BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C.

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

REPLY COMMENTS
OF THE
NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS

Pursuant to Sections 1.49, 1.415, and 1.419 of the Federal Communications Commission's ("FCC" or "Commission") Rules of Practice and Procedures, 47 C.F.R. Section 1.49, 1.415, and 1.419 (1998), the National Association of Regulatory Commissioners ("NARUC") respectfully submits these reply comments on the FCC's Further Notice of Proposed Rulemaking adopted March 31, 2000, and released April 3, 2000 [FCC 00-119] ("FNPRM"). NARUC (1) believes the FCC should abandon this rulemaking in favor of the waiver process outlined in its original depreciation order, (2) reiterates its position that any amortization of the reserve difference between the regulatory and financial reporting books should be below-the-line to, *inter alia,* assure no intra-state rate impacts, and (3) urges the FCC to continue depreciation oversight as long as the ILECs have dominate carrier status. In support of these positions, NARUC states as follows:

II. BACKGROUND

The Calls Filing:

On March 3, 2000 the Coalition for Affordable Local and Long Distance Service ("CALLS") submitted an *ex parte* alternative proposal ("*Ex Parte* Letter") to the FCC to eliminate the existing disparity between the regulatory and the financial accounting for depreciation expense and associated reserve balances over five years.

The proposal suggests that the CALLS participants intend to file a joint request for waiver of the FCC's depreciation requirements to (1) use the same depreciation factors and rates for both Federal regulatory and financial accounting purposes, and (2) commit to submit, under a request for confidentiality, information concerning their depreciation accounts when significant changes to depreciation factors are made.

Additionally, the proposal includes a five-year amortization, to begin with and be contemporaneous with the timing of the CALLS access charge/universal service reform proposal, of the difference between the regulatory reserve balances and the corresponding external financial reserve balances. The amortization expense would be an above-the-line expense. However, the amortization would have no effect on interstate price caps or interstate rates and the carriers commit not to seek recovery of the amortization expense through a low-end adjustment, an exogenous adjustment, or an above-cap filing.

Further, the CALLS carriers commit not to seek recovery of the *interstate* amortization expense through any action at the state level, including any action on UNE rates.

NARUC's Initial Comments:

NARUC, in its April 17, 2000 initial comments, stated that before rendering a decision in this proceeding the FCC should quantify the overall change that will result from moving to financial depreciation rates for all carriers. Further, the difference between the financial reserve position and regulatory reserve position should be recorded as a one-time below-the-line adjustment to ensure there is no customer rate affect. Additionally, to assure the FCC can update its life and salvage rates to use to calculate forward-looking economic costs for universal service high cost loop support purposes, as well as to provide States with information needed to approve interconnection and Unbundled Network Element ("UNE") prices, carriers should submit plant life information on an annual basis pursuant to the FCC's Report and Order in CC Docket No. 98-137 and Memorandum Opinion and Order ("Depreciation Order") in ASD-98-91, adopted on December 17, 1999 and released December 31, 1999. Also, questions arising from the Continuing Property Records ("CPR") audits should be resolved independent of the decision in this rulemaking. The potential impacts on depreciation expense and universal support levels, because of overstated investment levels, have no relationship to the amortization amount or the fact that it is non-recoverable.

III. DISCUSSION

A. ILEC Comment Overview:

NARUC appreciates the opportunity to offer reply comments to the first round of comments offered in response to this FNPRM. Not surprisingly, all of the CALLS-affiliated Incumbent Local Exchange Carrier ("ILECs") initial comments support the FCC's proposed rulemaking.

However, it is interesting to note the number of pleas for this rulemaking, if adopted, to be discretionary rather than mandatory for all ILECs. Most of the ILEC comments claim that an above-the-line treatment of the proposed amortization adjustment is in line with previous FCC actions.

A particularly disturbing clarification made by these carriers is that while they may commit not to seek recovery of the interstate portion (25%) of the amortization difference, they will not make any such commitment with respect to the intrastate portion (75%). Further, these carriers object to the Commission continuing to set depreciation ranges to be used in cost models that determine USF support and UNE and interconnection prices. In addition to the concerns the NARUC raised in its initial comments, these caveats made by the ILECs in their initial comments, raise serious concerns for the NARUC.

B. Mandatory versus Discretionary:

If the FCC concludes its proposed rulemaking is appropriate, US WEST Communications, Inc. ("US WEST"), BellSouth Corporation ("BS"), Bell Atlantic telephone companies ("Bell Atlantic"), the United States Telecom Association ("USTA"), and Cincinnati Bell Telephone Company ("CBT") argue that all price cap carriers should be given the option to voluntarily operate under such rules.

U S WEST claims that a mandatory requirement could be unlawful in that price cap ILECs would be precluded from the opportunity of recovering prudently invested capital during the proposed five-year amortization period through any lawful means. Further, U S WEST says the conditions set forth in the CALLS *Ex Parte* Letter to allow use of the same depreciation rates for regulatory purposes as for financial reporting purposes are unreasonable and states that it does not

care to join in this act of supposed self-sacrifice.[1] According to U S West, any possibility that shareholders might be able to recover the costs of their investments would be eliminated under this plan.

SBC states that the actions contemplated in this proceeding are conditioned on the FCC's acceptance of the CALLS entire access charge/universal service reform proposed package. This infers that without Commission approval of the entire CALLS package, the CALLS ILECs would not agree to the commitments proffered in the *Ex Parte* letter.

U S WEST claims that the CALLS ILECs *Ex Parte* Letter's proposal, if made mandatory by the Commission, would raise the issue of whether ILEC property has been taken without either specific authority or just compensation. Along with BS and CBT, U S WEST also states that this depreciation plan should be an optional election for ILECs that are not currently CALLS participants. Further, these carriers state that price cap ILECs electing the CALLS Plan after its adoption by the Commission should not be required to participate in the depreciation process outlined in the *Ex Parte* Letter. They believe that carriers should have the opportunity to evaluate their participation in the depreciation plan in light of the final CALLS proposal and their particular circumstances at that time.

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[1] Indeed, US West, which is currently not a signatory to the CALLS proposal, claims that "[a]ny attempt to condition interstate relief on "firm commitments" at the State level would be . . . unlawful." And points out that it "fully intends to seek recovery of all expenses lawfully incurred in the provision of intrastate service, including depreciation expense and any applicable depreciation reserve deficiency." US West April 17, 2000 Comments at 6-7.

The reason the FCC issued this FNPRM was because it perceived a need for rules that would apply to the industry as a whole. Otherwise, it could have continued under the waiver process set out in the Depreciation Order. *Given the ILECs hesitation to endorse a rule that would apply to the industry as a whole, and indeed their recommendation to apply any rules adopted in this proceeding on a company by company basis, the FCC should abandon this rulemaking and proceed with the waiver process as outlined in the Depreciation Order.*

C. Amortization of Financial/Regulatory Reserve Differences:

SBC Communications, Inc. ("SBC"), BST, Bell Atlantic, CBT, U S WEST, and GTE Service Corporation (collectively, "GTE") all support an above-the-line amortization of the difference between the financial and regulatory reserve positions. Indeed, the carriers collectively proffer that above-the-line treatment is appropriate because the amortized expenses represent expenses that should have been recorded in past years.

NARUC urges the FCC to review its previous orders cited in the carriers' comments. Contrary to ILEC claims that the Commission permitted AT&T Corp. ("AT&T") to reflect its write-down in above-the-line accounts, the fact is that the Commission never did this. While it is true that the FCC has allowed above-the-line reserve amortizations, these amortizations related to reserve deficiencies defined as the difference between the book reserve and the calculated theoretical reserve. The theoretical reserve calculation assumes that current estimates of life and salvage had historically been in effect and, under those conditions, determines the reserve balance theoretically correct today. The difference between the calculated theoretically correct reserve amount and a carrier's book reserve relates to a reserve imbalance. To the extent plant assets do not

live in accord with the assumed life and salvage parameters used in the theoretical reserve calculation, a reserve surplus or deficiency can occur. Such reserve imbalances are indicative of past ratepayers not paying their fair share; that is, an intergenerational inequity exists. NARUC asserts that a reserve deficiency is not an issue in this proceeding. The difference between the financial and regulatory reserve positions cannot be construed as a reserve deficiency. It is simply the difference between the two sets of books. The Commission clearly states in paragraph 30 of its Depreciation Order that it does not agree that the ILEC's plant is under depreciated. For this reason, the FCC's precedent of above-the-line amortizations for reserve deficiencies is not relevant.

Furthermore, the carriers' references to the FCC's actions taken with AT&T in 1989 is taken out of context. First, the FCC never allowed an above-the-line amortization of the difference between the financial and book reserve positions as is being contemplated in this proceeding. Indeed, in its Memorandum Opinion and Order ("AT&T Depreciation Practices Order"), adopted November 22, 1989 and released December 15, 1989, in AAD 9-1935, the FCC denied AT&T's request to set its depreciation rates for regulatory purposes based on the depreciation rates it used for financial reporting purposes. The reserve amortization approved related to a reserve deficiency based on the life and salvage parameters the FCC concluded to be appropriate for AT&T, not those used for financial accounting purposes. Second, the AT&T Depreciation Practices Order is clear that any write-down AT&T took would be for financial reporting purposes only and would have no effect on its regulated investment or depreciation rates. The FCC concluded explicitly that AT&T's asset value and depreciation expenses were determined separately for financial reporting and regulatory purposes. The FCC prescribed depreciation rates for AT&T did not reflect the write-down AT&T took on its financial reporting books. Third, the FCC continued prescribing

depreciation rates for AT&T as long as it was considered a dominant carrier. As MCI WorldCom, Inc. (MCI) points out in its comments, the Commission still denied AT&T nondominant status in 1993 even though AT&T's market share had fallen to 58.1%. NARUC shares MCI's concern with the FCC providing the ILECs depreciation freedoms while they are still considered dominant carriers with more than 95% market share.

D. Impact on Local Rates and Competition:

In the FNPRM, the Commission explicitly asked carriers to clarify whether their commitment not to recover any portion of the amortized amount extended to the intrastate portion. The record is clear that no ILEC is making a commitment not to seek recovery of the intrastate portion of the amortized amount (75%). While it is not clear that the Commission could enforce or impose a condition that the carriers not seek recovery of the intrastate portion, it is disconcerting to the NARUC that signatories to the *Ex Parte* Letter neglected to include any assurances that intrastate rates will not be increased due to actions the Commission would take to provide them with freedom from depreciation requirements. In fact, U S WEST strongly admits in its comments that it has no intention of waiving recovery of these amounts on an intrastate basis. The ILECs made only a cursory statement that the interstate portion (25%) will not be used to increase rates at the state level. This commitment has little meaning to state commissions. NARUC is concerned about the very harmful impact the Commission's above-the-line treatment will have on ratepayers. We agree with MCI's comments that accounting for an expense above-the-line creates the rebuttal presumption that the expense will be allowed in the revenue requirement charged to ratepayers.

The proposed amortization would give the ILECs a powerful new argument for increasing local rates. NARUC reminds the FCC of its conclusion in the Depreciation Order that the ILECs have not sufficiently demonstrated the validity of the assumptions underlying their proposed shorter lives for plant equipment categories other than digital switching.

Not surprising, the ILECs oppose the FCC's continued updating of its life and salvage ranges. GTE argues that if these ranges were valid, there would be no discrepancy between the regulatory and financial books. By the FCC modifying its rules to permit price cap ILECs to set their own depreciation rates, SBC, BST, and GTE state that the carriers would be authorized to use their proposed economic depreciation rates for all reporting purposes. According to SBC, this would include any future cost estimates or studies required to support increases in the interstate subscriber line charge above $5.00 and for any other purpose. The ILECs state that there should be a presumption that the depreciation parameters used for both financial and regulatory reporting purposes are appropriate for any future cost study. The NARUC reiterates its assertion made in our initial comments that use of financial depreciation rates should not be taken as tacit approval of the inherent shorter lives. As the FCC concluded in the Depreciation Order, "the incumbent LECs have not sufficiently demonstrated the validity of the assumptions underlying their proposed shorter lives for plant equipment categories other than digital switching equipment." Additionally, NARUC believes that the financial depreciation rate structure will impede competition by increasing UNE and interconnection prices today and will create an opportunity for uneconomic pricing.

SBC proposes that whenever a price cap LEC makes an asset life change that results in a net increase in depreciation expense of 3% or more, the Commission staff will be provided a summary statement of the change. NARUC believes this proposal provides ratepayers with little regulatory oversight and would be poor public policy.

Bell Atlantic states that the Commission's universal service high cost support model relied on Hatfield Model ("HAI") projected lives and not the lives approved under regulated depreciation. Additionally, Bell Atlantic states that to the extent more carriers base their depreciation on economic lives, the universal service model should be consistent and those rates are best reflected in the depreciation used on the companies' financial books. While NARUC agrees that the cost model relied on HAI projected lives, we disagree that these lives are not reflective of those prescribed under regulation. In the Tenth Report and Order, adopted October 21, 1999 and released November 2, 1999, in FCC 99-304, the FCC clearly states that the HAI lives adopted for use in the model are in fact based upon the weighted average of the projection lives which underlie the depreciation rates prescribed by the Commission. NARUC believes that financial depreciation rates are not appropriate for future cost studies and the FCC should reassert its position of using lives and salvage values within the FCC prescribed ranges for cost study purposes. The use of financial depreciation rates do not guard against adverse impacts on consumers as outlined in the Commission's Depreciation Order and as indicated in the NARUC's initial comments.

NARUC strongly urges the Commission to continue depreciation oversight and to keep depreciation ranges in place for use to support future cost studies. As clearly indicated by the ILEC comments, they fully intend to use financial lives in future cost studies that will have adverse

consumer impacts. This continued need for oversight is apparent from the current record in this proceeding. At least 15 other commenters pleadings highlight how critical it is for the FCC to continue depreciation oversight. See, e.g., initial comments filed by the Indiana Utility Regulatory Commission, the Public Service Commission of Wisconsin, the Ohio Public Utility Commission, MCI, AT&T, the Association for Local Telecommunications Services, General Services Administration, USTA, the National Exchange Carrier Association, the National Rural Telecom Association, the Association for the Promotion and Advancement of Small Telecommunications Companies, the Ad Hoc Telecommunications Users Committee, the International Communications Association and the Consumer Federation of America, and the National Telephone Cooperative Association).

III. CONCLUSION

In conclusion, since this rulemaking proceeding was initiated on the FCC's perception of a need for rules that would apply to the industry as a whole, *NARUC believes that the hesitation of the ILECs to endorse such a rule indicates this rulemaking should be abandoned and the FCC should proceed with the waiver process outlined in the Depreciation Order.*

NARUC reiterates its position that any amortization of the reserve difference between the regulatory and financial reporting books, should be below-the-line. Contrary to the ILEC comments, there is no FCC precedent for an above-the-line adjustment of this difference. This difference cannot be construed as a reserve deficiency, as the ILECs claim. Further, if these rules are adopted, NARUC is concerned that the ILECs will be given depreciation freedoms while they are still considered dominant carriers while the FCC did not grant such action to AT&T until it was considered a nondominant carrier.

Regardless of the outcome of this rulemaking, *NARUC believes that it is critical for the FCC to continue depreciation oversight as long as the ILECs have dominant carrier status.* It is clear from the ILEC comments that the carriers fully intend to use financial depreciation lives for all reporting purposes including future cost studies, if granted the depreciation freedom by this rulemaking. If this is allowed, there will be adverse consumer impacts. The FCC must make clear that this rulemaking does not presume that the carriers' financial depreciation rates are valid for determining universal service cost support, increases in the interstate subscriber line charge, or for states determination of interconnection and UNE price, or for any other purpose affecting customer rates. NARUC strongly urges the FCC to reiterate the public interest need to continue to use depreciation ranges in such proceedings.

Respectfully Submitted:

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Certificate of Service

I, James Bradford Ramsay, certify that a copy of the foregoing was service on the parties listed below by 1st Class Mail postage prepaid.

James Bradford Ramsay