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April 28, 2000

VIA ELECTRONIC COMMENT FILING SYSTEM

Ms. Magalie Roman Salas
Office of the Secretary
Federal Communications Commission
Room TW-A324
445 Twelfth Street, SW
Washington, D.C. 20554

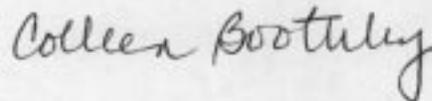
Re: *1998 Biennial Regulatory Review, CC Docket No. 98-137; Ameritech Corporation Telephone Operating Companies' Continuing Property Records, et al., CC Docket No. 99-117; GTE Telephone Operating Companies Release of Information Obtained During Joint Audit, AAD File No. 98-26*

Dear Ms. Salas:

Enclosed please find an electronic original of the Reply Comments of the Ad Hoc Telecommunications Users Committee in the above-captioned proceeding. These Comments are being filed via the Federal Communications Commission's Electronic Comment Filing System ("ECFS").

If you have any questions regarding this filing, please do not hesitate to call me at (202) 857-2543.

Sincerely,



Colleen Boothby

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

In the Matter of)	
)	
1998 Biennial Regulatory Review --)	
Review of Depreciation Requirements)	CC Docket No. 98-137
For Incumbent Local Exchange Carriers)	
)	
Ameritech Corporation Telephone)	
Operating Companies' Continuing)	CC Docket No. 99-117
Property Records Audit, <i>et al</i>)	
)	
GTE Telephone Operating Companies)	CC Docket No. 98-26
Release of Information Obtained During)	
Joint Audit)	

Reply Comments of the Ad Hoc Telecommunications Users Committee

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Users Committee

April 28, 2000

SUMMARY

Like Ad Hoc, representatives of virtually every potential stakeholder on this issue – including business users, residential users, CLECs, IXCs, small ILECs, state regulatory agencies, and even parties participating in the CALLS coalition – have filed comments opposing the depreciation changes demanded at the eleventh hour by the CALLS ILECs as the price for their support of the CALLS access reform proposals.

Despite the carefully worded misdirection in the ILECs' initial proposal, their comments confirm Ad Hoc's worst suspicions: the ILECs would use the changes produced by their proposal to raise rates to consumers and interconnection costs for competitors, even though the ILECs have enjoyed record earnings for the past several years. Though their proposal emphasizes that they would voluntarily forego increases in their interstate rates based on the amortization expense that their proposal would create, the ILECs' comments confirm that they will *not* make the same commitments when it comes to the other expenses created by their proposal and the other rates that would be affected, on which their initial description was silent.

Under their proposal as clarified, the ILECs can seek higher rates for *intrastate* services based on (1) the new amortization expense created by the proposal; or (2) the higher depreciation expenses that would result from their proposed move to financial depreciation. In addition, the ILECs can seek rate increases at the interstate level based on the higher *depreciation* expenses that would result from their proposal. And finally, the ILECs can use the accounting change they propose to increase UNE prices and universal service subsidies.

These consequences would be anti-consumer, anti-competitive, and antithetical to the public interest.

The comments also reveal that the ILECs' depreciation proposal provides no basis for treating as "moot" the Commission's audits of the ILECs property records. Those audits revealed that consumers were paying for more than \$5 billion in "phantom" plant that the ILECs may never have purchased. Because both price caps and the CALLS proposal retain linkages to regulatory accounting (such as the earnings-based trigger for a "low-end adjustment" that lets the ILECs raise rates when they report low earnings), any "phantom" plant like that exposed by the audits will still affect rates, consumers, and competition under the ILECs' depreciation proposal.

The proposal does nothing to protect ratepayers from an overstated reserve deficiency. The only way to insulate ratepayers, and to moot the audit findings, is to treat the entire reserve deficiency, and potential impacts associated with depreciation, on a below-the-line basis as the Commission described in its *Depreciation Order* only four months ago.

The ILECs desire to re-write the *Depreciation Order* is perfectly understandable: without it, they can mask their record-breaking earnings and justify price increases. The need to protect consumers and competition from such a result is equally understandable: a regulatory system that allows ILECs to charge exploitive rates is unlawful. Accordingly, the Commission must reject the ILEC's proposal.

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Reply Comments of the Ad Hoc Telecommunications Users Committee

The Ad Hoc Telecommunications Users Committee (“the Committee” or “Ad Hoc”) hereby submits its reply comments in response to the Commission’s Further Notice of Proposed Rulemaking (“*FNPRM*” or “*Further Notice*”) in the dockets captioned above.¹

In Ad Hoc’s initial Comments, the Committee urged the Commission to reject the depreciation proposal advanced by ILEC participants in CALLS on the grounds that proposal was “anti-consumer, anti-competitive, unnecessary, and

¹ 1998 Biennial Regulatory Review, CC Docket No. 98-137; Ameritech Corporation Telephone Operating Companies’ Continuing Property Records, *et al.*, CC Docket No. 99-117; GTE Telephone Operating Companies Release of Information Obtained During Joint Audit, AAD

irrelevant to the goals of access reform,” and “accomplished via a secretive and exclusionary process that limits input and record evidence from interested parties and compromises both the CALLS proceeding and the instant docket.”² The overwhelming consensus articulated in the comments opposes the ILEC proposal on these same fundamental grounds.

Indeed, all of the commenters, other than the ILEC participants in CALLS who sponsored the proposal (“the CALLS ILECs”), oppose the ILECs’ proposal. The commenters include representatives of virtually every potential stakeholder on this issue, including business users, residential users, CLECs, IXCs, small ILECs, state regulatory agencies, and parties participating in CALLS. The depth and diversity of the parties who reject the ILECs’ depreciation proposal, and support the protections recently established by the Commission in its *Depreciation Order*,³ expose not only the problematic nature of the ILEC proposal but its potentially disastrous impact on a broad range of parties and the greater public interest.

As discussed further in this reply, there is a clear consensus among commenters other than the CALLS ILECs that the ILEC depreciation proposal:

- does not satisfy the criteria identified in the *Further Notice*, *i.e.*, it does not “provide the same protections to guard against any adverse impact

File No. 98-26, Further Notice of Proposed Rulemaking, FCC No. 00-119, released April 3, 2000 (“FNPRM” or “Further Notice”).

² Ad Hoc Comments at 3. Unless otherwise indicated, all citations to comments refer to comments filed in the instant docket.

³ *1998 Biennial Regulatory Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers*, CC Docket No. 98-137, Report and Order, FCC 99-397, released December 30, 1999 (“*Depreciation Order*”).

on consumers and competition as provided by the conditions adopted in the Commission's *Depreciation Order*,"⁴ and

- will put consumers and competition at risk of serious financial harm by amortizing the difference between financial and regulatory depreciation on an *above-the-line* basis.

Similarly, there is a clear consensus among commenters other than the

CALLS ILECs that the only way to provide the same level of protection

contemplated in the *Depreciation Order* is to require ILECs seeking depreciation

forbearance to:

- to take a one-time *below-the-line* write-off of the difference between financial and economic depreciation; and
- to provide the FCC with information concerning significant changes to depreciation accounts so that the Commission can independently maintain appropriate depreciation ranges for use in determining universal service high cost support and setting UNE/interconnection prices.

Finally, there is a clear consensus among commenters (other than the

CALLS ILECs) that the issues raised by both the ILECs' depreciation

forbearance proposal and the conduct revealed by the continuing property

records ("CPR") audits are irrelevant to a proper consideration of the access

charge reform proposals embodied in CALLS.⁵ Accordingly, these commenters

uniformly observe that there is no sound justification for tying the resolution of

these matters to the treatment of the CALLS proposal. Significantly, the CALLS

ILECs present no convincing arguments or evidence to the contrary in their

comments.

⁴ *Further Notice* at ¶ 9.

⁵ See Ad Hoc Comments at i, 12, Wisconsin Public Service Commission Comments at 2, 5-6, NARUC Comments at 11, Indiana Regulatory Utility Commission Comments at 6, MCI Comments at 5, 21, AT&T Comments at 8, ICA/CFA Comments at 7.

The *Further Notice* left open the possibility that the CALLS ILECs would flesh out the commitments vaguely identified in their March 3, 2000 *ex parte* letter describing their proposal. In their comments, however, the CALLS ILECs remove any doubt as to the very limited nature of the “commitments” they are willing to make, and thus the limited nature of the protections for afforded consumers and competition if the ILEC proposal is granted. Indeed, the comments of the CALLS ILECs confirm the Committee’s worst suspicions, namely, that the ILECs have no intention of giving up the opportunities for increased revenue recovery that their proposal would produce and on which the proposal was silent. This feature alone requires rejection of the ILEC proposal under the criteria established by the Commission in the *Depreciation Order*:

A. The record demonstrates that only a one-time, below-the-line adjustment will adequately protect consumers and competition under the ILECs’ proposal

In its Comments, Ad Hoc identified no less than seven specific ways in which consumers and competition could be seriously harmed under the ILECs’ proposal to use a five-year above-the-line amortization of differences in financial and regulatory depreciation in lieu of the one-time below-the line write-off contemplated by the Commission in the *Depreciation Order*.⁶ Many of the

⁶ Ad Hoc Comments at 8-9. These included the ILEC’s ability to: 1) seek flow-through in their interstate rates of increased depreciation accruals resulting from the use of higher financial depreciation rates on a going forward basis; (2) seek flow-through in their *intrastate* rates of increased depreciation expenses on a going forward basis as well as past depreciation reserve deficiency amortizations, (3) increase high-cost amounts drawn from universal service funding mechanisms, (4) increase UNE rates set using higher financial depreciation rates, (5) increase rates for pole and conduit attachments, (6) shift revenue requirement between the state and federal jurisdictions, and (7) use low regulatory earnings resulting from use of higher financial depreciation rates as the basis for seeking adjustments under price caps or rate of return or even make a takings claim under the Fifth Amendment.

commenters confirm that the proposal would enable the ILECs to obtain additional revenue recovery from ratepayers in connection with either the proposed amortization, the higher going forward depreciation expenses, or both – and in both the state and interstate jurisdictions.

For example, NARUC as well as a number of individual state regulatory commissions emphasized the potentially significant and negative impact that the ILEC's proposed above-the-line amortization would have on universal service high cost funding and interconnection/UNE rates, two issues of obvious importance at both the state and federal level.⁷ These same concerns were also expressed by carriers across-the-board, including CLECs, IXC's, and small ILECs.⁸ A number of other commenters also noted the opportunity for ILECs to use the higher depreciation expenses associated with adoption of financial depreciation rates (as distinct from the amortization expense associated with the purported reserve deficiency) to trigger low-end adjustments.⁹

Several commenters, including ICA/CFA and MCI, note the ILECs' unreasonably high earnings and speculate that the ILECs' desire to obscure these high earning levels may be the impetus for what is otherwise a very confusing, and indeed, nonsensical accounting proposal on the part of the

⁷ See NARUC Comments at 8, Indiana Utility Regulatory Commission Comments at 2-3, Ohio Public Utilities Commission Comments at 3, Wisconsin Public Service Commission Comments at 5.

⁸ See ALTS Comments at 7, AT&T Comments at 7, MCI Comments at 4, 18-19, NECA Comments at 6, and NRTA/OPASTCO Comments at 3.

⁹ See NARUC Comments at 8, MCI Comments at 17.

ILECs.¹⁰ Why else, the argument goes, would the ILECs be so adamant about making the depreciation adjustment above-the-line, where it can be used to create the appearance of lower earnings, but be willing to “commit” to certain “below-the-line” protections against some of its rate impacts?

While Ad Hoc agrees that one of the effects of the ILECs’ proposal is this “earnings sham,”¹¹ the Commission must not lose sight of the fact that, whether or not this is the ILECs’ motivation for the proposal, the real and potentially harmful financial consequences for consumers and competition, which were identified in Ad Hoc’s original comments, are the same.¹² Moreover, as noted by Ad Hoc and others, above-the-line treatment of an investment or expense for a regulated entity, by definition, presumes entitlement to revenue recovery. But there is no basis for that presumption in this case, other than the fact that the regulated entities would push for such recovery using any of the many avenues that are open to them.¹³

Several commenters highlight the administrative burdens that would accompany the ILEC proposal, should the Commission actually try to monitor ILEC compliance with their commitment not to pass through any interstate amortization expense to ratepayers.¹⁴ This point cannot be over-emphasized. A

¹⁰ See ICA/CTA Comments at 5-6, 8, MCI Comments at 5. See also NARUC Comments at 7.

¹¹ Ad Hoc is in agreement with those raising the “earnings sham” theory that, for the Commission to adopt an otherwise nonsensical proposal for the sole purpose of allowing ILECs the opportunity to artificially depress regulatory earnings would badly tarnish the Commission’s record and credibility. See ICA/CFA Comments at 5.

¹² See footnote 5, *infra*.

¹³ See Ad Hoc Comments at 6-7, MCI Comments at 8.

¹⁴ See Indiana Utility Regulatory Commission Comments at 5, AT&T Comments at 3.

proposal as complex as the ILECs', which requires such extensive Commission oversight, hardly serves the Commission's professed goal in this docket of regulatory simplification.

All parties, other than the sponsoring CALLS ILECs, agree on the obvious solution to the problems identified above, namely, to require that any adjustment between regulatory and financial depreciation accounting that occurs in conjunction with depreciation forbearance be made on a below-the-line basis.¹⁵ Below-the-line treatment is the logical and economically correct method for eliminating differences between financial and regulatory depreciation, as the Commission properly concluded only four months ago in its *Depreciation Order*. Below-the-line treatment is the only means of ensuring ratepayers are fully insulated from the rate impacts associated with the use of higher financial depreciation rates. Moreover, as NARUC notes, given the high rates of return reported by the ILECs in their ARMIS filings, there is little likelihood of an adverse impact on the ILECs from such a write-off, whether it is spread out over multiple years or flash-cut.¹⁶

B. The CALLS ILECs comments reveal the very limited nature of both their “commitments” and the protections for consumers and competition.

¹⁵ See Ad Hoc Comments at 10, NARUC Comments at 5-6, 13, ALTS Comments at 5, MCI Comments at 6-8, Indiana Utility Regulatory Commission Comments at 4, Wisconsin Public Service Commission Comments at 3-4, AT&T Comments at 3, ICA/CFA Comments at 5-6.

¹⁶ NARUC Comments at 6.

As the Further Notice recognizes,¹⁷ and as commenters including state utility commissions observe in their comments,¹⁸ the ILEC proposal was vague regarding the ILEC's specific commitments to forego revenue recovery, especially in the context of state revenue requirements and the impact on intrastate rates. Ad Hoc was willing to give the ILECs the same benefit of the doubt the Commission was willing to give: "while the commitment in the [ILEC *ex parte*] letter refers to *interstate* amortization" only, the ILECs may have intended "to commit not to seek recovery, at the *state* level, of any portion of the amortization (*i.e.*, both state and interstate)."¹⁹ Accordingly, the *Further Notice* presumed that the ILEC commitment to forego revenue recovery would extend to "recovery of the amortization expense through a low-end adjustment, an exogenous adjustment, or an above-cap filing," and also "through any action at the state level, including any action on UNE rates."²⁰

Of course, as pointed out by Ad Hoc, even if the Commission's wishful interpretation of the proposal had been true, the broader commitment presumed by the Commission would still have applied only to amortization expense and not to the higher *depreciation* expense on a going-forward basis.²¹

In fact, the comments of the CALLS ILECs confirm Ad Hoc's' worst fears, namely, that the ILECs have no intention of foregoing increased revenue recovery at the state level (where roughly 75% of the potential cost recovery

¹⁷ *Further Notice* at ¶10.

¹⁸ See Ohio Public Utilities Commission Comments at 2, MCI Comments at 8.

¹⁹ *Further Notice* at ¶10 (emphasis added).

²⁰ *Id.*

²¹ See Ad Hoc Comments at 7.

would occur) based on the amortization expense or the higher depreciation rates that would result from their proposed move to financial depreciation. Nor do the ILECs intend to foreclose recovery opportunities at the interstate level associated with higher depreciation expenses.

For example, US WEST espouses the position that “the Commission has no jurisdiction to establish depreciation rates or practices at the State level,” and admonishes the Commission “not to be concerned about adverse impacts at the State level.”²² And in case there was any doubt as to the ILEC’s true intentions, US WEST unabashedly states its intention “to seek recovery of all expenses lawfully incurred in the provision of intrastate service, *including depreciation expense and any applicable depreciation reserve deficiency.*”²³ Other ILECs are less forthcoming about their intentions but nevertheless leave little doubt as to their unwillingness to preclude revenue recovery relating to the use of financial depreciation at the state level.²⁴

While it is true that “States retain jurisdiction over depreciation charges and practices for intrastate telephone plant”²⁵ as a matter of law, as a matter of practice, state depreciation policies are strongly influenced by federal policy. Federally-set depreciation rates are not only used routinely in cost models, they are used to determine universal service support and interconnection/UNE prices in state jurisdictions. Federal approval of a system that uses ILEC-determined

²² US WEST Comments at 5-6.

²³ *Id.* at 7, emphasis added.

²⁴ See SBC Comments at 10-11, BellAtlantic Comments at 3-4.

²⁵ *Id.* at 6.

financial depreciation rates, accompanied by above-the-line treatment of the reserve deficiency, would create a powerful argument that such treatment would be reasonable at the state level.

In response to the Commission's question as to whether the ILECs are willing to forego revenue recovery of the amortization expense on the state side, as they propose for the federal side, GTE answers that "no ILEC will be writing anything off the books on the intrastate side; there is nothing about the interstate adjustment that would affect any intrastate revenue requirement."²⁶ GTE's flippant response insults the reader's intelligence. Under the ILEC proposal, there would be no write-offs taken on the interstate books either. The very fact that the costs associated with the higher financial depreciation mechanism would *stay on the books* is precisely what leaves ratepayers exposed to increased revenue recovery by the ILECs. To say that the interstate adjustment does not affect any intrastate revenue requirement is true by tautology. Obviously, what *will* affect the intrastate revenue requirement is the use of higher financial depreciation rates – not the amount of any resulting interstate adjustment.

As to the ILECs' continued use of the low-end adjustment to guarantee favorable rates of return, GTE and other ILECs such as BellSouth continue to argue for this holdover from rate of return regulation – albeit with a new twist. Specifically, the ILECs argue that, while ILECs would not be precluded under their proposal from seeking a low-end adjustment, the ILECs would agree that the low earnings used to support any such adjustment would have to be

²⁶ GTE Comments at 4.

unrelated to the amortization.²⁷ This is a limited concession, however, as it does not exclude the use of the higher *depreciation* expense that results from the use of financial depreciation rates, set unilaterally by the ILECs, to calculate the low earnings used to trigger a low-end adjustment. Moreover, as mentioned earlier, the level of oversight and reporting required for the earnings calculation contemplated by the ILECs would be burdensome, if at all effective. A more fundamental objection to the ILEC proposal to retain the low-end adjustment, however, is that any reliance on the low-end adjustment is inconsistent with the fundamental “make whole or make money” principle framed by Ad Hoc and endorsed by the Commission in the *Depreciation Order*.²⁸

Similarly, ILEC claims that the amortization will not directly affect the calculation of UNE rates because forward-looking costs would not include recovery of the amortization expense²⁹ conveniently ignore the impact of the shorter economic lives and thus higher depreciation costs which would result from the ILECs’ proposal. Indeed, a number of ILECs specifically assert their right to use the higher financial depreciation rates for UNE costing.³⁰ Compounding this problem, the ILECs object to providing the full information necessary for the Commission to maintain realistic ranges of depreciation lives and other related factors,³¹ which will make it difficult, if not impossible, for other

²⁷ *Id.*, BellSouth Comments at 9.

²⁸ Ad Hoc Comments at 9, *citing Depreciation Order* at ¶ 35.

²⁹ GTE Comments at 5, BellSouth Comments at 9.

³⁰ See BellAtlantic Comments at 4.

³¹ See Cincinnati Bell Comments at 3, BellSouth Comments at 12.

parties to contest (and substantiate alternatives to) the higher depreciation rates that ILECs would use as inputs in setting universal service and UNE costs.

C. The comments reveal no justification for “mooting” the CPR audit findings

It is clear from the comments (and hardly surprising) that the ILECs disagree with the CPR audit findings and want very much for the matter to go away. However, ILEC arguments to that effect are nothing new. Similarly, arguments by parties in support of the CPR audit findings are pretty much unchanged as well.³² But the relative merits of the CPR audit findings are irrelevant to this proceeding. The questions raised by the Commission in this proceeding are whether those audit findings are somehow “mooted” by the ILEC depreciation proposal (as suggested in the *Further Notice*), and more generally, whether the issue of the CPR audits is at all related to the Commission’s consideration of CALLS in the first place. To both of these questions, the answer is unambiguously no.

For the reasons explained by Ad Hoc and a number of other commenters,³³ the problems identified in the CPR audits are in no way mooted by the ILEC’s depreciation proposal, nor should a resolution of the CPR audits be linked to consideration of the CALLS access reform proposal. The arguments to the contrary proffered by the CALLS ILECs are unpersuasive, if not off point entirely. As noted above, the issue before the Commission in this proceeding is

³² See AT&T Comments in CC. Docket No. 99-117, ASD File No. 99-22, dated September 23, 1999, appended to AT&T Comments in this proceeding as Attachment A.

³³ Ad Hoc Comments at 10. See also Indiana Utility Regulatory Commission Comments at 6, NARUC Comments at 11.

not the validity of the audit findings *per se*, yet a number of ILECs devote more attention to rehashing old arguments addressing the validity of the audit process than they do to addressing the relevant questions in this proceeding. For example, US WEST merely assumes the audit findings are moot, without any substantive discussion of why.³⁴

Those ILECs that do address the relevant question present no valid or persuasive arguments for treating the audits as moot. For example, according to Bell Atlantic, the audit findings are moot because (1) rate levels under either CALLS or the current price cap regime are not based upon regulatory accounting; and (2) “under the depreciation proposal, local carriers will reduce their net plant by amounts far in excess of anything proposed in the staff audit report.”³⁵ While these statements may be true, they do not support a finding that the audits are moot.

Both the current price cap regime and the CALLS proposal retain a number of linkages to regulatory accounting, including but not limited to the earnings-based trigger for a low-end adjustment and calculation of the amount of the adjustment; quantification of and adjustments for exogenous changes; and the ability to make a takings claim based on “confiscatory” rate levels. The ILECs have refused to give up these advantages of the regulated world, despite their professed desire to be treated like companies whose cost recovery is disciplined by competitive market forces. Moreover, under their depreciation proposal, as noted earlier, the ILECs’ commitment to forego revenue recovery

³⁴ US WEST at 9-10.

based on depreciation costs is limited to the interstate amortization adjustment only, not *intrastate* amounts or higher *depreciation* expenses going forward at both the interstate and intrastate levels.

Thus, as noted in Ad Hoc's comments,³⁶ the ILECs' proposed above-the-line amortization, as opposed to a below-the-line write-off, means that any overstatement of the reserve deficiency due to phantom investment of the kind exposed by the audits will still affect rates, consumers, and competition under the ILECs' depreciation proposal. That "local carriers will reduce their net plant by amounts far in excess of anything proposed in the staff audit report" is irrelevant and does nothing to lessen the potential harm to ratepayers if an overstated reserve deficiency is amortized above-the-line as the ILECs propose. The only way to insulate ratepayers, and to moot the audit findings, is to treat the entire reserve deficiency, as well as all potential impacts associated with depreciation, on a below-the-line basis.

CONCLUSION

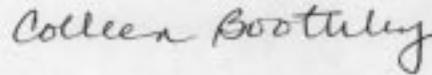
The comments of all key stakeholders, other than the ILEC participants in CALLS who concocted the depreciation proposal now under consideration, confirm that the ILECs' depreciation proposal is anti-consumer, anti-competitive, and antithetical to the public interest. The proposal is also irrelevant to resolution of the audits of the ILECs' continuing property records. Accordingly, the

³⁵ Bell Atlantic Comments at 7.

³⁶ Ad Hoc Comments at 10-11.

Commission should reject the approach proposed by the ILECs and continue to apply the standards it adopted just a few months ago in its *Depreciation Order*.

Respectfully submitted,

A handwritten signature in cursive script that reads "Colleen Boothby". The signature is written in black ink on a light-colored background.

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April 28, 2000

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