 10.

[59] See e.g., ICA Reply at 4; New York Commission Comments at 12; Nebraska Commission Comments at 2-3; North Dakota Commission Comments at 1-2; Oregon Commission Comments at 3; and SCA Comments at 21.

[60] See e.g., California Commission Comments at 8 and Idaho Commission Comments at 5.

[61] See e.g., Texas Commission Comments at 5; Utah Commission Comments at 4; and Wisconsin Commission Comments at 7.

way meetings.[62] Many state commissions emphasize that the three-way meeting process has been beneficial.[63] Some parties also question whether the option, as proposed, meets the legal standards imposed on the Commission by the Communications Act.[64] Essentially, these parties argue that under the price cap carrier option, as proposed, the Commission would be abdicating its mandate to "prescribe" rates and would fail to provide states a "reasonable opportunity" to present their views. Finally, some parties disagree that this option will encourage infrastructure development.[65]

41. The LECs and USTA argue that all of these concerns can be alleviated by adequate safeguards. They contend that there are adequate existing safeguards: (1) good business judgment;[66] (2) competition;[67] (3) external accounting requirements such as GAAP;[68] and (4) regulatory oversight by the SEC, this Commission and state regulators.[69] The LECs also suggest, however, that additional safeguards could be imposed. These additional safeguards include: (1) filing proposed depreciation rates in the first quarter of the year;[70] (2) requiring certification of proposed rates by independent auditors;[71] (3) imposing an annual reasonableness test for overall

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62 See e.g., Oregon Commission Comments at 1 and Virginia Commission Staff Comments at 1. The three-way meeting is an informal meeting held among this Commission's staff, the state commissions' staffs, and the carriers to discuss various depreciation rate proposals.

63 See e.g., Minnesota Commission Reply at 7; Oregon Commission Comments at 1; Virginia Commission Staff Comments at 1; and Wisconsin Commission Comments at 1.

64 See 47 U.S.C. §§ 220(b) and (i). Section 220(b) states that the Commission "shall, as soon as practicable, prescribe ... the percentages of depreciation which shall be charged [by carriers]." Section 220(i) states that the Commission "shall notify each State commission having jurisdiction with respect to any carrier involved, and shall give reasonable opportunity to each such commission to present its views, and shall receive and consider such views and recommendations."

65 See e.g., CCTA Comments at 3-8; ICA Reply at 6-7; and SCA Comments at 25.

66 See e.g., Ameritech Comments at 6-7 and Bell Atlantic Comments at 8-9.

67 See e.g., NYNEX Comments at 8-10.

68 See e.g., USTA Reply at Ernst & Young Report, "Depreciation Safeguards Under GAAP."

69 See e.g., Pacific Comments at 10, 12-13 and Southwestern Comments at 12-16.

70 See e.g., Bell Atlantic Comments at 8-9.

71 Id. at 7-8.

depreciation expense or composite rate changes;[72] and (4) imposing an annual depreciation rate change limitation for each account.[73] These safeguards, carriers argue, will alleviate concerns expressed by the state commissions and this Commission.[74]

(3) Discussion

(i) The Price Cap Carrier Option Generally

42. We agree with the carriers that this option is simpler and provides greater flexibility than any of the other proposed options; however, we conclude that, at this time, the LECs' regulatory and market circumstances do not justify adoption of this option for them. Specifically, this option creates a significant opportunity and incentive for LECs to undermine the sharing component of our price cap plan which would not be in the public interest. Moreover, the LECs are not yet in such a competitive posture that could safely allow the degree of flexibility afforded by this option. We also are not convinced that this option will produce greater administrative savings than the basic factor range option because of the state commissions' opposition to it.

43. Depreciation expense is the LECs' largest single expense. This option would create a unique opportunity and incentive for the LECs to limit their sharing obligation through unreasonable changes in their depreciation rates and thus, their depreciation expense. Because depreciation rate changes on their face may not appear unreasonable, we cannot be assured of their reasonableness without sufficient information.[75] Unlike the basic factor range approach, this option will not provide us with sufficient information.[76] Thus, we are unable to adopt an option that incorporates this degree of opportunity and incentive for carriers to undermine a vital component of the LEC price cap plan at this time. Moreover, the LEC price cap review is scheduled to begin in the near future and the issue of sharing will be addressed therein. We do not wish to take any action here that could be

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[72] See e.g., BellSouth Reply at 6-7. For a variation of this test, see United Comments at 6-7 (proposing a tracking system of depreciation expense changes over a multi-year time span).

[73] See e.g., BellSouth Reply at 8-9.

[74] See Notice at Concurring Statement of Commissioner Ervin S. Duggan.

[75] As United recognized, "[a] price cap LEC could use depreciation practices to micromanage earnings and 'game' the sharing process. This is the only weakness in the price cap carrier option that [United] and others have identified." United Comments at 6.

[76] We note that USTA's "definition" of this option is not significantly different from the option as proposed. Although the Notice did not expressly state that "major data elements" used to determine rates would be necessary, our description of the information to be filed should have alerted carriers to the fact that they would be required to file the current Statements A, B, and C. Under those statements, carriers must now file those "major data elements."

construed to prejudge that issue; we will evaluate the continued need for sharing only upon a record specifically addressing the issue. If, however, we were to conclude that sharing was no longer necessary for the public interest, we obviously would consider reevaluating our decision here.

44. We also do not believe that the LECs yet face a level of competition that would permit granting the degree of flexibility provided by this option. Although the LECs face emerging competition in the provision of certain services, we do not find that it is sufficiently vigorous for us to conclude that this option would be in the public interest. We note that we adopt today a modified form of the price cap carrier option for AT&T. But unlike the LECs, AT&T's price cap plan does not incorporate a sharing mechanism. And while we would not necessarily conclude that AT&T's level of competition is a benchmark for using the price cap carrier option, we do conclude that the LECs' competitive pressures must be greater than they are today before the price cap carrier option will be considered for them. Again, if we determine in the future that the sharing component of the LEC price cap plan is no longer necessary and/or competition in the LECs' markets is sufficiently robust, we would be prepared to revisit this issue.

(ii) Safeguards

45. The price cap carrier option is not saved by the LECs' suggested safeguards. First, these safeguards do not address our view that competition for LECs must be more robust before they can move down the depreciation reform spectrum. Second, such safeguards, while providing some minimal limitation on earnings management, still do not limit effectively the opportunity and incentive for carriers to avoid their sharing obligation.[77] For example, the LECs argue that good business judgment would dictate against proposing inaccurate rates because the carrier would not be able to pass extra expenses on to consumers. In a highly competitive environment, this statement is true, but the LECs are not yet in a highly competitive environment. Moreover, the LECs' depreciation choices affect rates. If a carrier were to increase depreciation rates and thus depreciation expense unnecessarily, it would lower earnings. If the carrier would have been in the sharing zone without the increased depreciation, ratepayers would lose future rate reductions that would normally accompany a carrier's sharing obligation.[78]

46. The LECs' argument that external controls are sufficient is also unpersuasive at this time. As the Ernst and Young Report states, GAAP places some limits on a carrier's ability to use depreciation expense to manage

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[77] We note that any option giving carriers more flexibility in the depreciation prescription process offers them some opportunity to manage their earnings. However, the basic factor range option minimizes such opportunity by its use of ranges based on currently prescribed depreciation rates, the opportunity for review of such ranges, and the determination of the reasonableness of factors within established ranges.

[78] A LEC could also affect prices paid by consumers through the lower formula adjustment threshold. If earnings were low enough to trigger the lower formula adjustment threshold, the LEC could increase rates.

earnings.[79] However, we do not find the Ernst and Young Report entirely persuasive because GAAP is investor-focused. One of the primary purposes of GAAP is to ensure that a company does not present a misleading picture of its financial condition and operating results by, for example, overstating its asset values or overstating its earnings, which would mislead current and potential investors. GAAP is guided by the conservatism principle which holds, for example, that, when alternative expense amounts are acceptable, the alternative having the least favorable effect on net income should be used. Although conservatism is effective in protecting the interest of investors, it may not always serve the interest of ratepayers. Conservatism could be used under GAAP, for example, to justify additional (but, perhaps not "reasonable") depreciation expense by a LEC to avoid its sharing obligation. Thus, GAAP would not effectively limit the opportunity for LECs to manage earnings so as to avoid the sharing zone as the basic factor range option. In this instance, GAAP does not offer adequate protection for ratepayers.

47. The LECs also argue that regulatory oversight will prevent carriers from using depreciation to manage earnings. Again, it is true that our oversight and state commissions' oversight can provide some protection through filing requirements and monitoring. However, we believe the best approach, the approach that most appropriately balances ratepayer and company interests, is to ensure carriers do not use depreciation to avoid their sharing obligation in the first place.

48. Nor are we convinced that the additional safeguards proposed by the LECs adequately address our concerns at this time. None of the safeguards individually minimizes the carriers' opportunity and incentive to avoid sharing through the use of depreciation expense as effectively as the basic factor range option. Moreover, imposing all of the proposed safeguards would produce a process more burdensome than the basic factor range option with less ratepayer protection. For example, if we were to require carriers to file rates in the first quarter, require independent auditors to certify rates, limit the percentage of change in overall depreciation expense LECs could make annually, and limit the percentage of depreciation expense or rate change per account LECs could make annually, this simple option becomes nearly as burdensome as the current process. Moreover, even with these safeguards, we would need to undertake analyses similar to that required by the basic factor range option.[80]

(iii) State Support

49. In addition, although not determinative of the issue, we note that state commissions aver they will reject the price cap carrier option, and many maintain that they will require carriers to follow, for intrastate purposes, the same requirements or ones similar to those now imposed by this

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[79] USTA Reply at Ernst and Young Report. GAAP may be an effective control in a vigorously competitive environment; however, the LECs do not yet face such an environment.

[80] For example, to limit the overall change in depreciation expense, we would need to ascertain what those limits should be, which would likely involve determining something similar to a range. This would require analysis of current and other depreciation data.

Commission's depreciation prescription process.[81] Without state support, we find USTA's estimate of administrative savings to be overstated, especially since the states' jurisdiction extends to approximately 75% of carriers' plant costs.

(iv) Other Objectives

50. We note that the LECs, in supporting this option, argue that the price cap carrier option can fulfill several objectives including some that were not the primary focus of this proceeding. Specifically, the LECs argue that this option is necessary because: the Commission does not prescribe "accurate" depreciation rates; the degree of flexibility afforded by the option is necessary for LECs to compete; and this option will provide incentives for LECs to modernize their networks. We disagree with the LECs' conclusions.

51. We disagree with the LECs that the price cap carrier option is necessary because the Commission has not prescribed "accurate" depreciation rates. We recognize that, in the past, our depreciation practices and rates may have lagged behind changes in the telecommunications market.[82] However, we have corrected for these past problems by focusing more on the future, rather than the past,[83] adopting a remaining life rate formula,[84] and adopting ELG methods.[85] Our review of the LECs' reserve positions overall indicates that the LECs' depreciation rates have not been unreasonable in recent history.[86] Moreover, we are unpersuaded by LEC comparisons of the lives of plant underlying their depreciation rates with plant lives used by cable

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[81] See e.g., Colorado Commission Comments at 5; Nebraska Commission Comments at 2-3; New York Commission Comments at 7; and Texas Commission Comments at 4-5.

[82] See Amendment of Part 31 (Uniform System of Accounts for Class A and B Companies) so as to Permit Depreciable Property to be Placed in Groups Comprised of Units with Expected Equal Life for Depreciation Under the Straight-Line Method, Report and Order, 83 FCC 2d 267 (1980) (ELG Depreciation Order), recon., 87 FCC 2d 916 (1981), supplemental opinion, 87 FCC 2d 1112 (1981).

[83] ELG Depreciation Order, 83 FCC 2d at 294. See also Ameritech Comments at 2-3 ("[T]he Commission prescribed life projections for the Companies' accounts that were within +/- 25 percent of the historical mortality factors less than 30 percent of the time. ... Companies provide the Commission estimates of their depreciation rates based on other analyses, such as technology substitution forecasts and product life cycle forecasts." (emphasis added)).

[84] ELG Depreciation Order, 83 FCC 2d at 288-290, paras. 76-84.

[85] Id. at 280-286 and 293, paras. 47-66 and 93, respectively.

[86] The overall LEC reserve is approximately 40%; this Commission's staff studies show that the reserve should be approximately 42%. Moreover, since 1981, the reserve has grown from approximately 19% to its current level of 40% today.

companies and foreign telecommunications companies. They have failed to demonstrate that their comparisons are reasonable. For example, the LECs do not show that the lives of plant for foreign telecommunications companies are measured in the same manner, determined by the same methodologies, or correspond to plant held by LECs.[87]

52. We also do not find that the price cap carrier option, standing alone, is likely to encourage investment in the telecommunications infrastructure. We understand the LECs to argue that higher (and in the LECs' view, more accurate) depreciation rates encourage infrastructure investment because, with higher depreciation rates, the likelihood of fully recovering investment costs is increased.[88] It has not been the Commission's experience that increased depreciation rates lead to increased infrastructure development.[89] There is currently no requirement that the additional revenue flowing from increases in depreciation expense actually be spent on infrastructure development. Moreover, while the LECs' argument that increased depreciation rates increase the likelihood of recovery of plant investment may have some validity under a cost-plus system (like rate of return/rate base regulation), under the price cap system this argument loses force. To ensure full recovery from ratepayers under price cap regulation, depreciation expense would need to be treated as an exogenous cost. Nothing on this record would lead us to conclude that exogenous treatment of depreciation expense is in the public interest.

53. Importantly, in regard to each of the LECs' additional objectives, "accurate" depreciation rates, competitive ability, and infrastructure development, we note that this Commission prescribes depreciation rates based on carriers' investment plans. Our rates are based on carriers' own decisions of when to deploy new plant and to retire old plant. In prescribing rates, we also give great weight to the companies' future plant investment plans. As the LECs implement network modernization plans, their depreciation rates and expense should follow naturally. Thus, we believe that the LECs' additional objectives are addressed under our current process and will continue to be addressed under the option we adopt today.

54. Finally, we find unpersuasive the LECs' arguments that this option is necessary for them to compete in the interexchange access market. Although facing emerging competition today, the LECs have long been the "bottleneck" of interexchange access. At this stage of competition's development, a dramatic change in our depreciation prescription process such as the price cap carrier option, is not necessary to place LECs on a level playing field with new market entrants. As discussed above, provided that our depreciation process is representative of actual rates of plant retirement, the existence of competition, standing alone, does not justify a change in depreciation rates. As competition increases, however, we will address specific depreciation issues when they arise.

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[87] We note also that foreign telecommunications companies may be more directly influenced by governmental policies than American corporations.

[88] <u>See</u> USTA Reply at 23. <u>See also</u> Pacific Comments at 5-8.

[89] For example, for the period 1980-1992, prescribed depreciation expense more than doubled, while network investment decreased.

55. At the same time, we recognize that the LECs are operating in a rapidly changing environment. Telecommunications technology is changing at an unprecedented pace, and there has been a rapid expansion of the services that new technology makes possible. The LECs now face emerging competition in their current markets, which is likely to increase.[90] They are deploying increasingly sophisticated networks that provide vastly increased intelligence and capacity.

56. We recognize that the increase in competition and the rapid changes in technology and services may lead LECs to request an acceleration of their depreciation to reflect an increase in their replacement of plant to ensure improved network functionality and service quality. We must ensure that the regulatory process will respond quickly to these dynamic market and technological changes. The goal of our depreciation prescription process is to accurately reflect the actual rate of plant retirement. We would not want any lag in that process to inhibit carriers from moving forward with their infrastructure development plans. We therefore intend to institute a further proceeding as expeditiously as possible to explore ways in which our depreciation process and policies can become more responsive to actual changes in patterns of LEC investment and plant retirement. We would expect to consider specific ways of rewarding, through increased depreciation, those companies that rapidly modernize their infrastructure to meet market and technological changes.

2. Implementation of the Basic Factor Range Option for the Price Cap LECs

a. Summary

57. We now address implementation issues raised by the decision to incorporate the basic factor range option into our depreciation prescription process. We conclude that:

(1) we will begin to incorporate ranges into the depreciation process in 1994;

(2) we will establish ranges for all accounts, to the extent feasible and as soon as possible;[91]

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[90] See supra n. 20.

[91] Although we speak of prescribing depreciation rates by account for convenience, as a practical matter, we prescribe depreciation rates by rate category. For a majority of plant accounts, there is only one rate category. However, for six plant accounts, we allow carriers to subdivide the accounts so that there is more than one rate category. See 47 C.F.R. §§ 32.2232, 32.2421, 32.2422, 32.2423, 32.2424, and 32.2426. The majority of carriers do subdivide these six accounts because they seek rates for more homogeneous groupings of plant within these accounts. For example, in the cable accounts, we generally prescribe a separate rate for copper (metallic) and fiber (nonmetallic) cable. We do not, by our reference to prescribing rates by account, foreclose the possibility that we will establish ranges based on the data at the rate category level.

(3) we will allow a carrier to begin using the range approach in 1994, if the carrier's current basic factors fall within the established ranges, as described herein;

(4) we will not allow a carrier to begin using the range approach until its next scheduled prescription, if its current basic factors fall outside the ranges; and

(5) we will allow a carrier, once its basic factors are in the established ranges for an account, some flexibility in selecting basic factors from within those ranges, as described herein.

We direct the Bureau to recommend to the Commission the initial set of range accounts and their ranges as soon as possible so that the Commission may seek comment on those accounts and ranges.

b. Data and Procedures to be Used to Establish Ranges

(1) Introduction

58. In the Notice, we invited comment on the data to be used to establish the ranges. We also invited comment on the appropriate width of the ranges. We set forth a tentative proposal to establish ranges of +/- one standard deviation from the industry-wide average of the basic factors underlying currently prescribed depreciation rates.[92]

(2) Comments

59. A majority of the commenting state commissions agree that the starting point for any set of ranges should be the basic factors underlying currently prescribed rates,[93] although a few suggest that the ranges should consider specific state plans affecting depreciation rates.[94] The LECs, as a group, reject this approach, especially for large accounts.[95] The carriers argue that these factors are too rigid in light of the continuing changes in technology and competition. They suggest that the Commission use, as a starting point, (1) basic factors underlying the LECs' and IXCs' most recently proposed depreciation rates; or (2) forward-looking data from the entire

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[92] Notice, 8 FCC Rcd at 148, para. 14.

[93] See e.g., Idaho Commission Comments at 3; Indiana Commission Comments at 4; and Michigan Commission Staff Comments at 5. See also SCA Comments at 12.

[94] See e.g., Missouri Commission Comments at 2.

[95] See e.g., Ameritech Comments at 10; GTE Comments at 11; and NYNEX Comments at 14-15. Bell Atlantic, however, suggests that basic factors underlying currently prescribed rates could be used for the small accounts, if a range width of two standard deviations is used. Bell Atlantic Comments at 11.

telecommunications industry.[96] United states that the Commission should, for specific accounts,[97] oversee the development of benchmark lives using "independent outside analysis by an Accounting Firm(s), a Technology Futures firm(s), and a Telecommunications Equipment Manufacturer(s), as well as the affected LECs."[98]

60. The commenters also address the issue of what the width of the ranges should be. Although many state commissions support our proposed range width of +/- one standard deviation,[99] some state commissions are concerned that a width of one standard deviation would be too narrow to effectively capture most of the companies' basic factors.[100] A number of those state commissions suggest alternative range widths.[101] All of the companies addressing this issue propose wider ranges.[102] USTA argues that ranges should be wide enough for carriers to have room for adjustments over time.[103]

(3) Discussion

61. Establishing these ranges requires us to consider our objectives in light of the public interest. On the one hand, we wish to make the ranges wide enough to accommodate a significant number, if not all, of the LECs. On the other hand, we must not make the ranges so wide that they would no longer enable us to exercise effective oversight of depreciation rates. It is for this reason that we proposed to establish ranges based on current basic factors with a width of one standard deviation. We have already reviewed

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[96] See e.g., Bell Atlantic Comments at 11; BellSouth Comments at 35; NYNEX Comments at 14-15; and SNET Comments at 18.

[97] The accounts are Central Office, Circuit, Copper, Fiber and Pole accounts.

[98] United Comments at 8-9.

[99] See e.g., Idaho Commission Comments at 3; Indiana Commission Comments at 4; and Michigan Commission Staff Comments at 5.

[100] See e.g., Washington Commission Comments at 3, California Commission Comments at 3; Wisconsin Commission Comments at 3.

[101] For example, California Commission suggests using a range width that would include all carriers' current basic factors. California Commission Comments at 3. Wisconsin Commission suggests that the Commission establish ranges wide enough to accommodate 80% of current basic factors. Wisconsin Commission Comments at 3.

[102] CBT and Bell Atlantic proposed a width of at least two standard deviations. CBT Comments at 11; Bell Atlantic Comments at 11. SNET recommended that the width be based on the highest and lowest proposed factors by carriers. SNET Comments at 18.

[103] USTA Comments at 19.

current basic factors and found them to be reasonable.[104] We sought comment on a width of one standard deviation because, under a normal distribution pattern, a majority of the carriers' basic factors would fall within that range.

62. After careful consideration of the comments and analysis of many of the basic factors underlying current rates, we believe that our proposal may be too rigid. Our analysis indicates that, because of variances among LECs' basic factors, a range width of one standard deviation around the mean could be either too narrow or too wide for some accounts. Moreover, because we will review ranges on a schedule that will not coincide with every carrier's represcription schedule,[105] we believe we should, when appropriate, consider company retirement and modernization plans to determine whether there are technological trends that might not be fully reflected in all of the carriers' current rates. Therefore, in establishing ranges, we will start with ranges of one standard deviation around an industry-wide mean of basic factors underlying currently prescribed rates. From that point, we will consider other factors such as the number of carriers with basic factors that fall within this initial range and future LEC plans in determining the actual range width for any one account.

c. Accounts for Which Ranges will be Established

(1) Introduction

63. In the Notice, we sought comment on whether we should adopt ranges for all accounts.[106] We tentatively concluded that we should not because we believed that the divergence of basic factors from company to company made a number of accounts less adaptable to ranges. We sought comment on this conclusion and on criteria to be used in the selection of range accounts.

(2) Comments

64. All carriers support adoption of ranges for all accounts, arguing that there would be little measurable savings without ranges for all accounts.[107] They also contend that establishing ranges for all accounts eliminates yet another regulatory hurdle -- establishing criteria and reviewing accounts to determine whether they meet the criteria. The state

[104] However, as we have stated previously, because the basic factors are estimates, they are subject to the exercise of reasonable judgment. By establishing ranges, we recognize this fact, and give carriers more flexibility in the final exercise of this reasonable judgment.

[105] Although we intend to establish ranges for all accounts if feasible and will allow carriers to move within those ranges annually, we will continue the three year represcription cycles for carriers because ranges will not be established all at once and not all carriers will use ranges for all accounts.

[106] Notice, 8 FCC Rcd at 148-149, para. 16.

[107] See e.g., Pacific Comments at 6; and SNET Comments at 18. See also USTA Comments at 17.

commissions generally support ranges for less than all of the accounts.[108] They suggest a wide range of criteria for determining which accounts are appropriate for range selection. For example, the Missouri Commission suggests that only accounts that individually constitute less than 2% of total plant investment company-wide be used.[109]

(3) Discussion

65. We believe that establishing ranges for all accounts would further our administrative savings goal for this proceeding. We will therefore, to the extent feasible, establish ranges for all plant accounts.[110] However, because we wish to implement this range approach for 1994, we find it impracticable to have ranges established for all accounts at once. With limited staff and resources, the analysis necessary to establish ranges for all accounts by 1994 cannot be completed. Thus, we direct the Common Carrier Bureau to identify those accounts readily adaptable to the range approach and recommend them to us so that we may invite comment on the initial ranges for those accounts for implementation in 1994. We further direct the Bureau to establish ranges for the remaining plant accounts where feasible and as soon as possible.

d. Range Participation

(1) Introduction

66. In the Notice, we proposed to mandate ranges for all carriers. We reasoned that our ranges would provide sufficient flexibility for carriers so that mandatory participation would be reasonable.[111] At the same time, we recognized that some carriers' basic factors initially would fall outside of the established ranges, and we would need to move these carriers' factors toward the ranges gradually. Also, we conceded that, in certain situations,

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[108] See e.g., Missouri Commission Comments at 2; New York Commission Comments at 9; and South Dakota Commission Comments at 1. But see Indiana Commission Comments at 5.

[109] Missouri Commission Comments at 2. Other suggested criteria include the amount of variance in basic factors among carriers and the extent to which accounts are affected by rapid technological or competitive changes.

[110] There are a few plant accounts for which it is technically difficult, and not feasible for 1994, to establish ranges because we have allowed the carriers flexibility in how the accounts are studied for depreciation purposes. For example, carriers are allowed to subdivide their buildings account and estimate lives for each category, although only one rate is prescribed for the account. As a result, there are a wide variety of categorization schemes --some categorize based on the size of the buildings, some by location, and others based on the use of the building. Because of the great differences among the categorization schemes, the projection lives among the companies are currently incompatible. If we are to establish ranges for this account, we must examine the categorization schemes in depth to ascertain the feasibility and desirability of ranges.

[111] Notice, 8 FCC Rcd at 149, para. 17.

some carriers' basic factors would need to remain outside the ranges established. We also proposed to limit LECs' ability to move within the ranges. We sought comment on each of these issues.

(2) Comments

67. There is no general consensus on this issue. A number of parties conclude that the use of ranges should be mandatory,[112] while others argue that they should be optional.[113] A third position is to make ranges optional, but to not allow a carrier that has selected ranges to later opt out of them.[114] However, all parties generally agree that carriers should be required to use ranges when feasible.

68. There is general agreement among a majority of the parties that, if the Commission mandates the use of ranges, carriers with current basic factors outside the ranges should be allowed to move into the ranges over time, a phase-in approach.[115] The commenters differ over the length of the phase-in period; some argue for a three-year transition period to coincide with a carrier's next depreciation prescription,[116] while others contend that a longer phase-in period with LEC discretion for transitioning into the ranges is appropriate.[117]

69. There is also general agreement that, if the Commission mandates ranges, a waiver process would be required. However, the parties differ over the appropriate waiver standard. For example, the Michigan Commission Staff and Pacific agree that a waiver should not be granted except under unique circumstances such as when there is a significant divergence between expected depreciation expenses and depreciation expenses resulting from use of the ranges.[118] The Oklahoma Commission Staff and the New Jersey Commission Staff suggest a waiver standard that incorporates state action affecting depreciation.[119] USTA argues that a carrier should always have the right to

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[112] Michigan Commission Staff Comments at 5; New Jersey Commission Staff Comments at 5; Pacific Comments at 18; and SNET Comments at 18-19.

[113] NARUC Comments at 6; NYNEX Comments at 14; and Utah Commission Comments at 2.

[114] See California Commission Comments at 4.

[115] See e.g., New York Commission Comments at 9; Pacific Comments at 19; USTA Comments at 18; and Washington Commission Comments at 3.

[116] See e.g., Colorado Commission Comments at 15; and Utah Commission Comments at 2. The SCA proposes a three-year transition period with percentage adjustments specified each year -- 33% adjustment from current rates allowed each year. SCA Comments at 14.

[117] See e.g., Pacific Comments at 19; and US West Comments at 11.

[118] Michigan Commission Staff Comments at 5; and Pacific Comments at 18.

[119] New Jersey Commission Staff Comments at 5; and Oklahoma Commission Staff Comments at 4.

request factors outside ranges, but should be required to make a showing using the current depreciation study requirements.[120]

70. Finally, parties address the issue of whether carriers should be allowed to move within established ranges if their current basic factors for an account fall within that range, both initially and thereafter. A few state commissions recommend limiting carriers to their current basic factors for their initial range selection.[121] The LECs argue that they should be allowed to choose any basic factor within a range initially.[122] The LECs also contend that after their initial range selection, they should be able to select any basic factor from within the range on an annual basis.[123] BellSouth reasons that additional flexibility is warranted in light of the price cap regulatory scheme, and current safeguards such as GAAP and ARMIS.[124] The state commissions are divided; a few agree that the LECs should be given additional flexibility,[125] but others would limit the flexibility by imposing a limit on the percentage change a carrier could make within the range.[126] Moreover, several state commissions would allow a carrier to change its basic factors only at the time of a new depreciation prescription.[127]

(3) Discussion

71. After careful consideration, we believe that we should not force carriers to use the basic factors within established ranges if their basic factors are now outside the ranges because of the Commission's long-held principle that an asset should be depreciated on a straight-line basis over the life of that asset.[128] That is, plant costs should be allocated to

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[120] USTA Comments at 18.

[121] See e.g., Colorado Commission Comments at 14; Michigan Commission Staff Comments at 5; and Utah Commission Comments at 3.

[122] See e.g., Pacific Comments at 19; and United Comments at 9. See also Wisconsin Commission Comments at 3.

[123] See e.g., BellSouth Comments at 36-38. See also CBT Comments at 11-12.

[124] See BellSouth Comments at 38.

[125] See e.g., Wisconsin Commission Comments at 3. See also NARUC Comments at 7.

[126] See e.g., Michigan Commission Staff Comments at 5; Colorado Commission Comments at 15; and Utah Commission Comments at 3. These commenters do not propose a specified percentage change.

[127] See e.g., Idaho Commission Comments at 4; Indiana Commission Comments at 5; and Missouri Commission Comments at 3.

[128] See 47 C.F.R. § 32.2000(g)(1)(i) ("depreciation percentage rates shall be computed in conformity with a group plan of accounting for depreciation and shall be such that the loss in service value of the property ... may be distributed under the straight-line method during the service life

depreciation expense at a rate representative of the consumption of the plant. If a projection life range of 20 - 25 years was established for a particular account, but a carrier, because of its unique circumstances, is currently using a 10 year projection life, forcing the carrier to use a life within the range would violate this principle. Prescribing depreciation rates that allocate plant costs over the useful life of plant is central to our depreciation policy. Thus, a carrier should use the basic factors that reflect its company operations. Obviously, if a carrier is using a 10 year life because of its unique circumstances, we have reviewed that company's operations and plans and determined that the 10 year life is consistent with such plans. Because we will not mandate the use of ranges for carriers outside the ranges, we need not address the issue of a transition period for moving carriers' basic factors within the ranges.

72. The basic factor range option we adopt today should achieve simplicity, conserve resources, and allow LECs greater flexibility in the depreciation process while remaining consistent with the public interest. We will allow a LEC to seek to change basic factors within the ranges as long as (1) the basic factors underlying that carrier's current rate for an account are within the established ranges and (2) the basic factors proposed to be used for a new rate are within the established range. If these conditions are met, the carrier will only be required to submit the streamlined data, as determined by the Common Carrier Bureau,[129] in its request for a new depreciation rate. Additionally, for range accounts, LECs may seek to change basic factors on an annual schedule as opposed to the current triennial schedule. However, in order to ensure adequate time for us to conduct our represcription proceeding, LECs must file for those changes by April 1 of the year in which new rates are sought. Finally, consistent with our current annual update process, carriers must update all plant accounts at the time they propose any new rate for a range account.[130]

73. We believe this approach is reasonable because the factors that will be the basis for establishing the ranges will have been analyzed and found generally reasonable. We further ensure the reasonableness of the ranges by seeking comment on them. The added degree of flexibility given by this approach means that for any carrier with a prescribed rate derived from basic factors within established ranges for an account, a presumption of reasonableness attaches to all basic factors within the established ranges for that account. However, such a presumption is not conclusive. Any proposed basic factor changes, either inside or outside the ranges, should be based on company operations. If a LEC makes a reasonable showing, based on current

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of the property.").

[129] We delegate to the Common Carrier Bureau the authority to determine the information to be submitted for these range accounts consistent with our decision here.

[130] See Prescription of Revised Percentages of Depreciation pursuant to Section 220(b) of the Communications Act of 1934, as amended, for: American Telephone and Telegraph Company - Long Lines Department, et al., Order, 96 FCC 2d 257, 268 at para. 33 (1984) ("[w]e can find no reason not to extend this procedure [annual updates] to all accounts to assure that composite rates are kept as current as possible.").

data requirements, that its basic factors should be different from those within established ranges, we would prescribe rates using appropriate basic factors. If other interested parties make reasonable showings that a LEC's operations require the use of basic factors different from those within established ranges or those proposed (although they fall within the ranges), we also would prescribe rates using appropriate basic factors. In either case, the showing would necessarily include a study consistent with our current depreciation analysis process.

74. Finally, we recognize that there may be instances when, for any one account, one basic factor may fall within an established range, but the other does not.[131] We have considered whether to allow a carrier to use the range approach for the factor within the range, but to require the LEC to provide data consistent with the current process to support the factor outside the range. However, because there is an interdependence between the LECs' decisions on appropriate life and salvage estimates,[132] we believe the better approach would be to require a LEC to provide supporting data for both factors consistent with the current depreciation practice. Therefore, if a LEC's current basic factors for any one account do not both fall within the established ranges for that account, the LEC may not use the range approach for that account.

e. Implementation Date for Ranges

(1) Introduction

75. In the Notice, we sought comment on when and how ranges should be implemented. We asked whether we should have a one-time conversion to ranges, or allow carriers to use ranges only after their next prescription.[133] We noted that, although a one time conversion would be expedient, converting all carriers at once might produce such an administrative burden upon regulators and carriers alike that implementation on a staggered basis might be warranted. We invited comment on these issues.

(2) Comments

76. All state commissions commenting on the issue and GTE favor phasing ranges in over the three-year prescription cycle.[134] Other suggestions

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[131] As discussed infra, we are not adopting a range of survivor curves for any range account. Instead, we will require carriers to use company-specific data to determine the appropriate survivor curve to be used for range accounts. The carriers will be required to submit sufficient data to support proposed curves. See infra para. 86.

[132] For example, motor vehicles kept in service for two years and then sold would likely yield higher salvage amounts than motor vehicles retired after ten years of service.

[133] Notice, 8 FCC Rcd at 149, para. 19.

[134] See e.g., GTE Comments at 11; Michigan Commission Staff Comments at 5; and Utah Commission Comments at 2. See also CBT Comments at 12.

include implementing ranges by 1994 for all carriers,[135] or beginning implementation of ranges in 1994, but allowing carriers to move to the ranges at their discretion over a 3 - 5 year period.[136] MCI would allow the range approach to go into effect only after the LEC price cap review is completed.[137]

(3) Discussion

77. We agree that the basic factor range approach should be implemented as soon as practicable. However, given current administrative resources, we are unable to complete a new depreciation prescription for every carrier in 1994. For that reason we set forth the following schedule:

1994 depreciation prescription carriers:

- if a carrier's current basic factors fall within the ranges, the carrier may use the range approach;

- if a carrier's current basic factors fall outside the ranges, the carrier must conduct and submit the regular depreciation analyses (and may show that its basic factors now fall within the established ranges);

- for non-range accounts, the carrier must conduct and submit the regular depreciation analyses.

1995 and 1996 depreciation prescription carriers:

- if a carrier's current basic factors fall within the ranges, the carrier may seek to change a basic factor as long as it is within the range, but the carrier must file for the change by April 1 (consistent with the Common Carrier Bureau's submissions requirements) and must update all other accounts consistent with our annual update process;[138]

- if a carrier's current basic factors fall outside the ranges, the carrier must wait until its next prescription date to show, through a depreciation study, that its basic factors fall within the ranges.

We believe that this approach balances the carriers' interest in simplification and flexibility provided by the range approach, our interest in reasonably allocating scarce administrative resources, and state commissions' right to present their views on depreciation rate changes. We recognize that 1995 and 1996 companies will not be able to make use of ranges for those accounts in which their current basic factors do not fall within the established ranges until their next prescription. However, we believe this minor inconvenience is outweighed by the LECs' ability to use ranges for those

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[135] See e.g., Bell Atlantic Comments at 11; and SNET Comments at 19.

[136] See e.g., Pacific Comments at 19; Southwestern Comments at 18; and USTA Comments at 17.

[137] MCI Comments at 9.

[138] See supra n. 130.

accounts in which their basic factors do fall within the established ranges and our ability to continue to prescribe depreciation rates in a timely fashion.

f. Reviewing and Updating Ranges

(1) Introduction

78. In the Notice, we sought comment on how and when we should review and update the established ranges. We invited comment on the length of time any set of ranges should be in place, the process for updating, and the data to be used for review.[139] One option we proposed was to complete a depreciation review on an industry-wide basis, which would result in carriers analyzing data and company plans and submitting such information for determination of new ranges. We also asked specifically whether we should simplify this review process further by reviewing data at the regional operating company level or by a sampling method.

(2) Comments

79. Commenters overwhelmingly favor a review period of 3 - 5 years.[140] However, at least three LECs would have us conduct an annual review of the ranges for some or all of the accounts.[141] For the actual updating process and the data to be used for review, NARUC argues that the Commission should establish new ranges based on the companies' continuing property records and mortality data.[142] NARUC also states a preference for review of data at the LEC level, but concludes that use of data aggregated at the regional level may have merit.[143] A majority of companies maintains that the Commission should establish new ranges on the basis of benchmark studies of other communications companies, individual company plans, and filings with the Commission.[144] United, however, proposes new ranges based on the recommendation of an informal depreciation review board composed of industry, Commission and state

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139 Notice, 8 FCC Rcd at 149, para.22.

140 California Commission Comments at 3 (3 years); CBT Comments at 12 (3-5 years, depending upon the account); Wisconsin Commission Comments at 3 (3 years). Both Utah and the SCA favor a two tier review approach. Utah would have the Commission review accounts impacted by technological changes every three years and other accounts every five years. Utah Commission Comments at 3. The SCA would have the Commission review accounts using ELG every three years and other accounts every five years. SCA Comments at 14-15.

141 See NYNEX Comments at 18; Pacific Comments at 19; and United Comments at 9.

142 NARUC Comments at 7.

143 Id.

144 See e.g., CBT Comments at 12; and Pacific Comments at 19. See also USTA Comments at 20.

representatives.[145]

(3) Discussion

80. We agree with those commenters who suggest that a three year review period is reasonable. We are persuaded that a three year review is necessary to keep ranges in line with technological, demand, and competitive changes. Therefore, barring unforeseen regulatory, market, or technological changes, we will begin a review of the range set for a given account three years after the range is introduced.

81. We believe it premature to establish an all inclusive list of specific data to be used in our review. Regulatory and market changes may require us to consider a broader range of information than our current process does. However, carriers must continue to maintain continuing property records. If we later determine that a review similar to that which we use today is appropriate, carriers will be required to provide such data.

3. Related Issues

a. Price Cap Treatment of Depreciation Expense

(1) Introduction

82. In the Notice, we tentatively concluded that adoption of this range process will not alter our endogenous treatment of depreciation expense changes. We reasoned that, under the basic factor range option, carriers would continue to exert control over their depreciation rates and expenses because the ranges would reflect the carriers' actual depreciation experience and future plans.[146] We found that this would result in carriers controlling the ranges to approximately the same extent that they control the rate-setting process today. Moreover, we recognized that they would have added control over the basic factors they selected within the ranges, and thus added control over depreciation rates and expenses.[147]

(2) Comments/Discussion

83. No party to this proceeding objects to our conclusion that the basic factor range option does not undercut our analysis supporting endogenous treatment of depreciation expense. We therefore conclude that incorporation of the basic factor range option into the depreciation prescription process does not affect our determination that depreciation expense should be an endogenous cost under price caps.

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[145] United Comments at 9.

[146] Notice, 8 FCC Rcd at 150, paras. 23-24.

[147] Id.

b. Equal Life Group Procedures

(1) Introduction

84. In the Notice, we sought comment on whether we should continue our equal life group (ELG) procedures in light of our proposal to use ranges for all of the basic factors used in the depreciation rate formula. As we explained there, we do not determine a future life expectancy for every asset in every account. Rather, we group assets by age (by vintage) and may further refine the group by subdividing assets of the same age into equal life groups. This grouping procedure is known as ELG. We believe ELG allows for more accurate depreciation than vintage grouping. However, because ELG rates are very sensitive to the survivor curve shape, we have only allowed the use of ELG when the necessary data to determine the curve shape is available for a specific account of an individual carrier.[148] Because we proposed to establish a range of survivor curves for plant accounts based on industry-wide data, we questioned whether this should affect our continued use of ELG.

(2) Comments

85. A majority of state commissions commenting on this issue advocates eliminating the use of ELG because company-specific data would not be used to develop the actual survivor curve selected by a carrier.[149] Moreover, these parties argue that eliminating ELG will greatly simplify the current depreciation prescription process.[150] The companies argue for the continued use of ELG.[151] USTA contends that ELG rates would not be materially affected by the use of industry curves.[152] CBT states that the Commission could devise one standard curve for each account for which ranges will be adopted. This, CBT contends, would allow the Commission to continue to use ELG because a standard curve would create a standard ELG recovery pattern for all carriers.[153]

(3) Discussion

86. Carriers employ various curve fitting techniques to determine the appropriate survivor curves to be used in computing their depreciation

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[148] See id. at 150, para. 25, citing, ELG Depreciation Order.

[149] See e.g., Colorado Commission Comments at 19; Florida Commission ex parte Comments at 3-4; and Washington Commission Comments at 3.

[150] See e.g., Colorado Commission Comments at 19.

[151] See e.g., GTE Comments at 11-12; and Pacific Comments at 20.

[152] USTA Comments at 21.

[153] CBT Comments at 12.

rates.[154] This divergence in curve-fitting techniques makes it impracticable to specify a range of curves that all carriers can apply. In addition, as we stated in the Notice, the use of ELG procedures is premised on the availability of company-specific survivor curves.[155] We have recognized that ELG procedures allow for more timely depreciation.[156] Thus, we find that the most rational approach to these issues is to allow carriers to employ company-specific curves, reflecting their actual experience and current curve-fitting techniques. This approach will allow for the continued use of ELG procedures. Carriers must submit data supporting their curves with their proposed rates for range accounts as required by the Common Carrier Bureau.[157] For non-range accounts, carriers will be required to continue to follow the current process. Because we will not establish ranges of survivor curves, the issue of eliminating ELG is moot.

c. Reserve Deficiencies

(1) Comments

87. A number of parties ask what should happen to current and future reserve deficiencies if any simplification option were adopted. A number of state commissions conclude that, because all of the options give LECs a greater degree of flexibility, LECs should be responsible for any future reserve deficiencies.[158] In effect, these parties argue that any resulting reserve deficiency would be caused by LEC decisions. The LECs, on the other hand, hold that under any option, except perhaps the price cap carrier option,[159] current and future reserve deficiencies would need to be taken care of through the amortization process.[160] They conclude that any reserve deficiency would be caused by regulatory oversight.

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[154] For example, most of the BOCs use Gompertz-Makeham curve fitting techniques. The Gompertz-Makeham curves are based on equations that smooth and extend an observed life table. Most of the other LECs use Iowa curves. Iowa curves are standardized tables that are fit to an observed life table by trial and error.

[155] Notice, 8 FCC Rcd at 150, para. 25.

[156] ELG Depreciation Order, 83 FCC 2d at 281 and 283, paras. 48 and 55.

[157] Carriers should continue to use the curves currently determined for those range accounts for which mortality data may not yet definitively describe retirement dispersions.

[158] See e.g., California Commission Comments at 4; Colorado Commission Comments at 16; and New York Commission Comments at 10.

[159] BellSouth suggests that the price cap carrier option would provide sufficient flexibility for carriers to deal with reserve problems without regulatory intervention. BellSouth Comments at 38-40. But see Southwestern Comments at 20-21.

[160] See e.g., BellSouth Comments at 38-40; Southwestern Comments at 20-21; and US West Comments at 13.

(2) Discussion

88. We have already taken steps to correct for reserve deficiencies that may have been caused, in part, by past regulatory decisions.[161] Furthermore, reserve studies do not demonstrate a significant overall LEC reserve deficiency at this time.[162] We also do not find persuasive either position taken by the parties regarding future reserve deficiencies. We believe the better approach is to evaluate any future reserve deficiencies on a case-by-case basis. Although we have adopted a depreciation rate formula that should correct for past inaccuracies in the depreciation process, we cannot say that every potential future reserve problem is, or should be, solved through that formula. We will continue our case-by-case approach.

C. Simplification for AT&T

1. Introduction

89. The Notice suggested that we were considering adopting the same simplification option for AT&T and the LECs. For example, in discussing the implementation issues for the basic factor range option, we sought comment on whether we should adopt separate ranges for LECs and AT&T for any particular account.[163] At the same time, we recognized the differences between AT&T and the LECs in regard to the competitiveness of their markets and their price cap plans.[164]

2. Comments

90. AT&T states that the price cap carrier option is appropriate for it, but not for the LECs.[165] AT&T cites as distinguishing factors the differences in the competitiveness of AT&T's and the LECs' respective markets and the absence of a sharing obligation under AT&T's price cap plan.[166] In addition, a number of state commissions and NARUC indicate that they believe the price cap carrier option "has merit" under a pure price caps system, i.e.,

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[161] Amortization of Depreciation Reserve Imbalances of Local Exchange Carriers, Report and Order, 3 FCC Rcd 984 (1988).

[162] See supra n.86.

[163] Notice, 8 FCC Rcd at 148, para. 15.

[164] See id. at 147-148, para. 8 ("significant competition in the interexchange market, emerging competition in the local exchange market") and at 152, para. 40 ("under the LEC price cap scheme, LECs must share earnings with their customers if earnings fall within the specified sharing zone").

[165] AT&T Comments at 5-8.

[166] Id. In its Reply, AT&T also points out that, for the period 1988-1991, its plant retirement rate was nearly three times greater than the LECs' composite retirement rate. AT&T Reply at Appendix B.

price caps without a sharing component.[167] Moreover, the Virginia Commission Staff expressly states that AT&T should be permitted to use the price cap carrier option.[168] However, the LECs argue that the price cap carrier option should not be turned into the "AT&T option."[169] BellSouth states that AT&T recognizes the benefits of the price cap carrier option, but then AT&T "blithely suggests that only it should be regulated under the [price cap carrier option]."[170] AT&T's suggestion, according to BellSouth is "blatantly self-interested, and must be rejected."[171]

3. Discussion

91. As we have stated, the goals of this proceeding are simplification, administrative savings, and flexibility. We have concluded that the price cap carrier option is the simplest and most flexible option. Moreover, if a carrier is not required to perform detailed depreciation analysis in the intrastate jurisdiction, we believe that this option would produce the most savings. Thus, we would adopt this option for any carrier if other public interest concerns were not raised.

92. After careful consideration of the record, we conclude that AT&T should be allowed to use a modified form of the price cap carrier option. Our reservations about adopting this option for the LECs do not extend to AT&T. AT&T's price cap plan does not include a sharing component. Thus, AT&T will not have an incentive to manage earnings to avoid sharing them with ratepayers. Furthermore, AT&T faces a more competitive market than the LECs.[172] We have recognized this by moving many of AT&T's services into streamlined regulation.[173] Only Basket 1 services, containing residential and small business services, remain fully under price cap regulation. Baskets 2

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[167] See California Commission Comments at 9; and NARUC Comments at 12. See also GSA Comments at 3 ("[a]t best, an argument could be made for deregulating AT&T's depreciation rates .. because AT&T is now a competitive enterprise.").

[168] Virginia Commission Staff Comments at 3.

[169] See e.g., BellSouth Reply Comments at 10-12.

[170] Id. at 10.

[171] Id.

[172] We note that AT&T's recent plant retirement rate is approximately 14.3%, and its composite depreciation rate is approximately 14.1%. In comparison, the LECs' recent composite plant retirement rate is approximately 4%, and their composite depreciation rate is approximately 7.3%.

[173] Most of AT&T's basket 2 and 3 services have been streamlined. See Competition in the Interstate Interexchange Marketplace, Report and Order, 6 FCC Rcd 5880 (1991), recon., 6 FCC Rcd 7569 (1991), further recon., 7 FCC Rcd 2677, pets. for recon. pending; see Competition in the Interstate Interexchange Marketplace, Memorandum Opinion and Order on Reconsideration, 8 FCC Rcd 2659 (1993).

and 3 have only one service each remaining under price cap regulation.[174] For these reasons, we find that AT&T should be allowed greater flexibility than the LECs in the depreciation prescription process. Thus, we will adopt a form of the price cap carrier option for AT&T.

93. Although we find that a price cap carrier option is reasonable for AT&T, we believe that AT&T should provide somewhat more information than that proposed in the Notice because such information will help us monitor the effectiveness of AT&T's price cap plan. Under the price cap carrier option proposed in the Notice, a carrier would need only to provide its current depreciation rates, its proposed depreciation rates, and the changes in depreciation expense that would occur if the proposed rates become effective. Under the price cap carrier option we adopt today, AT&T must submit the information set forth in the Notice, plus generation data, a summary of basic factors underlying proposed rates by account, and a short narrative supporting those basic factors, including company plans of forecasted retirements and additions, and recent annual retirements, salvage, cost of removal. These submission requirements are much less burdensome than the current submission requirements; decreasing the filing requirements from approximately 25 pages per account to approximately 5 pages per account.[175] AT&T may also seek revised depreciation rates under this new prescription process annually.

94. We note that in the Notice, we asked whether the proposed price cap carrier option met the requirements of Section 220 of the Communications Act.[176] The parties addressing this issue are divided. The carriers claim that the option as proposed does not violate the Commissions's obligations under Section 220; the state commissions claim that it does. We need not address the issue, however, because we are not adopting that proposal. Moreover, although we do not reach the issue of whether the price cap carrier option as proposed would be legally sufficient pursuant to Section 220, we are confident that the modified plan we adopt today, as applied to AT&T, addresses the concerns raised by the state commissions because this plan will provide us with the information necessary to review AT&T's proposed depreciation rates for reasonableness.

D. Simplification for Alascom

95. As we stated previously, we had considered whether applying the same simplification option to the LECs and AT&T and Alascom would serve the public interest, although we noted the differences among these carriers. No party spoke directly to the issue of which simplification option should be adopted for Alascom; neither Alascom nor the Alaska state commission has participated in this proceeding. After careful consideration, we have determined that simplification for Alascom should be deferred.

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[174] The service continuing under price cap regulation in basket 2 is 800 Directory Assistance. The service remaining under price cap regulation in basket 3 is analog private line service.

[175] These information submissions should be consistent with the Common Carrier Bureau's depreciation study guide in format, style, and content.

[176] Notice, 8 FCC Rcd at 152-153, paras. 41-42.

96. The Alaska interstate interexchange market structure is currently in transition. A Federal-State Joint Board has recently sought comment on a tentative recommendation to the Commission in regard to the provision of interstate interexchange service that directly affects Alascom.[177] In light of this, we will defer simplification for Alascom until the Joint Board makes a final recommendation regarding the changes that should be made in the provision of interstate interexchange service in Alaska.

E. Salvage

1. Introduction

97. In the Notice, we asked whether we should change our approach to salvage and cease to consider it in the depreciation prescription process.[178] Instead, carriers would account for the cost of removal and salvage as current period charges and credits on their regulated books of account. Specifically, carriers would account for cost of removal, when it occurred, as a current period charge and salvage as a current period credit.

2. Comments

98. The record on this issue is mixed. The LECs overwhelmingly oppose this change. For example, GTE and Pacific, among others, argue that to change the accounting treatment of salvage would be inconsistent with GAAP.[179] The state commissions, however do not provide such a united front. Many oppose the change,[180] while others believe the idea has merit, but requires further study.[181] GSA and the SCA give their unqualified support for this change, saying that this will result in greater simplification.[182] Two parties offer alternatives to the accounting change. The Oklahoma Commission Staff suggests that the Commission treat salvage as a separate rate which changes independently of the basic depreciation rate.[183] The Washington Commission, while supporting the proposal in the Notice, offers another approach; it proposes that we eliminate salvage accounting for each individual plant account, and establish a single salvage account applicable to all plant

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[177] See supra n. 10. That Tentative Recommendation endorses elimination of the Joint Service Arrangement (JSA), subject to the institution of suitable transition mechanisms, between Alascom and AT&T. Under the JSA, AT&T reimburses Alascom for its interstate interexchange costs incurred in the provision of interstate message telephone service and wide area telecommunication service, including a return on investment.

[178] Notice, 8 FCC Rcd at 153, para. 43.

[179] See GTE Comments at 14; and Pacific Comments at 21-22.

[180] See e.g., Michigan Commission Staff Comments at 6; Oregon Commission Comments at 3; and South Dakota Commission Comments at 3.

[181] See e.g., Missouri Commission Comments at 6; New York Commission Comments at 9; and Washington Commission Comments at 5.

[182] GSA Comments at 8-10; and SCA Comments at 27-30.

[183] Oklahoma Commission Staff Comments at 6.

accounts.[184]

3. Discussion

99. We have considered whether we should eliminate the future net salvage determination from the depreciation prescription process and instead consider it in current period accounting. We conclude that we will not change the accounting of salvage amounts based on the record before us. The record is mixed, and is replete with the suggestion that further study is needed to determine if the change could and should be made. Additional issues that would need to be studied include whether the proposed change is consistent with GAAP and whether it will create a matching problem. We find that delaying this simplification proceeding to study whether an accounting change should occur is unwarranted, especially in light of the simplification taking place. Therefore, we will continue to determine the future net salvage value in the depreciation process.

IV. ORDERING CLAUSES

100. Accordingly, IT IS ORDERED, pursuant to Sections 1, 4(i), 4(j), 220, and 403 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, 154(i), 154(j), 220(b), 403, that Section 43.43 of the Commission's Rules IS AMENDED, 47 C.F.R. § 43.43, to reflect the changes to our depreciation prescription process as described herein.

101. IT IS FURTHER ORDERED, that the motion for leave to file late filed pleadings by California Cable Television Association IS GRANTED.

102. IT IS FURTHER ORDERED, that pursuant to Section 1.427(a) of the Commission's Rules, 47 C.F.R. § 1.427(a), the amendment to Section 43.43 of the Commission's Rules, 47 C.F.R. § 43.43, shall be effective no later than January 1, 1994.

FEDERAL COMMUNICATIONS COMMISSION

William F. Caton
Acting Secretary

[184] Washington Commission Comments at 4.

APPENDIX A

Comments Filed

Ameritech Operating Companies (Ameritech)
American Telephone and Telegraph (AT&T)
Bell Atlantic (Bell Atlantic)
BellSouth Telecommunications, Inc. (BellSouth)
California Cable Television Association (CCTA) (late filed comments)
People of the State of California and the Public Utilities Commission of the State of California (California Commission)
Cincinnati Bell Telephone (CBT)
Colorado Public Utilities Commission (Colorado Commission)
Deloitte & Touche (Deloitte & Touche)
General Service Administration (GSA)
GTE Service Corporation and its affiliated domestic telephone operating companies (GTE)
Idaho Public Utilities Commission (Idaho Commission)
Indiana Utility Regulatory Commission (Indiana Commission)
MCI Telecommunications Corporation (MCI)
Michigan Public Service Commission Staff (Michigan Commission Staff)
Missouri Public Service Commission (Missouri Commission)
National Association of Regulatory Utility Commissioners (NARUC)
Nebraska Public Service Commission (Nebraska Commission)
New Jersey Board of Regulatory Commissioners Staff (New Jersey Commission Staff) (late filed comments)
New York State Department of Public Service (New York Commission)
New York Telephone Company and New England Telephone and Telegraph Company (NYNEX)
North Dakota Public Service Commission (North Dakota Commission)
Oklahoma Corporation Commission Public Utility Division Staff (Oklahoma Commission)
Oregon Public Utility Commission (Oregon Commission)
Pacific Bell and Nevada Bell (Pacific)
South Dakota Public Utilities Commission (South Dakota Commission)
Southern New England Telephone Company (SNET)
Southwestern Bell Telephone Company (Southwestern)
District of Columbia Office of People's Counsel, Florida Office of the Public Counsel, Indiana Office of Utility Consumer Counselor, Pennsylvania Office of Consumer Advocate (State Consumer Advocates or SCA)
Tennessee Public Service Commission Staff (Tennessee Commission Staff)
Public Utility Commission of Texas (Texas Commission)
United States Telephone Association (USTA)
U S West Communications, Inc. (US West)
United Telephone - Southeast, Inc. (United)
Utah Division of Public Utilities (Utah Commission)
Virginia State Corporation Commission Staff (Virginia Commission Staff)
Washington Utilities and Transportation Commission (Washington Commission)
Public Service Commission of Wisconsin (Wisconsin Commission)

Reply Comments Filed

AT&T
Ameritech
Bell Atlantic
BellSouth
Colorado Office of Consumer Counsel (Colorado Consumer Counsel)
Deloitte & Touche
GSA
GTE
International Communications Association (ICA)
Iowa Office of Consumer Advocate (Iowa Consumer Advocate) (late filed comments)
MCI
Minnesota Department of Public Service (Minnesota Commission)
NARUC
NYNEX
Pacific
Southwestern
USTA
US West
United

Ex Parte Filings

Ameritech
Bell Atlantic
BellSouth
Florida Public Service Commission (Florida Commission)
GTE
MCI
NARUC
Pacific
Southwestern
USTA
US West

APPENDIX B

Part 43 of the Commission's Rules and Regulations, 47 C.F.R. Part 43 is amended as follows:

Reports of Communication Common Carriers and Certain Affiliates

1. The authority citation for Part 43 continues to read as follows:

Authority: Sec. 4, 48 Stat. 1006, as amended; 47 U.S.C. 154, unless otherwise noted. Interpret or apply secs. 211, 219, 220, 48 Stat. 1073, 1077, as amended; 47 U.S.C. 211, 219, 220.

2. Section 43.43 is amended by revising paragraph (c) to read as follows:

§ 43.43 Reports of proposed changes in depreciation rates

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(c) Except as specified in subsections (c)(i) and (c)(ii) of this rule, when the change in the depreciation rate proposed for any class or subclass of plant (other than one occasioned solely by a shift in the relative investment in the several subclasses of the class of plant) amounts to twenty percent (20%) or more of the rate currently applied thereto, or when the proposed change will produce an increase or decrease of one percent (1%) or more of the aggregate depreciation charges for all depreciable plant (based on the amounts determined in compliance with paragraph (b)(2) of this section) the carrier shall supplement the data required by paragraph (b) of this section with copies of the underlying studies, including calculations and charts, developed by the carrier to support service-life and net-salvage estimates. If a carrier must submit data of a repetitive nature to comply with this requirement, the carrier need only submit a fully illustrative portion thereof.

(i) A Local Exchange Carrier regulated under price caps, pursuant to §§ 61.41 through 61.49, is not required to submit the supplemental information described above in paragraph (c) of this section for a specific account if: the carrier's currently prescribed depreciation rate for the specific account is derived from basic factors that fall within the basic factor ranges established for that same account; and the carrier's proposed depreciation rate for the specific account would also be derived from basic factors that fall within the basic factor ranges for the same account.

(ii) Interexchange carriers regulated under price caps, pursuant to §§ 61.41 through 61.49, are exempted from submitting the supplemental information as described above in paragraph (c) of this section. They shall instead submit: generation data, a summary of basic factors underlying proposed rates by account and a short narrative supporting those basic factors, including: company plans of forecasted retirements and additions; and recent annual retirements, salvage, and cost of removal.

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Separate Statement
of
Commissioner Ervin S. Duggan

In Re: Simplification of the Depreciation Prescription Process

Today we take a major step toward simplification of the Commission's depreciation prescription process by adopting a "range of basic factors" approach for as many accounts as we feasibly can. I support wholeheartedly the goal of simplifying regulation and conserving resources, both ours and the carriers', if we can do so without risk to consumers.

I also support our plans to explore, in a future proceeding, whether there are ways that we can make our depreciation process more responsive to the accelerating pace of carrier investment in their networks. The local telephone companies increasingly will find themselves impelled--- whether by foresight, competitive realities, or consumer demand--- to speed up infrastructure investment. They face increasing competition on all sides, often from companies lucky enough to be able to start with the newest technology. Consumers also stand on the threshold of an explosion of new services that the latest technology has made possible, and they deserve to benefit from that technology.

As we seek to encourage that, it is essential for the Commission to maintain the close tie between FCC-prescribed depreciation rates and the actual rate of new infrastructure investment by the affected carriers.

Carriers that accelerate their replacement of plant with sophisticated new technology should know that their stepped-up investment will also lead to a step-up in their depreciation expense. The promise of accelerated depreciation provides a strong incentive for carriers to invest in network upgrades--- to install digital switches, fiberoptic cable, and sophisticated signalling technology, for example.

Consumer protection also requires that the link between the rate of actual network investment and the rate of depreciation remain intact. First, that link preserves the integrity of the price caps sharing mechanism. Second, that link ensures that ratepayer revenues attributable to increased depreciation are not being funnelled into other telco endeavors--- or even abroad--- but instead are being pumped into the network. Any plan we adopt in a future proceeding must protect consumer interests as well.

The Commission, in its depreciation policies, must respond to the real world changes that telephone companies are undergoing. We must do so in a way that also continues to protect consumers. I have great confidence that we can accomplish both goals.

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SEPARATE STATEMENT
OF
COMMISSIONER ANDREW C. BARRETT

RE: Simplification of the Depreciation Prescription Process [CC Docket 92-296].

This decision is a substantial step forward in making adjustments to the Commission's depreciation prescription process, but it is clearly not reform. It streamlines the process of setting depreciation rates and provides both AT&T and price cap local exchange carriers needed flexibility in the determination of depreciation rates. These adjustments will result in significant resource savings for both the companies and the Commission. They also respond to the changing marketplace realities of increased competition faced by these carriers and the impact of that competition on the economic lives of their productive assets.

We adopt in this Order the so-called price cap carrier approach for AT&T. Under this approach the company will propose depreciation rates, with substantially reduced supporting information requirements. After receiving comment on the reasonableness of those rates from interested parties, the Commission will prescribe depreciation rates based on AT&T's submission and the comments received. AT&T may seek revision of its depreciation rates annually rather than the previous schedule of every two years.

Ranges for the basic factors that determine depreciation rates will be established for local exchange carriers under interstate price cap regulation. Carriers using basic factors within these established ranges will not need to submit the detailed supporting data required under the current scheme. Further, carriers may seek to change these basic factors annually, as opposed to the current triennial represcription cycle.

I am gratified that the Commission indicates its willingness to consider additional adjustment with an eye toward reform of its depreciation practices as changing circumstances warrant. In particular, the Order notes that elimination of the rate-of-return based sharing backstop for price cap LECs, or lack of LEC's ability to manipulate this to ratepayer's detriment, would warrant reexamination of the appropriate depreciation prescription process for these carriers. So while this is a step in the right direction, much will be needed as the environment continues to change.