B. Jeannie Fry
Director-Federal Regulatory

SBC Telecommunications, Inc.
1401 I Street, N.W.
Suite 1100
Washington, D.C. 20005
Phone 202 326-8894
Fax 202 408-4806

EX PARTE OR LATE FILED

RECEIVED

MAR 12 1999

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

March 12, 1999

Ex Parte

Ms. Magalie R. Salas
Secretary
Federal Communication Commission
Room TW-A325,The Portals
445 Twelfth Street
Washington, D.C. 20554

Re: CC Docket No. 98-137, In the Matter of 1998 Biennial Review—Review of Depreciation Requirements for Incumbent Local Exchange Carriers

ASD Docket No.98-91, USTA Petition For Forbearance from Depreciation Regulation

CC Docket No. 98-177, In the Matter of 1998 Biennial Regulatory Review—Petition for Section 11 Biennial Review filed by SBC Communications Inc., Southwestern Bell Telephone Company, Pacific Bell and Nevada Bell

ASD Docket No. 98-97, In the Matter of United States Telephone Association Petition for Rulemaking-1998 Biennial Regulatory Review

Dear Ms. Salas:

In accordance with the Commission's rules, please be advised that on March 11, 1999, Mr. Pat Doherty, Ms. Jane Knox, Dr. Bob Harris and the undersigned, representing SBC Communications Inc. (SBC) met with the persons listed below in separate meetings to discuss the manner in which the Commission currently regulates depreciation accounting and to urge the FCC to allow price cap carriers to utilize depreciation rates based upon Generally Accepted Accounting Principles. Alternatively, SBC recommends the Commission mandate a "Price Cap Carrier Option" whereby a carrier would file a notice with its depreciation rates when its these rates are revised.

- Andy Mulitz, Chief of the Legal Branch, Stephen Steckler, Reporting Management and Analysis Branch, and Tom David, Legal Branch, Accounting Safeguards Division
- Lisa Zaina, Deputy Bureau Chief, and Bill Bailey, Counsel, Common Carrier Bureau
- Bill Rogerson, Chief Economist, and Pat DeGraba, Deputy Chief Economist, Office of Plans and Policy
- Tom Power, Legal Advisor, Office of Chairman Kennard
- Kyle Dixon, Legal Advisor, Office of Commissioner Powell
- Paul Gallant, Legal Advisor, Office of Commissioner Tristani
- Linda Kinney, Legal Advisor, Office of Commissioner Ness
- Paul Misener, Chief of Staff and a Legal Advisor, Office of Commissioner Furchtgott-Roth

A summary of the discussion is outlined in the attached. An original and one copy of this letter and the attachments are being submitted. Acknowledgement and date of receipt of this transmittal are requested. A duplicate transmittal letter is attached for this purpose.

Please include this letter in the record of these proceedings in accordance with Section 1.1206(a)(2) of the Commission's Rules.

If you have any questions on this, please do not hesitate to contact Ms. Jeannie Fry at 202-326-8894.

Sincerely,

BJ Bauman Fry

Attachment

Cc: Mr. Ken Moran, Chief, Accounting Safeguards Division

BCC: Mr. Jon Royston, SBC
Mr. Pat Doherty, SBC
Ms. Jane Knox, SWBT
Ms. Mary Henze, Bell South
Mr. Scott Randolph, GTE
Mr. Bill Johnston, USWEST
Mr. Tony Alessi, Ameritech
Mr. Jerry Asch, Bell Atlantic

(expar98-137mar1199.doc)

CC Docket No. 98-137
Biennial Review of Depreciation Rate Regulation
SBC Communications Inc.
Summary

I. The Commission should eliminate depreciation regulation for Price Cap carriers.

II. SBC urges the FCC to allow price cap carriers to utilize depreciation rates based on GAAP principles. (Carriers would make changes to estimated lives as information becomes available.)

III. Use of GAAP depreciation rates would aid in addressing stranded plant.

IV. Implication of Increased and Accelerating Competition For Depreciation Policy:

V. Direct Local Competition is Accelerating.

VI. Indirect Competition is Substantial and Accelerating: Wireless (cellular and PCS), Private Networks (VSATs, PBXs).

See Attachment 1.

VII. Periodic Prescriptions Do Not Serve Well in Determining Current Economic Lives.

See Attachment 2 for comparison of prescribed and competitive market depreciation rates.

VIII. If depreciation rate regulation is not eliminated for PC carriers, the Commission should mandate the Price Cap Carrier Option for the applicable carriers.

- Proposed for ATT in 1992 by the FCC.
- Carrier would simply file its new rates with the Commission when rates are revised.

IX. SBC urges the FCC to allow Price Cap carriers to utilize GAAP based depreciation rates.

March 11, 1999

I. The Commission should eliminate depreciation regulation for Price Cap carriers.

- Accounting for Part 32 depreciation differently from GAAP requires significant investments in people/time.
- Filing studies for new depreciation rates is costly and time consuming(including Commission resources). SBC spends approximately $500K annually when filing studies.
- Recognition of economically based depreciation rates in Part 32 accounting yields a more representative interstate reported rate of return.

II. SBC urges the FCC to allow price cap carriers to utilize depreciation rates based on GAAP principles. (Carriers would make changes to estimated lives as information becomes available.)

- Accurate estimates of lives can be completed by carriers and reviewed by independent auditors. TFI and other data exist as a source to estimate the lives.
- Price cap rules have made depreciation regulation unnecessary. Depreciation is exogenous to this process.
- Rarely used low end adjustment filings do not constitute an issue. Burden of proof would be on the carrier if GAAP depreciation rates are utilized.
- Costs of regulation should be weighed against the value gained by prescribing rates.
- Depreciation rate changes do not impact the productivity calculation.
- The Base Factor Portion calculation will soon be completely revenue based.
- Universal Service calculations should use forward looking depreciation rates.
- State regulatory plans do not focus on cost based calculations anymore.

III. Use of GAAP depreciation rates would aid in addressing stranded plant.

- SBC recognized large write-offs in 1995 (GAAP books) as a recognition of under-depreciated plant. At year-end 1998, the accumulated depreciation on the regulated books differed by $7.7 Billion from the financial books.
- Carrier determination of depreciation rates would allow large carriers to begin prospectively addressing this problem.
  - Faster rates would allow some recovery of stranded investment or at a minimum halt the enlargement of the difference between the 2 sets of books.
  - Carriers have already proposed recovery in the Universal Service and Access Reform dockets to no avail.

(continued)

- May 16, 1997 First Report on Access Reform (Para. 49) stated an intent to examine compensation for historical costs that have no reasonable opportunity to recover as the market place becomes competitive.
- Reed Hundt (January 14, 1997 before the Competition Policy Institute) stated that the FCC has long recognized that they must address the issue of incumbents' historic costs in the access and universal service proceedings.
- California PUC has eliminated depreciation reviews and approvals (Oct 8, 1998, p-51) for Pacific Bell. Order concludes that this precludes "new stranded investment" from occurring.
- FERC has allowed recovery of stranded investment for gas/electric companies transitioning to a competitive environment mandated by the National Energy Policy Act of 1992. FERC does not regulate depreciation rates.

IV. Implication of Increased and Accelerating Competition For Depreciation Policy:

- Reduces the Need for Prescription/Regulation
  --- If ILECs tried to set depreciation rates at economically high levels and pass these costs on to customers, it would not be sustainable, because it would only stimulate or increase competitive entry.
  --- Thus, attempting to recover depreciation expenses at artificially high levels could undermine long-term capital recovery by increasing economic depreciation rates as entry increases.
- Increasing Competition shortens depreciation lives
  --- Particularly when competitors enter existing market with new technologies (jet planes vs. propellers).
- Accelerating competition makes depreciation forecasting harder, frequent changes and updates to forecasts are necessary.
  --- Prescription is untenable when competition accelerates.

V. Direct Local Competition is Accelerating.

- More CLECs exist than ILECS
- SBC has lost more than 1 million access lines to direct competition (*these lines are high revenue—cream skimming*)
- Competition from new or superior technologies will have a profound impact on depreciation
  --- The highest growth area in telecommunications is in the data transmission area (IP networks etc.) which will require massive investment and reconfigurations of ILECs existing networks which are optimized for voice and circuit switching, making many existing investments outdated *(continued)*

--- Cable companies are upgrading their networks to provide voice telephony and, critically for the future, cable modem services—competing with ILEC voice and DSL access lines
--- Fixed wireless CLECs: Winstar, Teligent, ART

VI. Indirect Competition is Substantial and Accelerating: Wireless (cellular and PCS), Private Networks (VSATs, PBXs).

See Attachment 1.

VII. Periodic Prescriptions Do Not Serve Well in Determining Current Economic Lives.

- Process has focused on past retirement data, which is by definition outdated
- Prescriptions can not infuse current data on technological change in real time mode. As soon as they are done they are out of date. Can not keep up with change
- FCC prescribed lives are far longer than comparable companies' lives e.g. AT&T, TCG etc.
- Unpredictable technological diffusion creates a need for real time adjustment of lives

See Attachment 2 for comparison of prescribed and competitive market depreciation rates.

VIII. If depreciation rate regulation is not eliminated for PC carriers, the Commission should mandate the Price Cap Carrier Option for the applicable carriers.

- Proposed for ATT in 1992 by the FCC.
- Carrier would simply file its new rates with the Commission when rates are revised.

IX. SBC urges the FCC to allow Price Cap carriers to utilize GAAP based depreciation rates.

Indirect Competition is Substantial and Accelerating

- **PBXs**- In 1999, there were 47 million PBX extension lines in the United States.[1] Assuming companies purchase 1 trunk for every 7 extension lines, net loss of 40 million access lines across the United States (in SBC territory including Pacific Bell net loss of almost 8 million access lines).[2]

- **Wireless** (Cellular and PCS) use is reducing wireline MOUs, message revenue and access lines

Forecast landline losses to wireless in the U.S.[3]

	1998	1999	2000
Price per wireless MOU	$.11	$.09	$.08
Total wireless subs	67m	80m	93m
Voice MOUs lost to wireless	7%	13%	21%

Source: TFI

- AT&T's widely marketed Digital One Rate Plan even stated that it "could make your wireless phone your only phone."[4]

- AT&T's latest promotion of a "Wireless Home Phone Option" in Plano, TX competes with local exchange service. The plan offers unlimited airtime within the fixed local calling area (i.e. the home cell site) at a comparable price to the wireline incumbent GTE's basic service. AT&T is considering rolling out this pricing plan on a national basis. This wireless calling plan is competing for voice minutes of use formerly reserved for wirelines, second local exchange lines, and some primary lines.[5]

- AT&T Wireless/GTE Mobilnet both offer wireless plans with no roaming or long distance charges.

(continued)

---

1 Total number of PBX extensions installed from Multimedia Telecommunications Association, *1999 MultiMedia Telecommunications Market Review and Forecast*, p. 102.

2 SBC territory contains slightly more than 19% of presubscribed wireline incumbent access lines in the United State according to the FCC SOCC.

3 See Lawrence K. Vanston & Ray L. Hodges, Wireless vs. Wireline for Voice Services: Forecasts and Impacts, *Technology Futures Inc*, Third Edition, July 1998.

4 AT&T Digital One Rate, *AT&T Wireless Services Web Site*, as of 12/2/1998. <www.attws.com>

5 "Wireless offered for secondary home lines in Plano," Dallas Morning News, November 12, 1998 and "AT&T Wireless Home Phone Option," *AT&T Promotional Materials*, September 1998.

Indirect Competition is Substantial and Accelerating *(continued)*

- **VSATs**

VSATs as of 1997 (in 000s)[6]

Geographic Area	World	United States	SBC Territory (include PB)
Number of VSAT Terminals	297	167	32

- Assuming each VSAT lead to a loss of between 1 to 5 access lines, SBC has lost between **32,000 and 160,000** access lines to VSATs.

- **Specific Example of VSATS Replacing Incumbent Land lines: Best Western Motels,** "Among the initial applications supported by this [VSAT] network is a new reservation system that instantly will account for rooms as they are depleted or added. *This system will replace the current one that uses phone lines to make a dial-up call each time a transaction is processed.*"[7]

[6] Total World VSAT Terminals from Comys http://www.comsys.co.uk. U.S. VSATs estimated using U.S. Share of world wide access lines from ITU. SBC VSATs estimated using SBC's share of total U.S. presubscribed access lines from FCC SOCC.

[7] HNS Press Release "Best Western Selects HNS For VSAT Services At 2,000 Locations," November 14, 1995. <http://www.hns.com>

Comparison of FCC Prescribed Depreciation Ranges for ILECs with Competitors Economic Lives (in years)

Plant Category	FCC Prescribed Range for ILEC	AT&T	Electric Lightwave	TCG
Digital Switching	13-18	9.7	10	10
Digital Circuit	11-13	7.2	10	8
Fiber Optic Cable	25-30	20	20	20

Sources:
--FCC Prescribed range for digital switching from: FCC NPRM, July 22, 1998, CC Docket No. 98-137.
--FCC prescribed ranges for all other plant categories from FCC Third Report and Order, May 5, 1995, CC Docket No. 92-296.
--Depreciation rates for AT&T, ELI and TCG as of 1995 from: Testimony of Robert Harris On Behalf of U S West Communications Inc. Before the Arizona Corporation Commission, AT&T-U S WEST Interconnection Arbitration, Docket No. U2428-96-417, September 30, 1996, p. 38.