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May 23, 2000

EX PARTE

Ms. Magalie Roman Salas  
Secretary  
Federal Communications Commission  
The Portals  
445 12th Street, SW  
Washington, DC 20554

RECEIVED  
MAY 23 2000  
FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

Re: Review of Depreciation, CC Docket 98-137

Dear Ms. Salas:

Today ILEC members of the Coalition for Affordable Local and Long Distance Service ("CALLS") submitted the attached letter regarding depreciation forbearance to Mr. Lawrence E. Strickling, Chief, Common Carrier Bureau. The attached letter to Mr. Strickling responds to inquiries and concerns made by the Ad Hoc Telecommunications Users Committee in a May 16, 2000 letter, and by MCI WorldCom in a letter on May 15, 2000.

As required by Section 1.1206(b)(2) of the Commission's rules, I am filing two copies of this notice for placement in the record for the proceeding identified above.

Sincerely,



Attachment

cc: Lawrence E. Strickling

No. of Copies rec'd 0+1  
List ABCDE

May 23, 2000

Mr. Lawrence E. Strickling  
Chief, Common Carrier Bureau  
Federal Communications Commission  
445 Twelfth Street, SW  
Washington, DC 20554

Re: Review of Depreciation, CC Docket 98-137

Dear Mr. Strickling:

Once again the undersigned incumbent local exchange carriers (“ILECs”) feel compelled to clarify issues related to depreciation relief addressed in the FCC’s above referenced docket.<sup>1</sup> Although this letter will be repetitive in many respects to earlier filings made by the ILECs, it is necessary to respond to recent letters filed by entities opposing depreciation relief.

The proposal in the Notice would grant the price cap carriers relief from the FCC prescribing depreciation parameters, which are used to determine depreciation rates for interstate purposes. In addition to granting the price cap carriers relief from the prescription process, the carriers would be allowed to adjust their regulatory depreciation reserve to match the reserve on their financial books. This adjustment would be amortized over a five year period as an above the line expense.

Those entities that oppose the relief contend that the FCC should continue to prescribe asset lives, and therefore depreciation rates. Moreover, if the FCC does grant relief, it is claimed that any adjustment made to reconcile the regulatory reserve to the financial reserve should be made as a below the line adjustment. The basis for these entities’ opposition to the proposed relief is composed mostly of misinformation about the effect that the relief and corresponding amortization will have on future consumer prices, both interstate and intrastate. The ILECs have exposed the concerns related to the amortization adjustment expressed by these opposing entities as either false, or an inchoate thought that, once taken to its logical conclusion, is no real issue of concern at all. Some of the concerns expressed simply reflect a philosophical difference regarding policy, rather than a failure to understand the ILEC commitment. The ILECs, however, have fully demonstrated why financial depreciation rates should be used for regulatory purposes on a going forward basis.

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<sup>1</sup> *In the Matter of 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*, ASD File No. 98-26, *Further Notice of Proposed Rulemaking*, FCC 00-119, released April 3, 2000 (“Notice”).

While many of the arguments against the proposal center on state impacts, the reality is that most states in the undersigned ILECs' regions have already granted some form of relief from the prescription process. Significantly, in granting this relief no state has required a below-the-line adjustment for moving the regulated depreciation reserve toward the financial statement reserve.<sup>2</sup> This illustrates that states have and will continue to independently determine depreciation rates to be used in intrastate ratemaking. Thus, there is no automatic effect on state rates as a result of any FCC action to allow the use of financial depreciation rates. More importantly, the relief proposed in the Notice is nothing more than what many state commissions have already done. Accordingly, the FCC should grant depreciation relief as proposed in the Notice.

### **The Ad Hoc Letter**

As discussed above, the arguments center around the amortization of the reserve adjustment and the use of financial depreciation rates on a going forward basis. On May 16, 2000, Ad Hoc Telecommunications Users Committee ("Ad Hoc") filed a letter in which it suggested several conditions that the FCC should levy on the ILECs in the event that the FCC grants the relief proposed in the Notice.<sup>3</sup> While the ILECs agree to some of the conditions, many are unnecessary or inappropriate. Each of these conditions is set forth below with a corresponding ILEC response.

#### **Ad Hoc Condition One:**

Require that ILECs not seek to recover through interstate or intrastate rates any portion of the increased depreciation expenses resulting from the use of higher financial depreciation rates.

#### **ILEC Response:**

The ILECs have already agreed (through multiple repetitions) that they will not seek to increase interstate or intrastate rates based on the amortization. We recognize that the FCC order would say as much. To the extent that Ad Hoc seeks more here, their condition makes no sense for three reasons. First, the Notice is limited to price cap LECs. Under price cap regulation, as opposed to cost based regulation, the link between a company's cost and its prices has been broken. Thus, any increase in depreciation expense would not generally impact prices.

Second, regardless of Ad Hoc's concerns regarding depreciation expense, for the vast majority of ILECs, the depreciation expense (excluding the amortization) will not increase as a result of the use of financial depreciation rates.

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<sup>2</sup> States allowed the recovery through either higher depreciation or the amortization of the adjustment. In none of these situations, however, did any state require that the increase in the reserve be taken below the line.

<sup>3</sup> Ad Hoc's letter did not express concern regarding the amortization amount and implied that the ILECs' commitments were sufficient to warrant above-the-line treatment.

Third, this condition assumes that the economic lives of the ILECs' fixed plant are not appropriate for determining proper depreciation expense. As the ILECs explained in detail in their Reply Comments,<sup>4</sup> economic lives, as opposed to regulatory prescribed lives, are more appropriate for calculating the ILECs' depreciation expense. Indeed, economic lives determined in accordance with generally accepted accounting principles ("GAAP") are deemed appropriate not only for reporting public financial information, but are allowed for use by the FCC for every other regulatory segment except dominant telecommunications carriers. Thus, economic lives are appropriate for use in determining depreciation expense in future proceedings. Furthermore, the FCC has already established that the use of economic lives is appropriate for both financial and regulatory purposes. In the Depreciation Order,<sup>5</sup> the FCC established a waiver process to allow ILECs to obtain relief from depreciation regulation. The significant difference between the conditions required to obtain the waiver and the conditions proposed in the Notice is related to the treatment of the reserve deficiency. Whether the amortization of the reserve deficiency is above-the-line or below-the-line has no impact on depreciation rates. Thus, because the waiver conditions specifically required that ILECs use the same factors and rates for both financial and regulatory purposes, the FCC not only saw the use of the same factors and rates for both financial and regulatory purposes as appropriate but as necessary in order to receive relief.

**Ad Hoc Condition Two:**

Require that ILECs not seek any flow through in high-cost amounts drawn from universal service funding mechanisms as a result of using higher financial depreciation rates in the development of ILEC cost benchmarks, either by administrative ruling or by legislation.

**ILEC Response:**

The ILECs agree with Ad Hoc that there should be no impact on high cost recovery. Indeed, on May 19<sup>th</sup> the United States Telecom Association ("USTA") filed a proposal that would ensure that the relief granted would have no material impact on cost recovery. The ILECs support this proposal.

**Ad Hoc Condition Three:**

Require that ILECs not seek any flow through in UNE rates as a result of using higher financial depreciation rates in the development of UNE costs, either by administrative ruling or legislation.

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<sup>4</sup> Reply Comments at 6 – 10.

<sup>5</sup> *In the Matter of 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 Dec 30, 1999 ("Depreciation Order").

**ILEC Response:**

All of the ILECs participating in the Coalition for Affordable Local and Long Distance Services (“CALLS”) proposal have consistently taken the position, both at the FCC and in state proceedings, that the appropriate economic lives to be used in forward-looking cost models should be those that the ILECs use in their financial reporting. Nevertheless, states have made their own decisions as to which lives to use in the cost models, including those that are different from the ILECs’ financial lives.<sup>6</sup> Permitting the ILECs to adopt their financial lives for FCC reporting will not affect any existing UNE rate, nor will it alter the states’ authority to determine depreciation inputs for cost model purposes in any future UNE proceeding.

**Ad Hoc Condition Four:**

Require that ILECs not seek any flow through in rates for pole and conduit attachments (used by competitors in providing local exchange services) established under FCC rules based on a formula that includes as one of its components a carrying charge factor based on depreciation costs, either by administrative ruling or legislation.

**ILEC Response:**

This condition is inappropriate. The depreciation rates used by the ILECs for poles and conduit are, and will likely continue to be, generally consistent with the range of the lives previously set by the FCC. Both poles and conduit represent stable older plant accounts that are not changing rapidly. Neither poles nor conduit are threatened by obsolescence, as are some of the technologies in the other plant accounts. As a result, the changes proposed here will not materially affect pole and conduit attachment rates.

**Ad Hoc Condition Five:**

Require that ILECs not use low reported regulatory earnings resulting from the use of higher financial depreciation rates (and/or the accompanying amortization) to avoid intrastate or interstate rate reductions.

**ILEC Response:**

This condition is inappropriate. As discussed above, and in the ILECs’ Reply Comments, economic lives are proper for determining depreciation expense in any future proceeding related to potential rate reductions. For interstate rates, the ILECs have already committed to significant rate reductions over the next five years through the CALLS proposal, which is intended to provide stability in federal policy during that period. Any other circumstances that might lead to future proposals for rate reductions – either federal or state – cannot be anticipated in this proceeding, and the Commission should not attempt to deal with them here.

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<sup>6</sup> FCC guidelines require that UNE costs should reflect economic depreciation; however states have authority to determine what is “economic.”

**Ad Hoc Condition Six:**

Require that ILECs not use low reported regulatory earnings from the use of higher depreciation rates and/or the accompanying amortization to support a "takings claim" under the Fifth Amendment.

**ILEC Response:**

This condition is inappropriate. As discussed above, and in the ILECs' Reply Comments, economic lives are proper for determining depreciation expense in future proceedings including the analysis of potential regulatory takings.

**Ad Hoc Condition Seven:**

Require that ILECs provide the information necessary to permit the Commission Staff to independently maintain appropriate depreciation ranges for major plant accounts for use in its cost models for universal service high cost support and UNE/interconnection prices. The reporting requirement would include information concerning forecast additions and retirements for major network accounts and replacement plans for digital central offices.

**ILEC Response:**

This condition is inappropriate. As the ILECs explained in detail in their Reply Comments, using the same depreciation lives for regulatory and financial book purposes will ensure that the ILECs do not manipulate depreciation lives in order to increase depreciation expense. The ILECs will have the incentive to concentrate on establishing rates that accurately reflect the lives of their assets in order to produce sound financial statements. By using the same factors for both financial and regulatory purposes, the Commission can thus be assured that the lives are reasonable for regulatory purposes. The Commission need only to look at the rates that ILECs have established for financial book purposes to see that the rates are reasonable in comparison to the rates currently used for regulatory purposes. Ad Hoc's suggestion that the FCC staff calculate "shadow" depreciation rates effectively is an argument to continue regulation of depreciation in spite of nominal deregulation. As the ILECs have previously demonstrated, such regulation is inconsistent with the deregulatory commands of the 1996 Act.

**The MCI Letter**

In addition to the letter filed by Ad Hoc, MCI filed a letter disputing the ILECs' commitments not to seek recovery of the amortization amount. In their reply comments, the ILECs committed not to seek recovery of any portion of the FCC amortization amount. Moreover, the ILECs filed a letter restating their commitment not to seek recovery of the FCC amortization amount through interstate or intrastate rate increases.

In spite of the ILECs' every effort to make this position as clear as possible, MCI filed a letter stating that this commitment is of limited value because "by referring to the 'FCC' (i.e.,

interstate) amortization amount, deliberately leaves the door open to recovery of any intrastate amortization expense via increases in intrastate prices.” The simple answer to MCI is that there is no intrastate amortization expense that would result from the adoption of the proposals in the Notice.

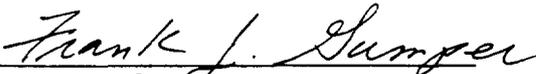
The Notice proposes only an interstate amortization expense. This would have no effect on intrastate rates, and in any event, the ILECs have committed not to seek intrastate recovery of this interstate amortization. Further, each state has authority to set its depreciation policies independently. Thus the proposals in the Notice cannot cause an intrastate amortization expense, just as the amortizations already adopted in many states have not caused a federal expense. The simple fact is that no state need have an intrastate amortization expense unless it chooses to do so – as many states already have.

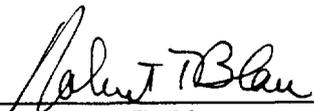
By suggesting that the Commission should somehow seek assurances from the ILECs regarding state actions, MCI is wandering far from the proper scope of the Notice. The Commission should not seek, as part of this proceeding, to circumscribe any future state decisions with respect to depreciation or intrastate ratemaking.

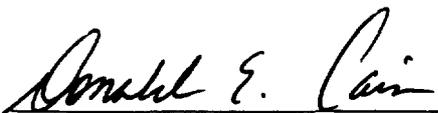
In addition to the above claim, MCI also makes much ado about the ILECs’ commitment that “in any state jurisdiction that automatically mirrors FCC depreciation rates, the ILECs agree not to seek intrastate price increases to recover the increased intrastate amortization expense that would occur as a result of this FCC amortization.” MCI states “with this statement, the ILECs would like to leave the impression that they are responding to NARUC’s concern that the ILECs could increase intrastate rates to recover intrastate amortization expense.” MCI then goes on to discuss that it is unaware of any state in the ILECs’ regions that mirror FCC rates.

MCI misses the point. If there are no states that mirror FCC results, this simply underscores the point, stated above, that every state makes an independent determination of its own depreciation policy. Thus, the federal proposals set forth in the Notice will not force any unwanted depreciation rates on any state. However, in recent ex parte meetings with the Commission, some parties have suggested that the proposals in the Notice could cause problems for a state that did mirror. The ILECs expanded the scope of the commitment in their previous letter to cover this possibility.

The arguments against the proposal continue to imagine deficiencies that do not exist in the real world. In contrast, there are strong public policy reasons to permit carriers to align their regulatory and financial depreciation levels. It will eliminate unnecessary regulation and reconcile the differences between the ILECs’ regulatory and financial books. It does this without raising any rates, interstate or intrastate. The FCC should act promptly to adopt the proposal.

  
/s/ Frank J. Gumper  
Vice President Regulatory and  
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Bell Atlantic Network Services

  
/s/ Robert T. Blau  
Vice President, Executive and  
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BellSouth Corporation

  
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