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

FCC 93-452

FCC MAIL SECTION

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| In the Matter of | ) | |
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| 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, see infra, 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. <u>See infra</u>. at paras. 42-48.

[29] In this section of our Order, and the Implementation section for price cap LEC depreciation simplification, <u>infra</u> 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. <u>See also</u> California Commission Comments at 4-5.

[45] <u>See e.g.</u>, BellSouth Comments at 34; NYNEX Comments at 14; and SNET Comments at 16-17. <u>See also</u>, 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. <u>Id</u>. 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 See USTA Reply at 23. See also 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 recognise 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 recognise 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 modernise their infrastructure to meet market and technological changes.

<u>2. Implementation of the Basic Factor Range Option for the Price Cap LECs</u>

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] <u>See</u> <u>supra</u> 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. <u>See</u> 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.