

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

In the Matter of)	
)	
1998 Biennial Regulatory Review --)	CC Docket No. 98-137
Review of Depreciation Requirements)	
For Incumbent Local Exchange Carriers)	
)	
USTA's Petition for)	
Forebearance from Depreciation Regulation)	ASD 98-91
Of Price Cap Local Exchange Carriers)	

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AMERITECH COMMENTS

I. INTRODUCTION AND SUMMARY

Ameritech¹ submits these comments in response to both the Notice of Proposed Rulemaking which seeks a review of the Commission's requirements to regulate the depreciation practices of local exchange carriers and the Petition for Forbearance from depreciation filed by the United States Telephone Association.²

In the Depreciation NPRM, the Commission undertakes a review of its depreciation practices as part of the biennial review of regulations mandated by Section 11 of the Telecommunications Act of 1996 (the "Act"). Proposals are made to reduce or streamline the process associated with the prescription of depreciation rates.

¹ Ameritech means: Illinois Bell Telephone Company, Indiana Bell Telephone Company, Incorporated, Michigan Bell Telephone Company The Ohio Bell Telephone Company and Wisconsin Bell, Inc.

² See In the Matter of 1998 Biennial Regulatory Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers, CC Docket No. 98-137, Notice of Proposed Rulemaking, released October 14, 1998, ("Depreciation NPRM"). See also Petition for Forbearance of the United States Telephone Association filed September 21, 1998, ("USTA Petition"). See also Modification of Pleading Cycle for United States Telephone Association's Petition for Forbearance from Depreciation Regulation of Price Cap Local Exchange Carriers, ASD 98-91, released October 16, 1998.

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Streamlining, as opposed to forbearance, is proposed even for price cap carriers because of the perceived impact that elimination of depreciation regulation would have in other areas of regulation such as the low-end formula adjustment (LFAM). The Depreciation NPRM also requests comments on the proposal of SBC to allow carriers to set their own depreciation lives and rates consistent with Generally Accepted Accounting Principles (GAAP).³

The USTA Petition requests that the Commission forbear from regulating the depreciation and amortization practices of price cap local exchange carriers effective January 1, 1999. Ameritech fully supports the USTA Petition, which, like SBC's and Ameritech's proposals, demonstrates that forbearance of depreciation regulation fully meets the conditions of Section 10 of the Act. Immediate forbearance of depreciation regulation also fulfills the requirement to repeal or modify any regulation not in the public interest under Section 11.

Ameritech disagrees with those modest proposals in the Depreciation NPRM which merely seek to refine outmoded regulation with an overlay of continued regulation. There is no justification for the Commission's continued oversight and regulation of depreciation. Further, relief in this area should not be contingent on waiver of LFAM or possible impacts on separations or funding mechanisms.⁴ Depreciation lives consistent with those used for external reporting under GAAP are legitimate and appropriate. To the extent there is any significant depreciation impact on other regulations, which

³ See In the Matter of Petition for Section 11 Biennial Review of SBC Communications, Inc., filed May 8, 1998 at 8-9. See also Depreciation NPRM at 19. See also letter from Ms. Robin Gleason, Director – Regulatory Finance, Ameritech, to Mr. Kenneth P. Moran of March 13, 1998.

Ameritech maintains there is not, the impact can be mitigated by the consistent use of appropriate lives. Finally, the Commission should not confuse the significance of depreciation as an operating expense with the need to regulate.

Alternatively, if forbearance is not granted at this time, the Commission should expand the life ranges beyond those proposed in the Depreciation NPRM to include Digital Circuit, Copper Cable, and Fiber. Additionally, further streamlining of documentation requirements should be adopted for all carriers and salvage/cost of removal matters should be left to the individual carriers' discretion.

II. THE COMMISSION SHOULD FORBEAR FROM REGULATION OF DEPRECIATION PRACTICES OF PRICE CAP CARRIERS.

Ameritech fully supports the USTA Petition that the Commission forbear from regulating depreciation and amortization practices of price cap carriers, effective January 1, 1999. As the USTA Petition effectively demonstrates, forbearance is fully consistent with the requirements of section 10 of the Act, principally because the sharing mechanism for price cap carriers was eliminated in 1997. As a result, regulation of depreciation practices is not necessary to ensure just and reasonable rates or protect consumers. Further, the Act amended section 220(b) by removing the requirement to regulate depreciation practices. Depreciation forbearance is also consistent with requirements of section 11 of the Act to repeal or modify unnecessary regulation no longer necessary in the public interest. The Commission should expeditiously grant the

⁴ See Depreciation NPRM at 6 and 18.

USTA Petition and forbear from regulation depreciation practices of price cap carriers as of January 1, 1999.

In the Depreciation NPRM, the Commission recounts the recent history of depreciation regulation and points out that it was a “central feature of traditional common carrier policy” when “cost of service or rate-of return regulation” was the form of regulation.⁵ Depreciation, as a significant expense component, was subject to detailed regulatory scrutiny, oversight, and prescription. Just as the Commission no longer reviews detailed cost support to prescribe rates for price cap carriers, so too should depreciation regulation be subject to forbearance for price cap carriers.

With respect to the tentative conclusion that the Commission should not prescribe depreciation rates in the absence of robust or full competition, Ameritech submits that the conditions for forbearance exist today.⁶ First, prices do not depend on costs under no-sharing price caps. Second, other regulatory implications provide no compelling need to regulate.⁷ Finally, carriers as well as their competitors need the increasing flexibility to set their own depreciation rates, consistent with GAAP. A prerequisite of local exchange competition is unnecessary and contrary to the deregulatory goals of the Act as defined under sections 10 and 11. The only condition the Commission need stipulate to ensure that the Commission’s oversight and enforcement responsibilities are not compromised is that carriers use depreciation lives consistent with those used for external reporting under GAAP.

⁵ See Depreciation NPRM at 2.

⁶ See Depreciation NPRM at 7.

⁷ See *infra* at 6-9.

The Commission has completed several depreciation simplification proceedings.⁸ All of these proceedings may have been necessary when the price cap carriers had a sharing provision. Since 1997, however, there has been no sharing, obviating the need for depreciation regulation in this area. Rather than further reduce or streamline the depreciation prescription process by allowing summary filings or establishing new ranges for the digital switching plant account, the Commission should forbear entirely. The proposed modifications do not significantly reduce the reporting burden or costs of price cap carriers associated with depreciation regulation. While the Depreciation NPRM provides for a modicum of increased flexibility, it fails to seize the opportunity of eliminating regulation where there is no need.

Ameritech disagrees with the Depreciation NPRM's conclusion that the Commission has, since 1980, relied on forward-looking factors in setting depreciation rates as evidenced from the increase in reserve ratios.⁹ While Ameritech agrees that the Commission has changed its methods in the setting of depreciation rates, including the establishment of life ranges, the use of forward-looking factors has not been adopted. For example, the projection lives for the state of Michigan for the Digital Switch, Circuit, Buried Cable, and Underground Cable accounts decreased only by 2.5, 2, 1, and 2 years, from 1986 to 1995 respectively. Since 1995, the projection lives for the Digital Switch, Circuit, Buried Cable, and Underground Cable accounts have decreased further only by .5, 1, 2, and 3, respectively. This hardly bears witness to the adoption of forward-looking factors. The increase in the reserve ratios is more the result of changed methodologies,

⁸ See Depreciation NPRM at 3.

such as the adoption of Equal Life Group and Remaining Life depreciation with reserve deficiency amortization in the early 1980s. These changed methodologies resulted in greater depreciation expense and associated reserve than allowed under the conventional vintage group depreciation method. Further, as shown in an Arthur Andersen LLP Paper, when the large ILECs discontinued the application of SFAS No. 71, billions of dollars in adjustments of plant assets for external reporting purposes occurred. These adjustments were caused by inadequate, mortality-based depreciation practices prescribed by the Commission.¹⁰ Adoption of the USTA Petition for Commission forbearance in this area would effectively result in the adoption of forward-looking factors.

III. DEPRECIATION REGULATION HAS NO SIGNIFICANCE UNDER PRICE CAP RULES.

The Depreciation NPRM mistakenly identifies the significant dollar amount of depreciation expense with the continuing need to regulate depreciation rates. After framing the need to regulate depreciation when carriers were under cost of service rate-of-return regulations, the Depreciation NPRM then describes current regulations where depreciation expense may have some impact, noting the significance of depreciation expense as the single largest operating expense incurred by carriers.¹¹ While depreciation expense is a significant operating expense for capital-intensive businesses, it does not follow that it should be subject to regulation, particularly when rates price cap carriers

⁹ See *Ibid.*

¹⁰ See *Accounting Simplification in the Telecommunications Industry*, prepared by Arthur Andersen LLP, Mr. Carl R. Geppert, July 15, 1998, at Page 29, (the "Arthur Andersen Accounting Paper"). See also Supplement to July 15, 1998 Position Paper, Prepared by Arthur Andersen LLP, November 10, 1998, at Page 16 (the "Arthur Andersen Accounting Paper Supplement") where it is shown that a true reserve deficiency of approximately \$34 B exists when the net realizable value of assets under GAAP are compared to those prescribed by the Commission.

use no longer depend on costs. None of the situations described in the Depreciation NPRM necessitate the continued regulation of depreciation rates.

Nor should LFAM be the quid pro quo for relief from depreciation regulation. LFAM was one of two rate of return backstop mechanisms in the transition to market based rates. The sharing provision was the second backstop mechanism. Both were vestiges of rate of return regulation. While LFAM still applies, sharing was eliminated in 1997, decrease the reliance on accounting costs, including any affect on prescribed accounting depreciation rates.¹² More fundamentally, the elimination of LFAM must be considered as part of a total reliance on market-based pricing, which would include a pricing flexibility framework, the phasing out of the price cap X-factor, and removal of services from price caps.¹³ There is no justification for conditioning forbearance from depreciation regulation on the elimination of LFAM. LFAM is rarely used and does not, in and of itself, support the continued application of depreciation regulation.

Further, changes in depreciation rates do not impact the recalculation of the productivity or X-factor. Professor Frank M. Gallop, on behalf of USTA, performed a sensitivity analysis of the FCC's X-factor model to assess the impact of accelerated depreciation. The analysis showed that moderate changes in depreciation rates have virtually no effect on the X-factor.¹⁴

¹¹ See Depreciation NPRM at 5.

¹² See *In the Matter of Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, Access Charge Reform, CC Docket No. 96-262, Fourth Report and Order and Second Report and Order, released May 21, 1997, at Para. 152.

¹³ See Comments of Ameritech, *In the Matter of Access Charge Reform*, CC Docket No. 96-262, CC Docket No. 94-1, RM-9210, filed October 26, 1998.

¹⁴ See USTA Reply Comments *In the Matter of Access Charge Reform*, CC Docket No. 96-262, CC Docket No. 94-1, CC Docket No. 97-250, RM-9210, filed November 9, 1998, at Attachment D.

With respect to exogenous cost determination, what is considered exogenous is specific and limited to those factors that the Commission permits or requires (See C.F.R. 61.44 (c)). Therefore, the grant of exogenous treatment for any particular item is not automatic. Depreciation expense changes receive endogenous price cap treatment and therefore have no impact on rates. To the extent that depreciation expense is a component in the calculation of a proposed exogenous change, these components are subject to Commission review and approval.

Regarding the BFP, access reform has changed the method for computing end user common line charges (EUCL) rates from a Base Factor Portion (BFP) of revenue requirement to a method based on the amount of price caps revenue (See CFR 69.152). The interim method based on revenue requirements will continue until the multi-line PICC does not recover any common line revenue. This interim nature of the BFP method of computing EUCL does not warrant the continued regulation of depreciation.

Similarly, considerations of above band filings is scant justification for continuing depreciation regulation because any relationship between depreciation rates and an above band filing is speculative at best. Moreover, since there would be a full review of any such request, any alleged abuse of depreciation expenses in excess of that allowed under GAAP would be readily apparent.

With respect to the use of Commission-prescribed depreciation life ranges in the calculation of high cost loop support, reliance on the Commission's authorized ranges artificially lowers what the actual costs are. If the Commission's goal is to obtain realistic, accurate information regarding loop costs, then depreciation factors need to be

based on forward-looking economic lives rather than the dated mortality-based lives currently used. This would result in more accurate high cost loop support amounts.

While the states may have defaulted to Commission depreciation factors when calculating rates for interconnection or unbundled network elements in the past, this is scant support for maintaining depreciation regulation. Rather, since pricing resides in the state jurisdictions they will need to determine appropriate depreciation factors.

Finally, forbearance from depreciation regulation will diminish or remove ILEC claims under the Fifth Amendment, since ILECs will be solely responsible for depreciation decisions.

In sum, there is no significant impact as a result of changes in depreciation for price cap carriers in the situations described in the NPRM. The only control the Commission needs is that carriers use depreciation lives consistent with those used for external reporting under GAAP.

IV. IN THE ABSENCE OF FORBEARANCE, ADDITIONAL STREAMLINING IS NEEDED.

The Depreciation NPRM's proposals to reduce the summary exhibits to four, use electronic files, and allow the rates to go into effect without Commission order provided carriers select from within the prescribed ranges with necessary certification are insufficient.¹⁵ Additional streamlining, and more fundamentally, expansion of the permitted ranges and additional accounts, is necessary. ILEC administrative expenses would not be significantly reduced by these proposals, since the complexity of the intermediate steps needed to complete the proposed summary exhibits remain. At a

minimum, the theoretical reserve study exhibit requirement should be eliminated. There is no value in this exhibit since the Commission parameters are compared to regulated rather than external reporting books of account.¹⁶

With respect to equipment life ranges, Ameritech agrees that the prescribed digital switching equipment lives should be lowered because of accelerated replacement rates due to rapid technological change.¹⁷ However, the Commission's reliance on retirement rates belies their contention of future reliance on forward-looking factors.¹⁸ Also, the current ranges were established by taking the average of the 1995 Commission prescriptions, which are mortality based, for all companies, +/- one standard deviation. This is a dated source, and no economic, forward-looking factors were considered, as the Commission itself concluded.¹⁹ Ameritech supports the adoption of the projection lives recommended by Technology Futures, Inc., (TFI) a recognized, independent expert in the field of analyses and forecasting of changing technology and its impact on depreciation.²⁰

Account	TFI Projection Lives	
	Current Range	New Range
Digital Switch	16 to 18	9 to 12
Digital Circuit	11 to 13	6 to 9
Copper Cable	20 to 30	14 to 20
Fiber	25 to 30	20

¹⁵ See Depreciation NPRM at 10.

¹⁶ See Arthur Andersen Accounting Paper at 29 and Arthur Andersen Accounting Paper Supplement at 16.

¹⁷ See Depreciation NPRM at 11.

¹⁸ See Depreciation NPRM at Footnote 42.

¹⁹ See In the Matter of Depreciation Simplification of the Depreciation Prescription Process, CC Docket No. 92-296, Third Report and Order, released May 4, 1995, at Page 6.

²⁰ See Transforming the Local Exchange Network: Analyses and Forecast of Technology Change, August, 1997 at Page 33.

The proposed ranges are justified because of changing technology, increased competition, and changing customer demand. Changing technology is the primary driver to lower lives and not physical obsolescence (mortality based) as relied on in the past. Competition has increased steadily and significantly as evidenced by the AT&T-Teleport and the MCI-WorldCom mergers, competition in dedicated and transport services, substantial CLEC activity, number of unbundled loops, and total competitive access lines.²¹ Customers increasingly demand new and improved products. For example, the continued increasing demand for higher bandwidth services relating to both video and data applications such as the Internet and advanced fax capabilities.

A truly forward-looking assessment of appropriate lives would reflect for example the increased deployment of SONET architecture, which requires state of the art technology to be able to link the switches, circuits, and fiber rings. SONET will replace today's circuit equipment much more rapidly than that reflected the prescribed range. Similarly, the continued deployment of fiber ring architecture needed to efficiently provide high bandwidth services reduces the life of copper cable. The original multimode fiber placed in the network is not compatible with new equipment based on single-mode fiber, again indicating the need for a shorter life for fiber than that currently prescribed.

The Commission needs to adopt the ranges recommended by TFI in order to implement forward looking factors in the regulation of depreciation rates.

V. PRICE CAP CARRIERS SHOULD BE GIVEN THE OPTION ON SALVAGE AND COST OF REMOVAL TREATMENT.

²¹ See footnote 12.

The Depreciation NPRM proposes to either eliminate the future net salvage factor from the depreciation calculation recording salvage and cost of removal as a current period expense, or allow carriers the option of treating net salvage as either a current period expense or a component in the depreciation calculation.²² Ameritech applauds the Commission's proposal to reduce the complexity associated with the computation of depreciation rates by eliminating the net salvage variable from the formula. Ameritech supports giving carriers the option of either implementing the Commission's proposed change to record cost of removal and salvage as either current period items or continue to treat such items as a component of depreciation expense. This will afford carriers the needed flexibility to align the regulatory treatment of these components with GAAP treatment, which is currently under review by the Financial Accounting Standards Board (FASB). Specifically, the FASB issued an exposure draft in February 1996, "Accounting for Certain Liabilities Related to Closure or Removal of Long-Lived Assets," ("Exposure Draft") addressing the recognition and measurement associated with cost of removal. The FASB's Exposure Draft proposes that legal and constructive obligations for removing an asset from service (i.e., cost of removal) be capitalized and recognized as part of the cost of the related long-lived asset. These capitalized retirement costs would then be systematically allocated to expense, more than likely via depreciation over the life of the long-lived assets. Assets within the telecommunications industry that may require this specific accounting treatment include outside plant and underground fuel storage facilities. Retirement costs, if any, incurred for general support type assets and

central office equipment would be recognized as an expense in the period incurred (i.e., in the same manner proposed by the Commission in the NPRM). By allowing the flexibility to adopt the proposed change contained in the Depreciation NPRM, carriers will not be involuntarily saddled with the added costs and administrative burdens associated with maintaining bifurcated accounting processes and procedures.

With respect to removing net salvage from the depreciation process,²³ any changes in depreciation rates should be treated prospectively with no changes to the current accumulated depreciation reserves. Since the computation of rates under the group depreciation method considers the current level of the accumulated depreciation reserve, any under or over depreciation arising from the previous inclusion of net salvage in the determination of rates is self correcting (i.e., to the extent a negative salvage was included in previous rates, depreciation expense going forward will be lower). This self correction inherent to the group depreciation method eliminates any need for additional accounting changes to effectuate the change. Lastly, to the extent it is determined that new rates need to be computed in advance of a carriers normal triennial rate schedule, only those asset categories where the net salvage factor does not equal 0 (zero) would require a recomputation of a rate (i.e., a wholesale recomputation of every depreciation rate is not necessary).

²² See Depreciation NPRM at 14.

²³ Ibid.

VI. OTHER MATTERS

Ameritech submits that the existing Commission confidentiality procedures²⁴ are sufficient. Pursuant to Sections 0.457(d)(1)(iii), information submitted to support Ameritech's depreciation process is automatically granted confidential treatment because it constitutes an examination of records.

The NPRM's proposal to eliminate the requirement for mid-size LECs to file a theoretical reserve should be applied to all carriers.²⁵ A comparison of a carriers book reserve to the theoretical reserve is of little, if any value, because it merely illustrates a reserve level using Commission prescribed parameters. As the Arthur Andersen Paper has shown, the proper comparison with respect to the adequacy of reserve levels is between that determined pursuant to GAAP and that using Commission prescribed parameters.²⁶ That comparison shows an RBOC and GTE reserve deficiency of approximately \$ 34 billion.

VII. CONCLUSION

Ameritech fully supports the USTA Petition for Forbearance of depreciation regulation. Regulation of depreciation is not necessary under section 10 of the Act to ensure just and reasonable rates or protect consumers. Forbearance is in the public interest.

The Commission should not confuse the relatively high amount of depreciation expense with the continuing need to regulate. Price caps no longer depend on costs and

²⁴ See Depreciation NPRM at 12.

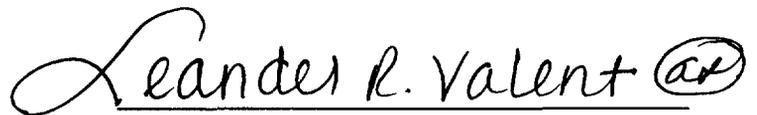
²⁵ See Depreciation NPRM at 17.

²⁶ See Arthur Andersen Accounting Paper Supplement at 16.

impacts on other Commission requirements are either insignificant or otherwise do not necessitate continued regulation. The Commission should allow price cap carriers to use depreciation lives no shorter than those used for external reporting under GAAP.

Alternatively, the Commission needs to expand the life ranges and accounts beyond those proposed and adopt the projection lives recommended by Technology Futures, Inc. Finally, treatment for salvage and cost of removal should be at a carrier's discretion.

Respectfully submitted,



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