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

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FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of	)	
	)	
1998 Biennial Regulatory Review	)	
Review of Depreciation	)	CC Docket No. 98-137
Requirements for Incumbent	)	
Local Exchange Carriers	)	
	)	
Forbearance from Depreciation	)	ASD 98-91
Regulation of Price Cap Local	)	
Exchange Carriers	)	

REPLY COMMENTS OF AT&T CORP.

AT&T offers the following Reply to the Comments on the Commission's Notice of Proposed Rulemaking ("NPRM") and the United Stated Telephone Association Petition for Forbearance ("USTA Petition") regarding the Commission's depreciation rules.[1]

I. INTRODUCTION AND SUMMARY.

The Comments of AT&T and others demonstrate that the Commission should adopt the proposals set forth in its NPRM, subject to the revisions suggested in AT&T's Comments and this Reply. The Comments further demonstrate that the Commission

[1] 1998 Biennial Regulatory Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers, CC Docket No. 98-137, FCC 98-170, released October 14, 1998; 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, DA 98-2092, released October 16, 1998.

need not revise its depreciation rates beyond the limited adjustment to the digital switching account proposed in the NPRM. Finally, the Comments show that the Commission should deny the USTA Petition for Forbearance.

II. THE COMMISSION SHOULD REDUCE DEPRECIATION FILING REQUIREMENTS.

The NPRM proposes substantial reductions in the information that must be filed by ILECs in support of their depreciation requests.[2] The Comments largely support this proposal.[3] Additionally, AT&T and others suggest that the Commission should continue to issue prescription orders to document the permitted rates, in order to reduce potential confusion.[4]

In a related vein, the Florida PSC suggests that the Commission should permit ILECs to modify depreciation factors only once a year, effective on January 1 of the filing year.[5] Not only should there be no need for more frequent adjustments to depreciation, but the Florida PSC's proposed limitation would avoid the risk that ILECs could seek to manipulate depreciation factors, and accordingly AT&T supports that suggestion.

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2 NPRM at ¶ 10 (assuming ILEC's proposals are within established ranges).

3 See Virginia State Corporation Commission Staff ("VSCC Staff") at 3-4; General Services Administration ("GSA") at 4; Florida Public Service Commission ("Florida PSC") at 4; MCI Worldcom at 9; AT&T at 3-4. While the ILECs argued that the Commission should eliminate all filing requirements, none suggested that the Commission should retain its current 170 page filing requirements.

4 AT&T at 4-5; VSCC Staff at 3-4; MCI Worldcom at 10; see also GSA at 5 (advocating continued public reporting of depreciation rates); Florida PSC at 2 (recommending that FCC continue to "oversee" depreciation even if it does not prescribe rates.)

5 Florida PSC at 4-5.

III. THE COMMISSION SHOULD NOT CHANGE DEPRECIATION FACTORS EXCEPT FOR DIGITAL SWITCHING EQUIPMENT.

The Commission reviewed its prescribed factors for all depreciation accounts and concluded that only the digital switching factor required updating.[6] The Commission therefore proposes a reduction in the projected life range for digital switching from a 16 to 18 year period to a 13 to 18 year period.[7] AT&T and the majority of the non-ILEC parties support the proposed reduction in the depreciation lives for digital switching equipment, which is based on the Commission's forward-looking principles for establishing such rates.[8]

The ILECs, by contrast, argue that the Commission's prescribed lives are not forward-looking, and that even greater reductions in depreciation lives are needed, not only for digital switching but for many other accounts as well.[9]

These ILEC claims are incorrect. The Commission has substantially and reasonably reduced depreciation lives over time, and as a consequence ILEC depreciation reserve levels are at record highs. Figure 1 shows that the depreciation reserve level has grown from 18.7 percent in 1980 to 48.8 percent in 1997, and that the depreciation rate has substantially exceeded the retirement rate in each year since 1980. The

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6 NPRM at ¶ 11.

7 Id. at ¶ 11.

8 AT&T at 5-6; VSCC Staff at 3-4; MCI Worldcom at 10-11; Florida PSC at 5; but see GSA at 6 (suggesting that current 3 percent retirement rate suggests an average life of 33 years, making the need for a reduction from 16 years to 13 years problematic).

9 See, e.g., Ameritech at 5-6; Bell Atlantic at 9-10; BellSouth at 6-7, 12; U S WEST at 10-13; GTE at 12-15; Southwestern Bell ("SBC") at 16-23 and Attachment A (Harris Statement) at 13-16.

Commission's continuing prescription of depreciation accrual rates much higher than the retirement rate indicates an expectation that the retirement rate will be much higher in the future – in other words, that the Commission's depreciation levels are forward-looking and reasonable.[10]

Notwithstanding these facts, several ILECs propose the adoption of projection lives based upon the recommendations of Technology Futures, Inc. ("TFI").[11] TFI develops its estimates through "substitution analysis", which attempts to forecast the pattern by which new technology will replace old technology.[12]

Substitution analysis has many shortcomings and limitations. It is, for example, not entirely forward-looking. For example, TFI predicts a substantial increase in plant retirements based on its review of past retirement patterns, such as the replacement of crossbar switches in the 1980's.[13] To the extent that future replacement patterns differ, substitution analysis will be inaccurate.

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[10] There is, therefore, no basis to the claims of Southwestern Bell, GTE and Ameritech that there is a "depreciation reserve deficiency." See SBC at 25; GTE at 5; Ameritech at 6. Instead, there may be a depreciation reserve surplus. See AT&T at 22-24. In any event, these ILEC assertions are based on depreciation lives that are used for financial reporting purposes, which as noted herein are not appropriate for regulatory purposes.

[11] Ameritech at 10; SBC at 21; Sprint at 6; Cincinnati Bell Telephone ("CBT") at 7-8.

[12] Transforming the Local Exchange Network: Analyses and Forecasts of Technology Change, by Lawrence K. Vanston, Ray L. Hodges and Adrian J. Poitras (2d ed. 1997) at 4-7.

[13] Id. at 29.

Substitution analysis also assumes that a new technology replaces, rather than supplements, an existing technology. Where new technology exists side by side with the older technology then substitution analysis yields incorrect predictions.

Most critically, substitution analysis is only as good as the technology assumptions that underlie it. TFI's recommendations assume that ILECs will replace their narrowband telecommunications networks with broadband integrated networks providing both telecommunications services and video services such as cable television.[14] TFI's calculations therefore assume that Fiber In The Loop ("FITL") will bring broadband to the home, displacing copper plant.[15] TFI also assumes that ILECs will upgrade all transmission systems to Synchronous Optical Network ("SONET"), replacing existing circuit equipment,[16] and that Asynchronous Transfer Mode ("ATM") switching equipment will replace today's switching facilities.[17]

While certainly TFI's vision of the telecommunications future is one of the many possible courses that the ILEC industry might take, it is by no means certain that it will do so. While in the early 1990's it appeared that the ILECs would replace their copper distribution plant with fiber and coaxial cables to provide broadband video services as well as telephony, that result is less apparent today. To the extent that future ILEC network deployment plans are more focused on internet-based architectures, this will lead to markedly different plant retirement patterns. If ILECs instead implement Digital

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14 Id. at 2, 27 and passim.

15 Id. at 2, 8-16 and 74-111.

16 Id. at 2, 16-19 and 113-125.

17 Id. at 2, 23-27 and 159-172.

Subscriber Line ("DSL") technology, this will extend the life of the existing copper facilities rather than displacing them with a substitute technology, as TFI assumes.[18]

For these reasons, the Commission cannot presume that TFI's technology forecast is accurate, and it certainly cannot adopt the substantially shorter life recommendations that TFI derives under its assumptions. Instead, the Commission's depreciation history provides clear evidence that its depreciation policies have been reasonable and fair and the wholesale and dramatic changes sought by the ILECs are both unnecessary and inappropriate.

Similarly, the Commission cannot accept SBC's proposals, which are based on the lives prescribed by the Commission for AT&T in 1994 and the lives used by the ILECs and other companies in preparing their financial books.[19]

First, the depreciation lives prescribed for AT&T in 1994 are irrelevant because the business and technology characteristics of local and long distance carriers are different. While both IXCs and ILECs use switches and cable, they use different types of switches and cables. Moreover, IXCs need far fewer switches and far less cable to provide national service than the ILECs require.[20] The sheer volume of ILEC investment means that it must necessarily take longer to replace or supplement ILEC plant with

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[18] Dr. Harris notes that the ILECs hope that DSL technologies "will extend the economic lives of a large portion of their existing plant by providing high speed connections to the Internet." SBC, Exhibit A at 11.

[19] SBC at 21-22.

[20] To service all homes and business in the nation, an IXC needs about 150 switches and 100,000 sheath kilometers of cable, whereas the ILECs require over 23,000 switches and 6,000,000 sheath kilometers of cable. See 1994 FCC Statistics of Common Carriers at 159.

newer technologies. For these reasons, the Commission recognized when it adopted depreciation lives for AT&T in 1994 that the characteristics of IXCs and ILECs required separate analyses.[21] Nothing has changed since 1994 to compel a different conclusion.

Nor is there any merit to SBC's claim that the Commission should rely on the depreciation lives used by ILECs and other telecommunications companies for financial reporting purposes.[22] As AT&T noted in its Comments, financial statements prepared under Generally Accepted Accounting Principles ("GAAP") are based on the idea of "conservatism," or ensuring that reporting companies do not overstate profits and mislead investors.[23] Depreciation lives used for regulatory purposes must balance the interests of investors, ratepayers, and competitors. Accordingly, the lives used for financial reporting purposes -- which are tailored to the needs of only a single constituency, investors -- are not a reasonable alternative to the Commission's processes.

IV. THE COMMISSION SHOULD ADOPT ITS PROPOSED CHANGES IN THE TREATMENT OF SALVAGE AND REMOVAL COSTS.

The NPRM proposes that salvage and the cost of removal should be treated as current items in the period actually incurred rather than capitalized.[24] AT&T and the

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21 See Depreciation Prescription Simplification, Report and Order, FCC 93-452, released October 20, 1993 at ¶ 46 ("We believe the underlying considerations that go into estimating the basic factors are sufficiently different for the two groups [IXC and ILEC] that they should be considered separately.")

22 See SBC at 21-22. See also BellSouth at 4-5; Bell Atlantic at 5-6; GTE at 12-15.

23 AT&T at 21-22. Thus the fact that GAAP-based depreciation lives are typically shorter than FCC prescriptions does not mean that GAAP lives are forward-looking and the FCC's are not, but only that GAAP lives are more conservative.

24 Id. at ¶ 14.

non-ILEC parties support this proposal.[25] The ILECs, by contrast, generally oppose this suggestion.[26]

The primary basis for the ILEC opposition is the fact that the Financial Accounting Standards Board ("FASB") is currently reviewing the treatment of salvage and removal costs, and the ILECs suggest that the Commission should not act while that evaluation is in progress.

For the reasons discussed above, the Commission need not adhere rigidly to FASB standards in setting its depreciation polices, since the Commission is seeking to achieve different public interest goals than the FASB. At the same time, AT&T believes that it would be appropriate for the Commission to await the action of the FASB, in order to determine *when* it should implement this change in its policies. If the FASB does adopt a comparable standard it would be appropriate for the Commission to set the effective date for its change in salvage and removal treatment to coincide with the effectiveness of the FASB pronouncement on the same subject. If, however, the FASB declines to adopt that standard within a reasonable length of time, then the Commission should proceed to implement its proposal.

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[25] VSCC Staff at 4; GSA at 7; MCI Worldcom at 12-14; AT&T at 6-9; see also Florida PSC at 6 (expensing of removal and salvage "has merit and should be examined in depth").

[26] Bell Atlantic at 4-5; GTE at 18-19; SBC at 27-28; but see Ameritech at 12-13 (supports Commission proposal provided it is at ILEC's option.)

V. THE USTA PETITION SHOULD BE DENIED BECAUSE CONTINUED COMMISSION DEPRECIATION REGULATION IS NECESSARY TO ENSURE JUST AND REASONABLE RATES AND PROTECT CONSUMERS AND THE PUBLIC INTEREST.

AT&T and the non-ILEC parties all oppose the USTA Petition.[27] These parties explain that the ILECs possess too much market power for the Commission to forbear from regulating such an important cost element, noting that the NPRM itself states that the ILECs continue to control about 97% of the local market. These parties also demonstrate that the Commission's regulation of depreciation plays an important role in a number of essential federal and state regulatory issues, and should not be eliminated at this time.

Not surprisingly, the ILEC parties maintain that the Commission can and should forbear from depreciation regulation.[28] The ILEC parties, however, offer no new reasons for the Commission to forbear from regulation other than those offered by USTA in its Petition, and those reasons were refuted by the Comments of AT&T and others. Accordingly, the Commission should dismiss the USTA Petition.

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27 Florida PSC at 9; Ad Hoc at 3; GSA at 10; VSCC Staff at 6; MCI Worldcom at 15-22; AT&T at 2-3, 10-25.

28 See, e.g., Ameritech at 2; CBT at 10; BellSouth at 5-10; GTE at 20; SBC at 1 and Attachment A (Harris Statement) at 5-12. While BellSouth (at 6) claims the Florida PSC supports forbearance, the Florida PSC's Comments herein state otherwise.

CONCLUSION

The Commission should adopt the proposals set forth in its NPRM, subject to the revisions suggested herein. Additionally, the Commission should deny the USTA Petition for Forbearance.

Respectfully submitted,

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Figure 1 **ILEC REPORTED DEPRECIATION INFORMATION**			
Year	Retirement Rate	Depreciation Rate	Depreciation Reserve Level
1997	4.0	7.1	48.8
1996	3.7	7.2	47.1
1995	3.5	7.1	45.1
1994	4.2	7.1	42.8
1993	4.5	6.9	41.0
1992	5.0	6.9	39.3
1991	5.5	7.0	37.8
1990	5.4	7.3	37.5
1989	3.7	7.5	36.2
1988	4.2	7.7	33.6
1987	4.0	8.1	31.6
1986	3.7	7.5	28.4
1985	3.8	6.9	25.7
1984	3.3	6.4	23.8
1983	3.9	6.5	22.2
1982	4.1	6.0	20.2
1981	4.0	5.8	19.2
1980	4.9	5.7	18.7

CERTIFICATE OF SERVICE

I, Margaret Brue, do hereby certify that on this 7th day of December, 1998, a copy of the foregoing "Reply Comments of AT&T Corp." was mailed by U.S. first class mail, postage prepaid, to the parties listed below:

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