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

FCC 95-181

In the Matter of	)	
	)	
Simplification of the Depreciation Prescription Process	)	CC Docket No. 92-296
	)	
	)	

Third Report and Order

Adopted: May 2, 1995 **Released:** May 4, 1995

By the Commission:

I. INTRODUCTION

1. On September 23, 1993, we adopted streamlined depreciation prescription procedures for the local exchange carriers ("LECs") regulated under our price cap incentive regulatory plan.[1] These procedures require us to establish ranges of acceptable values for the future net salvage and projection life estimates that are used to compute depreciation rates for plant categories.[2] The new procedures generally permit price cap LECs to make streamlined filings for changes

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[1] Simplification of the Depreciation Prescription Process, Report and Order, 8 FCC Rcd 8025 (1993) (Depreciation Simplification Order), petitions for recon. pending.

[2] Rates are determined by a depreciation rate formula:

$$\text{Depreciation Rate} = \frac{100\% - \text{accumulated depreciation}\% - \text{future net salvage}\%}{\text{average remaining life}}$$

This formula requires forecasting two parameters: future net salvage ("FNS") and average remaining life ("ARL"). The FNS is the estimated gross salvage of the plant less any estimated cost of removal. The ARL is the estimated average of the future life expectancy of investment in a particular plant account. The ARL is derived from two basic factors: a projection life and a survivor curve. The projection life is the life expectancy of new additions to plant, whereas the survivor curve describes the percentage of plant investment surviving at each age that the plant is in service. Id. at 8030.

in depreciation rates for these categories, as long as these estimates fall within the prescribed ranges. In our Second Report and Order in this proceeding,[3] we adopted underlying factor ranges for 22 depreciation rate categories. In this Third Report and Order, we establish streamlined procedures for the remaining 12 plant categories.

II. BACKGROUND

2. Prior to adoption of the Depreciation Simplification Order, the depreciation prescription process required carriers to submit extensive data to support the future net salvage, projection life, and survivor curve estimates underlying proposed depreciation rates.[4] These data requirements often resulted in voluminous submissions, consisting of up to 25 pages of analysis for each of 34 plant categories. In recognition of the regulatory, technological, and market changes that price cap LECs face, we decided to simplify the process by establishing ranges that specify maximum and minimum amounts for two of the underlying basic depreciation factors, the future net salvage and projection life estimates.[5]

3. Under our new process, if a price cap LEC meeting the requisite criteria[6] selects future net salvage and projection life estimates that are within the established ranges, it need not submit the detailed supporting data otherwise required.[7] In addition, under the new procedures, price cap LECs can change these basic factors annually, as opposed to being bound by the current triennial represcription cycle.[8] Any basic factor changes, however, must reflect carrier operations.[9] These streamlined procedures are intended to simplify the depreciation process,

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[3] Simplification of the Depreciation Prescription Process, Second Report and Order, 9 FCC Rcd 3206 (1994) (Second Report and Order).

[4] See Simplification of the Depreciation Prescription Process, Notice of Proposed Rulemaking, 8 FCC Rcd 146, 147 (1993).

[5] Depreciation Simplification Order, 8 FCC Rcd at 8026.

[6] There are two prerequisites for using the streamlined procedures. First, the basic factors underlying the price cap LEC's current depreciation rate for an account must be within the established ranges. If the basic factors are not within the established ranges, the price cap LEC must submit a full depreciation study to move the basic factors within the established ranges before it can use the streamlined procedures. Second, the basic factors proposed to be used for a new depreciation rate must also be within the established ranges. Id. at 8054-55.

[7] Id. at 8035, 8054-55. We delegated to the Common Carrier Bureau the authority to determine the filing requirements for accounts with basic factor values within the ranges we have set. Id. at 8054 n.129.

[8] Id. at 8054.

[9] "Prescribing depreciation rates that allocate plant costs over the useful life of plant is central to our depreciation policy. Thus, a carrier should use the basic factors that reflect its company operations." Depreciation Simplification Order, 8 FCC Rcd at 8054. The requirement that a new depreciation rate be consistent with carrier operations is designed to assure that carriers do not arbitrarily select life and salvage

achieve administrative savings, and allow the price cap LECs greater flexibility in the depreciation process, while continuing an appropriate oversight of their depreciation rates.[10]

4. We determined that the new, streamlined procedures should be implemented in two phases, beginning with the accounts most readily adaptable to the range approach. We have completed phase one of the streamlining process and adopted ranges for 22 plant categories.[11] On October 7, 1994, we initiated phase two by adopting a Further Order Inviting Comment proposing streamlined procedures for the 12 remaining plant categories.[12]

5. By this Third Report and Order, we are completing phase two by adopting ranges for eight of the remaining 12 categories and alternate simplified procedures for the other four.[13] With the adoption of this Order, we have now established ranges of projection life and future net salvage factors for 30 of the 34 plant categories representing 85% of the total plant investment.[14]

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estimates simply because they are within the prescribed ranges. Instead, carriers electing the new procedures must select life and salvage factors within the ranges that are consistent with their operations. A carrier's factors are considered to be consistent with its operations if the proposed depreciation rate results in the straight line depreciation of the service value over the average remaining life of the plant. 47 C.F.R. § 32.2000 (g)(1)(i). Generally, such determinations are made by analyzing the mix of assets in the carrier's account, studying historical retirement data, and considering expected retirements and additions to the account based on the carrier's construction and modernization plans.

[10] Id.

[11] See Second Report and Order, 9 FCC Rcd at 3211.

[12] Simplification of the Depreciation Prescription Process, Further Order Inviting Comments, 9 FCC Rcd 7651 (1994) (FOIC).

[13] In the Depreciation Simplification Order, we addressed such issues as the data, methodology and procedures to be used to establish, review and update the ranges, and eligibility criteria for using the ranges. Many of the parties filing in response to our FOIC included additional comments on these issues. Such comments are beyond the scope of this proceeding. To the extent these comments were also made by these parties in their petitions for reconsideration of the Depreciation Simplification Order, they will be considered as we analyze the petitions seeking modifications to that Order. In the paragraphs below, we address the issues raised by our FOIC.

[14] A total of 13 parties filed comments and reply comments. These parties include the Idaho Public Utilities Commission, the Missouri Public Service Commission, price cap LECs, GSA, MCI, NARUC, and USTA. Appendix A lists the parties filing each type of pleading as well as the short names this Order uses to refer to each of the parties.

III. DISCUSSION

A. Ranges for Eight Accounts

6. In the FOIC, we solicited comments on a specific set of proposed ranges for the future net salvage and projection life factors for eight of the remaining plant categories.[15]

1. Position of Parties

7. USTA and most of the LEC commenters urge the Commission to adopt the ranges so that the LECs can use them during the 1995 depreciation represcription process.[16] These commenters, however, give limited support to the ranges as proposed in the FOIC. They state that those ranges are based on "historical" data that are not forward looking.[17] In addition, they argue that the proposed projection life ranges encompass useful lives that are too long.[18]

8. GSA, MCI, and NARUC support the ranges proposed in the FOIC.[19] They state that the methodology the Commission used to determine the ranges is sound[20] and that the ranges are reasonable and should be adopted without modification.[21] MCI and NARUC further state that the proposed ranges appear to provide flexibility to a majority of the LECs, but are not so broad as to be meaningless.[22]

9. On the other hand, the Idaho Commission and the Missouri Commission contend that the ranges are based on inadequate data. They state that, while the data are useful for determining the depreciation factors for a specific company, they are not adequate to establish industry-wide

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[15] The remaining eight plant categories are: Digital switching; Operator systems - combined; Circuit equipment - digital; Poles; Aerial cable - metallic; Buried cable - metallic; Intrabuilding network cable - metallic; and Intrabuilding network cable - non-metallic. See Appendix B.

[16] Bell Atlantic Comments at 1; Southwestern Comments at 2; Pacific Comments at 1; United Comments at 1; USTA Comments at 1; U S WEST Comments at 6.

[17] Bell Atlantic Comments at 2-3; BellSouth Comments at 4-5; Pacific Comments at 3-4; Southwestern Comments at 5-6; USTA Comments at 3-4.

[18] Ameritech Comments at 2-3; Bell Atlantic Comments at 2-3; BellSouth Comments at 4; Pacific Comments at 3-4; Southwestern Comments at 5-6; United Comments at 2; USTA Comments at 3-4.

[19] GSA Reply Comments at 3-5; MCI Comments at 3; NARUC Comments at 4.

[20] GSA Reply Comments at 3-5; MCI Comments at 3; NARUC Comments at 3-4; NARUC Reply at 3.

[21] GSA Reply at 4,7; MCI Comments at 3; NARUC Comments at 3-4; NARUC Reply at 5.

[22] MCI Comments at 3; NARUC Comments at 4.

ranges.[23] The Missouri Commission and the Idaho Commission indicate that the proposed ranges are too wide and that the ranges could substantially increase the carriers' depreciation expense.[24] The Missouri Commission indicates that these ranges would give the price cap LECs discretion over approximately $1 billion in depreciation expense.[25] In addition, the Missouri Commission contends that the ranges' width should vary inversely with the size of the account so that the potential depreciation change would equal some "target discretion value." Thus, according to the Missouri Commission, accounts with large balances should have relatively small ranges and accounts with small balances should have relatively large ranges.[26]

2. Discussion

10. In the Depreciation Simplification Order, we set forth the specific methodology that should be used to establish the projection life and future net salvage ranges.[27] We have already used that methodology in establishing ranges for 22 depreciation rate categories in our Second Report and Order.[28] In this Order, we are again using that methodology to set ranges for eight additional plant categories. This methodology requires that we consider certain specifically enumerated data. To apply it for each account and for each of the two basic factors, we first developed a range of one standard deviation around the mean of the basic factors underlying the currently prescribed depreciation rates for each of the LECs. From that point, we determined whether there were technological trends or changing carrier plans that might not be fully reflected in some of the LECs' prescribed factors. We then considered the number of LECs with basic factors that fall within the initial ranges and altered the ranges where appropriate.[29] We recognized, however, that these specifically enumerated data must be considered in light of our obligation to prescribe reasonable depreciation rates:

> [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

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[23] Idaho Commission Reply at 1; Missouri Commission Comments at 4.

[24] Idaho Commission Reply at 1-2; Missouri Commission Comments at 2.

[25] Missouri Commission Comments at 2.

[26] Id. at 7.

[27] Depreciation Simplification Order, 8 FCC Rcd at 8050.

[28] See supra note 3.

[29] For example, for the circuit digital category (Account 2232.12), a life range of plus or minus one standard deviation about the mean would yield a 11.5 - 13 year life range, with 81% of the carriers falling within the range. Our decision to expand the range to 11 - 13 years resulted in 88.1% of the carriers falling within the range. Likewise, a salvage range of plus or minus one standard deviation about the mean would yield a 0% to 3% salvage range for this category, with 88.1% of the carriers falling within the range. By widening the range to 0% to 5%, 97.6% of the carriers would then fit within the range.

that they would no longer enable us to exercise effective oversight of depreciation rates.[30]

Thus, in developing the proposed ranges, we considered both the specific data enumerated in the Depreciation Simplification Order and our overriding responsibility to prescribe reasonable depreciation rates.[31]

11. After reviewing the comments, we have decided to adopt the ranges proposed in the FOIC.[32] As indicated above, these ranges are based on statistical studies of the most recently prescribed factors. These statistical studies required detailed analyses of each carrier's most recent plant retirement patterns, the carriers' plans, and the current technological developments and trends. Because the proposed ranges reflect these data, we do not believe that the ranges are too high, too low, or not accurate as several commenters contend. Moreover, the ranges are not so broad as to be considered meaningless by including all prescribed factors.

12. As we stated in the Second Report and Order, our objective in this rulemaking is to streamline the process used by the Commission to prescribe depreciation rates, not to change those rates.[33] We believe that the ranges adopted in this Order, and in the Second Report and Order, provide a reasonable degree of confidence that the basic factors falling within their bounds will produce depreciation rates accurately reflecting plant retirements, company plans, and technological trends. On the other hand, they allow the LECs sufficient flexibility in the selection of the final factors.[34] Consequently, we have decided not to deviate from any of the proposed ranges at this time. We believe that some experience with the ranges should be developed before we consider modifying them. As suggested by most of the commenters, this will also allow us to establish the ranges as quickly as possible so that the LECs can use them during the 1995 represcription process. If changing conditions require revisions in the ranges, we can modify them during our three-year range review.[35]

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[30] Depreciation Simplification Order, 8 FCC Rcd at 8049.

[31] In discussing the ranges, many of the commenters recommend that we consider other methodologies, criteria and data in establishing the ranges. For example, the LECs state that we should consider forward looking data rather than historical data and the Missouri Commission recommends that the ranges's width vary inversely with the size of the account. See supra paras. 5, 9. As stated above, these issues are beyond the scope of this FOIC, but will be addressed in the pending reconsideration of the Depreciation Simplification Order. See supra note 13.

[32] See Appendix B.

[33] Second Report and Order at 9 FCC Rcd 3209.

[34] See supra note 3.

[35] Depreciation Simplification Order, 8 FCC Rcd at 8058.

B. Four Accounts for Which Ranges Were Not Proposed

13. In the FOIC, we did not propose ranges for Account 2211, Analog Electronic Switching; Account 2215, Electro-mechanical Switching; and Account 2431, Aerial Wire.[36] We stated that the LECs are rapidly phasing out the obsolete equipment recorded in these "dying accounts"[37] and replacing it with equipment based on newer technologies. We proposed to calculate the depreciation rates for these accounts from specific plant retirement schedules that the LECs have developed based on company plans to modernize their networks.[38] We stated that these rates would be more accurate and easier to calculate than rates based on national averages that require detailed statistical analyses of forecasted basic factors.[39]

14. In addition, we did not propose a range for Account 2121, Buildings.[40] We stated that, for depreciation study purposes, we had permitted the LECs great flexibility in subdividing this account and estimating lives for each subcategory. We also stated that, because of the significant differences among the categorization methods, the LECs' current basic factors for the subaccounts could not be used to establish nationwide ranges. In the FOIC, we proposed to maintain the basic factors underlying the currently prescribed depreciation rates for the buildings account, until our three-year range review when we will reconsider whether ranges would be appropriate for this account.[41] In the interim, we proposed to require that the price cap LECs submit the same data for the buildings account that would be required under our streamlined study procedures.[42]

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[36] 47 C.F.R. §§32.2211, 32.2115, 32.2431.

[37] "Dying accounts are asset accounts in which little or no new investment is being made, and for which substantial retirements are impending." Amortization of Depreciation Reserve Imbalances of Local Exchange Carriers, Report and Order, 3 FCC Rcd 984, 990 n.10 (1988).

[38] For example, both Bell Atlantic-Maryland, Inc. and Ameritech-Michigan have already retired all of their electro-mechanical switching equipment. For Maryland, the final retirement occurred in 1989 and for Michigan in 1993. In addition, Bell Atlantic-Maryland, Inc. and Ameritech-Michigan plan to retire all of their analog electronic switching equipment by 1998 and 1999, respectively. See Bell Atlantic-Maryland, Inc. 1995 Depreciation Rate Study (November 11, 1994); Ameritech-Michigan 1995 Depreciation Rate Study (December 2, 1994).

[39] FOIC, 9 FCC Rcd at 7654.

[40] 47 C.F.R. §32.2121.

[41] See Depreciation Simplification Order, 8 FCC Rcd at 8058.

[42] Depreciation Rates Branch, The Federal Communications Commission, The Federal Communications Commission Depreciation Study Guide §I (1995) describes these streamlined study procedures.

1. Position of the Parties

15. The parties commenting on these matters support our proposals.[43] MCI, Southwestern, and USTA indicate that there is no need to establish ranges for "dying accounts."[44] NARUC agrees that our proposed method for determining the rates for the three "dying accounts" would be more accurate than rates based on national averages. NARUC maintains that these rates can be readily calculated using individual company retirement schedules without the need for statistical analyses to forecast lives.[45] The commenters also concur with our proposed treatment of the buildings account.[46]

2. Discussion

16. We conclude that the public interest would be best served by adopting the alternate streamlined procedures for these accounts proposed in the FOIC. We find that the cost of establishing and administering ranges for these accounts would outweigh the benefits. As we stated in the FOIC, depreciation rates on obsolete equipment recorded in "dying accounts" can be readily calculated from retirement schedules using a methodology less complicated than the range approach. Moreover, to establish ranges for the buildings account would require that the LECs' present data be recast into new, uniform subcategories. The LECs have indicated that the cost of compiling the information necessary to develop new subcategories would be substantial.[47]

17. Furthermore, we find that the depreciation rates calculated for these accounts using our alternate streamlined procedures will be more accurate than depreciation rates based on the range approach. For the "dying accounts," the rates will reflect company-specific retirement schedules rather than national averages of the underlying basic factors. For the buildings account, we believe the present rates will reflect company operations over the next few years. The LECs do not have plans to add or retire a significant number of buildings during that period. As a result, the underlying depreciation factors applicable to Account 2121 likely will not change, and an extensive analysis of the buildings account probably will not be necessary within the next few years. In the interim, we believe that the data required under the streamlined study procedures will be adequate, and we will allow price cap LECs to submit only these data for the buildings account.

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[43] MCI Comments at 2; NARUC Comments at 5; Sprint Comments at 1; Southwestern Comments at 7; USTA Comments at 2.

[44] MCI Comments at 2; Southwestern Comments at 7; USTA Comments at 2.

[45] NARUC Comments at 5.

[46] MCI Comments at 2; NARUC Comments at 5; Southwestern Comments at 7; USTA Comments at 2.

[47] See Letter from Thomas R. Whittaker, Chairman, United States Telephone Association Ad Hoc Depreciation Committee, to Ms. Fatina Franklin, Chief, Depreciation Rates Branch (June 21, 1994).

C. Carriers Scheduled for Review in 1996 and 1997.

18. Under our depreciation prescription process, one-third of the carriers for which we prescribe depreciation rates have their rates reviewed each year. LECs scheduled for review in 1996 and 1997 may file for changes in their depreciation rates in 1995 as long as they use basic factors within the ranges we have selected and the ranges chosen are consistent with their operations. These carriers must file these depreciation rate changes by July 1, 1995.

IV. ORDERING CLAUSES

19. Accordingly, IT IS ORDERED, pursuant to Section 4(i), 201-205 and 220(b), of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 201-205 and 220(b), that the ranges for the future net salvage and the projection life factors for the accounts listed in Appendix B are HEREBY ADOPTED as specified in Appendix B.

20. IT IS FURTHER ORDERED, that this order is effective thirty days after publication in the Federal Register.

21. IT IS FURTHER ORDERED, that carriers may use the ranges established herein for federal filing purposes prior to the effective date of this order.

FEDERAL COMMUNICATIONS COMMISSION

William F. Caton

William F. Caton
Acting Secretary

APPENDIX A

Comments Filed

Ameritech Operating Companies (Ameritech)
Bell Atlantic (Bell Atlantic)
BellSouth Telecommunications, Inc. (BellSouth)
MCI Telecommunications Corporation (MCI)
Missouri Public Service Commission (Missouri Commission)
National Association of Regulatory Utility Commissioners (NARUC)
Pacific Bell and Nevada Bell (Pacific)
Southwestern Bell Telephone Company (Southwestern)
United and Central Telephone Companies (United)
United States Telephone Association (USTA)
U S WEST Communications, Inc. (U S WEST)

Reply Comments Filed

Bell Atlantic (Bell Atlantic)
General Services Administration (GSA)
Idaho Public Utilities Commission (Idaho Commission)
MCI Telecommunications Corporation (MCI)
National Association of Regulatory Utility Commissioners (NARUC)
Southwestern Bell Telephone Company (Southwestern)
United States Telephone Association (USTA)

ACCOUNTS AND RANGES

ACCOUNT NUMBER	ACCOUNT NAME	DEPRECIATION RATE CATEGORY	PROJECTION LIFE RANGE (YEARS)		FUTURE NET SALVAGE RANGE (PERCENT)	
			LOW	HIGH	LOW	HIGH
2220	Digital switching	Digital Switching	16	18	0	5
2220	Operator systems	Combined	8	12	0	5
2232	Circuit equipment	Digital	11	13	0	5
2411	Poles	Poles	25	35	-75	-50
2421	Aerial cable	Metallic	20	26	-35	-10
2423	Buried cable	Metallic	20	26	-10	0
2426	Intrabuilding network cable	Metallic	20	25	-30	-5
2426	Intrabuilding network cable	Non-metallic	25	30	-15	0