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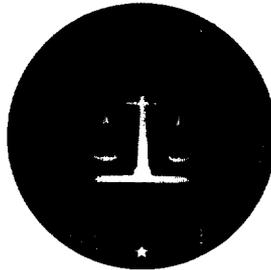
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1919 M Street, NW
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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

**RE: In the Matter of Simplification of the
Depreciation Prescription Process**

CC Docket 92-296 [FCC 93-492]

**Request to File Out of Time or
Ex Parte Comments**

Dear Sir:

Pursuant to Sections 1.41, 1.44, 1.415(d), 1.419(b), and 1.1206(a)(1) of the Federal Communications Commission's ("FCC" or "Commission") Rules of Practice and Procedure,¹ the National Association of Regulatory Utility Commissioners ("NARUC") respectfully requests that the Commission "authorize", within the meaning of Section 1.415(d), NARUC's attached out-of-time reply comments ("Comments") addressing responses to the "Order Inviting Comments" ("OIR") adopted November 8, 1993, and released November 12, 1993 in the above-captioned proceeding. The OIC sought comment on proposed selected account and factor ranges for use beginning in 1994. Alternatively, NARUC requests that those Comments be deemed written **ex parte communications** within the meaning of Section 1.419(b) and 1.1206 of the Commission's regulations.

¹ 47 C.F.R. Sections 1.41, 1.44, 1.415(d), 1.419(b), and 1.1206(a)(1) (1990).

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NARUC's January 24, 1994 Correspondence FEDERAL COMMUNICATIONS COMMISSION Page - 2 -
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In support of this request, NARUC notes the following:

(1) NARUC has participated in a timely fashion in all earlier phases of this proceeding, including the initial round of comments filed in response to the OIC.;

(2) Due to an unfortunate combination of events related to the extreme weather conditions experience last week, NARUC's counsel was unable to get final clearances from all requisite Commissioners in time to file our reply by the deadline last friday, January 21, 1994;

(3) Section 1.415(d) of the Commission's Rules states that "[n]o additional...", i.e., out-of-time, "...comments may be filed unless specifically requested or authorized by the Commission." If such Section 1.415 authorization is not forthcoming, subject to certain conditions, one can still file "informal" ex parte comments after the deadline for reply comments. [See 47 C.F.R. Section 1.419(b), which states that "[i]nformal comments filed after close of the reply comment period...should be labeled "ex parte" pursuant to section 1.12066(a) of this Chapter."]

(4) The subject matter at issue in this proceeding is of undeniable and significant interest to NARUC's state commission membership;

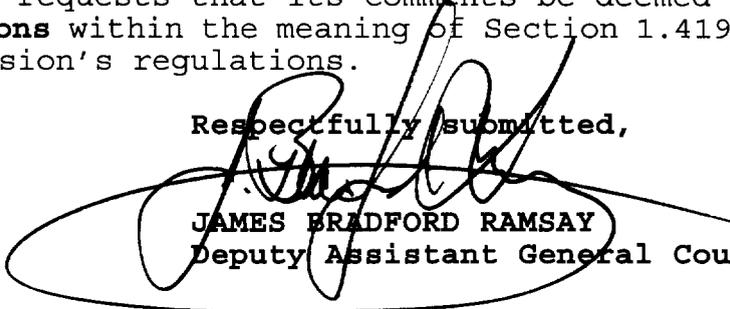
(5) No other participant's comments can adequately represent the viewpoint of NARUC's membership. This viewpoint is necessary to fully illuminate the issues raised by the FCC's proposal and assure a complete record upon which to base a decision. Hence, granting the requested authorization and/or waivers will serve the public interest by ensuring NARUC's full participation.

(7) No other participant will be prejudiced by allowing this late filing as

- (a) NARUC is filing its reply on the next business day after the scheduled date,
- (b) all participants will receive copies of these comments within one day of receipt of replies filed by other parties,
- (c) this is the reply round of comments and no formal rebuttal to this round of comments is scheduled; and
- (d) any party remains free to file ex parte a response to this and any other reply filed timely last friday at the Commission.

Accordingly, NARUC respectfully requests that the Commission grant any waivers and/or authorizations necessary to allow filing comments out-of-time in the above-captioned proceeding. Alternatively, NARUC requests that its Comments be deemed written **ex parte communications** within the meaning of Section 1.419(b) and 1.1206 of the Commission's regulations.

Respectfully submitted,



JAMES BRADFORD RAMSAY
Deputy Assistant General Counsel

National Association of
Regulatory Utility Commissioners

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of)	
)	
Simplification of the)	CC Docket 92-296
Depreciation Prescription Process)	[FCC 93-493]
)	

**REPLY COMMENTS OF THE
NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS**

Pursuant to Sections 1.49, 1.415 and 1.419 of the Federal Communications Commission's ("FCC" or "Commission") Rules of Practice and Procedure, 47 C.F.R. Section 1.49, 1.415, & 1.419 (1992), the National Association of Regulatory Commissioners ("NARUC") respectfully submits this reply to the December 17, 1993 initial comments filed by several local exchange carriers ("LECs") in response to the Federal Communications Commission's ("FCC" or "Commission") Order Inviting Comments ("OIR") adopted November 8, 1993, and released November 12, 1993 [FCC 93-492] in the above-captioned proceeding. The OIR sought comment on proposed selected account and factor ranges for use beginning in 1994.

I. FCC OBJECTIVE

NARUC cautions the FCC not to lose sight of its primary objective - simplification by making less burdensome the depreciation prescription process - rather than creating a process whereby the LECs might obtain unreasonable, unjustified or arbitrary depreciation rates.

The Report and Order released on October 20, 1993 (R&O) is quite clear that each carrier is responsible for assuring that its basic factors reflect that carrier's plans and operations.

Several LECs (Ameritech, Pacific Bell and Nevada Bell and NYNEX) commented that adoption of the Basic Factor Range Option appears to eliminate the streamlined process previously available for certain accounts representing less than 3% of the LEC's total investment. If the basic factors currently in effect for a given account do not fall within the prescribed range, these carriers opine that they must now undertake the complete and cumbersome study process. However, the R&O makes it clear that if a LEC's current basic factors do not fall within the established range, that carrier must submit sufficient information, "consistent with the current depreciation analysis requirements", R&O at ¶ 29, to demonstrate that its basic factors should fall within the established range to be free from a requirement of filing supporting data. It would seem, therefore, that the FCC does not intend to eliminate any process currently available, including the streamlined process. Under the circumstances, and because several of the companies raised this point, NARUC suggests that the FCC clarify that the R&O does not preclude continued use of the streamlined study process, either to prescribe rates as in the past or to demonstrate that basic factors fall within the established ranges.

II. NUMBER OF ACCOUNTS

All of the carriers commented on the number of accounts for which ranges are being proposed. NYNEX argues that the goal of simplification will not be met unless the list of accounts selected for ranges in 1994 is expanded to include major accounts. It contends that the omission of major accounts effectively postpones any meaningful simplification until at least 1995. USTA also argues for ranges for all accounts now. There was a unanimous declaration that the number of accounts should be expanded to include at least the metallic cable accounts, even though the R&O is clear that ranges for all accounts could not be completed for 1994 due to limited Staff and resources. NARUC believes that the accounts identified in the OIC represent those most readily adaptable to the range approach. However, as the R&O states, the FCC should move forward in establishing ranges for the remaining accounts as soon as possible. Nowhere in the R&O was there an attempt to set ranges for all accounts now. The carrier comments relating to this subject, therefore, should be considered irrelevant and more a reconsideration matter than an appropriate response to the OIC.

USTA comments that it should not be difficult for the FCC to set ranges for all accounts, plus establish ranges that are "forward-looking", if the FCC were simply to rely on the recommendations contained in a document prepared by Technology Futures, Inc. (TFI) submitted by USTA.

NARUC strongly urges the FCC not to solely rely on this document in establishing appropriate ranges but to also look to other sources such as state commission prescribed factors and equipment manufacturers. The FCC should be very wary of relying on a speculative document that has been produced solely from the carrier's bias.

While GTE endorses USTA's proposal for "forward looking" ranges for all accounts, it agrees that an argument can be made that certain technology-sensitive accounts (digital switching and metallic cable) could be excluded from the range setting process. With respect to the other accounts for which ranges have not been proposed, however, GTE concludes that the self-correcting aspect of the remaining life methodology would permit the Commission to exercise continuing effective oversight of LEC depreciation rates.

While the remaining life procedure will effectively ensure against more than 100% recovery, it will not prevent an intentionally improper rate of recovery. Thus, NARUC's concern is that once the ranges are established, the answer to whether or not a carrier uses basic factors that truly reflect consumption of its plant will not be known for some time. If the reserve for an account continues to increase without much retirement activity, then a conclusion could be drawn that the underlying life is too short. Conversely, if substantial retirements occur, driving the reserve into rapid decline, then it would be clear that the underlying factors were overestimated.

The bottom-line concern remains, i.e., the potential manipulation of depreciation to attain a certain earnings level.

BellSouth comments that the initial accounts should be expanded to include digital switching, digital circuit, and aerial and buried metallic cable. It maintains although that the OIC proposal will simplify the rescription process, there will not be substantive change in depreciation expense. Again, NARUC urges the FCC keep in focus the purpose of this proceeding, that is to simplify the study process, not to increase depreciation expense.

Southwestern Bell recognizes some potential benefit from the OIC's proposed first round of accounts, while urging that ranges be established for the remaining accounts as soon as possible. Depreciation of dying accounts, Southwestern Bell notes, should be dictated by company-specific plans. NARUC agrees.

Southern New England comments that it is unclear what technical problems prevent all accounts from being addressed at this time. NARUC believes, however, that addressing 22 of 34 categories is commendable and represents a significant step in the right direction, regardless of the amount of depreciation expense or investment involved. It stands to reason that the more volatile, controversial accounts would take longer to analyze. After all, the data available to the FCC for the initial 22 accounts is not readily available for the remaining accounts.

As stated in the OIC, these accounts will be addressed, if feasible, as soon as possible. In addition, the R&O is very clear that it is impractical to address ranges for all accounts at one time. NARUC applauds the FCC's initiative and speed in developing ranges for the accounts listed in the OIC.

For ranges proposed at a rate category level, the OIC makes simplification contingent on a carrier requesting basic factors at that level. NYNEX, Pacific Bell and Nevada Bell, and Southwestern Bell favor this approach. GTE was the only carrier opposed and opines that such a condition will strip away the benefits of simplification and create greater burdens unintended by the Commission. NARUC disagrees. We support Southwestern Bell's comments that establishing ranges for more homogeneous groupings will enable the LECs to streamline their analyses and will result in more accurate life and salvage estimates.

III. WIDTH OF RANGES

NARUC considers the proposed ranges presented in the OIC to be reasonable and is of the opinion that requests to widen the ranges should be rejected.

Ameritech and NYNEX argue that the proposed ranges are too narrow because for each range a single standard deviation of an industry-wide average was used to determine the width. This is simply incorrect. The ranges were developed giving consideration to several factors including, but not limited to, one standard deviation.

The starting point for developing the ranges was one standard deviation, but additional information was considered. This included examining the number of carriers with basic factors that fell within the initial range width for any one account. Therefore, many of the proposed ranges exceed one standard deviation. Clearly, as pointed out by MCI, the ranges are not so narrow as a single standard deviation.

Use of the ranges is optional. The R&O clearly states that carriers will not be forced to use the Basic Factor Range Option 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 the asset. NARUC believes that carriers have a responsibility to use basic factors that reflect their specific operations regardless of whether those factors fall within the range. Additionally, NARUC agrees with the R&O that if a LEC or any other interested party makes a reasonable showing that a LEC's basic factors should be different from those within the established ranges, rates should be prescribed using the appropriate basic factors.

The Basic Factor Range Option allows carriers to determine, within a reasonable range, the life and salvage factors it would use without submitting studies to justify its choices. Option 4, the Price Cap Carrier Option, would allow carriers to file proposed depreciation rates at its own discretion without supporting data.

If the ranges were widened to the point of including all currently prescribed factors, as requested by some carriers, or to reflect the factors recommended by TFI, the carriers would effectively obtain Option 4. Since this option has been rejected for the LECs, arguments to substantially widen the ranges should be seen for what they are, an attempt to bypass the Commission's rejection of Option 4.

IV. SETTING APPROPRIATE DEPRECIATION RATES

USTA and several of the carriers comment that the projection lives reflected in current company depreciation rates and, consequently, those used in determining the ranges proposed in the OIC are not sufficiently forward-looking. Some of the commenting companies, notably GTE, Pacific Bell and Nevada Bell, and BellSouth, imply that current FCC depreciation rates are based solely on historical data; and USTA asserts that in the past regulatory commissions have intentionally "set longer lives in order to keep telephone rates low".

Contrary to the assertions made in the industry comments, current and past FCC depreciation rates do reflect technological obsolescence, in at least two ways.

First, actuarial studies of retirements incorporate the effects of past obsolescence which in recent years has grown.

Secondly, the potential impact of current and forecast technological change is judged and, together with a consideration of company plans, the effects of competition and regulatory

changes, are used to modify the actuarial results. If the FCC had relied solely on historical data in setting depreciation rates, service lives would have been much higher, and rates lower, in the past for most of the outside plant accounts and some others as well. That is true for current rates also. In fact, for the most part, even the most recent level of retirements, which is influenced by today's telecommunications industry churning, is insufficient to support the service lives reflected in current depreciation rates for outside plant.

Further, contrary to USTA's assertion, it has never been the policy of the FCC nor the state Commissions to minimize depreciation expenses by intentionally using service lives that are too long. That assertion, as well as that concerning the FCC's sole reliance on historical data, has been made by the industry before and answered by NARUC.¹ The industry should be well aware by now that such arguments are blatantly false and unsupported by fact.

As indicated previously, USTA relies heavily on a document prepared by TFI in support of shorter service lives; GTE, Southwestern Bell and US West refer to it as well. The document discusses the forecasting of technological change and the extensive analyses that TFI has performed using the Fisher-Pry model to predict the substitution of one technology for another, older technology. The TFI document recommends remaining lives

¹ NARUC COMMENTS filed in FCC Reference No. 61730, October 3, 1983

for several types of cable as well as central office circuit and switching equipment. While NARUC recognizes that this technique can provide useful information, it is highly subjective and very sensitive to the assumptions made. Further, the procedure tracks the replacement of units, not invested dollars. Consequently, where the units studied represent portions of retirement units, e.g. copper cable pairs, the service lives generated are shorter than those actually experienced on a company's books where the total dollars remain until the retirement of entire cables.

Fisher-Pry is commonly applied shortly after substitution begins, when the penetration rate of the new technology is very low and generally at a time when the older technology is still being installed. This makes for a very volatile situation where a slight difference in the data points can lead to substantially different results. Generally only a very few data points are available on which to base the forecast substitution projection, and it is common that some of those data points are also forecasts. NARUC is of the opinion that Fisher-Pry should only be used where a dead technology, i.e. one that is no longer being installed, is being replaced by a new technology and retirements of the old technology are actually taking place.

The TFI document points to an example of the replacement of crossbar switching by electronic switching in the mid-to-late 1970's which, it states, could have been successfully predicted using Fisher-Pry, but could not have been captured by standard mortality analysis. The fact is, however, that mortality analysis

would not have been used in that situation. Rather, the life span method would have been applied, utilizing the LEC's office-by-office retirement schedule. In this situation the life span method yields highly accurate results.

Southern New England and NYNEX, in addition to USTA, contend that inadequacy of LEC depreciation rates is supported by the fact that interexchange carriers, alternative access providers and CATV companies apply significantly higher depreciation rates to comparable plant.

NARUC believes that comparison of LEC depreciation rates to those of interexchange carriers, alternative access providers and CATV companies is inappropriate. While the LECs are now experiencing growing competition, such competition exists only in limited areas of their business as compared to the extensive competition faced by the companies to which the LECs compare themselves. One would have to closely examine the earnings returns of those companies before concluding that stockholders were not absorbing the higher depreciation charges. Further, those largely unregulated companies, which have no captive base of customers from which to extract their higher depreciation charges, are investing large sums of new capital into their businesses, such as recently announced by MCI. The LECs on the other hand are not investing new capital into their systems and, in fact, are generally not reinvesting all of the funds generated from current depreciation accruals. They are eager, however, to recover their embedded investment even more quickly from current

customers and use those funds as the sole source of capital to build their future plant and make other investments as well. The LECs would then be in the enviable position of being able to provide all sorts of new services, including CATV, to new customers without having taken any significant financial risk.

USTA asserts that the recently enacted Rural Electrification Loan Restructuring Act of 1993 (RELRA), is a federal legislative mandate which the proposed ranges make impossible to deal with because "carriers will be denied the ability to promote capital recovery and prudent investment decisions".

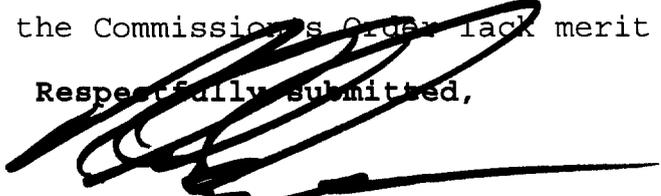
USTA's expressed concern about RELRA is misplaced. This legislation modifies the loan requirements for small rural LECs borrowing from the Rural Electrification Administration (REA) by requiring States to implement a modernization plan. According to the Federal Register Notice, 58 Fed. Reg. 66250, (December 20, 1993), although "...REA will not approve a [State Plan] unless it specifically provides that all telecommunications improvements are to be deployed concurrently in rural and non-rural areas... REA understands that changes in standards, technology, regulation and the economy could require amending the [State Plan]."

Significantly, the proposed rules also note that "[a]lthough the [RELRA objectives] must be part of a [State Plan], they are to be considered targets and not requirements." {Emphasis Added} All carriers in a state will be able to express their views on any State plan under development in response to RELRA. Moreover, depending on the action a particular state takes, non-REA

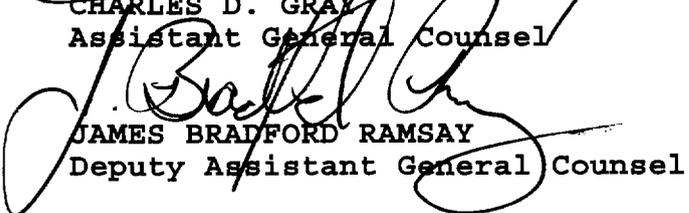
carriers may be only indirectly affected by any such plan. In any case, however, the contention that this program will somehow deny the FCC-subject LECs, none of which are REA borrowers, the "ability to promote capital recovery and prudent investment decisions" if the proposed depreciation ranges are not modified, is farfetched and disingenuous.

While NARUC endorses simplification of the depreciation process and commends the FCC for the measured steps taken in CC Docket 92-296, NARUC continues in its assertion that it is imperative for carriers to continue to maintain continuing property records and mortality data by account. Further, based on the foregoing, NARUC suggests the arguments presented by the LECs for modifying the Commission's Order lack merit and should be rejected.

Respectfully submitted,


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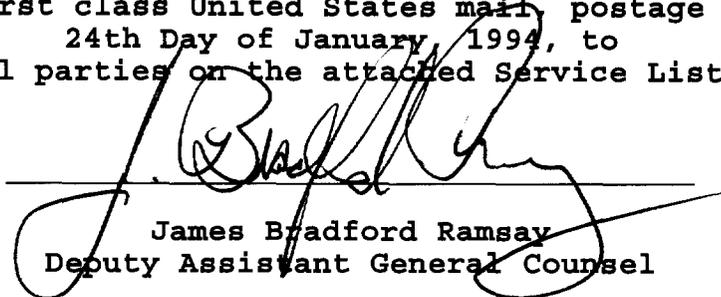
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January 24, 1994

CERTIFICATE OF SERVICE

I, JAMES BRADFORD RAMSAY, certify that a copy of the foregoing was sent by first class United States mail, postage prepaid, this 24th Day of January, 1994, to all parties on the attached Service List.



James Bradford Ramsay
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